

**Audits of Less Complex Entities****Supplemental Guidance – Authority of the [Draft] ISA for LCE****I. Purpose**

1. This publication provides additional information that may be of assistance when adopting and implementing the IAASB's proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE). It has been developed to further explain matters and circumstances that may be relevant in determining the use of the [draft] ISA for LCE, and may be useful to:
  - (a) *Legislative or regulatory authorities or relevant local bodies with standard-setting authority* (such as regulators or oversight bodies, national standard setters, professional accountancy organizations or others with authority for setting auditing standards) when determining the permitted use of the [draft] ISA for LCE in an individual jurisdiction.
  - (b) *Firms* for developing policies or procedures in relation to the use of the [draft] ISA for LCE.
  - (c) *Practitioners* when determining whether the standard is appropriate to use for a specific engagement at the client acceptance or continuance phase.
2. This staff-prepared publication does not amend or override the [draft] ISA for LCE, the text of which alone is authoritative. Reading this publication is not a substitute for reading the [draft] ISA for LCE. This guide is not meant to be exhaustive and reference to the [draft] ISA for LCE itself should always be made.

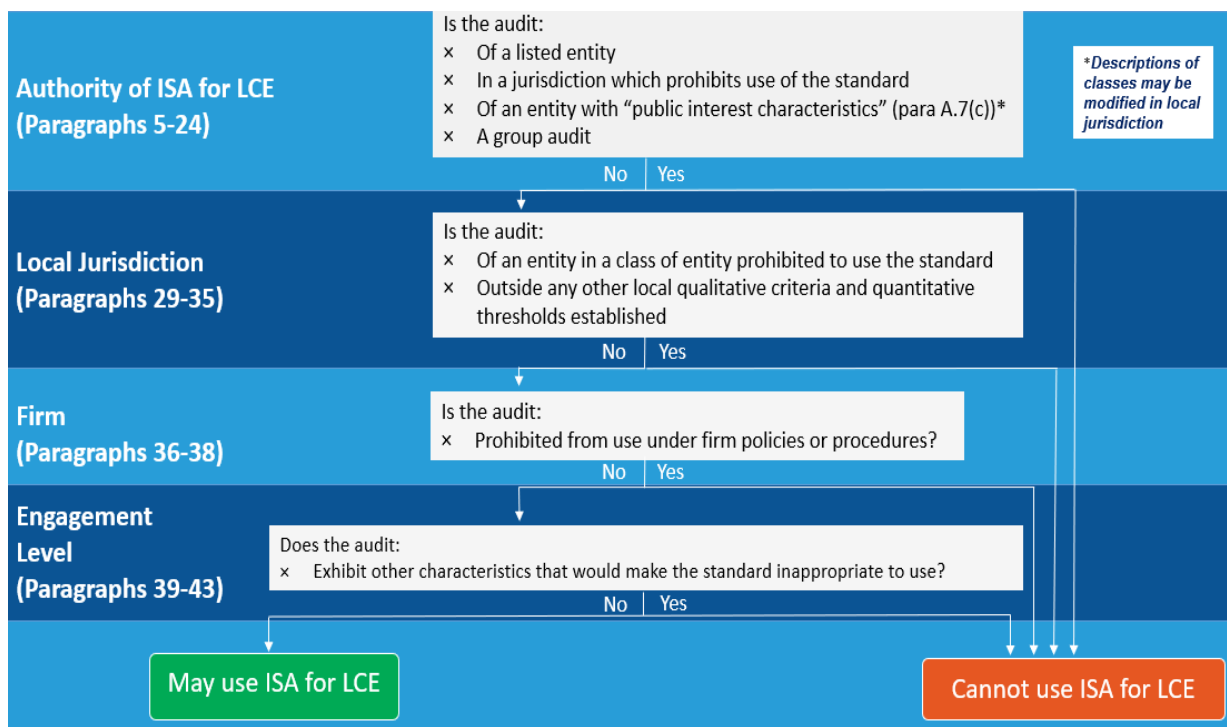
**II. Introduction**

3. The basis for the design of the [draft] ISA for LCE ([draft] standard) is a separate standard for an audit of the financial statements of an LCE that:
  - (i) Is proportionate to the nature and circumstances that would be typical of an audit of a less complex entity;
  - (ii) Is able to be used effectively and efficiently in those typical circumstances to be able to obtain sufficient appropriate audit evidence to support a reasonable assurance audit opinion.
  - (iii) Utilizes principles-based requirements using a risk-based approach to an audit so that it can be applied to entities with a wide range of circumstances, but is limited to audits of entities embodying common characteristics of being less complex.
4. To help with an understanding of when the standard is appropriate to use, the IAASB has developed the "authority" of the [draft] standard. This Authority sets out the intended scope of the [draft] standard and is set out in Part A of the [draft] standard. Part A describes the specific prohibitions and qualitative characteristics that will make the [draft] standard inappropriate for use in an audit of the financial statements of an LCE. Part A also explains the roles and responsibilities of legislative or regulatory authorities or relevant local bodies with standard-setting authority, as well as firms and practitioners in relation to the use of the [draft] standard.

### III. Limitations for Using the [Draft] ISA for LCE

5. The broad approach to the Authority of the [draft] standard is illustrated below. It is important to understand the limitations for using the [draft] standard because the requirements in the [draft] standard have been designed to be proportionate to the typical nature and circumstance of an audit of financial statements of an LCE in the private and public sectors. The [draft] standard has not been designed for obtaining sufficient appropriate audit evidence for, and therefore does not address, complex matters or circumstances.
6. The limitations for using the [draft] standard are designated into two categories:
  - (a) Specific classes of entities for which the use of the standard is prohibited (see paragraphs 7–20 of this Supplemental Guide); and
  - (b) Qualitative characteristics that if exhibited by an entity would preclude the use of the standard for the audit of the financial statements of that entity because they are indicators of, or proxies for, matters or circumstances for which the standard has not been designed (see paragraphs 21–24 of this Supplemental Guide).

In determining whether the [draft] ISA for LCE can be used, both (a) and (b) need to be considered. Even if an entity is not of a class that is specifically prohibited as set out in (a), the entity, by its nature, must still be an LCE for the purpose of the [draft] standard, in accordance with the qualitative characteristics as explained by (b).



#### *Classes of Entities that are Specifically Prohibited*

7. Paragraph A.7. in Part A of the [draft] standard sets out the classes of entities for which the use of the standard is specifically prohibited. Some classes of entities will always be prohibited from the

scope of the standard, i.e., the [draft] standard will never be able to be used for such entities. Other classes of entities may be able to be 'modified' in limited circumstances by legislative or regulatory authorities or relevant local bodies with standard-setting authority (although an entire class cannot be removed).

#### Classes of Entities for which there is an Outright Prohibition

8. Use of the [draft] standard is always prohibited for the following classes of entities:
  - (a) If law or regulation:
    - (i) Explicitly prohibits the use of the [draft] ISA for LCE (i.e., the [draft] standard cannot be used in a particular jurisdiction); or
    - (ii) Specifies the use of auditing standards other than the [draft] ISA for LCE for an audit of financial statements in that jurisdiction.
  - (b) If the entity is a listed entity.
  - (d) If the audit is an audit of group financial statements.<sup>1</sup>
9. Entities that have public interest characteristics could embody a level of complexity in fact or appearance and have been excluded from the scope of the [draft] ISA for LCE. For some entities, where the public interest is so significant, such as listed entities, the [draft] ISA for LCE is not appropriate and can never be used for audits of these entities.
10. Audits of group financial statements (group audits) have also been excluded because of the view that group audits inherently exhibit characteristics of complexity within an entity that have not been contemplated in the design of the [draft] standard and therefore is not aligned with the intended use of the [draft] standard.<sup>2</sup>

#### Classes of Entities Where the Prohibition For that Class Can be Modified

11. Although Part A sets out those entities exhibiting public interest characteristics for which use of the [draft] standard has been prohibited, describing these types of entities for a global audience is multifaceted. Some jurisdictions have defined public interest entities (PIEs) for that jurisdiction, while others have not. In the absence of a global definition of PIE's, the IAASB has described in Part A the classes of entities that would typically exhibit public interest characteristics for the purpose of determining the appropriate use of the [draft] standard.

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<sup>1</sup> Consistent with the proposed ISA 600 (Revised), group financial statements are financial statements that include the financial information of more than one entity or business unit through a consolidation process. The term consolidation process refers not only to the preparation of consolidated financial statements in accordance with the applicable financial reporting framework, but also to the presentation of combined financial statements, and to the aggregation of the financial information of entities or business units such as branches or divisions. This definition may change as ISA 600 (Revised) is finalized.

<sup>2</sup> The IAASB will obtain stakeholder views on matters related to group audits in the Explanatory Memorandum accompanying the Exposure Draft.

12. Listed entities, which are specifically prohibited as explained above, are defined:

*Entities, whose shares, stocks or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.*

Accordingly, if an entity meets the definition of a listed entity the audit of the entity may not be undertaken using the [draft] ISA for LCE.

13. However, there are other classes of entities that also exhibit public interest characteristics. Part A therefore sets out those classes of entities with *deemed* public interest characteristics, which are broadly based on:

- The nature of the business or activities of the entity, such as those entities taking on financial obligations to the public as part of an entity's primary business.
- Entities subject to regulatory supervision designed to provide confidence that the entity will meet its financial obligations.

14. As explained in paragraph A.7.(c) of the [draft] standard, the [draft] ISA for LCE shall not be used if an entity meets one of the following criteria:<sup>3</sup>

- (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 [draft] 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.

15. Some of the classes of entities described in paragraph 14 (a)–(d) may also be defined by local legislation governing, for example, entities undertaking banking or insurance businesses, but for the purpose of the [draft] standard, they are broadly described for global application in such a way so as to avoid any terms that are more jurisdiction specific.

16. Individual jurisdictions will always be able to add to the list of specifically prohibited entities (i.e., be able to further exclude more classes of entities from using the standard) because there may also be other classes of entities that exhibit public interest characteristics in that jurisdiction. This is done by utilizing the 'class of entity' set out in paragraph 14(e) above. For example, other 'public interest characteristics' that could be considered include:

- The importance of an entity to the sector in which it operates including how easily replaceable it is in the event of financial failure.

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<sup>3</sup> The classes of entities set out in paragraph 14 broadly align with the proposals by the International Ethics Standards Board for Accountants (IESBA) to describe a public interest entity – these are the same types of entities that the IAASB would consider exhibit public interest characteristics. As further changes are made by the IESBA as it progresses its project to define PIEs further consideration will be given to the appropriateness of this list for the purpose of the authority of the [draft] ISA for LCE.

- Number and nature of stakeholders including investors, customers, creditors and employees.
- The potential systemic impact on other sectors and the economy as a whole in the event of financial failure of an entity.

Further excluding classes of entities from using the [draft] standard could therefore be done by describing the class of entity or through quantitative thresholds.

17. In addition, modifications can be made to a class of entity described in paragraph 14 (a)-(d) above because there may be entities within a local context that are scoped in when they, in fact, do not exhibit public interest characteristics (they may be a 'sub-set' within the broad class described). Therefore, legislative or regulatory authorities or relevant local bodies with standing-setting authority have the ability to 'modify' a class of prohibited entities to permit a specific sub-class to be able to use the [draft] ISA for LCE. Such changes can only be made at a jurisdictional level.
18. For example, there may be entities in a specific jurisdiction whose main function is to provide post-employment benefits, but may have a limited number of beneficiaries and would therefore not exhibit the 'public interest characteristics' as contemplated. In such cases this specific sub-set could be specifically permitted to use the [draft] ISA for LCE by legislative or regulatory authorities or relevant local bodies with standard-setting authority in that jurisdiction.
19. The consideration of whether the "main function" of an entity is as described is a judgment. For example, if an entity sells goods or services but receives deposits for the purpose of securing the goods or service in advance of delivery of the good or service, the main function of the entity is unlikely to be taking deposits from the public. Each situation would be judged on the facts and circumstances as to what the entity's main function is deemed to be for the purpose of using the [draft] ISA for LCE.
20. Notwithstanding that modifications can be made as described, an entire class of prohibited entity in paragraph 14 (a)-(d) above cannot be removed.

#### **Further Guidance on Classes of Entities that May be Modified**

- ❖ *Entities with deposit-taking and insurance businesses take on significant financial obligations to the public (both individuals and corporate entities) and, as a consequence of both taking on those obligations and the interconnectedness of the role they play in the financial markets, are generally subject to significant financial and prudential regulation and supervision. The term "one of whose main functions" is used in order to capture entities that have other main functions such as credit and lending but also to exclude those entities for which deposit-taking or insurance is not a main function.*
- ❖ *Entities used to provide for post-employment benefits, such as pension funds, usually hold significant investments over the medium to longer term often on behalf of large numbers of stakeholders. The proposals are intended to capture both pension funds available to the public and those that are prohibited to the employees of specified entities. The term "one of whose main functions" is used in order not to include all employers that just contractually provide post-employment benefits to their employees.*
- ❖ *The class to capture entities whose function is to act as a collective investment vehicle and which issues redeemable financial instruments to the public is intended to cover those "fund vehicles" such as mutual funds, unit trusts or open-ended investment companies (OEICs) where an investor can only realize its*

*investment by selling it back to the entity. In using the phrase “an entity that issues,” the proposed class is restricted to only the “issuing” entity (i.e., the fund itself) but not the fund management company.*

*Qualitative Characteristics Limiting Use of the [Draft] ISA for LCE*

21. If the use of the standard is not prohibited as described above, it would be inappropriate for an audit of the financial statements of an entity to be undertaken using the [draft] ISA for LCE if the entity exhibits the following:
- Complex matters or circumstances relating to the nature and extent of the entity's business activities, operations and related transactions and events relevant to the preparation of the financial statements.
  - Topics, themes and matters that increase, or indicate the presence of, complexity, such as those relating to ownership, corporate governance arrangements, policies, procedures or processes established by the entity.
- These are indicators of, or proxies for, matters or circumstances that are deemed complex and for which the standard has not been designed to address.
22. The table below further describes and provides examples of the qualitative characteristics detailed in paragraph A.9. of Part A of the [draft] standard that may indicate that the standard is not appropriate for use for a particular entity. This list is not exhaustive and other relevant matters may also need to be considered – it is intended to illustrate how the requirements in the [draft] standard have been designed for audits of less complex entities.
23. Professional judgment is used in determining whether the entity exhibits the qualitative characteristics of a less complex entity and the [draft] standard is therefore appropriate to use. If there is uncertainty about whether, based on the consideration of typical characteristics associated with complexity, an audit is or is not an audit of an LCE, it is appropriate to conclude it not to be an audit of an LCE and so be excluded from using the [draft] standard. Accordingly, application of the full ISAs, or other applicable auditing standards, would be appropriate.
24. In the table below, characteristics designated by “✓” represent those that are commonly associated with an LCE, and those designated with “✗” are those that are commonly not associated with an LCE. Each of the qualitative characteristics may on its own not be sufficient to determine whether the [draft] ISA for LCE is appropriate or not in the circumstances, therefore the matters described in the list are intended to be considered both individually and in combination. The individual characteristics listed are not mutually exclusive (i.e., the presence of one ‘complex’ characteristic exhibited by an entity does not necessarily exclude the use of the [draft] ISA for LCE for that entity).

Business Activities, Business Model or Industry	
<i>The entity's business activities, business model or the industry in which the entity operates results in pervasive risks that increase the complexity of the audit, such as when the entity is new or emerging markets, or entities in the development stage (paragraph A9 of the [draft] standard).</i>	
✓	Business activities and business model are well established for the industry and products or services do not give rise to a pervasive risk of technological obsolescence, legal liability or reputational risk.
✗	Products and services that may result in technological obsolescence, legal liability or reputational risk.
✗	Entity operates in a new or emerging market or is in the start-up or development stage of its life cycle.
Organizational Structure	
<i>The organizational structure is not relatively straightforward or simple, such as</i> <ul style="list-style-type: none"> <li>• Multiple levels and reporting lines, with many individuals involved in financial reporting, to accommodate the entity's business activities; or</li> <li>• Including unusual entities or arrangements, such as special-purpose entities, joint ventures, off-balance sheet financing arrangements, or other complex financing arrangements (paragraph A9 of the [draft] standard).</li> </ul>	
✓	Straightforward or simple organizational structure, for example, entity's business activities comprising a few lines of business and few products within business lines, and requiring few employees involved in roles related to financial reporting.
✗	Multiple levels and reporting lines to accommodate the entity's business activities which may be varied, with many individuals involved in financial reporting
✗	Organizational structure that involves unusual entities or arrangements such as special-purpose entities, off-balance sheet finance or other complex financing arrangements.
Ownership or Oversight Structure	
<i>Ownership or oversight structures are complex (paragraph A9 of the [draft] standard).</i>	
✓	An owner-managed entity, including a single owner-manager or when there is a concentration of ownership and management in a small number of individuals.
✓	<p>All of those charged with governance are involved in managing the entity (i.e., those with a governance role generally do not include an independent or outside member(s).</p> <p>Note: For charities or public sector entities, the presence of independent or outside members in a governance role is not always an indicator of complexity.</p>
✗	Complex ownership arrangements (e.g., relating to determining controlling interest or joint ownership arrangements) or operations that necessitate a distinction based on geographic dispersion or industry segmentation.

X	The involvement of related parties is complex, such as when related parties operate through an extensive and complex range of relationships and structures.
<b>Regulation or Regulatory Oversight</b>	
<i>The entity's operations are subject to a higher degree of regulation or to significant regulatory oversight, such as being subject to prudential regulations (paragraph A9 of the [draft] standard).</i>	
✓	Operations are not subject to a higher degree of regulation or regulatory supervision.
X	Operations that are subject to a higher degree of regulation. Note: For public sector entities, regulation is not always an indicator of complexity.
X	The entity is subject to regulatory supervision, including where the entity's performance or financial position is measured against regulatory requirements such as prudential requirements, or regulatory ratio or exposure requirements.
<b>Transactions and Information Processing</b>	
<i>Transactions are complex or the information system and related processes relevant to the entity's financial statements are complex such that the data collection and processing involves complex accounting or calculations (paragraph A9 of the [draft] standard).</i>	
✓	Straightforward or uncomplicated transactions resulting from few lines of business or products, requiring simple record-keeping and few internal controls.
✓	Few levels of management with responsibility for a broad range of controls, including that many controls may be directly applied by management.
✓	Few personnel, many having a wide range of duties and few employees involved in roles related to financial reporting.
✓	If the entity uses a service organization relevant to financial reporting, the service processes transactions that are straightforward or uncomplicated, and it is anticipated that the auditor would be able to obtain the necessary audit evidence without difficulty from records available. For example, in order to obtain sufficient appropriate audit evidence, the auditor does have the ability to access the relevant accounting records directly for the purpose of obtaining sufficient appropriate audit evidence and will not need to rely on reports on the operating effectiveness of controls from the entity providing the services (e.g., 'Type 1' and 'Type 2' reports).
X	There is complexity in data collection and processing, including complicated transactions or accounting entries that may involve complex calculations. For example, complexity may arise when transaction processing has to account for different commercial terms with many different suppliers, customers or other parties, there are many interrelated commercial terms, or the processing of data involves many inter-related steps and the data is more difficult to identify, capture, access, understand or process.
X	The entity has a shared service center(s), whether as part of the entity itself or as part of the group to which the entity belongs, to centralize activities or processes relevant to the entity's financial reporting.



The Entity's IT Environment and IT System(s)	
<p><i>The entity's IT environment or IT systems are complex, such as when the IT environment and processes involve highly-customized or highly-integrated IT applications, with internal resources or external service providers that have software development and IT environment maintenance skills to support the IT environment and processes (paragraph A9 of the [draft] standard).</i></p>	
✓	The entity uses commercial software with no or limited modifications, including when the entity does not have access to the source code to make any program changes.
✓	The IT organizational structure is straightforward or uncomplicated, for example, the entity may not have dedicated IT resources but may have a person assigned in an administrator role for the purpose of granting employee access or installing vendor-provided updates.
✓	The entity's IT application(s) perform automated information processing controls, however, the underlying transactions by their nature are straightforward or uncomplicated. Although the transactions may be subject to highly automated processing with little or no manual intervention, their processing would typically involve the use of commercial software with no or limited modifications that is part of the entity's accounting software package or that provides for a simple interface with the entity's accounting software package.
✗	The IT organizational structure involves a dedicated IT department(s) that have structured processes, develop and implement program changes, manage access rights and are supported by personnel that have software development and IT environment maintenance skills. Alternatively, the entity may use internal or external service providers to manage certain aspects of, or IT processes within, its IT environment to meet its IT needs as indicated by the nature and extent of its business activities and related transactions and events.
✗	The entity has numerous IT systems and applications where information is passed from one IT system/application to another with limited controls over the data interface.
✗	The entity's IT environment includes highly-customized or highly-integrated IT applications, including financial reporting processes or IT applications that may be integrated with other applications (such as ERP systems). For example, IT applications that are used in the entity's business operations may be integrated with the IT applications relevant to the entity's flows of transactions and information processing.
Where the entity's accounting estimates are complex	
<p><i>The entity's accounting estimates are subject to a high degree of estimation uncertainty or the measurement bases requires complex methods that may involve multiple sources of historical and forward-looking data or assumptions, with multiple interrelationships between them. (paragraph A9 of the [draft] standard).</i></p>	
<p>Accounting estimates vary widely in nature and are subject to varying degrees of estimation uncertainty, which is the susceptibility to a lack of precision in measurement.</p> <p>In determining whether there are accounting estimates that do not fall within the scope of the [draft] standard, it is appropriate to have regard to the degree to which the selection and application of the method(s), assumptions and data used in making the accounting estimate(s), and the recognition criteria,</p>	

	<p>measurement bases and related presentation and disclosure requirements of the applicable financial reporting framework, are affected by complexity.</p> <p>Accounting estimates that do not require significant judgments (i.e., relating to methods, assumptions or data), or for which the process for making the accounting estimates is less complex, are within the scope of the [draft] standard. Although the accounting estimates may still be subject to or affected by estimation uncertainty, complexity, subjectivity, or other inherent risk factors, this is to a lesser degree.</p> <p>When considering the complexity of accounting estimates in the determination of whether the [draft] standard is appropriate for use, using an auditor's expert with regard to an accounting estimate is not automatically a proxy for complexity. The nature and circumstances (inherent characteristics) of the underlying accounting estimate are what drives the auditor's determination of complexity, not necessarily the need for using an auditor's expert.</p>
✓	Fair value accounting estimates that use quoted prices in active markets for identical assets or liabilities. Such inputs are readily available and observable. For example, International Financial Reporting Standards (IFRS) refer to such inputs as Level 1 inputs; these provide the most reliable evidence of fair value.
✓	Estimate has limited number of assumptions for which it is relatively straightforward to obtain sufficient audit evidence. For example, an allowance for doubtful accounts based on applying estimated loss percentages (which can be supported by reference to actual loss experience) to respective aging categories.
✗	Inherently the accounting estimate(s) is known to be associated with complicated transactions or accounting entries that involve significant subjectivity in judgments, complex calculations, or complex modelling.
✗	Classified as complex under known financial reporting frameworks that may distinguish accounting estimates based on the degree of complexity inherent in the recognition criteria, measurement bases, and related presentation and disclosure requirements. For example, the IFRS for Small and Medium Sized Entities (IFRS for SMEs) distinguishes between basic financial instruments and other more complex financial instruments and transactions.
✗	The measurement basis required by the applicable financial reporting framework results in the need for a complex method that requires multiple sources of historical and forward-looking data or assumptions, with multiple interrelationships between them, or that use a long forecast period.
✗	Management has developed a model internally and has relatively little experience in doing so or uses a model that applies a method that is not relatively straightforward and established or commonly used in a particular industry or environment.
✗	Complexity in the model as reflected by the degree to which there may be a need to apply probability-based valuation concepts or techniques, option pricing formulae or simulation techniques to predict uncertain future outcomes or hypothetical behaviors.
✗	Difficulty in applying the method due to many valuation attributes with many interrelationships between them, the use of multiple data sets (or data from multiple sources), multiple assumptions with various layers of correlation, multiple iterations of the calculation, or the calculation involves the application of sophisticated mathematical or statistical concepts.

X	High level of difficulty to identify, capture to obtain reliable or supportable data needed for making the estimate (e.g., owing to restrictions on the availability or observability of, or access to, data).
X	The data used is inherently difficult to understand. For example, the data used requires an understanding of technically complex business or legal concepts, or complex contractual terms.
X	The information system(s) used to obtain and process the data are complex or sophisticated. For example, extensive controls are required in relation to obtaining, transmitting, and processing data and maintaining the integrity of data and assumptions used in the model. Furthermore, there may be diverse systems required to process complex transactions, requiring either automated interfaces or extensive manual intervention (e.g., reconciliations).
X	Fair value accounting estimates that use unobservable inputs to measure the fair value of the asset or liability. For example, IFRS refer to such inputs as Level 3 inputs which an entity develops using the best information available in the circumstances (including the entity's own data) and that reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

#### **Illustrative example of a less complex entity**

- ❖ *A family-owned business (father and daughter) in a single location, making hand-made furniture and has limited number of employees and:*
  - *Owners involved in the day-to-day oversight of the business.*
  - *Transactions are routine with sales made in cash or by credit card, with credit offered for purchases over a certain amount.*
  - *Uses off the shelf point of sale (cash receipt) and bookkeeping software, with external third party IT support when needed.*
  - *Accounting estimates include debtors and depreciation on a small number of machines and equipment.*
  - *Premises is owned by the family and rent charged to business at an arms-length price.*
  - *Payroll is outsourced to a payroll processing agency.*
  - *Father's wife is responsible for the bookkeeping.*

#### *Impact on the [Draft] Standard of the Limitations for Use*

25. As explained in this Supplemental Guide, the [draft] standard has been designed for the likely circumstances of an LCE and does not contain requirements for matters or circumstances relating to prohibited entities, or where an entity exhibits qualitative characteristics related to complexity. Accordingly, for example, the [draft] standard does not include any requirements:
- (a) Specific to listed entities, including procedures or matters related to reporting on segment information or key audit matters.

- (b) When the auditor intends to use the work of internal auditors. Internal auditors are likely to be used to provide assurance, or add value or improve an organization's operations related to risk management, controls and governance processes of entities with higher complexity (e.g., more complex entity structures, complex IT systems etc.). In describing what is, and what is not complex for the purpose of using the [draft] standard many of the areas typically addressed by internal auditors have higher complexity and are not contemplated within the [draft] ISA for LCE.
26. In addition, because the [draft] standard only includes the 'core' requirements that are proportionate to the intended nature and circumstances of an LCE, in some specific areas the [draft] standard contains requirements to address less complex circumstances only (i.e., not including those designed to address complexities that would not be typical for an audit of an LCE), such as:<sup>4</sup>
- (a) *Accounting estimates*<sup>5</sup>—specific procedures in relation to the use of complex modelling and detailed requirements to address situations where there is higher estimation uncertainty have not been included (e.g., the estimate is not calculated using recognized or common measurement techniques or there is a highly specialized entity-developed model for which there are no observable inputs) as they are not expected to be relevant for the types of accounting estimates in an audit of a typical LCE.
- (b) Where the *entity uses a service organization* for processing transactions—Because the requirements in the [draft] standard have been designed for the nature and circumstances of a typical LCE, basic requirements for circumstances where an entity uses a service organization for processing transactions have been included (for example, many LCE's may have payroll processed by a service organization). However, situations that are deemed more complex relating to the entity's use of a service organization have not been addressed within the [draft] standard. For example, requirements relating to an auditor's ability to rely on reports on the operating effectiveness of controls from the entity providing the services (e.g., 'Type 1' and 'Type 2' reports) are not included as it is anticipated that where transactions are less complex, the auditor would be able to obtain the necessary audit evidence without difficulty from records available (including, if applicable, in relation to controls at the service organization).
- (c) *Management amendments to the financial statements after the date of the report*—Detailed requirements relating to the distribution of previously issued financial statements when financial statements are amended are not included as this is expected to be rare, and entities with public interest characteristics have been excluded.

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<sup>4</sup> For detailed differences between the [draft] ISA for LCE and the International Standards on Auditing see [[link to mapping documents](#)]

<sup>5</sup> Using an expert for accounting estimates is contemplated in the standard as a decision about how to audit the underlying account balance, class of transactions or disclosure, and is used not used when determining whether the standard is appropriate to use for a specific engagement. Although the need for an expert may be an indicator of complexity, it may also be because in many LCE's there may not be the expertise capable of making a reliable point estimate. Accordingly, it is the underlying accounting estimate and the complexity thereof that is taken into account when considering the application of the authority of the standard.

27. The Standard also does not include some requirements that accommodate jurisdictional specific circumstances, in particular relating to law or regulation or reporting, as legislative or regulatory authorities or relevant local bodies can include these where needed for that specific jurisdiction.
28. The [draft] ISA for LCE does not address additional responsibilities of auditors arising from local law, regulation or governmental authority, which may encompass a broader scope than an audit of financial statements in accordance with the [draft] ISA for LCE and so are addressed by legislative authorities or relevant local bodies within the relevant jurisdiction.

#### **IV. The Role of Legislative or Regulatory Authorities or Relevant Local Bodies**

29. Decisions about the required or permitted use of the IAASB's auditing standards in individual jurisdictions rest with legislative or regulatory authorities or relevant local bodies. This applies to the International Standards on Auditing (ISAs) (i.e., the full set of ISAs from ISA 200 to ISA 810) and the [draft] standard.
30. In conjunction with the issuance of the [draft] standard in a jurisdiction, legislative or regulatory authorities or relevant local bodies with standard-setting authority are expected to issue provisions and accompanying guidance for adoption and implementation of the [draft] standard, as appropriate. This may include a description of which audits are permitted to be conducted using the [draft] standard in accordance with Part A of the [draft] standard, taking into account, among other matters, the purpose of and information in this supplement as appropriate. Legislative or regulatory authorities or relevant local bodies with standard-setting authority may also include additional information for firms and auditors arising from local law, regulation or governmental authority.
31. It is in the public interest to ensure that the use of the [draft] standard in individual jurisdictions or regions is clarified as far as possible through local laws or regulations, or through modifying the categories of entities or the criteria to be used, as appropriate.
32. The limitations set out in Part A of the [draft] standard, and as further described above, explain the intended scope of the [draft] standard and are aimed at informing legislative or regulatory authorities or relevant local bodies with standard-setting authority regarding the types of entities for which the [draft] standard would be appropriate when making decisions to adopt or use the standard. The IAASB recognizes that the limitations and related characteristics of entities set out in the [draft] standard are broadly described, and no recognition is given to criteria that may be relevant to the nature and circumstances of entities and audits in an individual jurisdiction.
33. As explained, Part A of the [draft] standard allows legislative or regulatory authorities or relevant local bodies with standard-setting authority to modify use of the [draft] standard by, for example, setting size criteria appropriate for the jurisdiction and its circumstances, or permitting sub-classes of entities to use the standard that would be otherwise prohibited. As it would not be practicable for the IAASB to define size thresholds or other criteria about what may constitute an audit of an LCE that would be capable of global application, any further decisions (from what is already set out in the Authority) about additional criteria or prohibitions are left to legislative or regulatory authorities or relevant local bodies.
34. Legislative or regulatory authorities or relevant local bodies with standard-setting authority may add, modify, but not remove, classes of entities for the use of the [draft] ISA for LCE (as described in paragraphs 11–20 above).

35. Legislative or regulatory authorities or relevant local bodies with standard-setting authority may set quantitative size criteria (such as using revenue, assets or employee number limits) in designating for which audits within that jurisdiction the standard can be used. In doing so, legislative or regulatory authorities or relevant local bodies with standard-setting authority would also have regard to the specific prohibitions and the qualitative characteristics explaining complexity in an audit, as set out in Part A of the [draft] standard and this publication, as well as other specific needs that may be relevant in the jurisdiction, so that any quantitative size limits would not solely define the types of entities that the standard was developed for.

#### **Example of Jurisdictional Determinations**

*The following are examples of factors a legislative or regulatory authority or relevant local body may consider when evaluating the adoption and use of the [draft] ISA for LCE in that jurisdiction:*

- ❖ *The local regulatory environment e.g., certain industries or entity types may be deemed complex based on regulations they are subject to in that jurisdiction and so it may be appropriate to add to the list of audits of entities specifically prohibited from using the [draft] ISA for LCE.*
- ❖ *The nature of local entity structures or business models determines that entities that meet certain criteria as listed in paragraph A.7.(c) of the [draft] standard are excluded from the scope of the [draft] ISA for LCE. However, certain entities within a prohibited class may be deemed to be LCEs for a particular jurisdiction. For example, an entity that provides post-employment benefits for a defined contribution plan but is otherwise non-complex (e.g., holds actively traded “level 1” investments only, has few transactions which by their nature are regular and simple, is not subject to additional regulatory oversight, has few participants). It may therefore be appropriate to modify the description of the class at A.7 (c)(iii) to allow the use of the [draft] ISA for LCE for audits of such entities based on set criteria.*
- ❖ *The nature of local industries and what may be deemed complex in that jurisdiction. It may be appropriate to add to the list of audits of entities prohibited from using the [draft] ISA for LCE audits of entities in certain sectors (e.g., cryptocurrency, exploratory mining) that may be deemed of higher complexity in a particular market.*
- ❖ *Setting a quantitative threshold over which to exclude the audits of entities to be conducted using the [draft] ISA for LCE, based on key metrics of the entity (e.g., revenue, total assets) or the average number of employees during the period under audit.*

## **V. The Role of Firms and Practitioners**

### *Firms*

36. Firms are responsible for establishing policies or procedures in relation to the permitted use of the [draft] standard by the firm’s engagement teams. In doing so, the firm takes into account the specific prohibitions for use of the [draft] standard, any further modifications or prohibitions of such for the applicable jurisdiction, and the qualitative characteristic described in paragraphs 21–24 of the above.
37. Firms also may further restrict use of the [draft] standard for particular classes of entities or industries for which the engagements can be performed using the [draft] ISA for LCE based on the risk profile of the firm’s clients.

38. Determinations by a firm in its relevant policies or procedures relating to the use of the [draft] standard should not conflict with or override the prohibitions within the [draft] standard or any determinations made by legislative or regulatory authorities or relevant local bodies as to the authority of the [draft] standard in the relevant jurisdiction or region.

### *Engagement Teams*

39. If a jurisdiction does not prohibit use of the standard, and the firm's policies or procedures allow use of the standard, the engagement partner is still required to evaluate whether the use of the standard is appropriate for a particular engagement (i.e., at the engagement level).
40. For individual engagements, the engagement partner is required to determine that the audit engagement is an audit of a LCE in accordance with Part A of the [draft] standard in order to use the [draft] standard when accepting or continuing an engagement (see [draft] standard Part 4, paragraph 4.2.1.). For this purpose, the engagement partner has regard to:
- The list of entities for which the use of the standard is specifically prohibited as set out in the local jurisdiction (see paragraph A.7. of the [draft] standard) as well as any relevant firm policies or procedures; and
  - The qualitative characteristics (see paragraphs A.9.–A.10. of the [draft] standard).
41. In undertaking procedures to understand the entity and its environment, the applicable financial reporting framework and the entity's internal control system for the purpose of identifying and assessing risks of material misstatement, new information may come to the auditor's attention that may change the engagement partner's original determination to use the standard. Accordingly, there is a 'stand-back' requirement in paragraph 6.5.10. of the [draft] standard for the engagement partner to document an evaluation about whether the [draft] ISA for LCE continues to be appropriate for the nature and circumstances of the entity being audited.
42. The [draft] standard also highlights that the auditor should stay alert throughout the audit for further information that could come to the auditor's attention that may change the judgment made in this regard.
43. If the [draft] standard is used for audit engagements other than those contemplated in its design, the auditor will not obtain sufficient appropriate audit evidence to support a reasonable assurance opinion. In such instance, the auditor also is prohibited from representing compliance with the [draft] ISA for LCE in the auditor's report.