

An examination of comment letters on suggested Part 10: audits of groups' financial statements in the proposed ISA for less complex entities

Group audits
and ISA for
LCE

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Abstract

Purpose – The purpose of this paper is to investigate the comment letters (CLs) in the standard-setting process of audits of less complex entities (LCEs). The objective is to gain insight into the overall picture of the CLs and to report on areas where comment providers agree or disagree with IAASB's Part 10.

Design/methodology/approach – A content analysis of 60 comment letter (CLs) was conducted to investigate the suggested additional Part 10 on audits of groups' financial statements in the proposed ISA for LCEs. Hence, this study examines three specific topics: (1) the views related to the use of the International Standard on Auditing (ISA) for LCEs for group audits in which component auditors are involved, (2) the proposed group-specific qualitative characteristics to describe the scope of group audits and, finally, (3) insights into the content of the proposed Part 10 and related conforming amendments. The Gioia method is used to provide a holistic approach to concept development of the arguments about the new Part 10.

Findings – The CLs stated that, while the proposed Part 10 has some weak points, it still provides a solid and practical structure within which to undertake an LCE group audit and a promising basis for further development. For instance, when discussing the improvements, the CLs stated that Part 10 should allow for more auditor judgment when determining when the involvement of component auditors renders a group audit complex. In addition, the CLs asserted that professional judgment should be engaged when considering the qualitative characteristics and the complexity of the group.

Originality/value – This study contributes to the very scarce research about the ISA for LCEs and the role of lobbying in shaping the audit standard-setting process.

Keywords Audit quality, Harmonization, Regulation, ISAs, Group audits

Paper type Research paper

1. Introduction

This paper continues to examine comment letters (CLs), the standard-setting process and the formulation of the final standard in the case of audits of less complex entities (LCEs). Hence, this article extends the study conducted by [Haapamäki and Mäki \(2023\)](#), which investigated the comment letters received in the first consultation round of a new, stand-alone standard for audits of LCEs' financial statements from the International Auditing and Assurance Standards Board (IAASB). The key task of the IAASB is to advance the public interest by

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developing high-quality auditing standards and by assisting the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world. In addition, the IAASB aims to reinforce the public confidence in the global auditing and assurance profession. To respond to the various arguments that have been put forward in favor of the application of different standards for audits of LCEs, the IAASB published a draft stand-alone standard for audits of financial statements for LCEs in July 2021. Comments on it were accepted until January 31, 2022, and this comment period can be interpreted as the first consultation round. To illustrate, the parts from 1 to 9 [1] were open up for consultation in the first round.

The IAASB received 145 comment letters, [2] and it was clearly stated that a global solution to lighten the procedures when auditing LCEs would be warmly welcomed. However, many of the interest groups disagreed with the exclusion of audits of group financial statements from the proposed scope. They stated that the prohibition on employing the ISA for LCEs for group audits would heavily limit its potential use (Haapamäki and Mäki, 2023). To clarify, group audits were not included in the scope of the original Exposure Draft of the International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCEs). This was because the IAASB considered that group audits inherently exhibit characteristics of complexity within an entity and, consistent with other areas of complexity, had not been contemplated in the design of the proposed standard (IAASB, 2023). However, given the stakeholder feedback and suggestions in the comment letters, the IAASB reconsidered its decision to exclude group audits and developed proposals that address the audits of less complex groups. This proposed section, Part 10, Audits of Group Financial Statements, is intended to form part of the proposed ISA for LCEs when finalized. Part 10 was open for comments and suggestions for improvements until May 2, 2023; hence, in this second consultation round, there was a 90-day comment period. The comment and suggestions will allow, subject to the nature and extent of the comments received, the IAASB to approve Part 10 at the same time as the remaining parts of the proposed ISA for LCEs. The IAASB plans to approve the ISA for LCEs at its December 2023 meeting (IAASB, 2023).

To summarize, respondents were asked to comment on the clarity, understandability and practicality of application of the proposed Part 10 and the related conforming amendments. The IAASB emphasized that comments would be most helpful if they referred to specific aspects and included the reasons for any concern about clarity, understandability and practicality of application, along with suggestions for improvement. Furthermore, the IAASB underlined that interest groups should respond directly to the questions and provide the rationale for their answers, as well as specific suggestions, where appropriate. Finally, the IAASB highlighted that, when a respondent agreed with the proposals, it would be beneficial for the IAASB to be made aware of this view. The IAASB posed three specific questions [3] to the respondents and they were concerning prohibition of component auditor, group audit qualitative characteristics, and views on the content of Part 10. Finally, one particular issue is that IAASB did state, when issuing part 10 for consultation, that they would not invite or reconsider comments in this second round related to the parts 1–9 which was open up for consultation in the first round. This was due to that 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.

To summarize, different interest groups actively commented on Part 10, and the IAASB received 60 comment letters. These CLs are publicly available on the IAASB's web page, providing an essential opportunity to examine their content. Hence, this study takes a closer look at the comment letters concerning the change to include group audits under the standard. We emphasize that it is important to investigate the views and arguments

associated with this proposed section, Part 10. For instance, many comment letters shared the view that including less complex group audits that meet the appropriate criteria will increase the adoption and use of the ISA for LCEs globally. This argument was also highlighted in the comment letters in the first consultation round. It was clearly stated that prohibition on using the ISA for LCEs for group audits will heavily limit the potential use of ISA for LCE. Such a prohibition, along with the lack of clarity regarding the use of ISA for LCE for the audit of a component of a group audit engagement, where that component satisfies the criteria to use ISA for LCE, will have a significant detrimental effect on the adoption of the standard. Therefore, the international adoption of the suggested ISA for LCEs is a critical matter. The harmonization and convergence of LCEs' auditing practices will depend on the comprehensive adoption and implementation of the suggested ISA for LCEs.

To conclude, the findings of this study provide a useful framework of the most frequently used arguments supporting and opposing the new Part 10 and its content. Furthermore, this study aims to investigate the audit quality arguments in the comment letters, in particular how the new Part 10 is improving audit quality. Audit quality is investigated carefully because it has been emphasized that the ISAs are instrumental in advancing audit quality worldwide (Accountancy Europe, 2018). Furthermore, one of the main tasks of the IAASB is to enhance the audit quality and consistency of audit practice throughout the world. Because alternative standards in different jurisdictions for the same type of engagement (i.e. an audit of an LCE) may lead to inconsistencies in quality and cause confusion for user, it can be suggested that the adoption of ISA for LCE could affect positively to the audit quality. Finally, research related to group audits suggests that the group audits has become a key concern for standard-setters and regulators. This concern stems, in part, from audit inspections by regulators that have noticed numerous cases of poor coordination and oversight when component auditors— and particularly foreign component auditors— are involved in a multinational enterprise group audit (Carson *et al.*, 2022). To conclude, these concerns have implications to audit quality and, therefore, we want to examine the new Part 10 and its association with audit quality.

2. Prior literature and theoretical background

2.1 Prior studies related to the ISA for LCEs and research questions

The evolving reporting requirements and their increasing complexity have led to a need for a set of high-quality requirements tailored to the auditing of LCEs (van Nieuw Amerongen *et al.*, 2023a). It has been suggested that one of the attempts to enhance the audit quality in the auditing of an LCE is the international adoption of the latest risk-based audit standards, referring to the ISA for LCEs. However, a very limited number of studies have examined the ISA for LCEs. Coram *et al.* (2022) provided a technical note that contained comments from the Auditing and Assurance Standards Committee of the Accounting and Finance Association of Australia and New Zealand (AFAANZ) concerning the proposed ISA for LCEs. To summarize, their study revealed that a stand-alone standard has the potential to contribute to achieving the goal of improving confidence in LCEs' financial reports, and they clearly supported the IAASB's continuance with this project. However, they stated that the proposed standard, as presently drafted, would fall well short of realizing this potential.

van Nieuw Amerongen *et al.* (2023a) conducted quantitative and qualitative analyses of feedback provided by 49 roundtable participants, and their findings revealed clear support for an international LCE standard. Relatedly, van Nieuw Amerongen *et al.* (2023b) extended their research and provided a summary of the views heard during the second roundtable breakout session focused on the design, structure and content of the ED LCE. Their results showed substantial support for the structure and flow of the ED LCE, the stand-alone format and the content of the new standard. They also emphasized the potential for the LCE

standard to be applied in practice and to meet the needs of stakeholders. However, most importantly, [van Nieuw Amerongen et al. \(2023a\)](#) had already suggested that a majority of roundtable participants disagreed with the IAASB's decision to scope out all group audits. While the inclusion of certain group audits would, as noted by a few participants, make an LCE standard longer and more complicated, feedback from the roundtables indicated that this is an important issue for the IAASB to reconsider. Otherwise, the LCE standard is likely not to be an option for the auditing of many small, "less complex" entities across the globe. [Haapamäki and Mäki \(2023\)](#) found similar concerns when analyzing a relatively large number of comment letters (145 CLs) from different interest groups. Hence, the feedback from the roundtable discussions and the comment letters played an essential role in the standard-setting process. Given the stakeholder feedback and suggestions in the comment letters, the IAASB formulated the new section, Part 10, Audits of Group Financial Statements, which is intended to form part of the ISA for LCEs when finalized. The aim of this article is to investigate the CLs concerning the new Part 10 and determine how they will affect the final version of the standard. The IAASB received a relatively large amount of comment letters from different interest groups. The comment letters are publicly available, providing an opportunity to continue to investigate the role of comment letters (CLs) in shaping the final standard for audits of LCEs. Hence, this study aims to answer the following detailed research questions:

- (1) How are interest groups reacting to the new Part 10?
- (2) What reasons do interest groups give for their support for or opposition to the three specific themes that the IAASB asked for the opinion? These were the prohibition of component auditor, group audit qualitative characteristics, and views on the content of Part 10.
- (3) How do the comment letters describe the interest groups' views about the audit quality in relation to the new Part 10?

2.2 Comment letters and lobbying in the accounting and auditing standard-setting process

The role of lobbying in shaping international corporate reporting and standard setting has been widely acknowledged ([Allen and Ramanna, 2013](#)). Interested parties are given the opportunity to lobby the standard setter and thus influence the outcome of the process. Prior studies have suggested that, while potential benefits are the primary motivation for lobbying, different parties will not lobby unless they perceive that they have the possibility to influence the outcome of the process either individually or collectively ([Sutton, 1984](#); [Ryan et al., 2000](#)). Hence, the examination of various parties' motives to provide a comment letter is considered important for understanding the process of accounting and auditing standard setting. In other words, the examination of the comment letters from a number of parties in the standard-setting process can contribute to a better understanding of the mechanisms behind the outcome of the process. Researchers have utilized written comment letters because they are usually the main source available to them ([Weetman et al., 1996](#)). Therefore, a large number of articles have analyzed comment letters or similar submissions on proposed changes to accounting and auditing regulations or similar documents (for example, [Jupe, 2000](#); [Davis and Hay, 2012](#); [Allam et al., 2017](#); [Baudot et al., 2017](#); [Haapamäki, 2022](#); [Haapamäki and Mäki, 2023](#)). Moreover, content analysis of comment letters has been performed in many auditing studies as a technique to analyze the different and sometimes conflicting views of various parties ([Davis and Hay, 2012](#); [Haapamäki, 2022](#)).

For instance, [Davis and Hay \(2012\)](#) examined the content of comment letters with the objective of investigating the differences in the supporting arguments presented in the case of proposed regulations for auditing and assurance in New Zealand. They focused on the

content of the audit and assurance comment letters sent by respondents to ascertain the level of their support and the strategies that they used. In addition, [Haapamäki \(2022\)](#) emphasized that comment letters played a significant role in increasing the audit exemption thresholds in Finland. The majority of the comment letters were clearly against increasing the audit exemption thresholds in the Finnish case. The findings indicated that, because of the significant concerns raised in the opposing comment letters, the Finnish Government decided not to continue with the reform to increase the audit exemption thresholds. The opposing arguments in the comment letters were so significant and comprehensive that the reform could not be continued ([Haapamäki, 2022](#)). Hence, it was clearly stated that the lobbying opponents might have had a dominant effect.

2.3 The research literature on group audits

As the proposed Part 10 focuses on the audits of group financial Statements of the ISA for LCE, this section presents briefly some prior literature related to the group audits. Prior studies suggest that the setting of multinational group audits might be problematical, creating coordination and communication obstacles between group auditors and component auditors that potentially constrain professional skepticism in these types of audits ([Borkus et al., 2022](#); [Downey and Westermann, 2021](#)). Relatedly, [Sunderland and Trompeter \(2017\)](#) stated that when conducting audits of large multinational groups, audit firms often rely on the work of other auditors who have been engaged to conduct portions of the audit in distant locations. Of concern for firms, investors, and regulators is the extent to which these other auditors provide the expected uniform level of audit quality. [Borkus et al., \(2022\)](#) found that group auditors who have high self-esteem or who are prompted to take the regulator's perspective plan more effective next steps than those with low self-esteem or who are unprompted. Hence, [Borkus et al., \(2022\)](#) suggested that audit firms can use the insights from their study in selecting group auditors based on self-esteem and develop firm policies to consider the regulator's perspective when reviewing the findings of component auditors to enhance audit quality in multinational group audits. [Carson et al. \(2022\)](#) examined what determines the involvement of component auditors in multinational group audits and the association with audit quality. Their results suggest that involvement of component auditors benefits audit quality as long as the principal auditor conducts a substantial amount of work. Once the involvement of component auditors exceeds a certain level, audit quality decreases. However, they still state that for certain companies a high level of component auditor involvement is the best option. To conclude, the prior studies related to the association between sharing the same network auditor on audit quality have been unclear. One approach suggests that sharing the same network auditor among group affiliated firms is likely to enhance audit quality due to potential knowledge spillovers. While in contrast, it can be suggested that sharing the same network auditor can have an adverse impact on audit quality due to potential loss of auditor independence due to client importance ([Sun et al., 2020](#)). Hence, [Sun et al. \(2020\)](#) suggested that higher audit quality is associated with the use of a specialist auditor and firms that operate in more homogeneous industries.

3. Research design

3.1 Data collection

We searched for and downloaded all the documents categorized as comment letters on the IAASB's web page [4]. In total, the IAASB received 60 comment letters from different interest groups. The content of the comment letters concerning the new Part 10 are important for investigating whether there was agreement or disagreement with the use of the ISA for LCEs for group audits in which component auditors are involved as well as for obtaining precise

suggestions for the proposed group-specific qualitative characteristics. Furthermore, the term “audit quality” was utilized to find the relevant content from the comment letters discussing audit quality.

3.2 Content analysis

The Gioia method was chosen to be utilized to examine the stakeholders’ views written in the comment letters to induce meaningful inferences. The qualitative analysis was provided to gain “richer insights” into the argumentation and content because it focuses on the meaning behind the words (Yen *et al.*, 2007). The Gioia methodology was chosen because it provides a qualitative methodological approach to develop a data analysis that can meet the rigorous standards of trustworthy research (Magnani and Gioia, 2023).

Firstly, the comment letters received on the new Part 10 were read carefully. The critical element for the effective use of the content analysis is the minimization of the bias created by researcher subjectivity. For this project, two researchers analyzed the comment letters. All

	Europe	Africa	Asia/ Oceania	Americas	Worldwide	Total
<i>Panel A. Overall agreement with the new Part 10</i>						
Number of comment letters that clearly supported the new Part 10	2 (3.3%)	3 (5%)	1 (1.6%)	1 (1.6%)	4 (6.6%)	11 (18.3%)
Number of comment letters that partially supported the new Part 10	15(25%)	4 (6.6%)	7 (11.6%)	5 (8.3%)	8 (13.3%)	39 (65.0%)
Number of comment letters that unilaterally opposed the new Part 10	3 (5.0%)	0 (0%)	2 (3.3%)	2 (3.3%)	1 (1.6%)	8 (13.3%)
Number of comment letters that did not comment directly on the issue	1 (1.6%)	0 (0%)	0 (0%)	1(1.6%)	0 (0%)	2 (3.3%)
Total	21 (35%)	7 (11.6%)	10 (16.7%)	9 (15%)	13 (21.7%)	60 (100%)
<i>Panel B. View of the proposed prohibition on the use of the ISA for LCEs for group audits when component auditors are involved, other than in limited circumstances in which physical presence is required</i>						
Number of comment letters that clearly agreed with the proposed prohibition	6 (10%)	4 (6.6%)	3 (5.0%)	3 (5%)	5 (8.3%)	21 (35%)
Number of comment letters that in principle agreed with the proposed prohibition but required modifications	5 (8.3%)	1 (1.6%)	3 (5.0%)	0 (0%)	2 (3.3%)	11 (18.3%)
Number of comment letters that disagreed with the proposed prohibition	10 (16.7%)	2 (3.3%)	4 (6.6%)	6 (10.0%)	6 (10.0%)	28 (46.7%)
Total	21 (35%)	7 (11.6%)	10 (16.6%)	9 (15%)	13 (21.6%)	60 (100.0%)

Table 1.
Overview of the support and opposition

Source(s): Table by the authors

	Europe	Africa	Asia/ Oceania	Americas	Worldwide	Total
<i>Panel A. View of the proposed group-specific qualitative characteristics to describe the scope of group audits for which the proposed ISA for LCEs is designed to be used</i>						
Number of comment letters that clearly agreed	8 (13.3%)	5 (8.3%)	6 (10%)	5 (8.3%)	6 (10.0%)	30 (50%)
Number of comment letters that in principle agreed with the proposed group-specific qualitative characteristics but required modifications	10 (16.7%)	2 (3.3%)	0 (0%)	3 (5.0%)	5 (8.3%)	20 (33.3%)
Number of comment letters that disagreed with the proposed group-specific qualitative characteristics	3 (5.0%)	0 (0%)	3 (5.0%)	0 (0%)	2 (3.3%)	8 (13.3%)
Number of comment letters that did not comment directly on the issue	0 (0.0%)	0 (0%)	1 (1.6%)	1(1.6%)	0 (0%)	2 (3.3%)
Total	21 (35%)	7 (11.6%)	10 (16.7%)	9 (15%)	13 (21.7%)	60 (100%)
<i>Panel B. View of the content of the proposed part 10 and related conforming amendments</i>						
Number of comment letters that clearly agreed and agreed if their suggestions regarding question 1 or question 2 are taken into account	14 (23.3%)	7 (11.6%)	6 (10%)	6 (10%)	11 (18.3%)	44 (73.3%)
Number of comment letters that disagreed	6 (10%)	0 (0.0%)	2 (3.3%)	3 (5%)	2 (3.3%)	13 (21.7%)
Number of comment letters that were unclear	1 (1.6%)	0 (0.0%)	2 (3.3%)	0 (0%)	0 (0%)	3 (5%)
Total	21 (35%)	7 (11.6%)	30 (50%)	9 (15%)	13 (21.6%)	60 (100.0%)
Source(s): Table by the authors						

Table 2.
Overview of the support for and opposition to the group-specific qualitative characteristics, content of proposed Part 10 and related conforming amendments

the comment letters were coded and classified by the first researcher according to predetermined classification schemes (see [Tables 1](#) and [2](#)). The second researcher then independently analyzed all the comment letters. The two researchers discussed each case of disagreement and were able to resolve all the inconsistencies through clarification of the classification schemes. Hence, we coded the letters according to overall agreement with Part 10 and including group audits in the scope of the ISA for LCEs. For overall agreement with the new Part 10, we divided the CLs into those that clearly supported, partially supported, unilaterally opposed or expressed no opinion about the new Part 10, which meant that the agreement was unclear. Then we coded the comment letters according to the detailed questions expressed in the letters. To conclude, this type of content analysis studies do not have a role for theory in designing the analysis ([Vourvachis and Woodward, 2015](#)). Secondly, to understand the argumentation behind the supporting and opposing statements, we used a highly disciplined coding and analysis process, presenting the output with a three-order hierarchical data structure. Hence, the Gioia method is used to provide richer insights into the text and argumentation under analysis. This approach gives the CLs opportunity to provide an authentic picture of the important aspects of the Part 10. The first step in this process was

to carefully analyze the parts of the comment letters in which the interest groups stated their overall opinion about the suggested Part 10. After that we read punctiliously how the interest groups were answering the three specific questions that the IAASB provided. The objective was to develop a comprehensive understanding of how the interest groups described their views on prohibition of component auditor, group audit qualitative characteristics, and views on the content of Part 10. Finally, we investigated argumentation and audit quality in relation to the new Part 10. Hence, the qualitative data were analyzed to convey similar arguments about above mentioned topics with the aim of generating the first-order concepts. Having gathered the first-order categories, the next step involved identifying linkages among the first-order concepts to group them into second-order concepts. This phase of the analysis was conducted by moving back and forth between the first-order descriptive themes and the evolving patterns in the data until conceptual patterns were developed for the second-order themes (Gioia *et al.*, 2013). The final step was to examine whether the second-order themes could be further developed into “aggregate dimensions” (Gioia *et al.*, 2013). The aggregate dimensions describe the main themes obtained from the data analysis. Gioia (2020) suggested that a relevant descriptive study should generate a coherent explanation of a phenomenon of interest. Therefore, in the current study, the aggregate dimensions explain the wider picture behind the discussion related to new Part 10.

However, the CLs concerning Part 10 and the answers to the three specific questions that IAASB asked are sometimes complex to analyze. For instance, the respondents reported that they agree partly with the topic but suggested many improvements. In other words, the interest groups stated that they see potential in some parts of the new Part 10 but disagree with others within an overall context of being supportive or non-supportive of the IAASB’s proposals. For instance, the proposed prohibition on the use of the proposed ISA for LCEs for group audits involving component auditors divided opinions. To clarify, especially the questions related to prohibition of component auditor and group audit qualitative characteristics were not that straightforwardly coded. In contrast, the overall agreement and the third question concerning insights into the content of the proposed Part 10 and related conforming amendments were relatively transparent to analyze. To provide interrater reliability, we calculated and Cohen’s kappa for the coding of overall agreement and the three specific questions reported in Tables 1 and 2. The Cohen’s kappa for overall agreement and the third question were 1.0 and this finding suggests the authors agreed and both gave the same rating to the overall agreement and views on the content of Part 10. When observing the first question concerning the prohibition of component auditor the Cohen’s coefficient was 0.89 and for the second question concerning the qualitative characteristics it was 0.76. To clarify, Muñoz and Bangdiwala (1997) suggested that values between 0 and 0.20 fell under slight agreement, 0.21 and 0.40 indicated fair agreement, 0.41 and 0.60 could be put under moderate agreement, 0.61 and 0.80 indicated substantial and finally 0.81 and 1.00 was referred to as almost perfect. Hence, it can be interpreted that there is at least substantial agreement in the analyzing process and the authors gave similar ratings when coding the questions.

4. Findings

The following section contains the results. Firstly, the descriptive statistics and some general observations from the comment letters are discussed. Tables 1 and 2 present the descriptive statistics. Secondly, the results of the Gioia analysis are reported. Appropriate representative quotations from the analysis are provided to exemplify the arguments supporting or opposing the new Part 10. The quote selection is distributed across participants to represent the data set comprehensively.

4.1 Descriptive statistics and general remarks about the comment letters

Based on the function and legal status of the respondents, it was possible to differentiate the comment letters into four different groups. The accounting and auditing companies include Big 4 firms, mid-tier audit firms and individual auditors. The accounting and auditing associations contain recognized supervisory and professional bodies. The public authorities include national accounting and auditing standard setters, governmental institutions and national accounting and audit standard boards as well as national accounting and auditing authorities. The interest group “others” consists of an individual respondent who could not be attributed to any other interest groups. [Table 3](#) presents the descriptive statistics. An overview of the participating interest groups shows that the most comment letters were submitted by the accounting and auditing profession (44 of 60 participants in the sample or 73.3%). This finding is consistent with the prior literature ([Haapamäki and Mäki, 2023](#)). Interestingly, in the current lobbying case, no academics submitted CLs. This is partially supported by the prior literature because prior studies have revealed that usually a very limited amount of comment letters is received from academics ([Tandy and Wilburn, 1996](#)). In addition, Panel B of [Table 3](#) presents the descriptive statistics about the geographic regions from which the comment letters were submitted. Most of the comment letters were from Europe (35%). The second-highest participation rate was from Asia/Oceania (16.7%), and the lowest participation rate was from Africa (11.7%). These results are line with those of the first consultation round ([Haapamäki and Mäki, 2023](#)).

When analyzing the overall viewpoints in the CLs, it was clear that the IAASB’s decision to reconsider the inclusion of group audits in the scope of the ISA for LCEs as a separate section Part 10 is clearly needed and supported. Hence, the CLs stated that the IAASB’s commitment to and efforts toward the development of the new Part 10 for the auditing of LCEs’ financial statements were appreciated. The supporting arguments also stated that the ISA for LCEs is intended to serve both auditors and the marketplace as a separate and simpler alternative to the existing full suite of International Standards on Auditing (ISAs). Therefore, many comment letters stated that including less complex group audits that meet the appropriate criteria will increase the adoption and use of the ISA for LCEs globally. It is very important for the IAASB to provide a standard that has global relevance. In addition, many comment letters pointed out that a relatively large number of group entities are not complex and neither are their audits. Therefore, many interest groups still thought that, while the proposed amendment to the authority now includes some groups, it is still too restrictive and will exclude a number of groups that are genuinely less complex. Finally, the IAASB

	Total
<i>Panel A</i>	
Accounting and auditing companies	11 (18.3%)
Accounting and auditing associations	33 (55.0%)
Public authorities	15 (25%)
Others	1 (1.7%)
Total	60 (100%)
<i>Panel B</i>	
Europe	21 (35%)
Africa	7 (11.7%)
Asia/Oceania	10 (16.7%)
Americas	9 (15%)
Worldwide organizations	13 (21.7%)
Total	60 (100%)

Source(s): Table by the authors

Table 3.
Summary of the
interest groups
submitting a comment
letter and geographic
regions

stated when issuing Part 10 for consultation, that they would not invite or reconsider comments in this second round related to the Parts 1–9 which were open up for consultation in the first round. However, the CLs from the second consultation round still included arguments and suggestions related to the first round. For instance, the CLs emphasized the challenges in the transition between the full ISAs and the ISA for LCEs and the risk related to creating two “sets” of auditing standards. Finally, more supplemental guidance was also suggested to be included. By repeating their arguments, the interest groups wanted that the IAASB carefully considers their concerns and suggestions.

4.2 Data structure

Data structure is formed by using following phases. When a comprehensive set of first-order terms, second-order themes and aggregate dimensions is uncovered, the basis for putting together a data structure becomes possible. The data structure provides a way of understanding how all the terms, themes, and dimensions relate to each other in the case of ISA for LCE. It amounts to a graphic representation of how the analysis has progressed from raw data terms to themes when conducting the analysis. It has been argued that the data structure is the most pivotal in the analysis (Gioia, 2020). The data structure portrays a static picture of very dynamic phenomena. Tables 4 and 5 present data structure for arguments seeing potential, opposing and suggesting modifications to the Part 10. Table 4 presents also the arguments associated with audit quality. The data structure tables guide the presentation of the arguments and quotes related to the ISA for LCE.

4.3 Summary of the support and opposition

Panel A of Table 1 provides descriptive statistics about the overall support for and opposition to the new Part 10. To summarize, almost a fifth of the CLs (11 comment letters or 18.3%) clearly supported the new Part 10. Some of the CLs even tried to railroad the IAASB into making the decision to approve the ISA for LCEs. The following quotes demonstrate this:

We are very supportive of the ED. We believe that it is clear and simple and ringfences the use of the ISA for LCEs to the simplest groups, avoiding any risk of scope toward more complex groups. We therefore urge the IAASB, after having considered the comments received on exposure, to adopt the ISA for LCEs, including Part 10, without re-exposure. The process was launched more than six years ago at the first Paris conference. The various outreach and events, including three Paris conferences, have demonstrated the urgent need for such a standard for most of the economies of the world, where SMEs represent the bulk of the economic activity. It is now time to adopt and implement the audit standard for LCEs. (CL13)

Relatedly, the majority (39 comment letters or 65%) saw potential in including the group audits in the standard and hence were partially supportive but highlighted concerns. In contrast, a minority of the CLs (8 comment letters or 13.3%) unilaterally opposed the new Part 10. Only two comment letters (3.3%) did not clearly state an opinion. Among the opposing arguments, the CLs suggested that the Authority should focus on the complexity of the group rather than how the audit or engagement team is managed. Hence, it was acknowledged that the IAASB has a difficult task in appropriately defining the groups to be included within the scope of the proposed ISA for LCEs. However, CLs suggested that the proposal is unnecessarily restrictive and drew attention to concerns that it will prohibit the use of the proposed ISA for LCEs for the auditing of groups with a structure that is not complex. Furthermore, the CLs stated that having two sets of auditing standards is not optimal because the audit market might be fragmented and there is a risk that the requirements will be interpreted to allow the LCE standards to be used when they should not. Finally, the challenges in the transition between the full ISAs and the new ISA for LCEs were highlighted.

First-order concepts	Second-order concepts	Aggregate dimensions
<p><i>Arguments from the submissions that saw potential in the new Part 10</i></p> <ul style="list-style-type: none"> - Part 10 is coherent and ringfences the use of the ISA for LCEs to the simplest groups, avoiding any risk of scope toward more complex groups - The IAASB is recommended, after having considered the comments received on exposure, to adopt the ISA for LCEs, including Part 10, without re-exposure - It is supported that the IAASB develops the LCE standard by adding the new Part 10, the time is optimal for creating the standard and the part 10 should be included <p><i>Arguments from the submissions that saw potential in the proposed prohibition of the use of the ISA for LCEs for group audits when component auditors are involved</i></p> <ul style="list-style-type: none"> - In practice, component auditors are typically used in more complex group audit situations in which the use of the proposed ISA for LCEs would not be considered appropriate - The prohibition is in line with the nature and circumstances of a typical LCE for which the standard should be intended - It was recommended that, if the IAASB continues with the proposed prohibition, the Board should initiate an early post-implementation review, which should focus on the impact or effect that the current group audit scope has had on the overall application of the ISA for LCEs <p><i>Arguments from the submissions that saw potential in the qualitative characteristics</i></p> <ul style="list-style-type: none"> - The suggested qualitative characteristics used to describe the scope of group audits are suitable - The inclusion of these additional characteristics to describe “typical” less complex groups is important to ensure an appropriate entry point to the LCE ISA for group audits - There should not be hard lines drawn on limits such as qualitative characteristics because then professional judgment cannot be applied, but, for the sake of consistency of application, the proposed limits were seen as reasonable - It needs to be made clear that qualitative characteristics are guidance and that ultimately the determination of whether a group is less complex is a matter of professional judgment by the auditor <p><i>Arguments from the submissions that were discussing about audit quality and Part 10</i></p> <ul style="list-style-type: none"> - The IAASB expects that the auditing process will become more effective and efficient once the ISA for LCEs is in force and adopted. This expectation has implications for audit quality - CLs discussed the prohibition of the use of a component auditor, except in the sole circumstance in which their physical presence is necessary, and how this relates to audit quality - CLs highlighted the need to add clarification that the audit approach and, in particular, whether to use component auditors should not be driven by the group auditor’s desire to use the ISA for LCEs - CLs discussed that the proposed group-specific qualitative characteristics are associated with audit quality. For instance, while the proposed group-specific qualitative characteristics were supported, there were concerns that, as currently written, they could lead to inconsistencies in application by the stakeholders, creating confusion in the practice on when the ISA for LCEs can and cannot be used. This might have implications to audit quality 	<p>Part 10 is important part of the ISA for LCE standard</p> <p>The IAASB should move forward with the standard</p> <p>The proposed prohibition is seen relevant</p> <p>Essential to have clear criteria but there should be room for professional judgment</p>	<p>The proposed Part 10 has limitations, it still provides a solid framework within which to undertake an LCE group audit and a promising basis for further development</p> <p>Auditors’ professional judgment should not be underestimated</p> <p>High audit quality can’t be achieved unless there is standardization</p>

Source(s): Table by the authors

Table 4. Data structure for arguments seeing potential in the content of Part 10, prohibition of component auditors, qualitative characteristics and how Part 10 is associated with audit quality

Table 5.
Data structure for arguments that were not supportive for the content, prohibition of component auditors, qualitative characteristics, and for arguments that suggested improvements

First-order concepts	Second-order concepts	Aggregate dimensions
<ul style="list-style-type: none"> - Arguments from the <i>submissions that were not supportive of the content of the new Part 10</i> It should be focused on the complexity of the group rather than how the audit or engagement team is managed - The proposal is stringent and drew attention to concerns that it will prohibit the use of the ISA for LCEs for the auditing of groups with a structure that is not complex - The importance of guidance on how to transition from the ISA for LCEs to the full ISAs and when this should be done was highlighted 	<ul style="list-style-type: none"> - Complexity of the group should define the use of the ISA for LCE - More guidance needed 	<ul style="list-style-type: none"> - The proposal is too restrictive
<ul style="list-style-type: none"> - Arguments from the <i>submissions that were not supportive the proposed prohibition of the use of the ISA for LCEs for group audits when component auditors are involved</i> - The IAASB has a difficult task in defining the groups to be included within the scope of the ISA for LCEs - A blanket prohibition such as that proposed is likely to limit the use of the ISA for LCEs significantly in some jurisdictions, often when all other qualitative characteristics and specified criteria are met. - Physical presence was suggested to be particularly restrictive in an age when technology is enabling the performance of audits remotely - It is common for groups that are not complex to have subsidiaries situated overseas - Using component auditors situated in the same jurisdiction as the overseas subsidiary could improve the efficiency and effectiveness of a group audit, for example eliminating the need for travel and sharing the component auditors' knowledge on the overseas environment and legal requirements - Some concerns regarding the focus and wording of the prohibition and whether this may lead to a risk of inconsistencies in the different circumstances in which the standard is used - The explanatory material relating to component auditors is limited to defining a component auditor - As result of such a restrictive scope, the standard will be used in a very limited capacity, and groups with branches may not even be eligible. A more principle-based approach is preferred 	<ul style="list-style-type: none"> - The proposed prohibition is not justified - Modifications are needed 	<ul style="list-style-type: none"> - The concerns that the suggested prohibition will hinder substantially the use of the proposed ISA for LCEs
<ul style="list-style-type: none"> - Arguments from the <i>submissions that were not supportive about the proposed group-specific qualitative characteristics</i> - A purely qualitative view of a group and its components was preferred to a strict rules-based approach regarding the number of entities or jurisdictions - A certain number of units or a certain number of jurisdictions does not seem appropriate for the intended purpose. It was emphasized that the auditor's professional judgment should be used - The indicative numbers of entities within the group (e.g. 5 or less) or the indicative numbers of jurisdictions (e.g. 3 or less) should be removed from the standard - There should be more relevant, comprehensive examples of situations in which group audits would be considered less complex 	<ul style="list-style-type: none"> - A strict approach is not recommended 	<ul style="list-style-type: none"> - Professional judgments should be the key issue
<ul style="list-style-type: none"> - The current example is insufficient to explain a less complex group audit - Numbers in standards are very rare, if not nonexistent, and they could be taken as being imperative - The group structure and activities section should indicate that it is essential to understand relevant changes in the organizational structure - Arguments from the <i>submissions that were suggesting changes to the content of the proposed Part 10 and related conforming amendments</i> - CLs discussed the role of ISA 600 and its relation to the new Part 10 - ISA 600 (Revised) introduces new definitions of the component auditor and engagement team, and there are already concerns about how to interpret these key definitions. These issues will affect the interpretation of the scope of group audits in the LCE standard - More application material was needed. It was argued that Part 10 does not contain guidance about the risk assessment process - Risk assessment can be dynamic and challenging in a group audit when developing an initial expectation about the potential risks of material misstatements and initial identification of significant classes of transactions and significant accounts (refer to ISA 600 Revised) - It was stated that Part 10 does not appear to include any of the specific requirements from ISA 600 regarding the group auditor's relationship with the component auditor - The IAASB should develop requirements and application material for cases in which component auditors are involved but the engagement is conducted as per the ISA for LCEs, and these should be based on the relevant requirements of ISA 600 (Revised) 	<ul style="list-style-type: none"> - Part 10 should allow for more judgement when making the determination on when the involvement of component auditors renders a group audit complex - The new Part 10 and it's relation to ISA 600 should be clarified 	<ul style="list-style-type: none"> - Part 10 should allow for more judgement when making the determination on when the involvement of component auditors renders a group audit complex - The new Part 10 and it's relation to ISA 600 should be clarified

Source(s): Table by the authors

The challenges in the transition and the perception of two different levels of audit were also brought up in the first consultation round (Haapamäki and Mäki, 2023). The quotes below support these thoughts:

We are pleased that the IAASB has continued with this work. It is an important area and we support the IAASB in moving forward with the LCE standard. We believe it will be necessary to continue to evolve the standard once it has had an opportunity to be adopted. We hope you find our feedback useful as we are keen to see an auditing standard suitable for LCEs. (CL32)

The ED proposal to permit application of the ISA for LCEs to groups further emphasizes the importance of guidance on how to transition from the ISA for LCEs to the full ISAs and when this should be done. For example, if a less complex group acquires a subsidiary during the year, the use of the ISA for LCEs may no longer be appropriate. (CL18)

One year perhaps they can be used and the next not, and how is that transition managed if not enough work was done in the prior year for this year's audit? My advice to any auditor would be never to use the LCE standards, mostly for the additional time taken to understand whether they can be applied and somewhat for the risk that they might be applied when they should not. The current standards, properly understood, now allow a simple audit to be done simply—if properly planned. (CL1)

We remain uncertain as to the benefits of issuing a separate standard for LCE audits since this will create two different categories of audits, thereby fragmenting the audit market. (CL18)

4.3.1 The views about the proposed prohibition of the use of the ISA for LCEs for group audits when component auditors are involved. Panel B of Table 1 reveals the answers to the first question that the IAASB asked when investigating the views on the proposed prohibition of the use of the ISA for LCEs for group audits when component auditors are involved, other than in limited circumstances in which physical presence is required. The findings revealed that a third of the CLs (21 comment letters or 35%) clearly agreed with the proposed prohibition. Then a fifth of the CLs (11 comment letters or 18.3%) in principle agreed with the proposed prohibition but required modifications. The CLs that agreed with the proposed prohibition emphasized that, in practice, component auditors are typically used in more complex group audit situations in which the use of the proposed ISA for LCEs would not be considered appropriate. Those CLs that agreed also stated that the prohibition is in line with the nature and circumstances of a typical LCE for which the standard should be intended. Moreover, it was recommended that, if the IAASB continues with the proposed prohibition, the Board should initiate an early post-implementation review, which should focus on the impact or effect that the current group audit scope has had on the overall application of the ISA for LCEs. Interestingly, almost half of the CLs (28 comment letters or 46.7%) disagreed with the proposed prohibition. Those CLs that disagreed with the prohibition stated that, while the desire for clarity and consistent application of the standard was understood, Part 10 should allow for more judgment when making the determination on when the involvement of component auditors renders a group audit complex. This kind of concerns was already highlighted during the first consultation round. The CLs of the first round emphasized that such a prohibition, along with the lack of clarity regarding the use of ISA for LCE for the audit of a component of a group audit engagement can have a significant detrimental effect on the implementation of the standard (Haapamäki and Mäki, 2023).

Hence, it was clearly argued that the use of a component auditor does not have a direct connection with the entity's complexity. This is due to the fact that component auditors might be used for a variety of reasons, not just for more complex groups. Furthermore, the CLs stated that a blanket prohibition such as that proposed is likely to limit the use of the ISA for LCEs significantly in some jurisdictions, often when all other qualitative characteristics and specified criteria are met. Moreover, "physical presence" was suggested to be particularly restrictive in an age when technology is enabling the performance of audits remotely.

Relatedly, it was stated that it is common for groups that are not complex to have subsidiaries situated overseas. For instance, it was argued that using component auditors situated in the same jurisdiction as the overseas subsidiary could improve the efficiency and effectiveness of a group audit, for example eliminating the need for travel and sharing the component auditors' knowledge on the overseas environment and legal requirements.

Relatedly, those arguments that questioned the proposed prohibition stated that there are some concerns regarding the focus and wording of the prohibition and whether this may lead to a risk of inconsistencies in the different circumstances in which the standard is used. This is because, for instance, audit procedures may be performed by a component auditor or a member of the engagement team based at a remote location on physical items for which there is no reasonable alternative approach other than to use the component auditor for the performance of procedures (e.g. attending a physical inventory count or inspecting physical assets).

Furthermore, it was stated that the explanatory material relating to component auditors is limited to defining a component auditor. To conclude, the CLs underlined that the relevance and cost-benefit value of future audits of LCEs are quite strongly linked to the success and broad adoption of the LCE standard. In this regard, the way in which the IAASB will address the scope of prohibited group audits is critical since it will affect the overall use of the LCE standard. This is because auditors will not invest time or money in understanding and applying the LCE standard if many of their LCE audits will be excluded from the scope. The following quotes support the above thoughts:

We disagree with the restrictive circumstances in which component auditors can be used. We appreciate the IAASB's intention to make it simpler to apply the ISA for LCEs in group audits by proposing prohibition of the use of component auditors. The assessment of the need for component auditors for less complex group audits should be based on the complexity of the group. The prohibition restricts the use of component auditors to circumstances in which physical presence is required to undertake specific audit procedures. In our view, there will be instances in which component auditors may be required for a range of circumstances that is not limited to what is currently proposed (e.g. the audit of an entire overseas component) due to practical considerations. (CL6)

We do not agree with the proposed prohibition when component auditors are involved. We believe the use of component auditors does not necessarily reflect an increase in the complexity of the entity. The decision to use or not use component auditors may be driven by the structure and locations of the auditor's firm rather than by the characteristics of the entity. One example requiring specific consideration is the increasing use of remote and hybrid work arrangements by small firms. This may result in one "office" managed as a single team but spread over many physical locations, time zones or countries. Different firms may structure this as either one or multiple component teams. Excluding component auditors broadly may result in ineligibility of the LCE for certain firms but not others, creating unnecessary variability and a lack of comparability for both auditors and their clients. (CL23)

No, we do not agree with the outright ban on component auditors. As result of such a restrictive scope, the standard will be used in a very limited capacity, and groups with branches may not even be eligible. We would therefore prefer a more principle-based approach. We would need criteria to determine which groups may be considered less complex. (CL27)

4.3.2 The views about the proposed group-specific qualitative characteristics. Panel A of [Table 2](#) reveals the answers to the second question, which examined the agreement with the proposed group-specific qualitative characteristics to describe the scope of group audits for which the proposed ISA for LCEs is designed to be used. Half of the CLs (30 comment letters or 50%) clearly agreed with the proposed group-specific qualitative characteristics. One-third of the CLs (20 comment letters or 33.3%) in principle agreed with the qualitative characteristics but

required modifications to the qualitative criteria. Then eight of the CLs (13.3%) disagreed with the proposed group-specific qualitative characteristics. The most commonly used arguments supporting the proposed qualitative characteristics shared the view that the additional characteristics used to describe the scope of group audits are suitable. The supporting arguments also stated that the inclusion of these additional characteristics to describe “typical” less complex groups is important to ensure an appropriate entry point to the LCE ISA for group audits. The quote below supports these thoughts:

We agree with the proposals. The group-specific qualitative characteristics are fully and appropriately captured in the proposed ISA for LCEs. (CL15)

However, some of the comment letters stated that there should not be hard lines drawn on limits such as qualitative characteristics because then professional judgment cannot be applied, but, for the sake of consistency of application, the proposed limits were seen as reasonable. Hence, while the qualitative characteristics were supported, the CLs still emphasized the importance of auditors’ ability to exercise their professional judgment. The following quotes clarify this suggestion:

We agree with the proposed group-specific qualitative characteristics, which generally describe characteristics of a less complex group structure. However, the standard should include a reminder for practitioners to exercise their professional judgment in the evaluation of whether the standard is applicable as there may be circumstances specific to a group that may not be captured in the qualitative characteristics described under the Authority of the standard. For example, while “group entities or business units that are limited to a few jurisdictions” may be characteristic of a less complex structure in most circumstances, it may not be the case if one or more of the jurisdictions in question is of high risk. (CL30)

We largely agree with the proposed group-specific qualitative characteristics; however, it needs to be made clear that they are guidance and that ultimately the determination of whether a group is less complex is a matter of professional judgement by the auditor. (CL40)

The arguments opposing the qualitative characteristics brought up the following themes. Firstly, it was straightforwardly emphasized that a purely qualitative view of a group and its components was preferred to a strict rules-based approach regarding the number of entities or jurisdictions. The CLs stated that a quantitative limitation to a certain number of units or a certain number of jurisdictions does not seem appropriate for the intended purpose. This was due to the opposing CLs also emphasizing that the auditor’s professional judgment should be used. It has been argued that professional judgment represents the key to a successful audit. Therefore, the emphasis on professional judgment is essential given the nature of auditing and assurance work, which routinely requires assessments of audit evidence, risk and materiality, resulting in the expression of a professional “opinion” (West and Buckby, 2023). The prior literature has emphasized that auditors used to resolve different issues by returning to basic first principles, but nowadays they turn to the standards first. The essential puzzle is that audit practice standards are said to be principle rather than rule based and underline the importance of auditors exercising their professional judgment (Humphrey *et al.*, 2011). Therefore, the CLs are justified in highlighting the role of professional judgment and hesitating about the very strict qualitative characteristics. In addition, the CLs suggested that there should be more relevant, comprehensive examples of situations in which group audits would be considered less complex. Relatedly, it was suggested that the following factors should be addressed as additional qualitative characteristics: (1) the nature and complexity of the IT systems used within the group; (2) the existence of common or central management and finance teams; and (3) different or unrelated business activities within the group. In other words, the opposing arguments stated that the current example is insufficient to explain a less complex group audit. Hence, there should be clear examples, with qualitative

considerations, of what makes an entity less complex and what would increase its complexity (e.g. operating in more jurisdictions increases complexity due to differing laws and regulations, language differences, access to information, differing country practices, decentralization, the complexity of consolidation process and group oversight). Furthermore, it was highlighted that the group structure and activities section should indicate that it is essential to understand relevant changes in the organizational structure (e.g. acquisitions that occurred) because changes could increase, for instance, the complexity in ownership, IT systems and applicable regulations. Therefore, the importance of understanding the nature and timing of these changes prior to executing an audit under the ISA for LCEs cannot be underestimated. To conclude, the changes in overall complexity should primarily be considered when determining the applicability of the ISA for LCEs. The following quotes support these arguments:

We believe that the indicative numbers of entities within the group (e.g. 5 or less) or the indicative numbers of jurisdictions (e.g. 3 or less) should be removed from the standard. Numbers in standards are very rare, if not inexistent, and they could be taken as being imperative. There is a therefore a risk that they could be considered a rule instead of an illustration. The word “few” in English is sufficiently clear to prevent misuse of the standard. (CL13)

The qualitative characteristics in paragraph A3 should be clearly marked as examples of where the auditor needs to use their professional judgment in determining the qualitative characteristics. This is specifically important in terms of the qualitative examples for thresholds related to the number of entities or business units and the number of jurisdictions. In the European Union, with an open market for services, goods and finance, setting up entities in several (i.e. more than three) member states is also rather common for less complex groups. (CL25)

Given that and considering regional and jurisdictional differences in terms of both the reasons for and the frequency of less complex groups, we do not support the inclusion of quantitative examples linked to group structures and activities in paragraph A3. For example, in the European Union, with its open market for services, goods and finance, it is rather common for less complex groups also to set up entities in several (i.e. more than three) member states. If the IAASB would still like to provide quantitative examples as guidance, we suggest including them in another document, for example in the Supplemental Guidance for the Authority. (CL31)

The examples of less complex groups in the ED may lead to inappropriate application of the standard. In particular, there needs to be further guidance provided regarding the application of the ISA for LCEs when a group has operations in several jurisdictions. Differences in legislation, tax requirements, language, currency and customs as well as the remote location of personnel and accounting records, among other factors, can all lead to significant complexity for the entity and its operations. (CL18)

4.3.3 The views of the content of the proposed part 10 and related conforming amendments. Panel B of [Table 2](#) presents the answers to the third question, which examined the agreement with the content of the proposed Part 10 and related conforming amendments. We divided the CLs into the following groups: (1) comment letters that clearly agreed and agreed if their suggestions regarding question 1 or question 2 were taken into account; (2) comment letters that disagreed with the content of the proposed Part 10 and related conforming amendments; and, finally, (3) comment letters that did not answer the question. The majority of the comment letters (44 comment letters or 73.3%) belonged to the first categorization group. A fifth of the CLs (13 comment letters or 21.7%) can be classified into the second group, and three CLs (5%) did not answer the question.

The letters brought up the following themes. Many of the CLs discussed the role of ISA 600 and its relation to the new Part 10. For instance, concerning the usability of the LCE standard, it was stated that group audits are closely linked to ISA 600 (Revised), which has not even become effective yet. This is because ISA 600 (Revised) introduces new definitions of the

component auditor and engagement team, and there are already concerns and uncertainties about how to interpret these key definitions. The CLs stated that these issues will affect the interpretation of the scope of group audits in the LCE standard. In addition, those arguments that disagreed underlined that more application material was needed. It was argued that Part 10 does not contain guidance about the risk assessment process. Risk assessment can be dynamic and challenging in a group audit when developing an initial expectation about the potential risks of material misstatements and initial identification of significant classes of transactions and significant accounts (refer to ISA 600 Revised). Furthermore, it was suggested that the IAASB should develop requirements and application material for cases in which component auditors are involved but the engagement is conducted as per the ISA for LCEs, and these should be based on the relevant requirements of ISA 600 (Revised). Moreover, the CLs discussed the group auditor and component auditor relationship; for instance, it was stated that Part 10 does not appear to include any of the specific requirements from ISA 600 regarding the group auditor's relationship with the component auditor. To conclude, it was also suggested that a high-level summary of how the proposed Part 10 differs from ISA 600 (Revised) should have been prepared and posted on the IAASB's website. Such a document would have supported the respondents in performing a complete review of the proposed Part 10 and the conforming amendments. Finally, with respect to the proposed illustrative report, it was recommended that the proposed additional conditional text, to be included within the auditor's responsibilities section of the report, should be presented directly as part of the body of the illustrative report rather than as a footnote because a footnote may be overlooked, leading to an incomplete report. The following quotes represent the above discussion.

We believe that the following application guidance concerning certain definitions in ISA 600 (Revised) should be included in the ISA for LCEs as essential explanatory material to facilitate its consistent application across all standards:

- (1) Definition of component—ISA 600 (Revised), paragraph A20—which explains that the group auditor uses professional judgment in determining the components on which audit work will be performed and that the identification and assessment of the risks of material misstatement of the group financial statements encompass all of the entities and business units of which financial information is included in the group financial statements.
- (2) Definition of component auditor—ISA 600 (Revised), paragraphs A21–A23—which clarifies the members of the engagement team who are considered component auditors (CL49).

Part 10 does not appear to include any of the specific requirements from ISA 600 regarding the group auditor's relationship with the component auditor (e.g. instructions, reporting, review, documentation, etc.). We have a concern that this may lead to instances of poor-quality audit procedures being performed by a component auditor due to lack of communication, oversight and/or review by the group auditor. (CL10)

We recommend the use of guidance available in ISA 600 (Revised) par. A93 to indicate clearly the factors that are likely to increase the complexity of the group. (CL38)

We generally agree. If, as we hope, the IAASB decides to change the scope of when component auditors are involved, we recognize that this will require further consideration of the material in the proposed Part 10. (CL3)

4.4 *The results of the content analysis concerning audit quality and part 10*

The IAASB expects that the auditing process will become more effective and efficient once the ISA for LCEs is in force and adopted. This expectation has implications for audit quality. For instance, the CLs that supported the new Part 10 stated that the proposed ISA for LCEs is an important step in increasing the efficiency of LCE audits while achieving a high-quality audit; hence, the initiative was supported and the IAASB was encouraged to move forward with it.

The CLs also discussed the prohibition of the use of a component auditor, except in the sole circumstance in which their physical presence is necessary, and how this relates to audit quality. For instance, it was stated that, in the circumstance in which the group's components are based in other jurisdictions, the need to use one or more component auditors—even within the same jurisdiction—is due not necessarily to the group's complexity but rather to the group auditor's organizational requirements to ensure adequate audit quality. Relatedly, one comment letter emphasized that the prohibition on the use of a component auditor except in the sole circumstance that their physical presence is necessary to perform a specific audit procedure seems to be contrary to the general objectives of adequate audit quality and efficiency of the group audit while still referring to a less complex group. Furthermore, those CLs that agreed with the proposed prohibition of the use of the ISA for LCEs when component auditors are involved cautioned that this prohibition might result in decisions regarding the use of component auditors being driven by a desire to use the ISA for LCEs rather than the most effective way of gathering enough appropriate audit evidence. In circumstances in which, for example, there were one or two overseas components, to use the ISA for LCEs, group auditors could perform audits of those components themselves rather than engaging component auditors. Similarly, it was suggested that a group auditor might decide not to perform audit procedures on certain transactions and balances of a component to avoid utilizing a component auditor. Both scenarios could be detrimental to audit quality, the CLs suggested. Therefore, they highlighted the need to add clarification.

Some comment letters discussed how the proposed group-specific qualitative characteristics are associated with audit quality. For instance, while the proposed group-specific qualitative characteristics were supported, there were concerns that, as currently written, they could lead to inconsistencies in application by the stakeholders, creating confusion in the practice on when the ISA for LCEs can and cannot be used. Therefore, it was suggested that more guidance and clarification are necessary to promote audit quality and consistency across auditors. The CLs during the first round brought up that auditors need more support and guidance when implementing the proposed standard. Hence, the suggestions in the CLs during this second consultation are discussing similar concerns as in the first consultation round. The following quotes support the above thoughts:

Clear criteria are necessary to avoid unacceptable risks to audit quality, especially that the LCE standard is inconsistently applied in similar fact patterns. (CL27)

In our 2021 response, we also stated that any decision to permit the use of the proposed ISA for LCEs for group audits must be driven solely in relation to audit quality and be supported by clear criteria for when such use would be deemed appropriate, in addition to any qualitative size criteria that may be established. (CL36)

Given that the most likely users of the ISA for LCEs are small and medium-sized practitioners (SMPs) who do not necessarily have operations in multiple jurisdictions or geographic locations, the use of component auditors will often be necessary for group engagements as it is often more cost effective than the group audit team having to travel to component entities. The local knowledge of the entity that a local component auditor brings to the engagement may also improve audit quality. (CL40)

In our view, prohibiting the use of the ED ISA for LCEs for group audits when component auditors are involved can lead to situations in which auditors who believe that the ED ISA for LCEs is appropriate for the audit decide to perform the audit with a single team across several locations instead of appropriately involving component auditors with the adequate competence and capabilities (e.g. local knowledge of business practices and language), which would lead to a higher quality audit. (CL44)

5. Conclusions

This article continues to investigate the CLs, the standard-setting process and the final standard in the case of the auditing of LCEs. Prior studies have emphasized the importance of harmonizing audit practices for LCEs (Haapamäki and Mäki, 2023; van Nieuw Amerongen *et al.*, 2023a) because the audit market for LCEs has faced challenges in recent years. One of the reasons for this is the increasing complexity of audits for smaller firms. It has been suggested that the current ISAs are not intended for auditing LCEs as a significant number of requirements relate to a regulatory environment that is focused more on more complex or listed entities (IAASB, 2021). The IAASB has taken the opportunity to change this. It has been suggested that the ISA for LCEs provides clarity and international leadership regarding audits of LCEs, removing them from an increasingly complex environment of auditing standards that are difficult to apply to LCEs. The exposure draft of a standard for LCE audits has received a substantial amount of feedback from interest groups, and this study investigated comment letters concerning the new suggested Part 10 on audits of group financial statements. In the previous consultation round, it was clearly suggested that group audits should be included in the scope of the ISA for LCEs. In the second consultation round, the comment letters stated that, while the proposed Part 10 has limitations, it still provides a solid framework within which to undertake an LCE group audit and a promising basis for further development. While many interest groups were committed to the idea of a separate standard for LCE audits, others were concerned about the potential need to develop and maintain two audit systems, and it was emphasized that adding group audits under the standard will increase the adoption and implementation of the ISA for LCEs. It can be suggested that, by promoting a better-focused approach to auditing for LCEs, auditors may be able to provide more valuable services that come with a better understanding of their clients and their operations as opposed to merely conducting checklist-driven or tick-the-box exercises called audits.

To summarize, the results of this study reveal that the majority of the CLs supported the new Part 10. However, they suggested that the proposal is too restrictive and that there are no weighty arguments, for instance, to prohibit the use of component auditors (other than under limited circumstances) in a group audit engagement under the ISA for LCEs. The CLs argued that using a component auditor is not necessarily an indication of complexity. For example, component auditors may be involved for practical reasons rather than because they are contributing skills, experience or expertise in technical or other matters.

When it comes to the proposed qualitative characteristics, some of the comment letters stated that hard lines should not be drawn on limits such as qualitative characteristics because then professional judgment cannot be applied, but, for the sake of consistency of application, the proposed limits were seen reasonable. Hence, while the qualitative characteristics were supported, the CLs still emphasized the importance for auditors to exercise their professional judgment. Therefore, it was highlighted that the interest groups largely agreed with the proposed group-specific qualitative characteristics; however, it needs to be made transparent that they are guidance and that the final decision on whether a group is less complex is a matter of professional judgment by the auditor. Prior studies have emphasized the importance of recognizing the role of professional judgment in audit quality

(Holm and Zaman, 2012). To conclude, CLs stated that, while the proposed Part 10 has some weak points, it still provides a solid and practical structure within which to undertake an LCE group audit and a promising basis for further development.

Notes

1. The parts of the ISA for LCE are categorized as follows: Part 1: Fundamental Concepts, General Principles and Overarching Requirements; Part 2: Audit Evidence and Documentation; Part 3: Engagement Quality Management; Part 4: Acceptance or Continuance of an Audit Engagement and Initial Audit Engagements; Part 5: Planning; Part 6: Risk Identification and Assessment; Part 7: Responding to Assessed Risks of Material Misstatement; Part 8: Concluding; Part 9: Forming an Opinion and Reporting
2. The comment letters from the first consultation round are available here: <https://www.iaasb.org/publications/exposure-draft-proposed-international-standard-auditing-financial-statements-less-complex-entities>
3. The three specific questions were: (1) In the Authority, do you agree with the proposed prohibition on the use of the proposed ISA for LCEs for group audits when component auditors are involved, other than in limited circumstances in which 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 LCEs is designed to be used? (3) Do you agree with the content of the proposed Part 10 and the related conforming amendments?
4. The comment letters from the second consultation round are available at <https://www.iaasb.org/publications/proposed-part-10-audits-group-financial-statements-proposed-isa-audits-financial-statements-less>

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