



February 2023

Consultation Paper

Exposure of the IAASB's 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 Group Audits)*

Issued by the Auditing and Assurance Standards Board



Obtaining a Copy of this Consultation Paper

This Consultation Paper is available on the Auditing and Assurance Standards Board (AUASB) website: www.auasb.gov.au

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Consultation Paper
Exposure of the IAASB's 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 Group Audits)

Important Note and Disclaimer

This Consultation Paper is issued by the AUASB to provide information to auditors and assurance practitioners about the Exposure of the IAASB's *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 Group Audits)*.

This Consultation Paper does not establish or extend the requirements under an existing AUASB Standard(s) and is not intended to be a substitute for compliance with the relevant AUASB Standards with which auditors and assurance practitioners are required to comply when conducting an audit or other assurance engagement. No responsibility is taken for the results of actions or omissions to act on the basis of any information contained in this document or for any errors or omissions in it.

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CONTENTS

	<i>Paragraph</i>
Introduction.....	1-3
Objectives.....	4
ED ISA – LCE Group Audits	
Exposure of ED ISA – LCE Group Audits	5-6
Request for comment	7
Background to and AUASB approach to ED ISA – LCE Group Audits	
IAASB.....	8-9
AUASB	10-16
Outreach Activities.....	17
Appendix 1 – Questions on Exposure	
Appendix 2 – IAASB ED–ISA for LCE Group Audits (including Explanatory Memorandum)	

Consultation Paper

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CONSULTATION PAPER

Exposure of the IAASB's 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 Group Audits)

Introduction

1. In June 2021, the International Auditing and Assurance Standards Board (IAASB) issued [Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities](#) (ED ISA – LCE) which was open for public consultation until 31 January 2022. Since then, the IAASB has been evaluating feedback received from the exposure draft and other outreach activities. In its June 2022 and September 2022 meetings the IAASB discussed key areas of feedback and related revisions to targeted areas of the proposed standard. This included revisions to the Authority of the proposed standard taking into account the incorporation of audits of group financial statements (group audits).
2. Feedback from stakeholders strongly supported the inclusion of group audits as a part of the proposed standard and that a blanket prohibition was considered inappropriate. In the [AUASB's submission to the IAASB on ED ISA – LCE](#), the AUASB did not support the exclusion of group audits. The AUASB considered that the blanket prohibition disallowing the use of the proposed ED – ISA for LCE Standard on group audits was not justified, especially in the case of small, non-complex components of a group engagement. AUASB investigations highlighted that not all group audits are complex, and the exclusion of group audit engagements, particularly considering the recent changes made to the revised ISA 600, will restrict the usefulness of this standard for many 'simple' groups. The AUASB considered that the IAASB could establish some clearer criteria around which groups may be included in the scope of the proposed standard, in setting such criteria, the AUASB supported a 'bright lines' determination of which groups are within the scope of the proposed standard.
3. Overall feedback from stakeholders and analysis by the IAASB has led the IAASB to propose including group audits into the proposed standard subject to specified characteristics and with a 'bright line' exclusion where component auditors are used. The IAASB is now exposing this new part of the proposed standard that covers group audits (ED ISA – LCE Group Audits).

Objective

4. The objective of this Consultation Paper is to expose ED ISA – LCE Group Audits and request comments.

ED ISA – LCE Group Audits

Exposure of ED ISA – LCE Group Audits

5. The IAASB version of the ED ISA – LCE Group Audits has been issued for comment in Australia by the AUASB (Appendix 2 to this Consultation Paper) without modification in accordance with the AUASB's [Due Process Framework](#).
6. The approach of "wrapping-around" the IAASB's proposed standard with an Australian Consultation Paper:
 - (a) Provides the best opportunity to obtain robust feedback from Australian stakeholders about significant matters at the optimal stage in the AUASB standard-setting process, which is dependent on a high quality IAASB standard. Our stakeholders' feedback will feed into the AUASB's formal feedback to the IAASB on ED ISA – LCE Group Audits. This feedback will then be used by the ED ISA – LCE taskforce in determining the changes required to finalise the ED ISA – LCE standard.

Consultation Paper

Exposure of the IAASB's 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 Group Audits)

- (b) Results in an Australian exposure process which closely follows the IAASB release and maximises stakeholder's time to consider the changes.
- (c) The final Australian standard could be issued at a very similar time to the international standard with the advantage being Australian entities have the same adoption response time as international entities.

Request for comment

- 7. The AUASB requests comments on all matters relating to ED ISA – LCE Group Audits as contained in the appendices to this Consultation Paper. Stakeholders' responses will be used to inform the AUASB in their formal response to the IAASB on ED ISA – LCE Group Audits. Additionally, responses will be used in AUASB deliberations regarding the issuance of the final Australian standard, including assessing compelling reasons¹ for any Australian-specific enhancements.

Background to and AUASB approach to ED ISA – LCE Group Audits

IAASB

- 8. A background of the original ED ISA – LCE is provided in the [Consultation Paper Exposure of the IAASB's Auditing for Audits of Financial Statements of Less Complex Entities \(ISA for LCE\); and Consideration of Possible alternative options for Australian LCE audits](#).
- 9. A detailed background on ED ISA – LCE Group Audits is included in the IAASB's [Explanatory Memorandum to ED ISA – LCE](#).

AUASB

- 10. The AUASB has a strategic objective to develop, issue and maintain high quality Australian Auditing Standards. The AUASB takes input received from Australian stakeholders into account when preparing its submissions to the IAASB. The AUASB makes formal submissions on EDs issued by the IAASB to contribute to the setting of international auditing and assurance standards.
- 11. Throughout the development of ED ISA – LCE and ED ISA – LCE Group Audits, the AUASB has actively monitored and provided input into the development of the exposure drafts in accordance with its [International Strategy](#).
- 12. In accordance with its mandates under section 227 of the *ASIC Act 2001* and the Financial Reporting Council's (FRC) Strategic Direction, the AUASB's policy is to use, as appropriate, the IAASB's ISAs as a base from which to develop Australian Auditing Standards, unless there are compelling reasons not to do so; and to amend the ISAs only when there are compelling reasons to do so.
- 13. Compelling reasons fall broadly into two categories: legal and regulatory; and principles and practices considered appropriate in maintaining or improving audit quality in Australia. Compelling reasons are further guided by the AUASB's policy of [harmonisation with the standards of the New Zealand Auditing and Assurance Standards Board](#) (NZAuASB).

The AUASB will consider all stakeholder responses in the AUASB's submission to the IAASB. The AUASB will then actively monitor and influence as appropriate, any future IAASB amendments to ED ISA – LCE Group Audits before deliberating if any potential Australian compelling reasons are required to the final ISA LCE (including the group audit section) as part of its due process.

¹ Refer to paragraph 13 of this Consultation Paper for an explanation of compelling reasons.

Consultation Paper

Exposure of the IAASB's 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 Group Audits)

14. Additionally, the AUASB may decide to re-expose all or part of the proposed standard should it deem the changes from the ED originally published are significant, whether due to changes made by the IAASB or Australian specific changes the AUASB proposes to make in accordance with the “compelling reasons” test. Any decision about the timing or nature of re-exposure will be made by the AUASB after the IAASB has finalised its proposed standard and will be subject to the usual AUASB due process.
15. ED ISA – LCE Group Audits will be open to stakeholders for a **60-day comment period** closing on 11 April 2023. This is to allow stakeholders time to respond to the AUASB on the ED, for the AUASB technical group to collate all feedback and for the AUASB to consider and approve our submission to the IAASB due on 2 May 2023.
16. At the completion of the exposure period and consultation process, the AUASB will consider stakeholders’ submissions:
 - to inform us when developing our response to the IAASB on their ED; and
 - where the AUASB determines that a compelling reason exist, to inform us as to whether modifications may be required if the final standard is adopted, where considered appropriate.

Outreach Activities

17. The AUASB conducted outreach at the time of ED ISA – LCE being released. All AUASB feedback obtained at the time in relation to group audits has been considered in ED ISA – LCE Group Audits. ED ISA – LCE Group Audits will be shared on AUASB social media platforms, AUASB newsletters and the AUASB webpage. The Exposure Draft will be discussed by the AUASB at the March 2023 AUASB meeting. The AUASB welcomes any additional comments on ED ISA – LCE Group Audits, but due to the narrow scope of the Exposure Draft no dedicated outreach activities in relation to this Consultation Paper are planned.

* *

Consultation Paper
Exposure of the IAASB's 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 Group Audits)

Appendix 1 – Questions on Exposure

IAASB Questions

NB: There are no variations between the questions below and those in the IAASB's Explanatory Memorandum, but for completeness and ease of use by respondents they are replicated in this AUASB Consultation Paper (ED 01/23).

1. In the Authority, do you agree with the proposed prohibition on the use of the proposed ISA for LCE for group audits where component auditors are involved, other than in limited circumstances where physical presence is required?
2. In the Authority, do you agree with the proposed group-specific qualitative characteristics to describe the scope of group audits for which the proposed ISA for LCE is designed to be used?
3. Do you agree with the content of proposed Part 10 and related conforming amendments?

Australian Specific Questions

Considerations related to Australian Principles and Practices and Laws and Regulation

Stakeholders are asked to respond to the following AUASB specific questions which reflect considerations for ED 01/23 related to the Australian regulatory environment and principles and practices considered appropriate in Australia.

4. Have applicable laws and regulations been appropriately addressed in the proposed Part 10 and related conforming amendments? Are there any references to relevant laws or regulations that have been omitted?
5. Whether there are any laws or regulations that may, or do, prevent or impede the application of the proposed Part 10 and related conforming amendments, or may conflict with the proposed Part 10 and related conforming amendments?
6. Whether there are any principles and practices considered appropriate in maintaining or improving audit quality in Australia that may, or do, prevent or impede the application of the proposed Part 10 and related conforming amendments, or may conflict with the proposed Part 10 and related conforming amendments?
7. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the requirements of this proposed Part 10 and related conforming amendments? If significant costs are expected, the AUASB would like to understand:
 - (i) Where those costs are likely to occur;
 - (ii) The estimated extent of costs, in percentage terms (relative to audit fees); and
 - (iii) Whether expected costs outweigh the benefits to the users of audit services?
8. Are there any other significant public interest matters that stakeholders wish to raise?

Consultation Paper
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Appendix 2 – IAASB ED–ISA for LCE Group Audits (including Explanatory Memorandum)

**Exposure Draft
January 2023**

Comments due: May 2, 2023

International Standard on Auditing

**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)**

and

**Proposed Conforming
Amendments**

IAASB

International Auditing
and Assurance
Standards Board

About the IAASB

This Exposure Draft was developed and approved by the International Auditing and Assurance Standards Board (IAASB).

The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance.

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ISA.

IAASB
International Auditing
and Assurance
Standards Board.

REQUEST FOR COMMENTS

This Exposure Draft of 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) was developed and approved by the IAASB.

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by May 2, 2023.**

Respondents are asked to submit their comments electronically through the IAASB website, using the "[Submit Comment](#)" link. Please submit comments in both a PDF and Word file. First-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website.

This publication may be downloaded from the IAASB website: www.iaasb.org. The approved text is published in the English language.

EXPLANATORY MEMORANDUM

CONTENTS

	Page
Introduction	5
Background	5
Section 1 Guide for Respondents	6
Section 2 Significant Matters	6
Section 2-A – Proposed Additions to the Authority	6
Section 2-B – Proposed Part 10, <i>Audits of Group Financial Statements</i>	8
Section 2-C – Proposed Conforming Amendments Arising from Proposed Part 10	9
Section 3 Request for Comments	10
Appendix – Revisions to the Authority Since the ED-ISA for LCE	11
Exposure Draft	
Proposed Additions to the Authority for Group Audits	13
Proposed Part 10 – <i>Audits of Group Financial Statements</i>	15
Proposed Conforming Amendments Arising from Proposed Part 10	20

Introduction

1. This memorandum provides background to, and an explanation of, the Exposure Draft of proposed Part 10 of the proposed ISA for LCE which was approved for exposure by the IAASB in December 2022.

Background

2. In December 2020, the [Project Proposal](#) for the workstream to develop a separate standard for Less Complex Entities (LCE) was approved by the IAASB, and in July 2021 the [Exposure Draft of Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities](#) (ED-ISA for LCE) was published for public comment.
3. In the ED-ISA for LCE, audits of group financial statements (group audits) were excluded from the scope of the proposed standard. This was done because the IAASB, on balance, had the view that group audits inherently exhibited characteristics of complexity within an entity and, consistent with other areas of complexity, had not been contemplated in the design of the proposed standard. The IAASB was open to reconsider the decision to exclude group audits based on stakeholder feedback and included a specific question regarding whether group audits should be excluded from (or included in) the scope of the proposed standard.
4. Respondents to the ED-ISA for LCE along with participants of outreach activities showed strong support for the inclusion of group audits. Therefore, the IAASB reconsidered its decision to exclude group audits from the scope of the ED-ISA for LCE. The IAASB concluded that, taking into account the examples of less complex groups provided by respondents to ED-ISA for LCE and the revised definitions in ISA 600 (Revised),^{1 2} 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.
5. As the ED-ISA for LCE included a specific prohibition that excluded all group audits, it did not include any requirements or Essential Explanatory Material (EEM) related to group audits. Given the IAASB's June 2022 decision to include certain group audits in the scope of the proposed ISA for LCE, the IAASB subsequently developed requirements in this area which had not previously been exposed for public comment.
6. Contents of the proposed ISA for LCE not related to group audits are currently being considered for revision through analysis and discussions of the comments received from ED-ISA for LCE. Therefore, further feedback on such content (i.e., the Authority of the ISA for LCE (excluding the Authority related to group audits), Parts 1-9, Preface) is not invited at this time and will not be considered.
7. The 90-day comment period of this Exposure Draft will allow, subject to the nature and extent of comments received, the IAASB to approve Part 10 at the same time as the remaining parts of the proposed ISA for LCE. The IAASB plans to approve the ISA for LCE in its December 2023 meeting.

¹ ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

² ISA 600 (Revised) will be effective for audits of group financial statements for periods beginning on or after December 15, 2023 and includes a revised definition of group financial statements. Because of the revised definition, more LCEs are deemed to be a group than under extant ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.

Section 1 Guide for Respondents

The IAASB welcomes comments on all matters addressed in this exposure draft, but especially those identified in the Request for Comments section. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and make specific suggestions for any proposed changes to wording. Respondents are also free to address only questions relevant to them. When a respondent agrees with proposals in this exposure draft, it will be helpful for the IAASB to be made aware of this view as support for the IAASB's proposals cannot always be inferred when not stated.

Section 2 Significant Matters

8. Given the IAASB's decision to include certain group audits in the scope of the proposed ISA for LCE, the IAASB has proposed:
- Additions to Part A, *Authority of the ISA for Audits of Financial Statements of Less Complex Entities* (the Authority) (see **Section 2-A**);
 - A new part on group audits, proposed Part 10, *Audits of Group Financial Statements* (see **Section 2-B**); and
 - Conforming amendments to other parts of the proposed ISA for LCE (see **Section 2-C**).

Section 2-A – Proposed Additions to the Authority

A summary of changes that the IAASB has made thus far to the Authority (i.e., not related to group audits) since the ED-ISA for LCE is presented in the **Appendix**.

9. The Authority of the proposed ISA for LCE describes when the proposed standard is appropriate for use in undertaking an audit engagement. In addition to removing the prohibition on the use of the standard when the audit is a group audit, the IAASB discussed:
- A prohibition on the use of component auditors; and
 - Qualitative characteristics related to group audits.

Prohibition on the Use of Component Auditors

10. The IAASB had mixed views about whether group audits where component auditors are involved should be included in the scope of the proposed ISA for LCE.
11. On one hand, the IAASB noted that, generally, component auditors are more often used in more complex groups (e.g., in groups where activities for financial reporting is decentralized across individual entities or operations span across multiple jurisdictions such that the involvement of a component auditor would be needed). Therefore, the IAASB was of the view that prohibiting the use of component auditors was consistent with the nature and circumstances of a typical LCE that the proposed standard is intended to be designed for. The IAASB also noted that the use of a "bright line" prohibition would reduce the level of judgment by an auditor when determining if the ISA for LCE can be used and, therefore, would be easier to apply.
12. On the other hand, the IAASB did acknowledge that the use of component auditors may sometimes be due to a practical consideration rather than due to the complexity of the group itself. For example, there may be 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). Not including a specific prohibition for audits where component auditors are involved would also be consistent with the overall approach to the Authority of the proposed ISA for LCE as the use of the standard should be driven by the complexity of the entity and not that of the audit.

13. On balance, the IAASB was of the view that the use of component auditors should be excluded from the scope of the proposed ISA for LCE, recognizing the overall pervasive theme heard from respondents to ED-ISA for LCE that the scope of the proposed standard should better reflect the typical LCE for which the proposed ISA for LCE is intended to be designed for.
14. The IAASB did consider the examples provided through outreach and from respondents to ED-ISA for LCE of situations where component auditors may be involved in a less complex group audit. To address these circumstances the IAASB has proposed that the Authority prohibits the use of the ISA for LCE when component auditors are involved “*except when the component auditor’s involvement is limited to circumstances in which a physical presence is needed for a specific audit procedure for the group audit (e.g., attending a physical inventory count or inspecting physical assets)*” (see paragraph A.1 (d)(ii) of the Proposed Additions to the Authority for Group Audits).
15. The IAASB has also proposed EEM to provide guidance around determining whether the audit is a group audit and evaluating whether an auditor is a component auditor.

Qualitative Characteristics Related to Group Audits

16. The IAASB discussed if, and if so how, the qualitative characteristics of a less complex group differ from the qualitative characteristics of an LCE that is not a group and is of the view that the qualitative characteristics are broadly the same (i.e., a group as a whole and each of its individual entities and business units should meet the qualitative characteristics of an LCE that is not a group). At the same time, the IAASB noted that there are additional qualitative characteristics for group audits that should be considered (see paragraph 17 below).
17. The IAASB considered indicators of complexity that more specifically relate to group audits, including those described in paragraph 158 of the Explanatory Memorandum accompanying ED-ISA for LCE and those suggested by respondents to ED-ISA for LCE. The IAASB noted that most areas of complexity for a group were already addressed by the qualitative characteristics for an entity that is not a group, except the following group specific circumstances:
 - (a) *Group Structure and Activities* – a group may be more complex when the number of entities or business units increase or are in a number of jurisdictions.
 - (b) *Access to Information or People* – 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.
 - (c) *Consolidation Process* – a group may be more complex because of the consolidation process.

Based on the above, proposed additional “group-specific” characteristics are presented at paragraph A.3. of the Proposed Additions to the Authority for Group Audits.

Section 2-B – Proposed Part 10, *Audits of Group Financial Statements*

Background

18. Respondents to ED-ISA for LCE supported including the group audit requirements in a separate part rather than including requirements within the relevant parts of the proposed ISA for LCE because this would:

- 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.

The IAASB agreed that this would be an appropriate presentation.

Development of Proposed Part 10

19. Similar to the other parts, proposed Part 10 is based on the core requirements of the relevant ISA – for proposed Part 10 this is ISA 600 (Revised). The IAASB did not include requirements in ISA 600 (Revised) that:

- Relate 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). The IAASB is of the view that these limited circumstances would be appropriately addressed by requirements in other parts of the proposed ISA for LCE. This is consistent with how such circumstances are addressed in the ISAs. These include the requirements in Part 3 in relation to engagement quality, relevant ethical requirements, and the direction and supervision of the members of the engagement team and the review of their work.
- 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 (as described in the proposed qualitative characteristic relating to a group's consolidation process).

20. Taking into account the typical nature and circumstances of a less complex group, a number of requirements in ISA 600 (Revised) were not included in Part 10 as they were deemed to be sufficiently addressed by requirements in other parts of the proposed ISA for LCE. For example, paragraph 19 of ISA 600 (Revised) requires the group auditor to obtain agreement of group management regarding its responsibilities to provide the engagement team with access to people and information, and paragraph 4.3.1. of ED-ISA for LCE requires the auditor to obtain agreement of management regarding the same specific matters. In this instance, the IAASB was of the view that it was not necessary to include a specific additional requirement in proposed Part 10, to address paragraph 19 of ISA 600 (Revised) as it was sufficiently addressed by paragraph 4.3.1.

21. Consistent with ISA 600 (Revised), the introductory box to proposed Part 10 explains that the requirements and guidance in proposed Part 10 refer to, or expand on, the application of other parts of the proposed ISA for LCE to a group audit.

22. The IAASB included EEM based on the application material included in ISA 600 (Revised) when it was deemed to be appropriate and proportionate for a typical LCE and consistent with the general approach to EEM taken in the proposed ISA for LCE. As described in paragraph 88 of the Explanatory Memorandum accompanying ED-ISA for LCE, EEM serves a similar purpose to application and other explanatory material in the ISAs but is more limited and is targeted at a higher level.

Section 2-C – Proposed Conforming Amendments Arising from Proposed Part 10

23. The IAASB reviewed the other parts of the proposed ISA for LCE to identify areas where conforming amendments should be made due to the incorporation of group audits and identified conforming amendments to the Preface, Part 9,³ and the Glossary.
24. 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.
25. 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.* ISA 600 (Revised) describes requirements of both the group auditor and component auditor. As component auditors are not in the scope of the proposed ISA for LCE other than in limited circumstances, auditors using the proposed Part 10 can only be a group auditor (ISA 600 (Revised) only refers to the group auditor or a component auditor). Therefore, the IAASB concluded that it is not necessary to use the term “group” when referring to the auditor. This also aids in the consistency of proposed Part 10 with the other parts.
 - *Group audit opinion.* As there are no references to the group audit opinion in proposed Part 10, the IAASB did not include this definition
 - *Group engagement partner.* As there are no references to the group engagement partner in proposed Part 10, the IAASB did not include this definition.

³ Part 9, *Forming an Opinion and Reporting*

Section 3 Request for Comments

Respondents are asked to comment on the clarity, understandability and practicality of application of proposed Part 10 and related conforming amendments. In this regard, comments will be most helpful if they are identified with specific aspects and include the reasons for any concern about clarity, understandability and practicality of application, along with suggestions for improvement. When a respondent agrees with the proposals, it will be helpful for the IAASB to be made aware of this view.

Specific Questions

Please respond directly to the questions and provide the rationale for your answers, as well as specific suggestions, where appropriate. We appreciate all your feedback, and respondents may respond to all questions or only those questions where they have specific comments.

1. In the Authority, do you agree with the proposed prohibition on the use of the proposed ISA for LCE for group audits where component auditors are involved, other than in limited circumstances where physical presence is required?
2. In the Authority, do you agree with the proposed group-specific qualitative characteristics to describe the scope of group audits for which the proposed ISA for LCE is designed to be used?
3. Do you agree with the content of proposed Part 10 and related conforming amendments?

Respondents are reminded that the IAASB is not asking for further feedback on content of the proposed ISA for LCE that does not relate to group audits.

Appendix

Revisions to the Authority Since the ED-ISA for LCE

This content below is included for information purposes only. It is not part of the proposed additions to the Authority for group audits and, therefore, the IAASB is not inviting comment on this content.

Background

This Appendix includes a description of directional changes to the Authority that have been discussed by the IAASB since the ED-ISA for LCE. For more information on respondents' views on the Authority and the IAASB's proposals, please refer to the issues papers for the IAASB's [June](#) and [September](#) 2022 meetings.

Feedback on the Authority

Respondents to ED-ISA for LCE expressed concerns that the Authority was unclear as to the intended scope of the proposed ISA for LCE. It was noted that the Authority:

- Was too open (i.e., it was not clear enough about which entities on the “complexity spectrum” the standard was designed for); and
- Involved too much judgment;

and may therefore lead to inconsistent use of the proposed standard, or use of the proposed standard for complex entities.

Respondents to ED-ISA for LCE also noted that the Authority should be clearer about the qualitative characteristics that a typical LCE exhibit and suggested to focus on describing what is “less complex” (rather than describing complex circumstances). This would drive a conscious determination about whether the entity is truly “less complex.” To be more specific, respondents also suggested using illustrative numerical indicators (where appropriate).

The IAASB discussed proposed revisions to individual qualitative characteristics that describe a typical LCE for the purpose of determining the appropriate use of the proposed ISA for LCE. The proposed revisions include:

- *Business Activities, Business Model and Industry* – removing reference to new or emerging markets, or entities in the development stage and instead focusing on whether matters give rise to significant business risks, if there are specific laws or regulations that add complexity, and if transactions result from few business activities or revenue streams.
- *Organizational Structure and Size* – removing reference to unusual entities or arrangements and better describing what makes an entity's structure straightforward, including having few reporting lines or levels and a small key management team.
- *Ownership Structure* – focusing on the presence of clear transparency of ownership and control, such that all individual owners and beneficial owners are known.
- *Nature of Finance Function* – new characteristic describing centralized financial reporting with few employees involved in financial reporting roles.

- *Information Technology* – updating to be more consistent with the characteristics used to describe complexity in ISA 315 (Revised 2019)⁴ Appendix 5 (e.g., commercial software, limited access to make configurations, few formalized general IT controls needed).
- *Application of the Financial Reporting Framework and Accounting Estimates* – removing reference to estimation uncertainty and describing the presence of few accounts or disclosures that necessitate the use of significant management judgment and where financial statements typically do not include accounting estimates that involve the use of complex methods or models, assumptions or data.

⁴ ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

PROPOSED ADDITIONS TO THE AUTHORITY FOR GROUP AUDITS

Marked from Exposure Draft of the proposed ISA for LCE¹

A. Authority of the ISA for Audits of Financial Statements of Less Complex Entities

Limitations for Using the ISA for LCE

...

Specific Prohibitions

...

A.71. The ISA for LCE shall not be used if:

...

- (d) The audit is an audit of group financial statements (group audit) and:
 - (i) Any of the group's individual entities or business units meet the criteria as described in paragraph A.1.(b) or A.1.(c);² or
 - (ii) Component auditors are involved, except when the component auditor's involvement is limited to circumstances in which a physical presence is needed for a specific audit procedure for the group audit (e.g., attending a physical inventory count or inspecting physical assets).

A single legal entity may be organized with more than one business unit, for example, a company with operations in multiple locations, such as a store with multiple branches. When those business units have characteristics such as separate locations, separate management, separate general ledger and the financial information is aggregated in preparing the single legal entity's financial statements, such financial statements meet the definition of group financial statements because they include the financial information of more than one entity or business unit through a consolidation process.

In some cases, a single legal entity may configure its information system to capture financial information for more than one product or service line for legal or regulatory reporting or other management purposes. In these circumstances, the entity's financial statements are not group financial statements because there is no aggregation of the financial information of more than one entity or business unit through a consolidation process. Further, capturing separate information (e.g., in a sub-ledger) for legal or regulatory reporting or other management purposes does not create separate entities or business units (e.g., divisions) for purposes of this ISA for LCE.

¹ As described in Section 2-A, only additions to the Authority that are specific to group audits have been presented for comment.

² In ED-ISA for LCE the equivalent paragraphs to paragraphs A.1.(b) and A.1.(c) are paragraphs A.7.(b) and A.7.(c) relating to prohibitions for listed entities and certain classes of entities exhibiting public interest characteristics. As described in Section 2-A, revisions to these paragraphs are currently being discussed based on feedback from ED-ISA for LCE.

Component Auditors

A component auditor is an auditor who performs audit work related to a component³ for purposes of the group audit. A component auditor is a part of the engagement team for a group audit.

Part 3 contains requirements in relation to engagement quality, including relevant ethical requirements, and the direction and supervision of the members of the engagement team, and the review of their work.

When the auditor responsible for the group audit performs audit procedures related to a component, the auditor is not considered a component auditor.

...

Qualitative Characteristics

...

A.93.

...

For the purpose of group audits, these considerations shall apply to both the group and each of its individual entities and business units.

...

<u>Additional Characteristics Relevant for Group Audits</u>	
<u>For group audits, the following qualitative characteristics are to be considered in addition to those above:</u>	
<u>Group Structure and Activities</u>	<u>The group has few entities or business units (e.g., 5 or less).</u> <u>Group entities or business units are limited to few jurisdictions (e.g., 3 or less).</u>
<u>Access to Information or People</u>	<u>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.</u>
<u>Consolidation Process</u>	<u>The group has a simple consolidation process. For example:</u> <ul style="list-style-type: none"> • <u>Financial information of all entities or business units has been prepared in accordance with the same accounting policies applied to the group financial statements;</u> • <u>All entities or business units have the same financial reporting period-end as that used for group financial reporting;</u> • <u>There are no sub-consolidations; and</u> • <u>Intercompany, or other consolidation adjustments are not complex.</u>

...

³ A component is an entity, business unit, function or business activity, or some combination thereof, determined by the auditor responsible for the group audit for the purposes of planning and performing audit procedures in a group audit.

PROPOSED PART 10 – AUDITS OF GROUP FINANCIAL STATEMENTS

10. Audits of Group Financial Statements

Content of this Part

Part 10 sets out the special considerations that apply to an audit of group financial statements.

Scope of this Part

All parts of the ISA for LCE apply to an audit of group financial statements (a group audit). The requirements and guidance in this Part refer to, or expand on, the application of other parts of the ISA for LCE to a group audit.

10.1. Objective

10.1.1. The objective of the auditor is to identify and assess the risks of material misstatement of the group financial statements, whether due to fraud or error, and plan and perform further audit procedures to appropriately respond to those assessed risks.

10.2. Planning Activities

10.2.1. In applying Part 5, the auditor shall establish, and update as necessary, the scope, timing and direction of the group audit. In doing so, the auditor shall determine:

- (a) The components at which audit work will be performed; and
- (b) The resources needed to perform the group audit engagement.

Components

The determination of components at which to perform audit work is a matter of professional judgment. Matters that may influence the auditor's determination include, for example:

- *The nature of events or conditions that may give rise to risks of material misstatement at the assertion level of the group financial statements that are associated with a component, for example, newly formed or acquired entities or business units or entities or business units in which significant changes have taken place.*
- *The disaggregation of significant classes of transactions, account balances and disclosures in the group financial statements across components, considering the size and nature of assets, liabilities and transactions at the location or business unit relative to the group financial statements.*
- *Whether sufficient appropriate audit evidence is expected to be obtained for all significant classes of transactions, account balances and disclosures in the group financial statements from audit work planned on the financial information of identified components.*
- *The nature and extent of misstatements or control deficiencies identified at a component in prior period audits.*
- *The nature and extent of the commonality of controls across the group and whether, and if so, how, the group centralizes activities relevant to financial reporting.*

Based on the understanding of the group's organizational structure and information system, the auditor may determine that the financial information of certain entities or business units may be considered together for purposes of planning and performing audit procedures. For example, a group may have three legal entities with similar business characteristics, operating in the same geographical location, under the same management, and using a common system of internal control, including the information system. In these circumstances, the auditor may decide to treat these three legal entities as one component.

Resources

Part 3 requires the engagement partner to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner. The auditor's determination of the resources needed to perform the group audit are a matter of professional judgment and may include the understanding of the group, the components within the group at which audit work is to be performed and whether to perform work centrally, at components or a combination thereof.

- 10.2.2. If, after the acceptance or continuance of the group audit engagement, the engagement partner concludes that sufficient appropriate audit evidence cannot be obtained, the engagement partner shall consider the possible effects on the group audit.

10.3. Materiality

- 10.3.1. In applying Part 5, when classes of transactions, account balances or disclosures in the group financial statements are disaggregated across components, for purposes of planning and performing audit procedures, the auditor shall determine component performance materiality. To address aggregation risk, such amount shall be lower than group performance materiality.

The component performance materiality amount may be different for each component. Also, the component performance materiality amount for an individual component need not be an arithmetical portion of the group performance materiality and, consequently, the aggregate of component performance materiality amounts may exceed group performance materiality.

The ISA for LCE does not require component performance materiality to be determined for each class of transactions, account balance or disclosure for components at which audit procedures are performed. However, if, in the specific circumstances of the group, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the group financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the group financial statements, Part 5 requires a determination of the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures. In these circumstances, the auditor may need to consider whether a component performance materiality lower than the amount may be appropriate for those particular classes of transactions, account balances or disclosures.

The determination of component performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. Factors the auditor may take into account in setting component performance materiality include the following:

- *The extent of disaggregation of the financial information across components (e.g., as the extent of disaggregation across components increases, a lower component performance materiality ordinarily would be appropriate to address aggregation risk). The relative significance of the component to the group may affect the extent of disaggregation (e.g., if a single component*

represents a large portion of the group, there likely may be less disaggregation across components).

- *Expectations about the nature, frequency, and magnitude of misstatements in the component financial information, for example the nature and extent of misstatements identified at the component in prior audits.*

To address aggregation risk, paragraph 10.3.1. requires component performance materiality to be lower than group performance materiality. In some circumstances, however, component performance materiality may be set at an amount closer to group performance materiality because there is less aggregation risk, such as when the financial information for one component represents a substantial portion of the group financial statements.

10.4. Understanding the Group and Its Environment, the Applicable Financial Reporting Framework and the Group's System of Internal Control

10.4.1. In applying Part 6, the auditor shall obtain an understanding of:

- (a) The group's organizational structure and business model, including the locations in which the group has its operations or activities and the extent to which they are similar across the group.
- (b) The group's system of internal control, including:
 - (i) The consolidation process used by the group and consolidation adjustments;
 - (ii) The nature and extent of commonality of controls; and
 - (iii) How the group centralizes activities relevant to financial reporting.

10.5. Identifying and Assessing the Risks of Material Misstatement

10.5.1. In applying Part 6, based on the understanding obtained in paragraph 10.4.1. the auditor shall identify and assess the risks of material misstatement of the group financial statements, including with respect to the consolidation process.

In applying Part 6, the auditor is required to identify and assess the risks of material misstatement of the financial statements due to fraud, and to design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. Information used to identify the risks of material misstatement of the group financial statements due to fraud may include the following:

- *Whether there are particular components that are more susceptible to risks of material misstatement due to fraud.*
- *Whether any fraud risk factors or indicators of management bias exist in the consolidation process.*
- *How those charged with governance of the group monitor group management's processes for identifying and responding to the risks of fraud in the group, and the controls group management has established to mitigate these risks.*
- *Responses of those charged with governance of the group, and group management to the auditor's inquiry about whether they have knowledge of any actual, suspected, or alleged fraud affecting a component or the group.*

10.6. Responding to the Assessed Risks of Material Misstatement

10.6.1. In applying Part 7, the auditor shall determine the components at which to perform further audit procedures and the nature, timing and extent of the work to be performed at those components.

In response to the assessed risks of material misstatement, the auditor may determine the following scope of work to be appropriate at a component:

- *Design and perform further audit procedures on the entire financial information of the component;*
- *Design and perform further audit procedures on one or more classes of transactions, account balances or disclosures; or*
- *Perform specific further audit procedures.*

Further audit procedures may be designed and performed centrally if the audit evidence to be obtained from performing further audit procedures on one or more significant classes of transactions, account balances or disclosures in the aggregate will respond to the assessed risks of material misstatement, for example, if the accounting records for the revenue transactions of the entire group are maintained centrally.

The auditor may determine that the financial information of components can be considered as a single population for the purpose of performing further audit procedures, for example, when transactions are considered to be homogeneous because they share the same characteristics, the related risks of material misstatement are the same, and controls are designed and operating in a consistent way. In such cases, group performance materiality often will be used for purposes of performing these procedures.

Consolidation Process

10.6.2. The auditor shall design and perform further audit procedures to respond to the assessed risks of material misstatement of the group financial statements arising from the consolidation process. This shall include:

- (a) Evaluating whether all entities and business units have been included in the group financial statements as required by the applicable financial reporting framework;
- (b) Evaluating the appropriateness, completeness and accuracy of consolidation adjustments and reclassifications;
- (c) Evaluating whether management's judgments made in the consolidation process give rise to indicators of possible management bias; and
- (d) Responding to assessed risks of material misstatement due to fraud arising from the consolidation process.

The consolidation process may require adjustments and reclassifications to amounts reported in the group financial statements that do not pass through the usual IT applications, and may not be subject to the same controls to which other financial information is subject. The auditor's evaluation of the appropriateness, completeness and accuracy of the adjustments and reclassifications may include:

- *Evaluating whether significant adjustments appropriately reflect the events and transactions underlying them;*

- *Determining whether those entities or business units whose financial information has been included in the group financial statements were appropriately included;*
- *Determining whether significant adjustments have been correctly calculated, processed and authorized by group management and, when applicable, by component management;*
- *Determining whether significant adjustments are properly supported and sufficiently documented; and*
- *Evaluating the reconciliation and elimination of intra-group transactions, unrealized profits, and intra-group account balances.*

10.7. Specific Communication Requirements

Communication with Group Management and Those Charged with Governance of the Group

10.7.1. If fraud has been identified by the auditor, or information indicates that a fraud may exist, the auditor shall communicate this on a timely basis to the appropriate level of group management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities.

10.7.2. The auditor shall communicate the following matters with those charged with governance:

- (a) An overview of the work to be performed at the components of the group.
- (b) Fraud or suspected fraud involving group management, component management, employees who have significant roles in the group's system of internal control or others when the fraud resulted in a material misstatement of the group financial statements.

10.8. Specific Documentation Requirements

10.8.1. In addition to the general documentation requirements (Part 2.5.) for an audit engagement, the auditor shall include in the audit documentation:

- (a) The basis for the auditor's determination of components for purposes of planning and performing the group audit.
- (b) The basis for the determination of component performance materiality.

PROPOSED CONFORMING AMENDMENTS ARISING FROM PROPOSED PART 10, AUDITS OF GROUP FINANCIAL STATEMENTS

Marked from Exposure Draft of the ISA for LCE

Preface ISA for LCE

...

Format of the [Draft] ISA for LCE

P.12. The [draft] ISA for LCE includes:

- The Authority (Part A), which sets out the circumstances for which the [draft] ISA for LCE is prohibited or not appropriate to use.
- Part 1, which sets out the fundamental concepts and overarching principles to be applied throughout the audit.
- Part 2, which sets out the general requirements for audit evidence and documentation, as well as the overall objective of the audit.
- Part 3, which sets out the auditor's and engagement partner's obligations and responsibilities for quality management in an audit of an LCE.
- Parts 4 to 9, which follow the flow of an audit engagement, and set out the detailed requirements for the audit. Each of these Parts also includes specific communication and documentation requirements as necessary.
- Part 10, which sets out special considerations that apply to an audit of group financial statements (a group audit). When the ISA for LCE applies to a group audit, the requirements and guidance in Part 10 refer to, or expand on the application of other relevant parts of the ISA for LCE to a group audit.
- Appendices, which include the glossary of terms used in this [draft] standard, assertions, an illustrative engagement letter and an illustrative representation letter, as well as other relevant supporting materials for implementation of the requirements within this [draft] standard.

...

Part 9. Forming an Opinion and Reporting

...

9.4. Auditor's Report

9.4.1. The auditor shall report in accordance with the specified format and content below unless:

...

INDEPENDENT AUDITOR'S REPORT

...

Auditor's Responsibilities for the Audit of the Financial Statements^{1 2}

...

...

Glossary of Terms

...

Aggregation risk—The probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statement as a whole.

...

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

Component auditor— An auditor who performs audit work related to a component for purposes of the group audit. A component auditor is a part of the engagement team for a group audit.

Component management—Management responsible for a component.

Component performance materiality—An amount set by the auditor to reduce aggregation risk to an appropriately low level for purposes of planning and performing audit procedures in relation to a component.

...

Group—A reporting entity for which group financial statements are prepared.

Group audit— The audit of group financial statements.

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 the ISA for LCE, a consolidation process includes:

- (a) Consolidation, proportionate consolidation, or an equity method of accounting;
- (b) 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

¹ When the auditor disclaims an opinion on the financial statements, the description of the auditor's responsibilities only includes the matters required by paragraph 9.5.4.

² When Part 10 applies, further describe the auditor's responsibilities in a group audit engagement by stating that:

- (i) The auditor's responsibilities are to plan and perform the group audit to obtain sufficient appropriate audit evidence regarding the financial information of the entities or business units within the group as a basis for forming an opinion on the group financial statements;
- (ii) The auditor is responsible for the direction, supervision and review of the audit work performed for purposes of the group audit; and
- (iii) The auditor remains solely responsible for the auditor's opinion.

- (c) The aggregation of the financial information of entities or business units such as branches or divisions.

Group management—Management responsible for the preparation of the group financial statements.

Group performance materiality— Performance materiality in relation to the group financial statements as a whole, as determined by the auditor.

...

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