

EXPLANATORY MEMORANDUM

The focus is on the complexity of an entity rather than on its size.

The IAASB developed ED-ISA for LCE as a standalone, 'self-contained' standard. This means that if there is a circumstance that has not been contemplated in the design of ED-ISA for LCE as addressed in the Authority of the proposed standard (see below), relevant ISA requirements cannot be used to 'top up' ED-ISA for LCE in order to address the circumstance.

The IAASB has used the requirements in the ISAs as the basis for the requirements within ED-ISA for LCE. This was accomplished by replicating and adapting requirements from the ISAs that are considered core to an audit, for the nature and circumstances of less complex entities as contemplated by the proposed standard. Audit procedures that are not relevant to an LCE, as contemplated by the proposed standard, are not included within ED-ISA for LCE.

The content of ED-ISA for LCE have been grouped into nine 'parts' that follow the flow of an audit engagement (rather than by subject matter or topic like the ISAs). The parts are preceded by a preface to the standard, and the Authority.

It is not envisioned that ED-ISA for LCE will necessarily reduce the core procedures the auditor is required to perform to support the overall quality of the audit.

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.

Although ED-ISA for LCE is based on the core requirements from the ISAs, it does not contain requirements relating to prohibited entities, or where there are matters or circumstances that would have been deemed more complex as described in the Authority of the proposed standard (see below), for example segment information, key audit matters and relying on the work of internal auditors.

PREFACE

The standard:

- Has been designed to achieve reasonable assurance about whether the financial statements (of an LCE) as a whole are free from material misstatement
- Applies to LCEs in the private and public sectors
- Will result in the consistent performance of a quality audit engagement

Descriptions of the type of entities for which an audit in accordance with this standard is permitted rest with legislative and regulatory authorities or relevant local bodies. Such descriptions may or may not align with the limitations for use as set out in Part A of the standard.

If this standard is used for audit engagements other than those contemplated in Part A on the Authority, the auditor is not permitted to represent compliance with the ISA for LCE in the auditor's report.

THE APPLICABLE FINANCIAL REPORTING FRAMEWORK

Not prescriptive.

AUTHORITY

Specific prohibitions

The ISA for LCE shall not be used if:

- Law or regulation explicitly prohibits the use of the ISA for LCE (that is, the standard is not authorised for use in a particular jurisdiction); or specifies the use of auditing standards other than the ISA for LCE for an audit of financial statements in that jurisdiction.
- The entity is a listed entity.
- The entity is one of whose main functions is to take deposits from the public or to provide insurance to the public or whose function is to provide post-employment benefits or whose function is to act as a collective investment vehicle and that issues redeemable financial instruments to the public.
- For a class of entities where use of the ISA for LCE is prohibited for that specific class of entity by a legislative or regulatory authority or relevant local body with standard-setting authority in the jurisdiction.
- The audit is an audit of group financial statements.

QUALITATIVE CHARACTERISTICS

If an audit engagement is not prohibited from use of the ISA for LCE, it would be inappropriate for an audit of the financial statements of the entity to be undertaken using the ISA for LCE if the entity exhibits the following:

- 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
- Topics, themes and matters that increase, or indicate the presence of, complexity, such as those relating to ownership, corporate governance arrangements, policies, procedures, or processes established by the entity

These are indicators of, or proxies for, matters or circumstances for which the ISA for LCE has not been designed to address.

If there is uncertainty about whether an audit is an audit of the financial statements of an LCE, the use of the ISA for LCE is not appropriate.

FIRMS AND AUDITORS

Firms are responsible for establishing policies or procedures in relation to the permitted use of the ISA for LCE by the firm's engagement teams. In doing so, the firm takes into account the specific prohibitions for use of the standard, including any further modifications or limitations for the applicable jurisdiction, as well as the qualitative characteristics. The firm may also further limit the classes of entities for which the firm's engagement teams can use the ISA for LCE. For individual audit engagements, as part of the firm's acceptance or continuance procedures and the engagement partner's responsibilities related thereto, the engagement partner is required to determine that the audit engagement is in fact an audit of an LCE to use the ISA for LCE.

**ISA for LCE:
Specific Prohibitions**

Is the audit:

- Of a listed entity
- In a jurisdiction which prohibits use of the standard
- Of an entity with "public interest characteristics" (para A.7(c))*
- A group audit.

No

Yes

**Descriptions of classes may be modified in local jurisdiction*

**Jurisdiction Level
Limitations**

Is the audit:

- Of an entity in a class of entity prohibits in jurisdiction to use the standard
- Outside any other qualitative criteria and thresholds established with jurisdiction.

No

Yes

**Firm Policies or
Procedures**

Is the audit:

- Prohibited from using the standard under firm policies or procedures ?

No

Yes

**Engagement Level
Evaluation**

Does the audit::

- Exhibit qualitative characteristics that would make the standard inappropriate to use?
- May use ISA for LCE Cannot use ISA for LCE

No

Yes

May use ISA for LCE

Cannot use ISA for LCE