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Re.: Exposure Draft: Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities Management (ISA for LCE)

Dear Willie,

We would like to thank you for the opportunity to provide the IAASB with our comments on the Exposure Draft: Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities Management (ED-ISA for LCE), hereinafter referred to as “the LCE standard” or “the IAASB LCE standard”. When referring to the recently issued draft of the IDW Auditing Standards for audits of financial statements of LCEs, we refer to the “German LCE standards”.

Before addressing, in the Appendix 1 to this letter, the individual questions posed in the draft (and set forth in the Optional Response Template), we provide some general comments on the LCE standard.

We would like to commend the IAASB for having taken up the call to provide a workable response to the issues that have arisen with respect to the use of the ISAs for audits of financial statements of LCEs and for having drafted a standard for such audits with dispatch. The IDW had already discussed the issue of scalability and proportionality of the ISAs with the IAASB in 2009, which helped engender the staff guidance on the issue. However, since 2015 we have observed how the increasing influence of audit regulators – in particular those regulators with an interest in the audits of banks, insurance companies and

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listed entities – has driven standards towards greater length and complexity to address the public interest issues that have arisen from these audits. Without in any way denigrating these issues of great public interest, these developments, as exemplified through the issuance of revised standards for ISA 540, ISA 315, and ISA 600, have increasingly overengineered the ISAs for audits of LCEs worldwide. The length and complexity of the revisions to ISA 540 and, recently, ISA 315, lead to considerable granularity in the application of the requirements and bureaucracy in their documentation in a fashion that is simply not needed for audits of financial statements of LCEs. In addition, we note that the pace of change in standards has become a major barrier to their proper implementation in LCE audits. Ideally, we would prefer a building blocks approach to the ISAs based upon a “think small first” paradigm using the CUSP project as a basis. However, given the introduction of the revised ISAs 540 and 315, we do not believe that the IAASB has the luxury of time and we have become increasingly convinced that this is simply no longer a realistic option given the focus of audit regulators on audits of financial statements of banks, insurance companies and listed entities. For these reasons, and as discussed in our comment letter dated 12 September 2019 to the IAASB on its discussion paper on audits of LCEs, an LCE standard has become necessary.

For the reasons addressed in our comment letter from 2019, in mid-2020 the IDW commenced a project to draft standards for the audits of financial statements of LCEs for the German audit market. We issued the German LCE standards in December 2021. Both the IAASB LCE standard and the German LCE standards are predicated upon the auditor obtaining reasonable assurance that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. We refer to our response in the Appendix to this letter to Question 1 c) in the Explanatory Memorandum for a further discussion of this issue. Without getting into the details explained there, we believe that the public interest test that the IAASB should use in determining which entities should qualify as LCEs, and what the requirements for LCE audits ought to be, should be whether, compared to the application of the ISAs, the application of the LCE standard has virtually no impact on the assurance obtained and the resulting report in the vast majority of audits of financial statements of LCEs: there is no perfect solution beyond this.

However, since our approach to the German LCE standards was somewhat different than that of the IAASB, we gained considerable experience from our work and consequently address a number of issues in Appendix 1 to this letter with our detailed responses to the questions posed in the Explanatory Memorandum, providing suggestions for improvement to the IAASB LCE

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standard based upon our experience. We strongly recommend that the IAASB take these considerations into account.

See Appendix 2 to this letter for an outline of the approach used by the IDW in writing its German LCE standards and the crucial differences to the IAASB LCE standard.

One issue not directly related to the content or authority of the LCE standard that the IAASB may wish to clarify in relation to the ISAs is the applicability of the LCE standard for components when group auditors use the ISAs. It seems to us that, since under ISA 600 (Revised 2021), group auditors determine what needs to be done at component level, it is a group auditor decision as to the nature, timing and extent of audit work needed, which may involve application of the ISAs or the IAASB LCE standard, as needed. We believe such a clarification in relation to the ISAs would be helpful.

Since in the long run for international comparability reasons and the impact of an international standard on the audit market, including for cross-border LCEs, we would prefer to adopt an international standard for audits of financial statements of LCEs as the basis for any national standard rather than just creating or maintaining our own German LCE standards, we have a vested interest in the IAASB's LCE standard being fit for purpose both for our jurisdiction and worldwide. For this reason, we believe that the issues addressed in Appendix 1 of our comment letter (see also our response to Question 17) – and in particular those relating to the identification and assessment of risks of material misstatement in our response to Part 6 of Question 9 and to audit reporting in our response to Question 10 – need to be considered carefully so that the IAASB LCE standard is fit for purpose and therefore capable of being adopted and further customized in our jurisdiction. If the IAASB LCE standard is improved as we note to make it fit for purpose, then we would be prepared to withdraw the German LCE standards that we have issued.

Given the urgent need for an LCE standard, we urge the IAASB to undertake the improvements that we have identified and complete the LCE standard as soon as possible.

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We would be pleased to provide you with further information if you have any additional questions about our response and would be pleased to be able to discuss our views with you. In particular, we would welcome the opportunity to share experiences and potential solutions resulting from the drafting of the German LCE standards and the IAASB LCE standard.

Yours truly,



Melanie Sack
Deputy Chief Executive Officer



Wolfgang Böhm
Technical Director Assurance Standards,
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Appendix 1: Questions Posed in the Exposure Draft and Optional Response Template

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?

We support having a stand-alone standard because having an LCE standard refer to the full ISAs would undermine the purpose of an LCE standard, which is to not require auditors (and not have audit regulators seek to require auditors) to apply the requirements of the ISAs when these may not be proportionate to the nature and size of an entity whose financial statements are being audited. For this reason, with the exception of drawing upon the ISAs to help delineate the scope of application of the LCE standard, we believe that the LCE standard should be sufficiently comprehensive and therefore stand-alone (that is, be fully detached from the ISAs) without needing to refer to the ISAs.

b) The title of the proposed standard.

We support the proposed title of the standard because it appropriately describes the nature of the standard – that is, a standard for audits of financial statements of less complex entities.

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

While we believe that the standard is “stand-alone,” we disagree with the statement in the third sentence of paragraph 26 of Section 4 A of the Explanatory Memorandum that ISA requirements (or application material) “cannot be used to “top-up” ED-ISA for LCE”. While, quite rightly, there is no requirement to use the ISAs, or any other standards, beyond the ISA for LCE, auditors can always choose to do more than is set forth in the ISA for LCE and draw on any sources they wish to guide them to do so – including the ISAs or other standards. If, for example, an entity that qualifies as an LCE happens to have a single individual as an internal auditor, this should not preclude an auditor from applying the ISA for LCE and then choosing to draw on other standards and guidance (including the ISAs) without being required to do so to seek to address the situation. We address this matter further when dealing with the scope of the standard in our response to Question 3 (c) in Section 4 B.

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The other matter mentioned in Section 4A that we would like to address relates to the need to obtain reasonable assurance. We support the view that the objective of a standard for LCE audits is for the auditor to obtain reasonable assurance that the financial statements are prepared, in all material respects in accordance with the applicable financial reporting framework. However, the IAASB needs to recognize that reasonable assurance is not a concept that (other in cases of sampling risk) can be numerically defined, and that reasonable assurance represents a range based upon cost-benefit decisions at assertion level (for further literature on this issue we refer to two FEE papers that, among other matters, explore the meaning of reasonable assurance¹). Not only do no two audits obtain precisely the same level of assurance, but even the same audit performed by two different auditors does not lead to precisely the same level of assurance – indeed, precisely the same level of assurance is not even attainable for different assertions. What matters is the impact on the assurance obtained using the LCE standard compared to the assurance obtained from applying the ISAs. If properly written so that the LCE standard covers those matters relevant to audits of financial statements of LCEs, compared to the application of the ISAs, the application of an LCE standard should have virtually no impact on the assurance obtained and the resulting report in the vast majority of audits of financial statements of LCEs: there is no perfect solution beyond this. In our view, this is the reasonable public interest test that the IAASB should use in determining which entities should qualify as LCEs and what the requirements for LCE audits should be.

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?

We agree with the proposed conforming amendments to the IAASB Preface with the one minor exception of the words “may also encompass” in the first sentence of paragraph P7. The second sentence deals with situations when the financial reporting framework encompasses standards as well as law or regulation. In line with paragraph A5 of ISA 200, the first sentence of P7 deals with situations when the financial reporting framework encompasses financial

¹ See FEE Issues Paper „Principles of Assurance: Fundamental Theoretical Issues with Respect to Assurance in Assurance engagements,” FEE (now Accountancy Europe), April 2003; and “Selected Issues in Relation to Financial Statements Audits, FEE, October 2007).

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reporting standards or alternatively law or regulation. Consequently, the words “may also encompass” should be deleted.

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?

We believe that the Authority (or scope) of the proposed standard is implementable at a jurisdictional level. Nevertheless, additional jurisdictional requirements and guidance need to be provided for implementation at a national level in Germany. However, since the Authority contemplates jurisdictional requirements and guidance (e.g., in relation to the types of entity and their size), the Authority has in most cases gone as far as it can. However, as we note in our comments on the Authority below, we do believe that significant improvements can be made to the Authority.

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

One of the issues that may arise is that there may be pressure on local authorities or standard setters to not restrict the application of the LCE standard beyond those restrictions already set forth in the Authority. Given the views we express in (a) above in relation to implementability, it may therefore be helpful if the IAASB expresses in the Authority the IAASB’s expectation that local authorities or standard setters will provide additional requirements and guidance on scope as described in the examples of jurisdictional determination of the Supplemental Guidance for the Authority of the [Draft] Standard.

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

We believe that the sixth bullet in paragraph A.9 can be clarified by referring to the far-right column of the table in Appendix 6 of ISA 315 (Revised 2019) in relation to large or complex IT applications, which should preclude the use of the LCE standard. We do not believe that referring to the ISAs to delineate the scope of application of the LCE standard in this respect would cease making the LCE standard a stand-alone standard. In addition, the seventh bullet in paragraph A.9 can be clarified by referring to the need to apply an expected loss model or to value complex financial instruments for which there are no robust market prices.

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A further matter requiring clarification relates to circumstances when a matter arises that is not covered by the LCE standard. These circumstances need to be made explicit in the criteria (such as not having any internal audit as defined in ISA 610). Furthermore, requirements and guidance need to be given as to what auditors need to do when such circumstances not covered do arise, such as when an entity has a single individual as an internal auditor. Even though the LCE standard does not cover internal audit, an auditor should not automatically be unable to apply the LCE standard just because a matter is not covered in that standard. One way of dealing with this issue is to provide additional requirements in a separate section or “conditional modules” for such circumstances.

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

We are not convinced that most stakeholder groups will consult the Authority when considering the scoping of the standard. At most, we expect practitioners, national standard setters, and regulators to consult the Authority to inform themselves about the scoping. Other stakeholders would need to be informed by IAASB outreach and other promotional activities – in particular in relation to the achievement of reasonable assurance by the LCE standard.

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

We believe that the proposed role of legislative or regulatory authorities, or relevant local bodies with standard setting authority, is clear and appropriate, but the IAASB should augment the Authority to explain the IAASB’s expectation that local authorities or standard setters will provide additional requirements and guidance on scope as described in the examples of jurisdictional determination of the Supplemental Guidance for the Authority of the [Draft] Standard.

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

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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.

With the exception of the exclusion for group audits (see our responses to questions posed in Section 5 below) and the matters explained below, we agree with the specific prohibitions and that these need to be supplemented by local authorities or standard setters.

In line with the current discussions at IESBA, which we expect to be reflected in the final Code of Ethics, we believe that the specific prohibitions in paragraph A.7 (c) (iii) and (iv) should be deleted, because these types of entities need not be associated with the public interest characteristics and are not always complex.

With respect to the qualitative characteristics, we note our comments to 3 (c) above on the clarity of paragraph A.9 and the need to deal with circumstances not covered by the LCE standard. We also believe that clarification is required that the existence of a qualitative characteristic may not give rise to complexity on its own, but that the aggregate impact of characteristics needs to be considered by the auditor when considering the appropriateness of using the LCE standard.

5. *Regarding the Authority Supplemental Guide:*

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

We believe that the guide is helpful in understanding the Authority.

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

No.

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

We have no further comments on the Authority.

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).

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We agree with using the ISAs as a basis and retaining a risk-based audit approach to obtain sufficient appropriate audit evidence and therefore reasonable assurance. We also agree that those requirements not relevant to LCEs should not be included, but as we note in our response to Question 9 below, we believe that the IAASB could have considerably simplified risk identification and assessment for audits of LCEs and strengthened the ability of auditors to reduce unnecessary documentation. As we note in our response to Question 10, we have concerns that the objective of the IAASB to reduce the length of the standard led to a severe truncation of the requirements in relation to the auditor's report together with the prescription of the specified wording and format of the auditor's report, which upsets the careful balance between specificity and flexibility that the IAASB achieved in ISAs 700, 705, and 706.

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

We support the reduction of the number of objectives by aggregating them for each audit phase. When writing our draft German LCE standards, we also considered whether setting separate objectives for each separate standard would be helpful. We decided that the key requirements in relation to risk assessment, risk response and reporting serve almost like objectives and therefore we chose not to have objectives for each standard.

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

We agree with the principles and approach taken in relation to professional skepticism, professional judgment, and relevant ethical requirements. Since these apply throughout the engagement, in the German LCE standards we placed these in the first operational standard (AuSLCE 2 – see our response to Question 8, which deals with the fact that the German LCE standards are a set of standards, rather than one standard), which covers the overarching requirements that apply throughout the audit. In contrast to the IAASB LCE standard, we chose to allocate the quality management requirements to those standards representing the important milestones of the audit, which means that engagement partner responsibilities are largely included in the AuSLCE 2, but some quality management requirements are included in other standards as appropriate to reflect the audit process, such as planning. We believe that the IAASB should also allocate the quality management requirements to that part of the audit process to which they apply (e.g., to audit planning).

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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.**

We would like to commend the IAASB for having reduced the application material by such a large amount, which makes the LCE standard easier to read. However, one of the most important ethical requirements in the Code of Ethics is that professional accountants – including auditors – are professionally competent and exercise due care. There is therefore a presumption in the ISAs, and there ought to be a presumption in the LCE Standard, that engagement partners and any senior staff on an audit have the needed professional competence, which includes having an understanding of the applicable auditing standards and considerable experience in applying them. Furthermore, auditing and quality management standards are never applied directly at the level of an individual audit: the requirements in the LCE standard form a basis for firm methodologies and as a reference for auditors when seeking to apply those methodologies. For these reasons and given the fact that we are dealing with a simpler LCE environment, as a matter of principle, we believe that auditors ought to have the requisite competence through extensive education, training, and experience to apply the LCE standard without any additional explanatory guidance. However, there are matters, such as the so-called “negative requirements” in the application material of the ISAs and statements of a crucial nature for the benefit of third parties (such as regulators), that do need to be included in an LCE standard.

For these reasons, when writing the German LCE standards, we limited the essential explanatory material (EEM) to such negative requirements and statements of a crucial nature for the benefit of third parties. On this basis, we believe that the nature and extent of the EEM in the IAASB LCE standard to be excessive and unnecessary because the principles in paragraph 90 of the Explanatory Memorandum are too broad. On the other hand, some important material is missing – particularly in relation to the so-called “negative requirements”. Our response to Question 9 provides further details. We are less concerned with the presentation of the EEM, as long as it is clear that this material does not represent requirements.

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).*

We do not believe that the organization, structure or numbering of the IAASB LCE standard is sufficiently conducive to navigation or the design of simple audit methodologies for the audits of financial statements of LCEs. For the German LCE standard we used the following structure in separate standards that is much more closely aligned to the audit process:

- AuSLCE 1 Scope and Preface (This standard includes a description of audits, the overall objectives of the auditor, requirements for the scope of the standard, and an authoritative appendix with the definitions)
- AuSLCE 2 Overarching Requirements (This standard includes all requirements that apply throughout the audit are therefore integrated into the audit process, including overarching communication and documentation requirements)
- AuSLCE 3 Preconditions of an Audit, Audit Planning and Preparatory Activities (This standard includes engagement acceptance, planning and the determination of materiality)
- AuSLCE 4 Identification and Assessment of the Risks of Material Misstatements (This standard includes all requirements related to understanding the entity and its environment, risk identification and risk assessment, and the related documentation; an appendix is included with material on assertions and inherent risk factors)
- AuSLCE 5 Responses to Assessed Risks (This standard includes all requirements related to responses to assessed risks, including dealing with misstatements, and related documentation)
- AuSLCE 6 Concluding Auditing Procedures, Communication with Those Charged with Governance and Obtaining Written Representations (This standard includes the noted matters)
- AuSLCE 7 Forming an Opinion, Auditor's Report and Archiving (This standard includes the noted matters)

The German LCE standards (without the German specialties, such as the assurance on the management report) comprise 7 standards compared to 9 sections for the IAASB LCE standard. Having 7 separate standards based upon the actual audit process increases clarity and eases the sequential numbering of

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paragraphs: the numbering system for the IAASB LCE standard is very cumbersome for navigation and referencing. Furthermore, by having separate standards it may be easier to add additional conditional modules as needed (e.g., if the entity has an internal auditor or the audit is a group audit).

While we agree with combining the requirements of the ISAs to the extent they can be combined (e.g., combining risk assessment procedures or responses to risk from different standards from the ISAs), we are concerned about the application of the CUSP principles to the LCE standard without having done so on a retroactive basis for the ISAs. When writing our German LCE standard, we discovered that seeking to simplify the wording of existing requirements in the ISAs leads to confusion because sometimes changes in wording can be construed to mean that less or more needs to be done than required by the original wording – sometimes the simplified wording is just more ambiguous than the original. For these reasons, in the German LCE standard, we took the view that if a requirement applies without exception to an LCE audit, then the wording in the existing ISAs should be used to prevent confusion. We therefore recommend that the IAASB revert to the original ISA wording in its LCE standard to the extent that an entire requirement from the ISAs applies. We recognize that this may increase the length of the LCE standard slightly, but this is a small price to pay for clarity.

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.*

Part 1

The requirement in paragraph 1.4.1. requires the auditor to comply with all relevant requirements. One major criticism by SMPs is the fact that some audit oversight authorities and audit regulators often ask auditors to justify (and document) why auditors have regarded certain requirements as not being relevant, even though the ISAs do not require such justification. To combat this tendency among audit oversight authorities and audit regulators, the German LCE standards augment the requirement in paragraph 1.4.1. with a negative requirement that states: “The auditor need not justify [to others] why a requirement is not relevant in the circumstances unless significant professional judgment is required to determine this relevance.” While this “negative

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requirement” in effect applies in the ISAs, we believe that in an LCE audit environment, it is crucial that this be made explicit and therefore recommend that the IAASB incorporate such a negative requirement (which could be in the EEM) in its LCE standard.

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

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

Part 2

In line with our proposed negative requirement for Part 1, we recommend that the IAASB explicitly limit the documentation required for LCE audits for cases when the auditor decides that a requirement is not relevant by adding a negative documentation requirement using the following words “The auditor need not document why a requirement is not relevant in the circumstances unless significant professional judgment is required to determine this lack of relevance.”

Given the definitions taken up in the Appendix, we believe that the EEM to paragraph 2.2.2. is unnecessary and can be deleted. We also believe that competent auditors will not need the EEM to paragraphs 2.3., 2.3.1., 2.5.1. (c) and that this EEM can be deleted. However, in line with the approach taken in the German LCE standard, we do believe that Part 2 of the IAASB LCE standard should include EEM for the negative requirements in relation to documentation currently in ISA 230 paragraphs A4, A7 (second and third sentences), A16 (second sentence), and A19.

Part 3

As we noted in our response to Question 7 (c), in contrast to the IAASB LCE standard, in the German LCE standards we chose to allocate the quality management requirements to those standards representing the important milestones of the audit, which means that engagement partner responsibilities are largely included in our first operation standard AuSLCE 2, but some quality management requirements are included in other standards as appropriate to reflect the audit process, such as planning. We believe that that IAASB should also allocate the quality management requirements to those parts of the audit

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process to which they apply (e.g., to audit planning). As a result, we are not convinced that a separate Part 3 is necessary.

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). Most of these engagements may not be subject to a separate engagement quality review. For quality management, small and medium-sized practitioners will most likely have less formal processes that are supplemented by other sources such as guidance from professional accounting organisations and consulting colleagues in other firms.

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 network's monitoring and remediation processes and engagement quality reviews should be presented as conditional requirements at the end of this section or in a separate module for cases when these are relevant.

Part 4

Given the close relationship between acceptance and continuance, activities that need to be undertaken for initial audit engagements, and planning, we are not convinced that a Part 4 separate from Part 5 is needed. This is why in our German LCE standards, we merged these parts into a single standard. We also believe that the requirements in Part 4 for the engagement letter should cover the eventuality that, as the audit progresses, the auditor determines that the LCE standard is no longer applicable and therefore a transition to the use of the full ISAs may be necessary. This may need to be augmented by some clarification that if the full ISAs need to be applied, then these need to be applied in their entirety as relevant, but that auditors may use the audit work that they have already completed in seeking to comply with the full ISAs.

Part 5

In relation to the requirements on materiality we believe that the text from paragraphs 2, 3 and 4 from ISA 320 needs to be taken up as EEM because this text forms the basis for all materiality decisions. We agree with the other EEM that was included in this Part. Additional application material in ISA 320 that might be needed by auditors should be included in non-authoritative guidance, rather than in the EEM of the LCE standard.

Part 6

Based upon our experience in drafting the German LCE standards, we believe that risk assessment is the area in the IAASB LCE standard that requires the greatest improvement in terms of performing the audit – that is, where requirements can be condensed, simplified, or removed without affecting the assurance obtained for the vast majority of LCE audits. In particular, we note the following issues:

- As we had predicted in our comment letter dated 13 November 2018 to the exposure draft of ISA 315 (Revised 2019), our experience with practitioners indicates that very few practitioners – and particularly no practitioners of which we are aware from SMPs that audit the financial statements of LCEs – are in a position to understand the intricacies and interplay among the definitions and requirements of ISA 315 (Revised 2019). While this is not a serious issue for those firms that are members of larger international networks with highly qualified methodology departments that can faithfully convert the definitions and requirements of ISA 315 (Revised 2019) into an operationalizable methodology, most SMPs do not have the technical resources to obtain an adequate understanding of that standard or perform this conversion into a workable methodology. For these reasons, when drafting our German LCE standards: we changed the definitions of inherent and control risk to eliminate double-counting of thresholds; changed and augmented definitions of assertions to distinguish more clearly between assertions actually made by management, those required, and those used by the auditor; added definitions of “relevant risks of material misstatement” (for both financial statement and assertion levels) and “relevant inherent risks” to signify those risks that have been assessed as not being acceptably low to align with ISA 200 and ISA 330 paragraph A4 second last sentence; and deleted the definition of “relevant assertion” and adjusted the definition of significant classes of transactions, account balances and disclosures to reflect those that contain at least one relevant inherent risk. These changes in the definitions permit a simplification of the requirements and facilitate an understanding of these, as well as permitting further simplifications (see third bullet point below). We believe that the IAASB should consider similar simplifications and restructuring.
- The main reason for the requirements for the “evaluation” of the control environment, risk assessment, monitoring, and information and communication, components of internal control in paragraphs 21 (b), 22

(b), 24 (c), and 25 (c) in ISA 315 (Revised 2019) is that such a detailed evaluation (which, pursuant to the Glossary of Terms encompasses an analysis and additional audit procedures as needed) is needed for more complex systems of internal control. By definition, LCEs do not have such complex systems of internal control. This implies that auditors need not perform such an evaluation in an LCE environment – rather, based upon fulfillment of the requirements in paragraphs 21 (a), 22 (a), 24 (a) and (b), and 25 (a) and (b), a consideration by the auditor of whether these components of internal control are adequate for the purposes of the entity suffices. For these reasons, in line with our German LCE standards, we believe that the IAASB LCE standard should no longer require the noted evaluations of these components of internal control, but rather only a consideration thereof.

- We believe that the requirement for a separate identification of risks of material misstatement at the assertion level (i.e., inherent risks, in which the likelihood and magnitude of a material misstatement is reasonably possible – *we note that the LCE standard does not include the application material from the conforming amendments from ISA 315 (Revised, 2019) to paragraph A15a of ISA 200, which leaves the LCE standard without an appropriate threshold for its model of risk identification*) and assessment of those risks, together with separate documentation of the identified and assessed risks, is overengineered for LCE audits, because by definition the inherent risks for an LCE are simple and therefore easy to identify and assess. Consequently, in line with our German LCE standards, we strongly recommend that the IAASB set forth a combined identification and assessment of inherent risks and define those inherent risks requiring a response (i.e., an inherent risk relevant to the audit, or “relevant inherent risk”) as those with a greater than acceptably low level of risk of material misstatement. This approach would greatly reduce the bureaucracy associated with the audits of financial statements of LCEs from the introduction of ISA 315 (Revised 2019) without discernably reducing the assurance obtained for the vast majority of LCE audits.
- The significant classes of transactions, account balances and disclosures should be redefined as those that contain an inherent risk that exceeds an acceptably low level of material misstatement (a relevant inherent risk), rather than one with a reasonable possibility of a material misstatement, which is a much lower threshold. This change would often lead to the required understanding of the information processing activities to a somewhat smaller set of such processing

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activities that are now defined as significant (i.e., only those with an assertion that has a greater than acceptably low level of risk of material misstatement). Given the simpler nature of processing activities at LCEs, this change would not result in a discernable reduction in the assurance obtained for the vast majority of LCE audits.

- Since inherent risks are so much simpler to identify and assess in LCEs, there is no need to identify controls in the control activities component and perform tests of design and implementation of those controls to assist the auditor in identifying and assessing inherent risks for risks that have been assessed as significant risks (which represents a circularity within ISA 315 (Revised 2019), since the auditor needs to assess the risks as significant risks prior to identifying controls). For these reasons, unless auditors plan to test the operating effectiveness of particular controls (whether due to efficiency or because substantive procedures alone do not provide sufficient appropriate audit evidence), we do not believe auditors need to test the design and implementation of controls addressing significant risks. We therefore believe that (a) and (d) in paragraph 6.3.14 can be deleted without reducing the assurance obtained in LCE audits.

Based on our proposals in the bullet points above, with the exception of the second sentence of the EEM to paragraph 6.1.1. and the EEM to paragraphs 6.2.1., 6.2.2., 6.3.5., the second paragraph within 6.3.5., 6.8. and 6.8.1. (c), the EEM in Part 6 is not needed and can therefore be deleted.

Part 7

We note that if the IAASB were to follow our proposals for Part 6, then the wording for Part 7 would be simpler and easier to understand, as is the case in our German LCE standards. It seems to us that paragraph 7.4.16. is redundant, because it is covered by the general requirement to respond to assessed risks of material misstatement. We also believe that all of the EEM included is not necessary and can be deleted with the exception of that to paragraphs 7.3.6., 7.4.1., 7.4.5., 7.5.1., and 7.6.1. However, we do believe that the application material in the second last sentence of paragraph A4 of ISA 330 from the conforming amendments to ISA 315 (Revised 2019) needs to be included in the EEM to clarify that auditors need not respond to risks of material misstatement that are assessed at an acceptably low level (of course, if the IAASB were to restructure Part 6 and the related definitions as we propose above, this would not be necessary). In addition, we also believe that the application material to

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ISA 500 paragraph A53 should be introduced prior to paragraph 7.3.5. to clarify the difference between sampling and other selection.

Part 8

In relation to paragraphs 8.4.5. and 8.4.6., we note that paragraphs 12 and 15 of ISA 560 allow the auditor to dual date the auditor's report or amend the auditor's report, which is not the same as issuing a new auditor's report as required by paragraph 8.4.5. This applies not only to matters becoming known before the date the financial statements are issued, but also for facts which become known to the auditor after the financial statements have been issued. For these reasons, we believe that paragraphs 8.4.5. and 8.4.6. need to be augmented to recognize that auditors may not only issue new auditors' reports, but may also dual date an auditor's report or amend an auditor's report.

The following requirements can be removed because they are redundant:

- Paragraph 8.5.2. (c), which requires the engagement partner to evaluate that sufficient appropriate evidence has been obtained with respect to accounting estimates. This is already covered by paragraph 8.5.5. where the auditor is required to make the same evaluation.
- Paragraph 8.8.3, which requires the auditor to communicate to those charged with governance significant matters arising during the audit in connection with the entity's related parties. This is already covered by paragraph 8.8.2 (c) and (d).

We also believe that the EEM to paragraphs 8.5.1. and 8.5.3. is not needed and can therefore be deleted.

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.**

With respect to b) regarding the approach to include a specified format and content of an unmodified auditor's report as a requirement, we note that our discussions with our stakeholders when we drafted our German LCE standards and discussed the IAASB LCE standard indicated to us that, since both sets of standards are designed to achieve reasonable assurance, there should be no difference between the requirements for reporting under the ISAs and reporting

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under both sets of LCE standards (other than the reference to the LCE standards rather than the ISAs), because any differences might be construed as indicating that the results of the audit may be different. While we recognize the efforts of the IAASB to keep its LCE standard short by using a required specified format and content, from our point of view it is much more important that the requirements are the same, because when writing the requirements for ISAs 700, 705 and 706, the IAASB sought a very delicate balance between definitive requirements with respect to wording and flexibility in the wording for an international environment – flexibility that is often needed at a national level. By seeking to include a specified format and content as a requirement, we believe the IAASB has upset this balance. It is for these reasons that – despite the length of the reporting requirements in ISAs 700, 705 and 706 – we chose to include all of the relevant requirements in our German LCE standards, rather than seeking short-cuts. Also for these reasons, we do not believe that including a specified format and content for an unmodified auditor’s report as a requirement is a tenable solution at an international level. Therefore, we believe that the IAASB should include all of the relevant reporting requirements from the ISAs in its LCE standard, rather than requiring a specified content and form. Doing so would also ensure the completeness of the requirements.

We also note that the presentation of the required report with “footnotes” as requirements may make it difficult to adopt the standard in some jurisdictions – particularly those jurisdictions in which the requirements need to be in form of a statutory or regulatory instrument of some sort – which is another reason why the requirements rather than a required specified content and form ought to be used.

With respect to a) regarding the presentation and content of the rest of Part A, we note that the use of the tables instead of the requirements as written in the ISAs may make it difficult to adopt the standard in some jurisdictions – particularly those jurisdictions in which the requirements need to be in form of a statutory or regulatory instrument of some sort.

In relation to a) as well, we have identified a number of matters related to lack of completeness of Part 9:

- Paragraph 9.4.1.(a) does not specify what the “significant elements of the specified format and content” are. Paragraph 50 of ISA 700 listed the specific elements that need to be included with great care for circumstances when law or regulation of a particular jurisdiction prescribe the layout or wording of the auditor’s report. We therefore

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recommend that the elements listed in paragraph 50 be included in Part 9.

- Part 9 ignores the important role national standards have for auditor reporting as reflected in paragraphs 51 and 52 of ISA 700: often it is national standard setters that adopt and, as necessary, adapt standards – and in particular auditors’ reports – for their jurisdiction and then create national standards that – to the extent legally possible – are in compliance with the ISAs. Even when the IAASB LCE auditing standard is adopted, in many cases reference will be made in the auditor’s report to national standards that have adopted the LCE auditing standard in some way and that references to the IAASB LCE standard will be in addition to – rather than instead of – the reference to the national standard adopting the IAASB LCE standard. We therefore strongly recommend that paragraphs 51 and 52 of ISA 700 be included in Part 9 of the IAASB LCE standard.
- Missing from Part 9 is the requirement in paragraph 15 of ISA 705 prohibiting piecemeal opinions when expressing an adverse opinion or disclaimer of opinion on the financial statements as a whole. By not including this prohibition, auditors might issue such piecemeal opinions in auditors’ reports under the LCE standard, which would undermine LCE audits. We therefore recommend that paragraph 15 of ISA 705 be included in Part 9.
- Also missing from Part 9 is the requirement in paragraph 27 of ISA 705 that requires all matters that would lead to a modification to be included in the auditor’s report when the auditor expresses an adverse opinion or disclaimer of opinion. This requirement had been introduced to prevent the practice of management masking important matters in the financial statements from stakeholders by forcing an adverse opinion or disclaimer of opinion. We therefore recommend that paragraph 27 of ISA 705 be included in Part 9.

In relation to c), we agree with the approach of providing example auditor’s reports in the non-authoritative Reporting Supplemental Guide. Normally, auditors of financial statements of LCEs will draw on example reports to draft their auditors’ reports. However, this is not a substitute for ensuring the needed requirements from ISAs 700, 705 and 706 are within the standard so that when special circumstance arise, auditors are in a position to consult the requirements to ensure that there are no differences between reports for audits performed using the ISAs and audits performed using the IAASB LCE standard.

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We believe that with the exception of the EEM to paragraphs 9.5. and 9.5.1., all of the EEM is not needed and can therefore be deleted.

11. With regard to the Reporting Supplemental Guide:

a) Is the support material helpful, and if not, why not?

We believe that the support material is helpful, but it need not and should not repeat the requirements that are – or ought to be – in the LCE standard.

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

We believe that all of the relevant reports in the ISAs should also be included in the support material.

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.

We have no additional comments with respect to improving the standard within Parts 1-9 beyond those provided in our response to Questions 9 and 10 above.

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?

As noted in our response to Part 4 of Question 9, we believe that there needs to be a requirement for the terms of engagement to deal with situations when, during an LCE audit, the auditor determines that the LCE standard is not appropriate. In addition, as we note in our response to Question 3 c) above, clarification is needed in relation to circumstances when a matter arises that is not covered by the LCE standard. These circumstances need to be made explicit in the criteria (such as not having any internal audit as defined in ISA 610). Furthermore, requirements and guidance need to be given as to what auditors need to do when such circumstances not covered do arise, such as when an entity has a single individual as an internal auditor or does issue other information. Even though the LCE standard does not cover internal audit, an auditor should not automatically be unable to apply the LCE standard just because a matter is not covered in that standard. One way of dealing with this

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issue is to provide additional requirements in a separate section or “conditional modules” for such circumstances.

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

We note that the process for transitioning is explained in the Explanatory Memorandum. This process can be included in non-authoritative guidance that addresses the steps that may be necessary.

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

Our experience with revisions to the ISAs since the auditor reporting and disclosures project (revisions of ISA 540, ISA 315, and ISA 600) indicates that standard setting projects in relation to the ISAs are being largely driven by regulatory concerns regarding audits of listed entities, banks, and insurance companies. This is a main source of the increasing complexity of the ISAs. Consequently, there is a danger in establishing a process that automatically engenders a project for revisions to the LCE standard when revisions have taken place to the ISAs, which would ultimately lead to greater length and complexity for the LCE standard beyond that required for LCE audits. For these reasons, we believe that there needs to be a robust and timely process for determining which, if any, of the changes to the ISAs are actually needed for audits of financial statements of LCEs. We therefore expect that over time there will need to be an increasing divergence between the length and complexity of the ISAs and those of the LCE standard.

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

With the exception of major changes in reporting requirements, early adoption should be allowed so that LCE audits benefit from the latest thinking on such audits. Like for the ISAs, we do not believe in early adoption of major changes in reporting requirements because having comparable auditors' reports in the market, rather than varying ones, is important in preventing confusion among stakeholders.

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

At the present time, we believe that the LCE standard should be limited to audits of complete sets of general purpose financial statements. If the IAASB determines that there is market demand (which we believe there is) for audits of

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special purpose financial statements, or of single financial statements or elements of financial statements, of LCEs, then the IAASB should commence a separate project to augment the LCE standard for modules that cover ISAs 800 and 805. We are not convinced that ISA 810 is relevant to most audits of financial statements of LCEs.

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:

- ***Whether the proposed standard can, and will, be used in your jurisdiction.***

There is a high demand for a separate standard or set of standards for audits of LCEs in Germany. However, whether or not the LCE standard can and will be used in our jurisdiction for other than voluntary audits will depend upon the quality of the LCE standard from our point of view. We have addressed a number of very important issues in our comments above that we believe need to be dealt with adequately by the IAASB for the LCE standard to be fit for purpose in our jurisdiction. In particular, if our comments in response to

- Question 3 c) and 4 b) on dealing in at least in a modular manner with circumstances when a matter arises not covered by the LCE standard,
- Question 8 in relation to the departures in wording from the ISAs that lead to a different understanding of the requirement than in the ISAs,
- Question 9 relating risk identification and assessment in Part 6,
- Question 10 on audit reporting in Part 9, and
- Our response to the issue of group audits in Section 5 below

are not adequately dealt with, we will likely not see ourselves in a position to adopt the IAASB LCE standard. If, however, these matters are adequately dealt with in the final IAASB LCE standard, we would certainly adopt the standard as a basis for further customization at a national level as contemplated in the LCE standard, and as a result may even lead to the withdrawal our own German LCE standard.

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

In our view, unless the issues addressed in our response to a) above are adequately dealt with, we do not believe that the proposed standard meets the

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needs of auditors, audited entities, users of audited financial statements, and other stakeholders, in our jurisdiction. If the final LCE standard adequately deals with these issues, then we believe that that standard would meet those needs.

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

See our response to the questions above, and in particular to 17 a) above.

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?***

There are no other matters that we wish to address.

Section 4G – Approach to Consultation and Finalization

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

At the IDW, we are in a position to provide the support and guidance needed for our practitioners to implement the proposed standard. In our view, the current non-authoritative guidance in the authority and reporting (amended and augmented as we suggest in our responses above) should suffice at an international level.

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.***

We have not identified any translation issues that we have not already identified for the translation of the full ISAs.

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.***

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We agree that given the need for national due process and translation, as well as to provide support for effective implementation, an effective date beginning at least 18 months after the approval of the final standard is appropriate. We also agree that earlier application ought to be permitted.

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.

We very much agree with the IAASB's approach of not addressing group audits within the draft LCE standard until ISA 600 (Revised 2021) is issued and providing an opportunity to stakeholders to address the issue in the responses to the Explanatory Memorandum because, as the LCE standard was being drafted, there were ongoing discussions at the IAASB about the scope of application of ISA 600 that could have an impact on the scope of the LCE standard. While in the older ISA 600, the application material in paragraph A2 pointed to the inclusion of branches and divisions to being within the scope of ISA 600, depending upon how the group is structured, and paragraph 10 of the definitions section of ISA 600 referred to the consolidation process, there continued to be some uncertainty (at least among some regulators and practitioners) about the scope of application of ISA 600 with respect to branches and divisions.

Now ISA 600 (Revised 2021) has been finalized by the IAASB and clarity has been achieved around its scope of application: even if financial statements do not need to include the financial information of consolidated subsidiaries, entities accounted for by the equity method, or entities proportionately consolidated, if the financial statements of an entity include the financial information of branches and divisions by means of a consolidation process, then those financial statements are group financial statements. This implies that there is more clarity about the fact that many entities that would otherwise qualify as LCEs would have group financial statements as defined in ISA 600 (Revised 2021). Furthermore, there are many simple groups and therefore simple group audits for which a scalable approach to the audit as set forth in the LCE standard would be appropriate. For these reasons, we have concluded that certain kinds of group audits relating to simple groups should be included within the scope of the LCE standard.

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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:

Would you use the standard if group audits are excluded? If not, why not?

While we did not include group audits in our initial draft of the German LCE auditing standards, we do intend to augment those standards to include group audits for simple groups. Consequently, subject to our other issues in relation to the IAASB LCE standard as noted in our responses to the questions above, our practitioners believe that the scope of application and therefore use of the IAASB LCE standard would be significantly reduced if simple group audits were not included.

a) 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?

There are no statistics upon which our practitioners would be able to draw to provide an approximate percentage of audits that would be group audits under ISA 600 (Revised 2021) for which the LCE standard could otherwise be applied. However, given the very large number of entities (commercial proprietors and commercial partnerships as well as small and limited liability companies in Germany that have voluntary audits or mid-sized limited liability companies that are subject to statutory audits) with branches or divisions for which financial information is aggregated into the financial statements of those entities, we expect the number of such entities to be a substantial proportion of those entities that would otherwise qualify as LCEs.

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

Common examples of one or more characteristics of group structures and circumstances within the practices of our practitioners for groups that would otherwise be considered a less complex group may include:

- Entities or business units (in particular, branches or divisions) operating within one or few (similar) jurisdiction(s), such as within the single EU market
- Few entities or business units that need to be consolidated into the group financial statements

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- No or little involvement of component auditors needed, for example, when the entities and business units of the group are at the same location
- Local expertise is not needed
- Simple consolidation process.

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.**

We prefer an augmented Option 2 because proxies for complexity may not cover all complexity issues. Option 2 could be augmented by referring to the need to use component auditors.

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?

No, we believe that our response to Question 24 covers the matter.

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.**

From our point of view, this a matter of technology. Part of our planning for the German LCE standards included considering the creation of modules of requirements for specific circumstances beyond the customization of our current draft German LCE standards (e.g., group audits and internal audit). When these modules apply, an auditor should be able to click that these modules apply, and the relevant requirements would then automatically be inserted into the

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appropriate places in German LCE standards. The IAASB may wish to consider such a technological approach so that the appropriate requirements are placed into the appropriate place within each part of its LCE standard.

If such technology is not readily available, another option we are considering for our German LCE standards is to add a module with the appropriate requirements in one place to the German LCE standards. If the IAASB followed this approach, it would involve adding a module (perhaps a separate Part) with the relevant requirements. This can even be done soon after the LCE standard without requirements for group audits has been issued to not delay the issuance of the LCE standard.

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Appendix 2: IDW Approach to Its LCE Standards and Crucial Differences to the IAASB LCE Standard

The Steps Applied by the IDW in Writing the German LCE Standards:

1. Set the parameters regarding the type, complexity and size of entity for which the financial statements are being audited
2. Remove from the pool of standards all those standards that are not applicable (e.g., ISA 610)
3. Remove requirements from the remaining standards that are not applicable given the parameters set
4. Allocating the requirements to major milestones (milestone standards: see response to Question 8 in Appendix 1 to the comment letter)
5. Reordering of the requirements within the milestone standards and connecting them so that they flow properly
6. Rewrite the remaining requirements to make them more directed to, and more proportionate for, the type of entity in question – in particular in relation to risk identification and assessment and auditing accounting estimates
7. Move the remaining applicable definitions to a glossary in an appendix
8. Filter out application material that is purely educational, covers banal matters, etc. or otherwise not deemed to be necessary
9. Write the first standard setting the scope of application of the standard.

The following matters represent major differences of the German LCE standards from the IAASB LCE standard:

- The IDW restricted the use of German LCE standard based upon much clearer criteria due to the particular German legal situation – in particular, for example:
 - The IDW used the EU definition of a PIE (and the IAASB definition of listed entities) to scope out entities, which makes such scope-outs really clear. The IDW also restricted the use of German LCE standard to mid-sized limited liability companies (and smaller ones) and to commercial partnerships – stock corporations and large

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- limited liability companies are excluded. The IDW used the EU size criteria to determine what a mid-sized limited liability company is.
- o The standard is applicable only to entities that use German Legally Required Accounting Principles (which are simpler than IFRS) – i.e., other financial reporting frameworks, such as IFRS, are out of scope.
 - o The entity should not have any transactions or balances involving derivative financial instruments.
 - o The entity does not have a complex IT as described in Appendix 6 of ISA 315 (Revised 2019).
- When a requirement from the ISAs was deemed applicable, the IDW chose not to rewrite the requirement so as to not reduce the clarity of what is required. The IAASB attempted to shorten the requirements using CUSP principles that had not yet been fully agreed by the IAASB. In our view, this led to situations in which it is unclear whether the requirement in the LCE standard required the same thing as the ISA requirement – in some cases it could be interpreted as requiring less or more, or it was unclear. The IDW is more concerned about clarity than the optics of length alone.
 - The IDW retained separate standards for the milestones, rather than seeking to include everything into one standard (which makes the paragraphing and paragraph references more difficult)
 - The IDW chose to retain all of the requirements for reporting because most practitioners just draw on the example reports and only refer to the reporting requirements when they run into matters requiring adjustment to those example reports – the IDW were less concerned about the optics of having less requirements and more concerned about having consistent reports when reports require adjustment. In addition, the IAASB approach of requiring very specific wording through a report upsets the balance between specific wording and the flexibility needed for the adoption of an international standard at national level.
 - In terms of performing an audit, the German LCE standards have the following major differences from the ISAs and the IAASB LCE standard:
 - o Because one is dealing with entities with simpler accounting requirements and systems, the IDW permitted a combined identification and assessment of risks of material misstatement at the financial statement level and of inherent risks and to identify significant classes of transactions, account balances and

disclosures. This has the added advantage of not needing to deal with the “reasonable possibility” threshold. The IDW also needed to change the definition of inherent and control risks, as well as of relevant assertions to do this because under the IAASB definitions, these exist only if material misstatements are reasonably possible. The IDW believes this will allow major reduction in work effort and documentation for the audit of LCEs without a significant (if any) reduction in the level of assurance obtained

- o The IDW only requires a consideration of the internal control components, rather than an evaluation (as defined in the IAASB Glossary of Terms) because for simple entities, such an evaluation is not needed. This should also reduce some work effort and documentation.
- o The IDW does not require the identification of controls (in the control activities component) for significant risks because the IDW believes that for these simple entities, auditors will be in a position to identify and assess the risks of material misstatement (prior to considering controls) without testing the design effectiveness and the implementation of these controls. The IDW also deleted the requirement to identify other controls (see paragraph 26 (a)(iv) in new ISA 315), since we believe this is superfluous: if auditors need to test the design effectiveness and implementation of such controls for other reasons, they would be required to do so by the overall objective of the standards, and cases where this would be applicable less complex entities would be very rare. However, the IDW retained the other two requirements for identifying controls, which would be relevant to significant and other risks when auditors rely on those controls.
- o The IDW considerably shortened the risk assessment section of the requirements in ISA 540 and the requirements for evaluating the methods, data and assumptions for accounting estimates (in this case, the changes are somewhat similar to those in the IAASB LCE standard).
- o The IDW was much more thorough in the removal of application material and removed almost all of the appendices. The IDW found that if auditors are properly educated and trained, they do not need most of the application material as EEM.