



PROPOSED INTERNATIONAL STANDARD ON AUDITING FOR AUDITS OF FINANCIAL STATEMENTS OF LESS COMPLEX ENTITIES (ISA FOR LCE)

Issued 31 January 2022

ICAEW welcomes the opportunity to comment on the Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE) published by the International Auditing and Assurance Standards Board (IAASB) on 23 July 2021, a copy of which is available from this [link](#).

Summary of Major Points

An Exposure Draft (ED) of an auditing standard for less complex entities (LCEs) has been issued by the International Auditing and Assurance Standards Board (IAASB). These proposals clearly demonstrate IAASB's commitment to the public interest, the global economy and wider society.

Auditing standards supporting high-quality audit services for the world's smaller and less complex entities are important, improving confidence in the credibility of the published financial information of those entities. Audit provides assurance to credit agencies, banks and potential investors. Without it, LCEs may find it harder to obtain access to finance. This proposed standard has the potential to play a critical role in repairing the financial ecosystem, and ensuring that the post-pandemic global economy recovers, grows, innovates and thrives. That potential makes the unprecedented level of interest in this ED, among a wide range of stakeholders, unsurprising.

The ED is a very good start, but it needs work. As it stands, it is insufficiently distinct from the extant ISAs, in terms of the work effort and documentation it requires, to be a truly viable alternative. Significant shortcomings include the exclusion of all groups, the way in which the standard is described as standing-alone from the extant ISAs, and the work required in the key areas of risk assessment and accounting estimates.

Despite these shortcomings, we strongly urge IAASB to address these issues and finalise the standard, as a standard, in accordance with the proposed timetable. This will allow those jurisdictions most in need of it to adopt it immediately, and for auditors, regulators, software methodology and training providers globally to work with it, refine it and learn from its use. This 'beta testing' approach will allow the standard to be refined and improved in real time in a range of markets.

If such an approach is not adopted, we fear that the remarkable and very successful global consensus on auditing standards built by IAASB over 40 years will be eroded. The risk of fragmentation of global auditing standards will be reduced if IAASB progresses to finalisation sooner rather than later.

ICAEW

Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
T +44 (0)20 7920 8100 F +44 (0)20 7920 0547 icaew.com

The Institute of Chartered Accountants in England and Wales (ICAEW) incorporated by Royal Charter (RC000246)
Registered office: Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK

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This response of 31 January 2022 has been prepared by the ICAEW Audit and Assurance Faculty. Recognised internationally as a leading authority and source of expertise on audit and assurance issues, the faculty is responsible for audit and assurance submissions on behalf of ICAEW. The faculty has around 7,500 members drawn from practising firms and organisations of all sizes in the private and public sectors.

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This ICAEW response reflects consultation with an exceptionally wide range of stakeholders, including auditors and regulators in the public and not-for-profit sectors, providers of finance and credit rating agencies and related industry representative groupings, and business groupings.

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KEY POINTS

UNPRECEDENTED SUPPORT FOR AN LCE AUDITING STANDARD

1. ICAEW congratulates the International Auditing and Assurance Standards Board (IAASB) on the issue of its exposure draft (ED) of a less complex entity (LCE) auditing standard.
2. As the ED acknowledges, smaller and less complex entities are important to the global economy and wider society. The credibility of the financial information they produce is important in the context of access to finance and the economic recovery post-pandemic. The level of interest shown in this ED among a wide range of stakeholders is, in our experience, unprecedented, if unsurprising. In addition to practitioners and preparers, we engaged with users in the public sector, the third sector, providers of finance and credit reference agencies. Specifically, we have discussed the ED with staff with responsibility for audit issues within the Charities Commission, UK Finance (representing banks and other lenders), and the British Information Providers Association (representing the major credit reference agencies). Interest among parties such as these in a proposed auditing standard is rare, and they provided us with valuable insights and encouraged us in our efforts to seek the issue of a standard on a timely basis.
3. Among the UK's national audit agencies, we held discussions with staff in the technical departments of the National Audit Office, Audit Wales and the Northern Ireland Audit Office. An LCE auditing standard could be particularly relevant for the UK public sector as there is no audit exemption for small central government bodies.
4. There is widespread concern in the UK, particularly among some credit reference agencies, about the quality of information provided on the public record by smaller entities. There are long-standing problems in this area and some of them are UK-specific and relate to the information required, and the absence of an audit requirement. However, many we spoke to pointed to the recently revised ISAs 315 and 540 on risk assessment and the audit of accounting estimates respectively, as being the latest in a long line of standards that are particularly difficult to apply specifically and efficiently to the audit of LCEs. This is important when an audit is required or is performed voluntarily.
5. The availability of high-quality audit services to LCEs is important even in jurisdictions, such as the UK, in which audit exemption limits are high. This is because of the large number of audits performed on entities that would be audit exempt were it not for their membership of larger groups, the requirements of banking and other covenants, lower audit exemption levels in the third sector, and voluntary audits. The availability of audit services to LCEs depends on the willingness of practitioners to provide such services; this, in turn, depends on the availability of efficient and effective auditing standards.

"IAASB first consulted on this project back in 2017. Since then, we've had revisions to the ISAs on risk assessment and estimates that have made compliance on small audits even more difficult and expensive – reading the standards is tortuous applying them to my clients even worse. Those ISAs are designed for much bigger businesses. They are not scalable as claimed. If they were we wouldn't have this problem."

Peter Hollis, Principal, Hollis and Co Chartered Accountants, member of IFAC's SMP Advisory Group and ICAEW's Technical Strategy Board

THE ED NEEDS WORK: LINKING AND DISTINGUISHING THE ED AND THE EXTANT ISAS

6. The ED is a very good start. Improved flow, relative succinctness and comprehensibility are key features.

"This standard will improve audit quality if for no other reason than it's easier to understand."

Alex Peal, Joint Managing Partner, James Cowper Kreston and member of IFAC's SMP Advisory Group and ICAEW's Audit and Assurance Faculty Board

7. In particular, we applaud the changes made to material on communications with those charged with governance, materiality and accounting estimates. But more is needed -

considerably more - and stakeholders expressed disappointment that IAASB has not taken a bolder approach to this project.

8. Rather than a standard that directly addresses the needs of LCEs, the ED has the feel of a first draft of the requirements of the extant ISAs based on the Complexity, Understandability, Scalability and Proportionality (CUSP) project drafting guideline, with limited simplification of language and reformatting.
9. There was a clear consensus among a majority of those we consulted that the extant ISAs are not scalable. While firms are always able to perform such audits, the audits are often inefficient.

“Small businesses - doesn't matter how complex they are - aren't simply scaled down versions of big ones. A finance department of three people - a bookkeeper and a couple of accounts assistants - isn't simply a smaller version of one with 25. The business operates differently, and the way they approach risk and documentation is different.”

Catherine Hardinge, Compliance Partner, Price Bailey, member on ICAEW's Education and Training Board and Technical and Practical Auditing Committee, and Chair of its LCE Audits Working Group.

10. In the view of many we spoke to, as it stands and despite its positive attributes, the ED is insufficiently distinct from the extant ISAs, in terms of the nature and extent of work and documentation it requires, for it to be truly viable as an alternative. The most significant shortcomings are as follows:
 - the failure to include groups in the standard. Groups must be included in some form if there is to be any meaningful any take-up of the standard;
 - the manner in which the standard is described as stand-alone, which is inconsistent and illogical. The standard is not being issued in a vacuum and auditors cannot be prohibited from drawing on their knowledge and experience;
 - work required in the key areas of risk assessment and accounting estimates.

FINALISING THE STANDARD

11. We strongly urge IAASB to finalise the standard, as a standard, in accordance with the proposed timetable and to use the time available to it to focus on the three areas noted above. It should also focus on any other areas highlighted by jurisdictions that seem most likely to adopt it immediately. This is not an approach we have recommended in the past, but we believe that the public interest in the issue of this standard sooner rather than later is overwhelming.
12. IAASB cannot and should not attempt to fix all of the issues highlighted by respondents prior to finalisation. That would be a recipe for a lengthy, and perhaps indefinite deferral. Pursuit of perfection is the enemy of the good in this instance. Nor should it seek to issue the standard as guidance on how to apply ISAs, repurpose the work performed to date within the CUSP project or change the level of assurance the standard seeks to provide.
13. IAASB must take advantage of the current opportunity to develop this standard and finalise it, to allow those jurisdictions most in need of it to adopt it without delay. Auditors, regulators, software methodology and training providers globally can then work with it, refine it and learn from its use. Longer-term, there is a clear need for differentiation in terms of work effort and documentation between this standard and the extant ISAs.
14. The remarkable global consensus on auditing standards built by IAASB over 40 years is at risk. If jurisdictions currently planning or considering the development of a local standard for smaller or LCE audits lack confidence in, or are disappointed with the outcome of IAASB's project, they will progress those projects locally. The risk of this is minimised if IAASB progresses to finalisation sooner rather than later. The ED published by the IDW in Germany in January 2022 for the audit of LCEs is the most recent example of this, and we believe that other jurisdictions will follow Germany's lead if IAASB does not finalise a standard quickly.

15. Moreover:
- the public interest cannot be harmed by the issue of a standard which is closely aligned with the extant ISAs;
 - the public interest will be served if the issue of a standard prevents or slows further global fragmentation of auditing standards for less complex entities;
 - the finalisation of this standard will enable IAASB to move forward and be more realistic in its focus on the audits of more complex entities. A necessary corollary of this is that IAASB must consider very carefully the inclusion of new or revised requirements in the LCE audits standard after finalisation, and acknowledge the likelihood of greater divergence between the standard and the extant ISAs in the future.

WHAT IS THE STANDARD INTENDED TO CHANGE?

16. The ED has highlighted different views about expected outcomes. Those we spoke to are agreed that reasonable assurance and audit quality are paramount, but there is less consensus on what, if anything, the standard is expected to change in practice. Three issues have emerged: the length, flow and comprehensibility of the standard, what is to be done differently, and documentation requirements.
17. *Length, flow and comprehensibility:* repeated requests by auditing standard-setters for details about which ISA requirements cause problems for LCEs have often elicited responses that refer, inter alia, to the absolute length of the ISAs, their flow and comprehensibility, including the poor use of language. The fact that the ED is considerably easier to read and flows better than the extant ISAs is therefore welcome, regardless its other limitations.
- “This standard is 100 pages long. It flows, it’s far easier to read than the 1200-page version a lot of which just isn’t relevant to my clients. It’s short enough for me to take it out on a job and use. That is a massive improvement.”*
- Peter Hollis, Principal, Hollis and Co Chartered Accountants, member of IFAC’s SMP Advisory Group and ICAEW’s Technical Strategy Board
18. *What is to be done differently?* In the eyes of many, the principal shortcoming in the ED is the lack of clarity about what auditors can and should do differently. The IAASB’s 500-page mapping document suggests that while many requirements have been tweaked, and some requirements have been modified, very few have been eliminated or substantially modified. The overall impression is that the nature and extent of the work to be performed is very similar under both regimes. We believe that it is perfectly possible to create much more clear blue water between the two regimes without losing the link, and without compromising reasonable assurance or audit quality. We have been clear in our messaging on this from the outset: this is not an ‘easier’ or ‘cheaper’ audit, ‘audit lite’ or one performed to lower standards. Rather, it is a full audit, providing the same level of assurance as the extant ISAs, but with redundancy and waste stripped out.
19. *Documentation:* while there is no requirement within ISAs for auditors to document their justification of their non-application of an irrelevant matter, in practice audit software, methodologies and audit regulators demand that they do. This standard and the extant ISAs should explicitly state that such justifications are not required. Audit software and methodology providers should work towards providing technical solutions that eliminate this de facto requirement.
20. When the standard is finally released, the messaging around it must be clear, so auditors and audit regulators clearly understand what the ISA for LCE is trying to achieve, particularly in relation to audit quality. Bigger is not necessarily better when it comes to audit quality, which must necessarily take account of fitness for purpose. No-one thinks that getting from Manhattan to New Jersey by Concorde is better than going by light aircraft, simply because Concorde is bigger, takes longer and costs more. The use of the proposed standard will result in a higher level of audit quality for LCEs than the extant ISAs, where it is more appropriate.

A CONDITIONAL OR MODULAR APPROACH

21. There is a wide range of views regarding the type of entity to which this standard should be applied and it is important to recognise that LCEs are not a homogenous group. Greater use of conditionality within the standard, or a modular approach, would be helpful to distinguish between very simple LCEs and other LCEs. For example: most LCEs have no internal audit department, but the standard should be able to accommodate an entity that employs a single internal auditor on a part time basis. We provide examples of how this might be achieved in Appendix 1.

WHO NEEDS TO 'BUY' THIS STANDARD, AND WHICH FIRMS WILL ADOPT IT?

22. Many practitioners, and those who provide them with software and methodologies, do not yet see the benefit of the proposed standard, because it is insufficiently differentiated from the requirements of the extant ISAs. In any jurisdiction, some firms perform mostly LCE audits and others perform a mixture of LCE and non-LCE audits. Unsurprisingly, those in the first category of firms include some of the most enthusiastic supporters of the project. Of those who perform a mix, larger firms seem willing to do what it takes to work with the LCE standard, as necessary.
23. However, concerns have been expressed by some, including those in the public sector, and particularly those with legacy systems, relating to the perceived need to develop and maintain two audit systems and two types of training. Some firms, methodology and software providers with more recently developed systems believe that they will have few problems in adapting to parallel systems and switching between the two.
24. Market forces seem likely to drive the use of the standard where it is applied effectively. But if practitioners and the software and methodology providers who serve them are not confident that they have a better product to offer, they will be reluctant to make the necessary investment in systems. A key issue longer-term is the need for more clear blue water between the two regimes.

REGULATORY CONCERNS

25. We are acutely aware of regulatory disquiet at many levels over this project. This is no small matter, because the attitude of regulators to adoption is critical. IAASB should actively encourage regulators to add size and other national criteria where necessary to reduce concerns, and we encourage IAASB to engage with IFIAR, CEAOB and other regulatory groupings on this issue.
26. If audit regulators simply ignore this standard, there is a risk that the standard will only be used by the unregulated and/or that the standard will take on a life of its own in a commercial context, outside existing regulatory and standard-setting structures. This would be a highly undesirable outcome, and we do not believe it is a fanciful notion.

LOOKING FORWARD

27. We look forward to the finalisation of this standard, which will enable IAASB to refocus some of its efforts on the audit of entities listed on the world's capital markets. Provided IAASB does not default to including all newly developed requirements in the LCE standard as a matter of course, more of the much-needed clear blue water between this standard and the extant ISAs will appear over time.
28. IAASB's overarching objective should not be the preservation of forms of words simply because of the time and effort expended on them, but the dynamic maintenance of a corpus of ISAs that are fit for purpose.

ANSWERS TO SPECIFIC QUESTIONS

Section 4A – Overarching Positioning of ED-ISA for LCE

Question 1: Views are sought on:

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?***

29. We agree that the standard should stand alone, but this must not mean that auditors are discouraged from using their judgement or common sense, or from drawing on their existing knowledge of the extant ISAs where appropriate. Paragraph 26 of the Explanatory Memorandum states that:

“...if there is a circumstance that has not been contemplated in the design of ED-ISA for LCE as addressed in the Authority of the proposed standard (Part A), relevant ISA requirements cannot be used to “top-up” ED-ISA for LCE in order to address the circumstance.”

30. This statement is not replicated in the proposed standard or supplemental guidance. It is in direct conflict with the requirement of 2.2.2 of the ED which states that:

“The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence”

31. There is no indication in this paragraph that the procedures to be performed should be circumscribed in any way and paragraph 27 of the proposed Supplemental Guidance on the Authority of the Standard makes it crystal clear that the presence of one ‘complexity’ characteristic exhibited by an entity does not necessarily exclude the use of the standard. While that paragraph applies to audits not yet commenced, it makes no sense to discriminate on the basis of when complexities are discovered. The standard must stand-alone, but it does not exist in a vacuum.

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

32. We are content with the title of the proposed standard.

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

33. *Reasonable assurance:* IAASB should resist calls to issue the standard as guidance, to downgrade the level of assurance provided or to fold the project into the CUSP project. Without a standard, IAASB risks the slow disintegration of the global consensus on auditing standards it has worked so hard to achieve.

34. *Audit opinion:* to include a reference to this standard is transparent, but risks creating the impression that a different audit has been performed. Support for this approach from those who do not believe that this standard can deliver reasonable assurance is therefore unsurprising. However, upholding the principle that all audits are equal and simply referring to the ISAs, and including this standard among them, lacks transparency. A reference to the standard, together with a statement to the effect that it is equivalent to the ISAs, would be both transparent and uphold the principle that all audits are carried out to the same standard.

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

35. We are content with the proposed amendments.

Section 4B – Authority of the Standard

Question 3: Views are sought on the Authority (or scope) of ED-ISA for LCE (Part A of the proposed standard). In particular:

a) ***Is the Authority as presented implementable? If not, why not?***

36. If the authority as presented was implemented, the standard would be unlikely to gain any significant traction in any jurisdiction because of the blanket exclusion of groups - see section

5, below. We find it hard to understand IAASB's explanation of its assertion that all groups are inherently complex.

37. The reference to entities with PIE characteristics that 'appear' complex in A.5 is too subjective to be helpful.
38. IAASB should consider the need to revise the proposed authority to accommodate IESBA's finalised revisions (December 2022) to its Code of Ethics and remove the following categories from its list of exclusions:

- an entity whose function is to provide post-employment benefits;
- an entity whose function is to act as a collective investment vehicle and that issues redeemable financial instruments to the public.

39. Practitioners noted that pension funds can be among the simplest audits they do.
40. We welcome the clear statement in the Preface that the standard can be applied to public sector entities. However, jurisdiction-specific guidance will be required regarding the type of public sector bodies in scope. Many of the examples at A9, such as complex oversight structures and significant regulation, could be interpreted as applying to almost all public sector bodies in many jurisdictions, even though many have simple operations and transaction streams.

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

41. We think unlikely that IAASB has left many stones unturned, but we urge it to engage with audit regulators individually and collectively to address their concerns and to emphasise IAASB's belief in the public interest in this standard.
42. Audit regulators in developed jurisdictions in which there are high audit exemption limits, or no audit requirements at all outside the listed sector, may ignore this standard. If they do, they risk seeing it take on a life of its own in a commercial context, outside existing regulatory and standard-setting structures.
43. We understand the reason for the exclusion of all listed entities, some of which are quite simple, but care needs to be taken with the messaging to ensure that stakeholders understand that this standard provides the same level of assurance as the extant ISAs.
44. IAASB should also engage closely with Supreme Audit Institutions to ensure appropriate and consistent adoption of the standard in the public sector.

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

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

45. Areas of concern within the qualitative characteristics where the wording is potentially contradictory or confusing include the three paragraphs that follow.
46. A8: this starts by stating that use of the standard would be inappropriate if entity exhibits the bulleted characteristics but ends with a statement that the bullets are merely indicators of, or proxies for, issues the standard is not designed to address. It is unclear whether the two bullets are to be taken together or individually - 'and' or 'or' needed after the first bullet.
47. A9: explicitly states that use of the standard is inappropriate if an entity exhibits one or more of the characteristics listed but ends by saying that each of these characteristics may on its own be insufficient to determine whether the ISA is appropriate, and that the presence of one characteristic exhibited by an entity does not necessarily exclude the use of the standard. This is a contradiction and a non-sequitur. We agree that the presence of one characteristic exhibited by an entity should not necessarily exclude the use of the standard and the first part of the paragraph should be amended accordingly. It might instead state that the standard is inappropriate for entities 'displaying some or all the characteristics listed'.
48. A9: 7th bullet refers to 'complex methods' with accounting estimates. The perceived complexity of methods depends on the skills and experience of the firm and engagement partner. Accounting estimates with a higher degree of estimation uncertainty should not themselves preclude application of the standard.

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

49. The proposed role of legislative or regulatory authorities or relevant local bodies with standard setting authority is clear. They have an important role in clarifying at a local level the regulatory context within which the qualitative measure will be applied.

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.

50. Other than the matters noted in response to Question 3, above, and subject to the imposition of additional criteria by audit regulators locally, we are broadly content with the other specific prohibitions, even though some LCEs will be excluded. The prohibitions should be considered further once the standard is established and IAASB should emphasise the importance of local reinforcement in this area.
51. All of the qualitative characteristics are by definition open to interpretation and more detailed guidance from IAASB is unlikely to eliminate this, hence the need for additional local criteria. However, IAASB's guidance relating to accounting estimates, in relation to the level of complexity and the extent of uncertainty, needs work and we note in our answer to Question 3, above, our belief that high estimation uncertainty should not preclude the use of this standard.

Question 5: *Regarding the Authority Supplemental Guide:*

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

52. The Supplemental Guide is helpful. However, a separate document rather than an appendix appended within the standard means it is longer than it needs to be as it repeats what is already in the Authority. Stripping this out would facilitate shorter and more succinct guidance which could readily sit within the standard as guidance material, either appended to the Authority or within it.
53. References in the tables that seem excessively wide-ranging include references to legal liability or reputational risk, the use of business angels or employee share schemes, and to a separate IT department.

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

54. Further guidance could be included on how local regulators might develop and clarify the interaction between the different qualitative characteristic and examples of where entities should be in or out of scope.

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

55. The Authority must enable firms and regulators to clearly distinguish between entities that are in and out of scope. Jurisdictions applying the standard must facilitate this by the application of additional criteria, if appropriate.
56. The IAASB should consider developing contrasting examples of complex and non-complex estimates, covering, for example, the valuation of share options using a recognised model, the valuation of defined benefit pension schemes, and impairment reviews using discounted cash flows.

Section 4C – Key Principles Used in Developing ED-ISA for LCE

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

- a) **The approach to how the ISA requirements have been incorporated in the proposed standard (see paragraphs 74-77).**
- b) **The approach to the objectives of each Part of the proposed standard (see paragraphs 78-80).**
- c) **The principles in relation to professional skepticism and professional judgement, relevant ethical requirements and quality management (see paragraphs 81-84).**
- d) **The approach to EEM (see paragraphs 85–91) including:**
 - i. **The content of the EEM, including whether it serves the purpose for which it is intended.**
 - ii. **The sufficiency of EEM.**
 - iii. **The way the EEM has been presented within the proposed standard.**

57. We note in our key points above the wide range of views regarding the type of entity to which this standard should be applied and that it is important to recognise that LCEs are not a homogenous group. IAASB should consider amending the drafting principles to facilitate and encourage the greater use of conditionality within the standard, or a modular approach, to distinguish between very simple and other LCEs.
58. For example: most less complex entities have no internal audit department, but the standard should be able to accommodate an entity that employs a single internal auditor on a part time basis. Very simple accounting systems consisting of an off-the-shelf package to which few if any modifications are possible, used by an entity that does not have the technical expertise to make modifications, should be treated differently to systems which may have been modified, but not extensively, by employees with the relevant technical skills but who are not IT specialists.
59. Other than the lack of conditionality or a modular approach, we are broadly content with the key principles used in developing the ISA. However, we do not think that they have been applied properly.
60. The proposals as they stand look to be modified ISA minus approach, rather than a genuinely risk or principles-based approach. More can and must be done in terms of modifications, as well as deletions, to address the specific risks of LCE audits. We make suggestions for modifications and deletions in Appendix 1, below.
61. The mapping documents are an excellent record of the work performed and an essential link between the LCE standard and the ISAs. But they are heavy on detail and light on analysis. In our messaging, we will emphasise the importance of audit quality in this context, and the need for more efficient and effective LCE audits. However, stakeholders have a legitimate interest in the overall nature and extent of change, and what might be done differently under the standard. At present, there is little change and more needs to be done prior to finalisation. We note in our key points above our belief that IAASB should finalise the standard in accordance with the current timetable. However, going forward, IAASB should be circumspect about how much it adds to it, so that more clear blue water between the two regimes is created over time, without losing the link to the extant ISAs, and without compromising reasonable assurance and audit quality.
62. The nature and extent of the EEM is broadly appropriate. IAASB must very carefully consider any calls for further EEM based on its merits and consensus amongst respondents.

Section 4D – Overall Design and Structure of ED-ISA for LCE

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

63. The overall design and structure of the standard is generally good. However, we note in our answer to Question 7 above, our belief that the drafting principles have not been properly applied.

Section 4E – Content of ED-ISA for LCE

Question 9: Please provide your views on the content of each of Parts 1 through 8 of ED-ISA for LCE, including the completeness of each part. In responding to this question, please distinguish your comments by using a subheading for each of the Parts of the proposed standard.

64. See Appendix 1

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

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

65. See Appendix 1

Question 11: With regard to the Reporting Supplemental Guide:

- a) **Is the support material helpful, and if not, why not?**
- b) **Are there any other matters that should be included in relation to reporting?**

66. See Appendix 1

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

67. See Appendix 1

Section 4F – Other Matters

Question 13: Please provide your views on transitioning:

- a) **Are there any aspects of the proposed standard, further to what has been described above, that may create challenges for transitioning to the ISAs?**

68. It is not unusual during an audit of a less complex entity for issues to arise, which management did not think to discuss with auditors at a planning stage, typically, as the draft standard notes, relating to accounting estimates. Nevertheless, we believe that the need to transition to the extant ISAs should be rare, because transitioning should be linked to the statement in paragraph 27 of proposed Supplemental Guidance on the Authority of the Standard which states that

“...the presence of one ‘complexity’ characteristic exhibited by an entity does not necessarily exclude the use of [draft] ISA for LCE for that entity.”

69. This statement should be amplified to include a statement that the complexity assessment should be applied to the entity as a whole, as well as its constituent parts.
70. The problem of the need to transition, rare or otherwise, and the solution, depend on the approach taken by methodology and software providers. It is currently often difficult to transition from an ‘extant’ ISA audit to a ‘smaller’ ISA audit template within such systems. Some methodology and software providers are clear that they can provide the linkage easily

and that transition in both directions should not be difficult. For those with older systems, the linkage will need to be established.

71. The standard is closely aligned to the extant ISAs as demonstrated by the mapping documents and on the face of it, it should not therefore be difficult to move between the two and the requirement to 'restart' the audit due to emerging complexities makes little sense.
72. We agree that if complexities arise the auditor should reconsider the planning and audit work and approach and consider whether additional work is required.

b) *What support materials would assist in addressing these challenges?*

73. Additional, separate guidance on the practical implications of transitioning between the standards should be developed by IAASB, after liaising with methodology and software providers.

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

74. We agree with the proposed approach to the future updates and maintenance of the standard every three years. We re-iterate the need for IAASB to consider carefully its approach to this and not to default to include everything within the standard when an ISA is developed or revised.

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

75. Early adoption should be permitted but not required.

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

76. A separate part on the ISA-800 series should be included at a later date. In the UK, ISA 800 is used as the basis for work performed on less complex entities such as micro-entities and service charge audits. However, we believe it more important for IAASB to focus its efforts on the key areas of the standard for now.

Question 17: In your view, would ED-ISA for LCE meet the needs of users and other stakeholders for an engagement that enables the auditor to obtain reasonable assurance to express an audit opinion and for which the proposed standard has been developed? If not, why not. Please structure your comments to this question as follows:

- a) ***Whether the proposed standard can, and will, be used in your jurisdiction.***
- b) ***Whether the proposed standard meets the needs of auditors, audited entities, users of audited financial statements and other stakeholders.***
- c) ***Whether there are aspects of the proposed standard that may create challenges for implementation (if so, how such challenges may be addressed).***

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

77. Despite the lack of critical distinction between the proposed standard and the extant ISAs, we re-iterate the unprecedented level of support for this standard expressed by users of financial information produced by LCEs noted elsewhere in this response. We acknowledge regulatory concerns and believe that IAASB must do more to address these by engaging with regulators to persuade them of the public interest in issuing this standard, and the risks associated with not doing so.

Section 4G - Approach to Consultation and Finalization

Question 19: What support and guidance would be useful when implementing the proposed standard?

78. Further guidance could be included on how local regulators might develop and clarify the interaction between the different qualitative characteristic and examples of where entities should be in or out of scope.
79. We note that further criteria are needed locally, but that IAASB's guidance relating to accounting estimates, in relation to the level of complexity and the extent of uncertainty, needs work.
80. IAASB should consider very carefully calls for further EEM, and include it only where there is consensus. Further criteria need be developed locally, wherever possible.

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

81. The condensed nature of this standard highlights the importance of clarity in wording in all languages, including English.

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

82. We agree with IAASB's proposed approach but the emphasis should be on the words 'at least' - the effective date should be at least 18 months after final approval. Early adoption should be permitted if agreed locally.

Section 5 – Group Audits

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

83. We acknowledge that the concept of a group audit is understood differently in different jurisdictions and that for some, a group audit by definition must include a component auditor. This is not the approach take in the UK and there is widespread consensus both here and in many other jurisdictions that the standard must cover group audits in some way, before the standard is finalised, if it is to be viable. This is because of the high volume of very simple group audits in many jurisdictions. We do not agree that all groups are inherently complex.
84. We also acknowledge widespread concerns about the potential challenges presented by group audits in which some components are audited under the extant ISAs, and others under this standard. Belief in the provision of reasonable assurance under this standard is critical to its adoption and we strongly urge relevant groups to be included in the scope of this standard.
85. Many of those we spoke to believe that there is no good reason to exclude groups involving the use of other auditors, or groups crossing jurisdictional boundaries. The focus should be on the complexity of the group, not the audit. The presence or otherwise of a component auditor is only relevant if the group itself is complex.

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

We are responding to all sub-sections of this question as a Professional Accountancy Organisation in consultation with our members in public practice, rather than as respondents in public practice

- a) ***Would you use the standard if group audits are excluded? If not, why not?***
- b) ***Approximately what % of the audits within your firm or practice would be group audits that would likely be able to use ED-ISA for LCE (i.e., because it is likely that such group audits could be considered less complex entities for the purpose of the proposed standard) except for the specific exclusion?***
86. For a variety of commercial, fiscal, operational and historical reasons, the UK has a large number of groups. We performed a survey of our practitioner members in December 2021 on this and other LCE audits issues, the results of which are summarized in Appendix 2.
87. Included in the survey was a question about the number of group audits performed that might qualify under this standard. The question lacks clarity about how groups are to be counted, in that neither IAASB's nor our question specifies whether sub-groups within groups are to be counted. Nevertheless, it seems clear from our engagement and the results of our survey that most practitioners will be reluctant to apply the standard if groups are excluded. The vast majority of smaller UK firms audit groups and a high number of these are less complex.
- c) ***What common examples of group structures and circumstances within your practice would be considered a less complex group.***
88. Less complex groups include:
- straightforward companies with dormant or straightforward subsidiaries;
 - charitable companies with trading subsidiaries;
 - family businesses using a holding company which may own the property used in the trade and a separate trading subsidiary;
 - holding companies with a few wholly owned subsidiaries with slightly different trades that operate using separate entities for legitimate business or regulatory reasons.
89. The related consolidations are straightforward. In most cases the same audit team will be involved in auditing the group and the individual entities and the audit will be carried out at a similar time. The auditors of such groups should all be able to apply the proposed standard.

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

- a) ***The IAASB establishes a proxy(ies) for complexity for when the proposed standard may be used ("Option 1 - see paragraph 169); or***
- b) ***ED-ISA for LCE sets out qualitative characteristics for complexity specific to groups (Option 2 - see paragraph 176), to help users of the proposed standard to determine themselves whether a group would meet the complexity threshold.***
90. Different views were expressed regarding the merits of these options.
91. On balance, we believe that there is little need for proxies, particularly those relating to multiple locations in different jurisdictions, or regulatory requirements. This is because of the possibility of 'slight' variations in regulatory requirements, and because variations often relate to the nature of the business.

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

92. Yes. Group audits could be incorporated into the scope of the proposed standard using the same criteria for complex groups and complex single entities.

Question 26: If group audits are included in ED-ISA for LCE, how should the relevant requirements be presented within the proposed standard (please provide reasons for your preferred option):

a) Presenting all requirements pertaining to group audits in a separate Part; or

b) Presenting the requirements pertaining to group audits within each relevant Part.

93. Requirements should be presented within each relevant part, on a conditional basis. If all groups are included, this would include distinguishing between group audits with a single auditor, and those with more than one auditor.

APPENDIX 1: DETAILED COMMENTS ON PARTS 1-9

PART 2: AUDIT EVIDENCE AND DOCUMENTATION

The modifications for succinctness are welcome and do not appear to detract from the requirements of the extant ISAs.

The additional EEM include references to Automated Tools and Techniques which is welcome in the current audit environment.

Drafting/flow: ISA 520 (Analytical Procedures) and ISA 530 (Audit Sampling) appear in Part 7 of the draft ISA for LCEs and might reasonably have been included within Part 2.

2.5.1: Part (a) might make reference to the source of the information.

2.5.1: Part (c) might specifically refer or cross refer to the recording of any corrected/uncorrected misstatements as part of the conclusions reached.

PART 3: ENGAGEMENT QUALITY MANAGEMENT

The slight difference between the objective in 3.1.1 and the objective in ISA 220.11 is a good example of a situation in which more might be read into the change than is intended, and a change which might ultimately be retrofitted to ISA 220. It would be helpful if a record could be made available specifically highlighting changes that are not intended to make any difference to the work performed.

3.2.1 to 3.2.13 still seem repetitive and labour the point in places. The EEM to 3.2.1 is good but seems to be repeated in requirements that follow. Is the explanatory material in 3.2.1 also covered in 3.2.3 and 3.2.4?

3.2.2 is particularly verbose and some attempt might be made to slim it down while retaining the key points about collective responsibility, culture, behaviours, good communication and scepticism. For example, in 3.2.2, subsections (a) and (c), and subsections (b) and (d), could be merged. 3.2.1 could be strengthened to enable 3.2.3 to be further pruned. The key point of 3.2.3 is that even if tasks are assigned, the engagement partner still has overall responsibility.

3.2.6 is wordier and less helpful than ISA 220.18

3.2.11 is well worded.

Condensed requirement for EQR in 3.2.14 is nicely drafted – a model for other sections.

Flow:

- The responsibility to determine sufficient and appropriate resources assigned does not appear until 3.2.7 under 'Other Engagement Partner Responsibilities', when the resources are the foundation for a high-quality audit.
- The timing of the review of documentation, responsibility for resolving differences of opinion and consultations (3.2.11-13) are also rather lost at the end of the section and might be better follow on from 3.2.3 - 3.2.4.
- Overall, the structure of this section does not have to be so closely tied to the structure of ISA 220. Suggest starting with content explaining the principles, then actions to meet those principles.

PART 4: ACCEPTANCE OR CONTINUANCE OF AN AUDIT ENGAGEMENT AND INITIAL AUDIT ENGAGEMENTS

The wording of sections 4.2 on determining applicability, the preconditions for an audit in 4.3 and the communication and documentation requirements in 4.7 and 4.8 could be tightened. For example, the following words could be deleted here (and in the extant ISAs where relevant):

4.3.1 (b) (i) ...including where relevant their fair presentation.

4.3.1 (b) (ii) ...that are free from material misstatement, whether due to fraud or error.

4.3.1 (b) (iii) a. ...such as records, documentation and other matters.

PART 5: PLANNING

Paragraph 5.2.2 (d) refers to 'preliminary risk activities' without making it clear what these might be. 5.2.2 (d) might be expanded to clarify what is meant, or some EEM be added.

PART 6: RISK IDENTIFICATION AND ASSESSMENT

In practice, risk identification and assessment for LCEs are performed at the same time and there is no meaningful distinction between them. The explanatory material to 6.1.1 should reflect this.

LCEs have straightforward control environments, risk assessment processes and monitoring controls. There is no need for these controls to be 'evaluated', but they should be "considered" by means of enquiry. This is reflected in suggested amendments to 6.3.2, 6.3.7, 6.3.7, and 6.3.8 below.

For very simple entities, it is sufficient to understand control activities relating to significant risks where controls are not to be tested, by 'considering' them. It is not necessary to specify work on design and implementation as part of obtaining the understanding. See suggested amendments to 6.3.14.

The specific points suggested below may add to the length of the standard but will eliminate redundancies in the performance of very simple audits and help create the all-important clear blue water between this standard and the detailed ISAs.

6.2.2: there is no need to distinguish between management and other appropriate individuals within the entity and there is no meaningful distinction between observation and inspection. This paragraph should refer to 'Inquiry' along and 'Observation or inspection'.

6.2.4 and 6.2.5 should be reversed.

6.2.4 should be reworded as follows:

When identifying risks of material misstatement, the auditor shall determine whether fraud risk factors are present by considering information relating to, amongst other things: (a) the acceptance or continuance procedures; and (b) any other engagements performed by the engagement partner for the entity.

6.3.1: item (f) is usually performed as part of the fieldwork rather than the risk assessment process. This is the only item to specify process and the material relating to the inspection of minutes, etc, should appear in the EEM. It is arguable that points (e) and (f) both point towards more complex entities and could be removed.

6.3.2: we suggest the deletion of 6.3.7 below. Management of LCEs rarely if ever have a process for risk assessment. The risk assessment component should be dealt with here but should be limited to an enquiry of management about the risks of fraud and error. The wording should require auditors to 'enquire of management about risks and controls, if any, to address the risk of fraud and error'.

6.3.5: the use of the defined term 'inherent risk factors' adds a wholly unnecessary layer of complexity and could be deleted such that the requirement is to identify (rather than 'understand') 'events or conditions that affect susceptibility...'.

6.3.6: this could be restructured and the meandering lead-in carved out or cut down. The requirement should be to understand rather than 'evaluate'. (b) should be deleted (assignment of authority) and the other elements, with the possible exception of 'culture', could be included within the EEM.

6.3.7: delete – see 6.3.2 above.

6.3.8 suggest delete.

6.3.9: Auditors should be required to understand the process relating to the preparation of the financial statements, not the information system. There is no need for the reference to SCOTABD. Item (i) the information system and (b) the IT environment can be deleted or included with item (iii) resources.

6.3.10: suggest delete.

6.3.12: properly belongs after 6.3.9. © is already dealt with under other requirements relating to control and (d) rarely happens. Both could be eliminated. (d) is in any case covered by the requirements relating to estimates.

6.3.13: delete – dealt with by 6.3.18.

6.3.14: (b) should be restricted to non-recurring and unusual items, the word ‘including’ deleted. Auditors should only be required to understand controls responsive to risk at the assertion level. Items (d) and (e) (‘other’ controls and service organisations (covered by 6.3.17) could be deleted. The requirement to deal with design and implementation is not necessary where auditors are not intending to test controls, they should instead be required to ‘consider’ such controls in such cases.

6.3.15 and .16 can be merged and should be limited to situations in which auditors were planning to test controls.

6.3.17: some reference might be made to the use of auditors’ reports on service organisations which might be appropriate where investment managers are used as custodians.

6.3.18: this should be amended to refer to the determination being based on what the auditor has understood.

6.4.1: merge with 6.4.3 and amend to require auditors to identify risk, including the risk of fraud, at the financial statements and assertion levels, determining which of those are significant.

6.4.2: this presumption does not work for less complex entities in the way that does for larger entities. One solution may be to require auditors to determine whether there is a risk of fraud in revenue recognition and whether that risk is a significant risk.

6.4.3: moved into 6.4.1, suggest delete.

6.5.1 and 6.5.2: much of this is effectively covered by the previous paragraphs. Most of the points are covered elsewhere in this section. 6.5.1: unnecessarily complex for LCEs. Part (a) can be deleted, as can the reference to inherent risk factors in part (b). 6.5.2: the reference to ‘other’ inherent risk factors should be deleted and the reference should be the susceptibility of the estimate to fraud, error or bias, deleting (a) and (b).

6.5.3: this is already covered by 7.5.2 and elsewhere. Suggest delete. We think it unlikely that situations in which substantive procedures alone are inadequate will be common.

6.5.5 and .6: Suggest merge.

6.5.7: amend to reflect changes made to 6.4.2 (a) (ii).

6.5.9: unnecessarily verbose.

6.8.1: (a) and (f) should be relegated to the EEM and other points belong elsewhere.

6.8.2: suggest delete.

PART 7: RESPONDING TO ASSESSED RISKS OF MATERIAL MISSTATEMENT

7.3.5: material on audit sampling is a little light given this is likely to be used. More EEM may be needed.

7.3.4: there is a need to avoid creating unrealistic expectation about ATT and the reference to social media in the EEM may not be helpful.

7.3.8 -15: some of this could be included as EEM, such as interim controls testing

7.4.18: in the vast majority of cases, only (a) applies. Where it does not provide sufficient appropriate audit evidence, (b) or (c) may be needed but not both. 7.4.17 should be folded into this paragraph.

PART 9: FORMING AN OPINION AND REPORTING

The elements of the audit report are presented as an example report. Firstly, this means there is a full audit report in the middle of the standard, not an appendix, which interrupts the flow. Readers may skip over it, assuming it is not part of the detail. Should it be made clearer that this is not the case? Several reporting elements are presented in tabular form and while this is easy to read, it is different to what auditors are used to and they may assume that it is simply a summary.

APPENDIX 2: DECEMBER 2021 SURVEY OF PRACTITIONER MEMBERS

We surveyed just over 2,000 Audit Compliance Partners on 10 December 2021 to gather views on the proposed LCE Auditing Standard. All of the responses received were from smaller firms. The questions we asked, and the responses we received are set out below. Overall, there was strong support for a new standard. Most respondents asked for more help with determining the scope over the standard, and suggested thresholds such as size criteria. Respondents clearly believe that group audits should not be excluded because group audits are not, by definition, complex.

1. *In principle, do you support the development of an ISA for Less Complex Entity (LCE) audits for adoption in the UK? Please explain why or why not.*

96% supported the standard. The 4% that did not cited concerns about audit quality and confusion in the audit market. Respondents noted a belief that the extant ISAs should be amended to better facilitate the audit of such entities.

2. *Do you think your firm might use an LCE audits standard if it were available? Please explain why or why not.*

95% said yes, 3% said no, 2% said that the new standard does not go far enough to make the changes required, including updating software, worthwhile.

3. *Which audits do you think the standard should be applied to? Should group audits be excluded?*

74% said that groups should be included if all group members meet all of the criteria. Most respondents noted that size and ownership criteria are determinants of complexity in group audits and that that a group structure alone is not by definition complex. A majority wanted further help with determining whether the standard should be applied to groups.

4. *If group audits were included within the scope of the proposed LCE audits standard, approximately what % of the audits your firm or practice performs are less complex group audits? (i.e., because it is likely that such group audits could be considered less complex entities for the purpose of the proposed standard).*

25% had no group audits or said that none of their groups would be included under the current criteria. 32% said that if groups meeting the current criteria were permitted to use the standard, they could apply the standard to all of their audits. 23% said a quarter or less of their group audits would fall within the criteria. The remaining 20% estimated that 50-90% of their group audits could potentially apply the standard.

5. *What other changes do you think might be needed to make the proposals fit for purpose?*

40% had nothing to add to the proposals. Others wanted further help with determining whether the standard should be applied, including the use of size criteria.

6. *Do you think the standard would enable you to perform more efficient audits while maintaining the same level of quality as an audit under the full ISAs?*

87% agreed with this statement. Some who did not, or were unsure, were concerned about whether the new standard went far enough.

7. *Should the standard be 'stand-alone', or should auditors be explicitly permitted to refer to the more detailed ISAs in some cases?*

62% said that there would be a need to apply the extant standards as necessary to ensure the provision of a high-quality audit. Others said that the standard should be completely stand-alone to avoid confusion, and some noted that having to refer to the extant ISAs might imply that the entity was not in fact less complex.

8. *Do you have any other observations or feedback to share?*

Several respondents wanted further clarity in how the standard would interact with charities legislation.