



Exposure Draft - Proposed Part 10, *Audits of Group Financial Statements* of the Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE)

ICAJ Audit Practice Committee

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Background

July 2021

Exposure Draft of proposed ISA LCE approved June 2021 was published for public comment.

ISA LCE Prohibitions

Audits of group financial statements have also been excluded from the scope of the proposed standard due to complexity.

Jan 2022 - Feedback

Significant support for inclusion of group financial statements ED-ISA-LCE.

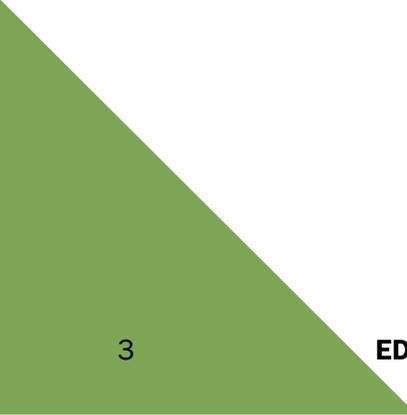
Jan 2023 - ED Part 10 Group Audits

IAASB made a decision for inclusion of group audits and ED for proposed Part 10 Audits of group FS issued for public comment.

Dec 2023 - Approval

Approval of the standard is expected at December 2023 meeting of the IAASB.





ED-ISA for LCE Review

ED-ISA for LCE – Review

Question

How many revisions to ISAs and quality control standards have there been in recent times?

- A. None
- B. Two
- C. More than 10
- D. Approx. 5 - 6

Recent Revisions to ISAs or Quality Control Standards

ISA 540 Revised

ISA 315 Revised

ISA 600 Revised

ISA 220 Revised

ISQM 1

ISQM 2

ED-ISA for LCE - Review



Why ED-ISA for LCE ?

- Need for global solution to challenges faced by LCEs
- Need for a standard designed to be proportionate to the nature and circumstances of LCE
- Growing concern about the length, complexity, and understandability of the existing standard and their application to audits of LCEs
- Questions on whether ISAs remain relevant and can be applied in a cost-effective manner to all audits

ED-ISA for LCE - Review

Composition of the standard

- ❑ Introduced as a standalone standard; and is not meant to be a top up standard
- ❑ Provides reasonable assurance using the concepts and principles already used in an ISA audit

- ❑ Incorporates the core aspects of ISA but excludes requirements addressing complexities, rare or exceptional circumstances.

For example included are

ISA 315 Revised – Risk assessment

ISA 240 - Fraud

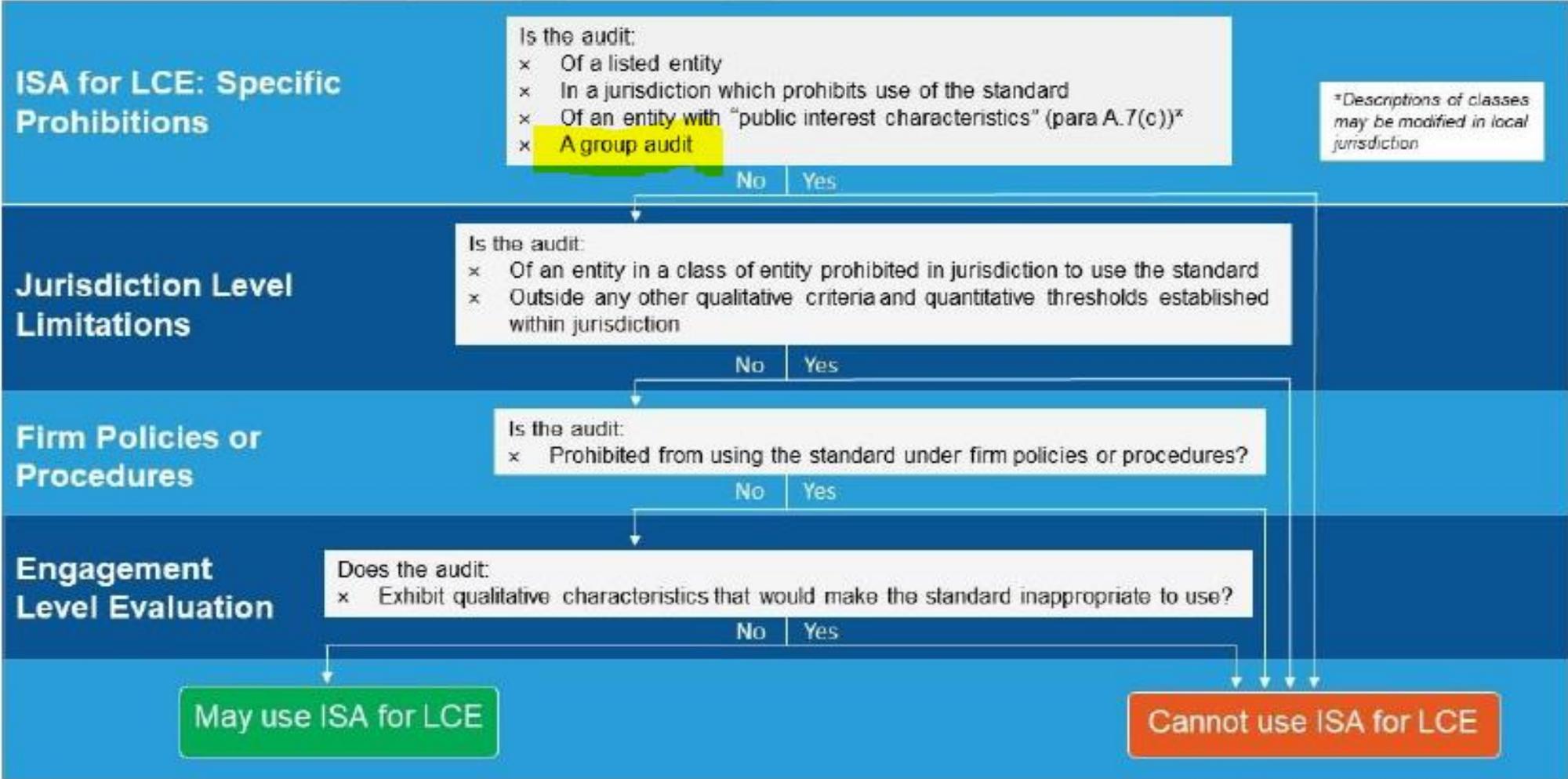
ISA 540 Revised – Estimates

ISA 550 – Related parties

Excluded are aspects of ISA 701 dealing with Key Audit Matters, ISA 501 on segment and aspects of ISA 600 Revised on group audits

Requirements on amendments to the financial statements after the date of the auditor's report are excluded as in most jurisdictions this is expected to be rare.

ED-ISA for LCE limitations for an individual engagement



ED-ISA for LCE – Review

Additional limitations – proxies for complexity:

- Use of Internal audit
- Accounting estimate with a higher degree of estimation uncertainty involving complex modelling
- The organizational structure is not relatively straightforward or simple, such as multiple levels and reporting lines, unusual entities or arrangements, such as special-purpose entities, complex joint ventures, off-balance sheet financing arrangements, or other complex financing arrangements.
- Complex oversight structure, IT environment and IT systems
- Operations subject to a higher degree of regulation or to significant regulatory oversight, such as being subject to prudential regulations
- Complex matters or circumstances relating to the nature and extent of the entity's business activities, operations and related transactions and events relevant to the preparation of the financial statements.
- Requirements for service organization relating to an auditor's ability to rely on reports on the operating effectiveness of controls from the entity providing the services (e.g., 'Type 1' and 'Type 2' reports).

ED-ISA for LCE - Review

Benefits of ED-ISA for LCE:

User friendly layout – draft standard is concise, succinct and relevant information readily available at hand. For example each section clearly outlines objectives, specific communication requirements to management and those charged with governance as well as specific documentation requirements.

A new section has also been added collating all of the various specific “inquiries” of management throughout the various standards to enable an easier understanding of the specific matters that need to be addressed.

Saves time - For example, auditors of LCEs will not need to spend time identifying what is applicable and what is not (e.g., as they would need to do if they were using the ISAs).

The auditor would therefore be able to invest more time executing appropriate procedures that more effectively targets the risks of material misstatement, when appropriately used for an audit of an LCE.

ED-ISA for LCE - Review

Benefits of ED-ISA for LCE:

- ❑ Reduced fragmentation of standards being applied globally with consistency in application resulting in development of the profession
- ❑ Greater confidence in audits from regulators and quality inspection reviews as requirements for LCE are more streamlined with clear focus on what is required.
- ❑ Better quality audit documentation

ED-ISA for LCE requirements follows the flow of audit engagement



ED-ISA for LCE - Review



The ED-ISA for LCE DOES NOT:

Reduce the core procedures the auditor is required to perform to support the overall quality of the audit.

FOCUS ON THE RIGHT AMOUNT OF WORK NOT LESS WORK!!

There has been a strong message from the IAASB's stakeholders that the separate standard should be based on the ISAs, and retain the robustness of an audit using the ISAs.

Accordingly, the separate standard would present the requirements for an audit of an LCE based on the core requirements of the ISAs but drafted and presented in a more understandable and straightforward way, including that the requirements follow the flow of an audit engagement.

ED-ISA for LCE – Review

Differences between Auditor's report in ISAs and ED-ISA for LCE:

The key differences between an auditor's report in ED-ISA for LCE and an ISA auditor's (unmodified) report include:

- ❑ Within the Basis for Opinion and the Auditor's Responsibilities sections: the auditor's report refers to the audit being conducted in accordance with the ISA for LCE.
- ❑ There is no ability to present the auditor's responsibilities elsewhere except in the body of the auditor's report. The ISAs also allow the auditor's responsibilities to be presented within an appendix to the auditor's report or by specific reference within the auditor's report to the location of such description on a website of an appropriate authority where expressly permitted by law, regulation or national auditing standards.

ED-ISA for LCE – Review

Transitioning Between ED-ISA for LCE and the ISAs:

The auditor is required to consider appropriateness at engagement acceptance or continuance and subsequent to engagement acceptance or continuance. Keep in mind future plans of the entity.

If it is determined that ED-ISA for LCE is no longer appropriate for use in an audit engagement, to transition the auditor would broadly need to (as appropriate in the circumstances):

- Re-establish the terms of engagement, for example through the issuance of an updated engagement letter.
- Reissue communications with those charged with governance, where relevant.
- Evaluate whether sufficient work has been performed with regard to planning the audit, including:
 - (i) Establishing an overall audit strategy.
 - (ii) Determining whether the audit plan is sufficient and appropriate.
 - (iii) Determining whether experts or others (e.g., internal audit) need to be involved, to address the complex circumstance(s).
 - (iv) Determining the work to be performed at a service organization (if applicable).

ED-ISA for LCE – Review

Transitioning Between ED-ISA for LCE and the ISAs:

- ❑ Consider whether there are any additional procedures required on opening balances.
- ❑ Evaluate the sufficiency and appropriateness of work already performed, including with respect to:
 - (i) Understanding the entity and its environment, the applicable financial reporting framework and the entity’s system of internal control, and risk identification and assessment.
 - (ii) Further audit procedures that have already been designed and performed.
 - (iii) Documentation.
- ❑ Design and perform additional procedures necessary to comply with all applicable ISA requirements (or requirements of other applicable auditing standards), with additional documentation as appropriate.
- ❑ Undertake other actions as considered necessary to meet the objectives of the ISAs (or requirements of other applicable auditing standards) or to meet the obligations in terms of the firm’s policies or procedures



Group Audits

Proposed Changes



1. Additions to Part A, Authority of the ISA for LCE

Prohibition on use of component auditors; and
Qualitative Characteristics related to group audits

2. New part on group audits (Proposed Part 10)

Separately identified section dealing with all Group audit matters.

3. Conforming amendments to other parts of proposed ISA for LCE – Group Audits

Proposed changes

IAASB concluded that based on the examples of groups which could be considered LCE from feedback received and the revised definitions in ISA 600 (Revised) not all group audits inherently exhibit characteristics of complexity and supported the inclusion of certain group audits in the scope of proposed ISA for LCE.



Definitions (ISA600 Revised)

Group

A reporting entity for which group financial statements are prepared

Group Audit

The audit of group financial statements

Component

An entity, business unit, function or business activity, or some combination thereof, determined by the group auditor for purposes of planning and performing audit procedures in a group audit

Group Financial Statements

Financial statements that include the financial information of more than one entity or business unit through a consolidation process. For purposes of this ISA, a consolidation process includes: (Ref: Para. A26–A28)

- (i) Consolidation, proportionate consolidation, or an equity method of accounting;
- (ii) The presentation in combined financial statements of the financial information of entities or business units that have no parent but are under common control or common management; or
- (iii) The aggregation of the financial information of entities or business units such as branches or divisions.

Prohibition on use of component auditors



Proxy for complexity or threshold for ISA LCE

Different jurisdictions, different languages, different laws or regulations, decentralized activities, including information systems and controls, greater experience and more in-depth knowledge of local requirements by the component auditors,

Group audits with no component auditor is consistent with the nature and circumstances of a typical LCE that the proposed standard is intended to be designed for and reduces judgement with use of a “bright line”.

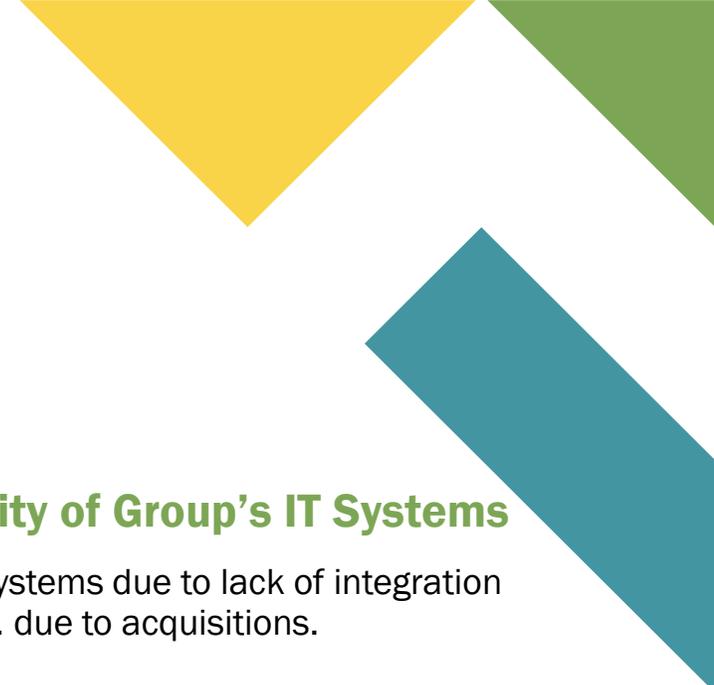
Practical considerations exception

Situations where a physical presence is required for a specific audit procedure in an otherwise less complex group (e.g., an inventory count or the verification of a physical asset performed at a component

Application restriction

This should be distinguished from a situation where a single legal entity is a component of a group and that entity’s financial statements are audited for statutory or other reasons, and the auditor of such entity is also involved in performing audit work for the purposes of the group audit at the request of the group auditor (i.e., is also a component auditor).

Qualitative Characteristics



Complexity of Group Structure

Multiple subsidiaries

Multiple equity accounted investments

Multiple branches, divisions, business units or locations

Different legal vs operating structure e.g. for tax purposes

Accounting for goodwill, joint ventures or special purpose entities

Structure and complexity of Group's IT Systems

Complex IT environment and systems due to lack of integration of entities within the group e.g. due to acquisitions.

Use of multiple external service providers for IT.

Regulatory factors

Operations may be subject to law or regulation in multiple jurisdictions, or entities or business units in the group that operate in multiple industries that are subject to different types of laws or regulations.

Qualitative Characteristics



Ownership, and relationships between owners and other people or entities

Many entities or business units or that operate over multiple jurisdictions

Changes in ownership through formation, acquisitions or joint ventures

Geographic locations of the Group's operations

Multiple geographic locations gives rise to different laws, regulations, languages, cultures and business practices.

Consolidation process used by the group

Example sub-consolidations and consolidation adjustments. The level of centralization versus decentralization of the group's activities or processes relevant to its financial reporting process, and the consistency of the accounting policies and practices applied across the group may also add complexity to the consolidation process.

Qualitative Characteristics amendments

Group structure and activities

The group has few entities or business units (e.g., 5 or less).

Group entities or business units are limited to few jurisdictions (e.g., 3 or less).

A group may be more complex when the number of entities or business units increase or are in a number of jurisdictions

Access to information and people

Group management will be able to provide the engagement team with access to information and unrestricted access to persons within the group as determined necessary by the auditor.

A group may comprise of multiple entities or business units and therefore it may be more complex for group management to provide access to information or people.

Consolidation process used by the group

A group may be more complex because of the consolidation process

The group has a simple consolidation process, for example where:

Financial information of all entities or business units has been prepared in accordance with the same accounting policies applied to the group financial statements;

All entities or business units have the same financial reporting period-end as that used for group financial reporting;

There are no sub-consolidations; and

Intercompany, or other consolidation adjustments are not complex.

Examples suggested by respondents of LCE Group Audits

Feedback Comments

A holding company with one wholly owned trading subsidiary and one or more dormant subsidiaries all of which are individually considered to be less complex entities;

Groups with dormant components where the group auditor (group engagement partner at a minimum and perhaps also the engagement manager) audits all components, all of which are performed under the LCE standard (i.e., no use of other component auditors).

Groups that consist of one or more holding companies (which hold investments or property, plant and equipment)

Wholly-owned components with little or no revenue-generating operations

Certain group structures that are done only for tax planning purposes; the consolidated entity is operated as a single unit with common management of all entities in the group.

Trusts with corporate trustees

A sole proprietor business with a local trust holding the beneficial interest

A group of companies in same jurisdiction with one or two components and similar IT environment.

Proposed Part 10, Audits of Group Financial Statements



Proposed separate part rather than including within relevant parts of ISA for LCE

- Keep the body of the proposed standard more streamlined and easier to use, especially for audits that are not group audits;
- Make it easier for auditors of groups to see all relevant additional requirements in one place; and
- Make it easier to exclude proposed Part 10 if a jurisdiction decided to not allow the proposed standard to be used for group audits.

Proposed Part 10, Audits of Group Financial Statements



Exclude relevant sections of ISA 600 Revised that:

Relates to the involvement of component auditors (to reflect the decision to exclude the use of component auditors from the scope of the proposed ISA for LCE other than in limited circumstances).

Are deemed to indicate complexity that would not be typical for an LCE. For example, requirements related to the evaluation of consolidation adjustments for entities or business units with different accounting policies or reporting periods are not included, as these matters are deemed to be indicators of complexity in the Authority.

Proposed Conforming Amendments Arising from Proposed Part 10

Conforming Amendments:

In Part 9, proposed revisions explain additional content of the Auditor's Report in a group audit. It is anticipated that the Non-Authoritative Supplemental Guide on Reporting will be updated for matters relevant for group audits (including illustrative reports) after finalization of the proposed ISA for LCE

In the Glossary, the IAASB added definitions for terms used in proposed Part 10. These definitions are similar to the definitions in ISA 600 (Revised).

The IAASB decided not to include the following definitions from ISA 600 (Revised): *Group auditor, Group audit opinion and Group engagement partner.*

ED-ISA for LCE - Resources

Mapping documents – ISAs to ED-ISA for LCE

<https://www.iaasb.org/publications/mapping-documents-isas-proposed-isa-lce>

Exposure Draft, Proposed International Standard on Auditing of financial statements of less complex entities

<https://www.iaasb.org/publications/exposure-draft-proposed-international-standard-auditing-financial-statements-less-complex-entities>

Proposed Part 10, Audits of Group Financial Statements of the proposed ISA for audits of financial statements of less complex entities

<https://www.iaasb.org/publications/proposed-part-10-audits-group-financial-statements-proposed-isa-audits-financial-statements-less>

Practice transformation hub:

<https://www.ifac.org/practicetransformation>

IFAC SMP Advisory Group:

<https://www.ifac.org/smp>



Thank You!

