

# Draft IDW Auditing Standard for Less Complex Entities: Supplementary Requirements for Specific Circumstances (IDW AuSLCE 9)

IDW AuSLCE 9

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*Within the context of the audit of financial statements of small and medium-sized entities (SMEs) as a model, the Hauptfachausschuss (HFA) [Auditing and Assurance Board] has issued the following draft IDW Auditing Standard for Less Complex Entities: Supplementary Requirements for specific circumstances.*

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<sup>1</sup> Issued by the HFA on June 17, 2022.

# 1 Preface

1 The requirements set out by this IDW Auditing Standard for Less Complex Entities (IDW AuSLCE) shall be applied by the auditor in addition to the requirements contained in IDW AuSLCE 1 to IDW AuSLCE 7 when the following circumstances apply:

- (a) An initial audit,
- (b) The entity uses a service organization,
- (c) The work of an auditor's expert is to be used or
- (d) An internal audit function exists at the entity whose financial statements are being audited.

*This IDW AuSLCE specifies the requirements for the audit of the financial statements of an LCE in circumstances where one or more of the characteristics set out by IDW AuSLCE 1<sup>2</sup> para. 19 (g), (h), (n) and (o) are absent.*

## 2 Initial Audit Engagements

### 2.1 Planning and Risk Assessment

2 The auditor shall undertake the following activities prior to starting an initial audit:

- (a) Performing procedures required by IDW AuSLCE 2 and IDW AuSLCE 3 regarding the acceptance of the client relationship and the specific audit engagement<sup>3</sup>; and
- (b) Communicating with the predecessor auditor, where there has been a change of auditors, in compliance with relevant ethical requirements.

3 If the prior period's financial statements were audited by a predecessor auditor and there was a modification to the opinion, the auditor shall evaluate the effect of the matter giving rise to the modification in assessing the risks of material misstatement in the current period's financial statements in accordance with IDW AuSLCE 4<sup>4</sup>.

### 2.2 Audit Procedures

4 The auditor shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.

5 The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

- (a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated;
- (b) Determining whether the opening balances reflect the application of appropriate accounting policies; and
- (c) Performing one or more of the following:

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<sup>2</sup> See IDW Auditing Standard for Less Complex Entities: Scope and Preface (IDW AuSLCE 1).

<sup>3</sup> See IDW Auditing Standard for Less Complex Entities: Overarching Requirements for a Financial Statement Audit (IDW AuSLCE 2) and IDW Auditing Standard for Less Complex Entities: Engagement Acceptance and Preparatory Activities for a Financial Statement Audit (IDW AuSLCE 3).

<sup>4</sup> See IDW Auditing Standard for Less Complex Entities: Identification and Assessment of Risks of Material Misstatement (IDW AuSLCE 4).

- (i) Where the prior year financial statements were audited, reviewing the predecessor auditor's working papers to obtain evidence regarding the opening balances;
- (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
- (iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

6 The auditor shall obtain sufficient appropriate audit evidence about whether the accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, and whether changes in the accounting policies have been appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

### 2.3 Audit Conclusion and Reporting

7 If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance in accordance with IDW AuSLCE 5<sup>5</sup> und IDW AuSLCE 6<sup>6</sup>.

8 If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements, as appropriate, in accordance with IDW AuSLCE 7<sup>7</sup>.

9 If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not appropriately accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with IDW AuSLCE 7.

10 If the auditor concludes that:

- (a) the current period's accounting policies are not consistently applied in relation to opening balances in accordance with the applicable financial reporting framework; or
- (b) a change in accounting policies is not appropriately accounted for or not adequately presented or disclosed in accordance with the applicable financial reporting framework,

the auditor shall express a qualified opinion or an adverse opinion as appropriate in accordance with IDW AuSLCE 7.

11 If the predecessor auditor's opinion regarding the prior period's financial statements included a modification to the auditor's opinion that remains relevant and material to the current period's financial statements, the auditor shall modify the auditor's opinion on the current period's financial statements in accordance with IDW AuSLCE 7.

<sup>5</sup> See IDW Auditing Standard for Less Complex Entities: Responses to Assessed Risks (IDW AuSLCE 5).

<sup>6</sup> See IDW Auditing Standard for Less Complex Entities: Concluding Auditing Procedures, Communication with Those Charged with Governance and obtaining Written Representations (IDW AuSLCE 6).

<sup>7</sup> See IDW Auditing Standard for Less Complex Entities: Forming an Opinion, Auditor's Report and Archiving (IDW AuSLCE 7).

- 12 If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited.

### **3 Requirements Relating to an Entity Using a Service Organization**

#### **3.1 Obtaining an Understanding of the Services Provided by a Service Organization, Including Internal Control**

- 13 When obtaining an understanding of the user entity in accordance with IDW AuSLCE 4, the user auditor shall obtain an understanding of how a user entity uses the services of a service organization in the user entity's operations, including:

- (a) The nature of the services provided by the service organization and the significance of those services to the user entity, including the effect thereof on the user entity's internal control;
- (b) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organization;
- (c) The degree of interaction between the activities of the service organization and those of the user entity; and
- (d) The nature of the relationship between the user entity and the service organization, including the relevant contractual terms for the activities undertaken by the service organization.

*In the case of outsourced accounting or financial statement preparation procedures to auditors or tax advisors the auditor will generally consider, apart from the professional qualification of the service organization, the following aspects in order to obtain an understanding of the service provided by the service organization:*

- (a) The nature of the service provided by the auditor or tax advisor (e.g., taking over the whole accounting procedures or performing closing entries to prepare financial statements);*
- (b) The application of professional pronouncements in the preparation of financial statements by the auditor or tax advisor;*
- (c) The design of the service provided, i.e. whether the services are individual services for single clients only or standardized services with corresponding processes for a large number of clients*

- 14 When obtaining an understanding of the entity's system of internal control in accordance with IDW AuSLCE 4, the user auditor shall identify controls in the control activities component at the user entity that relate to the services provided by the service organization, including those that are applied to the transactions processed by the service organization, and consider their design and determine whether they have been implemented, in cases where controls address relevant inherent risks.

- 15 The user auditor shall determine whether a sufficient understanding of the nature and significance of the services provided by the service organization and their effect on the user entity's system of internal control has been obtained to provide an appropriate basis for the identification and assessment of the risks of material misstatement.

- 16 If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor shall obtain that understanding from one or more of the following procedures:

- (a) Obtaining a type 1 or type 2 report, if available;

- (b) Contacting the service organization, through the user entity, to obtain specific information;
- (c) Visiting the service organization and performing procedures that will provide the necessary information about the relevant controls at the service organization; or
- (d) Using another auditor to perform procedures that will provide the necessary information about controls at the service organization.

17 In determining the sufficiency and appropriateness of the audit evidence provided by a type 1 or type 2 report, the user auditor shall be satisfied as to:

- (a) The service auditor's professional competence and independence from the service organization; and
- (b) The adequacy of the standards under which the type 1 or type 2 report was issued.

18 If the user auditor plans to use a type 1 or type 2 report as audit evidence to support the user auditor's understanding about the design and implementation of controls at the service organization, the user auditor shall:

- (a) Consider whether the description and design of controls at the service organization is at a date or for a period that is appropriate for the user auditor's purposes;
- (b) Evaluate the sufficiency and appropriateness of the evidence provided by the report for the understanding of the controls at the service organization; and
- (c) Determine whether complementary user entity controls identified by the service organization are relevant to the user entity and, if so, obtain an understanding of whether the user entity has designed and implemented such controls.

### **3.2 Responding to the Assessed Risks of Material Misstatement**

19 In responding to assessed risks in accordance with IDW AuSLCE 5, the user auditor shall:

- (a) Determine whether sufficient appropriate audit evidence concerning the relevant financial statement assertions is available from records held at the user entity; and, if not,
- (b) Perform further audit procedures to obtain sufficient appropriate audit evidence or use another auditor to perform those procedures at the service organization on the user auditor's behalf.

20 When the user auditor's risk assessment includes an expectation that controls at the service organization are operating effectively and the user auditor plans to rely upon them, the user auditor shall obtain audit evidence about the operating effectiveness of those controls from one or more of the following procedures:

- (a) Obtaining a type 2 report, if available;
- (b) Performing appropriate tests of controls at the service organization; or
- (c) Using another auditor to perform tests of controls at the service organization on behalf of the user auditor.

21 If, in accordance with paragraph 20, the user auditor plans to use a type 2 report as audit evidence that controls at the service organization are operating effectively, the user auditor shall determine whether the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment by:

- (a) Consider whether the description, design and operating effectiveness of controls at the service organization is at a date or for a period that is appropriate for the user auditor's purposes;
- (b) Determining whether complementary user entity controls identified by the service organization are relevant to the user entity and, if so, obtaining an understanding of whether the user entity has designed and implemented such controls and, if so, testing their operating effectiveness;
- (c) Evaluating the adequacy of the time period covered by the tests of controls and the time elapsed since the performance of the tests of controls; and
- (d) Evaluating whether the tests of controls performed by the service auditor and the results thereof, as described in the service auditor's report, are relevant to the assertions in the user entity's financial statements and provide sufficient appropriate audit evidence to support the user auditor's risk assessment.

### **3.3 Specific Requirements**

- 22 If the user auditor plans to use a type 1 or a type 2 report that excludes the services provided by a subservice organization and those services are relevant to the audit of the user entity's financial statements, the user auditor shall apply the requirements of this IDW AuSLCE with respect to the services provided by the subservice organization.
- 23 The user auditor shall inquire of management of the user entity whether the service organization has reported to the user entity, or whether the user entity is otherwise aware of, any fraud, non-compliance with laws and regulations or uncorrected misstatements affecting the financial statements of the user entity. The user auditor shall evaluate how such matters affect the nature, timing and extent of the user auditor's further audit procedures, including the effect on the user auditor's conclusions and user auditor's report.
- 24 The user auditor shall modify the opinion in the user auditor's report in accordance with IDW AuSLCE 7 if the user auditor is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organization relevant to the audit of the user entity's financial statements.

## **4 Using the Work of an Auditor's Expert**

- 25 If expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the auditor shall determine whether to use the work of an auditor's expert.
- 26 With respect to accounting estimates, the auditor shall determine whether the engagement team requires specialized skills or knowledge to perform the risk assessment procedures, to identify and assess the risks of material misstatement, to design and perform audit procedures to respond to those risks, or to evaluate the audit evidence obtained.
- 27 In determining the nature, timing and extent of the auditor's procedures with respect to the requirements in paragraphs 28-32, the auditor shall consider matters including:
- (a) The nature of the matter to which that expert's work relates;
  - (b) The risks of material misstatement in the matter to which that expert's work relates;
  - (c) The significance of that expert's work in the context of the audit;
  - (d) The auditor's knowledge of and experience with previous work performed by that expert; and
  - (e) Whether that expert is subject to the auditor's firm's quality control policies and procedures.

- 28 The auditor shall evaluate whether the auditor's expert has the necessary competence, capabilities and objectivity for the auditor's purposes. In the case of an auditor's external expert, the evaluation of objectivity shall include inquiry regarding interests and relationships that may create a threat to that expert's objectivity.
- 29 The auditor shall obtain a sufficient understanding of the field of expertise of the auditor's expert to enable the auditor to:
- (a) Determine the nature, scope and objectives of that expert's work for the auditor's purposes; and
  - (b) Evaluate the adequacy of that work for the auditor's purposes.
- 30 The auditor shall agree, in writing when appropriate, on the following matters with the auditor's expert:
- (a) The nature, scope, timing and objectives of that expert's work;
  - (b) The respective roles and responsibilities of the auditor and that expert;
  - (c) The nature, timing and extent of communication between the auditor and that expert, including the form of any report to be provided by that expert; and
  - (d) The need for the auditor's expert to observe confidentiality requirements; and
  - (e) Extent of documentation.
- 31 The auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including:
- (a) The relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence;
  - (b) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and
  - (c) If that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data.
- 32 If the auditor determines that the work of the auditor's expert is not adequate for the auditor's purposes, the auditor shall: (Ref: Para. A40)
- (a) Agree with that expert on the nature and extent of further work to be performed by that expert; or
  - (b) Perform additional audit procedures appropriate to the circumstances.

## **5 Using the Work of Internal Auditors**

### **5.1 Risk Assessment and Obtaining an Understanding of the Entity and its Environment**

- 33 The risk assessment procedures shall include inquiries of individuals within the internal audit function.
- 34 As part of these inquiries of appropriate individuals within the internal audit function the auditor shall determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity, and obtain its views about the risks of fraud.
- 35 When obtaining an understanding of the entity's process for monitoring the system of internal control relevant to the preparation of the financial statements, through performing risk assessment procedures the auditor shall understand those aspects of the entity's process that address the entity's internal audit function, including its nature, responsibilities and activities.

## 5.2 Determining Whether, in Which Areas, and to What Extent the Work of the Internal Audit Function Can Be Used

- 36 The external auditor shall determine whether the work of the internal audit function can be used for purposes of the audit by considering the following:
- (a) The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors;
  - (b) The level of competence of the internal audit function; and
  - (c) Whether the internal audit function applies a systematic and disciplined approach, including quality control.
- 37 The external auditor shall not use the work of the internal audit function if the external auditor determines that:
- (a) The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;
  - (b) The function lacks sufficient competence; or
  - (c) The function does not apply a systematic and disciplined approach, including quality control.
- 38 As a basis for determining the areas and the extent to which the work of the internal audit function can be used, the external auditor shall consider the nature and scope of the work that has been performed, or is planned to be performed, by the internal audit function and its relevance to the external auditor's overall audit strategy and audit plan.
- 39 The external auditor shall make all significant judgments in the audit engagement and, to prevent undue use of the work of the internal audit function, shall plan to use less of the work of the function and perform more of the work directly:
- (a) The more judgment is involved in:
    - (i) Planning and performing relevant audit procedures; and
    - (ii) Evaluating the audit evidence gathered;
  - (b) The higher the assessed risk of material misstatement at the assertion level, with special consideration given to risks identified as significant;
  - (c) The less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; and
  - (d) The lower the level of competence of the internal audit function.
- 40 The external auditor shall also evaluate whether, in aggregate, using the work of the internal audit function to the extent planned would still result in the external auditor being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed.
- 41 The external auditor shall, in communicating with those charged with governance an overview of the planned scope and timing of the audit in accordance with IDW AuSLCE 3, communicate how the external auditor has planned to use the work of the internal audit function.

## 5.3 Using the Work of the Internal Audit Function

- 42 If the external auditor plans to use the work of the internal audit function, the external auditor shall discuss the planned use of its work with the function as a basis for coordinating their respective activities.



- 43 The external auditor shall read the reports of the internal audit function relating to the work of the function that the external auditor plans to use to obtain an understanding of the nature and extent of audit procedures it performed and the related findings.
- 44 The external auditor shall perform sufficient audit procedures on the body of work of the internal audit function as a whole that the external auditor plans to use to determine its adequacy for purposes of the audit, including evaluating whether:
- (a) The work of the function had been properly planned, performed, supervised, reviewed and documented;
  - (b) Sufficient appropriate evidence had been obtained to enable the function to draw reasonable conclusions; and
  - (c) Conclusions reached are appropriate in the circumstances and the reports prepared by the function are consistent with the results of the work performed.
- 45 The nature and extent of the external auditor's audit procedures shall be responsive to the external auditor's evaluation of:
- (a) The amount of judgment involved;
  - (b) The assessed risk of material misstatement;
  - (c) The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors; and
  - (d) The level of competence of the function;
- and shall include reperformance of some of the work.
- 46 The external auditor shall also evaluate whether the external auditor's conclusions regarding the internal audit function in paragraph 32 and the determination of the nature and extent of use of the work of the function for purposes of the audit in paragraphs 34–35 remain appropriate.

## **5.4 Documentation**

- 47 If the external auditor uses the work of the internal audit function, the external auditor shall include in the audit documentation:
- (a) The evaluation of:
    - (i) Whether the function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors;
    - (ii) The level of competence of the function; and
    - (iii) Whether the function applies a systematic and disciplined approach, including quality control;
  - (b) The nature and extent of the work used and the basis for that decision; and
  - (c) The audit procedures performed by the external auditor to evaluate the adequacy of the work used.

## Appendix 1: Definitions

Term	Definition
Auditor's expert	An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor's expert may be either an auditor's internal expert (who is a partner or staff, including temporary staff, of the auditor's firm or a network firm), or an auditor's external expert.
Complementary user entity controls	Controls that the service organization assumes, in the design of its service, will be implemented by user entities, and which, if necessary to achieve control objectives, are identified in the description of its system.
Expertise	Skills, knowledge and experience in a particular field.
Initial audit engagement	An engagement in which either: (a) The financial statements for the prior period were not audited; or (b) The financial statements for the prior period were audited by a predecessor auditor.
Internal audit function	A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.
Opening balances	Those account balances that exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.
Predecessor auditor	The auditor from a different audit firm, who audited the financial statements of an entity in the prior period and who has been replaced by the current auditor.
Report on the description and design of controls at a service organization (referred to as a type 1 report)	A report that comprises: (a) A description, prepared by management of the service organization, of the service organization's system, control objectives and related controls that have been designed and implemented as at a specified date; and (b) A report by the service auditor with the objective of conveying reasonable assurance that includes the service auditor's opinion on the description of the service organization's system, control objectives and related controls and the suitability of the design of the controls to achieve the specified control objectives.
Report on the description, design, and operating effectiveness of controls at a service organization (referred to as a type 2 report)	A report that comprises: (a) A description, prepared by management of the service organization, of the service organization's system, control objectives and related controls, their design and implementation as at a specified date or throughout a specified period and, in some

Term	Definition
	<p>cases, their operating effectiveness throughout a specified period; and</p> <p>(b) A report by the service auditor with the objective of conveying reasonable assurance that includes:</p> <ul style="list-style-type: none"> <li>(i) The service auditor's opinion on the description of the service organization's system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and</li> <li>(ii) A description of the service auditor's tests of the controls and the results thereof.</li> </ul>
Service auditor	An auditor who, at the request of the service organization, provides an assurance report on the controls of a service organization.
Service organization	A third-party organization (or segment of a third-party organization) that provides services to user entities that are part of those entities' information systems relevant to financial reporting.
Service organization's system	The policies and procedures designed, implemented and maintained by the service organization to provide user entities with the services covered by the service auditor's report.
Subservice organization	A service organization used by another service organization to perform some of the services provided to user entities that are part of those user entities' information systems relevant to financial reporting.
User auditor	An auditor who audits and reports on the financial statements of a user entity.
User entity	An entity that uses a service organization and whose financial statements are being audited.

## Appendix 2: Conforming and Consequential Amendments to IDW AuSLCE 1 “Scope and Preface”

As a result of the requirements set forth by this standard, conforming amendments to IDW AuSLCE 1, which are shown with marked changes in the following, are necessary.

### Extract from IDW AuSLCE 1:

#### Para. 19

The IDW AuSLCE may generally be applied if the entity meets the following characteristics:

[...]

This list is not exhaustive and other relevant matters may also need to be considered. The absence of a characteristic does not necessarily exclude the use of the IDW AuSLCE, requires however the planning and execution of further audit procedures. If characteristics in (g), (h), (n) and (o) are absent, the auditor shall comply with the requirements set forth by IDW AuSLCE 9. The matters described in the list are intended to be considered both individually and in aggregate. Notwithstanding that professional judgment is to be used in determining whether the standards are appropriate to use, if there is uncertainty about whether an audit is an audit of the financial statements of an LCE, as set forth by this section, the use of the IDW AuSLCE is not appropriate.