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Mr. Willie Botha  
IAASB Technical Director  
International Auditing and Assurance Standards Board  
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## Proposed Part 10, Audits of Group Financial Statements of the Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE) and Proposed Conforming Amendments

Dear Mr. Botha

Ernst & Young Global Limited, the central coordinating entity of the Ernst & Young organization welcomes the opportunity to offer its views on the Proposed Part 10, *Audits of Group Financial Statements* of the Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE) and Proposed Conforming Amendments (ED-ISA for LCE Part 10), issued by the International Auditing and Assurance Standard Board (IAASB).

We support the IAASB's efforts to continue to bring focus to the challenges in applying the International Standards on Auditing (ISAs) to less complex entities (LCEs). We acknowledge the significant ongoing effort that is being made by the IAASB to analyze stakeholder feedback received on the original Proposed ISA for LCE (ED-ISA for LCE) and the effort undertaken to reconsider the decision to exclude group audits from the scope of the proposed standard. We continue to believe that the ED-ISA for LCE should only focus on entities at the lowest level of complexity (and potentially size) and deliver a standard that is obviously different from the full suite of ISAs (i.e., a standard that excludes many audit circumstances, is much more condensed and has sufficient guidance but still includes the requirements necessary to achieve reasonable assurance). We also continue to believe that this approach would address the strongest calls for a separate auditing standard, which are coming from stakeholders of these small audits.

Based on our understanding from the Authority document, including consideration of the *Appendix – Revisions to the Authority Since the ED-ISA for LCE* of the ED-ISA for LCE Part 10, that the intended users of the ED-ISA for LCE will remain relatively broad and open to judgment, we believe that group audits should be allowed to use the ED-ISA for LCE because we do not believe simply having a group structure inherently demonstrates complexity. As such, we do not support the proposed prohibition on the use of the ED-ISA for LCE for group audits where component auditors are involved.

Additionally, in our view, the limited circumstances (where physical presence is required) presented in the ED-ISA for LCE Part 10 for the use of component auditors does not appear to substantiate the use

of component auditors as defined by ISA 600 (Revised). Rather, the situation described in ED-ISA for LCE Part 10 is the inclusion of additional members on the engagement team as allowed under ISA 220 (Revised). Therefore, if the prohibition of using component auditors is not removed altogether, we suggest removing this carveout from ED-ISA for LCE Part 10 as we don't believe the inclusion of an auditor for the sole purpose of performing a physical inventory or fixed asset observation constitutes involvement of a component auditor.

Our responses to the specific questions on which the IAASB is seeking feedback follow and include further clarifying details in respect of our overall comments above, when applicable.

(1) In the Authority, do you agree with the proposed prohibition on the use of the Proposed ISA for LCE for group audits where component auditors are involved, other than in limited circumstances where physical presence is required?

We do not agree with the proposed prohibition in A.1(d)(ii) of the Authority on the use of ED-ISA for LCE for group audits where component auditors are involved, other than in limited circumstances where physical presence is required. Consistent with our comment letter dated 31 January, 2022 on ED-ISA for LCE, we continue to believe that group audits can be less complex in nature and believe that the ED-ISA for LCE should not exclude group audits with component auditors. The fact that an audit is a group audit does not inherently make the audit exhibit characteristics of complexity. For example, an audit can be a group audit with a limited number of business units with the same management, have integrated systems, and operate within the same jurisdiction or country. In this scenario, the use of component auditors may make sense depending on the location of the business units and likely will not result in an overly complex group audit. To acknowledge this situation and similar ones, we believe there needs to be flexibility in the proposed standard for simple group structures and that group auditors should be allowed to determine the applicability of the ED-ISA for LCE for a group audit or for "in-scope" components based on the specific facts and circumstances of the entity and the criteria outlined in Paragraph A3 of ED-ISA for LCE Part 10.

In our view, prohibiting the use of ED-ISA for LCE for group audits when component auditors are involved can lead to situations where auditors, who believe that the ED-ISA for LCE is appropriate for the audit, decide to perform the audit with a single team across several locations instead of appropriately involving component auditors with the adequate competence and capabilities (e.g., local knowledge of business practices and language) which would lead to a higher quality audit.

For the reasons stated above, we believe that paragraph A.1(d)(ii) of the Authority section in ED-ISA for LCE Part 10, which prohibits the use of component auditors, except in certain circumstances, should be removed as the primary determinant of when the ED-ISA for LCE can be used in group audits.

If the proposed prohibition in ED-ISA for LCE Part 10 on group audits where component auditors are involved remains in the ED-ISA for LCE Part 10, we believe the carve out for the "limited circumstances where a physical presence is needed" should be removed from the requirement. We believe that the example of performing audit procedures in another physical location as described in ED-ISA for LCE Part 10 includes situations that do not necessarily involve component auditors. Paragraph A1 of ISA

220 (Revised)<sup>1</sup> and Paragraph 3 of ISA 600 (Revised)<sup>2</sup> indicate that ISA 600 (Revised) “may be useful” when the engagement team uses individuals from another firm and provides examples of attending a physical inventory count or inspecting property, plant and equipment. Additionally, Paragraph A17 of ISA 220 (Revised)<sup>3</sup> creates the distinction between a component auditor and attendance at a physical inventory count or inspecting a physical fixed asset at a remote location. This distinction in both ISAs indicates that a “location” that is subject to a physical inspection should not automatically fall into the definition of a “component” and that an individual from another firm performing audit procedures at these locations is included as a member of the engagement team, but not in the capacity of a component auditor. We believe this distinction is important because the individuals performing physical counts or asset verifications are performing procedures as instructed through direct supervision and review, rather than a component auditor who is typically involved in risk assessment procedures and designing and performing procedures responsive to the assessed risks for the purpose of a group audit.

As a result, we recommend that the IAASB remove the carve out for the “limited circumstances in which a physical presence is needed for a specific audit procedure for the group audit (e.g., attending a physical inventory count or inspecting physical assets)” from the requirement at Paragraph A1(d)(ii) and instead include guidance in the Essential Explanatory Material (EEM) based on the content in ISA 220 (Revised) and ISA 600 (Revised). The guidance in the EEM should explain that involving individuals from another firm to attend a physical inventory count or inspect property, plant and equipment does not automatically result in these individuals meeting the definition of component auditors, although they are members of the engagement team because they are performing audit procedures.

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<sup>1</sup> “...ISA 600, adapted as necessary in the circumstances, may also be useful in an audit of financial statements when the engagement team includes individuals from another firm. For example, ISA 600 may be useful when involving such an individual to attend a physical inventory count, inspect property, plant and equipment, or perform audit procedures at a shared service center at a remote location.”

<sup>2</sup> “As explained in ISA 220 (Revised), this ISA, adapted as necessary in the circumstances, may also be useful in an audit of financial statements other than a group audit when the engagement team includes individuals from another firm. For example, this ISA may be useful when involving such an individual to attend a physical inventory count, inspect property, plant and equipment, or perform audit procedures at a shared service center at a remote location.”

<sup>3</sup> “Engagement teams include personnel and may also include other individuals who perform audit procedures who are from:

- (a) A network firm; or
- (b) A firm that is not a network firm, or another service provider.

For example, an individual from another firm may perform audit procedures on the financial information of a component in a group audit engagement, attend a physical inventory count or inspect physical fixed assets at a remote location.”

- (2) In the Authority, do you agree with the proposed group-specific qualitative characteristics to describe the scope of group audits for which the Proposed ISA for LCE is designed to be used?

We agree that qualitative characteristics should be used to determine whether a group audit can be performed using the ED-ISA for LCE. However, we also believe that the additional characteristics relevant for group audits should be considered in combination to determine if an entity meets the criteria for a group audit under the ED-ISA for LCE. As a result, we recommend that the IAASB include EEM to clarify that the qualitative characteristics of a group audit should be considered individually and in combination and that no single qualitative characteristic is sufficient by itself to support the adoption of the ED-ISA for LCE. For example, if the group has only five physical locations, but each is in its own jurisdiction and the entity does not have centralized activities or common controls, this may be a sign of complexity because of the group structure and activities.

Overall, we believe there should be more relevant, comprehensive examples in the EEM of the Authority paragraph A.1 for situations where group audits would be considered less complex. In our view, the current example is insufficient to illustrate a less complex group audit and there should be comprehensive, detailed examples, with qualitative considerations, of what makes an entity less complex and what would increase complexity (e.g., operating in more jurisdictions increases complexity due to differing laws and regulations, language differences, access to information, differing country practices, decentralization, complexity of consolidation process and group oversight).

More specifically, we have observations for the IAASB's consideration related to the characteristics described in the following sections- of paragraph A.3 of the Authority:

#### Group Structure and Activities

- The group structure and activities section indicates that the group entities or business units should be limited to few jurisdictions (e.g., 3 or less). However, in our view, the number of jurisdictions involved seems less relevant than the similarity (e.g., applicable regulations, additional requirements for audits, etc.) of those jurisdictions or the complexity of the jurisdictions involved.

However, we do agree that as the number of jurisdictions increases, different risks arise and the level of consolidation and group oversight needs to increase, which increases complexity. In our view, the ED-ISA for LCE should only be applicable to group audits that have business units that operate in the same jurisdiction or when the jurisdictions involved (which are expected to be few in number) have similar characteristics such that there is not an effect on the complexity of the group audit. If the level of oversight has to be increased because of a number of different jurisdictions, this is a sign of complexity and the ED-ISA for LCE would likely not be applicable.

- The group structure and activities section indicates that the group should have few entities or business units (e.g., 5 or less). We believe that the ED-ISA for LCE should emphasize that the numerical threshold on the number of entities or business units are just examples and that the number of entities or business units should be considered in combination with the other qualitative characteristics in determining complexity of a group. We believe that the number

of entities or business units within a group does not drive complexity in and of itself and this should not be a deciding factor of complexity.

- We believe that the group structure and activities section should indicate that it is important to understand significant changes in an organizational structure (e.g., acquisitions that occurred) because changes could increase the complexity in ownership, IT systems, applicable regulations, etc. Therefore, it is important to understand the nature and timing of these changes prior to executing an audit under the ED-ISA for LCE. We suggest that EEM be added to the Authority of the ED-ISA for LCE to consider changes in complexity when determining the applicability of the ED-ISA for LCE. This guidance should describe situations when a practitioner would be required to transition to the full suite of ISAs because the Authority of the ED-ISA for LCE may no longer be met in the current year. It is our view that this transitional guidance needs to cover both transitioning from the ED-ISA for LCE to the full suite of ISAs during the audit and transitioning between the standards from audit period to audit period.

#### Consolidation Process

- In our view, the existence of sub-consolidations is not considered by itself to add complexity to a group. We believe that further explanation of what the IAASB means when using the term 'sub-consolidation' would be helpful. We believe that an EEM paragraph should be added to the Authority to explain when a sub-consolidation adds complexity and when it does not.

#### Other Characteristics Relevant for Group Audits

- Relevant factors (e.g., level of centralization of activities relevant to financial reporting, nature and extent of commonality of controls, similarity of the group's activities and business lines) for determining centralized audit procedures in ISA 600 (Revised) paragraph A124 have been excluded from paragraph 10.6.1 in ED-ISA for LCE Part 10. These factors could drive complexity and therefore we recommend that they are included within the Additional Qualitative Characteristics Relevant for Group Audits in the ED-ISA for LCE Authority paragraph A.3.
- In a group audit, auditors need to understand and document the Group and its Environment, the Applicable Financial Reporting Framework and the Group's System of Internal Control. The requirements for these items are included in the ED-ISA for LCE Part 6. However, additional guidance is needed to reflect group considerations related to the requirements from ISA 600 (Revised) paragraph 30 (specifically (a)(i)(c), (a)(ii)). We believe that the extent to which the group's business model integrates the use of information technology (ISA 600 (Revised) paragraph 30(a)(i)(c)) and the regulatory factors impacting the entities and business units in the group (ISA 600 (Revised) 30(a)(ii)) should be included as considerations of complexity in the Authority of ED-ISA for LCE.

(3) Do you agree with the content of proposed Part 10 and related conforming amendments?

For the relevant requirements and guidance for group audits to be properly incorporated into the ED-ISA for LCE (based on the proposed Authority), we believe the following items should be included or revised in the ED-ISA for LCE Part 10:

- Paragraph 10.5.1 of ED-ISA for LCE Part 10 does not contain guidance about the risk assessment process being iterative and dynamic in a group audit when developing an initial expectation about the potential risks of material misstatements and initial identification of significant classes of transactions and significant accounts (refer to ISA 600 (Revised) paragraph A108). In our view, this process is similar regardless of an entity's complexity and the ED-ISA for LCE Part 10 should be aligned to ISA 600 (Revised).
- Even if there is a single audit team performing procedures, it may be appropriate for auditors to communicate with group management regarding the structure of the group audit (refer to ISA 600 (Revised) paragraph 54 and ISA 600 (Revised) paragraph 57). As a result, we believe the guidance in ED-ISA for LCE Part 10.7 should be expanded to address how the auditor has set up the structure and this would include situations when the group auditor considered certain entities or business units together as a component for purposes of planning and performing the group audit.
- We believe that additional EEM for evaluating the sufficiency and appropriateness of audit evidence obtained should be included in ED-ISA for LCE Part 10 (a new section will need to be created). There are different considerations around the sufficiency and appropriateness of audit evidence within a group audit context. A group auditor needs to evaluate whether sufficient appropriate audit evidence has been obtained from the audit work performed on components, on which to base a group audit opinion. Additionally, the group auditor needs to evaluate the effect on the group audit opinion of any uncorrected misstatements and any instances when there has been an inability to obtain sufficient appropriate audit evidence (refer to ISA 600 (Revised) paragraph 13(d), ISA 600 (Revised) paragraph 51 and ISA 600 (Revised) paragraph 52).
- In paragraph 10.6.1 of ED-ISA for LCE Part 10, we believe the flow of determining an audit response to the identified risks of material misstatement in the EEM should be reversed such that the engagement team first considers performing audit procedures centrally and then considers performing audit procedures at the component level, which is consistent with ISA 600 (Revised) paragraph A124 and ISA 600 (Revised) paragraph A127 and would also be consistent with our expectations for group audits of LCEs.

As indicated in our response to Question 1 above, we believe that the proposed prohibition for group audits where component auditors are involved is too restrictive. We believe that there should be no prohibition on the involvement of component auditors, and it should be the auditor's judgment to determine if the use of component auditors creates complexity. As a result, we believe that paragraphs 23-28, 34, 35(b), 36, 42, 45-52, 54, 58, and 59 (c, d, f, and g) from ISA 600 (Revised) should be included within ED-ISA for LCE Part 10 as requirements when component auditors are involved. In addition, the excluded definitions from ISA 600 (Revised) paragraph 14 (h-j) should be added to the ED-ISA for LCE Glossary. EEM or other guidance should be added to the Auditor's Report in ED-ISA for LCE regarding the circumstances when group financial statements are required by law or regulation to refer to a component auditor (refer to ISA 600 (Revised) paragraph 53).



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We would be pleased to discuss our comments with members of the International Auditing and Assurance Standards Board or its staff. If you wish to do so, please contact Eric Spiekman, Global Deputy Vice Chair, Professional Practice ([eric.spiekman@eyg.ey.com](mailto:eric.spiekman@eyg.ey.com)).

Yours sincerely,

*Ernst + Young Global Limited*