Supplement 1-02 to Agenda Item 4

Audits of Less Complex Entities – ED-ISA for LCE – Q9 (Part 1) and Q7 (c) (Selected Responses Related to Professional Skepticism and Professional Judgment)

Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE\2) Responses on Parts 1 through 8\Part 1\a. General Comments

5. Accounting Firms
Crowe Macro Brazil

Proposed standard – Parts 1, 2 and 3

Excellent. It reinforces the concept that an examination conducted by applying SA for LCEs is not ‘second class audit’.

7. Professional Accountancy and Other Professional Organizations
Indonesian Committee on Public Accountant Profession (KPAP)

Part 1: Fundamental Concepts, General Principles, and Overarching Requirements
The explanation in part 1 is complete and the same as that covered in the ISAs. KPAP agrees with the ED-ISA for LCE, which has covered fundamental concepts, general principles, and overarching principles to be applied throughout the audit. KPAP appreciates that some of the changes enhance the auditor’s exercise of professional skepticism referred to in ISA 540 and 315.

9. Individuals and Others
ASK KSA Consulting Inc.

Part 1: Fundamental Concepts, General Principles and Overarching Requirements
We fully support the concept that the ED-ISA for LCE is to obtain reasonable assurance.

Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE\2) Responses on Parts 1 through 8\Part 1\b. Specific Comments\0.Introductory box

5. Accounting Firms
BDO International

Suggestions re EEM:
Introductory text box for Part 1 - Consider adding a cross-reference to the Glossary in this text box so that readers are aware of the Glossary in Appendix 1.

Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE\2) Responses on Parts 1 through 8\Part 1\b. Specific Comments\1.1. Effective Date

8. Academics
Hunter College Graduate Program

1. The current standard suggests that the effective date will be for periods beginning on or after [XXX], a date to be determined. The normal process suggests that the standard will become effective within 18 months after the standard is approved. However, we believe that the guidance should suggest the effective date as set forth below.

Section 1.1.1 (ED Pg 68)
This [draft] standard is effective for audits of financial statements of periods beginning on or after [XXX], the second financial reporting period of the affected company after the date of approval of this draft. However, the company may implement the new standard in part, or in its entirety earlier as allowed by local laws.
Specific Questions: Section 4E – Content of ED-ISA for LCE
Question 9 - Views on the content of Parts 1 through 8 of ED-ISA for LCE
2) Responses on Parts 1 through 8
Part 1b. Specific Comments
1.2. Relevant Ethical Requirements and Firm-Level QM

3. Regulators and Audit Oversight Authorities
Committee of European Auditing Oversight Bodies
Relevant Firm-Level Quality Management
Additionally, the statement that ISQM1 (or national requirements that are at least as demanding) applies to all firms that perform audits should be a requirement of the standard rather than essential explanatory material in section 1.2.

Irish Auditing and Accounting Supervisory Authority
Relevant Firm-Level Quality Management
In section 1.2, the statement that ISQM1, or national requirements that are at least as demanding, applies to all firms performing audits should be a requirement rather than essential explanatory material.

4. National Auditing Standard Setters
Hong Kong Institute of Certified Public Accountants
Question 12
Are there any areas within Parts 1 – 9 of the proposed standard where, in your view, the standard can be improved? If so, please 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 would like to propose the following editorial comments for the IAASB’s consideration:

Paragraph 1.2.1 requires the auditor to comply with relevant ethical requirements, including those pertaining to independence, for financial statement audit engagements. However, the proposed standard does not make explicit reference on what ethical requirements the auditor should comply with. Although the definition is given in the “Glossary of Terms”, we suggest to include an explicit reference of relevant ethical requirements in the proposed standard for ease of reference and clarity, without requiring auditors to locate it separately.

5. Accounting Firms
BDO International
Paragraph 1.2.1 - EEM under section 1.2.1 states: “If an engagement quality review is required by the firm’s policies or procedures established in accordance with ISQM 1, then ISQM 2 applies.”
Paragraph 34(f) of ISQM 1 states: “The firm establishes policies or procedures that address engagement quality reviews in accordance with ISQM 2, and require an engagement quality review for:
(i) Audits of financial statements of listed entities;
(ii) Audits or other engagements for which an engagement quality review is required by law or regulation; and (Ref: Para. A133)
(iii) Audits or other engagements for which the firm determines that an engagement quality review is an appropriate response to address one or more quality risk(s). (Ref: Para. A134-A137)”
The application material under paragraphs A133 & 134 in ISQM 1 further describes scenarios where an engagement quality review may be appropriate in relation to points ii) & iii) above. Consider adding these paragraphs from ISQM 1 as EEM.

KPMG IFRG Limited
In addition to the matters described elsewhere in this letter, we note that requirements are included in respect of Engagement Quality Control Reviews, however, we question the inclusion of these requirements, as our view is that the need to perform such a review is a response to complexity in the audit, and therefore an example of a “proxy for complexity”, and in such situations we would recommend that the full-scope ISAs are used.

Mazars
Part 1: Fundamental concepts
1.2 Ethical requirements - How would the word “relevant” be interpreted within various jurisdictions?
1.2.1 EEM: If firms policies require an engagement quality review, this could be an indication that the audit is complex. At the same time the reason to appoint an engagement quality reviewer can be to respond to other risk management reasons, i.e. initial audit, audit performed by an auditor with recently obtained signing rights or similar reasons.

PriceWaterhouseCoopers
Appendix 3 - Detailed Comments
Draft Standard
The section below sets out our other observations and editorial comments by paragraph within the ED. These comments are intended to be read in addition to our overarching comments in our cover letter and appendices 1 & 2 regarding the need for more extensive revisions to the requirements of the standard to better distinguish the ISA for LCE from the ISAs.

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.

7. Professional Accountancy and Other Professional Organizations
Institute for the Accountancy Profession in Sweden (FAR)
Part 1:
1.2.1 EEM: If firms’ policies require an engagement quality review, this could be an indication that the audit is complex. At the same time the reason to appoint an engagement quality reviewer can be to respond to other risk management reasons, i.e. initial audit, audit performed by an auditor with recently obtained signing rights or similar reasons. We suggest that the EEM is expanded to explain this.

Nordic Federation of Public Accountants
The title of the subsection 1.2.1 refers to “both relevant ethical requirements and firm-level quality management”. We notice that the part that deals with quality management is exclusively dealt with in a blue box, i.e. as EEM which by design is supposed to provide further explanation relevant to a sub-section or a specific requirement, and wonder if this is intentional.

South African Institute of Chartered Accountants (2)
Paragraph 1.2: Relevant Ethical Requirements and Firm-level quality management
This paragraph should follow after the Overall Objectives of the Auditor section. This flow will also be consistent with the flow of ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with the ISAs.

8. Academics
Accounting and Finance Association of Australia and New Zealand
Part 1 – Fundamental Concepts, General Principles, and Overarching Requirements
We are of the view that the coverage of material on relevant ethical requirements and firm level quality management (Section 1.2), as well as professional skepticism (Section 1.4.5 – 1.4.6), needs to be elaborated upon in order to reflect unique but important characteristics of less complex entity audits.

While we acknowledge that responsibility for ethical standards lies with IESBA, we are concerned that extant ethical requirements, especially as they relate to the provision of non-assurance services (i.e., Section 600 of the Code), are such that they may potentially impede the realization of the public interest benefits of the proposed standalone standard. We encourage the IAASB to liaise with IESBA with a view to considering whether, as is the case with audits of public interest entities, practitioners performing audits of less complex entities should be subject to different requirements when ensuring independence.

Consistent with research focused on publicly listed entities (see Beardsley et al. 2021 for a recent summary), the limited research addressing private companies reports mixed results as to the effect on audit quality of auditors also providing non-assurance services (Dedman et al. 2014). We recommend that the IAASB liaise with IESBA with a view to being confident that Section 600 of the Code as it relates to the provision of non-assurance services (i.e., Section 600 of the Code), are such that they may potentially impede the realization of the public interest benefits of the proposed standalone standard. We encourage the IAASB to liaise with IESBA with a view to considering whether, as is the case with audits of public interest entities, practitioners performing audits of less complex entities should be subject to different requirements when ensuring independence.

We also note research reporting that the demand for audit in a voluntary environment is positively associated with the provision of non-assurance services (Dedman et al. 2014). We recommend that the IAASB liaise with IESBA with a view to being confident that Section 600 of the Code as it relates to the provision of non-assurance services to less complex clients remains fit for purpose and facilitates, and does not inhibit, the achievement of a high-quality audit under the proposed standalone standard.

Independent of the appropriateness of Section 600 of the IESBA Code to less complex clients, we are of the view that, given the fundamental importance of complying with ethical requirements, and issues impacting audits of less complex entities, reference to the ethical requirements in Section 1.2.1 warrants the addition of essential explanatory material (at present, this material is limited to reference to firm level quality management).

Less complex entities are more likely to be audited by smaller practices (Ghosh and Lustgarten 2006), and threats to independence manifest themselves in different ways when small to medium practices audit less complex entities. While social bonding and familiarity manifest themselves in different ways when small to medium practices audit less complex entities. While social bonding and familiarity threats may be more of a concern in audits of less complex entities (e.g., Langli and Svanstrom 2015), threats from economic bonding may be less of a concern (Hope and Langli 2010). In addition, research highlights that the voluntary demand for audit in private companies is associated with the demand for non-assurance services (Dedman et al.
2014), putting additional pressure on practitioners to remain compliant with ethical standards. We recommend that the essential explanatory material associated with Section 1.2.1 be elaborated upon to reinforce auditors’ responsibilities in this regard. We also believe that the proposed standard can be enhanced to reinforce opportunities to improve firm level quality management in small to medium practices. Practitioners working in small to medium practices do not have the same opportunities as auditors in large practices to seek advice from colleagues and to discuss difficult judgments. They have less access to firm training and policy manuals and cannot as easily access quality reviews (with many practices operating as sole practitioners or with a small number of partners) (Langli and Svanstrom 2014). This can impede the effective application of the proposed standard for less complex entities and even cloud judgments as to whether the proposed standard remains applicable in circumstances of increased complexity.

Challenges in managing firm level quality in a small practice are significant. In addressing these challenges, Frank et al. (2021) report that smaller practices can benefit from the risk management knowledge of their insurers, and Bills et al. (2018) find that small firm membership of accounting associations and networks (AANs) can help build competencies and improve audit quality (as well as enhance market legitimacy).

With reference to this research, we recommend that the IAASB elaborate on the essential explanatory material in paragraph 1.2.1 to increase the salience of the unique challenges in small to medium practices and to reinforce the need to manage these unique threats to quality management.

Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE: Responses on Parts 1 through 8\Part 1\b. Specific Comments\1.3.Overall Objectives of the Auditor

5. Accounting Firms
Grant Thornton International Limited

Part 1, Fundamental Concepts, General Principles and Overarching Requirements
1.3 Overall Objectives of the Auditor – Paragraph 1.3.3 requires the auditor to ‘determine whether any audit procedures in addition to those required by the relevant Part are necessary to achieve the objectives stated in this [draft] standard.’ We believe that additional EEM is needed in support of this requirement to explain whether this may result in the auditor being unable to use ED-ISA for LCE.

6. Public Sector Organizations
Office of the Auditor General of Alberta

Part 1
Section 1.3.3 indicates that when the audit evidence is not sufficient or appropriate, the auditor may follow one or more of the provided approaches, including "Extend the work performed in applying one or more requirements." We agree with this requirement; however, the IAASB should consider the need for a GAAS hierarchy to guide the auditor when making such an assessment, similar to a GAAP hierarchy. The exposure draft states IAS for LCE is to be a new, independent standard, equal to the ISAs and ISAE 3000. As a standalone standard, it has equal authority to other assurance standards and users should be able to consider it when making judgements when another standard is silent or unclear. Providing a GAAS hierarchy would be useful to users and help to clearly establish ISA for LCE as an independent standard. The ISAs for More Complex Entities should also include a GAAS hierarchy.

Swedish National Audit Office

Part 1 Fundamental concepts
1.3.3 – The EEM following the requirement is an indirect requirement. It describes a situation where the evaluation of audit evidence is indicating that the evidence is not sufficient. We believe that there should be a requirement stating that the auditor shall perform additional procedures to get the needed audit evidence.

1.3.4 b) – Would possibly need more clarification. Does it mean not being able to fulfill an objective because of the circumstances of the auditee (limitation in audit scope) or? The balance between achieved specific requirements and the overall objective – any reasoning on that could be helpful.

7. Professional Accountancy and Other Professional Organizations
South African Institute of Chartered Accountants (2)

Part 1: Fundamental concepts, general principles and overarching requirements
Paragraph 1.3: The following paragraph should be included as 1.3.1:
“The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements.”
Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE\Responses on Parts 1 through 8\Part 1\b. Specific Comments\1.4. Fundamental Concepts and General Principles for Performing the Audit

3. Regulators and Audit Oversight Authorities
Independent Regulatory Board for Auditors (IRBA)

ISA Paragraph Reference: ISA 200, paragraph. 18 and 22
ISA for LCE Paragraph Reference: Part 1, paragraph 1.4.1.

Proposed Wording Change: ISA 200.22(b) is relevant to and an ISA for LCE audit and should be incorporated into Para. 1.4.1: The auditor shall comply with all relevant requirements, unless the requirement is not relevant because it is conditional and the condition does not exist or unless paragraph 1.4.3. applies. A requirement is relevant when the circumstances of the audit addressed by the requirement exist.

Comment: ISA 200.22(b) is relevant to an ISA for LCE audit and suggest that it be included in paragraph 1.4.1. of the proposed standard since there are a number of conditional requirements contained in the proposed standard.

4. National Auditing Standard Setters
Institut der Wirtschaftspruefer in Deutschland e.V. (IDW)

Part 1
The requirement in paragraph 1.4.1. requires the auditor to comply with all relevant requirements. One major criticism by SMPs is the fact that some audit oversight authorities and audit regulators often ask auditors to justify (and document) why auditors have regarded certain requirements as not being relevant, even though the ISAs do not require such justification. To combat this tendency among audit oversight authorities and audit regulators, the German LCE standards augment the requirement in paragraph 1.4.1. with a negative requirement that states: "The auditor need not justify [to others] why a requirement is not relevant in the circumstances unless significant professional judgment is required to determine this relevance." While this "negative requirement" in effect applies in the ISAs, we believe that in an LCE audit environment, it is crucial that this be made explicit and therefore recommend that the IAASB incorporate such a negative requirement (which could be in the EEM) in its LCE standard.

In the same vein, in the German LCE standard we deleted the second sentence of 1.4.3. because we believe that even if a requirement for a procedure is relevant and effective, if the auditor has performed alternative procedures that are effective in meeting the required procedure, it should be clear that this should be permitted. We suggest that the IAASB consider this approach.

We are not convinced that the EEM to paragraphs 1.4.4., 1.4.6., 1.5., 1.5.1., 1.5.2., 1.6., 1.6.2., 1.6.3., 1.7.1, 1.8.2., 1.8.3. and 1.8.6. is essential because competent auditors do not need it and it can therefore be deleted.

5. Accounting Firms
Mazars

1.4.1: The wording in this paragraph should be modified. The documentation requirements when a requirement is relevant or not should involve an amount of professional judgment. In the draft standard is says "A requirement is relevant when the circumstance of the audit addressed by the requirement exists" In our view the wording should be changed to "A requirement is relevant when in the circumstance of the audit the auditor, using his or her professional judgment, consider the requirement relevant." We suggest that specific documentation requirements should be included to Part 1 or as EEM to this paragraph including that clearly not applicable requirements do not require further documentation. This could be included in section 2.5.4. Also 1.4.4 covers professional judgment and could be also referenced.

1.4.3 – alternative procedures – we need more guidance on what these alternative procedures could be to help the implementation.
It would be advisable to repeat § A2 and A8 of ISA 620 which relate to the definition of an expert. Furthermore, it would be appropriate to specify that the cases where it is necessary to call in an expert can reveal a complex situation.
In addition, a linkage should be created concerning the following 3 subjects (relevant sections of the ED ISA LCE - 7.3.5 to 7.3.19): sampling, tests of effectiveness of controls, tests of details and substantive analytical procedures, if possible in an EEM, otherwise in an application guide.

6. Public Sector Organizations

Swedish National Audit Office

1.4.4 – Shouldn’t professional judgement apply to the whole audit process and not just planning and performing?

Going concern is only addressed in the section on Planning and not as fundamental concept. We would suggest including it in the general concept section as well.

7. Professional Accountancy and Other Professional Organizations

Institute for the Accountancy Profession in Sweden (FAR)

1.4.1: The wording in this paragraph should be modified. The documentation requirements when a requirement is relevant or not should involve an amount of professional judgment. In the draft standard it says “A requirement is relevant when the circumstance of the audit addressed by the requirement exists”. In our view the wording should be changed to “A requirement is relevant when in the circumstance of the audit the auditor, using his or her professional judgment, considers the requirement relevant.” We suggest that specific documentation requirements should be included to Part 1 or as EEM to this paragraph including that clearly not applicable requirements do not require further documentation. This could be included in section 2.5.4.

Institute of Chartered Accountants of Pakistan

Part 1: Fundamental Concepts, General Principles and Overarching Requirements

Section 1.4 of the draft ISA for LCE discusses the Fundamental Principles and General Principles for Performing the Audit.

This section uses the term ‘relevant requirements’. Paragraph 1.4.3 relates to the exceptional circumstances where the auditor may judge to depart from a relevant requirement and perform alternative procedures. However, it is unclear whether those alternative procedures could be those listed in the ISAs. This needs to be clarified.

Institute of Chartered Accountants of Scotland

Response to Question 9

We are broadly supportive of the content of each of Parts 1 through 8 of ED-ISA for LCE and found the mapping documents very useful in forming this assessment. Our specific comments are set out below. We do not view any of these of being of a fatal flaw nature.

Our specific comments are as follows:

PART 1: FUNDAMENTAL CONCEPTS, GENERAL PRINCIPLES AND OVERARCHING REQUIREMENTS

Paragraph 1.4.4 – Professional Judgement

Given how prominently references to financial reporting feature in the bullets of paragraph A25 of ISA 200, should there not likewise be a reference in paragraph 1.4.4 of the ED-ISA for LCE to the applicable financial reporting framework given its importance in this context?

“Professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and this [draft] standard and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances.”

International Federation of Accountants’ Small and Medium Practices Advisory Groups

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.

Nordic Federation of Public Accountants

PART 1: FUNDAMENTAL CONCEPTS, GENERAL PRINCIPLES AND OVERARCHING REQUIREMENTS
Part 1 of the draft standard is of utmost importance since it provides the overall framework within which the standard ought to be applied. We believe this part covers the necessary areas, but at the same time there are some paragraphs that need to be further elaborated on.

In our view, section 1.4 is key for determining whether and to what extent this standard will be applied in practice. As mentioned earlier, even a standard with a limited and focused scope needs to be scalable and proportionate while still ensuring that the objectives of the audit will be reached. The majority of mandatory statutory audits in the Nordic region concerns micro entities. This is also the audit segment where applying the full ISAs is most challenging. The success – and use – of this standard in our region will depend upon its ability to enable the performance of quality audits in an effective and efficient way within this audit segment. Performing certain overly procedural requirements in the draft standard does not make any sense or adds any value to the audits of these entities. Therefore, we strongly recommend that the ability to use scalability and proportionality combined with the proposed emphasis on exercising professional judgment, be both expanded and clarified in the standard.

The definition of “relevant” in 1.4.1 is broad since it is linked to "circumstances that exist". Often in an audit of a smaller LCE such circumstances can exist without the related procedural requirements having any effect on achieving the audit objectives. In addition to this broad definition of “relevant”, the possibility to deviate from these requirements in 1.4.3 is very limited, especially since the ability to use the exception ought to be based on “necessity”.

In our view, taking into account the risk-based approach in the standard, the exercise of professional judgment in the specific circumstances ought to be included as an added factor in the general description of how to use scalability and proportionality. This could be done, for example, by either including a reference to professional judgment in the definition of “relevant requirements” or by including professional judgment as a relevant factor when determining whether the conditions in 1.4.3 exist.

Regarding the exception in 1.4.3, we do not object to the rationale behind the exception, i.e. linking the possibility to depart from a requirement to "specific procedures that would be ineffective in achieving the aim of the requirement", but the proposed drafting is unnecessarily limiting. Broadening the possibility to use scalability and proportionality, based on professional judgment, in these specific circumstances, will contribute to more effective and efficient audits of LCEs while at the same time maintaining audit quality.

We suggest that specific documentation requirements linked to the application of section 1.4 needs to be addressed either in Part 1 or in Part 2. Such documentation requirements should also include a statement that clearly not applicable requirements do not require further documentation.

8. Academics

Accounting and Finance Association of Australia and New Zealand

Part 1 – Fundamental Concepts, General Principles, and Overarching Requirements
We are of the view that the coverage of material on relevant ethical requirements and firm level quality management (Section 1.2), as well as professional skepticism (Section 1.4.5 – 1.4.6), needs to be elaborated upon in order to reflect unique but important characteristics of less complex entity audits.

Research also highlights opportunities for the proposed standard to note unique circumstances impacting the exercise of professional skepticism in an audit of a less complex entity and, in doing so, make it more likely that auditors will exercise a level of professional skepticism appropriate to the circumstances. Research notes that social bonding is a greater threat in audits of less complex entities as auditors build strong, often long term, relationships with owner-managers (Langli and Svanstrom 2013).

Research highlights that objectivity can be compromised in circumstances where the auditor identifies with the client (Bamber and Iyer 2007; Stefaniak et al. 2012) and Kadous et al. (2013) suggest that auditors may be overly trusting when there is a strong social bond. We recommend that the essential explanatory material associated with paragraph 1.4.6, and in particular the material on past experience with the entity's management, be elaborated upon such that the auditor using the proposed standard is aware of the threats to the appropriate exercise of professional skepticism that they must address.

9. Individuals and Others

Vera Massarygina

Part 1. It seems strange that going concern it not included into the range of the fundamental concepts, general principles and overarching principles and is included only into Part 5, 7 and 8.
Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE\2) Responses on Parts 1 through 8\Part 1\b. Specific Comments\1.5.Fraud

4. National Auditing Standard Setters
American Institute of Certified Public Accountants
The following represents those ISA paragraphs and corresponding ISA for LCE paragraphs that we assigned a “B” rating – meaning that omission or revision of the ISA requirement might create an issue for auditors when any one item is aggregated with another or others. We are pleased to provide additional information if requested.
From Mapping Document #1
ISA 240, paragraph 39/ISA for LCEs paragraph 1.5.2

Institut der Wirtschaftspruefer in Deutschland e.V. (IDW)
We are not convinced that the EEM to paragraphs 1.4.4., 1.4.6., 1.5., 1.5.1., 1.5.2., 1.6., 1.6.2., 1.6.3., 1.7.1, 1.8.2., 1.8.3. and 1.8.6. is essential because competent auditors do not need it and it can therefore be deleted.

5. Accounting Firms
Ernst & Young Global Limited
Fraud 1.5.2 – The use of the words “determine legal and professional responsibilities” used in the ED-ISA for LCE are a vague summary of the requirements of ISA 240.39 (a) and (b) when an auditor is unable to continue an engagement due to fraud. Additionally, the ED-ISA for LCE has removed the requirement from ISA 240.39 (c) to communicate when the auditor withdraws. We suggest that the IAASB revisit including these requirements in the ED-ISA for LCE.

Famme & Co. Professional Corporation
Part 1. Auditor responsibility for fraud is clearly addressed here. There is no need to address it again in each subsequent section.

Grant Thornton International Limited
1.5 Fraud EEM – The EEM setting up the context of the section on fraud is somewhat lengthy and duplicative. For example, it repeats part of the objectives of the auditor in paragraph 1.3.1(a) and it states twice that ‘misstatements in the financial statements can arise from either fraud or error. Additionally, the final sentence of the EEM may be misleading as it states that, ‘the requirements of this [draft] standard are designed to assist the auditor identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.’ The Proposed Standard is designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and error, not just fraud.

1.5.2 Considerations Specific to Public Sector Entities – The EEM indicates that withdrawing from an engagement may not be available due to public interest considerations. We question whether the audit should be capable of being performed under the Proposed Standard if there are public interest considerations that need to be taken into account.

PriceWaterhouseCoopers
Appendix 3 - Detailed Comments
Draft Standard
The section below sets out our other observations and editorial comments by paragraph within the ED. These comments are intended to be read in addition to our overarching comments in our cover letter and appendices 1 & 2 regarding the need for more extensive revisions to the requirements of the standard to better distinguish the ISA for LCE from the ISAs.

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

7. Professional Accountancy and Other Professional Organizations
Institute of Chartered Accountants of Pakistan
Section 1.5.1(c) has EEM covering specific considerations for Public Sector Entities. We understand 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 the entities that are not PIEs, and otherwise meet the criteria for using this standard.

International Federation of Accountants’ Small and Medium Practices Advisory Groups
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.

8. Academics
Hunter College Graduate Program

2. We would suggest adding in the last sentence on the section referenced below as it provides more context when the auditor is unable to withdraw from an engagement due to laws or regulations.

Section 1.5.2 (ED Pg 72)
If, as a result of misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor’s ability to continue performing the audit, the auditor shall determine the legal and professional responsibilities applicable in the under the circumstances or consider whether it is appropriate to withdraw, where withdrawal is possible under law or regulation. In the event that the auditor is unable to withdraw from an engagement due to laws or regulations, the auditor should consult with an audit committee and obtain legal representation and refer the matter to a legal body for further review.

Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE\2) Responses on Parts 1 through 8\Part 1\b. Specific Comments\1.6.Law or Regulation

4. National Auditing Standard Setters
Institut der Wirtschaftspruefer in Deutschland e.V. (IDW)
We are not convinced that the EEM to paragraphs 1.4.4., 1.4.6., 1.5., 1.5.1., 1.5.2., 1.6., 1.6.2., 1.6.3., 1.7.1, 1.8.2., 1.8.3. and 1.8.6. is essential because competent auditors do not need it and it can therefore be deleted.

5. Accounting Firms
BDO International
Part 1 - Fundamental Concepts, General Principles and Overarching Requirements
Suggestions re Requirements:
Paragraph 1.6.2 - The statement “In the absence of identified or suspected non-compliance with law or regulation, the auditor is not required to perform audit procedures regarding the entity’s compliance with law or regulations, other than what is required by this [draft] standard” may create the impression that the only requirements are in paragraphs 1.6.1 and 1.6.3. Consider adding a cross-reference to paragraphs 7.4.24 and 7.4.25 at a minimum as EEM.

Paragraph 1.6.2 - There may be local legal or regulatory requirements (e.g., whistle-blowing or anti-money laundering procedures) that require the auditor to perform some audit procedures regarding the entity’s compliance with laws and regulations. This should be mentioned within the requirement paragraph itself. Alternatively, the reference to local legal and regulatory requirements could be added as EEM, consistent with the considerations specific to public sector entities.

PriceWaterhouseCoopers
Appendix 3 - Detailed Comments
Draft Standard
The section below sets out our other observations and editorial comments by paragraph within the ED. These comments are intended to be read in addition to our overarching comments in our cover letter and appendices 1 & 2 regarding the need for more extensive revisions to the requirements of the standard to better distinguish the ISA for LCE from the ISAs.

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

6. Public Sector Organizations
Auditor-General of New Zealand
Part 1 – Fundamental Concepts, General Principles and Overarching Requirements
Paragraph: 1.6.2

Observation: This contains no “shall” statement.

Possible Correction: Perhaps this is extended explanatory material?
**Swedish National Audit Office**

1.6 and 1.7 – The paragraphs indicate that the auditor should not assess the risks and instead only remain alert throughout the audit. At the same time in 6.2.3 the auditor is required to assess the risk of material misstatements due to related parties. We find this being inconsistent.

**7. Professional Accountancy and Other Professional Organizations**

**Institute of Chartered Accountants of Pakistan**

Section 1.6.3 covers noncompliance with laws and regulations (NOCLAR). IESBA Code of Ethics also covers requirements 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.

**International Federation of Accountants’ Small and Medium Practices Advisory Groups**

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.

**Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE\2) Responses on Parts 1 through 8\Part 1\b. Specific Comments\1.7. Related Parties**

**4. National Auditing Standard Setters**

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

We are not convinced that the EEM to paragraphs 1.4.4., 1.4.6., 1.5., 1.5.1., 1.5.2., 1.6., 1.6.2., 1.6.3., 1.7.1, 1.8.2., 1.8.3. and 1.8.6. is essential because competent auditors do not need it and it can therefore be deleted.

**5. Accounting Firms**

**Grant Thornton International Limited**

1.7 Related Parties – The Mapping Documents – ISAs to Proposed ISA for LCE – Document 2 (the Mapping Document 2) includes the requirement in paragraph 1.7.1 of the Proposed standard to ‘remain alert for information about the entity’s related parties, including circumstances involving a related party with dominant influence.’ This particular requirement is mapped to ISA 550, paragraph 19, which is a requirement for the auditor to ‘consider … information when identifying and assessing risks of material misstatement’ when the auditor has identified fraud risk factors. It goes on to explain that ‘a broad requirement to ‘consider’ information relating to related parties when identifying risks of material misstatement has been retained. We are of the view that a requirement to ‘remain alert’ for information is less robust than a requirement to ‘consider’ information. We therefore recommend that consideration is given to revising the requirement in the Proposed Standard.

**6. Public Sector Organizations**

**Swedish National Audit Office**

1.6 and 1.7 – The paragraphs indicate that the auditor should not assess the risks and instead only remain alert throughout the audit. At the same time in 6.2.3 the auditor is required to assess the risk of material misstatements due to related parties. We find this being inconsistent.

**7. Professional Accountancy and Other Professional Organizations**

**Institute of Chartered Accountants of Scotland**

Paragraph 1.7

In the context of LCEs it would appear useful as a reminder to highlight in EEM that the risk of related party transactions in such entities is not likely in many instances to be mitigated by an entity’s system of internal control.

**Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE\2) Responses on Parts 1 through 8\Part 1\b. Specific Comments\1.8. General Communications with Management and TCWG**

**4. National Auditing Standard Setters**

**Austrian Chamber of Tax Advisors and Public Accountants (KSW)**

For clarification purposes we suggest:
Section 2.5. deals with general communication requirements. In our view, the requirement in paragraph 2.5.5. is a specific communication requirement that would be better placed at the end of Section 1.8. or in Section 7.7. after paragraph 7.7.3.

Part 1: Fundamental Concepts, General Principles and Overarching Requirements
The auditor’s communication with the management, and those charged with governance (TCWG) where relevant, is paramount to audit quality. Part 1 of the ED-ISA for LCE includes general requirements for communicating with the entity’s management and TCWG. Other specific matters to be communicated by the auditor are required throughout Parts 2-9.

We recommend the IAASB to categorize these requirements into 2 groups starting from a simple case scenario:
Essential communication requirements (for entities where all of those charged with governance are involved in managing the entity)
Conditional communication requirements (for entities where those charged with governance are separate from management)

Paragraph 1.8.3. contains a requirement to communicate with management, and when appropriate, those charged with governance. Therefore, we suggest amending the EEM thereto as follows: “… and the actions to be taken by management or, where appropriate, by those charged with governance.”

Paragraph 1.8.4. further elaborates the content of paragraph 1.8.2. Therefore, we suggest changing the sequence of paragraphs 1.8.3. and 1.8.4.

Like the heading above paragraph 1.8.7. we suggest including a heading “Specific Communications to Management in Relation to Fraud” above paragraph 1.8.6.

Institut der Wirtschaftspruefer in Deutschland e.V. (IDW)
We are not convinced that the EEM to paragraphs 1.4.4., 1.4.6., 1.5., 1.5.1., 1.5.2., 1.6., 1.6.2., 1.6.3., 1.7.1, 1.8.2., 1.8.5. and 1.8.6. is essential because competent auditors do not need it and it can therefore be deleted.

5. Accounting Firms
BDO International
Paragraphs 1.8.6 and 1.8.8 - In the event fraud is perpetrated by senior management themselves and there are no other members of TCWG, the application of this communication requirement would not be practical. As this is a common scenario for LCEs, consider if there should be an EEM paragraph discussing it.

Ernst & Young Global Limited
Part 1
Specific Communications to Those Charged with Governance in Relation to Fraud 1.8.8 – This section does not address what should happen if the auditor suspects fraud involving the highest level of authority at the entity. Just because an entity is a LCE does not mean that fraud at the highest level of authority will never occur. The ED-ISA for LCE needs to be clear what the auditor should do in this scenario. We suggest adding the requirement from ISA 250.24 (Where no higher authority exists, or if the auditor believes that the communication may not be acted upon or is unsure as to the person to who to report, the audit shall consider the need to obtain legal advice) to the ED-ISA for LCE.

PriceWaterhouseCoopers
Appendix 3 - Detailed Comments
Draft Standard
The section below sets out our other observations and editorial comments by paragraph within the ED. These comments are intended to be read in addition to our overarching comments in our cover letter and appendices 1 & 2 regarding the need for more extensive revisions to the requirements of the standard to better distinguish the ISA for LCE from the ISAs.

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.
6. Public Sector Organizations

Auditor-General of New Zealand

Part 1 – Fundamental Concepts, General Principles and Overarching Requirements

Paragraph

Observation

Possible Correction

1.8.6

If this requirement is applied literally the auditor could end up reporting an alleged fraud to management when the auditor suspects the fraud involves management.

Precede paragraph 1.8.6 with the words “Subject to 1.8.8, ….”.

7. Professional Accountancy and Other Professional Organizations

Accountancy Europe

PART 1: FUNDAMENTAL CONCEPTS, GENERAL PRINCIPLES AND OVERARCHING REQUIREMENTS

The auditor’s communication with the management, and those charged with governance (TCWG) where relevant, is paramount to audit quality. Part 1 of the ED ISA for LCE includes general requirements for communicating with the entity’s management and TCWG. Other specific matters to be communicated by the auditor are required throughout Parts 2-9.

We recommend that the IAASB categorise these requirements into 2 groups starting from a simple case scenario:

Essential communication requirements (for entities where all of those charged with governance are involved in managing the entity)

Conditional communication requirements (for entities where those charged with governance are separate from management)

Chamber of Auditors of the Czech Republic

PART 1: FUNDAMENTAL CONCEPTS, GENERAL PRINCIPLES AND OVERARCHING REQUIREMENTS

We recommend the IAASB categorise requirements for auditor’s communication with the management and those charged with governance into 2 groups starting from a simple case scenario:

Essential communication requirements (for entities where all of those charged with governance are involved in managing the entity)

Conditional communication requirements (for entities where those charged with governance are separate from management)

Finnish Association of Authorised Public Accountants

1.8 Communication

In the requirements and EEMs in Paragraph 1.8 it is stated that professional judgement is being used in deciding on the form, timing and content of communication as well as the appropriate persons with whom to communicate. Nevertheless, other parts of the standard include several communication requirements that overrun these general communication requirements.

The auditor should be able to use professional judgement in determining the form, timing and content of communication regarding all sections of an audit. In SME audits it should be possible to make necessary inquiries and communicate relevant issues in one phone call or meeting – not separately at planning phase, during the audit and after audit. Professional judgement should apply to the appropriate form (oral/formal written/informal written) and content depending on the circumstances, risk assessment, previous experience with the client and the structure of ownership/management etc.

From the SME point of view, some requirements are not always necessary in obtaining reasonable assurance and should therefore be removed or at least made conditional – examples of these are the requirements in 5.4.1 and 6.6.1.

Nordic Federation of Public Accountants

Consistent with our suggested approach, we also believe that the section on “General communications with management and those charge with governance” could be amended in that the auditor throughout the entire standard should be able to use professional judgment in determining the form, timing and content of such communication, especially when there is no particular matter to communicate and/or the matters are routine and simple.

Self-Regulatory Organization of Auditors Association (SRO AAS)

1.8

General Communications with Management and Those Charged with Governance

We suggest establishing the term of the TCWG for the LCE; as discussed in EEM, existing term of the TCWG can potentially mislead about the applicability of the ISA for LCE, since what is described clearly relates to complex corporate governance.
Text of the standard statement

Comments

South African Institute of Chartered Accountants (2)

Section 1.8 – the reference as to who forms the collective, “Those Charged with Governance” within the ambit of LCEs need to be made more relevant and applicable to LCE environment by removing references to governance bodies that will not ordinarily make up the governance structures of an LCE such as audit committees. Rather, the LCE standard should include references to governance bodies that are relevant to an LCE such as the owner who is also the only director. Emphasis must be placed on the inverse and inter-relationship between management and those charged with governance who, in a LCE setting, are mostly one and the same and cognisance must be taken of this specific characteristic of LCEs throughout this standard as a whole. An example of where this approach may be followed is in the requirement for a management representation letter to be signed by both management and those charged with governance to be simplified to just signed by management and those charged with governance where applicable.

Union of Chambers of Certified Public Accountants of Turkey (TURMOB)

PART 1: FUNDAMENTAL CONCEPTS, GENERAL PRINCIPLES AND OVERARCHING REQUIREMENTS

In the LCE, those charged with governance may or may not be separate from management. As communication of auditor with those charged with governance and the management are essential part of the audit process, it would be useful for IAASB to clearly differentiate and state essential communication requirements and optional communication requirements depending on the separation or involvement of the above-mentioned groups.

Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE\2) Responses on Parts 1 through 8\Part 1\c. Other Comments

3. Regulators and Audit Oversight Authorities

Botswana Accountancy Oversight Authority

We propose that this part should include the requirement for competence and capabilities check for the audit team.

Specific Questions\Section 4C – Key Principles Used in Developing ED-ISA for LCE\Question 7 - Views on the key principles used in developing ED-ISA for LCE\Question 7(c) - The principles of professional skepticism and professional judgement, relevant ethical requirements and quality management\2) Agree with Comments\a. Comment on Professional Skepticism and Professional Judgment

4. National Auditing Standard Setters

New Zealand Auditing and Assurance Standards Board

The NZAuASB is of the view that the proposed standard’s approach to professional scepticism and judgement, ethical requirements and quality management are appropriate, taking into consideration AFAANZ’s view. On the basis of the extant academic research, the AFAANZ is of the view that the coverage of material on relevant ethical requirements and firm level quality management (Section 1.2), as well as professional scepticism (Section 1.4.5 – 1.4.6), needs to be elaborated upon in order to reflect unique but important characteristics of less complex entity audits.

7. Professional Accountancy and Other Professional Organizations

ASSIREVI

We believe that professional skepticism and professional judgement underpin all audit engagements and are, therefore, fully applicable to the LCEs. However, it would be preferable to explain in the proposed standard that application of due professional skepticism implies consideration of the intrinsic characteristics of these entities and, specifically:

a) the smaller level of contrary evidence that can be obtained from an LCE as the quantity and quality of the evidence is expected to be less in the case of a smaller entity with less developed internal control systems;
b) the greater bias given the limited reporting lines, the possible involvement of the owners in governance and the structure of the LCE. The less complex structure of the LCE effectively reduces the involvement of those charged with governance in company decisions and means that internally-developed assessments are less reliable as they are subjective.

Finnish Association of Authorised Public Accountants

Although we agree with the risk-based approach, we would emphasize that in the smallest of LCEs the risks are fairly clear, low and few. The auditor should always be able to exercise professional judgement in a way that allows an efficient quality audit.
Nordic Federation of Public Accountants
We support the emphasis on both professional skepticism and professional judgment. Since the exercise of professional judgment is so closely linked to a risk-based approach, we think it would be helpful if the IAASB could further explore and clarify how the standard allows auditors to exercise professional judgment when planning and performing the audit, but also how this concept is expected to be taken into account in regard to the documentation requirements.

Saudi organization for Chartered and Professional Accountants
The principles related to professional judgment and professional skepticism appear to be clear and helpful to comprehend the necessity to practice those concepts during the auditing process (planning and performing audit). However, we believe that an emphasis could be made in paragraph (1.4.4.) to highlight the importance of using professional judgement in assessing the complexity of client-specific circumstances which may disqualify the client from being LCE and therefore a judgment should be made about the appropriateness of continuing applying the ED-ISA for LCEs.