

May 1, 2023

Mr. Willie Botha  
Technical Director  
International Auditing and Assurance Standards Board  
529 Fifth Avenue  
New York, NY 10017  
U.S.A.

Dear Mr. Botha,

**RE: IAASB Exposure Draft, *Proposed Part 10, Audits of Group Financial Statements of the Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities***

The Canadian Auditing and Assurance Standards Board (AASB)<sup>1</sup> is pleased to comment on the IAASB's Exposure Draft, *Proposed Part 10, Audits of Group Financial Statements of the Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities* (ED-ISA for LCE Part 10). In our response, "we" refers to the AASB.

We appreciate the IAASB's ongoing efforts to develop a global solution to address the challenges in performing audits of less complex entities (LCEs), including being responsive to concerns respondents raised on the ED-ISA for LCE.

Small and micro-entities make up a substantial segment of the Canadian economy.<sup>2</sup> We firmly believe that auditors need an effective solution to perform high-quality, cost-effective audits of LCEs. Consequently, we committed in our [2022-2025 Strategic Plan](#) to provide solutions that respond to the environment for small and medium-sized entities and allow auditors to apply standards in a scalable and proportional way on the less complex elements of an entity.

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<sup>1</sup> The AASB operates as an independent decision-maker with the authority and responsibility for setting standards for quality management, audit, sustainability assurance, other assurance and related services engagements and guidance in Canada.

<sup>2</sup> [Innovation, Science and Economic Development Canada, Key Small Business Statistics](#) (Ottawa, ON: ISED, November 2022). As of December 2021, of the 1.21 million businesses in Canada, 97.9 per cent were small businesses (fewer than 100 employees) and 55.3 per cent were micro-businesses (one to four employees).

We are closely monitoring the IAASB's progress in developing the proposed ISA for LCE with great interest. Our [Audits of Less Complex Entities Advisory Group](#) supports us in our review and responses to IAASB material. The Advisory Group, which includes experts with various backgrounds and experiences – including auditors from small, medium and large accounting firms, and the public sector – provided us with valuable input in formulating this response.

We have not yet decided whether having a separate standard for LCE audits (for example, the ISA for LCE when finalized) is an appropriate solution for the Canadian environment. As noted in our [response letter](#) to the ED-ISA for LCE, we will base our decision to adopt the proposed ISA for LCE on whether it will meet the needs of Canadians and serve the Canadian public interest. In making our decision, we will consider the revisions made in finalizing the ISA for LCE, and the implications of having two sets of auditing standards.

In addition to our [Overall Comments](#), we provide detailed answers to the questions in ED-ISA for LCE Part 10. The [Appendix](#) to this letter contains our responses.

If you have any questions or require additional information, please contact me at [bbosshard@asbcanada.ca](mailto:bbosshard@asbcanada.ca) or Karen DeGiobbi at [kdegiobbi@asbcanada.ca](mailto:kdegiobbi@asbcanada.ca).

Yours very truly,



Bob Bosshard, CPA, CA, ICD.D  
Chair, Auditing and Assurance Standards Board (Canada)

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Julie Corden, FCPA, FCA, IAASB Member

Eric Turner, FCPA, FCA, IAASB Member

## Overall Comments

We are pleased with the IAASB’s proposal to include audits of group financial statements (group audits) in the scope of the proposed ISA for LCE. Not all group audits exhibit characteristics of complexity. As such, audits of less complex groups should be within the scope of the proposed ISA for LCE.

However, we have significant concerns with the proposed “bright line” exclusion of the use of the proposed ISA for LCE when component auditors are involved. This is because there is significant judgment involved in determining:

- whether the individual performing audit procedures on the component is a component auditor or a group auditor; and
- under what circumstances, other than attending a physical inventory count or inspecting physical assets, the proposed ISA for LCE can be used where physical presence may be needed for a specific audit procedure.

We believe that the proposed prohibition could increase the complexity of the auditor’s decision-making process regarding the use of the proposed ISA for LCE. Consequently, we believe the prohibition will considerably limit the application of the proposed ISA for LCE in Canada and will be a significant factor as we assess whether the proposed ISA for LCE meets the needs of Canadians.

As a result, we recommend that the Authority not include a prohibition when component auditors are involved. In our view, the qualitative characteristics set out in the Authority that describe the typical LCE, in addition to the group-specific qualitative characteristics set out in ED-ISA for LCE Part 10, should be adequate for the purpose of determining the appropriate use of the proposed ISA for LCE for group audits.

We further explain these concerns and our recommendation in our response to Question 1 in the Appendix to this letter.

## Appendix – Responses to Specific Questions

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

### **Prohibition on the Use of the Proposed ISA for LCE when Component Auditors Are Used**

We do not agree with the proposed prohibition. We have significant concerns that the proposed prohibition will make the auditor's consideration of whether the proposed ISA for LCE is appropriate for use more complicated. This is because there is no "bright line" criteria or guidance to assist the auditor's judgment in determining:

- a) whether the individual performing audit procedures on the component is a component auditor or a group auditor; and
- b) under what circumstances, other than attending a physical inventory count or inspecting physical assets, the proposed ISA for LCE can be used where physical presence may be needed for a specific audit procedure.

We are concerned that the judgment required in (a) and (b) above may have unintended consequences, such as the following:

- The firm's structure would have a greater impact on whether the auditor could use the proposed ISA for LCE than the complexity of the entity itself. For example, smaller firms have fewer resources than larger firms and may be more likely to be excluded from the proposed ISA for LCE due to the need to outsource resources. The prohibition may result in disproportionately scoping out smaller firms from using the proposed ISA for LCE.
- There may be inconsistent application of the proposed ISA for LCE in practice, as practitioners may arrive at differing conclusions.
- The auditor may be inclined to not use the proposed ISA for LCE, as practice inspectors may challenge the applicability of the Authority in a group audit.
- The auditor's decision to use component auditors may be driven by whether the auditor wishes to use the proposed ISA for LCE instead of the ISAs. As a result, auditors may avoid involving component auditors when it would otherwise be beneficial.

## Judgment in Determining if the Individual Is a Component Auditor or a Group Auditor

ISA 600 (Revised)<sup>3</sup> is written in a manner that appropriately allows auditors the flexibility to use judgment when determining whether individuals performing audit procedures on a component are component auditors or group auditors. We believe this is because ISA 600 (Revised) was developed to address the most common scenarios when component auditors are involved in a group audit and can be adapted as necessary in other scenarios. However, when this flexibility is applied to the proposed ISA for LCE, it increases the complexity of applying the Authority.

Our Advisory Group identified scenarios in practice where it may not be straightforward to determine whether individuals performing audit procedures on a component would be considered component auditors or group auditors. Such scenarios include when the group engagement partner uses an individual from:

- another office, within the same firm as the group auditor to perform audit procedures on the component;
- another firm to perform audit procedures on the component; or
- another firm to perform audit procedures on the group and on the component.

In considering these scenarios, the Advisory Group members arrived at different conclusions regarding the application of the proposed ISA for LCE. Some concluded that the use of the proposed ISA for LCE would be prohibited, while others concluded that it could be used. They noted that in these scenarios there is no definitive way to decide whether an individual is a component auditor or a group auditor, as it involves judgment and depends on the circumstances of the engagement.

The Advisory Group identified several factors that they may consider in exercising their judgment on whether the individual performing audit procedures on the component is a component auditor. Those factors include:

- whether another partner besides the group engagement partner oversees the auditor performing audit procedures on the component;
- the extent of the individual's involvement beyond the circumstances requiring physical presence to perform audit procedures;

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<sup>3</sup> ISA 600 (Revised), *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*

- the manner and extent to which the group engagement partner instructs the individual (e.g., clear instructions limited to the performance of specific audit procedures versus broad instructions requiring the individual to apply professional judgment in addressing the risk of material misstatements); and
- how the individual communicates the results of the audit procedures performed to the group engagement partner (e.g., providing separate reporting correspondence versus working papers with the results of audit procedures performed).

Judgment in Determining Other Circumstances where a Component Auditor’s Physical Presence May Be Needed

The proposed Authority permits the use of proposed ISA for LCE in limited circumstances where the physical presence of a component auditor is needed for a specific audit procedure in a group audit, such as, attending an inventory count or inspection of physical assets. However, it is unclear to us whether the limited exception can be applied to circumstances other than those indicated as examples.

Our Advisory Group identified additional circumstances where a physical presence at the component may be needed, such as when:

- a local auditor is needed to physically inspect documentation in a foreign language;
- the internet service in remote locations does not allow for documents to be digitized and transmitted electronically;
- the group auditor determines that there is an issue at a component and needs an auditor to meet in person with the client;
- an audit procedure requires verifying whether employees on the payroll work at the component and such verification needs to be observed; or
- a walkthrough needs to be performed and documented on certain controls, whether automated or manual, to confirm that they are being followed.

## Our Recommendation

To address the concerns with the “bright line” prohibition, we recommend that group audits can be dealt with in the proposed ISA for LCE as follows:

- a) **Remove the proposed prohibition on using the proposed ISA for LCE when component auditors are involved.**
- b) **Use the qualitative characteristics in the Authority that describe the typical LCE, in addition to the group-specific qualitative characteristics, to determine whether the proposed ISA for LCE can be used for a group audit.** We believe complex entities with group financial statements would be appropriately scoped out of proposed ISA for LCE based on the qualitative characteristics set out in the Authority, including:
  - the number of lines of business or revenue streams;
  - whether there is a larger key management team with multiple reporting lines;
  - whether the finance function is not centralized and has numerous employees;
  - the number of entities or business units in multiple jurisdictions; or
  - whether there is a complicated consolidation process.
- c) **Add requirements and EEM to Part 10 to address situations when the audit involves component auditors, but the entity is otherwise an LCE.** A draft of Part 10 that the IAASB discussed in September 2022 contained material addressing component auditors. The material was clearly identified through shading as only relevant when component auditors are involved in the audit (see also our response to Question 3). Such requirements and EEM are necessary to ensure that the group auditor interacts appropriately with the component auditor.

In our view, removing the proposed prohibition on the use of the proposed ISA for LCE when component auditors are involved would support better consistency of the auditor’s determination of whether the proposed ISA for LCE can be used. In addition, it would be easier to apply in practice.

We also believe that removing the proposed prohibition is appropriate for the following reasons:

- The involvement of component auditors does not in itself drive complexity of the group audit. The use of component auditors may be due to a practical

consideration rather than the complexity of the group itself. The use of the proposed ISA for LCE should be driven by the complexity of the entity and not that of the audit.

- It would avoid disproportionately scoping out smaller firms from using the proposed ISA for LCE as they have fewer resources than larger firms and are more likely to go outside their firm to hire/outsource resources.

We recognize that there may be concerns that the absence of the proposed prohibition may inappropriately scope in group financial statements that may be complex. In our view, this risk is low because of the robust qualitative characteristics of less complex entities, including those specific to less complex groups, set out in the Authority. The Authority will require auditors to consider the qualitative characteristics of the entity to determine if the proposed ISA for LCE is appropriate for use. Therefore, the auditor would not be able to use the proposed ISA for LCE for a more complex group as it would not exhibit those qualitative characteristics.

#### Alternative Options Considered

We recognize the IAASB's view, noted in paragraph 13 of the Explanatory Memorandum, that the use of component auditors should be excluded from the scope of the proposed ISA for LCE. Therefore, before arriving at our recommendation set out above, we considered whether our concerns with the "bright line" prohibition could be alleviated through modifications other than removing the prohibition. For example, we considered:

- a) **Retaining the prohibition and adding EEM to assist auditors in determining whether an individual performing audit procedures on the component is a component auditor or a group auditor.** However, ISA 600 (Revised) does not contain any material that could be used as a basis for such EEM. Adding EEM in the proposed ISA for LCE that is not in ISA 600 (Revised) could lead to confusion and inconsistency in the application of ISA 600 (Revised). Further, even with such EEM, the auditor would still need to exercise discretion when determining whether the individual performing work on the component is a component auditor or a group auditor.
- b) **Retaining the prohibition and adding more examples in the EEM to clarify under what other circumstances the proposed ISA for LCE can be used where physical presence may be needed for a specific audit procedure.** Such clarity could lead to broader use of the proposed ISA for LCE for smaller firms, as they are more likely



to outsource their resources when physical presence is required in a group audit than larger firms. However, it would not address our other concern regarding the auditor's judgment in determining whether the individual performing work on the component is a component auditor or a group auditor.

### **Determining When the Audit is a Group Audit**

In addition to our recommendations above, we recommend that the Authority provide additional EEM on group financial statements to better support auditors in applying the Authority of proposed ISA for LCE to group audits.

We recommend that the IAASB make the following changes in the EEM to the Authority as they are fundamental to helping auditors determine when the audit is a group audit:

- a) **Move the definitions of “group financial statements” and “component” so they are more prominently located than their current locations in the Glossary of Terms and footnote, respectively.**
  - The ED-ISA for LCE Part 10 included the definition of “group financial statements” in the Glossary of Terms. We recommend that this definition, with its integrated description of the consolidation process, be made more prominent in the Authority, as it is fundamental for the auditor's determination of whether the audit is a group audit. Doing so would emphasize that the consolidation process includes the equity method of accounting and, therefore, is considered group financial statements. This was a point of confusion for our Advisory Group.
  - The ED-ISA for LCE Part 10 included the definition of “component” in a footnote to the EEM in the Authority. We recommend that this definition be moved from the footnote to EEM in the Authority. The definition will help auditors understand how a component may be structured, such as by entities, business units, function or business activities.
- b) **Provide further explanation of the consolidation process.** We recommend adding EEM in the Authority based on paragraph A27 of ISA 600 (Revised), to explain that “consolidation process” is not the same as “consolidation” or “consolidated financial statements” as defined or described in financial reporting frameworks. Such change would clarify and improve the auditor's understanding that the term refers more broadly to the process used to prepare group financial statements. It

would also emphasize the significance of the consolidation process as it relates to group financial statements and a group audit.

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

Yes – we agree with the proposed group-specific qualitative characteristics in the proposed Authority but suggest an enhancement to increase clarity.

The qualitative characteristic under the category of “Group Structure and Activities” describes a less complex group structure as “group entities or business units that are limited to a few jurisdictions (e.g., 3 or less)”.

In our view, the term “few” and the example of “3 or less” do not necessarily reflect what makes an LCE that includes components located in other jurisdictions complex. Leveraging from paragraph A35 of ISA 600 (Revised), we recommend that the IAASB amend this characteristic as follows:

Group entities or business units ~~are limited to few jurisdictions~~ operate in jurisdictions with similar culture, language, laws or regulations (e.g., 3 or less).

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

Yes – we agree. We have not identified any issues with the proposed requirements and EEM set out in ED-ISA for LCE Part 10.

However, in our response to Question 1, we recommended that the IAASB remove the prohibition on the use of the proposed ISA for LCE when component auditors are involved. If the IAASB accepts our recommendation and includes component auditors in the scope of the proposed ISA for LCE, proposed Part 10 would need to be amended to include requirements and EEM relevant for an LCE related to the use of component auditors.

As noted in our response to Question 1, a draft of Part 10 that the IAASB discussed in September 2022 contained requirements and EEM addressing component auditors. Such material is necessary to ensure the group auditor interact appropriately with the component auditor. We recommend that this material be reinstated.