

Consultation Response

Exposure Draft Proposed International Standard on Auditing of Financial Statements of Less Complex Entities

Date: 27 January 2022

Executive Summary

AIA is pleased to respond to the International Auditing and Assurance Standards Board's (IAASB) Exposure Draft Proposed International Standard on Auditing of Financial Statements of Less Complex Entities (ISA for LCEs). This response is based on the views of AIA and relevant questions asked in the Exposure Draft which AIA has comments on. AIA has not responded to every question in the Exposure Draft but has added in additional comments which we feel are relevant to the further development of the proposed ISA for LCEs.

AIA supports the creation of an ISA for LCEs. AIA is of the view that such a standard would respond to demands to have a set of high-quality standards which are specifically tailored to LCEs. The view of many commentators of a 'think small first' approach to standard-setting is one which AIA agrees with. Over the years, and particularly since the IAASB's Clarity Project, ISAs have become increasingly complex and demanding, which is undeniably one of the contributors to standards in audit quality diminishing. As countries around the world work to improve confidence in the audit market, the publication of an Exposure Draft of ISA for LCEs is both timely and very welcome.

Auditors of LCEs often struggle with the increased technical content and length of the ISAs and hence AIA is of the view that a proportionate standard, befitting an LCE, would be in the best interests of the auditing profession. Audit quality for LCEs would increase as the standards applied would be more conducive to the type of audit being carried out and the overall credibility of the financial statements is unlikely to be diminished.

The introduction of the proposed ISA for LCEs would be up to each jurisdiction to decide. However, AIA would support the use of the ISA for LCEs in the UK and would encourage the Financial Reporting Council to consider its adoption in the UK once the ISA for LCEs is issued. AIA is also of the view that audit firms, in general, would also support an ISA for LCEs.

While AIA is broadly supportive of the proposals in the Exposure Draft, there are some concerns which this response letter highlights. AIA have only made comments on specific questions in the Exposure Draft for which we feel input is necessary.

AIA Response

Question 1:

Views are sought on:

1 (a) The standalone nature of the proposed standard, including detailing any areas of concern in applying the proposed standard, or possible obstacles that may impair this approach?

AIA supports the standalone nature of the proposed standard. There must be 'clear water' between the mainstream ISAs and the proposed ISA for LCEs. AIA feels that proposed standard achieves this through the application of a conceptual and contextual approach in the essential explanatory information.

However, auditors will need to have a sound understanding of the clear distinction between the proposed ISA for LCEs and the mainstream ISAs and appreciate that there is no overlap or ability to 'top-up' from the mainstream ISAs in the event of ambiguity or contentious issues when applying proposed ISA for LCEs. This should be achieved through training in the proposed standard's use as well as through the IAASB's own publications to ensure that everyone who will be involved in the application of the proposed standard fully understands its scope and prohibitions. AIA considers the use of 'case study' style scenarios or 'Q&As' to be more beneficial to aid the learning process rather than reliance of text within the proposed standard itself.

1 (b) The title of the proposed standard.

While AIA broadly supports the title 'International Standard on Auditing of Financial Statements of Less Complex Entities', we take the view that the phrase 'less complex entities' may need further elaboration or clarification. Is there room for the term to be formally defined, perhaps? Management of some entities may take the view that their organisation is not complex, whereas the proposed standard may take a different view.

Regard must also be hand to interpretational issues among different jurisdictions. Some countries may interpret 'less complex entities' differently than other countries.

In some jurisdictions (for example, the UK), the size of a company is determined by reference to turnover thresholds, gross assets and average number of employees. Without some formal explanation or definition of what a 'less complex entity' is, there is the danger that some entities may interpret 'less complex' as being 'small' and hence apply the proposed ISA for LCEs to a small audit. If the small entity has transactions that are considered complex (such as a complex accounting estimate), the entity would

be prohibited from applying the standard as it is currently drafted. Hence, AIA takes the view that a formal definition of 'less complex entity' would benefit (potential) users and reduce the scope for incorrect application.

Question 4:

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

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

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

AIA agrees with the prohibitions in respect of:

- Listed entities
- Entities in a jurisdiction where the standard is prohibited
- An entity with public interest characteristics (such as banking, insurance or pension companies)

However, the specific prohibition in respect of groups may be too restrictive and is likely to be a major deterrent in the overall uptake of the standard. AIA does not agree with the IAASB's view that all groups are inherently complex and hence should all be prohibited from applying the proposed standard.

While there are clearly groups with diverse operations and subsidiaries that do have complex operations and/or transactions (such as material and complex financial instruments and/or material and complex accounting estimates) who will clearly be outside the scope of the proposed standard, there are groups which are inherently less complex.

For example, a parent may just be a holding company that has a wholly owned trading subsidiary and is required to prepare consolidated financial statements because the size of the subsidiary may be such that there are no exemptions or exceptions from preparing consolidated financial statements. This does not mean that the group is complex. In AIA's view, it is incorrect to assume that all groups are complex in nature and hence be beyond the scope of the proposed standard. AIA would suggest that the IAASB considers those groups which are unlikely to have complex transactions and/or be inherently less complex in nature and allow them to be brought within scope of the proposed standard.

Scope and application may also be problematic in the absence of any specific definition or threshold which helps define an LCE (as noted in the previous section). For example, an apparently 'simple' entity may be more complex than first thought or vice versa. There may also be differences of opinion

between auditors and clients where the potential application of the proposed ISA for LCEs is concerned. Again, this may be an area where thresholds, or some other eligibility criteria, may help to reduce this problematic scope issue.

Other matters AIA considers to be relevant

AIA is taking the opportunity of addressing other issues which may be considered by the IAASB throughout the continuing development of the Exposure Draft into a final standard as follows:

Need for additional training

Training issues may be a concern of some auditors that may be reluctant to use the proposed standard on the grounds that investment in additional may be needed (such as keeping up to date with current ISA standards and learning the ISA for LCEs standard). This may particularly be the case if the practitioner has not covered the ISA for LCEs standard in their professional qualifications. IAASB may need to consider making available additional resources to auditors on applying the proposed ISA for LCEs, such as through webinars, published written material and conference settings, especially when the standard is issued in its final form.

Additional training on transitional issues will also be needed and hence the IAASB may need to consider publishing some guidance and/or training materials on how to deal with a transition from mainstream ISAs to proposed ISA for LCEs.

Parallel running of two sets of ISAs

Running two sets of standards, i.e. mainstream ISAs and ISA for LCEs, may run the risk of auditors becoming confused between the two requirements. While a clear understanding of both standards is critical in conducting an audit under the relevant standard, there is the risk that audits carried out under the mainstream ISAs may suffer in terms of audit quality if audit firms incorrectly presume the two frameworks are consistent. This can be linked into the training considerations mentioned above.

Consequential amendments to the mainstream ISAs as a result of the ISA for LCEs

The need for a standard for LCEs is without question. As noted in the introductory section of this response, since the IAASB's Clarity Project in 2009, the mainstream ISAs have become voluminous, difficult to understand in many areas and incorrectly applied by many auditors, resulting in diminishing audit quality. AIA takes the view that there may be the opportunity for 'reverse engineering' where the

proposed ISA for LCEs is concerned, in that flaws, deficiencies or weaknesses in the mainstream ISAs could be addressed through development of the ISA for LCEs. Understandably, any redrafting exercise of the mainstream ISAs would take years to accomplish, but any improvement in the mainstream ISAs (upon which the proposed ISA for LCEs is primarily based) would be welcome.

Mainstream ISAs have far too much repetition and overlapping terms which causes problems. From an international perspective, translation issues are also a concern of AIA because one auditor may interpret a requirement or a term in one way, whereas another auditor may make a different interpretation, resulting in incorrect application by at least one side.

AIA takes the view that the mainstream ISAs should have been developed on a 'think small first' approach using a principles basis. In an ideal situation, the mainstream ISAs could then have then been tailored to be specific to LCEs. In view of the complexities inherent with this exercise, AIA welcomes the ISA for LCEs.

Credibility of the proposed ISA for LCEs

AIA does have a slight concern in that some stakeholders may view the proposed ISA for LCEs as being less 'credible' than the mainstream ISAs and that any audit conducted under the proposed ISA for LCEs is not as rigorous as it may otherwise have been. This may particularly be the case for some of AIA member firm's audit clients who may have concerns that audit work under the proposed ISA for LCEs is 'watered down' or not as thorough.

About AIA

The Association of International Accountants (AIA) was founded in the UK in 1928 as a professional accountancy body and promotes the concept of 'international accounting' to create a global network of accountants.

AIA is recognised by the UK government as a recognised qualifying body for statutory auditors under the Companies Act 2006, across the European Union under the mutual recognition of professional qualifications directive and as a prescribed body under the Companies (Auditing and Accounting) Act 2014 in the Republic of Ireland. AIA also has supervisory status for its members in the UK under the Money Laundering Regulations 2017. AIA is a Commonwealth Accredited Organisation.

AIA believes in creating a global accountancy profession and supports the International Federation of Accountants (IFAC) in their vision of a global accountancy profession recognised as a valued leader in the development of strong and sustainable organisations, financial markets and economies. AIA has adopted IFAC's Code of Ethics for professional accountants and also incorporates IFAC's International Education Standards (IES) into its qualifications and policies.

AIA has members working throughout the whole spectrum of the accountancy profession. Many of our members are at the top of the accountancy industry, from senior management to director level. Conversely, significant numbers of our members work in small and medium sized businesses (SMEs) and we strive to champion the importance of SMEs and their needs.

Further Information

The above replies represent our comments upon this consultation document. We hope that our comments will be helpful and seen as constructive. AIA will be pleased to learn of feedback, and to assist further in this discussion process if requested.

If you require any further information, please contact:

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