

## **IFAC Small and Medium Practices Advisory Groups Response to the IAASB's Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE)**

### **INTRODUCTION**

The SMP Advisory Group (SMPAG) is pleased to respond to the IAASB (the Board) Exposure Draft (ED), *Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE)*. The SMPAG is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small- and medium-sized entities (SMEs). The constituents of the SMPAG are small- and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members and Technical Advisers serving the SMPAG are drawn from IFAC member bodies representing 22 countries from all regions of the world

### **GENERAL COMMENTS**

The SMPAG strongly welcomes this ED. In our [comment letter](#) on the related discussion paper as well as our [response](#) to the IAASB Proposed Strategy for 2020-2023 and Work Plan for 2020-2021, we stated that this is an extremely important initiative that should be a high priority for the Board. We have been pleased with the swift action of the Board to move this project to the proposed standard development phase and appreciate all of the work to progress this proposal, as well as the multiple opportunities provided for the SMPAG to engage and provide feedback as the ED was being developed.

Overall, we are generally supportive of the flow, structure, and volume of the draft standard and believe the IAASB should proceed with issuing a standard for Audits of LCEs as soon as possible. However, we do have some concerns, which have been summarized below, and explained in greater detail later in this letter, as follows:

- In our opinion, there are further enhancements that could be made to the scalability and proportionality of the standard. In particular, with some of the overly procedural requirements (e.g., in Risk Identification and Assessment), documentation, and the need for practitioners to be able to use more professional judgment. In our view, more focus needs to be placed on ensuring the (reduced) work effort is only that which is essential for an LCE audit. Specifically, more attention is needed to tease out where an auditor should do different procedures and where an auditor could avoid unnecessary procedures.
- As the IAASB will be aware, the SMPAG has raised strong concerns in relation to group audits being excluded from the standard and the impact this will have in severely limiting the use of the proposed standard. As explained further later in our letter, we believe this approach should be reconsidered by the IAASB.
- We believe the messaging around the standard being an alternate path to reasonable assurance should be clear and consistent, in order to quell concerns that audits performed using the standard are somehow “less than” an audit using the full ISAs.
- There is also concern about whether the level of work effort that would be undertaken in an audit using the full ISAs versus using the proposal for LCEs would result in any significant time or cost savings. The SMPAG believes that even with the extensive mapping exercise undertaken, there

remain questions on how different the standard is from the ISAs and therefore a need for much clearer communication to both practitioners and other financial statement users and key stakeholders. Additional context and background should not only be provided in the Basis for Conclusions and supporting materials, but also in any additional resources provided by IAASB.

- While the SMPAG believes the standard as drafted provides a good foundation for the auditor to perform an audit of an LCE, we believe that additional implementation guidance outside of the standard may be needed to assist with consistent implementation.

Below are our detailed comments related to the questions posed in the ED.

## **DETAILED COMMENTS- QUESTIONS POSED IN THE ED**

### **Section 4A- Overarching Positioning of ED-ISA for LCE**

#### **1. Views are sought on:**

- (a) *The standalone nature of the standard, including detailing any areas of concern in applying, or possible obstacles that may impair this approach.***

The standalone nature of the proposed standard has both benefits as well as some perceived challenges. For auditors that only work with LCE clients and plan to adopt this proposed standard (provided it is allowed in their jurisdiction), it results in a shorter standard that is less complex and easier to read than the full set of ISAs.

There was some feedback about the amount of time potentially needed to determine whether or not an entity is prohibited from using the standard. However, the challenges of developing the authority of the standard at the global level is recognized as well as the need for professional judgment on qualitative characteristics.

- (b) *The title of the proposed standard.***

The title “Audits of Financial Statements of Less Complex Entities” seems to be an appropriate title and should be well understood, even when translated to multiple languages.

- (c) *Any other matters related to the overarching positioning of ED-ISA for LCE as discussed in this section (Section 4A).***

We understand that there may be challenges to adoption in certain jurisdictions, but we do not believe this should stop the IAASB from moving forward in creating this separate standard for LCEs. We believe the messaging around the standard should be clear and consistent, as there are concerns that the standard may be perceived as “less than” an audit using the full ISAs. For example, it will be critical for financial statement users to understand that use of this standard still results in a reasonable level of assurance and is not akin to say a compilation or review engagement.

#### **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 changes to the IAASB Preface to reflect the authority of the new standard.

## Section 4B- Authority of the Standard

### **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 believe the Authority is implementable. Of course, there will be differing interpretations and adaptations done in the various jurisdictions, but we believe Part A will be a good starting point for determining whether or not an entity would be able to use this standard.

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

There is one issue that could be problematic. There could be cases where a single complex item is encountered that was not clear at the engagement acceptance stage. The final paragraph in A9 states that the “*presence of one characteristic exhibited by an entity does not necessarily exclude the use of the ISA for LCE for that entity*”. However, the introductory sentence states “*the ISA for LCE is inappropriate for the audit of the financial statements if an entity exhibits one or more of the following characteristics*”. The use of professional judgment is important, but this may cause auditors confusion. The introduction could be clarified to capture the same sentiment as the first paragraph.

In addition, we suggest the IAASB consider clarifying in the Basis of Conclusions that an auditor can refer to application material in the ISAs when it would prove to be helpful.

We also believe that in cases where an auditor changes their decision to move into the Audits of LCEs from the full ISAs or back to the full ISAs as audit work progresses, this should not reflect negatively on their client acceptance and continuance process, nor should this result in any additional documentation requirements.

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

We believe that setting specific prohibitions as well as listing qualitative characteristics that might prohibit an entity from being able to adopt this standard is a good approach, and also allows local jurisdictions to modify (including modifying qualitative characteristics) as needed.

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

We believe the Authority sets a basis by which local jurisdictions will be able to provide additional guidance on scoping and perhaps even offer additional examples for specific jurisdictions.

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

Yes, we believe the proposed role of legislative or regulatory authorities or relevant local bodies with the standard setting authority in individual jurisdictions is clear and appropriate.

### **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 subjections) need to be made? Please distinguish your response between the:**

**(a) Specific prohibitions**

The SMPAG believes that less complex group audits should be within the scope of the standard, provided they meet certain criteria, as outlined in option 2 of the ED. For example, we believe that a holding company for two small, noncomplex entities that otherwise meets all of the characteristics of an LCE should be permitted to use this standard. We believe that prohibiting all group audits from the scope could disqualify a large number of entities from being able to use the standard, where otherwise they meet all of the qualitative characteristics and specified criteria. We provide additional context in our responses to questions 22-26 that are specific to group audits.

As the IAASB will be aware, the IESBA has also recently made changes to the definition of a PIE and listed entities which should be considered during finalization of this standard. We believe that achieving consistency between the IAASB and IESBA is critical as in practice it is problematic when differences exist between definitions and expressions used.

**(b) Qualitative characteristics.**

A.9 that states the following:

*“The entity’s accounting estimates are subject to a higher degree of estimation uncertainty or the measurement basis requires complex methods that may involve multiple sources of historical and forward-looking data or assumptions, with multiple interrelationships between them”.*

We believe this criterion should be clarified or examples should be added. Specifically, as it relates to fair value measurements where level 3 inputs are used. We believe there could be situations whereby an LCE holds investments where level 3 inputs are used to measure fair value, but otherwise meet all other qualitative characteristics to qualify as an LCE for purposes of the standard.

Additional examples of estimates that we believe could be fairly simplistic in many cases but might preclude use by entities otherwise considered to be LCEs as currently drafted include indicators of impairment, percentage of completion accounting, stock-based compensation, goodwill, foreign currency transactions, and inventory obsolescence provisions. Again, we believe that professional judgment should be applied in such cases and the auditor could consult implementation guidance or other practice aids in limited cases, similar to how auditors currently apply judgment when determining whether the ISAs are the appropriate standards to be used in certain circumstances.

Further, we believe the characteristic in A.9 regarding the standard being inappropriate for entities in new and emerging markets, or entities in the development stage, is too restrictive in nature. There are many entities that happen to be in the development stage, but otherwise would qualify for using the standard. We believe that no matter what stage and entity is in, if it meets all of the other characteristics of a LCE, it should not be prohibited from using the standard. In other words, if the IAASB believes there are certain characteristics within an entity's start-up stage that would be so complex that the standard would not be applicable, those characteristics should be mentioned in the standard rather than referring so broadly to a certain stage in an entity's development.

We also believe there should be additional clarity for non-governmental organizations (NGOs) and whether they would qualify to use this standard if all other criteria are met. For example, during field testing of the authority of standard in Canada, questions arose about when regulated entities are “subject to a higher degree of regulation”. Examples of non-complex, but regulated entities include day cares, law firms or real estate agents holding trust accounts, and small insurance brokers / dealers. We believe that if all regulated entities or entities who have regulated operations are excluded, then the pool of potentially eligible entities is greatly diminished in many jurisdictions.

**5. Regarding the Authority Supplemental Guide:**

**(a) Is the guide helpful in understanding the Authority? If not, why not?**

Yes, we believe this guide will be helpful in understanding the authority of the standard.

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

We could not come up with any additional matters that should be included in the Authority Supplemental Guide.

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

We could not come up with any additional matters related to the Authority that the IAASB should consider at this time.

**Section 4C- Key Principles Used in Developing ED-ISA for LCE**

**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).**

The focus seems to have been on keeping the standard as short and succinct as possible and on changing some wording (which may be confusing if it is intended to have the same meaning as an “equivalent in the full ISAs”). This could also be challenging with translations which we will discuss later.

In our view, more focus needs to be placed on ensuring the (reduced) work effort is only that which is essential for an LCE audit. Specifically, more attention is needed to tease out where an auditor should do different procedures and where an auditor could avoid unnecessary procedures. We discuss this further below.

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

We agree with the approach to the objectives of each Part of the proposal as outlined in paragraphs 78-80.

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

We agree with the principles in relation to professional skepticism and professional judgement, relevant ethical requirements, and quality management as outlined in paragraphs 81-84 of the proposal.

**(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.**

We believe the EEM highlights what is important and should be considered in each sub section and is clearly differentiated from the requirements. However, we also think that additional non-authoritative implementation guidance will be needed to help guide auditors through using this standard by providing additional examples and practical guidance. See additional point below regarding potential IFAC and IAASB collaboration.

(ii) ***The sufficiency of EEM.***

We suggest IAASB revisit the sufficiency of the EEM in some specific places so that the proposed standard could be standalone. For example, audit sampling is dealt with in paragraphs 7.3.5 to 7.3.7 of the ED with one EEM on misstatements and this guidance is much shorter than those in equivalent ISA 530, *Audit Sampling*. There is a similar issue with the use of electronic confirmations which we discuss further in our response to question 9 related to part 7, *Responding to Assessed Risks of Material Misstatement*.

(iii) ***The way the EEM has been presented within the standard***

The SMPAG supports the way that the EEM has been presented within the standard.

**Section 4D- Overall Design and Structure of ED-ISA for LCE**

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

Overall, the SMPAG was generally supportive of the design and structure of the standard and agrees with the structure being similar to the flow of an audit.

**Section 4E- Content of ED-ISA for LCE**

**9. *Please provide your views on the content of each of Parts 1 through 8 of ED-ISA for LCE, including the completeness of each part. In responding to this question, please distinguish your comments by using a subheading for each of the Parts of the proposed standard.***

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

As it relates to the exceptional circumstances noted in section 1.4.3, it is unclear whether those alternative procedures to be performed could be those listed in the full ISAs.

There could also be limited circumstances whereby using the ISA application material would be helpful but would not indicate that the entity is too complex to use this standard. For example, in some cases, the ISAs have more robust implementation guidance that could be helpful to the auditor when auditing specific transactions or account balances. As noted earlier, we suggest the IAASB consider clarifying in the Basis of Conclusions that an auditor can refer to application material in the ISAs.

The idea of creating separate modules to address some of the more common “one off” types of complex issues or transactions that might arise has been discussed. However, the SMPAG recognizes this could take significant time and effort and we would not want it to delay issuance of the standard.

Section 1.6.3 covers noncompliance with laws and regulations (NOCLAR). We would suggest this section needs to acknowledge that there could be situations whereby an auditor would be precluded from disclosing confidential client information. IESBA also has their own set of rules regarding NOCLAR that perhaps should be referenced in this section as a reminder that there are also ethical responsibilities related to NOCLAR that must be adhered to.

## ***Part 2: Audit Evidence and Documentation***

Some of the SMPAG members found the icons previously used to identify key documentation points to be very helpful when reading the proposal. If those icons do not get put back in the final standard, consideration could be given to whether a table similar to Table C in the reporting section could be generated to reflect the documentation requirements.

We also believe that there should be more auditor judgment permitted with regard to which items to document, with the focus on those items that involved the greatest risk and/or auditor judgment being applied. Documentation is an area where auditors can spend too much time resulting in overdocumentation without an increase in audit quality. Allowing for more professional judgment about the nature and extent of documentation may help to reduce the additional burden placed on auditors in this area.

Perhaps the IAASB could consider limiting documentation requirements to those specific areas and matters that involved the auditor exercising considerable professional judgment. For example, we believe the standard should reflect clarification in ISA 320, *Materiality in Planning and Performing an Audit*, and specifically note that there is no requirement for the auditor to justify what was not done (i.e., not applicable in the engagement circumstances).

## ***Part 3: Engagement Quality Management***

There is general support for the content in Part 3. As the IAASB will be aware, the SMPAG did raise [concerns](#) about the scalability of the new quality management standards and continues to focus on developing and sharing resources to SMPs how can effectively implement the new standards.

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

As it relates to paragraph 106(b) in the Explanatory Memorandum and the use of service organizations, we believe there are many situations where LCEs use a service organization for processing transactions and receive a Type 1 or Type 2 report, but otherwise meet all other criteria for being considered an LCE. We do not think this criterion should be limited to payroll processors as obtaining reports from all service organizations has become common practice in many jurisdictions and is not necessarily an indicator of an entity's complexity.

For example, in many jurisdictions, there are entities that hold investments managed by a broker and therefore receive income from this portfolio. In many cases, these could be very straightforward, noncomplex entities, but the auditor would normally get a type 1 or 2 report in respect of the investment manager as a typical audit procedure as part of the risk assessment and testing controls process. We do not believe an entity should automatically be characterized as complex just because such a report is obtained. Developments are expected to evolve with regard to use of service organizations (as it is becoming more and more common), so we believe the application of the standard should not be limited.

## ***Part 5: Planning***

The full ISAs include performing an independence assessment when using the work of an expert. We believe it would be helpful to add this requirement to the proposal.

## **Part 6: Risk Identification and Assessment**

Some of the SMPAG members were of the view that when it comes to both identifying and assessing risks, this section may be unnecessarily close to the ISA as many times with LCEs, there is not always the need to separately identify and assess every risk, but rather consider how the individual LCE's system of internal control impacts the overall risk assessment. Risk assessment is a key area where we believe this standard can be made much more scalable than the ISA so special consideration should be given to the requirements in this section, which we believe should be revisited by the IAASB.

The argument that comprehensive design testing is needed for risk assessment is counter to the supposition that the control environment of an LCE is less complex than for an entity that has to be audited under the full ISAs. Specifically, in an LCE/ SMP environment, risk identification and assessment could be a single step process.

In particular, paragraph 6.3.14 requires the auditor to evaluate the design of specific controls irrespective of whether the auditor plans to test the operating effectiveness of the identified controls. While we appreciate that this can assist with the auditor's understanding of management's approach to addressing certain risks, we do not believe it would be necessary in situations where the auditor does not plan to test the operating effectiveness of identified controls.

The requirement currently states that inquiry alone is not sufficient and that more procedures should be performed in order to evaluate the design and implementation. We would suggest that the requirement to go beyond inquiry is made conditional, with inquiry alone being sufficient in cases where, for example, a full substantive audit approach is taken. We believe this is a key issue that auditors who work with LCEs have struggled with for years.

We also believe the circularity regarding the assertions could also be dropped.

There was also a question on the requirements related to assessing risk as section 7.3.16 states that *"irrespective of assessed risk required, substantive procedures shall be performed on material class of transactions, account balance and disclosure"*. Perhaps there could be additional guidance on how to group items for purposes of materiality as defined in this paragraph.

We were curious why the stand back provision in the ISAs was not retained for purposes of this proposal, as we believe this provision could be just as effective in an audit of an LCE as it would a more complex entity as it involves exercising professional skepticism.

## **Part 7: Responding to Assessed Risks of Material Misstatement**

As it relates to going concern in section 7.4.1, we believe this should be reworded to match the wording on going concern in section 5.2.12 which specifically discusses that these responsibilities exist even if the financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern.

Regarding external confirmations, perhaps consideration should be given to electronic means of obtaining external confirmations. As such, section 7.3.21(c) uses the term "sending the requests", which could be construed as a printed confirmation being sent via the mail only, and not by other

electronic means that are now often used for obtaining external confirmation of account balances and transactions. Electronic requests have become a preferred method of confirming balances (especially when COVID lockdowns caused office closures so sending through the mail was not an effective method). ISA 505, *External Confirmations*, includes a specific statement in paragraph 6 that an external confirmation can be “in paper form, or by electronic or other medium” and we believe a similar statement should be included in the standard.

***Part 8: Concluding***

Consideration could be given as to whether there should be an explicit statement in section 8.6.3 that failure to obtain a management representation letter could result in the auditor withdrawing from the engagement and not issuing an audit report, similar to the scope limitations noted in the ISAs. This type of language might also be added to section 9.3.3 for situations when the auditor deems the financial statements to be misleading.

***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 and content, and completeness, of Part 9.***

We agree with the presentation and content and believe the only real difference between an auditors’ report issued under the ISAs and under the proposed standard should be the framework used to provide a basis for the audit opinion. Table C of Part 9 is helpful. However, it may be too prescriptive, and this approach is not used in other ISAs, so perhaps the IAASB may consider including the table in the Reporting Supplemental Guide as an alternative.

***(b) The approach to include a specified format and content of an unmodified auditor’s report as a requirement?***

Generally, yes, the SMPAG believes that similar to the ISAs, the specified format and content of an unmodified auditors’ report should be a requirement rather than presented as supplemental material. However, there were concerns raised by some members of the SMPAG about allowing flexibility for jurisdictions to modify as needed.

We found the tables to section 9 particularly helpful in addressing how to handle specific circumstances that would result in a modification to the auditor’s opinion.

***(c) The approach to providing examples auditor’s reports in the Reporting Supplemental Guide.***

We believe the “standard” report should be included in the requirements. Moving further illustrative examples of auditors’ reports outside the standard is unhelpful as these need to be readily available even if they are not often used.

***11. With regard to the Reporting Supplemental Guide:***

***(a) Is the support material helpful, and if not, why not?***

We do believe the support material is helpful and will assist in adoption of the standard.

***(b) Are there any other matters that should be included in relation to reporting?***

We believe that paragraphs 15 and 27 of ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report* related to the issuance of an adverse or disclaimer of opinion should also be reflected in the standard.

In addition, we believe the IAASB should consider including paragraphs 50 and 51 of ISA 700 (Revised) related to how to report when the auditor applies both ISAs and auditing standards of a particular jurisdiction. Further, we believe it would be helpful to include paragraph 15 prohibiting piecemeal opinions and paragraph 27 of ISA 705 preventing the possibility of "hiding" significant issues the auditor has identified behind a disclaimer or adverse opinion within section 9. These are important conditional requirements that auditors applying the LCE auditing standard should be required to adhere to when the circumstances arise.

**12. Are there any areas within Parts 1–9 of the 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.**

We believe that section 9.3.3 should specifically include the option to resign from the engagement – when not precluded by law or regulation – when the auditor determines that they cannot continue with an audit engagement, perhaps due to circumstances similar to those noted in section 8.6.5.

**Section 4F- Other Matters**

**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?**

There is a risk that the auditor may have to revisit and redo audit procedures, only to end up with the same result, for example an unmodified audit opinion still being issued even after additional procedures are performed. In cases where the auditor determines partway through the audit that the client does not in fact meet the requirements to use the standard, this could also result in audit fee renegotiations and even delays in issuance of the audit report. Auditors will need to be aware of this risk and plan accordingly, especially on first time through audits where they were not previously auditing an entity under the ISAs. There could even be additional time and cost spent in determining whether an entity meets all of the requirements to be considered an LCE for purposes of this standard.

**(b) What support materials would assist in addressing these challenges?**

We believe there could be additional support materials that provide for some of the rare situations that could arise and what steps an auditor should take in those circumstances.

**(c) Do you agree with the proposed approach to the future updates and maintenance of the Standard and related supplemental guidance?**

The SMPAG believes that a stable platform should be maintained where possible. However, there are mixed views on how often changes should occur. While some felt changes should be reviewed on a periodic basis, others thought that making at least the more significant changes as needed would result in such changes being reflected in a timelier fashion.

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

Yes, we believe that any subsequent revisions should allow for early adoption when appropriate.

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

In our opinion, a separate Part on the ISA-800 series should not be included if it would delay the finalization of the standard. However, this could be developed as soon as practicable.

**16. In your view, would ED-ISA for LCE meet the needs of users and other stakeholders 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.**

Several of the jurisdictions represented on the SMPAG seem likely to support adoption of the standard, but many have also indicated that it is too early to make this determination until the standard is finalized and it will ultimately depend on the local regulators. Generally, the group strongly supports the notion of one international standard for audits of financial statements of LCEs rather than different LCE standards in different jurisdictions. As the IAASB is aware, there remains an urgent need for action at the global level to address the significant risk of fragmentation to the international standard setting ecosystem, due to further national and regional initiatives specifically targeted at LCE audits.

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

We believe that – with some modification as suggested in this letter – the proposed standard could meet the needs of auditors and other stakeholders by providing a less complex framework to use when performing audits of LCEs.

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

Some firms are wondering how or whether this would impact their audit methodologies and how timely those changes could be adopted to allow firms to begin utilizing the new standard in time for the effective date. In addition, there are some firms that are concerned about the potential cost of having to purchase or develop two sets of audit methodology; one based on the full ISAs, the other on audits of LCEs. There is also a recognition that there could be diversity in practice in jurisdictions or even at the firm level on when to apply this standard. In addition, the pre-requisite to have an understanding of the full ISAs may not have as much cost benefit for firms that deal exclusively with smaller, less complex clients.

There was also concern about client expectations when the standard is used and whether they would expect lower audit fees.

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

As noted earlier in this letter, we believe that messaging around the perceived value and benefits of using this standard will be critical, as well as ensuring there is additional non-authoritative implementation guidance provided closer to the effective date of this new standard.

#### **Section 4H- Approach to Consultation and Finalization**

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

In 2007, IFAC developed a [guide](#) providing practical support for small and medium-sized practices when implementing the ISAs for SMEs. The guide has been revised several times and is in its fourth edition. IFAC will coordinate with the IAASB on whether a similar guide or material can be developed to support the implementation of the proposed standard.

##### ***19. 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 respondents note in reviewing ED-ISA for LCE.***

Section 1.5.1 has EEM covering specific considerations for Public Sector Entities. Some members of the SMPAG believe that this statement could be confusing as in some jurisdictions, the terms Public Sector Entity and PIE are somewhat synonymous. Perhaps some context could be added to this section to make it clear that this is referring to the entities that are not PIEs, and otherwise meet the criteria for using this standard.

As noted in our response to question 4C, we realize that the focus seems to have been on keeping the standard as short and succinct as possible and on changing some wording, which could result in some translation issues. In addition, covering translation costs and the time needed to achieve a high-quality translation can be a significant issue, especially for some of the smaller PAOs with less resources.

##### ***20. 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.***

We believe that 18 months after approval of the final standard may be a reasonable time period to support effective implementation and those auditors that are prepared sooner can always early adopt the standard if permitted in their respective jurisdiction.

However, we do recognize the time and effort that may be needed to review all of the comments received and ensure proper due process, which could take more time than anticipated based on the number of comment letters and feedback received through the IFAC and IAASB survey. Then, once the standard is finalized, it will take time for translations and to provide communication of the changes to key stakeholders. In addition, time will also be needed for firms to develop their methodologies, train staff and also allow other providers to develop tools, practice aids, and other implementation support materials. Therefore, a period of 24 months may be more realistic.

## Section 5- Group Audits

**21. The IAASB is looking for views about whether group audits should be excluded (or included in) the scope of ED-ISA for LCE. Please provide reasons for your answer.**

In some jurisdictions, it was noted that it may come down to whether the local regulators will permit group audits to utilize the standard. The SMPAG believes that less complex group audits should be included in the scope of the standard as long as the entity meets certain criteria, which may include size, complexity, and the reporting structure of the entities involved in the group. If group audits are permitted (provided they meet certain criteria), we believe that some additional guidance may be needed to help explain scenarios where an entity has a less complex reporting structure and would qualify to use the standard.

**22. 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, from your perspective, view that ED-ISA for LCE can and will still be used for audits other than group audits, even if there are groups that would otherwise be considered to be less complex entities? If not, why not?**

Yes, however, if group audits are completely removed from the scope, it will drastically reduce the number of entities that would qualify to use the standard in some jurisdictions.

**(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?**

Due to the fact that this group is comprised of members from 18 different jurisdictions, it is very hard to be able to say what percentage of audits within each of those firms would likely use the standard. Some jurisdictions also have more statutory requirements that would result in a lower adoption percentage.

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

One common example might be a restaurant chain with a holding company that has many restaurants within the group, but each restaurant individually meets all of the characteristics to be considered an LCE. Another might be whereby a parent entity has a related entity that holds all of the properties that are then leased back to the parent entity. It is also common in some jurisdictions for a not-for-profit entity to have a small subsidiary to perform trading activities. Many of these groups would be very simple and otherwise "less complex". It is also very common for a trading company to have a dormant holding company to facilitate the shareholders' investment that requires group accounts.

Single, less complex entities may also use a consolidation process for branches and thus fall within ISA 600. It would generally be counterproductive to exclude them from applying the standard.

**23. If group audits are to be included in the scope of ED-ISA for LCE, the IAASB is looking for views about how this 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), to help users of the proposed standard to determine themselves whether a group would meet the complexity threshold.***

The SMPAG believes that setting out qualitative characteristics for complexity specific to groups would allow for more auditor judgment and would enable more group audits to be able to use this proposed standard. Potential additional qualitative factors to consider include:

- Components only operating within one or few (similar) jurisdiction(s)
- There has been no significant use of component auditors/ little use of their work
- When entities or business units have simple operations (e.g., car dealerships having several locations, but identical operations)
- When the group consists of a parent company and wholly owned subsidiaries or a single entity with branches
- When group structures involve consolidation but are set up for tax planning purposes (rather than complex operating purposes)

***24. 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 other proxies for complexity other than what is presented in paragraph 169 that the IAASB should consider?***

We could not think of any other ways besides those previously mentioned that group audits could be incorporated into the scope of the proposed standard that have not otherwise been considered.

***25. 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.***

The SMPAG would prefer including a separate Part within the standard that is specific to group audit situations.

## **CONCLUDING COMMENTS**

We hope that the IAASB finds this letter useful. We are committed to helping the Board in whatever way we can to build upon the results of the ED.

Please do not hesitate to contact me should you wish to discuss matters raised in this submission.

Sincerely,

*Monica Foerster*

Monica Foerster

Chair, IFAC SMP Advisory Group