



Ernst & Young Global
Limited
6 More London Place
London
SE1 2DA

Tel: + 44 20 7980 0000
Fax: + 44 20 7980 0275
ey.com

31 January 2022

Mr. Willie Botha
IAASB Technical Director
International Auditing and Assurance Standards Board
529 Fifth Avenue, 6th floor

Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities

Dear Mr. Botha

Ernst & Young Global Limited, the central coordinating entity of the Ernst & Young organization welcomes the opportunity to offer its views on the Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ED-ISA for LCE), issued by the International Auditing and Assurance Standard Board (IAASB).

We support the IAASB's efforts to bring focus to the challenges in applying the International Standards on Auditing (ISAs) to less complex entities (LCEs). We acknowledge that significant effort has been made by the IAASB to create an alternative to the full suite of ISAs and clarify and scale down the ISA requirements for LCEs in the proposed separate standalone ED-ISA for LCE. We support the development of an ISA for LCE that promotes audit quality for audits of entities that have a low level of complexity by clearly setting forth the requirements and guidance that provide the basis for the auditor obtaining reasonable assurance.

We continue to believe the fundamentals of the ISAs are sound, but it is the practical application of the requirements, and understanding when certain requirements may not be applicable or how the nature or extent of procedures may be adapted, that is the source of the majority of challenges for auditors of LCEs. We believe the ISAs are scalable and the requirements should be capable of consistent application to any size entity, and it is only that the extent of procedures and documentation necessary in an LCE audit may be simpler and less extensive due to less complexity. Our experience tells us that determining the appropriate nature and extent of documentation for audits of LCEs is the most challenging aspect of the execution of a LCE audit.

When considering the ED-ISA for LCE in context of the current challenges faced, we believe the most beneficial aspect of the ED-ISA for LCE is its structure presented in the flow of an audit, with explanatory material provided in direct context of the related requirement. Having the requirements in the order of the natural flow of the audit will be very helpful to auditors. We do believe the standard includes the appropriate requirements to achieve reasonable assurance with a few exceptions that we have included in our detailed response (refer to our responses to Q9 and Q10). However, we do not

believe that the ED-ISA for LCE is responsive to the challenges mentioned regarding adapting audit procedures and scaling documentation. We have the following overarching concerns:

- ▶ As a separate standalone standard, we do not believe that the ED-ISA for LCE contains sufficient explanatory material to guide the auditor in proper and consistent application of the requirements. This lack of sufficient guidance creates a risk that the standard will not enable consistent achievement of audit quality or reasonable assurance. Refer to Q1(a) for more details.
- ▶ The Authority of the ED-ISA for LCE is very broad such that very few ISAs or audit circumstances are excluded from the scope of the standard, which results in an unclear distinction between an audit performed under the ED-ISA for LCE versus an audit performed under the full suite of ISAs. While the aim of the ED-ISA for LCE is to make the audit of LCEs more effective and efficient, it is our view that in substance, the standard does not change the nature or extent of audit procedures or documentation from what would be required under the full suite of ISAs (i.e., it does not assist in actually adapting or scaling audit procedures or documentation). Refer to Option #1 in Q1(a) for more details.
- ▶ Because of the broad Authority and the ability to apply the proposed standard to a wide range of entities (e.g., there is no limit, either based on engagement hours or entity revenues to guide usage of the proposed standard):
 - ▶ The ED-ISA for LCE is not directly responsive to the challenges of auditing very small or small entities, which we understand are the audits driving the initiatives in many jurisdictions to create separate auditing standards.
 - ▶ We do not believe it is appropriate to exclude group audits, which can be less complex in nature.

We also see the following potential unintended consequences for the ED-ISA for LCE arising from our overarching concerns:

- ▶ Because it appears to us that an audit using ED-ISA for LCE and an ISA audit will involve the same work effort (and therefore similar cost), stakeholders may not see value in an opinion that indicates an audit was performed in accordance with the ED-ISA for LCE (i.e., if an audit under the full suite of ISAs would have an equivalent work effort and cost, such an audit may be more desirable to stakeholders, which may affect the usage and value of the ED-ISA for LCE). Additionally, application of a separate auditing standard with the specific reference to it in the audit opinion might create a perception of a lesser quality audit to stakeholders.
- ▶ Because of the broad applicability of the ED-ISA for LCE, we believe issuing a separate standard as proposed risks creating a two-tier profession where some auditors may only conduct audits under the ED-ISA for LCE (i.e., many auditors may have few audits in their portfolio that would not qualify for the ED-ISA for LCE) and these auditors may not develop the breadth of experience and expertise of auditing under the full suite of ISAs that has been a foundation of promoting public confidence in the audit profession. It is our view that it is important that auditor qualifications remain based in robust knowledge of the full suite of ISAs.

- ▶ Consideration of qualitative characteristics by firms and practitioners may lead to unintended inconsistencies across the profession on the use of the proposed standard since these are only expected to be indicators of matters or circumstances that are deemed complex. The use of professional judgment will be required to evaluate the qualitative characteristics, and this will inherently result in inconsistencies of use across the profession because each characteristic is subject to interpretation.
- ▶ There is a risk that issuing a separate standard will result in the creation of two tiers of entities under the International Standards on Auditing – complex entities and less complex entities. We believe that the creation of two tiers of entities will create expectations from audited entities regarding their classification of an entity as complex or less complex.

If the proposed Authority is maintained, addressing our concerns about the lack of sufficient guidance and the exclusion of group audits, will undoubtedly add substantial length to the standard and also will lessen the distinction between an audit under the full suite of ISAs and the ED-ISA of LCE even further. Additionally, if the proposed Authority is maintained we believe that transitional guidance is needed. It is our view that transitional guidance needs to cover both transitioning from the ED-ISA for LCE to the full suite of ISAs during the audit and transitioning between the standards from audit period to audit period.

Our overall recommendation is to progress the ED-ISA for LCEs by focusing on reducing the scope of applicability of the separate standalone standard to only entities at the lowest level of complexity and potentially size (i.e., refine the Authority) and deliver a standard that is obviously different from the full suite of ISAs (i.e., a standard that excludes many audit circumstances, is much more condensed and has sufficient guidance). We also believe that this approach would address the strongest calls for a separate auditing standard, which are coming from stakeholders of these small audits.

In parallel, we also recommend that the IAASB repurpose the current draft of the ED-ISA for LCE as a non-authoritative guide to demonstrate the scaling of the ISAs to audits of LCEs that are larger than or have certain complexities or circumstances such that they would not meet the refined Authority for use of the ED-ISA for LCE. The current ED-ISA for LCE is very helpful in depicting the flow of the audit. A conversion to a guide would allow the IAASB to focus on developing supplemental guidance on adapting or scaling the nature and extent of procedures as well as documentation.

Our responses to the specific questions on which the IAASB is seeking feedback follow and include further clarifying details in respect of our overall comments above, when applicable.

Q1. 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?

In our view, the ED-ISA for LCE is not a standalone separate standard for audits meeting the Authority of the Standard requirements because the ED-ISA for LCE does not contain sufficient Application Material from the ISAs. We do not believe that audits that would qualify for using the ED-ISA for LCE will be capable of consistent application of the standard without underlying knowledge and of, and access to, the Application Material in the ISAs. The Essential Explanatory Material (EEM) in the ED-ISA for LCE is currently not detailed enough to consistently execute a high-quality audit that achieves reasonable assurance.

We believe that auditors performing an audit using the ED-ISA for LCE will need to, and should, directly reference the Application Material in the ISAs and this is not intended in the ED-ISA for LCE as the explanatory memorandum to the ED-ISA for LCE states that if there is a circumstance that has not been contemplated in the design of ED-ISA for LCE as addressed in the Authority of the proposed standard, relevant ISA requirements cannot be used to “top-up” ED-ISA for LCE in order to address the circumstance. Additionally, auditors using the ED-ISA for LCE may find it difficult to discern why certain ISA requirements have been omitted from or modified in the ED-ISA for LCE, which may be better understood through clarifying EEM.

We believe that the current ED-ISA for LCE is very helpful in depicting the flow of the audit. However, its applicability is too broad, and we recognize that additional requirements will need to be included (see Questions 9 and 10) in the ED-ISA for LCE based on respondent’s feedback. Additionally, we have concerns about the summarization of the Auditor Reporting Standards in the ED-ISA for LCE and, based on the proposed Authority of the ED-ISA for LCE, it is our view that group audits should not be excluded because they can be less complex in nature.

While the aim of the ED-ISA for LCE is to make the audit of LCEs more effective and efficient, it is our view that in substance it does not change any requirements to core procedures or documentation, but rather is a rewriting of the ISAs following the flow of the audit, with certain exclusions making the standard not applicable in many instances of otherwise less complex audits. Additionally, since the ED-ISA for LCE does not provide guidance on how to execute a LCE audit and the requirements are largely extracted from the ISAs, we believe that users will have to apply the requirements of the ED-ISA for LCE based on their knowledge of the ISAs or rely on implementation guidance issued by the IAASB. The former will become increasingly challenging as new auditors come into the profession who may lack the legacy knowledge of the full ISAs. Based on the above concerns, it is our view that the ED-ISA for LCE would need to be expanded if the Authority remains as proposed (i.e., application is permitted to a wide range of entities).

Our overall recommendation is for the IAASB to pursue one or both of the following options (to which we refer throughout the remainder of this letter) in moving the ED-ISA for LCE forward:

- ▶ Option #1 - Narrow down the criteria in the Authority to make the ED-ISA for LCE applicable to only entities at the lowest level of complexity and potentially size (i.e., refine the authority of use) and deliver a standard that is obviously different from the ISAs (i.e., a standard that excludes many

audit circumstances, is much more condensed and has sufficient EEM) and is clear that it is only meant for audits of entities at the lowest level of complexity. These entities would be those that have a very simple business model, are not group audits (but may be a subsidiary of a group) and would not have complex estimates. Additionally, based on our experience, audits of these entities are fully substantive audits and are not expected to exceed 1000 hours. This approach would clearly differentiate an ISA versus ISA for LCE audit and will also help to reduce the length of standard. To further support this view, we understand that one of the main reasons that the IAASB developed the ED-ISA for LCE was to provide an international solution, as many jurisdictions are developing their own versions of LCE standards that have significant differences among them. However, those jurisdictions that are developing these standards appear to be targeting the lowest level of complexity or smallest end of the market, whereby the IAASB ED-ISA for LCE is addressing a very wide range of entities and even many large audits greater than 1,000 hours would seem to potentially qualify for use of the ED-ISA for LCE. Therefore, it is our view that if the IAASB was to narrow the scope of the ED-ISA for LCE it would better address the needs of jurisdictions that want a LCE standard.

- ▶ Option #2 - Repurpose the ED-ISA for LCE to be non-authoritative guidance for auditors of LCEs. We believe that the ED-ISA for LCE is very helpful in depicting the flow of an audit and repurposing it as non-authoritative guidance would be a timely solution to the issue of promoting consistency in the application of the ISAs across jurisdictions. Since the guidance that currently exists ('Guide to Using International Standards on Auditing in the Audits of Small- and Medium-Sized Entities, '), does not appear to be satisfying the needs of those auditing LCEs, issuing the ED-ISA for LCE as non-authoritative guidance would serve as a timely alternative and provide user-friendly guidance for auditors of LCEs. What the ED-ISA for LCE does well is providing a roadmap in the flow of the audit of the relevant ISA requirements in the context of audits of LCEs. Guidance relating to the scalability of requirements (e.g., scalability of procedures or documentation) and hyperlinks to the relevant ISA could also be added. Additionally, a guide allows for more plain English explanations and could provide examples and directional guidance.

The IAASB could also possibly explore developing educational guidance that could assist stakeholders in determining if a review (instead of an audit) is a satisfactory alternative for their needs (i.e., a review can involve a range of limited assurance that can approach reasonable assurance). One of these approaches may be better understood by users of LCE financial statements and would provide a clear distinction from an audit performed/conducted under the full ISAs.

(b) The title of the proposed standard.

Yes, we believe the title of the proposed standard distinguishes the standard from the ISAs, while maintaining identification as a global IAASB standard.

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

We believe the requirements included in the ED-ISA for LCE along with sufficient EEM that draws from the relevant application material from the ISAs is what is needed to obtain reasonable assurance. We suspect that the ED-ISA for LCE is longer than expected by stakeholders and may be met with some resistance. However, the length of the document is impacted by: (a) the standard must still retain the objective of enabling auditors to obtain reasonable assurance, (b) the authority criteria covers a wide

range of entities and (c) the standard allows for a wide range of audit circumstances (e.g., tests of controls, specialists, service organizations, etc.). We recognize that adding EEM would make the ED-ISA for LCE even longer. As set forth in our response to Q1(a), we recommend that the IAASB narrow down the criteria in the Authority to make the ED-ISA for LCE applicable to only entities at the lowest level of complexity and potentially size, which we believe would allow the standard to be substantially reduced in length.

Q2. 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?

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

Q3. Views are sought on the Authority (or scope) of ED-ISA for LCE (Part A of the proposed standard). In particular: Is the Authority as presented implementable? If not, why not?

The Authority as presented in the ED-ISA for LCE will achieve the intended objective of appropriately informing stakeholders about the scoping of the proposed standard but we believe that a large range of entities could qualify for using the ED-ISA for LCE and there is not a sufficient differentiation in the population of those entities that would qualify under the ED-ISA for LCE and those entities being audited under the full suite of ISAs. This lack of distinction could lead to inconsistency, misunderstanding and confusion by stakeholders on why two entities, very similar in nature, might be audited under two different standards. We also believe that for the authority to be implementable, the authority needs clarification, either by the IAASB or by the jurisdictions that adopt the standard, on when the ED-ISA for LCE applies.

We also believe that the use of the ED-ISA for LCE for group audits should not be specifically prohibited based on the proposed Authority in the standard. The fact that an audit is a group audit does not inherently make the audit exhibit characteristics of complexity. For example, an audit can be a group audit and only have a limited number of components (all of which are less complex) that operate within the same jurisdiction or country. As a result, we believe that group auditors should be allowed to conclude on the use of the ED-ISA for LCE in a group audit or for "in-scope" components. We believe that components that have a non-complex business model and operations could use the ED-ISA for LCE in many circumstances for group reporting purposes and statutory reporting purposes.

If group audits are excluded from the ED-ISA for LCE, we believe the IAASB needs to address situations when a component team is using the ED-ISA for LCE for statutory audit purposes (i.e., will they be permitted to use the ED-ISA for LCE for audit work to support the group audit (provided the group auditor agrees) under the Authority of the standard?)

We would like to note that with our recommendations set forth in our response to Q1(a) to reduce the scope of applicability and significantly scale back the Authority (option 1), we would expect that the ability to implement the Authority and the distinction from the ISAs would both be enhanced. We also would expect group audits to be scoped out of this scaled-back version of the ED-ISA for LCE. However, under our recommendation to repurpose the ED-ISA for LCE as non-authoritative guidance (option 2), we believe that group audit guidance should be included.

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

We are concerned that stakeholders may not value an opinion that indicates an audit was performed in accordance with the ED-ISA for LCE if an audit will involve the same effort (and therefore similar cost) as an audit under the full ISAs. If an audit under the full ISAs would have an equivalent work effort and cost, such an audit may be more desirable to stakeholders, which may affect the usage and value of the ED-ISA for LCE. Generally, users of the financial statements of private companies (i.e., owners, bankers and potential investors) expect a quality audit that provides reasonable assurance, like they expect from public company audits. In our view, application of a separate auditing standard with the specific reference to it in the audit opinion might create a perception of a lesser quality audit to stakeholders. We are concerned that the ED-ISA for LCE could be viewed as an 'ISA diluted product' (i.e., perhaps viewed to be closer to a review), which would be an unfortunate consequence as we do not believe the standard will result in a reduced cost or work effort compared to an audit under the full ISAs.

Issuing a separate standard that has broad capability of application risks creating a two-tier profession where some auditors may only conduct audits under the ED-ISA for LCE (i.e., many auditors may have few audits in their portfolio that would not qualify for the ED-ISA for LCE) and these auditors may not develop the breadth of experience and expertise of auditing under the full ISAs that has been a foundation of promoting public confidence in the audit profession. Given the broad applicability of the ED-ISA for LCE, it is our view that it is important that auditor qualifications remain based in robust knowledge of the full suite of ISAs.

We believe that the consideration of qualitative characteristics by firms and practitioners may lead to unintended inconsistencies across the profession on the use of the proposed standard since these are only expected to be indicators of matters or circumstances that are deemed complex. The use of professional judgment will be required to evaluate the qualitative characteristics, and this will inherently result in inconsistencies of use across the profession because each characteristic is subject to interpretation. We believe that the proposed supplemental guidance for the authority of the proposed International Standard on Auditing for Audits of Financial Statements of LCEs will help eliminate some inconsistencies, however, because this is non-authoritative guidance, we question if users of the ED-ISA for LCE will refer to this supplemental guidance. Additionally, we believe that the supplemental guidance for the authority needs comprehensive examples to be useful and to help reduce inconsistencies in application. We recommend that the IAASB develop a series of comprehensive examples that demonstrate the application of the specific prohibitions and qualitative characteristics and include these examples in the supplemental guidance. This will be particularly important for the firms if the IAASB does not narrow the applicability of the ED-ISA for LCE to only audits of lowest complexity, and realizing some jurisdictions will not either, then these examples will be needed by the firms to apply the ED-ISA for LCE consistently.

We also believe that an inevitable consequence will be the creation of two tiers of entities under the International Standards on Auditing - complex entities and less complex entities. We believe that the creation of two tiers of entities will create expectations from audited entities regarding their classification of an entity as complex or less complex. Issues for auditors could arise when a client wants to be classified as a LCE so the audit can be conducted under the ED-ISA for LCE. For example, there could be a scenario where an entity may pressure competing auditors to make decisions about the complexity of the entity prior to being engaged to set expectations about lower fees (i.e., entities

may believe that fees should be lower because the auditor has a less complex audit to perform). This would then in turn create undue pressure on auditors to maintain their original complexity assessment after accepting the audit and understanding the business model in greater depth.

(b) Are there specific areas with the Authority that are not clear?

There are no specific areas with the Authority that are not clear.

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

The Authority, as set out, will achieve the intended objective of appropriately informing stakeholders about the scoping of the proposed standard. However as previously suggested, we recommend that the IAASB narrow down the criteria in the Authority to make the ED-ISA for LCE applicable to only entities at the lowest level of complexity and potentially size (i.e., refine the Authority). Our recommendation is that the Authority clearly indicate that the standard is only meant for audits of entities at the lowest level of complexity and potentially size, and that it excludes many audit circumstances that, if present, would require use of the full ISAs.

(d) 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 in individual jurisdictions is clear. However, we do not believe it is appropriate. We believe the proposed Authority of the ED-ISA for LCE needs further customization by jurisdictions to provide firms with clear guidance on when the standard applies in a jurisdiction. We believe there is high risk of inconsistent application if local authorities do not fulfill this role (i.e., leaves the decision for use of the ED-ISA for LCE to be made by firms or practitioners). We believe that audit firms should not have the responsibility for establishing additional classes of entities prohibited from using the ED-ISA for LCE that have not already been determined by local jurisdictions.

If clear guidance is not provided by the legislative or regulatory authorities or relevant local bodies, we find the criteria to be very subjective and we do not believe that audit firms will be able to consistently apply the criteria set out in the Authority. We believe that the potential for inconsistent application across audit firms will cause transition problems (i.e., change in auditors or changes in characteristics at an entity could prompt different decisions in applicability of the ED-ISA for LCE). Additionally, differences in local regulations could have implications for group audits if use is allowed by the ED-ISA for LCE. For example, there could be situations when the ED-ISA for LCE could be allowed to be used for group audit purposes and not for statutory audit purposes or vice versa.

We also believe that the role of legislative or regulatory authorities or relevant local bodies is to communicate and educate stakeholders on the rationale for the applicability and any specific prohibitions, which would help differentiate the ED-ISA for LCE from the ISAs to stakeholders.

We also recognize that having legislative or regulatory authorities or relevant local bodies responsible for determining the additional classes prohibited from using the ED-ISA for LCE for their local jurisdiction will result in inconsistent application across jurisdictions (i.e., it is possible that for two essentially identical entities that are domiciled in different jurisdictions that one may qualify for an audit under the ED-ISA for LCE and one may not due to differences in local regulations). However, if the IAASB were to

take our recommendation of narrowing of the scope of applicability of the standard to entities at the lowest level of complexity, we believe that such differences would be reduced, and would be less impactful, such that there would be greater international consistency in the authority of the standard.

Q4: Do you agree with the proposed limitations related 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 items(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.

(a) Specific prohibitions

We agree with the specific prohibitions related to the use of the ED-ISA for LCE except for the prohibition of group audits. We believe that the use of the ED-ISA for LCE for group audits should not be specifically prohibited in the ED-ISA for LCE as proposed. We do not believe that a blanket statement can be made by the IAASB to say that group audits inherently exhibit characteristics of complexity within an entity. Refer to our response to Q3 for additional details.

Regarding jurisdictional-level limitations and firm policies and procedures limitations, we believe that local legislatures or authorities should determine the permitted use of the ISA for LCE for that local jurisdiction. Refer to Q3 (d) for additional details.

(b) Qualitative characteristics

We support the proposal to include qualitative characteristics in determining complexity at an LCE. However, it is our view that excluding specific procedures in relation to complex accounting estimates will make the ED-ISA for LCE not applicable to many LCEs. We understand that certain specific procedures concerning the use of complex modelling and detailed requirements addressing situations where there is higher estimation uncertainty have not been included in the ED-ISA for LCE as the IAASB has indicated that they are not expected to be relevant for the types of accounting estimates in an audit of a typical LCE. However, it is our view that the complexity of the underlying accounting estimate should be considered when considering the Authority of the ED-ISA for LCE. For example, a common situation for an LCE may be the impairment of their non-current assets that may use more complex modeling. However, because of the potential complexity in determining this estimate, there may be situation where auditors would not be able to use the ED-ISA for LCE. As a result, we suggest that the IAASB revisit this decision to exclude certain specific requirements from the ED-ISA for LCE related to accounting estimates. We believe that the presence of a complex characteristics should be determined based on judgment by the auditor about whether it is still appropriate to perform the audit under the ED-ISA for LCE. The auditor would need to determine if the complex matter or circumstance identified is not in the spirit of what the standard intended to be allowed as an accounting estimate.

However, if the IAASB was to adopt our suggestion to narrow down the criteria in the Authority to make the ED-ISA for LCE applicable to only entities at the lowest level of complexity (i.e., refine the authority of use) then this prohibition on complex estimates would be more understandable.

Q5. Regarding the Authority Supplemental Guide:

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

The Authority Supplemental Guide is helpful to further discuss different characteristics of LCEs. However, the Authority Supplemental Guide lacks examples of a qualifying LCE, which diminishes its usefulness. We suggest several comprehensive examples be included (refer to Q3a).

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

Other than comprehensive examples, we have not identified other matters that should be included in the Authority Supplemental Guide.

One specific comment we had on the Authority Supplemental Guide is that it is difficult to reconcile the 'Classes of Entities Where the Prohibition For that Class Can be Modified' section with the ED-ISA for LCE. It is assumed that this section is providing guidance to paragraph A7(c) in the ED-ISA for LCE and how those categories can be modified. If so, it would be clearer to start this section of the Authority Supplemental Guide with paragraph 16 in the Authority Supplemental Guide. Paragraph 16 restates what is in the standard and then the subsequent paragraphs could provide supporting explanation to that paragraph (i.e., that this approach was taken because Public Interest Entities are not defined globally and may have different jurisdictional definitions (current paragraph 14 of the Authority Supplemental Guide) and the categories in paragraph A7(c) in the ED-ISA for LCE are those that exhibit public interest characteristics (current paragraph 15 of the of the Authority Supplemental Guide) and then that some public interest characteristics could be defined at the jurisdictional level (current paragraph 17 of the Authority Supplemental Guide).

Q6. Are there any other matters related to the Authority that the IAASB should consider as it progresses ED-ISA for LCE to finalization?

As previously discussed, we believe that the IAASB should consider narrowing down the criteria in the Authority section of the standard to make the ED-ISA for LCE applicable to only entities at the lowest level of complexity and potentially size. This approach would clearly differentiate an ISA versus ISA for LCE audit and will also help to reduce the length of standard.

Q7. 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).

The standard indicates that an audit in accordance with this ED-ISA for LCE will facilitate the auditor obtaining reasonable assurance about whether the financial statements of a LCE are free from material misstatements. However, if the ED-ISA for LCE is intended to provide the same level of assurance that the ISAs provide (i.e., reasonable assurance) then users of the ED-ISA for LCE, including auditors, may find it difficult to discern why certain ISA requirements have been omitted from or modified in the ED-ISA for LCE. Under the current proposal, for the users of the ED-ISA for LCE to understand what is different than the ISAs they must refer to the mapping documents. We believe that

differences may be better understood through clarifying EEM in the ED-ISA for LCE. We also believe to help eliminate this concern, that the auditor's report needs to have more transparency about the difference between ISA audit and ISA for LCE audit. Refer to Q10(b) for additional details.

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

We believe that the flow of the ED-ISA for LCE based on the separate objectives allows the content from the ISAs to be appropriately organized for a holistic standard.

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

We believe that sufficient detail is given to professional skepticism and professional judgement, relevant ethical requirements, and quality management within the ED-ISA for LCE.

(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.

The approach to using EEM within the text of the ED-ISA for LCE is helpful to ensure that the explanatory guidance is included in direct context of the respective requirement. However, we do not believe that the EEM is sufficient to promote consistent achievement of reasonable assurance and audit quality. It is our view that audits that qualify for using the ED-ISA for LCE will not be able to implement the standard without referring to, or having sufficient knowledge and experience about, the relevant Application Material in the ISAs. We believe that the EEM should be expanded to a sufficient extent to enable the standard to truly standalone or there should be an explicit acknowledgement that the ED-ISA for LCE has been designed under the assumption the auditors who apply it have a sufficient working knowledge of the ISAs, including the Application Material.

Q8. Please provide your views on the overall design and structure on ED-ISA for LCE, including where relevant, the application of the drafting principles (paragraph 98-101).

We support the design and structure of the ED-ISA for LCE to follow the flow of an audit (rather than topic-based like the ISAs). The consistent structure of each part helps the users to easily understand the requirements.

One comment we have on the overall flow of the ED-ISA for LCE is that we suggest that the Acceptance/Continuance of an Audit Engagement section (part 4) of the standard come before the Engagement Quality Management (part 3) section of the standard because if the auditor does not accept an audit engagement, then there are no further procedures performed.

Q9. 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.

We have the following specific comments on Parts 1 to 8:

Part 1

- ▶ *Specific Communications to Those Charged with Governance in Relation to Fraud 1.8.8* - This section does not address what should happen if the auditor suspects fraud involving the highest level of authority at the entity. Just because an entity is a LCE does not mean that fraud at the highest level of authority will never occur. The ED-ISA for LCE needs to be clear what the auditor should do in this scenario. We suggest adding the requirement from ISA 250.24 (Where no higher authority exists, or if the auditor believes that the communication may not be acted upon or is unsure as to the person to whom to report, the auditor shall consider the need to obtain legal advice) to the ED-ISA for LCE.
- ▶ *Fraud 1.5.2* - The use of the words “determine legal and professional responsibilities” used in the ED-ISA for LCE are a vague summary of the requirements of ISA 240.39 (a) and (b) when an auditor is unable to continue an engagement due to fraud. Additionally, the ED-ISA for LCE has removed the requirement from ISA 240.39 (c) to communicate when the auditor withdraws. We suggest that the IAASB revisit including these requirements in the ED-ISA for LCE.

Part 2

- ▶ *General Documentation Requirements 2.5.2* - This requirement appears to be duplicated with 2.5.5(b). Additionally, it is unclear in 2.5.2 is intended to/needs to cover suspected or actual fraud.

Part 5

- ▶ *Specific Documentation Requirements - 5.5.1* - We believe that documenting significant changes made during the audit should be within Part 7 or Part 8 of the ED-ISA for LCE instead of Part 5 (planning).

Part 6

- ▶ *Procedures for Identifying and Assessing Risks and Related Activities 6.2.2* - The EEM for this paragraph refers to “each aspect of the auditor’s understanding required” but the ED-ISA for LCE never defines the different aspects the auditor is to obtain an understanding of.
- ▶ *Understanding the Entity and Its Environment 6.3.2* - This paragraph is part of understanding the system of internal control and we believe it would be better placed in the “Understanding the Entity’s Internal Control System” section rather than the “Understanding the Entity and Its Environment” section.
- ▶ *Understanding the Entity’s Internal Control System 6.3.6* - The requirement from ISA 315.21 (Revised) for the auditor to evaluate whether management or those charged with governance have created and maintained a culture of honest and ethical behavior has been removed. Currently, the ED-ISA for LCE only includes the requirement to understand the culture of the entity, including whether the culture supports honestly and ethical behavior. Just because an entity is LCE does not mean that the auditor should not evaluate whether management or those charged with

governance have created and maintained a culture of honest and ethical behavior. We suggest the requirement from 315.21 be added to the ED-ISA for LCE.

- ▶ *Understanding the Entity's Internal Control System 6.3.6* - This paragraph uses the term deficiencies in the control environment, and we suggest that the ED-ISA for LCE consistently use the term control deficiencies and not just deficiencies.
- ▶ *Understanding the Entity's Internal Control System 6.3.11* - We suggest this paragraph refer to the understanding obtained in paragraphs 6.3.9 and 6.3.10 (i.e., Based on the understanding obtained in 6.3.9 and 6.3.10, the auditor shall evaluate whether the entity's information system and communication appropriately supports the preparation of the entity's financial statements in accordance with the applicable financial reporting framework.) in order to more clearly link the requirements and avoid misinterpretation by users of the scope of the evaluation required.
- ▶ *Understanding the Entity's Internal Control System 6.3.13* - Although this paragraph is consistent with ISA 315 (Revised 2019), the ED-ISA for LCE does not have sufficient requirements that would achieve alignment with ISA 265.7, which requires determining whether control deficiencies exist based on all audit work performed and not just risk assessment procedures. We suggest the IAASB broaden the requirements in ED-ISA for LCE to cover the intent of ISA 265.7. See also comment below on paragraph 6.3.18.
- ▶ *Understanding the Entity's Internal Control System 6.3.14 (e) and 6.3.17* - More guidance is needed relating to the use of controls over information processed by a service organization. The use of service organizations is a common situation that occurs in practice (e.g., payroll) and we believe that more guidance on using service organizations should be included in the ED-ISA for LCE. Specifically:
 - ▶ 6.3.17 (c)-(e) does not infer the same meaning as ISA 402.9 (c)-(d).
 - ▶ 6.3.17 (d)-(e) appears to duplicate what is in 6.3.14 (e) and it is not clear what is meant by "if applicable" in 6.3.14 (e)
 - ▶ Guidance should be included relating to how auditors should handle situations where relevant SOC-1 reports may need to be included if ITGCs are relevant under paragraph 6.3.16 and outsourced to the service organization.
- ▶ *Understanding the Entity's Internal Control System 6.3.16* - To improve readability, we suggest that the second part of this paragraph be made into a separate sentence ("The auditor shall evaluate whether the identified general IT controls are...").
- ▶ *Understanding the Entity's Internal Control System 6.3.18* - This paragraph in the ED-ISA for LCE limits the ISA 265.7 requirement to just deficiencies identified in understanding internal controls systems. ISA 265.7 requires consideration of deficiencies in internal control identified when performing all audit procedures and not just risk assessment procedures. There needs to be an overarching consideration to cover ISA 265.7 in the concluding section of the ED-ISA for LCE (The auditor shall determine, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control).

- ▶ *Understanding the Entity's Internal Control System 6.3.18* - The significant deficiency language should be updated to require identification of control deficiencies in the entity's system of internal control to align to ISA 315 (Revised 2019). The assessment of whether identified control deficiencies are significant deficiencies should be based on all control deficiencies identified. See also comment on 6.3.13 above.
- ▶ *Identifying Risks of Material Misstatement 6.4* - The ED-ISA for LCE extracted the requirements from the ISAs but does not demonstrate how it can be applied for an LCE. In this case, reading the ISAs provides more information on how the auditor can identify risks of material misstatement in an LCE.
- ▶ *Evaluation of the Procedures to Identify and Assess Risks of Material Misstatement and Revision of Risk Assessment 6.5.9-6.5.10* - LCE audits can have material classes of transactions or account balances or disclosures that have been determined not to be significant. As a result, we believe the requirement from ISA 315.36 (Revised) (For material classes of transactions, account balances or disclosures that have not been determined to be significant classes of transactions, account balances or disclosures, the auditor shall evaluate whether the auditor's determination remains appropriate) is still applicable to LCE audits and should be added to the ED-ISA for LCE.

Part 7

- ▶ *Substantive Analytical Procedures 7.3.4* - More guidance is needed on how to operationalize Substantive Analytical Procedures for LCEs.
- ▶ *Tests of Controls 7.3.12* - This paragraph is difficult to read. We suggest that the requirements in parts (a) and (b) of the paragraph be broken down into bullets to make them more readable. Additionally, the requirement in the ED-ISA for LCE does not include the requirement from ISA 330.13 for the auditor to consider whether there have been personnel changes affecting the application of a control. We believe that personnel changes are a common situation for all audits. We suggest that the IAASB include the requirement in the ED-ISA for LCE from ISA 330.13.
- ▶ *Tests of Controls 7.3.15* - The requirement from ISA 330 paragraph 17 included in ED-ISA for LCE requires auditors to make inquiries to understand the deviations and the potential consequences of control issues. We do not believe that the modified requirement included in ED-ISA for LCE properly depicts the requirements of ISA 330.17. We suggest that the ED-ISA for LCE use the requirement as worded in ISA 330.17.
- ▶ *Substantive Procedures 7.3.19* - The requirement from ISA 330.23 (If misstatements that the auditor did not expect when assessing the risks of material misstatement are detected at an interim date, the auditor shall evaluate whether the related assessment of risk and the planned nature, timing or extent of substantive procedures covering the remaining period need to be modified) should be included in ED-ISA for LCE. Unexpected interim misstatements can occur in an audit of an LCE. We suggest the IAASB include the requirements from ISA 330.23 in the ED-ISA for LCE.
- ▶ *Audit Sampling 7.3.5 and 7.3.6* - The ED-ISA for LCE has eliminated a significant portion of the requirements in ISA 530. We believe that the concept of sampling is integral to an audit and

believe all requirements from ISA 530 should be included in the ED-ISA for LCE as sampling is a fundamental audit procedure for fully substantive audits, in particular. We suggest the IAASB revisit the requirements from ISA 530 that have been excluded from the ED-ISA for LCE.

- ▶ *External Confirmations 7.3.23 and 7.3.25*- There is no guidance or EEM that addresses situations when a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence (ISA 505.13). ISA 505.13 contains an important provision that when the auditor requires a positive confirmation, alternative procedures will never be appropriate. We believe what is specified in ISA 505.13 is a different connotation than what the ED-ISA for LCE implies in 7.3.23 and 7.2.25. We suggest that this be revised by the IAASB.
- ▶ *Accounting Estimates 7.4.16 - 7.4.18* - Specific procedures in relation to complex accounting estimates are not covered by the ED-ISA for LCE, which potentially makes the ED-ISA for LCE not applicable to many LCE audits. We suggest that the IAASB revisit this decision to exclude specific procedures in relation to the use of ISA 540 and allow the auditor to exercise judgement to determine if an estimate is complex and not in the spirit of the ED-ISA for LCE. Refer to Q4 for more details.
- ▶ *Inventory 7.4.20* - The way paragraph 7.4.20 currently reads is that the auditor only needs to perform audit procedures on intervening transactions if the auditor did not attend the inventory count and observes counts on an alternative date, which is narrower requirement than the ISA 501.5 requirement to perform procedures on intervening transactions when the inventory count date is not the financial statement date (regardless of attendance). We recommend that the 'perform audit procedures on intervening transactions' be removed from 7.4.20 and put into its own sentence.
- ▶ *Litigation and Claims 7.4.22 - 7.4.23* - There is no guidance or EEM to address situations when the auditor is unable to send a legal letter, or no response is received when a legal letter is sent (ISA 501.11). These situations do occur in an audit of an LCE. We suggest that the IAASB include the requirements from ISA 501.11 in the ED-ISA for LCE.
- ▶ *Audit Procedures When Non-Compliance with Law or Regulation is Identified or Suspected - 7.4.25(d)* - The use of the words 'take appropriate action' is not strong enough to match 'consider the need to obtain legal advice' from ISA 250.19. There is also insufficient guidance or EEM from ISA 250.25 to enable auditors to handle situations where management or those charged with governance are involved and whom the auditors would need to contact in these situations. We suggest that the IAASB update the wording to match ISA 250.19 and ISA 250.25.
- ▶ *Using the Services of a Service Organization* - The use of service organizations is very common for LCE audits. In general, the guidance included related to using the services of a service organization included in the ED-ISA for LCE is minimal. We do not believe that the assumption can be made that an LCE audit will not need to obtain a Type 1 or Type 2 Report or test controls at the Service Organization since the use of service organizations are common at LCEs. We suggest the IAASB reconsider which paragraphs from ISA 402 are included in the ED-ISA for LCE.
- ▶ *Specific Communication Requirements 7.6.2* - ISA 265.11 (b) (i) (ii) and (iii) need to be included in the ED-ISA for LCE, as least as EEM. We believe that there is not currently enough information in

ED-ISA for LCE paragraph 7.6.2 to determine what constitutes sufficient information in the communication of significant deficiencies.

- ▶ *Specific Documentation Requirements 7.7* - ISA 330.29 requirement (If the auditor plans to use audit evidence about the operating effectiveness of controls obtained in previous audits, the auditor shall include in the audit documentation the conclusions reached about relying on such controls that were tested in a previous audit) is missing from the ED-ISA for LCE. We suggest that the IAASB add this paragraph to the ED-ISA for LCE.
- ▶ *Specific Documentation Requirements 7.7 (f)* - ISA 450.7 requirement (i.e., If, at the auditor's request, management has examined a class of transactions, account balance or disclosure and corrected misstatements that were detected, the auditor shall perform additional audit procedures to determine whether misstatements remain) is not properly addressed in paragraph 7.7.1 (f) because as written the auditor would not have obtained evidence regarding whether other misstatements remain. We suggest that the IAASB add the requirement from ISA 540.7 to the ED-ISA for LCE.

Part 8

- ▶ There needs to be an overarching consideration to cover ISA 265.7 in the concluding section of the ED-ISA for LCE (The auditor shall determine, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control). We suggest that the IAASB add this requirement from ISA 265.7 to the ED-ISA for LCE. Refer to related comments in Part 6 above.
- ▶ There are numerous scenarios that could impact the Auditor's Report related to subsequent events. The ED-ISA for LCE scoped out certain requirements from ISA 560 because the IAASB believed these situations to be unusual and unlikely to occur for an LCE. However, if these various scenarios were to occur on an LCE audit, the ED-ISA for LCE does not contain the guidance to determine the implications to the Auditor's Report. As a result, we believe the ISA 560.11-13 and 560.15-17 requirements that discusses auditor's report consequences should be included in the ED-ISA for LCE.
- ▶ The title of 8.6 Written Representations from Management and Those Charged with Governance implies that written representations are always required from Those Charged with Governance. The title should reflect that representations are only required from Those Charged With Governance, if applicable.
- ▶ *Written Representations from Management and Those Charged with Governance 8.6.3/Appendix 6* - We do not believe that it is rare for there to be comparative periods (e.g., this is an AICPA requirement) or misstatements in prior periods, but ISA 710.9 was excluded from the ED-ISA for LCE. We disagree with this exclusion and believe ISA 710.9 (The auditor shall request written representations for all periods referred to in the auditor's opinion. The auditor shall also obtain a specific written representation regarding any restatement made to correct a material misstatement in prior period financial statements that affect the comparative information) should be included in the ED-ISA for LCE as this exclusion implies that financial statements including a restatement would require an audit under the ISAs.

Q10. 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.

We are concerned that the presentation of the auditor reporting requirements in the ED-ISA for LCE will result in unintended consequences because the ED-ISA for LCE summarizes the reporting requirements from the auditor reporting standards and thus different interpretations could be made from the summary than from the full ISAs. In our view, Part 9 is helpful, but we do not believe it replaces or includes all relevant guidance from the ISAs and creates a risk of inappropriate or incomplete reporting when a report other than an unmodified report is appropriate in the circumstances.

We have the following specific comments regarding Part 9:

- ▶ The current version of the ED-ISA for LCE or the Reporting Supplemental Guidance does not provide sufficient guidance or examples for situations specified in ISA 705.10-13, 15, and 24 or ISA 710.11 and 18. As a result, if any of these excluded scenarios exist, the auditor will have to transition the engagement to the ISAs after the entire audit has already been completed because the IAASB has stated that if there is a circumstance that has not been addressed within the ED-ISA for LCE relevant ISA requirements cannot be referenced to address the deficiency. We suggest that the IAASB revisit if these scenarios from ISA 705 and ISA 710 should be included in the ED-ISA for LCE.
- ▶ *Table C Specific Circumstances When the Auditor's Opinion is to be Modified 9.5.1.0* - This procedure 'If alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory cannot be performed' is listed under external confirmations. The procedure does not appear to be related to confirmations as it refers to inventory, unless this is intended to refer specifically to external inventory confirmations, but that is not specified. We suggest that the IAASB clarify this or move the procedure to the appropriate place in the ED-ISA for LCE.
- ▶ *Other Matters Paragraphs 9.6.3* - There is no EEM or guidance in the Reporting Supplemental Guidance that includes what to do if an auditor finds items to the magnitude of modifying the auditor's report where the prior year auditor did not modify the report (ISA 710.18). The IAASB has indicated that they believe this content is addressed through the requirement in paragraph 8.8.2 relating to communication of significant matters arising during the audit and does not believe that a separate requirement in relation to this topic area is necessary. We do not believe this reporting requirement is fully addressed in paragraph 8.8.2 and suggest that the IAASB update the ED-ISA for LCE to properly reflect the requirement from ISA 710.18.
- ▶ *Comparative Information - Corresponding Figures and Comparative Financial Statements 9.7.3* - We suggest that EEM be added to address what happens when prior period financials are audited by a predecessor auditor. We would expect this situation to occur as LCEs certainly change auditors.

- ▶ *Other Information 9.8.6* - We do not believe that it is apparent to users of ED-ISA for LCE that the same requirements on handling misstatements (ISA 720.18-19) are similarly applicable to Other Information that is issued after the financial statements (as opposed to before or concurrently). In particular, if there are material misstatements in Other Information issued after the date of the financial statements that management does not intend to correct, these have a different practical path for the auditor to take as the financial statements have already been issued and would be different from the Other Information. ISA 720.19 (b) indicates that if the auditor concludes that a material misstatement exists in other information obtained after the date of the auditor's report, the auditor shall, if the other information is not corrected after communicating with those charged with governance, take appropriate action considering the auditor's legal rights and obligations, to seek to have the uncorrected material misstatement appropriately brought to the attention of users for whom the auditor's report is prepared. Because the audit would already have been complete, reverting the audit back to being performed under the ISAs would not be possible at this point. We suggest the IAASB address this situation in the ED-ISA for LCE.

(b) The approach to include a specified format and content of an unmodified auditor's report as a requirement?

We support the approach to include a specified format and content of an unmodified auditor's report as a requirement within the ED-ISA for LCE. The presentation of the report through inclusion of a direct example is the easiest way to demonstrate and remove the complexity of bringing the related ISAs into a single streamlined ED-ISA for LCE. However, we believe that we cannot assume that a LCE will have an unmodified audit opinion. We believe that there will be unintended consequences, such as misinterpretation of the reporting standards, by creating a summarized version of the auditor reporting standards in the ED-ISA for LCE. We suggest that the IAASB revisit the standalone approach of the ED-ISA for LCE for auditor reporting and consider referring directly to the ISA 700 series in the ED-ISA for LCE. We have the same recommendation should the IAASB pursue narrowing the scope of the standard (i.e., refining the Authority as recommended in our response to Q1(a)). We believe that the authoritative reporting guidance should be that of the full ISAs, unless there will be specific differences in reporting requirements for audits of LCEs.

Additionally, because the outcome of the audit using ED-ISA for LCE and an ISA audit will result in the same report, a potential unintended consequence of the ED-ISA for LCE is that stakeholders may not value an opinion that indicates an audit was performed in accordance with the ED-ISA for LCE. Referencing the ED-ISA for LCE may impact the perception of the quality of the audit undertaken, the perceived value of the audit and increase confusion amongst users of financial statements if they do not understand the difference between an ISA audit and an ISA for LCE audit. If the ED-ISA for LCE is intended to provide the same level of assurance that the ISAs provide (i.e., reasonable assurance), then stakeholders need to have sufficient transparency of the differences between the ED-ISA for LCE and the ISAs. If stakeholders find it difficult to determine the differences between an audit performed under the ED-ISA for LCE and an audit performed under the ISAs, a perception could be created that a different or lesser level of assurance will be obtained through application of the ED-ISA for LCE., irrespective of whether the same level of assurance is obtained. Users need to understand that application of the full suite of ISAs involves addressing many audit circumstances that are not present or relevant in audits of LCEs, and therefore are not included in the ISA for LCE. In our view, the auditor's report on ED-ISA for LCE should provide transparency about the nature of the entity audited being less complex and about the difference between an ISA audit and ISA for LCE audit. For example, the auditor's report for a LCE

could be expanded to help users understand that an audit of a LCE is a streamlined application of the full suite of ISAs since certain audit circumstances do not exist in LCEs.

(c) The approach to providing example auditor's reports in the Reporting Supplemental Guide.

In our opinion, the approach to providing further guidance and examples on modifications to auditor's reports in the Reporting Supplemental Guide appears inconsistent with the ED-ISA for LCE being a separate standalone standard because reference to the guidance in this supplement is necessary when modifications to auditor's reports are needed. Additionally, because the guidance in the Reporting Supplemental Guide is non-authoritative guidance, we question if users of the ED-ISA for LCE will refer to this supplemental guidance.

Q11. With regard to the Reporting Supplemental Guide: (a) Is the support material helpful, and if not, why not? (b) Are there any other matters that should be included in relation reporting?

The support material in the Reporting Supplemental Guide is helpful. However, as indicated above we have concerns about this material residing outside of the ED-ISA for LCE.

Q12. Are there any areas with 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.

Please see response to Q9 and Q10 above. We have captured any areas of completeness and improvements in our response to these questions.

Q13. 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? (b) What support materials would assist in addressing these challenges?

It is our understanding that, when designing the ED-ISA for LCE, the IAASB expected that it would be relatively rare for an audit to need to transition during the period under audit after engagement acceptance or continuance from using ED-ISA for LCE to using the full suite of ISAs because the specific prohibitions or relevant qualitative characteristics are likely to be known at the time of engagement acceptance or continuance. However, even though it is expected that it would be rare for an audit to transition from using ED-ISA for LCE to using the full suite of ISAs mid-audit, we believe that transitional guidance is needed. It is our view that transitional guidance needs to cover both transitioning from the ED-ISA for LCE to the full suite of ISAs during the audit and from audit period to audit period.

We believe that, when it is determined the ED-ISA for LCE is no longer applicable due to new circumstances or events (e.g., audit increases in complexity over time) transitioning to the full suite of ISAs will be challenging because the differences between the ED-ISA for LCE and the full suite of ISAs are not clear. We believe that these time-consuming transition activities potentially could preclude auditors to initially elect to apply the ED-ISA for LCE, or for clients to agree to revised terms of engagement that include application of the ED-ISA for LCE. We believe that detailed transition guidance will need to be provided and it will need to include what incremental procedures need to be performed when transitioning from the ED-ISA for LCE to comply with the full suite of ISAs. For

example, when complexities are discovered during the audit and the auditor must transition from the ED-ISA for LCE to the full suite of ISAs, the terms of the engagement would need to be re-established, an updated engagement letter would need to be signed, communications to management and those charged with governance would need to be revised and updated, requirements scoped out of the ED-ISA for LCE would need to be identified and addressed, entire ISAs scoped out of the ED-ISA for LCE would need to be identified and addressed, etc.

Additional areas that we believe should be addressed in this transitional guidance include, but not limited to, the following:

- ▶ Guidance to address how the change from the ED-ISA for LCE to the full suite of ISAs (or vice versa) would affect the comparability of the audited information if an audited entity is an LCE in one audit period and not in a subsequent audit period (e.g., guidance on how the auditor's report on comparative financial statements would look when one year the audit was performed in accordance with the ED-ISA for LCE and the following year the audit was performed in accordance with the ISAs).
- ▶ Guidance to address what additional audit work would need to be performed when an entity is going to undergo an initial public offering and was audited under the ED-ISA for LCE and now needs to transition to a full ISA audit (e.g., what additional work will the auditor have to perform on the prior year financial statements to be included in the offering document, since they were not audited under the ISAs).
- ▶ Guidance to address the difference between a statutory audit performed under the ED-ISA for LCE versus a 'full scope' audit of a component as part of a group audit performed under the ISAs. Specifically, what, if any, additional procedures would the group auditor need to consider relative to their ability to issue the group audit opinion.

Q14. Do you agree with the proposed approach to the future updates and maintenance of the Standard and related supplemental guidance?

We agree with the proposed approach to the future updates and maintenance of the ED-ISA for LCE and the related supplemental guidance. Amendments to the ED-ISA for LCE need to be made periodically to align to the timing of when projects to revise ISAs are undertaken. It is important that, as part of each ISA project, there will be explicit consideration given as to when the changes to ED-ISA for LCE should be made.

Q15. For any subsequent revisions to the standard once effective, should early adoption be allowed? If not, why not?

It depends. We believe that, if subsequent revisions to the standard are made once it is effective, early adoption should be allowed for the ED-ISA for LCE if early adoption was allowed for the respective ISA that caused the ED-ISA for LCE to be updated. In other words, if the reason for the revisions to the ED-ISA for LCE was because of revisions made to the ISAs and early adoption was allowed for the respective ISAs, then early adoption should be allowed for the ED-ISA for LCE.

Q16. Should a separate Part on the ISA 800 series be included within ED-ISA for LCE? Please provide reasons for your response.

From a global point of view, we do not see an issue with scoping out the ISA 800 series for the ED-ISA for LCE. However, we believe that the IAASB needs to perform further information gathering from jurisdictions on the prevalence of ISA 800 engagements that are for LCEs. Certain jurisdictions may have specific needs for the requirements and guidance of ISA 800 with respect to audits of financial statements of LCEs prepared in accordance with special purpose frameworks (e.g., frameworks that comply with specific requirements of partnership agreements, lender agreements, joint venture agreements, private equity funds).

Q17. 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.

We cannot comment on which jurisdictions will use the ED-ISA for LCE. Because the decisions about the required or permitted use of the ISAs rests with legislative or regulatory authorities or relevant local bodies with standard-setting authority, we encourage the IAASB to proactively obtain input from National Standard Setters and Professional Accountancy Organizations as to whether the standard will be used in their jurisdictions.

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

As previously stated, we do not believe that the proposed standard meets the needs of auditors because it does not contain sufficient EEM from the application material in the ISAs to obtain reasonable assurance and the authority may be incapable of consistent application in jurisdictions where it has not been customized by jurisdictional or regulatory authorities.

We cannot comment on whether the proposed standard meets the needs of audited entities, users of audited financial statements or other stakeholders. We encourage the IAASB to seek input on this matter through its outreach, particularly on the perception of the auditor's report and what stakeholders would want to know about the audit of an LCE to be able to understand whether there is difference in an audit opinion resulting from an ISA for LCE audit versus an ISA audit.

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

We believe that the following aspects of the proposed standard may create challenges for implementation and guidance should be developed to address these scenarios:

- ▶ Lack of guidance on transitioning from the ED-ISA for LCE to the full suite of ISAs and vice versa (refer to our response to Q13 for additional details).

- ▶ Lack of guidance on situations when a practitioner would be required to transition to the full suite of ISAs (i.e., no longer meets the Authority of the ED-ISA for LCE and the full suite ISAs must be used).
- ▶ Lack of guidance (or an explicit prohibition) for auditors on whether it is appropriate to situationally refer to the ISA application material when the ED-ISA for LCE lacks the necessary application material for the requirement on which they are seeking additional guidance.
- ▶ Lack of comprehensive examples on the application of the Authority of the ED-ISA for LCE to help reduce inconsistencies in application (refer to our response to Q3(a) for additional details).
- ▶ Lack of guidance on scaling the documentation for audits using the ED-ISA for LCE (refer to our response to Q18 for additional details).

Q18. Are there any other matters related to ED-ISA for LCE that the IAASB should consider as it progresses the proposed standard to finalization?

We believe that for the ED-ISA for LCE to be useful, the IAASB needs to address the issue of scaling documentation for LCEs. While the aim of the proposed new standard is to make the audit of LCEs more effective and efficient, the ED-ISA for LCE does not include ways to scale back documentation for LCE audits. As such, we do not see a substantial difference in application between the full suite of ISAs and ED-ISA for LCE. We believe that scaling of documentation is critical for LCEs because in our experience auditors have been challenged to provide documentation as to why an ISA requirement or whole ISAs are not applicable regardless of the overall documentation principles set by ISA 230. Although the ED-ISA for LCE has reduced the volume of requirements, we believe the issue will persist to some degree such that documentation may be expected to cover all requirements that remain in the ED-ISA for LCE.

Because stakeholders have expressed concerns about whether the ISAs can be applied in a cost-effective manner, we believe that the ED-ISA for LCE should sufficiently enable auditors of LCEs to have a clear understanding of the level of documentation that would be appropriate under ED-ISA for LCE and that this level of documentation is reduced from the full suite of ISAs because of the proposed scope and the circumstances in the audit that are not relevant or applicable. It is our view that not addressing documentation for a LCE audit would limit any intrinsic cost savings that stakeholders may be expecting from the ED-ISA for LCE.

We also believe that the IAASB should assess the potential unintended consequences that will result from the ED-ISA for LCE. Refer to our response to Q3(a) for details on the unintended consequences that we believe will result from the ED-ISA for LCE.

Q19. What support and guidance would be useful when implementing the proposed standard?

Based on our experience we have found it necessary to develop specific enablement (e.g., forms and documentation guidance) to help auditors of LCEs. When lower complexity criteria are met, documentation should be able to be streamlined. Refer to Q18 for additional thoughts. Also, guidance would be useful to explain how management involvement in an LCE affects the identification and

assessment of risks of material misstatement at the assertion level (both positive and negative effects).

Q20. 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.

No comment.

Q21. 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 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.

The effective date of ED-ISA for LCE should be closely considered by the IAASB because the implementation of this standard will require a different approach than for a revision to a full ISA due to decisions that will need to be made about the authority in each jurisdiction (and potentially by firms). Firms will also need to assess and address the implications of providing audits under the ED-ISA for LCE on their systems of quality management, including how the standard may affect the portfolio of their audit engagements and determining transition plans for existing audit engagements that may qualify (e.g., updates to engagement acceptance, revised terms of engagement, communications with those charged with governance, assignment of staff, adaptation of methodologies/enablement/training).

Overall, we believe that the implementation of ED-ISA for LCE will require significant effort and coordination. We believe that the IAASB should establish an effective date that allows sufficient time for implementation considering the various parties involved in implementation. In particular, we believe that firms will need to defer implementation considerations until local jurisdictional plans for implementing the ED-ISA for LCE are known because decisions about the required or permitted use of the standard will rest with standard-setting, legislative or regulatory authorities in many jurisdictions. Because of the need for firms to understand any restrictions on use of the ED-ISA for LCE in the jurisdiction, it is our view that the IAASB consider the effect this may have on the establishment of the effective date. It would not seem to be appropriate for firms to implement the standard prior to adoption (or prior to the effective date that is established) by the jurisdiction, which is sometimes later than the effective date established by the IAASB. Otherwise, there would be a risk that a firm may apply the ED-ISA for LCE to an audit of entity for which the application is subsequently prohibited by the jurisdiction, which may call into question the validity of the audit opinion issued.

We do not agree that earlier application should be permitted, unless it is permitted by the jurisdiction or regulatory authority, for the same reasons expressed above.

Q22. 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.

As discussed above, we believe group audits should be included in the scope of ED-ISA for LCE based on the proposed Authority in the standard. We do not believe that the IAASB can make a blanket statement that group audits inherently exhibit characteristics of complexity within an entity. Many LCEs are a group and will require a group audit. The determination of the complexity of a group audit needs to be determined by the auditor using professional judgment and considering the specific characteristics of the entity. For example, if an LCE group operates entirely within the same jurisdiction, has only one or two components that have the same IT environment and no segments, as well as meets the other qualitative considerations set forth in the authority, we believe that it would be appropriate for such audits to apply the ED-ISA for LCE.

However, if the IAASB were to narrow down the criteria in the Authority section of the standard to make the ED-ISA for LCE applicable to only entities at the lowest level of complexity and potentially size, then we do not believe group audits should be included in the ED-ISA for LCE.

Regardless, we believe guidance is likely needed for entities that are subject to statutory audit requirements (and qualify for application of the ED-ISA for LCE for the purposes of the statutory audit), but also are components of a group audit that is performed in accordance with the full suite of ISAs. It would be useful for the IAASB to develop guidance on any specific adaptations to the work performed by the component under the ED-ISA for LCE that would be needed for that work to also meet the needs of the group audit.

Q23. 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?

Our member firms would need to understand the views of the standard-setters and other authorities at the jurisdictional level to determine the effect on the use of the standard in their respective jurisdictions. Overall, however, we would not expect that excluding group audits would preclude use of the standard; rather, there would be many audits that would otherwise seem to qualify for use if not for the fact they are group audits (at least under the proposed Authority).

(b) Approximately what % of the audits with 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?

This question is difficult to answer without knowing the specifics about an engagement's complexity. Of our 31 December year-end audits globally, less than 30% of our group audits are less than 500 audit hours and are likely to be considered LCEs. However, there may be many more audits that are less complex based on the qualitative criteria in the ED-ISA for LCE.

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

Although not specific to any jurisdiction or EY member firm, the following examples of group structures and circumstances that could be considered a less complex group are as follows:

- ▶ A group audit entirely within the same jurisdiction (country) with one or two components that have the same IT environment.
- ▶ An owner-managed group that comprises a head office location, several components that operate from the head office location, and one component that operates in another city within the same country. The head office and the components that operate at that head office location are audited by the group auditor. The remaining component is audited by a component team from the same firm.

Q24. If group audits are to be included in the scope of ED-ISA for LCE, how should this be done (please provide reasons for your preferred option): (a) The IAASB establishes a proxy(ies) for complexity 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.

Our preferred option would be for the ED-ISA for LCE to set out qualitative characteristics for complexity specific to group audits (Option 2). The qualitative characteristics could be used to help auditors determine whether the group audit would meet the complexity threshold. This would allow the auditors to exercise professional judgement based on the characteristics of the audit to determine if it is an LCE.

Q25. 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?

Additional proxies based on the criteria for complexity in paragraph 158 could be developed. For example, if there were more than one IT system, the presence of a shared services center, the entity operates in multiple jurisdictions or the entity has certain ownership structures present, then these characteristics would deem the entity more complex and prohibit the use of the ED-ISA for LCE. However, we do not support this option as we believe the determination of whether a group audit is an LCE should be made based on professional judgment considering the facts and circumstances of the entity. However, if the IAASB was to adopt our suggestion to narrow down the criteria in the Authority to make the ED-ISA for LCE applicable to only entities at the lowest level of complexity (i.e., refine the authority of use), then the prohibition to exclude group audits would be more understandable.

Q26. If group 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.

Since the ED-ISA for LCE is structured to follow the flow of an audit, we believe that the relevant requirements for group audits should be presented within each relevant part of the ED-ISA for LCE. It is our view that option (b) would be the most seamless approach to presenting the group audit content since using this approach would result in the guidance on group audits being presented within the ED-ISA for LCE when relevant to each part of the audit.

We would be pleased to discuss our comments with members of the International Auditing and Assurance Standards Board or its staff. If you wish to do so, please contact David Kane, Global Vice Chair, Professional Practice (david.kane@eyg.ey.com) or Kurt Hohl, Global Deputy Vice Chair, Professional Practice (kurt.hohl@eyg.ey.com).

Yours sincerely,

Ernst + Young Global Limited