For the attention of Mr. Willie Botha
Technical Director
International Auditing and Assurance Standards Board
529 Fifth Avenue, 6th Floor
New York, New York, 10017
USA

[Submitted via IAASB website]

28 January 2022

Dear Mr. Botha,

**IAASB Exposure Draft: Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE)**

We[1] appreciate the opportunity to comment on the International Auditing and Assurance Standards Board (IAASB's) Exposure Draft (ED) of the proposed ISA for LCE. This is a significant project that could potentially have fundamental implications for the adoption and use of the IAASB's standards for audits of financial statements in jurisdictions around the world. Across member firms of the PwC Network, there are a significant number of audit entities that are smaller and less complex and, therefore, we have consulted extensively across our Network in forming the views in this letter.

In our response to the 2019 Discussion Paper, *'Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs'* we expressed concerns that a separate standard may give rise to challenges, including possibly adversely affecting audit quality, or the perception of it, more broadly. For those reasons, we stated our preference to maintain a single set of auditing standards applicable to all audits, adapted to better demonstrate scalability to entities of differing sizes.

We continue to be of the view that addressing the inherent complexity and perceived lack of scalability of the requirements in the ISAs themselves is the optimal solution in the longer term, as it avoids many of the possible unintended consequences that we foresee could result from a separate standard. We therefore encourage the IAASB's ongoing Complexity, Understandability, Scalability and Proportionality (CUSP) project to fully address this issue. However, we acknowledge the broad range of views expressed by other respondents to the Discussion Paper that supported the development of a separate standard and respect the Board's decision to move forward with a proposal. We are also aware that some jurisdictions have taken the initiative to develop local LCE standards to address the issues, and recognise the risk of a patchwork of differing solutions emerging.

In developing this response, our overarching priority has been to identify recommendations and a way forward that can result in a separate standard that best safeguards audit quality, maintains the integrity and reputation of an ISA audit, and avoids any unintended consequences for the audit and audit profession.

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[1] This response is being filed on behalf of the network of member firms of PricewaterhouseCoopers International Limited and references to "PwC", "we" and "our" refer to the PwC network of member firms.

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*Concern that proposal will not meet user expectations*

Understanding the specific needs of users in different segments of the audit market is critical in delivering a product that best meets those needs. We acknowledge the extensive outreach performed to date by the IAASB in this project but recognise there are limitations on the ability of the IAASB, on a global basis, to understand individual market segment needs across different jurisdictions. Therefore, we support the proposed role of jurisdictional bodies in determining the appropriate use of the standard in their own jurisdictions. It will be essential that the legislative or regulatory authorities, or relevant local bodies with standard-setting authority, seek input from relevant users in their market (such as banks, owners, private equity firms, and others) on whether to adopt the proposed ISA for LCE.

For listed, public interest entities (PIEs) and medium/larger-sized private entities, we firmly believe that a reasonable assurance audit conducted in accordance with the ISAs is the appropriate benchmark, and that this is a widely accepted premise. Creating a separate standard for audits at the smaller and less complex end of the audit market could create risks that undermine that premise unless designed very carefully. In our view, it is essential that any separate LCE standard:

- be targeted at a sufficiently well-defined population of smaller and less complex entities; and
- does not facilitate or encourage a diminution in audit quality, or erode the trust associated with the established concept of a reasonable assurance ISA audit.

While the ED contains a number of practical enhancements that are responsive to individual specific concerns identified by certain stakeholders, we have two overarching and interrelated concerns with the basis of development of the proposed ISA for LCE, described below, that lead us to conclude that it will not meet the overall expectations of users without further significant revisions.

*Reasonable Assurance and Applicability*

The ISAs set out an appropriate basis for delivering a high-quality reasonable assurance audit that should represent the presumptive basis for an audit of financial statements. We believe the manner in which the Authority of the proposed ISA for LCE has been defined creates an impression that the LCE standard is the presumptive starting position for an audit unless complexity is deemed to exist, which is based on highly subjective criteria. We do not consider this premise, and resultant potential breadth of scope of application of the ISA for LCE standard, to be appropriate. In our view, the Authority needs to be much more narrowly defined based on more specific, and less subjective, criteria, and be clear that the presumptive starting point for an audit is the ISAs.

We also believe the decision taken by the IAASB that it was necessary to base the proposed standard on the objectives and requirements of the ISAs has constrained the Board's ability to think more radically, resulting in a product that many stakeholders may feel is too similar, in terms of work effort, to an audit performed in accordance with ISAs. The acknowledgement in the Explanatory Memorandum that "it is not envisioned that ED-ISA for LCE will necessarily reduce the core procedures the auditor is required to perform" is likely to disappoint many. Consequently, the expectations of stakeholders at the smaller and less complex end of the market who were seeking a proposal that resulted in greater efficiency, and a reduction in required work effort and documentation, are unlikely to be met.

The decision to replicate the ISA requirements but amend them, in the interests of simplification and clarification, has also introduced ambiguity as to whether the changes are intended to drive a different (lesser) work effort. In many cases we do not believe this was the intent. The ambiguity presents a risk to audit quality, as auditors could interpret the required work effort differently in audits of LCEs that share similar characteristics, as well as potentially undermining the interpretation and application of the equivalent requirements in the ISAs. This risk is further heightened by the omission of the vast majority of application material from the ISAs. These concerns have added significance due to the breadth of application in the Authority, creating risks to audit quality because the ISA for LCE could be applied on audits of entities for whom we believe the ISAs remain the appropriate and widely accepted benchmark, as noted above.

*Refining the proposals to meet expectations and minimise unintended consequences*

To address our concern over the potential breadth of application, and enable further tailoring of the requirements within the proposed standard appropriate to the nature and circumstances of LCEs, we believe the standard needs to be targeted at a more defined population of entities, taking into account both complexity and size. We believe that this can be achieved through a combination of two changes within the Authority:

- Refocusing the qualitative characteristics on those that are commonly associated with attributes of an LCE, rather than describing characteristics of complexity that would indicate use of the standard is not appropriate. This would drive a more conscious determination of whether the entity is truly considered to be small and less complex and that it was therefore appropriate to apply the LCE standard rather than the ISAs; and

- Introducing quantitative thresholds that, in combination with the consideration of the qualitative characteristics, safeguard audit quality by providing clear and important public interest boundaries around the size of entity for which the standard is deemed appropriate for use. Our responses to questions 3(a) and 7 in appendix 1 provide further details in this regard, including permitting legislative or regulatory authorities or relevant local bodies with standard setting authority to amend those “baseline” thresholds as deemed appropriate for their jurisdiction.

In making these changes, we believe the Board would have greater latitude to more directly articulate an appropriate work effort for the audit of such entities, without seeking to directly mirror an ISA audit. In appendix 2 to this letter, we have set out illustrative recommendations for how we believe the proposals could be further refined to achieve this goal for what we understand to be the most common critical “pain points” cited by auditors of smaller and less complex entities: risk assessment and accounting estimates. We have also explored an alternative structuring of the proposed documentation requirements to further enhance clarity and understanding of what needs to be documented.

The Board and its stakeholders may ultimately conclude that a further refined work effort continues to constitute reasonable assurance for an entity of that size and complexity. Or, consensus may be reached that the appropriate level of work effort is not considered sufficient to obtain reasonable assurance, but is nevertheless a desirable assurance product for that segment of the market. In our view, both outcomes are acceptable if the needs of users and the market are addressed. In that regard, ensuring a clear understanding and articulation of the specific segment of the audit market that this standard is seeking to address and a clear expectation that the end product satisfies the needs of that segment will be a critical success factor.

*Group audits*

We believe there are significant challenges in permitting use of the proposed standard on group audits. We acknowledge that there can be simple group audits but believe that in order to avoid unacceptable risks to audit quality (including that the LCE standard is inconsistently applied in similar fact patterns), clear criteria need to be prescribed for when the standard may be applied to such groups. In our response to questions 22 and 24, we describe our recommendations for such criteria. However, in summary we suggest this be limited to group audits conducted by a single firm and without the involvement of component auditors.

**In conclusion,** while we continue to believe that building appropriate scalability into the ISAs is the best solution, we accept the broad support from many of the Board's stakeholders for the development of a separate standard. In our view, it is essential that any separate LCE standard be targeted at a sufficiently well-defined population of smaller and less complex entities; and does not facilitate or encourage a diminution in audit quality, or erode the trust associated with the established concept of a reasonable assurance ISA audit. To do so, we believe that the Authority of the standard needs to be narrowed by introducing clearer limitations on the size of entity for which the standard is appropriate for use, as well as articulating less subjective qualitative characteristics. The requirements can then be tailored to the circumstances of that narrower group of entities, with a clearer but appropriate distinction in work effort from an ISA audit. In our view, this will help serve both to meet the expectations of those seeking an efficient and effective audit for smaller and less complex entities, while protecting audit quality for audits of entities other than those falling within the scope of a narrower Authority.

We hope our observations in this letter and the accompanying appendices provide useful input in achieving the Board’s goals. We would be happy to discuss our views further with you.

If you have any questions regarding this letter, please contact Diana Hillier, at diana.hillier@pwc.com, or me, at james.chalmers@pwc.com.

Yours sincerely,

James Chalmers

James Chalmers
Global Assurance Leader

## Appendix 1 - Responses to specific questions

1. **Views are sought on:**

   **(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?**
   **(b) The title of the proposed standard.**
   **(c) Any other matters related to ED-ISA for LCE as discussed in this section (Section 4A).**

Understanding the specific needs of users in different segments of the audit market is critical in delivering a product that best meets those needs. For listed, PIE and medium/larger-sized private entities (i.e., those entities that do not meet the quantitative thresholds suggested in our response to question 3), we believe that a reasonable assurance audit conducted in accordance with the ISAs is the appropriate benchmark, and that this is a widely accepted premise. Creating a separate standard for audits at the smaller end of the audit market could create risks that undermine that premise unless the standard is designed very carefully. If the IAASB proceeds with finalising a separate LCE standard, in our view, it is essential that the standard:

- be targeted at a sufficiently well-defined population of smaller and less complex entities;
- does not facilitate or encourage a diminution in audit quality, or erode the trust associated with the established concept of a reasonable assurance ISA audit; and
- is standalone in nature, and includes guidance as necessary to promote consistent application of its requirements.

We know first-hand how important the application material in the ISAs is to understanding how the ISAs' requirements are intended to be interpreted and applied. As a result of the lack of essential explanatory material (EEM) in the draft ISA for LCE, we are concerned that there may be an implied reliance on an understanding of the ISAs, in particular the application material, to properly understand and apply the requirements of the proposed standard. This puts auditors in a difficult position – the standard claims to be stand-alone, but there is a high likelihood of being challenged as to why they did not refer to the ISAs for additional guidance in a particular circumstance. Considerably more EEM is needed in the draft ISA for LCE to guide consistent understanding of its requirements (and specifically what is not required). The lack of sufficient EEM creates a significant threat to audit quality and increases the potential for misunderstandings which increase the expectation gap (see further discussion in our response to question 7(d)).

In our view, greater divergence from the ISAs is also necessary to achieve the underlying intent of the standard. We believe the decision taken by the IAASB that it was necessary to base the proposed standard on the objectives and requirements of the ISAs has constrained the Board's ability to think more radically, resulting in a product that many stakeholders may feel is too similar, in terms of work effort, to an audit performed in accordance with ISAs. Consequently, the expectations of stakeholders at the smaller end of the market who were seeking a proposal that resulted in greater efficiency, and a reduction in required work effort and documentation, are unlikely to be met. At the same time, whilst wanting to be fully aligned with the ISAs yet combining some requirements and modifying the wording of others to simplify them, ambiguity has been created about whether or not the intention is that the requirements drive the same work effort. We provide further comment on this issue in our response to questions 7 and 17.

As explained in our response to question 3 on the Authority, we recommend the standard be designed and targeted at a more defined population that precludes the option for the standard to be applied to medium/larger-sized private entities, for which we believe the ISAs remain appropriately scalable. Delivering a product that directly satisfies the smaller and less complex segment of the audit market should be the IAASB's overarching priority. In doing so, we believe a more targeted application provides greater latitude for the Board to more directly articulate an appropriate work effort for an audit of such entities, without seeking to directly mirror an ISA audit. The Board and its stakeholders may ultimately conclude that such work effort continues to constitute reasonable assurance for an entity of that size and complexity. Or, consensus may be reached that the appropriate level of work effort is not considered sufficient to obtain reasonable assurance, but is nevertheless a desirable assurance product for that sector of the market. In our view, both outcomes are acceptable if the needs of users and the market are addressed.

With respect to the title of the standard, consistent with our suggestions on quantitative limitations in response to question 3(a), we suggest the title needs to reflect an intent that it applies to *smaller and* less complex entities. Our recommendation for the title is: "International Standard for Financial Statement Audits of Smaller and Less Complex Entities".

**2. Do you agree with the proposed conforming amendments to the IAASB Preface (see paragraphs 39-40)? If not, why not, and what further changes may be needed?**

We agree with the proposed conforming changes to the Preface.

**3. Views are sought on the Authority (or scope) of ED-ISA for LCE (Part A of the proposed standard). In particular:**

**(a) Is the Authority as presented implementable? If not, why not?**

We have significant concerns that the Authority is not implementable in a manner that will result in outcomes that achieve the Board's second and fourth public interest objectives: *"Helping auditors of LCEs undertake consistent, effective, and high-quality audits"* and *"Promoting a more consistent application of the auditing standards to audits of LCEs"*.

Establishing what constitutes an LCE is challenging. Defining the scope of entities for which the standard may be applied has implications for its content, and vice versa. We agree with the Board's assessment that a "significant" level of judgement in determining the applicability of the standard is not appropriate from a consistency perspective. However, we find the level of subjective judgement required in applying the qualitative characteristics described within the Authority section to remain at a level that we consider "significant". We are concerned that the subjectivity in judgements about what does and does not constitute complexity could result in decisions being made that the standard is appropriate for use on potentially quite large private entities. This level of subjectivity could also lead to inconsistent judgements being drawn by different auditors, both within and across jurisdictions, which would not be desirable from an audit quality or comparability perspective.

As noted in our response to question 1, we believe that a reasonable assurance audit in accordance with the ISAs remains the appropriate benchmark for all audits other than those that truly represent smaller and less complex entities. Therefore, in our view, the boundaries for when use of the standard is appropriate needs to be more narrowly defined, based on more specific criteria, to drive greater clarity on the intended scope of its application and to mitigate the risks arising from the inherent subjectivity of applying solely qualitative characteristics describing what constitutes complexity.

We believe that this can be achieved through a combination of two changes within the Authority:

- Refocusing the qualitative characteristics on those that are commonly associated with attributes of an LCE and that would make use of the standard appropriate, rather than describing characteristics of complexity that would indicate use of the standard is not appropriate. This would drive a more conscious determination of whether the entity is truly considered to be smaller and less complex and that it was therefore appropriate to not apply the ISAs, rather than the current implied construct of only being forced to use the ISAs if the auditor cannot justify using the ISA for LCE. We support the message in the standard that "if in doubt, use the ISAs" and we believe this approach better reinforces that warning - we address this in detail in our response to part (b) below and question 4(b); and

- Introducing quantitative thresholds that, in combination with the consideration of the qualitative characteristics, safeguard audit quality by providing clear and important public interest boundaries around the size of entity for which use of the standard is deemed appropriate - described below.

While we recognise and agree that there are challenges in specifying quantitative thresholds for application due to jurisdictional variations, we believe the IAASB needs to reconsider the decision not to specify applicable quantitative thresholds to indicate the intended scope of application. Although the IAASB had good reasons for moving from a concept of "smaller" entities to that of "less complex" entities, we believe that size of the entity is a factor to be considered alongside characteristics that indicate an entity is less complex.

Specifying the size of entity the IAASB had in mind when developing the standard allows the Board to be much clearer in its justification of the requirements to be included in the standard and provides a clear message to users about the intended scope of application. It would serve to remove much of the debate over whether certain requirements need to be included, because the scope is so subjective and broad, and help the Board coalesce around agreeing a work effort that is deemed appropriate for such entities. And, as we describe in our response to question 1, this would allow the Board to be bolder in developing a proposal that is more distinguishable from the ISAs, potentially delivering a more targeted work effort that users were seeking from the project, without undermining the work effort associated with an ISA audit.

Furthermore, to directly address the fact that different jurisdictions adopt varying thresholds for defining small entities or statutory audit requirements, we recommend the Board could amend the principle already proposed in paragraph A6 and explicitly permit legislative or regulatory authorities or relevant local bodies with standard setting authority to amend those thresholds as deemed appropriate for their jurisdiction. This retains the flexibility the Board sought to include in the Authority, while establishing a clear baseline and safeguard for audit quality, which is also important for those jurisdictions that directly adopt the IAASB's standards without amendment.

Our recommendations for the content of the standard, described primarily in response to question 7 and appendix 2, are based on an assumption that such quantitative thresholds be established to clearly define the intended population of entities for whom the standard may be applied. We suggest that appropriate thresholds could be (entities that meet at least two of the following):

- Turnover not exceeding: [Currency] 10,000,000
- Balance Sheet total not exceeding: [Currency] 7,500,000
- Number of employees not exceeding: 100

In suggesting the above thresholds, we had regard to the Accountancy Europe analysis[2] of audit exemption thresholds in Europe, as a proxy for the size of entity that, above which, we deem an audit in accordance with ISAs to be appropriate[3]. Where audit exemption thresholds do not exist, we believe the proposed ISA for LCE could be used as an appropriate standard.

As described, the quantitative thresholds would act as public interest safeguards, or "boundaries", around what would be considered the appropriate use of the standard and would need to be considered alongside the rearticulated qualitative characteristics. We provide our further recommendations with respect to the qualitative characteristics in our response to question 4(b).

**(b) Are there unintended consequences that could arise that the IAASB has not yet considered?**

We believe there are two specific unintended consequences that could result from the proposed approach to drafting of the Authority section that the Board needs to reconsider:

- As noted in our response to part (a), the potential to apply the standard on larger private entities may result in risks to audit quality if the work effort that would result from applying the standard is not deemed commensurate with the nature and circumstances of the entity and its operations. Further, the level of subjectivity in the Authority will likely lead to inconsistency in the appropriate use of ISA for LCE versus the ISAs in similar fact patterns, which would be undesirable from an audit quality and comparability perspective (including potential confusion from users of the financial statements with regard to the level of audit work performed on audits of similar entities). Audit inspection findings are not limited solely to listed and PIE audits and maintaining appropriate safeguards to quality in all segments of the audit market, including audits of medium/large private entities, is important. As we note in our response to question 1, we believe the ISAs remain the appropriate benchmark for audits in this segment of the audit market.

- The ISAs set out an appropriate basis for delivering a high-quality reasonable assurance audit that, in our view, should represent the presumptive basis for an audit of financial statements. We believe the manner in which the scope and authority of the proposed ISA for LCE has been defined undermines this presumption. As drafted, it sets an expectation that the LCE standard can be used for any audit unless the auditor determines that complexity exists. We believe that the opposite should hold true: an audit should be conducted in accordance with the ISAs unless the auditor determines that the specific criteria for use of the LCE standard can be met. This would serve to protect the primacy of the ISAs as the "default" global auditing standards. As such, we recommend revising the qualitative characteristics to focus on the

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[2] https://www.accountancyeurope.eu/wp-content/uploads/Accountancy-Europe_Audit-exemption-thresholds-in-Europe_2020_survey-update.pdf

[3] The suggested thresholds, being derived from the Accountancy Europe analysis, are based on Euros. Consistent with our recommendation on jurisdictional tailoring, the appropriate thresholds would need to be adjusted to reflect the currency of the jurisdiction.

characteristics that are indicative of an LCE and that, when exhibited, would make the standard appropriate for use. We describe these changes in our response to question 4(b).

**(c) Are there specific areas within the Authority that are not clear?**

Further to our response to part (a), we do not believe the characteristics and guidance described in paragraphs A8 and A9 alone are sufficient to drive consistent judgements. We also question whether there is an inherent contradiction within paragraph A9. The paragraph commences by stating "...*the [draft] ISA for LCE is inappropriate for the audit of the financial statements <u>if an entity exhibits one or more of</u> the following characteristics"* but then within the hanging paragraph states "*Each of the qualitative characteristics <u>may on its own not be sufficient to determine</u> whether the [draft] ISA for LCE is appropriate or not in the circumstances…".*

We provide comments on individual qualitative characteristics in response to question 4(b).

**(d) Will the Authority, as set out, achieve the intended objective of appropriately informing stakeholders about the scoping of the proposed standard?**

The Authority section conveys an overarching principle of intent. However, as described in our responses to question 1 and the other parts of this question, we believe the degree of subjectivity required in applying the qualitative characteristics results in an unacceptably wide "grey area" of entities for which application of the standard is ambiguous.

**(e) Is the proposed role of legislative or regulatory authorities or relevant local bodies with standard setting authority in individual jurisdictions clear and appropriate?**

We recognise there is a role for legislative or regulatory authorities or relevant local bodies with standard setting authority to further refine or restrict the application of a standard in a particular jurisdiction based on an evaluation of needs in the particular market, including user input. That is the case today. However, as with the ISAs, we believe the Board needs to establish a stronger baseline for what it considers to be the nature and circumstances of an entity for which the standard is appropriate for use (see response to part (a) of this question).

Similarly, while we recognise the challenges that certain classes of entity might be treated in a specific way within a jurisdiction, we believe there is an inherent tension between, on the one hand, stating that entities that have public interest characteristics could embody a level of complexity in fact or appearance (and are therefore specifically prohibited from using the standard), and then permitting legislative or regulatory authorities or relevant local bodies with standard setting authority to modify (override) those prohibitions to allow use of the standard for sub-classes of such entities. For example, if an entity exhibits characteristics of a PIE then we believe the ISAs remain the appropriate standards to be applied. We therefore support local bodies being permitted to expand, but not reduce, the population of entities deemed to exhibit PIE characteristics. We view the consideration of PIE characteristics to be of a higher public interest matter as compared to our recommendation that local bodies be granted authority to amend (including increasing) any quantitative thresholds specified in the standard.

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:**

**(a) Specific prohibitions; and**

We agree with the specific prohibitions. With respect to paragraph A7(c) describing entities with characteristics of a PIE, please see our response to question 3(e). In addition, in light of changes proposed by IESBA in this area the Board may also need to further consider the proposed appropriateness of the “jurisdictional modification” permission granted in the Authority.

We note from outreach that confusion persists about the relationship between the prohibitions in paragraph A7(a)(i) and A7(c)(v). We suggest that part (a)(i) could simply be amended to state that law or regulation may prohibit use of the standard in a jurisdiction for audits of all entities or certain classes of entity.

With respect to listed entities, we recognise that groups often set up corporate structures with listed holding companies for tax and other reasons. While such entities may hold very few assets and liabilities, in our view, the risks of permitting some form of exemption for certain classes of listed entities outweigh the perceived benefits. There is a consequential cost of choosing to establish a listed entity. Therefore, we support the proposed prohibition.

We have addressed the prohibition regarding group audits in our response to question 22.

**(b) Qualitative characteristics.**

**If you provide comments in relation to the specific prohibitions or qualitative characteristics, it will be helpful to clearly indicate the specific item(s) which your comments relate to and, in the case of additions (completeness), be specific about the item(s) that you believe should be added and your reasons.**

As noted within our response to question 3 we find the level of subjective judgement required in applying the qualitative characteristics to be too great and open to differing interpretations. The inherent subjectivity would, in our view, necessitate a robust level of risk assessment procedures to understand the entity to enable an informed judgement on the appropriateness of using the standard on a new audit engagement, which is counterintuitive. In particular, we highlight the following characteristics:

- *The entity’s business activities, business model or the industry in which the entity operates results in pervasive risks that increase the complexity of the audit* - This represents a highly judgemental determination that will be influenced by personal experiences of financial statement preparers and auditors with regard to perceptions of risk and complexity. We believe directly describing attributes of an entity’s operations that are considered to be less complex is easier to visualise.
- *Ownership or oversight structures are complex* - It is unclear how oversight alone may reflect the underlying complexity of the entity, its operations and financial reporting i.e., the subject matter of the audit.
- *Transactions are complex or the information system and related processes relevant to the entity’s financial statements are complex….* - Defining characteristics of complexity which themselves refer to complexity does not support auditors in understanding what may be deemed a complex transaction or a complex information system. Many information systems in today’s business environment would likely be deemed complex to some degree. Again, we believe describing what types of information system or IT packages would be considered less

complex helps remove much of the subjectivity and reduces the risk of inconsistent judgements being drawn by different auditors for similar fact patterns.

- *The entity's IT environment or IT systems are complex… -* As per previous bullet.
- *The entity's accounting estimates are subject to a higher degree of estimation uncertainty or the measurement basis requires complex methods...* - Implementation of ISA 540 (Revised) has shown that this is an area where there are often significant interpretation differences as to both what comprises an accounting estimate and when an estimate is deemed to be subject to complexity. Clearer direction on this characteristic is more challenging but is perhaps the area that is driving most concern amongst stakeholders as to its interpretation. More examples of estimates, or methods, that are deemed less complex would likely help drive consistency in judgements made by auditors for similar fact patterns.

As noted in our response to question 3(e) and above, we therefore recommend rearticulating characteristics of complexity by instead describing characteristics and examples that are deemed to represent or be indicative of less complexity rather than complexity.

We find the "green tick" examples described in the supplemental guidance on the Authority to be more compelling and persuasive in guiding auditors. They describe characteristics of a less complex entity. We recommend replacing the qualitative characteristics that describe what makes an entity "complex" with these direct statements about the characteristics typical of an entity for which use of the standard is appropriate. The additional examples of characteristics that may indicate complexity could be retained as a supplemental guidance appendix to the standard. We provide additional comments in appendix 3.

We also recommend that clearer statements be made about what the standard does not address, which if present, would result in the standard not being appropriate for use. This could include:

- Using the work of internal auditors
- Segmental reporting
- Accounting estimates involving higher estimation uncertainty and those that involve modelling i.e., determined using methods other than straightforward arithmetical calculations
- Certain enhanced auditor reporting, including Key Audit Matters

**5. Regarding the Authority Supplemental Guide:**
**(a) Is the guide helpful in understanding the Authority? If not, why not?**

The perceived usefulness of the Supplemental Guide depends on the target stakeholder group:

- *Legislative or regulatory authorities or relevant local bodies with standard-setting authority* - For this stakeholder group, this document can provide a mechanism for sharing additional insight into the IAASB's thought process and could serve a specific purpose. See, however, our response to question 4 on the extent to which we believe jurisdictional tailoring is deemed appropriate.
- *Firms* - While the document may provide some insight into the IAASB's thought process (as for legislative or regulatory bodies), we do not believe the content will significantly assist firms in determining the types of entities for which they may wish to further restrict use of the standard. As explained in our response to question 4(b) we believe revising the articulation of the criteria for which use of the standard is deemed appropriate within the Authority section itself is more important, which may largely negate the need for firms to make subjective

judgements about how to further restrict use of the standard.

- *Audit engagement teams* - Much of the material is targeted at legislative or regulatory authorities, or relevant local bodies with standard-setting authority to assist in local jurisdictional tailoring. As noted in our response to question 3, we believe engagement teams require sufficient clarity on the scope of entities for which the standard may be used, and such clarity needs to be built into the body of the standard. Our responses to questions 3 and 4(b) describe our recommendations for how to address this.

**(b) Are there other matters that should be included in the guide?**

As noted in our response to question 3, we perceive an inherent contradiction in paragraph A9. In the absence of more specific, less subjective criteria for the Authority section as recommended in our response to question 4(b), we believe further guidance (in the body of the standard) is necessary to address the interaction of individual qualitative characteristics and how the auditor may judge these "in combination" with one another. Without this additional clarity, the level of subjectivity could lead to inconsistent judgements being drawn by different auditors, both within and across jurisdictions, which would not be desirable from an audit quality or comparability perspective.

**6. Are there any other matters related to the Authority that the IAASB should consider as it progresses ED-ISA for LCE to finalization?**

No further matters noted.

**7. Views are sought on the key principles used in developing ED-ISA for LCE as set out in this Section 4C. Please structure your response as follows:**

**(a) The approach to how the ISA requirements have been incorporated in the proposed standard (see paragraphs 74-77).**

As described in our response to question 1, we believe there are several potential unintended consequences arising from the interaction between the proposed Authority and decision of the Board to develop the standard based on the ISA requirements. As the Authority has been defined broadly and in subjective terms, there is significant uncertainty as to the potential population of entities to which the standard may be applied. This has led to an outcome where the vast majority of ISA requirements have been maintained, reflecting differences of view as to the range of possible circumstances that may need to be addressed in an audit conducted in accordance with the standard, as a safeguard to audit quality. By incorporating the majority of ISA requirements without any substantive simplification, the standard will not lead to any significant efficiencies in LCE audits. Consequently, expectations from stakeholders are unlikely to be met.

We support the intent behind the proposed simplification of requirements to enhance understandability and focus on the "right" work effort. However, we think the Board needs to go further to create a standard that is targeted and appropriate for a clearly defined and narrower population, truly stands alone, and is not subject to direct reconciliation with the related ISA requirements. As we describe in our response to question 1, the ambiguity introduced by replicating the ISA requirements but combining some requirements and modifying the wording of others to simplify them will lead to auditors, and potentially regulators, second guessing the expected work effort.

We agree that the overall objectives of the ISAs provide a useful starting point as to the desired outcomes to be achieved and some principles-based requirements will undoubtedly remain similar.

However, by instead using the ISAs as helpful “reference material” to guide its thinking, we believe the Board can make informed decisions about what to require in the standard without being constrained from re-writing requirements more broadly.

Similar to the IAASB, in our outreach we often hear that the biggest concerns for auditors of smaller and less complex entities relate to the work effort associated with risk assessment procedures and audit of accounting estimates. In line with our vision to achieve greater distinction between the ISAs and proposed LCE standard, and also further simplification, we have suggested possible revisions in these two areas to illustrate how such an approach could be applied, which could be replicated across the remaining Parts of the proposed standard. We have also explored an alternative structuring of the proposed documentation requirements to further enhance clarity and understanding of what needs to be documented. Appendix 2 presents the outcome of this exercise. In appendix 3, we provide some additional narrative comments with respect to the other Parts of the proposed standard.

**(b) The approach to the objectives of each Part of the proposed standard (see paragraphs 78- 80).**

We support the principle of establishing objectives for each Part of the standard. Unlike the standard’s requirements, given the higher-level nature of objectives it is not unreasonable to use the objectives of the ISAs as a starting point. We also agree that the objectives of each Part should focus on the outcomes to be achieved by the auditor in complying with the requirements of that Part.

**(c) The principles in relation to professional scepticism and professional judgement, relevant ethical requirements and quality management (see paragraphs 81-84).**

Other than our comments in response to part (d) below regarding the sufficiency of EEM, we are comfortable with the approach in relation to professional scepticism, professional judgement, relevant ethical requirements and quality management.

**(d) The approach to EEM (see paragraphs 85–91) 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**

EEM plays a critical role in supporting a clear understanding and interpretation of requirements as a foundation for consistent application and audit quality. We do not believe there is sufficient EEM to achieve these objectives. There may be an underlying presumption of ISA knowledge supporting auditors in determining the expectations of individual requirements. In the short term this may not present a problem. However, over time there is a potential risk of institutional ISA knowledge and training reducing over time if smaller firms predominantly use the proposed ISA for LCE. As noted in our response to question 1, the standard must be able to stand alone and be capable of consistent interpretation and application without relying on auditors’ understanding of the ISAs.

A further consequence of choosing to leverage the majority of ISA requirements is that it is hard to justify why application material that is deemed important to support consistent understanding, interpretation and application of the ISA requirements is not considered necessary within the proposed LCE standard. We believe this risks giving rise to inconsistent interpretation and work effort.

The decision to significantly limit EEM restricts the ability of the Board to explain the “why” (intent) of a requirement. As evidenced in the recent revision of ISA 315 (Revised 2019)), the application material can serve a critical purpose in bringing the necessary clarity to the intended outcome of a requirement, including its scalability. Based on a more narrowly defined Authority, there would also be greater scope for the EEM to better reflect the nature and circumstances of audits of entities for whom the standard was intended for use.

The length of the standard should not be prioritised at all costs over its clarity and understandability. We therefore encourage the Board to consider the adequacy of EEM in key areas of the standard and have provided comments in this regard within appendix 3. Further examples within the standard may also be useful to illustrate the application of a requirement.

We support the approach to the presentation of EEM within the standard.

8. **Please provide your views on the overall design and structure of ED-ISA for LCE, including where relevant, the application of the drafting principles (paragraph 98-101)**

   We support the concept of reordering the standard to follow the logical flow of an audit. We also support the principle of avoiding long sentences, and the idea of addressing “one thought per sentence”. However, as described in our responses to the preceding questions, limited re-drafting and a changed presentation of, largely the same, ISA requirements is not, in our view, going to meet stakeholder expectations. If the goal was simply to present the ISAs in a more understandable way, that should be addressed through the CUSP project and revisions to the ISAs themselves. We believe stakeholders are seeking more substantive differences.

   While supportive of the structure, we note that with respect to specific subject matters that today are addressed by individual ISAs (such as Going Concern, Fraud, Laws and Regulations and Related Parties), an element of holistic understanding of the interconnectivity of individual requirements may be lost. It might be useful to include an appendix that consolidates and “maps” where all the requirements relating to specific topics can be located across the various Parts of the standard to aid this holistic understanding. The same can also be said for providing a roadmap to requirements addressing significant risks. Alternatively, these may be developed as supporting non-authoritative guidance material.

   Similarly, in conducting the illustrative simplification exercise described in our response to question 7(a), we noted that the separation of documentation requirements across Parts of the standard results in elements of duplication. We suggest consideration be given to whether all documentation requirements would be better consolidated into a single Part at the back of the standard, which would allow for streamlining of those requirements, as illustrated in appendix 2. We suggest such an approach may indirectly help to address stakeholders concerns about the documentation burden associated with audits of LCEs by providing a more holistic picture and understanding of what needs to be documented. Appropriate cross-references could be incorporated into relevant Parts for key phases of the audit to link to the documentation requirements.

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.**

   Please see our response to question 7. We have provided comments as follows:

- Appendix 2 - illustration of possible changes to Part 6, elements of Part 7 pertaining to accounting estimates, and documentation requirements.
- Appendix 3 - other comments relating to other Parts of the standard.

**10. For Part 9, do you agree with the approach taken in ED-ISA for LCE with regard to auditor reporting requirements, including:**
  **(a) The presentation, content and completeness of Part 9.**
  **(b) The approach to include a specified format and content of an unmodified auditor's report as a requirement?**
  **(c) The approach to providing example auditor's reports in the Reporting Supplemental Guide.**

The way that the IAASB has chosen to present Part 9 is innovative. The work done to rationalise and present relevant requirements from ISAs 705 and 706 demonstrates a bolder approach to better distinguish the standard from the ISAs that we encourage across other Parts of the standard to enhance its standalone nature. We also support the proposal to include a specified form and content of the auditor's report. For entities of a size and nature that we describe in our response to question 3(a), there should be little need to deviate from this standard wording.

The reporting examples in the supplemental guidance document are a useful resource.

**11. With regard to the Reporting Supplemental Guide:**
  **(a) Is the support material helpful, and if not, why not?**
  **(b) Are there any other matters that should be included in relation to reporting?**

The supplementary material is useful. Elements of it are, however, more akin to EEM, rather than non-authoritative supplementary content. Further to our comments in response to question 7(d), consideration should be given as to whether certain elements of this content need to be reflected within the standard itself. We have provided comments, as appropriate, in appendix 3.

We recommend also including an illustration of a qualified opinion arising from a limitation in scope and a modified Other Information section, for completeness.

**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.**

Please refer to our responses to questions 7 to 11.

**13. Please provide your views on transitioning:**
  **(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?**
  **(b) What support materials would assist in addressing these challenges?**

Much of the uncertainty around "transition" stems, in our view, from the subjectivity inherent within the Authority section. The potential for larger entities that may become subject to complexity in subsequent periods, or even during a period, raises inevitable questions as to how to address those circumstances.

With a more clearly defined narrower scope, and a standard that is more clearly differentiated from the ISAs, the risk of audits being commenced using the ISA for LCE and subsequently judged to no longer meet the criteria for use, diminishes, reducing the need for extensive transition guidance.

Such an approach also reduces the likelihood of audits flipping between the ISA for LCE and ISAs in subsequent years, again helping to eliminate challenges and questions that arise around the potential impact under a comparative financial statements model. We also note that some territories with statutory audit exemption thresholds also introduce time-related transitional rules into these exemptions i.e., that the criteria for exemption are met in both the current and preceding period. While many of the transitional issues should, in our view, be eliminated by a narrower Authority, consideration could be given to introducing similar criteria to address the separate issue of flipping back and forth between the applicable standard(s) in successive periods.

With a narrower Authority, in the rare circumstances that matters arise that lead to a determination that the ISA for LCE is no longer appropriate for use, we recommend pragmatic guidance be provided that explains how any work completed using the ISA for LCE can be leveraged as part of an ISA audit.

**14. Do you agree with the proposed approach to the future updates and maintenance of the Standard and related supplemental guidance?**

We agree that consideration of any changes to the standard on a triennial basis is reasonable to provide a somewhat stable platform for all stakeholders. Circumstances may however arise that necessitate a more urgent need for change, for example if there is a substantive revision to the IESBA Code that requires more immediate alignment. The Board should retain flexibility to address such circumstances should they arise.

Notwithstanding our comments on the importance of the separate standard being sufficiently distinguishable from the ISAs, it would be appropriate for the Board to accumulate relevant changes to any ISAs during the triennial period and subsequently consider whether the nature of such changes would warrant a corresponding change to the ISA for LCE.

**15. For any subsequent revisions to the standard once effective, should early adoption be allowed? If not, why not?**

This question cannot fully be answered without an understanding of the nature and significance of the proposed changes. Notwithstanding, and subject to considering the merits of individual prospective revisions, we believe the default position should be that early adoption is permissible.

**16. Should a separate Part on the ISA-800 series be included within ED-ISA for LCE? Please provide reasons for your response.**

The ISA 800 series should be incorporated. In our experience, smaller and less complex entities can and do use special purpose frameworks. In territories where there is no statutory audit requirement, entities may still request an audit due to lending or other arrangements. Third parties often also request an audit of an individual financial statement or elements thereof for similar reasons. The ISA 800 series contains limited additional requirements, and therefore their incorporation into the LCE standard should not be unduly onerous.

**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:**

**(a) Whether the proposed standard can, and will, be used in your jurisdiction.**

No specific comment. This matter is best addressed by jurisdictional standard setters, who would need to seek input from relevant users in their market, such as banks, owners, private equity firms and others.

**(b) Whether the proposed standard meets the needs of auditors, audited entities, users of audited financial statements and other stakeholders.**

As described in our cover letter and other responses above, while the exposure draft demonstrates a number of practical enhancements that are responsive to individual specific concerns identified by stakeholders, we have two overarching and interrelated concerns with the basis of development of the proposed ISA for LCE that lead us to conclude that it will not meet the overall expectations of users without further significant revisions.

For auditors, in particular small and medium sized practitioners, we believe the decision taken by the IAASB that it was necessary to base the proposed standard on the objectives and requirements of the ISAs has constrained the Board's thinking, resulting in a product that many stakeholders may feel is too similar, in terms of work effort, to an audit performed in accordance with ISAs. Consequently, the expectations of these stakeholders of a proposal that resulted in greater efficiency, and a reduction in required work effort and documentation burden, are unlikely to be met.

For audited entities and users of the auditor's report, the debates within the Board in relation to reasonable assurance are unlikely to be perceived or understood. For many stakeholders in these groups, the audit opinion is the primary focus, alongside an expectation that a high-quality audit is being performed. The basis for the auditor's opinion may be seen as more a technical process matter for the Board and firms. It is therefore more difficult to assess the specific expectations of these user groups and whether, and if so to what extent, such expectations will be met. However, based on the ED proposals, there may be little or no perceived difference to an ISA audit. Consequently, it is unlikely that audited entities will discern any significant difference in the work effort or assurance, and related cost, and may therefore question the benefits of adopting this alternative. For other users who rely solely on reading the auditor's report, the report content alone does not provide any basis for such users to judge whether an audit in accordance with the LCE standard meets their expectations compared to an ISA audit. As noted, for these users, the opinion and statement that reasonable assurance has been obtained will be the primary focus.

**(c) Whether there are aspects of the proposed standard that may create challenges for implementation (if so, how such challenges may be addressed).**

Our primary concern with respect to implementation challenges relate to the proposed Authority - please see our response to question 4.

We also note that requirements that are based closely on the ISAs but with a degree of amendment, combined with insufficient EEM, are likely to create significant methodology implementation challenges. The ability to discern the intent of the Board and explain differential work effort as compared to the related ISA requirements may be problematic. As noted in previous responses, if the outcome is that the methodology and work effort are deemed unchanged, expectations of stakeholder are unlikely to be met.

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?**

    Please see our response to question 22 with respect to the challenges posed by the interaction of component statutory audits and group audits, should a decision be made to permit application of the standard to certain group audits.

    We also strongly encourage the Board to take the appropriate amount of time in finalising the standard. While we recognise the importance of this proposal to many stakeholders, ensuring a final product that results in a high-quality audit and that minimises the potential unintended consequences of its design must take priority over the speed of its finalisation.

19. **What support and guidance would be useful when implementing the proposed standard?**

    Recognising that many smaller practitioners may be reliant on third-party methodology providers, it may be useful for IAASB to work with IFAC to explore what assistance IFAC can provide to support development of software/methodology tools that could support effective implementation.

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.**

    We note that seemingly minor wording changes being introduced as part of the drafting efforts to seek simplification and clarity may have unintended consequences for translation, if the choice of words introduces ambiguity or a perceived difference between the underlying ISA and related LCE requirements. Coupled with the absence of much EEM, addressed in our response to question 7(d), this limits the Board's ability to explain any intended differentiation in work effort resulting from the choice of alternative language.

    Also, as we note in our response to question 7(d), the decision to significantly limit EEM further restricts the ability of the Board to explain the "why" (intent) of a requirement and aspects of the "how" (it may be approached) - often the application material in the ISAs serve the critical purpose of bringing the necessary clarity to the intended outcome of those requirements, including with respect to translation.

    It will be important for the Board to reflect and respond to feedback from non-native English speakers on whether, based on the current adopted approach, changes to wording of requirements has introduced any uncertainty as to the expected work effort.

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**

Absent any mandated adoption in a jurisdiction, which is unlikely, the determination of whether to adopt and use the LCE standard will primarily be a firm level decision, taking into account a number of factors, including necessary changes to methodology, tools and training and audit client demand.

A sufficient implementation period should be set to avoid setting unrealistic expectations in the market that the standard can be adopted without appropriate implementation work. If revisions to the proposals are developed, as we recommend, to better distinguish the standard from an ISA audit, thereby meeting expectations of stakeholders, this will inevitably have an incremental impact on the costs and effort required relating to implementation. The costs involved in attaining these benefits will not be insignificant and will necessitate development of a new methodology, documentation tools, and training together with the delivery of that training to staff. Associated activities, such as supplementary firmwide and engagement level quality review processes, will also need to be developed and implemented. The Board should not underestimate the scale of effort required.

Recognising the already significant implementation burden being placed on firms as a result of ISA 315 (Revised), the various Quality Management Standards, and shortly ISA 600 (Revised), we believe that the Board should adopt an effective date that is no less than 24 months after approval by the Board.

As with most standard revisions, we support the position that early adoption of the standard should be permitted. However, given the voluntary nature of this standard, we do not understand why early adoption of the standard needs to be “encouraged” by the IAASB.

**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.**

In our response to the 2019 Discussion Paper, we supported the IAASB’s decision that group audits should be excluded from scope as they inherently embody a higher degree of complexity. However, we accept that small groups can exist for which the audit thereof may be deemed less complex.

Any decision to permit the use of the proposed ISA for LCE for group audits must be driven solely in relation to audit quality. Furthermore, any decision to do so must also be supported by a clear description of the criteria for when such use would be deemed appropriate, in addition to any qualitative size criteria that may be established as described in our response to question 3(a). We further comment on criteria in response to question 24.

If a decision is taken by the Board to permit use on certain group audits without specifying the criteria we describe in our response to question 24, we believe it is critical that the Board also addresses the question of the standards that may be applied in respect of the audit of components of a group and how that may impact a group audit required to be conducted in accordance with the ISAs.

If a component entity is considered to be an LCE for purposes of a local statutory audit and the auditor plans to conduct that audit in accordance with the ISA for LCE, guidance will be required as to whether the evidence obtained from that audit can meet the group auditor’s purposes, if the group auditor is required to assert in their report on the group financial statements that the audit was conducted in accordance with ISAs. There may also be circumstances where a group may be deemed less complex but the use of the ISA for LCE is prohibited in the jurisdiction of a component. As we discuss in our response to question 24, as soon as an audit crosses national borders or includes using the work of component auditors, complexities are introduced, including that different jurisdictions may or may not adopt the ISA for LCE.

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:**
    (a) **Would you use the standard if group audits are excluded? If not, why not?**

If authorised for use in a jurisdiction, there is likely to be a sufficient population of less complex entities to generate a level of interest and demand for its use that could not reasonably be ignored.

(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?**

There will undoubtedly be groups within individual jurisdictions where engagement teams may believe those groups are not complex. However, as this is a highly subjective judgement, it is not possible to specify a percentage.

(c) **What common examples of group structures and circumstances within your practice would be considered a less complex group.**

Similar to our comments on the application of qualitative characteristics of complexity in the Authority section, what may constitute a less complex group is a highly subjective judgement. However, structures that may result in a group being considered less complex may include groups with:

- A holding company with one wholly owned trading subsidiary and one or more dormant subsidiaries; or
- A holding company with a small number of wholly owned subsidiaries, all of which are individually considered to be less complex entities.

24. **If group audits are to be included in the scope of ED-ISA for LCE, how should be done (please provide reasons for your preferred option):**
    (a) **The IAASB establishes a proxy(ies) for complexity for when the proposed standard may be used ("Option 1 - see paragraph 169); or**
    (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.**

As noted in our response to question 22, clear criteria would be needed to avoid inconsistent and inappropriate judgements being made on whether or not a group audit was within the scope of the standard. For the reasons we describe in our comments on the Authority section, we believe it will be difficult to describe qualitative characteristics that would not result in significant subjective judgements.

Therefore, we support Option 1 and suggest that, in addition to the overarching quantitative and qualitative criteria established in the Authority, additional proxies for complexity be established in relation to group audits by introducing the following criteria.

Use of the ISA for LCE may be permitted for a group audit when the:

- group entity and all components are audited by a single firm;
- consolidation does not require adjustments to reconcile financial information of components recorded under a local financial reporting framework to that of the group financial reporting framework; and
- group audit does not involve using the work of component auditors.

Consideration could also be given to whether a "jurisdictional boundary" should also form part of the relevant criteria, for example, that the group audit is conducted entirely within one jurisdiction or established geographical region. However, recognising that law, regulation or other jurisdictional agreements may permit or restrict the ability of a firm to operate in a jurisdiction other than its own, this is a matter that is likely best addressed through appropriate jurisdictional tailoring by legislative or regulatory authorities or relevant local bodies with standard setting authority.

**25. 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?**

Please see our response to question 24.

**26. 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):**
**(a) Presenting all requirements pertaining to group audits in a separate Part; or**
**(b) Presenting the requirements pertaining to group audits within each relevant Part.**

Alternative options likely need to be initially explored by the Board to determine what works most effectively in practice. If groups are incorporated based on the criteria we suggest, in particular excluding the need for any requirements relating to involvement of component auditors, then it may be relatively straightforward to incorporate additional requirements into each respective Part.

## 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.

### Risk identification and assessment:

| Illustrative revisions | Comments |
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| **6.1 Objectives** | |
| 6.1.1 The objectives of the auditor are to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement. | No change |
| **6.2. Procedures for Identifying and Assessing Risks and Related Activities** | |
| 6.2.1 The auditor shall design and perform procedures **<u>in an unbiased manner</u>** to obtain audit evidence that provides an appropriate basis for:<br>a. The identification and assessment of risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels; and<br>b. The design of further audit procedures. | While paragraph 1.4.6 sets the overarching requirement to design and perform procedures in a manner that is not biased, it is separated from the core requirement here and in Part 7. We suggest a small amendment could be added here that provides a hook for the related EEM to paragraph 6.2.1. |
| 6.2.2 The procedures to identify and assess risks of material misstatement shall include:<br>a. Inquiries of management, and other appropriate individuals within the entity;<br>b. Analytical procedures.; and | No change |

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| c. Observation and inspection. | |
| 6.2.3 In designing and performing procedures to identify and assess risks of material misstatement, the auditor shall consider possible risks of material misstatement arising from:<br>a. Fraud or error;<br>b. Related parties; and<br>c. Events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. | No change |
| 6.2.4. ~~**When identifying risks of material misstatement, including those arising from fraud, t**~~ The auditor shall consider information from all procedures designed and performed for risk identification ~~**to determine whether fraud risk factors are present**~~, including:<br>a. The acceptance or continuance procedures; and<br>b. When applicable, other engagements performed by the engagement partner for the entity. | Introduction amended to make more of a statement of principle. Requirement is also broader than just to determine whether fraud risk factors are present. |
| 6.2.5. The auditor shall evaluate whether unusual or unexpected relationships that have been identified in performing analytical procedures, including those related to revenue accounts, may indicate risks of material misstatement due to fraud. | No change |
| 6.2.6. If the audit opinion on the prior period's financial statements was modified the auditor shall evaluate the effect on the current year's financial statements when identifying and assessing risks of material misstatement. | No change |
| **6.3. Understanding Relevant Aspects of the Entity**<br>*Understanding the Entity and Its Environment* | |
| 6.3.1 The auditor shall understand:<br>a. The entity's organizational structure, ownership and governance, business model (including how the entity uses IT in its business model).<br>b. The industry and other external factors.<br>c. How the entity's financial performance is measured internally and externally.<br>d. The legal and regulatory framework applicable to the entity, and how the entity is complying with that framework.<br>e. The entity's transactions and other events and conditions that may give rise to the need for, or changes in, accounting estimates to be recognized or disclosed.<br>f. Agreements or relationships that may result in unrecognized liabilities, future commitments or changes to current asset valuations through | No change |

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| inspecting minutes of meetings and correspondence with legal counsel and inspecting legal expense accounts. | |
| 6.3.2. The auditor shall ~~**understand how**~~ **inquire of management and, when applicable,** those charged with governance**, regarding:**<br>**a.** ~~**exercise oversight of management's processes for identifying and responding to**~~ the risks of fraud or error in the entity **they have identified** and the controls that ~~**management has**~~ **have been** established to mitigate these risks**;**<br>**b.** **The identity of the entity's related parties, including changes from the prior period; the nature of the relationships between the entity and these related parties; and whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions;**<br>**c.** **Non-compliance with law or regulation that may have a material effect on the financial statements, and inspecting correspondence, if any, with the relevant licensing or regulatory authorities;** ~~**and**~~<br>**d.** **Whether events or conditions have been identified that individually, or collectively, may affect the ability of the entity to continue as a going concern; and**<br>**e.** **The basis, when applicable, for the intended use of the going concern basis of accounting.**<br><br>6.6.1 [See deletion below]<br><br>*5.2.12 [For reference]*<br><br>~~*5.2.12 The auditor shall determine whether inquire of management has already performed a preliminary assessment of the entity's ability to continue as a going concern and:*~~<br>~~*a. If such an assessment has been performed, discuss the assessment with management and determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern and, if so, management's plans to address them; or*~~<br>~~*b. If such an assessment has not yet been performed, discuss with management the basis for the intended use of the going concern basis of accounting, and inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.*~~ | Expanded to incorporate inquiry of management regarding risks, in lieu of paragraph 6.3.7 on Understanding the Risk Assessment Process component of the system of Internal Control, reflecting that many LCEs will not have a risk assessment process.<br><br>Inquiries required by paragraph 6.6.1 have been elevated to form part of the requirement rather than having a separate section at the end of Part 6 that is disconnected from other inquiry procedures. All of this understanding therefore provides the basis for an informed engagement team discussion.<br><br>Paragraph 5.2.12 also incorporated into this overarching requirement. Whether or not management has conducted an assessment is not the critical focus - the important outcome is to understand management's awareness of matters and justification for using the going concern basis. |
| 6.6.2 The auditor shall make inquiries of management, and as appropriate, those charged with governance, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. | Moved but no change |
| 6.3.3. The auditor shall understand: | No change |

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| a. The applicable financial reporting framework including, for accounting estimates, the recognition criteria, measurement bases, and the related presentation and disclosure requirements and how these apply in the context of the nature and circumstances of the entity and its environment.<br>b. The entity's accounting policies and reasons for any changes thereto. | |
| 6.3.4. The auditor shall evaluate whether the entity's accounting policies are appropriate and consistent with the applicable financial reporting framework. | No change |
| **6.X Engagement Team Discussion** | |
| 5.2.6 **Based on the understanding obtained of the entity and its environment and applicable financial reporting framework, t**~~T~~he engagement partner and other key engagement team members shall discuss the susceptibility of the entity's financial statements to material misstatement, including:<br>a. The application of the applicable financial reporting framework to the entity's facts and circumstances.<br>b. How and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur, and how fraud or error could arise from related party relationships or transactions **(fraud risk factors)**.<br><br>Discussions among the engagement team shall occur setting aside beliefs the engagement team may have that management, and where appropriate, those charged with governance are honest and have integrity. | As noted in appendix 3, paragraphs 5.2.6 & 5.2.7 relate directly to risk assessment and are therefore more appropriately located in Part 6. Suggest this placement represents a logical order having obtained the understanding of the entity and its environment and applicable financial reporting framework.<br><br>Reference to fraud risk factors deemed more helpful here than 6.2.4. |
| 5.2.7 When there are engagement team members not involved in the discussion, the engagement partner shall determine which matters are to be communicated to those members. | Moved but no change |
| ***~~Inherent Risk Factors~~Events or Conditions that Affect Susceptibility to Misstatement and Significant Classes of Transactions, Account Balances and Disclosures*** | |
| 6.3.5. **Based on the auditor's** ~~**In**~~ understanding **of** the entity and its environment and the applicable financial reporting framework ~~**in accordance with this Part**~~, the auditor shall:<br><br>**a.** **consider how events or conditions** ~~**understand how inherent risk factors**~~ affect the susceptibility of ~~**assertions**~~ **the financial statements** to misstatement, and the degree to which they do so; and | Intended simplification by deletion of the defined term "Inherent Risk Factors" and focusing instead on the substance of what needs to be understood by utilising wording from the definition. Reinforced the link to consideration |

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| b. **<u>identify classes of transactions, account balances and disclosures the auditor expects to be significant classes of transactions, account balances and disclosures based on an expectation that a risk of material misstatement may exist</u>**. | being "based on" the understanding of the entity.<br><br>Part (b) added to provide the basis for the extent of understanding to be obtained in subsequent requirements addressing the understanding of the system of internal control (to avoid the circularity question embedded in ISA 315 (Revised 2019)). We suggest that some short EEM be added that includes paragraph A15a of ISA 200 as approved in the conforming amendments arising from ISA 315 (Revised 2019)). |
| *Understanding the Entity's* ***~~Internal Control System~~<u>Control Environment and Process to Prepare its Financial Statements</u>*** | |
| 6.3.6. The auditor shall **~~evaluate whether management (with the oversight of those charged with governance, if applicable) has created and maintained a control environment that provides an appropriate foundation for the other components of the entity's internal control system, including determining whether there are any deficiencies in the control environment that undermine the other components of the entity's internal control system. For this purpose, the auditor shall~~** understand:<br>a. How management~~,~~ and**<u>,</u>** where appropriate, those charged with governance, oversee the entity, and demonstrate integrity and ethical values**<u>, including communicating to employees regarding expectations for business practices and ethical behavior</u>**;<br>b. The entity's assignment of authority and responsibility;<br>c. The culture of the entity, including whether the culture supports honesty and ethical behavior; and<br>d. When applicable, **<u>if and</u>** how **<u>the active involvement of</u>** owner-managers **~~have an active involvement and~~<u>may</u>** influence the risks arising from management override of controls due to lack of segregation of duties.<br><br>**<u>and evaluate whether the control environment created provides an appropriate foundation for the other components of the entity's internal control system, and whether there are any deficiencies in the control environment that undermine the other components of the entity's internal control system.</u>** | Lead in language moved to a hanging paragraph and simplified, to focus first on the matters the auditor is required to understand.<br><br>Incorporated 6.6.1(d) into part (a) as elements are related. |
| **~~6.3.7. The auditor shall evaluate whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature and complexity of the entity. For this purpose, the auditor shall understand the entity's risk assessment process relevant to the preparation of the financial statements (i.e., how risks are identified, assessed and addressed), including how this process identifies and~~** | Excluded on the basis that proposed 6.3.2 achieves a similar outcome in a more direct manner, recognising that many LCEs are unlikely to have a "process". |

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| ~~**addresses risks related to accounting estimates.**~~ | |
| ~~**6.3.8. The auditor shall evaluate whether the entity's process for monitoring the internal control system is appropriate to the entity's circumstances considering the nature and complexity of the entity. For this purpose, the auditor shall understand the entity's process to monitor the entity's internal control system, including the sources of information and the basis upon which management considers the information to be sufficiently reliable, as well as how deficiencies are remediated.**~~ | Deemed not essential to the nature and circumstances of an audit of an LCE. Inquiries under 6.3.2 deemed sufficient to identify relevant matters. |
| 6.3.9. The auditor shall understand ~~**the information system relevant to the preparation of**~~ the **entity's process to prepare its** financial statements, including:<br>**a.** **The accounting records and other records that support the classes of transactions, account balances and disclosures in the financial statements;**<br>b. ~~**a.**~~ For **expected** significant classes of transactions, account balances and disclosures, how ~~**those**~~ transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements~~**, as well as:**~~<br>c. ~~**i.**~~ How ~~**the information system captures, processes and discloses**~~ events and conditions, other than transactions**, are identified, processed and disclosed**;<br>~~**ii. The accounting records, specific accounts in the financial statements and other supporting records for the flows of information;**~~<br>d. ~~**iii.**~~ The entity's resources used in the financial reporting process**, including the IT systems and processes used**;<br>**e.** **Controls within the process that address expected significant classes of transactions, account balances and disclosures.**<br>~~iv. The financial reporting process used to prepare the entity's financial statements, including disclosures; and~~<br>~~**b. The IT environment relevant to (a)(i) to (iv) above.**~~ | Requirement simplified to focus on the entity's process to prepare its financial statements. Understanding of IT simplified. Elements reordered based on assessment of logical flow. Original part (b) incorporated into new (d). |
| ~~**6.3.10. The auditor shall understand how the entity communicates significant matters related to the preparation of the financial statements, and related reporting responsibilities, between people within the entity, between management and those charged with governance (if applicable) and with external parties (such as regulatory authorities or others as required).**~~ | Deemed not essential to the nature and circumstances of an audit of a LCE. |
| 6.3.11 [moved below 6.3.12] | 6.3.12 is a granular extension of the matters covered in paragraph 6.3.9 in the context of accounting estimates. The evaluation in paragraph 6.3.11 would cover both these requirements and therefore logically follow both. |

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| 6.3.12. For accounting estimates and related disclosures for **expected** significant classes of transactions, account balances or disclosures, the auditor~~'s~~ ~~understanding of the information system and the flow of information relevant to the preparation of the financial statements shall include~~ **also understand how management**:<br>**a.** ~~How management i~~Identifies, selects and applies relevant methods, assumptions and data that are appropriate in the context of the applicable financial reporting framework, including identification of significant assumptions;<br>**b.** ~~How management u~~Understands the degree of estimation uncertainty and addresses such uncertainty, including selecting a point estimate and related disclosures for inclusion in the financial statements;<br>~~(c) Controls over management's process for making accounting estimates;~~ and<br>**c.** ~~(d) How management r~~Reviews the outcomes of previous estimates and responds to the results of that review. | Simplified lead-in and deleted reference to management's controls as will already be covered by base requirement in 6.3.9. |
| 6.3.11. The auditor shall evaluate whether the entity's ~~information system and communication~~ **processes** appropriately support~~s~~ the preparation of the entity's financial statements in accordance with the applicable financial reporting framework. | Simplified language based on 6.3.9. |
| ~~6.3.13. Based on the auditor's evaluations about whether the control environment, the entity's risk assessment process, the monitoring of the entity's internal control system and the information system are appropriate in context of the nature and circumstances of the entity, the auditor shall determine whether one or more control deficiencies have been identified.~~ | Deemed adequately addressed by revised 6.3.18. |
| 6.3.14-6.3.16 [moved below 6.5.7] | All controls related work now consolidated in a single section below. |
| ***Service organisations*** | |
| 6.3.17. If the entity uses the services of a service organization, the auditor's understanding of the information system shall include:<br>a. The nature of the services provided by the service organization and the significance of those services to the entity;<br>b. The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organization;<br>c. The relevant contractual terms for the activities undertaken by the service organization;<br>d. Controls at the service organization relevant to the entity's transactions; and<br>e. The controls **within the entity that relate to the information provided by**~~applied to transactions with~~ the service organization. | New sub-heading added for conditional requirement. Language in (e) amended to make clear these are controls within the entity. |
| *Deficiencies in the Entity's Internal Control System* | |
| 6.3.18. **Based on the auditor's evaluation of each of the components of the entity's system of internal control,** ~~T~~the auditor shall determine whether **there are any control** deficiencies identified in the entity's internal control system, individually or in combination, **and, if so, if they** constitute | Updated to address both identification (6.3.13) and determination of significance, and more |

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| significant deficiencies. | explicitly linked to the understanding obtained. |
| ***Evaluation of the Procedures to Identify and Assess Risks of Material Misstatement*** | |
| 6.5.9. The auditor shall evaluate whether the audit evidence obtained from procedures to identify and assess the risks of material misstatement provides an appropriate basis for the identification and assessment of the risks of material misstatement. If not, the auditor shall perform additional procedures until audit evidence has been obtained to provide such a basis. In identifying and assessing the risks of material misstatement, the auditor shall take into account all audit evidence obtained from the procedures to identify and assess the risks of material misstatement, whether corroborative or contradictory to assertions made by management. | Moved from below. This requirement and related evaluation determines whether the auditor has obtained sufficient evidence to provide a basis for identifying and assessing risks. It therefore logically should follow the risk assessment procedures and precede the identification and assessment requirements. |
| **6.4. Identifying Risks of Material Misstatement** | |
| 6.4.1. The auditor shall identify the risks of material misstatement, due to fraud or error, at:<br>a. The financial statement level; and<br>b. The assertion level for classes of transactions, account balances, and disclosures**, identifying the relevant assertions and the related significant classes of transactions, account balances and disclosures**. | 6.4.3 incorporated into 6.4.1(b). |
| **6.4.1A The auditor shall determine whether risks of material misstatement identified at the financial statement level affect risks at the assertion level.** | Moved from 6.5.1 below - as this relates to identification of risks so deemed more appropriately located in this section. |
| 6.4.2. In identifying the risks of material misstatement due to fraud, the auditor shall **determine whether**~~**, based on a presumption that there are risks of fraud in revenue recognition, evaluate which**~~ **there are** types of revenue, revenue transactions or assertions **that** give rise to such risks**, which when identified shall be considered to be significant risks**. | Slight softening of the presumptive risk while retaining a requirement that such risks, if so identified, are to be treated as significant risks. |
| ~~**6.4.3. The auditor shall determine the relevant assertions and the related significant classes of transactions, account balances and disclosures.**~~ | 6.4.3 incorporated into 6.4.1(b). |

| **6.5. Risk Assessment**<br>*Assessing Inherent Risk* | |
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| 6.5.1. ~~**For identified risks of material misstatement, t**~~**T**he auditor shall assess:<br>a. The risks of material misstatement **identified** at the financial statement level~~**,**~~**. ~~In doing so, the auditor shall determine whether such risks affect risks at the assertion level, and~~** evaluat**ing**~~**e**~~ the nature and extent of their pervasive effect on the financial statements; and<br>b. **For the risks of material misstatement identified at the assertion level, inherent risk,** ~~**Inherent risk for identified risks of material misstatement at the assertion level**~~ by assessing the likelihood and magnitude of misstatement. ~~**In doing so, the auditor shall take into account how, and the degree to which inherent risk factors affect the susceptibility of relevant assertions to misstatement.**~~ | Further simplification proposed. Element of 6.5.1(a) moved to new 6.4.1A above. Reference to Inherent Risk Factors deleted in (b) - suggestion that this concept (events or conditions) could be incorporated as EEM. |
| 6.5.2. In ~~**identifying and**~~ assessing risks of material misstatement relating to an accounting estimate and related disclosure at the assertion level, the auditor shall take into account the degree to which the accounting estimate is subject to estimation uncertainty, and the degree to which the following are affected by complexity, subjectivity or **susceptibility to misstatement due to management bias or** other ~~**inherent**~~ **fraud** risk factors:<br>a. The selection and application of the method, the assumptions and data used; and<br>b. The selection of management's point estimate and related disclosures. | Change to replace "other inherent risk factors" with "susceptibility to misstatement due to management bias or other fraud risk factors" as these are the other critical factors to be considered. Deemed more directive. |
| ~~**6.5.3. The auditor shall determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the risks of material misstatement at the assertion level.**~~ | Deleted as this is a response matter and is already covered by 7.3.2(d). However, also now proposed as an explicit addition in 6.5.8(b). |
| 6.5.4. The auditor shall determine whether any of the assessed risks of material misstatement are, in the auditor's professional judgment, a significant risk. | No change |
| 6.5.5. In exercising professional judgment as to which assessed risks are significant risks, the auditor shall determine whether the **following are significant risks:**<br>**i.** assessed risks associated with related party relationships and transactions**; and**<br>**ii.** **assessed risks relating to accounting estimates** ~~**are significant risks**~~.<br><br>~~**6.5.6. The auditor shall determine whether risks of material misstatement assessed relating to accounting estimates are significant risks.**~~ | 6.5.6 merged into 6.5.5 with the language simplified. |
| 6.5.7. The auditor shall treat the following as significant risks: | (a)(ii) aligned with proposed amended 6.4.2. |

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| a. Identified fraud risks including:<br>i. Management override of controls. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur it is a risk of material misstatement due to fraud and therefore a significant risk; and<br>ii. **Types of revenue, revenue transactions or assertions, if any, that the auditor identified as significant risks in accordance with 6.4.2**~~**Risk of fraud in revenue recognition. Based on a presumption that there are risks of fraud in revenue recognition the auditor shall evaluate which types of revenue, revenue transactions or assertions give rise to such risks**~~; and<br>b. Identified significant related party transactions outside the entity's normal course of business | |
| ***Understanding the Entity's Control Activities*** | Requirements relating to understanding control activities relocated from above to:<br>(i) provide an enhanced flow (follows the assessment of significant risks, which is referred to in part (a), and co-locates the understanding of controls with assessing control risk); and<br>(ii) increase the perception of scalability. |
| 6.3.14. The auditor shall **perform procedures to evaluate the design and implementation of the following** ~~**identify**~~ controls~~**that address risks of material misstatement at the assertion level as follows**~~:<br>a. Controls that address risks determined to be significant risks;<br>b. Controls over journal entries **related to identified risks of material misstatement at the assertion level,** including **journals** to record non-recurring, unusual transactions or adjustments;<br>c. Controls**, if any,** for which the auditor plans to test the operating effectiveness of controls in determining the nature, timing and extent of substantive testing~~**, including those controls that address risks for which substantive procedures alone are not enough to obtain sufficient appropriate audit evidence**~~;<br>~~d. **Other controls, based on the auditor's professional judgment, where the auditor considers it appropriate to meet the objectives of identifying risks of material misstatement at the assertion level;**~~<br>~~e. **If applicable, controls that relate to information processed by a service organization;**~~ and<br>f. Controls, if any, **related** to ~~**identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework, authorize and approve**~~ significant transactions and relationships with related parties, and ~~**authorize and approve**~~ significant transactions and arrangements outside the normal course of business. | Lead in text amended to bring forward the primary obligation from the hanging paragraph. Deletion from (c) due to being implicitly covered by remainder of (c) and can be explained in EEM. (d) deleted as not widely understood in practice and technically covered by (c). (e) deleted as already covered by 6.3.17. (f) simplified. |

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| **The procedures performed shall include more than inquiry.** ~~**For each control identified in (a)–(f) above, the auditor shall evaluate whether the control is designed effectively to address the risk of material misstatement at the assertion level, or effectively designed to support the operation of other controls, and determine whether the control has been implemented, by performing procedures more than inquiry.**~~ | |
| 6.3.15. For the controls identified in paragraph 6.3.14. the auditor shall ~~**identify the IT applications and other aspects of the IT environment that are subject to risks arising from the use of IT.**~~<br><br>~~**6.3.16. For the IT applications and other aspects of the IT environment identified in paragraph 6.3.15, the auditor shall**~~ identify ~~**the related**~~ risks **to the design and operating effectiveness of those controls** arising from the use of IT**,** and the entity's general IT controls ~~**that respond to those risks**~~, and evaluate whether the general IT controls are effectively designed to address the risk of material misstatement at the assertion level, or effectively designed to support the operation of other controls, and determine whether the control has been implemented by performing procedures more than inquiry. | 6.3.15 and 6.3.16 merged. Principles retained but language simplified. |
| *Assessing Control Risk* | |
| 6.5.8. ~~**If the auditor plans to test the operating effectiveness of controls t**~~**T**he auditor shall assess control risk **when:**<br>**a. The auditor has determined that the substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the risks of material misstatement at the assertion level; or**<br>**b. The auditor otherwise plans to test the operating effectiveness of controls,**<br><br>~~,~~ otherwise the risk of material misstatement is the same as the assessment of inherent risk. | Added additional clarity on when control risk needs to be assessed in lieu of 6.5.3. |
| ***~~Evaluation of the Procedures to Identify and Assess Risks of Material Misstatement and~~ Revision of Risk Assessment*** | |
| 6.5.9 [moved before 6.4.1] | |
| 6.5.10 The auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained. In circumstances where the auditor obtains audit evidence from performing further audit procedures, or if new information is obtained, either of which is inconsistent with the audit evidence on which the auditor originally based the assessment, the auditor shall revise the assessment and modify the further planned audit procedures accordingly. | No change |
| *Evaluation of the Appropriateness of Using the [draft] ISA for LCE* | |

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| 6.5.11 Based on the procedures performed to identify and assess the risks of material misstatement, the engagement partner shall evaluate whether the [draft] ISA for LCE continues to be appropriate for the nature and circumstances of the entity being audited. | No change |
| **~~6.6. Specific Inquiries of Management and Those Charged with Governance~~** | |
| **~~6.6.1. In designing and performing procedures to identify and assess the risks of material misstatement due to fraud or error, the auditor shall make inquiries of management regarding:~~**<br>~~a. Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments;~~<br>~~b. Management's process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist;~~<br>~~c. Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity;~~<br>~~d. Management's communication, if any, to employees regarding its views on business practices and ethical behavior;~~<br>~~e. The identity of the entity's related parties, including changes from the prior period; the nature of the relationships between the entity and these related parties; and whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions;~~<br>~~f. Non-compliance with law or regulation that may have a material effect on the financial statements, and inspecting correspondence, if any, with the relevant licensing or regulatory authorities; and~~<br>~~g. Events or conditions that exist that individually, or collectively, may affect the ability of the entity to continue as a going concern.~~ | This is not deemed to be a "specific communication" requirement as such (see 6.7 below) and is considered to form part of the required understanding to be obtained. Consequently, the following changes have been made:<br>a. Deleted - not deemed necessary given (b)<br>b. Deemed covered by 6.3.2<br>c. Deleted - not deemed critical<br>d. Moved to 6.3.6(b)<br>e. Moved to 6.3.2<br>f. Moved to 6.3.2<br>g. Moved to 6.3.2 |
| **~~6.6.2. The auditor shall make inquiries of management, and as appropriate, those charged with governance, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity.~~** | Moved to new 6.3.2A |
| **6.7. Specific Communication Requirements** | |
| 6.7.1 The auditor shall communicate to management, and where appropriate, those charged with governance, the significant risks identified by the auditor. | No change |
| **6.8. Specific Documentation Requirements** | |
| 6.8.1-6.8.2 - See separate table below for specific documentation requirements | Paragraph 5.5.3 moved to sit alongside other |

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| | risk assessment related documentation requirements. |

## Accounting estimates (Part 7):

| **Illustrative revisions** | **Comments** |
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| **7. Responding to Assessed Risks of Material Misstatement** | |
| **7.4. Specific Focus Areas**<br>*Accounting Estimates* | |
| 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 |
| ***Evidence available from events occurring up to the date of the auditor's report***<br><br>**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**. | Proposed new requirement |
| 7.4.17. **For accounting estimates for which the outcome is not yet known from events occurring up to the date of the auditor's report,** ~~T~~the 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. **For accounting estimates for which the outcome is not yet known from events occurring up to the date of the auditor's report,** ~~T~~the auditor's further audit procedures to respond to assessed risks of material misstatement at the assertion level relating to an accounting estimate shall | Added language to lead-in to make conditional on 7.4.16A and made two amendments to (a) to |

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| include one or more of the following approaches:<br>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>**;<br>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:<br>i. The method selected is appropriate, including any changes from the prior period;<br>ii. The significant assumptions and data are consistent and appropriate, and their integrity maintained in applying the method;<br>iii. Management has the intent to carry out specific courses of actions;<br>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;<br>v. Changes from prior periods are appropriate;<br>vi. The data is relevant and reliable in the circumstances; and<br>vii. Calculations are mathematically accurate and whether judgements have been applied consistently; or<br>c. Developing an auditor's point estimate or range. In doing so, the auditor shall:<br>i. Evaluate whether the methods, assumptions or data used are appropriate in the context of the applicable financial reporting framework; and<br>ii. Determine that the range includes only amounts that are supported by sufficient appropriate audit evidence. | 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. |

**Documentation:**

The suggested revisions below illustrate our suggested logical order if the documentation requirements were consolidated into one section. Certain edits to consolidate, simplify or relocate the requirements, may also remain applicable if the requirements are retained within each individual Part.

| Illustrative alternative requirement | Comment |
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| ~~**2. Audit Evidence and Documentation**~~<br>~~**2.5 General Documentation Requirements**~~ | |

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| 2.5.1 [moved below 4.8.1] | |
| 2.5.2 [moved below 7.7.1] | |
| 2.5.3 [consolidated into 2.5.2 and moved below 7.7.1] | |
| 2.5.4 [consolidated into 2.5.2 and moved below 7.7.1] | |
| 2.5.5 [moved below 8.9.6] | |
| 2.5.6 [moved below 8.9.6] | |
| 2.5.7 [moved below 8.9.6] | |
| 2.5.8 [moved below 8.9.6] | |
| **~~3. Engagement Quality Management~~**<br>**~~3.3 Specific Documentation Requirements~~** | |
| 3.3.1 [moved to follow 2.5.1A below] | |
| **~~4.~~ Acceptance or Continuance of an Audit Engagement and Initial Audit Engagements**<br>**~~4.8. Specific Documentation Requirements~~** | |
| 4.8.1 [moved below 4.8.5] | |
| 4.8.2. The auditor shall document the determination made for using the [draft] ISA for LCE. | Proposed combined documentation section would commence with the overarching documentation obligations relating to the |

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| | determination made for using the ISA for LCE.<br><br>No change |
| 4.8.3. The auditor shall document changes, if any, to the determination of the use of the [draft] ISA for LCE if further information comes to the auditor's attention during the audit that may change the professional judgment made in this regard. | No change |
| 4.8.4. The auditor shall record in an audit engagement letter or other suitable form of written agreement:<br>a. That the audit will be undertaken using the [draft] ISA for LCE.<br>b. The objective and scope of the audit of the financial statements;<br>c. The respective responsibilities of the auditor and management;<br>d. Identification of the applicable financial reporting framework for the preparation of the financial statements;<br>e. Reference to the expected form and content of any reports to be issued by the auditor; and<br>f. A statement that there may be circumstances in which a report may differ from its expected form and content. | No change |
| 4.8.5. If law or regulation prescribes in sufficient detail the terms of the audit engagement referred to in this [draft] standard, the auditor need not record them in a written agreement, except for the fact that such law or regulation applies, and that management acknowledges and understands its responsibilities. | |
| 4.8.1. **~~In addition to the general documentation requirements (Part 2.5.),~~** **<u>To the extent necessary to evidence key decisions made in engagement acceptance,</u>** the auditor shall include in the audit documentation matters identified, relevant discussions, and conclusions reached with respect to the acceptance and continuance of the client relationship and audit engagement. | Suggestion to follow the initial determination requirements with the acceptance related documentation.<br><br>Language amended to reflect restructuring of requirements. |
| ~~*2.5*~~ **General Documentation Requirements <u>for the performance of the audit</u>** | Amended subheading to reflect new positioning |
| 2.5.1. **~~Specific matters to be documented are set out throughout this [draft] standard.~~** The auditor shall prepare audit documentation on a timely basis that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand: | Language amended to reflect restructuring of requirements. |

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| a. The nature, timing and extent of the audit procedures performed in accordance with this [draft] standard and applicable legal and regulatory requirements, including recording~~: (i)T t~~he identifying characteristics of the specific items or matters tested;<br>~~**ii. Who performed the work and the date such work was completed;**~~<br>~~**iii. Who reviewed the audit work performed and the date and extent of such review, including what was reviewed;**~~<br>b. The results of the audit procedures performed, and the audit evidence obtained; and<br>c. Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.<br><br>***Responsibilities when there are members of the engagement team other than the engagement partner***<br><br>**2.5.1A When there are members of the engagement team other than the engagement partner, the audit documentation shall also include:**<br>**a. Who performed the work and the date such work was completed;**<br>**b. Who reviewed the audit work performed and the date an extent of such review, including what was reviewed.** | 2.5.1(a)(ii) and (iii) - Now suggested 2.5.1A. (With unbold new sub-heading) |
| **Engagement quality management** | |
| 3.3.1. ~~**In addition to the general documentation requirements (Part 2.5.) for an audit engagement, t**~~**T**he auditor shall ~~**include in the audit**~~ document~~**ation**~~ matters identified, relevant discussions, and conclusions reached with respect to fulfillment of responsibilities for relevant ethical requirements, including applicable independence requirements. | Language amended to reflect restructuring of requirements and made language consistent with other requirements ("shall document"). |
| ~~**5.**~~ **Planning**<br>~~**5.5. Specific Documentation Requirements**~~ | |
| 5.5.1. ~~**In addition to the general documentation requirements (Part 2.5.) for an audit engagement, t**~~**T**he auditor shall **document the audit plan that** include**s:**<br>**a.** a description of the scope, timing and direction of the audit**;**~~**, and**~~<br>**b.** **any** significant changes made during the audit, together with the reasons for such changes~~**, in the audit documentation.**~~**;**<br>**c.** ~~**5.5.4 The auditor shall include in the audit documentation**~~ the ~~**following**~~ amounts and the factors considered in the~~**ir**~~ determination of **the following** ~~**materiality (including any revisions as applicable)**~~:<br>**i.** Materiality determined for the financial statements as a whole;<br>**ii.** if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures;<br>**iii.** Performance materiality; **and**<br>**iv.** **The amount below which misstatements would be considered clearly trivial.** | Language amended to reflect restructuring of requirements.<br><br>Redrafted 5.5.1(c)(i) to (iii) moved from 5.5.4 to consolidate into one requirement.<br><br>Redrafted 5.5.1(c)(iv) moved from 7.7.1(e).<br><br>Redrafted 5.5.1(d) to (f) moved from 5.5.2. |

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| ~~**The auditor shall include in the audit documentation a description of:**~~<br>**d.** ~~**5.5.2 The auditor shall include in the audit documentation a description of: a.**~~ The nature, timing and extent of planned risk identification and assessment procedures.<br>**e.** ~~**b.**~~ The nature, timing and extent of planned further audit procedures at the financial statement and assertion level.<br>**f.** ~~**c.**~~ Other planned audit procedures that are required to be carried out so that the engagement complies with the requirements of this [draft] standard.<br><br>~~**5.5.2. The auditor shall include in the audit documentation a description of:**~~<br>~~**a. The nature, timing and extent of planned risk identification and assessment procedures.**~~<br>~~**b. The nature, timing and extent of planned further audit procedures at the financial statement and assertion level.**~~<br>~~**c. Other planned audit procedures that are required to be carried out so that the engagement complies with the requirements of this [draft] standard.**~~<br><br>~~**5.5.4. The auditor shall include in the audit documentation the following amounts and the factors considered in their determination of materiality (including any revisions as applicable):**~~<br>~~**a. Materiality for the financial statements as a whole;**~~<br>~~**b. If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures; and**~~<br>~~**c. Performance materiality.**~~ | |
| 5.5.3 [Moved below 6.8.1] | |
| ~~6.~~ **Risk Identification and Assessment**<br>~~**6.8. Specific Documentation Requirements**~~ | |
| 6.8.1. ~~**In addition to the general documentation requirements (Part 2.5.) for an audit of an LCE, t**~~**T**he auditor shall ~~**include the following in the audit**~~ document~~**ation**~~:<br>a. Key elements of the understanding obtained regarding**:**<br>**i.** ~~**each of the aspects of**~~ the entity and its environment~~,~~ **and** the applicable financial reporting framework ~~**and the entity's internal control system**~~;<br>**ii.** **The entity's control environment and process to prepare the financial statements;**<br>**iii.** **The controls set out in paragraphs 6.3.14 and 6.3.15 including the evaluation whether the control is designed effectively and determination whether the control has been implemented; and**<br>**iv.** **For accounting estimates, key elements of the auditor's understanding of the accounting estimates, including controls as** | Language amended to reflect restructuring of requirements and made language consistent with other requirements ("shall document").<br><br>Parts (e) and (f) of this requirement moved to be a sub-list of (a) to consolidate all related "understanding" matters together.<br><br>Part (d) updated to reflect changes proposed in |

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| **appropriate and any indicators of management bias and how those were addressed.**<br>b. The names of the identified related parties (including changes from prior period) and the nature of the related party relationships;<br>c. The identified and assessed risks of material misstatement, including risks due to fraud, at the financial statement level and at the assertion level, including significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made;<br>d. If applicable, the reasons for the **determination** ~~**conclusion**~~ that there **are no types of revenue, revenue transactions or assertions that give rise to** ~~**is not**~~ a risk of material misstatement due to fraud related to revenue recognition;<br>~~e. **The controls set out in paragraphs 6.3.14. and 6.3.16 and the evaluation whether the control is designed effectively and determination whether the control has been implemented; and**~~<br>~~f. **For accounting estimates, key elements of the auditor's understanding of the accounting estimates, including controls as appropriate, the linkage of the assessed risks of material misstatements to the auditor's further procedures, and any indicators of management bias and how those were addressed.**~~ | risk assessment requirements table above. |
| 5.5.3 The auditor shall document the discussion among the engagement team and significant decisions reached including significant decisions regarding the susceptibility of the entity's financial statements to material misstatement due to fraud or error. | No change |
| ~~**6.8.2. The auditor shall document the evaluation about whether the [draft] ISA for LCE continues to be appropriate for the nature and circumstances of the entity being audited.**~~ | Covered by 4.8.3. |
| **~~7.~~ Responding to Assessed Risks of Material Misstatement**<br>~~**7.7. Specific Documentation Requirements**~~ | |
| 7.7.1. ~~**In addition to the general documentation requirements (Part 2.5.) for an audit engagement, t**~~**T**he auditor shall ~~**include the following in the audit**~~ document~~**ation**~~ **the following regarding how the audit responded to assessed risks of material misstatement**:<br>a. The overall responses to the assessed risks of material misstatement at the financial statement level;<br>b. The linkage between the procedures performed and the assessed risks at the assertion level**, including** ~~**7.7.2 W**~~ **w**he~~n~~**re** the assessed risk of material misstatement is due to fraud, the ~~**auditor's documentation shall include the**~~ specific fraud response;<br>c. The results of the audit procedures, including the conclusions where these are not otherwise clear;<br>**cA**. ~~**7.7.4**~~ For accounting estimates, the ~~**auditor shall document**~~ significant judgments relating to the auditor's determination of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated.<br>d. The results of audit procedures designed to address the risk of management override of controls;<br>~~e. **The amount below which misstatements would be considered clearly trivial;**~~ and | Language amended to reflect restructuring of requirements and made language consistent with other requirements ("shall document").<br><br>7.7.2 and 7.7.4 now built into the redrafted 7.7.1<br><br>7.7.1(e) moved to redrafted 5.5.1. |

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| f. All misstatements accumulated during the audit and whether they have been corrected.<br><br>~~**7.7.2. Where the assessed risk of material misstatement is due to fraud, the auditor's documentation shall include the specific fraud response.**~~<br><br>7.7.3. [presented alongside 2.5.2 below]<br><br>~~**7.7.4. For accounting estimates, the auditor shall document significant judgments relating to the auditor's determination of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated.**~~ | |
| 2.5.2. The auditor shall **also** document **the following specific matters:**<br>**a.** **if the auditor has** identified or suspected non-compliance with law or regulation, ~~**and**~~ the results of discussion with management, and where appropriate, those charged with governance and parties outside the entity**, the audit procedures performed, the significant professional judgments made, and the conclusions reached thereon;**~~.~~<br>**b.** ~~**2.5.3**~~ If the auditor identified information that is inconsistent with the auditor's conclusion regarding a significant matter, ~~**the auditor shall document**~~ how the inconsistency was addressed;<br>**c.** ~~**2.5.4**~~ If, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement of this [draft] standard, ~~**the auditor shall document**~~ how the alternative audit procedures performed achieve the aim of that requirement, and the reasons for the departure.<br><br>~~**2.5.3. If the auditor identified information that is inconsistent with the auditor's conclusion regarding a significant matter, the auditor shall document how the inconsistency was addressed.**~~<br><br>~~**2.5.4. If, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement of this [draft] standard, the auditor shall document how the alternative audit procedures performed achieve the aim of that requirement, and the reasons for the departure.**~~<br><br>~~**7.7.3. Where the auditor has identified or suspected non-compliance with law or regulation, the auditor shall document the audit procedures performed, the significant professional judgments made, and the conclusions reached thereon.**~~ | 2.5.3 and 2.5.4 incorporated in (b) and (c) of redrafted 2.5.2.<br><br>7.7.3 incorporated within redrafted 2.5.2. |
| **~~8.~~ Concluding**<br>~~**8.9. Specific Documentation Requirements**~~ | |

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| 8.9.1 [moved below 8.9.2] | |
| 8.9.2 The auditor's documentation shall demonstrate that information in the financial statements agrees or reconciles with the underlying accounting records, including agreeing or reconciling disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers. | No change |
| 8.9.1. **~~In addition to the general documentation requirements (Part 2.5.) for an audit engagement, t~~T**he auditor shall **~~include the following in the audit~~** document**~~ation~~ the following regarding the conclusions on which the auditor's opinion is based**:<br>a. T**~~he amount below which misstatements would be regarded as clearly trivial, all misstatements accumulated during the audit and whether they have been corrected, and t~~**he auditor's conclusion as to whether the uncorrected misstatements **accumulated during the audit** are material, individually or in aggregate, and the basis for that conclusion.<br>b. The nature and scope of, and conclusions from, consultations undertaken during the audit, including how such conclusions were implemented. | Language amended to reflect restructuring of requirements and made language consistent with other requirements ("shall document").<br><br>"*The amount below which misstatements would be regarded as clearly trivial*" - moved to redrafted 5.5.1.<br><br>"*all misstatements accumulated during the audit and whether they have been corrected*" - covered by redrafted 7.7.1(e). |
| 8.9.3 [moved below 8.9.5] | |
| 8.9.4 [moved below 8.9.5] | |
| 8.9.5 If applicable, the auditor shall document the failure to meet an objective of any Part of the [draft] ISA for LCE, and the resulting action (such as the effect on the auditor's opinion or withdrawal from the engagement if the overall objective of the auditor cannot be met). | No change |
| 8.9.3 The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report. | No change |
| 8.9.4 After assembly of the final audit file is complete, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period. | No change |

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| 8.9.6 If the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the assembly of the final audit file has been completed, the auditor shall, regardless of the nature of the modifications or additions, document:<br>a. The specific reasons for making them; and<br>b. When and by whom they were made and reviewed. | No change |
| **Documentation of Communications** | Moved from section 2 |
| 2.5.6 The auditor shall document discussions of significant matters with management, and where appropriate, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place. | No change |
| 2.5.5 The auditor shall ~~include in the audit~~ document~~ation~~ any:<br>a. Communications about fraud made to management, those charged with governance, regulators and others; and<br>b. Discussions of significant matters related to non-compliance with law or regulation, or fraud, with management, those charged with governance and others, including how the matter has been responded to. | |
| 2.5.7 Where matters required to be communicated by this [draft] standard are communicated orally, the auditor shall include them in the audit documentation, and when and to whom they were communicated. | No change |
| 2.5.8 Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of the audit documentation. Written communications need not include all matters that arose during the audit. | No change |

## 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.

*Preface*

- Paragraphs P.1 and P.6 - These paragraphs do not reference the current proposed limitation of applying the standard only to general purpose financial statements. If the 800 series is not incorporated, this limitation should explicitly be addressed.

*Authority*

- Paragraph A.11(a) - There is a theoretical risk that by allowing the specific prohibitions to be modified through the introduction of quantitative thresholds under which entities in that category may be audited using the standard the end result is a de facto "removal" of that category. As described in our response to questions 3(e) , we recommend the prohibitions in paragraph A7(c) all be outright prohibitions and an overarching set of quantitative thresholds adopted for all other entities (see response to question 3(a)).

- In addition to our comments in response to question 4(b), the following additional characteristics are suggested:
    - Management does not engage experts nor does the auditor anticipate the need to engage an auditor's specialist or expert.
    - The entity meets the criteria set out in law or regulation for applying a small entity financial reporting framework.

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

- Paragraph 1.2.1 - Given the importance of ethical and independence requirements in an audit, we recommended that EEM be included that addresses the fundamental concepts and principles addressed in paragraphs A17 & A18 of ISA 200. We suggest the EEM also addresses that "relevant" in this context encompasses the fact that there are differential ethical requirements for different classes of entities subject to financial statement audit.

- Section 1.5 - Introductory EEM - We recommend elevating paragraph 3 to become paragraph 1 to enhance the flow of this material.

- Paragraph 1.6.2 - We suggest this would be better positioned as EEM.

- Paragraphs 1.8.1-1.8.7 - To further enhance the perceived scalability of the standard, we recommend carving out all references to those charged with governance in section 1.8 and creating a new conditional section 1.9 that includes separate requirements under an overarching requirement (1.9.1) that indicates the section applies when those charged with governance are separate from management. This would provide separate streamlined requirements addressing required communications with management and those charged with governance.

- Paragraph 1.8.4 - We suggest this would be better positioned as EEM to the proposed conditional requirement 1.9.1 described above.
- Paragraph 1.8.5 - We recommend incorporating this requirement into requirement 2.3.4(a) as the purpose and importance of the requirement is to appropriately respond to inconsistencies in audit evidence rather than being a communication requirement.

*Part 3 - Engagement Quality Management*

- Paragraph 3.2.2 - We recommend bifurcating the requirement. The engagement partner's responsibility for clear, consistent and effective actions being taken that reflect the firm's commitment to quality should reflect an overarching principle requirement. The remainder of the requirement could be addressed in a conditional requirement that resides under a sub-heading of "Responsibilities when there are members of the engagement team other than the engagement partner". This concept, consistent with the requirements in ISA 600 (Revised) when component auditors are involved, can also be applied to other requirements that only apply when there are other members of the engagement team (for example, paragraphs 3.2.5 and 3.2.11). This would further help segregate and highlight requirements that are not applicable in specific circumstances.
- Paragraph 3.2.7 - we suggest the sub-heading be amended to "Engagement Resources". The sub-heading "Other Engagement Partner Responsibilities" can be relocated to above paragraph 3.2.10.

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

- Section 4.3 - We consider that there are certain fundamental principles addressed in the application material of ISA 210 that should be reflected in EEM. These include the matters addressed in paragraphs: A11 (parts not addressed under P.6) and A14.
- Section 4.5 - We recommend the first paragraph of the EEM be relocated to sit under section 4.4 as it pertains to acceptance and continuance rather than the terms of engagement.
- Paragraph 4.8.2 - It is unclear whether the expectation is that the auditor is to document the rationale and significant judgements made in making the determination that use of the ISA for LCE was appropriate as opposed to simply documenting the decision itself. We recommend the intent be clarified and supported by EEM.

*Part 5 - Planning*

- Paragraphs 5.2.6 and 5.2.7 - These requirements relate to the identification and assessment of risks of material misstatement. They would therefore be better placed in Part 6.2/6.3.
- Paragraph 5.2.8 - We believe EEM is necessary to support this requirement. There is extensive application material in ISA 500 and it seems inconsistent to conclude that no EEM is necessary. We suggest that, as a minimum, the matters addressed in the following ISA 500 paragraphs should be addressed in EEM: A47-A50, A52, A54 and A59.

- Paragraph 5.2.12 - This requirement relates to understanding the entity as part of risk assessment procedures and would therefore be better located in Part 6.2/6.3.

- Section 5.3 - We question the sufficiency of EEM in this section to both describe the concept of materiality and to support the relevant requirements. For example, we believe paragraphs 2, 4, and the remainder of paragraph 6 of ISA 320 not included in the draft standard, provide necessary context for understanding and determining materiality. We also suggest that elements of ISA 320.A11 and further content from ISA 320.A13 would be useful additions. Further examples of typical benchmarks would also be useful, as is the guidance in ISA 320.A8.

- Paragraph 5.5.3 - Related to paragraph 5.2.6 & 7 above, we believe this requirement relates to risk assessment and should be located in section 6.8.

*Part 6 - Risk Identification and Assessment*

Please see appendix 2. In addition we note the following comments:

- Paragraph 6.2.1 - The second paragraph of the EEM hanging off paragraph 6.2.1 refers to "... compliance with the *procedures* in this Part". The standard sets out requirements not procedures. The auditor designs and performs audit procedures to meet the requirements.

- Paragraph 6.2.3 - The accompanying EEM does not provide additional guidance on the potential heightened risks of material misstatement relating to related parties that may arise due to the ownership structure of a LCE. Additional EEM describing specific types of related parties that are more prevalent in the LCE sector - for example, close family members or trading entities under common control would be useful. This could also be incorporated as EEM to paragraph 1.7.1.

- Paragraph 6.3.1 - We believe there is insufficient EEM to support elements of this requirement. Specifically, we suggest EEM is required to address the matters in ISA 315 (Revised 2019) paragraphs A68-A70 and A73, to support an understanding of what is meant by "industry and other external factors".

- Paragraph 6.3.5 - Inherent Risk Factors is a new concept introduced by ISA 315 (Revised 2019). We believe there is a lack of EEM to explain this concept and how it is applied. The IAASB determined that extensive application material and an accompanying appendix were necessary to explain this concept, together with the interrelationship with the defined terms of Relevant Assertion, and Significant Classes of Transactions, Account Balances and Disclosures, in ISA 315 (Revised 2019). Absent further EEM, we do not believe this can be effectively and consistently implemented by auditors using the ISA for LCE and have recommended a simplification, as illustrated in appendix 2.

- Paragraph 6.3.6(d) - We suggest some brief EEM is needed to explain what is meant by "how owner-managers …. influence the risks arising from management override of controls…". It is unclear what "influence" in this regard means.

- Paragraph 6.3.9 - Related to paragraph 6.3.5, we believe EEM is necessary to support the concept of Significant Classes of Transactions, Account Balances and Disclosures. In particular, recognising the importance of revisions arising from the IAASB's previous Disclosures project, we suggest that the emphasis given in ISA 315 (Revised 2019) paragraph A204 on significant disclosures is important.

- 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.

- Paragraph 6.5.9 - This requirement and related evaluation determines whether the auditor has obtained sufficient evidence to provide a basis for identifying and assessing risks. It therefore logically should follow the risk assessment procedures and precede the identification and assessment requirements. We recommend relocation to precede 6.4.1.

*Part 7 - Responding to Assessed Risks of Material Misstatement*

- Paragraph 7.1.1(d) - While we recognise this represents part of the objective of ISA 250 (Revised) we question the omission of the more important element of the ISA 250 (Revised) objective, being to obtain sufficient appropriate audit evidence regarding compliance with laws and regulations that have a direct effect on the financial statements.

- Paragraph 7.3.3 - We suggest paragraphs A63 and A66 of ISA 500 represent important contextual guidance that should be incorporated as EEM.

- Paragraphs 7.3.4 and 7.3.5 - Given they have entire ISAs dedicated to them, we question whether the omission of almost all application material from these ISAs can support consistent interpretation and application of the requirements.

- Paragraph 7.3.16 - In revising ISA 315 in 2019, there was clear evidence that paragraph 18 of ISA 330 is not well understood. We believe some supporting EEM is needed to address this confusion. At a minimum, we suggest paragraphs A42 and A42a of ISA 300, as amended by the conforming and consequential amendment arising from ISA 315 (Revised 2019), be included.

- 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.

- 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.

- Paragraph 7.4.26(b) - We believe there is a risk of confusion about whether or not the standard addresses reliance on controls at a service organisation. The explanatory memorandum describes that Type 1 and Type 2 reports are not addressed as it is expected that evidence can be obtained directly by the auditor of the entity. However, the standard makes several references to controls at a service organisation, and it may be relatively common for an LCE to use a larger payroll provider who provides such service auditor reports to its customers. We believe additional requirements and EEM are likely necessary to guide auditors on the expected work effort in such circumstances.

- Paragraph 7.5.3 - Given the heightened focus on fraud, we believe it would be appropriate to include ISA 240 paragraph A52 as EEM.

- Paragraph 7.6.2 - The “context of the communication” referred to in the requirement can only be understood if EEM is provided that addresses the matters described in the remainder of ISA 265 paragraph 11(b) not incorporated in the draft i.e., parts (i) - (iii) of the requirement.

*Part 8 - Concluding*

- Paragraph 8.4.5 - We question the omission of paragraphs 12 and 13 of ISA 560. These paragraphs direct the appropriate response of the auditor in different circumstances.

- Paragraph 8.4.6 - Similar to the preceding point, we believe the omission of paragraphs 15-17 if ISA 560 is problematic for the same reason.

- Paragraph 8.6.6(c) - If the “required written representations” referred to in this paragraph are those described in paragraph 8.6.1, we question whether this requirement is too onerous. ISA 560 only requires the auditor to disclaim when management refuses to provide three critical representations.

- Paragraph 8.8.1 - This should be located in Part 7 as it corresponds to the requirements described in section 7.5.

- Paragraph 8.8.3 - This could be incorporated into the list in paragraph 8.8.2.

*Part 9 - Reporting*

- Paragraph 9.4.1 - When the audit report's layout or wording is prescribed by law or regulation, paragraph 9.4.1(a) permits the auditor to refer to the draft LCE standard only when "*all significant elements of the specified format and content are included*". We recommend including some brief EEM to explain that the meaning of the term "all significant elements" is described in the reporting supplement.
- Paragraph 9.4.1 - The auditor's report set out in Part 9.4 includes the section "Responsibilities of management for the financial statements". This paragraph, and the related footnotes, make no reference to those charged with governance. However, the first line after the bulleted list of Auditor's Responsibilities makes reference to communicating with those charged with governance. We suggest the pro-forma audit report include optional text for when those charged with governance are separate from management, to explain their respective responsibilities.
- Table C - We recommend that some brief EEM be added to acknowledge that when multiple options may be applicable in the circumstances, the appropriate opinion to be expressed is a matter of professional judgement based on the nature and circumstances of the matter. It would be useful to cross-reference the supplemental guidance on reporting, which provides necessary supporting guidance. Otherwise, we believe the content of the supplement needs to be incorporated as necessary EEM to enable the auditor to comply with the requirements.
- Paragraph 9.5.2 - This paragraph logically follows on from paragraph 9.4.3 and we recommend it be relocated so that these paragraphs are read consecutively.
- Section 9.8 and Table E - There is no reference within this section or Table E that states where the Other Information section should be included within the auditor's report. We recommend the illustrative pro forma audit report in part 9.4 include an Other Information section.
- Other - We believe paragraphs 24 and 27 of ISA 705 (Revised) addressing the need to include reasons in the basis for modification paragraph when the auditor expresses a modified opinion based on a limitation of scope or otherwise expresses an adverse or disclaimer of opinion need to be included as explicit requirements. The reporting supplement (see comment below) indicates this is optional which would be a fundamental change that we do not support.

### Supplemental Guidance - Authority

We provide the following comments on the Supplemental Guidance on Authority:

- Paragraph 31(c) - The guidance document is useful in clearly stating that circumstances where management amends the financial statements after the date of the auditor's report are outside the scope of the LCE standard. However, this point is not made clear within the standard itself. As noted in our comments on Part 8 above, we question whether the standard is sufficiently addressing subsequent events requirements. It is not uncommon for financial statements of less complex entities to be revised due to prior period errors.
- Paragraph 40 - Based on our recommendation that quantitative thresholds be established within the Authority section of the standard itself, this guidance would need to be updated if that proposal was supported.

## Supplemental Guidance - Reporting

We provide the following comments on the Supplemental Guidance on Reporting:

- Part IV - The guidance on the Basis for Opinion section states that: "*If the modification results from an inability to obtain sufficient appropriate audit evidence, the Basis for Opinion section may include the reasons for that inability.*" and *"Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the Basis for Opinion section may describe the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion."* As described in our comments on Part 9 above, we do not agree with this guidance and believe that the requirements established under ISA 705 (Revised) should be retained.

- Part VI - The penultimate paragraph of Part VI, relating to Other Matter paragraphs, provides guidance on circumstances when the auditor provides a new or amended auditor's report as a result of subsequent events. We support the guidance on Other Matter paragraphs. However, this content appears inconsistent with the decisions regarding the content of the draft standard pertaining to subsequent events that we comment on in Part 8 above. As noted, we believe the standard needs to include requirements addressing the circumstances that would give rise to the situation described in this section of the supplemental reporting guidance.

- Illustrative example 3 - The fact pattern states that those responsible for the oversight of the financial statements are different from those responsible for the preparation of the financial statements. See our related comment on paragraph 9.4.1 on whether there should be conditional language relating to those charged with governance within the illustrative "responsibilities of management and those charged with governance" section of the report, similar to ISA 700 (Revised). It appears inconsistent to amend the sub-heading of the report to refer to those charged with governance, but only then refer to management in the body of the section.

- Illustrative reports - For completeness, we recommend illustrating a qualified opinion due to a limitation on scope and a modified Other Information section.