



Agenda Item 3

Discussion Memorandum: Audits of LCEs

Objective of Agenda Item

To discuss issues associated with the International Auditing and Assurance Standards Board's (IAASB's) project to develop an audit standard for less complex entities (LCEs) and the ASB's Audits of LCEs Task Force's plan to obtain input for the ASB's comment letter on the IAASB's exposure draft.

Audits of LCEs Task Force

Horace Emery, Chair – Member of the ASB

Denny Ard – Chair of ARSC

Diane Hardesty – Member of the ASB

Kathleen Healy – Member of the ASB

Michael Manspeaker – Member of ARSC (and immediate former member of TIC)

The Task Force is staffed by Mike Glynn.

Status of IAASB's Project to Develop a Standard for Audits of LCEs

To address complexity and scalability in the International Standards on Auditing (ISAs) as well as the specific needs for audits of LCEs and users of their financial statements, the IAASB developed the proposed International Standard on Auditing for Financial Statements of Less Complex Entities (ISA for LCEs).¹ In the draft explanatory memorandum² intended to accompany the exposure draft of the proposed standard, the IAASB stated that it has concluded:

- That a global solution is preferred to increasingly fragmented solutions.
- That a standard that has been designed to be proportionate to the typical nature and circumstance of an audit of an LCE would be responsive to those stakeholders who have identified challenges with applying international standards in audits of LCEs.

¹ While the final exposure draft has not been made publicly available as of the preparation of this discussion memorandum, the draft presented to the IAASB at its June 14-23, 2021 meeting is available at <https://www.ifac.org/system/files/meetings/files/20210614-IAASB-Agenda-Item-2-A-Updated-for-23-June-Draft-ISA-for-LCE-Full-FINAL.pdf>.

² The draft explanatory memorandum has not been made public.

- There is an urgent need for action.

Recognizing that the proposed ISA for LCEs was developed on an accelerated basis, at its meeting in June 2021, the IAASB approved the draft for public exposure. In presenting the draft to the IAASB, the IAASB Task Force stated that it is at a point where it needs to receive input from comment letters to continue the process leading to the ultimate issuance of a high-quality standard. In addition, other stakeholders (CAG, PIOB, and SMP Advisory Group) expressed an urgency in exposing the draft for public comment. At the same time, IAASB acknowledged that because the draft standard includes certain items that have not been fully explored, the explanatory memorandum that accompanies the exposure draft is vital in obtaining the input that the IAASB Task Force needs to progress the proposed standard.

The approval of the proposed standard for public exposure was prior to the development of the explanatory memorandum. That explanatory memorandum was distributed on July 6, 2021. The IAASB Task Force requested *substantial comments* on the content of the explanatory memorandum by July 14, 2021. The ASB's Audits of LCEs Task Force met on July 13, 2021 and provided comments for the American IAASB representatives' consideration in responding to the IAASB Task Force.

The exposure draft is expected to be issued in July 2021 with a comment period end date of January 31, 2022.

ASB Audits of LCEs Task Force Issues with IAASB ED

The ASB Audits of LCEs Task Force believes that, in the United States, most concerns with respect to scalability relate to risk assessment, documentation, and quality management. Accordingly, during the exposure period the Task Force will engage with the ASB and other committees and task forces to evaluate the separate standard and its merits for use in the United States.

The ASB's Audits of LCEs Task Force identified the following overriding issues with the proposed standard. Each of the following are discussed in further detail in this discussion memorandum.

- 1) Standalone standard
- 2) Assurance obtained
- 3) Authority of the proposed ISA for LCEs/exclusion of group audits
- 4) Exclusion of requirements/guidance from the ISA 800 series

Issue #1 – Standalone Standard

The proposed ISA for LCEs has been developed as a separate, standalone "self-contained" standard, designed to be proportionate to the typical nature and circumstances of an audit of the financial statements of an LCE. The proposed standard is based on the core requirements of the ISAs but is separate from the ISAs and with no need to directly reference back to the ISAs in its application. This means that if there is a circumstance that has not been addressed within the proposed standard, relevant ISA requirements cannot be used to address the deficiency. Paragraph A.9 of the proposed ISA for LCEs states "notwithstanding that professional judgment is used in

determining whether the [draft] standard is appropriate to use, if there is uncertainty about whether an audit is an audit of the financial statements of an LCE, the use of the [draft] ISA for LCE is not appropriate.”

The IAASB determined to expose the proposed standard as a standalone standard as it concluded that providing auditors the ability to refer back to the ISAs may create further challenges and issues, or other unintentional consequences, when determining whether the ISA for LCEs is appropriate to use. A particular concern was the potential for encouraging the inappropriate use of ISA for LCEs when the ISAs would have been appropriate given the nature and circumstances of the entity and the needs of the users of the entity’s audited financial statements. There may also be issues related to reporting when explaining which standards have been complied with in the auditor’s report.

The proposed explanatory memorandum includes the following specific request for comment:

Excerpt from IAASB Request for Comments – Specific Questions

1. Stakeholders are asked for their views on:
 - (a) The standalone nature of the standard, including detailing any areas of concern in applying, or possible obstacles that may impair this approach? ...

ASB Consideration

At this point, prior to the development of the draft ASB comment letter, what are the ASB’s views with respect to the proposed standalone nature of the ISA for LCEs that the ASB Audits of LCEs Task Force should keep in mind as it obtains input?

Issue #2 – Assurance Obtained

The proposed standard is intended to provide reasonable assurance in the circumstances of an audit of the financial statements of an LCE as contemplated in the proposed standard. The proposed standard is not intended to be designed for obtaining sufficient appropriate audit evidence for, and therefore does not address, complex matters or circumstances.

The IAASB Task Force prepared mapping documents with significant detail (approximately 450 pages) that are intended to illustrate how the ISA requirements map to the proposed ISA for LCEs and to highlight those requirements that have been omitted.³ The draft explanatory memorandum includes a URL linking to the mapping documents. Examples of omitted procedures include:

- ISA 530, *Audit Sampling*, paragraph 15 (coincides with paragraph 14 of AU-C section 530)

³ While the final mapping documents have not been made publicly available as of the preparation of this discussion memorandum, the drafts presented to the IAASB at its June 14-23, 2021 meeting are available at <https://www.ifac.org/system/files/meetings/files/20210614-IAASB-Agenda-Item-2-B1-Proportionality-Mapping-Draft-ISA-for-LCE-Documents-1-Final.pdf> (Parts 1 - 6 of the proposed ISA for LCEs) and <https://www.ifac.org/system/files/meetings/files/20210614-IAASB-Agenda-Item-2-B2-Proportionality-Mapping-Draft-ISA-for-LCE-Documents-2-Final.pdf> (Parts 7-9 of the proposed ISA for LCEs).

15. The auditor shall evaluate:
 - (a) The results of the sample; and (Ref: Para. A21–A22)
 - (b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. (Ref: Para. A23)
- ISA 300, *Planning an Audit*, paragraph 9 (coincides with paragraph 9 of AU-C section 300)
 9. The auditor shall develop an audit plan that shall include a description of:
 - (a) The nature, timing and extent of planned risk assessment procedures, as determined under ISA 315.4
 - (b) The nature, timing and extent of planned further audit procedures at the assertion level, as determined under ISA 330.5
 - (c) Other planned audit procedures that are required to be carried out so that the engagement complies with ISAs. (Ref: Para. A12)
 10. The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit.

The removal of certain requirements is the most important element to be considered in relation to the proposed ISA for LCEs and may challenge the implementation and acceptance of the proposed standard. The ASB Audits of LCEs Task Force believes that potential commenters/stakeholders may find it very difficult to discern why certain ISA requirements have been omitted from the proposed standard and recommended that the explanatory memorandum include a summary of the mapping documents that the IAASB prepared to illustrate the “full blown ISA” requirements that are omitted from the proposed ISA for LCEs. The summary need only list significant omitted requirements but should include an explanation as to why the IAASB believes that each omitted requirement is not necessary in an audit of an LCE. Without such a summary, it will be very difficult for respondents to consider and conclude whether the proposed ISA for LCEs results in the auditor having obtained reasonable assurance. The ASB Audits of LCEs Task Force recommended a specific request for comment such as:

Given that an audit performed in accordance with the ISAs is intended to provide the auditor with reasonable assurance on which to base his or her opinion, stakeholders are asked for their views as to whether an audit performed in accordance with the proposed ISA for LCE results in the auditor obtaining reasonable assurance on which to base an audit opinion. If stakeholders believe that reasonable assurance would not be obtained in an audit performed in accordance with proposed ISA for LCE, what additional procedures should be required to be performed for the auditor to have obtained reasonable assurance?

ASB Consideration

At this point, prior to the development of the draft ASB comment letter, does the ASB have any views with respect to whether the proposed ISA for LCEs results in the auditor having obtained reasonable assurance?

Issue #3 – Authority of the proposed ISA for LCEs/exclusion of group audits

The proposed ISA for LCEs explicitly prohibits its application when:

- a) Prohibited by law or regulation.
- b) The entity is a listed entity.
- c) An entity meets one of the following criteria:
 - a. An entity one of whose main functions is to take deposits from the public;
 - b. An entity one of whose main functions is to provide insurance to the public;
 - c. An entity whose function is to provide post-employment benefits;
 - d. An entity whose function is to act as a collective investment vehicle and which issues redeemable financial instruments to the public; or
 - e. An entity in a class of entity where use of the ISA for LCE is prohibited for that specific class of entity by a legislative or regulatory authority or relevant local body with standard-setting authority in the jurisdiction.
- d) The audit is an audit of group financial statements.

It is the understanding of the ASB's Audits of LCEs Task Force that group audits are excluded from the authority for the proposed ISA for LCEs because some IAASB members view group audits as a "gateway to complexity." The ASB's Audits of LCEs Task Force challenges this assertion as many group audits are less complex. In addition, at the March 2021 IAASB meeting, CAG representatives encouraged the IAASB to reconsider the need to exclude requirements relating to group audits.

In addition, the ASB's Audits of LCEs Task Force encourages the IAASB to address whether a component audit may be performed in accordance with the proposed ISA for LCEs and provide the basis for that conclusion in the explanatory material accompanying the exposure draft.

ASB Consideration

At this point, prior to the development of the draft ASB comment letter, does the ASB have any additional feedback for the Task Force's consideration with respect to the exclusion of group audits from the proposed ISA for LCEs?

Issue #4 – Exclusion of ISA 800 series

The ISA 800 series includes:

- ISA 800 (Revised), *Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*;
- ISA 805 (Revised), *Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*; and
- ISA 810 (Revised), *Engagements to Report on Summary Financial Statements*.

AU-C sections 800, 805, and 810 correspond with the respective ISA sections.

Requirements relating to the ISA 800 series have not been included in proposed ISA for LCEs as the IAASB agreed to focus on developing an auditing standard for audits of financial statements of LCEs first (i.e., an audit of a complete set of general purpose financial statements for an LCE). It is the view of the IAASB that consideration will be given at a later time to adding part(s) to address special considerations for audits of financial statements prepared in accordance with

special purpose frameworks and audits of single financial statements and specific elements, accounts or items of a financial statement, as well as, if a need exists, to address summary financial statements.

As many less complex entities prepare their financial statements in accordance with a special purpose framework, and the fact that the IAASB has stated that if there is a circumstance that has not been addressed within the proposed standard, relevant ISA requirements cannot be used to address the deficiency, the proposed standard will be limited in its applicability upon issuance. The ASB's Audits of LCEs Task Force plans to emphasize the need for requirements and guidance with respect to audits of financial statements of LCEs prepared in accordance with a special purpose framework in the comment letter on the proposed ISA for LCEs.

ASB Consideration

At this point, prior to the development of the draft ASB comment letter, does the ASB have any additional feedback for the ASB Audits of LCEs Task Force to consider with respect to the omission of the ISA 800 series from the proposed ISA for LCEs?

Plan for the Development of the ASB's Comment Letter on the Proposed ISA for LCEs

The ASB Audits of LCEs Task Force will perform a thorough analysis of the IAASB mapping documents to determine which ISA requirements are omitted from the proposed ISA for LCEs. If the Task Force identifies any omitted requirements that it believes will result in less assurance being obtained in an audit performed in accordance with the proposed standard or that will negatively impact audit quality, such omitted requirements will be flagged for further consideration.

In addition, the Task Force will continue its discussions with representatives from the Canadian Auditing and Assurance Standards Board as well as the Institute of Chartered Accountants in England and Wales, and potentially others to share information and perspectives regarding the ED. The Task Force will also set up meetings with the AICPA's Technical Issues Committee and, perhaps, the Accounting and Review Services Committee to obtain additional feedback.

The Task Force plans to bring issues to the ASB at the ASB meetings in September and October 2021 for further discussion and a final draft comment letter at the ASB meeting in January 2022. The comment letter will be sent to the IAASB no later than the due date of January 31, 2022.

ASB Consideration

Does the ASB have any additional direction for the ASB's Audits of LCEs Task Force as it commences development of a draft comment letter on the proposed ISA for LCEs?

No Additional Agenda Materials Presented