Audits of Less Complex Entities: Separate Standard

Presented by:
Kai Morten Hagen
Working Group Chair

IAASB Virtual Meeting
December 7-11, 2020
By Videoconference
Where Are We?

What We Discussed in June

• Agreement to commence development of a separate standard
• Broad agreement on proposed high-level principles
• Encouragement that the standard be developed as a standalone standard
• How proportionality between the ISAs and the separate standard had been considered

What We Will Discuss this Week

• Project proposal
• Matters set out in issues paper to help develop the next draft
The standard has been developed as a standalone standard

Applicability

Basis of the auditor’s opinion (reporting)

High quality audit
What Still Needs to be Considered

- Name for the separate standard
- Drafting principles for consistency, readability, understandability
- Moving from the separate standard to the ISAs
- Support for the implementation of the standard
Part 1: Fundamental Concepts and General Principles

Part 1A: Overarching Responsibilities for Engagement Quality Management

Part 2: Gathering Audit Evidence-Underlying Concepts and Principles

Part 3: Acceptance or Continuance of an Audit Engagement and Initial Engagements

Part 4: Planning

Part 5: Risk Identification and Assessment

Part 6: Responding to Risks of Material Misstatement

Part 7: Concluding

Part 8: Forming an Opinion and Reporting
Objectives of Developing a Separate Standard

- Delivers a **high-quality audit** that maintains the degree of confidence in the audit of the financial statements for the intended users thereof.
- Delivers an audit that will result in a **reasonable assurance opinion**.
- Is able to be **used effectively and efficiently** to be able to obtain sufficient appropriate audit evidence to support the audit opinion.
- **Promotes consistency in application** through clear and understandable requirements that will result in a high-quality audit.
- Is **proportionate to the public interest benefits** of using a separate standard for an audit of an LCE.
- Facilitates the performance of a high-quality audit that is **appropriate in the circumstances of a less complex entity**.
IAASB agrees to formal workstream to explore issues related to audits of LCEs

Discussion Paper issued / 2nd Paris Conference

IAASB agrees to develop separate standard

Initial Draft of Separate Standard to IAASB / Project Proposal

Initial Draft of Separate Standard to IAASB / Project Proposal

Consultation on Exposure Draft of Separate Standard

Development of separate standard

Discussion of input from Discussion Paper – two workstreams approach

Develop initial draft of separate standard

June–Dec. 2020

June 2021

June 2020

Dec. 2020

Jan.–June 2021

Dec. 2019

June 2020

June–Dec. 2020

Dec. 2018

Apr.–May 2019

Dec. 2019
Outreach and LCE Reference Group

Significant outreach during the development of the first draft
- SMP Advisory Group
- Forum of Firms
- CAG
- Roundtable focused on fraud and going concern
- NSS

LCE Reference Group
- 15 individuals (mainly practitioners) from jurisdictions generally not represented in other IAASB forums
- Agile approach
  - Met 6 times to progress the draft
- High level views to help with direction
- Not to replace the LCE Working Group
- Will continue to provide input to finalization of exposure draft
CAG Comments – Project Proposal (December)

• **Broad support** for the project
  – Urgent need for a sustainable solution for audits of LCE’s in Europe highlighted
  – Separate standard could be used for statutory and voluntary audits (subject to being allowable in that jurisdiction)
  – Development of other standards and similar initiatives globally risks fragmentation

• **Quality** and impact on the audit market
  – Concerns that there may be confusion for users if two types of audits, however other views that **users** would not necessarily perceive a lower quality
    • Encouragement to consider IASB’s IFRS for SMEs – this did not create a two-tier system
  – How it may affect firms – training, methodologies etc. – are two sets needed?
CAG Comments – Project Proposal (Cont.)

• Scoping (applicability) – essential that this is clear and appropriate
  – Highlighted by those who supported development of the separate standard and those that did not
  – Need transparency about differences between ISAs and the separate standard
  – Needed to be documented and explained to users of audit reports

• Other matters for consideration
  – Clarity in auditor’s report what standard has been used – need to be clear to users what standards have been used
  – How to transition from the separate standard to the ISAs
  – How are changes made when ISAs are revised
The Board is asked for views and comments on the project proposal set out in Agenda Item 2-A

- General comments
- Part I (Subject) and Part II (Background) (paragraphs 1-12)
- Part III (How the Project Serves the Public Interest) (paragraphs 13 – 17)
- Parts IV, V and VI (Project Objectives, Project Scope and Outline of the Project) (paragraphs 18 – 23)
- Rest (paragraphs 24 – 36 and Appendix)
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- Moving from the separate standard to the ISAs
- Support for the implementation of the standard
Areas Where Further Consideration is Needed

• Matters already noted in issues paper:
  – Group audits;
  – Where the entity uses a service organization;
  – Using an auditor’s expert

• Topics where we need to further consider how to make more appropriate for audits of LCE’s
  – Documentation
  – Fraud
  – Those Charged with Governance and how its dealt with in the separate standard
  – IT and automated tools and techniques

• Public sector considerations
Considerations:

• Mainly practitioners but also other relevant stakeholder groups (public sector, academics, NSS and audit methodology developers / providers)

• Stakeholders with whom the LCE Working Group does not have a regular opportunity to interact with

• Representatives from regions who have already developed or are in a process of developing their own solutions for audits of LCEs

• Broad geographical coverage
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CAG Comments (September)

• CAG broadly supported work in two workstreams
  – Emphasized need to focus on scalability and proportionality in both projects

• CAG encouraged IAASB to focus on delivering a standard that would result in a high-quality audit
  – Should not create confusion that it is a different quality

• Applicability
  – Very important that the standard clearly sets out when it is applicable
  – Mixed views about how prescriptive the applicability should be
  – Listed entities should be scoped out – further consideration needed whether this is more than just listed entities
  – Support for a decision tree to illustrate applicability
Applicability

**When is separate standard appropriate to use?**

- Listed
- Laws & Regulations

Specifically excluded

- Structure
- Business model
- Information system

Nature & characteristics of entity

- As complexity of financial reporting increases the complexity of audit procedures increases

Application of financial reporting standards

Professional judgment

Stand-back in Part 5
Matters for Board Consideration

1. The Board is asked for views on:

   a) The **approach** to describe the applicability of the [draft] audit standard by linking the scoping to the nature of the entity and the application of the applicable financial reporting framework.

   b) A **stand-back** with regard to using the standard, and whether this is at the appropriate point (i.e., once the risk identification and assessment is done).

   c) The **matters described as leading to complexity** in the audit when determining applicability as described in the “Introduction” section of Agenda Item 2-B.
Structure of Each Part

- Introduction Box
- Objective
  - Specific communication requirements
  - Specific documentation requirements
- Requirements
- Essential material
- Appendices
2. The Board is asked for views on:

a) The **flow of the [draft] audit standard**, including whether the Parts appropriately reflect a practical approach to the audit.

b) Whether **Part 1A** on Engagement Quality Management should be maintained in a **separate Part** or whether it should be incorporated into each relevant Part.

c) The **overall structure of each individual Part** as described in paragraph 31.

d) Whether there are **any other matters** related to overall structure that the LCE Working Group should consider as it further develops the [draft] audit standard.
Broad Content of the Standard

- Introduction Boxes
- Objectives
- Definitions
- Drafting guidelines - Understandable and usable

Still to consider: Support for implementation
3. The Board is asked for views on the LCE Working Group’s proposals regarding:
   a) **Introduction boxes**.
   b) Use of **objectives**.
   c) Approach to **definitions**.
What is In and What is Out

- “Core” requirements included

- Standards not included
  - ISA 610 (Using the work of internal auditors)
  - Part of ISA 500 (relating to segment reporting)
  - ISA 701 (Key Audit Matters)

- Mapping documents show what has been included and what has not been included
Agreement of Working Group to not include application material

Will need supporting material to implement the standard

Essential material included

Distinguishable from requirements – highlighted in light blue and in italics
Matters for Board Consideration

4(a) The Board is asked for views on the LCE Working Group’s **approach** of including the ‘**core requirements**’ within the [draft] audit standard.

4(b) The Board is asked for view on the **ISAs** (or part thereof) **not addressed** within the [draft] audit standard.

7. The Board is asked for views on the LCE Working Group’s **approach to “essential material”** within the standard.
Topics Needing Further Consideration

- Group audits
- Entity’s use of a service organization
- Using an auditor’s expert
Matters for Board Consideration

5. The Board is asked whether it agrees with the proposed approach to have a clear ‘boundary’ (i.e., there are no component auditors involved in the group audit), or whether further consideration is needed about how to incorporate group audits deemed to be less complex (i.e., describing what drives complexity in a group audit as the basis for deciding whether an audit is scoped in or out)?

6. The Board is asked for its views on the LCE Working Group’s initial proposals to include limited material related to:
   a) Using the work of an auditor’s expert; and
   b) The entity’s use of a service organization.
STANDALONE STANDARD

BASIS FOR AUDITOR’S OPINION (REPORTING)
Matters for Board Consideration

8. The Board is asked for views on the matters still being considered as set out in paragraphs 70–78 including:
   a) The standalone nature of the [draft] audit standard; and
   b) The basis for the auditor’s opinion.
9. Notwithstanding the premise of scaling the requirements as appropriate to the nature and circumstances of the audit of a less complex entity, the Board is asked whether there are any standards that do not appear to be sufficiently addressed? In particular, in relation to:

a) ISA 540 (Revised);
b) ISA 220 (Revised); and
c) Other standards.

If so, what appears to have been omitted, or alternatively, what areas of the audit need to be enhanced in relation to the requirements of the standard
10. Time permitting, the Board is asked for views on:

(a) The detailed content of each Part as set out in Agenda Item 2-B (this Board discussion is focussed on the content and matters contained within each Part, with less focus on the specific drafting – the drafting will be the focus of the next Board discussion on the [draft] audit standard).

(b) The essential material that has been provided within each Part, including whether there are any areas where essential material would be helpful.
LCE – Revised Project Proposal

• Prerequisite knowledge of the ISAs
• Reasonable assurance
• If its appropriate for the auditor to use the separate standard – it’s a choice at that point
• “Pain points” from consultation
• Application material
  – Negative requirements
  – Application versus essential material
• Timeline
The Board is asked for views and comments on the project proposal set out in *Updated Agenda Item 2-A*

- Part I (Subject) and Part II (Background) (paragraphs 1-12)
- Part III (How the Project Serves the Public Interest) (paragraphs 13 – 17)
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