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Prague 31<sup>st</sup> January 2022

**Subject: Exposure draft – ISA for LCE**

Dears

We are pleased to respond to the International Auditing and Assurance Standards Board (IAASB) Exposure draft (ED) – ISA for less complex entities (LCE).

Chamber of Auditors of the Czech Republic (CA CR) welcomes the ED as it aims to increase efficiency in LCE audits. We appreciate the way how the requirements are presented (reflecting on the flow of the audit from engagement acceptance and planning through risks identification to concluding and reporting) which is more practical for auditors and could lead to higher quality of audits as it could be easily incorporated to the practitioners' audit methodology guides. However, we suggest that IAASB reconsiders the positioning of the standard. We believe that ISA for LCE shall be positioned as the main or basic standard on auditing while the ISAs are to be used (only) for audits of more complex entities. We believe that renaming both sets of standards would help to achieve this change in paradigm.

Below you can find our answers on the Board's questions with our arguments, where relevant. We, as a member of the Accountancy Europe, agree with majority of the points/comments provided by Accountancy Europe in its response to this ED. Therefore, we focus mainly on areas where we have some additional points compared to the Accountancy Europe.

CA CR is relevant local authority in the Czech Republic which could adopt and hence enable usage of the ISA for LCE in the practice.

Yours sincerely



Irena Liškařová  
President of the CA CR

## General Comments on Proposed ISA for LCE

### Response:

The proposed standard is an important step to increase efficiency in LCE audits. We fully support the initiative and the IAASB moving forward with this initiative as soon as possible.

We acknowledge also that the ED is simpler, shorter hence more accessible than the full set of ISAs. We believe that the way how the requirements are presented (reflecting on the flow of the audit from engagement acceptance and planning through risks identification to concluding and reporting) is more practical for auditors and could lead to higher quality of audits as it could be easily incorporated to the practitioners' audit methodology guides. We believe that the standard has not explored all possibilities to simplify the audit requirements especially regarding the documentation and audit procedures related to the entity's internal control system.

The main key success factor will be the communication to all stake holders (not only auditors).

We suggest the IAASB delivers a clear message on the fact that the ISA for LCE provides the same level of assurance as the ISAs (i.e., reasonable assurance). This impacts perceptions about the value of the audit for LCEs and acceptance of the proposed standard.

We even suggest that IAASB reconsiders the positioning of the standard. We believe that ISA for LCE shall be positioned as the main or basic standard on auditing while the ISAs are to be used (only) for audits of more complex entities. We believe that renaming both sets of standards would help to achieve this change in paradigm.

## Specific Questions

### *Section 4A – Overarching Positioning of ED-ISA for LCE*

1. Views are sought on:

- (a) The standalone nature of the proposed standard, including detailing any areas of concern in applying the proposed standard, or possible obstacles that may impair this approach?

### Response:

We support the standalone nature of the proposed standard for LCE. The key to success is whether the ISA for LCE will be comprehensive enough on its own (i.e., fully detached from the ISAs) and concise at the same time.

- (b) The title of the proposed standard.

### Response:

We believe that the proposed name of the standard may lead to an inappropriate perception and unwanted consequences. It may suggest that the ISAs are the main default standards while the ISA for LCE is a second-class standard for certain limited circumstances. We believe that the positioning of both sets of standards shall be reverted. In many countries, majority of audit engagements are likely to be audits of LCEs. The ISA for LCE should therefore be positioned as a basic standard while the full set of ISAs would be required to be used only in case the entity is not in the scope of this standard due to its complexity. The names of the standards shall reflect this concept. We therefore propose that the ISA for LCE is renamed (for example) to International Standard on Auditing while the existing ISAs are renamed to International standards on audit of complex entities.

- (c) Any other matters related to ED-ISA for LCE as discussed in this section (Section 4A).

**Response:**

Proposed ED gives clear and understandable set of requirements, but they can be harder to understand without a simultaneous knowledge of full set of ISAs. Also, some terms are used in ISA for LCE without adequate guidance (which is contained in ISAs). There is a risk that such terms could be interpreted incorrectly. Auditors who will be performing only ISA for LCE engagements will have to be given enough framework and support. This should include practical examples and guidance to explain the objectives and requirements in the ISA for LCE.

2. Do you agree with the proposed conforming amendments to the IAASB Preface (see paragraphs 39-40)? If not, why not, and what further changes may be needed?

**Response:**

Yes, we agree with the proposed conforming amendments to the Preface.

*Section 4B – Authority of the Standard*

3. Views are sought on the Authority (or scope) of ED-ISA for LCE (Part A of the proposed standard). In particular:
- (a) Is the Authority as presented implementable? If not, why not?

**Response:**

Clearly, the authority of a separate standard for less complex entities will be determined by local authority as we are. We agree that it is not practicable to set quantitative thresholds at global level. At local level, however, we expect that we as a local authority will define the scope of the standard more precisely, including quantitative criteria such as company size.

However, we assume that the current wording of the applicability rules of the standard (mainly the existence of many qualitative criteria) could be a significant barrier for practical usage or adoption of the standard. The evaluation of qualitative criteria requires a significant professional judgement by the auditor. These criteria need to be assessed not only at the beginning but also at the final stage of the audit. Auditors may be hesitating to use this standard as they would be afraid that their professional judgement might be questioned (e.g. by the regulator) or that they will have to switch to the full set of ISAs at the end of an audit (upon discovery of some qualitative criteria that are not met). The standard shall be constructed to lower this risk to the maximum possible extent. For example, if only one qualitative criterion is not met, the use of the standard shall still be allowed with certain “add-ons” responding to the qualitative criterion not met. We believe that the most common issue might be the existence of certain complex estimate(s) that may be possibly overcome by additional procedures within the ISA for LCE rather than switching to full set of ISAs.

It is also important to note that in many jurisdictions, the local authorities may intend to mandate the use of this standard for certain well-defined groups of entities. Such definitions may be based on quantitative criteria (financial and non-financial) to provide legal certainty as to which standard is required to be used. We would welcome more clarity for such situation when the local authorities introduce a set quantitative criteria for mandatory use of ISA for LCE without requiring (or allowing) the auditor to apply the qualitative criteria contained in the standard.

- (b) Are there unintended consequences that could arise that the IAASB has not yet considered?

Response:

We are concerned that the ISA for LCE might be perceived as a lower-quality audit with less procedures. This would lead to a significant damage to the value of LCE audits and pressure on the audit fee. Therefore, clear messaging by the IAASB will be essential to inform stakeholder expectations. The standard should be promoted conveying the message that, while the standard has been simplified, the level of assurance obtained by the auditor is not compromised and the work to be carried out is not less but will be performed in a proportionate manner and more efficiently.

- (c) Are there specific areas within the Authority that are not clear?

Response:

We have no comments.

- (d) Will the Authority, as set out, achieve the intended objective of appropriately informing stakeholders about the scoping of the proposed standard?

Response:

We have no comments.

- (e) Is the proposed role of legislative or regulatory authorities or relevant local bodies with standard setting authority in individual jurisdictions clear and appropriate?

Response:

Yes.

4. Do you agree with the proposed limitations relating to the use of ED-ISA for LCE? If not, why and what changes (clarifications, additions or other amendments) need to be made? Please distinguish your response between the:

- (a) Specific prohibitions; and

- (b) Qualitative characteristics.

If you provide comments in relation to the specific prohibitions or qualitative characteristics, it will be helpful to clearly indicate the specific item(s) which your comments relate to and, in the case of additions (completeness), be specific about the item(s) that you believe should be added and your reasons.

Response:

We agree with specific prohibitions except group audits (see our response to questions 22 to 26)

For the qualitative characteristics, the auditor is expected to use professional judgement. Most entities will probably be rather clear to assess whether they are LCE or not. However, there might be instances where two auditors come to different conclusions regarding the complexity

assessment for the same entity and this might confuse entity's management, users and the regulators.

It should be emphasised that existence of one complex qualitative characteristic (especially in the area of estimates) may not give rise to complexity on its own and the aggregate impact of the characteristics should be considered by the auditor when deciding on the appropriateness of the ISA for LCE.

For estimates, we believe that it should be allowed to use ISA for LCE even if one or few complex estimates are present. In such case, the auditor shall be required to use ISA 540R (or other set of requirements) in addition to ISA for LCE. Similar solution shall also be available in the area of ownership and organisational structure and related party transactions.

5. Regarding the Authority Supplemental Guide:

(a) Is the guide helpful in understanding the Authority? If not, why not?

Response:

Yes.

(b) Are there other matters that should be included in the guide?

Response:

We have no comments.

6. Are there any other matters related to the Authority that the IAASB should consider as it progresses ED-ISA for LCE to finalization?

Response:

We have no comments.

#### *Section 4C – Key Principles Used in Developing ED-ISA for LCE*

7. Views are sought on the key principles used in developing ED-ISA for LCE as set out in this Section 4C. Please structure your response as follows:

(a) The approach to how the ISA requirements have been incorporated in the proposed standard (see paragraphs 74-77).

Response:

In general, we agree with taking the ISAs as a starting point and having a risk-based audit approach with principles-based requirements for LCE.

As further explained in our response to question 9, there is still room for simplifying the ED ISA for LCE in certain areas. In addition, we believe that it will be helpful to provide further requirements and guidance in some areas to ensure that the ISA for LCE is a standalone standard.

- (b) The approach to the objectives of each Part of the proposed standard (see paragraphs 78-80).

Response:

We have no comments.

- (c) The principles in relation to professional skepticism and professional judgement, relevant ethical requirements and quality management (see paragraphs 81-84).

Response:

We have no comments.

- (d) The approach to EEM (see paragraphs 85–91) including:
- (i) The content of the EEM, including whether it serves the purpose for which it is intended.
  - (ii) The sufficiency of EEM.
  - (iii) The way the EEM has been presented within the proposed standard.

Response:

We believe that currently proposed EEMs are not sufficient. We are missing for example guidance on materiality or sampling.

#### *Section 4D – Overall Design and Structure of ED-ISA for LCE*

8. Please provide your views on the overall design and structure of ED-ISA for LCE., including where relevant, on the application of the drafting principles (paragraph 98-101).

Response:

We appreciate the way how the requirements are presented (reflecting on the flow of the audit from engagement acceptance and planning through risks identification to concluding and reporting) which is more practical for auditors and could lead to higher quality of audits as it could be easily incorporated to the practitioners' audit methodology guides.

#### *Section 4E – Content of ED-ISA for LCE*

9. Please provide your views on the content of each of **Parts 1 through 8** of ED-ISA for LCE, including the completeness of each part. In responding to this question, please distinguish your comments by using a subheading for each of the Parts of the proposed standard.

Response:

### **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)

## **PART 2: AUDIT EVIDENCE AND DOCUMENTATION**

We have no comments.

## **PART 3: ENGAGEMENT QUALITY MANAGEMENT**

Many LCE audits are carried out entirely by the engagement partner (who may be a sole practitioner) or by a small audit team (who may be small or medium-sized practitioners). Therefore, we recommend the IAASB restructure the requirements in section 3.2 (The Engagement Partner's Responsibilities) starting from a simple case scenario. Requirements referring to the firm's or network's monitoring and remediation processes and engagement quality reviews should be presented as conditional requirements at the end of this section.

## **PART 4: ACCEPTANCE OR CONTINUANCE OF AN AUDIT ENGAGEMENT AND INITIAL AUDIT ENGAGEMENTS**

The information available to the auditor at the acceptance stage will be deepened and supplemented as the auditor performs risk identification and risk assessment, therefore the engagement letter should specifically include the possibility for transitioning to the ISAs unless the local regulations impose the use of the ISA for LCE.

The requirement in 4.5.4 seems to be relevant only for voluntary audits. If an audit of the financial statements is required by legislation, it is often forbidden by law to change the level of assurance. We proposed to skip it.

## **PART 5: PLANNING**

We observe that materiality is an area where auditors often seek guidance. Hence, we suggest the IAASB to provide more direction for the determination of the materiality and performance materiality in the ISA for LCE. We believe that in illustrative examples or other EEM, the IAASB should focus not only on profit-orientated entities but also on non-profit organisations as an audit is often required for such entities.

## **PART 6: RISK IDENTIFICATION AND ASSESSMENT**

We believe that this part is too excessive and should be simplified.

We proposed to remove or simplified following requirements:

- 6.3.6, 6.3.7 and 6.3.8 should be merged and auditors should be required to understand the entity's internal control system as a whole instead of having specific requirements for 3 elements from the COSO framework. There is unlikely to be separate risk assessment and monitoring processes established in a less complex entity. As a consequence, documentation requirements related to auditor's understanding of the entity's internal control system should be proportionate and focusing on the description of the key process including IT and controls identified (mainly authorisation).
- 6.4.2 should be removed since the risk of fraud in revenue recognition should not be by default presumed to be a significant risk in an LCE audit.

- 6.5.7 should be simplified by stating that all fraud risks identified should be treated as significant risks.

#### **PART 7: RESPONDING TO ASSESSED RISKS OF MATERIAL MISSTATEMENT**

We support the IAASB's decision not to require two separate documents for audit strategy and audit plan. However, we believe that using one document (audit plan) where the conclusions about risk assessment on the level of balances in the balance sheet/transactions in the income statements and assertion level are linked to audit response is very useful and increase audit quality. The identified risks could be spread over several documents and the auditor may forget to plan relevant audit response. Therefore, we believe that an audit plan as one document agreed by the engagement leader should be an integral part of the audit documentation.

#### **PART 8: CONCLUDING**

We have no comments.

10. For **Part 9**, do you agree with the approach taken in ED-ISA for LCE with regard to auditor reporting requirements, including:
  - (a) The presentation, content and completeness of Part 9.
  - (b) The approach to include a specified format and content of an unmodified auditor's report as a requirement?
  - (c) The approach to providing example auditor's reports in the Reporting Supplemental Guide.

#### **Response:**

Yes, we agree with the overall approach taken by the IAASB. We further propose to distinguish (also in the table itself) the qualification of the audit opinion due to a material misstatement and due to insufficient audit evidence.

11. With regard to the Reporting Supplemental Guide:
  - (a) Is the support material helpful, and if not, why not?

#### **Response:**

We have no comments.

- (b) Are there any other matters that should be included in relation to reporting?

#### **Response:**

We have no other comments.



12. Are there any areas within Parts 1–9 of the proposed standard where, in your view, the standard can be improved? If so, 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.

**Response:**

See our response to question 9. We also proposed to use a combined assertions approach described in the IFAC Guide to Using ISAs in the Audits of Small and Medium- Sized Entities, Volume 1, Chapter 6.

*Section 4F – Other Matters*

13. Please provide your views on transitioning:

- (a) Are there any aspects of the proposed standard, further to what has been described above, that may create challenges for transitioning to the ISAs?

**Response:**

We suggest that a single or a few complex matters (mainly in relation to estimates) should not lead to transition immediately. Instead, auditors should be allowed to continue the engagement with the LCE standard where auditor must still obtain sufficient appropriate audit evidence in accordance with general requirements and additional guidance to be provided with a modular approach. In this approach there will be modules including specific procedures for a more complex topic or area that could be “added on” where needed.

- (b) What support materials would assist in addressing these challenges?

**Response:**

We have no other comments.

14. Do you agree with the proposed approach to the future updates and maintenance of the Standard and related supplemental guidance?

**Response:**

The ISA for LCE should be revised only when there are changes in ISAs relevant for LCE.

15. For any subsequent revisions to the standard once effective, should early adoption be allowed? If not, why not?

**Response:**

Yes, early adoption should be allowed.

16. Should a separate Part on the ISA-800 series be included within ED-ISA for LCE? Please provide reasons for your response.

**Response:**

We believe that there should be a separate Part for the audit of special purpose financial statements or single statements or separate elements of the financial statements (ISA 800 and 805 equivalents). For example, in our jurisdiction, such audit is often required by the legislation or government grant rules. Such audits are also common in business combinations. If the separate Part on the ISA-800 issues is not included, it needs to be clarified whether a full set of ISA is required to be used when dealing with audit of special purpose financial statements, single statements or elements of the financial statement or whether ISA for LCA can still be applied.

17. In your view, would ED-ISA for LCE meet the needs of users and other stakeholders for an engagement that enables the auditor to obtain reasonable assurance to express an audit opinion and for which the proposed standard has been developed? If not, why not. Please structure your comments to this question as follows:

- (a) Whether the proposed standard can, and will, be used in your jurisdiction.

**Response:**

We expect that CA CR as a regulatory body will encourage the use of ISA for LCE and incorporate it to the relevant legislation. So far there is no standard for LCE in the Czech Republic and due to the existing thresholds for statutory audits (which are lower compared to most other EU states) the majority of audits in the Czech Republic are audits of LCE. Therefore there are lot of SMPs or sole practitioners who would benefit from such standard.

- (b) Whether the proposed standard meets the needs of auditors, audited entities, users of audited financial statements and other stakeholders.

**Response:**

The proposed standard is fairly easy to understand for auditors and overall meet their needs. Other stakeholders may perceive the ISA for LCE engagements as a lower-quality audit with less procedures and cost. Therefore, clear messaging by the IAASB will be essential to convince stakeholders that the audit quality is not compromised.

- (c) Whether there are aspects of the proposed standard that may create challenges for implementation (if so, how such challenges may be addressed).

**Response:**

Please see our response to questions 1 and 3.

18. Are there any other matters related to ED-ISA for LCE that the IAASB should consider as it progresses the proposed standard to finalization?

Response:

NO.

*Section 4G - Approach to Consultation and Finalization*

19. What support and guidance would be useful when implementing the proposed standard?

Response:

It would be useful if the IAASB provides an example of a sample audit file for an engagement carried out in accordance with the ISA for LCE. That would help visualizing the differences and maybe the increased efficiency created by the application of the proposed standard.

In addition, an implementation guide such as the IFAC Guide to Using ISAs in the Audits of Small and Medium-Sized Entities would be very beneficial.

20. Translations—recognizing that many respondents may intend to translate the final ISA for LCE in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing ED-ISA for LCE.

Response:

The draft standard as proposed is easy to understand and it usually uses plain English with a few exceptions.

21. Effective Date—Recognizing ISA for LCE is a new standard, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning at least 18 months after the approval of a final standard. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA for LCE.

Response:

The proposed period for the effective date is sufficient.

## Section 5 – Group Audits

22. The IAASB is looking for views on whether group audits should be excluded from (or included in) the scope of ED-ISA for LCE. Please provide reasons for your answer.

### Response:

We do not agree with prohibiting the use of the proposed standard to group audits. Less complex group situations are common (for sure in the Czech Republic) and exhibit one or more of the following characteristics:

- components operating within one or few (similar) jurisdiction(s)
- non-involvement of component auditors
- local know-how is not essential
- simple consolidation process set by a non-complex financial reporting framework

23. Respondents in public practice are asked to share information about the impact of excluding group audits from the scope of ED-ISA for LCE on the use of the proposed standard. In particular:

- (a) Would you use the standard if group audits are excluded? If not, why not?

### Response:

Even if the group audits are excluded, the standard could still be used for less complex non-group audit engagements.

- (b) Approximately what % of the audits within your firm or practice would be group audits that would likely be able to use ED-ISA for LCE (i.e., because it is likely that such group audits could be considered less complex entities for the purpose of the proposed standard) except for the specific exclusion?

### Response:

In the Czech Republic, the threshold for a statutory audit of consolidated FS is relatively low and therefore there are lot of local groups with few entities which will fulfil the Less complex group definition. There are often arrangements where the group consists of a parent company that is effectively dormant except for holding shares in one (or few) less complex subsidiaries.

- (c) What common examples of group structures and circumstances within your practice would be considered a less complex group.

### Response:

A group structure where all the components are operating in the same jurisdiction or within EU and the same audit team (or network) is conducting the audits of all components would qualify for a less complex group. In our view, consolidation does not necessarily create complexity if the applicable financial reporting framework is relatively straightforward, or the group has a single subsidiary that holds a property or another asset. For group audits, there could be more complex estimates related to the initial acquisition of a subsidiary or an associate. However, in the

following years, if the group remains unchanged, the complex estimates related to consolidation itself are not common.

24. If group audits are to be included in the scope of ED-ISA for LCE, the IAASB is looking for views about how should be done (please provide reasons for your preferred option):
- (a) The IAASB establishes a proxy(ies) for complexity for when the proposed standard may be used ("Option 1 - see paragraph 169); or
  - (b) ED-ISA for LCE sets out qualitative characteristics for complexity specific to groups (Option 2 - see paragraph 176), to help users of the proposed standard to determine themselves whether a group would meet the complexity threshold.

Response:

The same/similar qualitative characteristics listed in the paragraphs A.8 and A.9 could be used in determining the authority of the standard for group audit engagements. Additional factors such as those listed in our response to question 22 could be considered as qualitative characteristics for complexity specific to groups.

25. Are there other ways that group audits could be incorporated into the scope of the proposed standard that is not reflected in the alternatives described above? For example, are there proxies for complexity other than what is presented in paragraph 169 that the IAASB should consider?

Response:

We have no comments.

26. If group audits are included in ED-ISA for LCE, how should the relevant requirements be presented within the proposed standard (please provide reasons for your preferred option):
- (a) Presenting all requirements pertaining to group audits in a separate Part; or
  - (b) Presenting the requirements pertaining to group audits within each relevant Part.

Response:

Our preferred option will be having a separate part for requirements related to group audits. This will be more practical for auditors to identify relevant requirements.