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**GAO's Response to the International Auditing and Assurance Standards Board's  
*Proposed International Standard on Auditing for Audits of Financial Statements of Less  
Complex Entities (ISA for LCE)***

This letter provides GAO's comments on the International Auditing and Assurance Standards Board's (IAASB) proposed International Standard on Auditing (ISA) for audits of financial statements of less complex entities (LCE). GAO promulgates generally accepted government auditing standards, which provide professional standards for auditors of government entities in the United States.

We support the IAASB's efforts to develop a standard for the audit of financial statements of LCE. In our responses, we identify several areas where improvements and clarifications are necessary. In particular, we believe that clarification is necessary in the Authority section of the proposed standard to include what entities can be considered a LCE. The current language focuses too much on the limitations and prohibitions rather than the type and structure of an entity that would be considered a LCE. Also, the language for the requirements in the exposure draft differs from the language for the same requirements in the other ISAs. We believe this increases the risk of inconsistent application of the requirements between a LCE audit and a non-LCE audit. We recommend providing guidance to identify the requirements in the ISA for LCE and the corresponding requirements in the other ISAs. As part of this guidance, we suggest a crosswalk of the requirements in the ED-ISA for LCE to the requirements in the other ISAs, including the requirements that are not part of the ISA for LCE.

In addition, we do not believe that entities needing a group audit should meet the criteria for a LCE. We believe that including group audits in the ISA for LCE would make the standard more complex, and the addition of complexity to the ISA for LCE is counter to the intention of the standard.

The IAASB seeks comment on 26 specific questions. Our responses to the questions follow in the enclosure to this letter.

Thank you for the opportunity to comment. If you have questions about this letter or would like to discuss any of our responses, please feel free to contact me at (202) 512-3133 or [dalkinj@gao.gov](mailto:dalkinj@gao.gov).

A handwritten signature in black ink, appearing to read "James R. Dalkin". The signature is fluid and cursive, with a prominent loop at the end.

James R. Dalkin  
Director  
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Enclosure

## Enclosure

### **Responses to Questions to the International Auditing and Assurance Standards Board's Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE)**

- 1. For Section 4A – Overarching Positioning of Exposure Draft – International Standard on Auditing (ED-ISA) for LCE, views are sought on:**
  - (a) The standalone nature of the proposed standard, including detailing any area of concern in applying the proposed standard, or possible obstacles that may impair this approach?**

We believe that using a stand-alone standard for less complex entities (LCE) is a preferred approach to integrating the requirements throughout the other standards. However, we noted that the language for the requirements from the other International Standards on Auditing (ISAs) differs from the language for the requirements in the Exposure Draft (ED) ISA for LCE. Our concern is that differences between requirements in the other ISAs and the ED-ISA for LCE will increase the risk of inconsistent implementation of the requirements. We recommend providing guidance to identify the requirements in the ED-ISA for LCE and the corresponding requirements in the other ISAs. As part of this guidance we suggest including the requirements that are not part of the ED-ISA for LCE to help users identify requirements of the ISAs that are not part of the ED-ISA for LCE.

- (b) The title of the proposed standard.**

The title of the proposed standard for the audits of financial statements of LCE is reasonable.

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

We do not have any additional overarching views on section 4A.

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

Including the conforming amendments to the International Auditing and Assurance Standards Board (IAASB) Preface in the IAASB Handbook is appropriate for creating a new category of audit in the IAASB standards.

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

We believe the ED-ISA Authority section is structured to identify where the standard should not be used and, as far as identifying prohibited or limitations the proposed Authority section, appears reasonable and implementable.

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

We are not aware of any unintended consequences that may arise that IAASB has not considered.

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

We believe that the Authority section needs to communicate the type and structure of an entity that would be considered an LCE. We do not believe that solely focusing on the prohibitions and limitations for the type of entity that the standard can be applied to is sufficient.

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

We believe that the Authority section does not clearly discuss what audits would be allowed to use the proposed standard. The Authority section in the ED-ISA for LCE provides the scope of what is excluded from using the proposed standard, but we believe that information should be added to explain the nature and scope of entities to be considered a LCE.

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

The subsection of the Authority section on the role of legislative and regulatory authorities provides sufficient information.

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

- (a) Specific prohibitions; and**
- (b) Qualitative characteristics.**

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

The proposed limitations identified in the Authority are sufficient. The inclusion of specific prohibitions and qualitative characteristics provide sufficient depth for considering the types and nature of entities that are not within scope of an LCE.

**5. Regarding the Authority Supplemental Guide:**

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

We believe that the guide is helpful to understanding the Authority section of the ED-ISA for LCE.

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

We did not identify any other matters that should be included in the Authority Supplemental Guide.

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

The matters we identified in responses to prior questions on the Authority section are the only matters that we have identified for consideration for this section.

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

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

We believe that adopting and adapting the requirements from the ISAs is a reasonable approach to developing the requirements for the ED-ISA for LCE.

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

We believe that the IAASB's approach of providing objectives for each Part of the proposed standard is reasonable. The use of objectives that match the corresponding ISA helps provide a clear and comparable standard. The areas where multiple objectives are merged together is necessary and still provides the auditor with an understanding of the Part.

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

We agree that including the requirements related to professional skepticism, professional judgment, ethics, and quality management is appropriate.

- (d) The approach to essential explanatory material (EEM) (see paragraphs 85-91) including:**

- i. The content of the EEM, including whether it serves the purpose for which it is intended.**
- ii. The sufficiency of EEM.**
- iii. The way the EEM has been presented within the proposed standard.**

We believe that including essential explanatory material (EEM) is helpful to the auditor performing a financial audit of an LCE. We did not identify areas in the ED-ISA for LCE where the EEM was insufficient. However, the presentation of EEM within the proposed standard is not clear. Without the information from paragraphs 85 through 91, it would be difficult to understand why certain text was italicized and highlighted in blue. A paragraph in the Preface section explaining that the EEM is italicized and highlighted in blue would help users of the standard.

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

The overall design and structure of the ED-ISA for LCE is logical and presents the standard in a logical manner.

**9. Please provide your views on the content of each of the 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 reviewed parts 1 through 8 of the ED-ISA for LCE and did not identify any additional requirements that we believe are necessary. We also do not have any additional comments on these parts.

**10. For Part 9, do you agree with the approach taken in ED-ISA for LCE with regard to auditor reporting requirements, including:**

- (a) The presentation, content and completeness of Part 9.**
- (b) The approach to include a specified format and content of an unmodified auditor's report as a requirement?**
- (c) The approach to providing example auditor's reports in the Reporting Supplemental Guide.**

We reviewed part 9 and found that it presented the requirements completely. We believe that the title of the audit opinion report should clearly reflect that the audit was conducted using the LCE standard.

We find it appropriate to include guidance on the format and content of an unmodified auditor's report in the standard. We also find the examples of auditor's reports in the Reporting Supplemental Guide will be useful as the standard is implemented.

**11. 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 to reporting?**

We believe that the Reporting Supplemental Guide is helpful supporting material. We did not identify any other matters that should be included in the guide related to reporting.

**12. Are there any areas within Parts 1-9 of the proposed standard where, in your view, the standard can be improved? If so, provide your reasons and describe any such improvements. It will be helpful if you clearly indicate the specific Part(s) which your comments relate to.**

We do not have additional comments beyond what has been covered by our responses to the other questions.

**13. Please provide your view 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?**

We believe that there may be lack of clarity when reporting on financial statements presenting multiple years of data where in some years auditors followed the ISA for LCE and in other years auditors followed the regular ISAs. To address this, the IAASB could add examples of reports where this occurs to the Reporting Supplemental Guide.

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

The IAASB's determination to maintain a stable platform for an ISA for LCE does cause some concern. We believe that another ISA being updated without a corresponding update in the ISA for LCE may create confusion and possible incorrect use of an updated requirement in a LCE audit. Assessing the nature of updates to ISAs may be necessary to determine whether

corresponding updates to the ISA for LCE should occur concurrently or wait until a predetermined update. We believe that a structured cycle for updating this standard should be implemented with a set planned interval for update, including consideration of whether significant updates to related standards necessitate more frequent updates.

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

We believe that determining whether early adoption of an update to the standard is permitted should be part of the updating process. Such a determination should be based on the significance of the update and the nature of the areas updated.

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

We believe that the IAASB should, as indicated, consider part of the ISA-800 series in the ED-ISA for LCE. The timing of the consideration may be more appropriate after the ED-ISA is effective. In addition, it may be appropriate to assess the needs of the audit community regarding this additional area of potential application.

**17. In your view, would ED-ISA for LCE meet the needs of users and 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.**

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

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

Our jurisdiction has multiple standard setters which provide auditing standards for multiple types and sizes of entities, so we do not plan to implement the ED-ISA for LCE in our jurisdiction. While we do not plan to implement this standard in our jurisdiction, we believe that the proposed standard should meet user and stakeholder needs where implemented. There may be issues with convincing audited entities that engaging for an LCE audit is going to provide the same level of assurance as a regular financial statement audit.

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

We did not identify any other matters related to the ED-ISA for LCE that the IAASB should consider as it works to finalize this proposed standard.

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

The use of implementation guides and discussions with standard setters and auditors who will implement the proposed standard would be helpful.

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

We are not providing a response to this question.

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

We find the 18 months sufficient for an effective date.

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

We do not believe that entities needing a group audit should meet the criteria for a LCE. We believe that including group audits add a layer of complexity to audits; this makes their inclusion in the ED-ISA for LCE inappropriate.

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

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

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

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

We are not an organization in public practice, so we are not responding to this question.

**24. If group audits are to be included in the scope of ED-ISA for LCE, the IAASB is looking for views about how should be done (please provide reasons for your preferred option):**

**(a) The IAASB establishes a proxy(ies) for complexity for when the proposed standard may be used (Option 1 – see paragraph 169); or**

**(b) ED-ISA for LCE sets out qualitative characteristics for complexity specific to groups (Option 2 – see paragraph 176), to help users of the proposed standard to determine themselves whether a group would meet the complexity threshold.**

We do not believe that entities needing a group audit should meet the criteria for a LCE. Both options presented in the exposure draft would add complexity to the ED-ISA for LCE, so we do not believe that the options would be appropriate.

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

We have not identified other ways for including group audits in the ED-ISA for LCE that would not make the ED-ISA more complicated.

**26. If group audits are included in ED-ISA for LCE, how should the relevant requirements be presented within the proposed standard (please provide reasons for you 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.**

As noted in our previous responses, we do not believe that group audits should be included in the ED-ISA for LCE.