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Our ref SRA/288

31 January 2022

Dear Mr Seidenstein

Re: IAASB Exposure Draft, *Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities*

We appreciate the opportunity to comment on the above Exposure Draft (ED) issued by the IAASB (the "LCE ISA"). We have consulted with, and this letter represents the views of, the KPMG network.

We set out our overarching comments below. Our more detailed responses to the specific questions posed by the IAASB are set out in Appendix 2 of this letter.

In responding to this ED, we have made certain assumptions to enable us to provide meaningful input. These assumptions are set out in Appendix 1 to this letter. If these assumptions are not appropriate this will affect our response and we note in our responses to the specific questions posed by the IAASB when this may apply.

Overarching Comments

We acknowledge the concerns and challenges faced by auditors of less complex entities (LCEs) regarding the scalability of the ISAs and we welcome the IAASB's exploration of ways to address this and assist auditors of those entities, not only via this particular project, but also the broader IAASB workstream addressing complexity, understandability, scalability and proportionality in relation to the application of the ISAs (the "CUSP project").

We also recognise the IAASB's intentions in developing the LCE ISA to maintain global auditing standards that drive high quality audits, and to avoid fragmented solutions in terms of separate standards being developed locally in many different jurisdictions.

Scaling Solutions

Our overall view is that, in terms of developing a more scalable solution for auditing an LCE, the approach taken to developing the LCE ISA, which essentially retains nearly all applicable ISA requirements other than for the ISAs scoped out by the authority criteria but eliminates much of the application material (including material relevant to LCE audits), is an opportunity missed. We believe that LCE auditors would greatly benefit

from clear guidance as to how to achieve compliance with ISA requirements in an appropriately scaled way for an LCE, e.g., how to approach risk identification and assessment, and through such guidance, have greater confidence that they can perform certain procedures differently/ to a lesser extent than for a more complex entity and/or to reduce related audit documentation. We believe that these key challenges have not been addressed in developing the LCE ISA, and instead, by removal of the majority of the application guidance, the auditors of LCEs will be required to develop their own interpretations in terms of how to comply with the requirements, which could lead to inconsistency in application and may have a detrimental effect on audit quality.

We note that a particular challenge that may disproportionately affect LCE auditors is a lack of clarity regarding the extent of documentation that is necessary to meet the requirement for this to be “sufficient” for an experienced auditor to understand. We believe that many auditors would welcome application material to address what are perceived to be overly burdensome/onerous documentation requirements for LCE audits, such as the extent to which auditors need to document judgements made and factors considered when obtaining an understanding sufficient to identify and assess the risks of material misstatement on an LCE audit.

Accordingly, we recommend that additional guidance be developed to provide further detail as to how requirements could be operationalised when auditing an LCE as opposed to a more complex entity, with worked examples including comparing and contrasting examples for audits conducted in accordance with the full-scope ISAs versus the LCE ISA. We also suggest that content from the IFAC *Guide to Using ISAs in the Audits of SMEs*, which is intended to explain fundamental principles and provide practical support, could be repurposed to help achieve this objective. We recommend that the IAASB consider this as part of their CUSP documentation workstream more fully.

Recommended Courses of Action to Address Concerns with the LCE ISA

With regard to the LCE ISA, we highlight a number of significant concerns with pursuing a separate, standalone standard to address scalability challenges. We raised several of these concerns in responding to the previous Discussion Paper (DP), *Audits of Less Complex Entities: Exploring Options to Address the Challenges in Applying the ISAs* and we include these again below as we believe these continue to be relevant. We also have concerns which relate specifically to the approach taken/decisions made by the IAASB in developing the LCE ISA, including whether it will really achieve the IAASB’s objectives, or whether it may result in inconsistency and divergence in practice both within individual jurisdictions, as well as across different jurisdictions, and overall may undermine audit quality and potentially have unintended consequences for the profession as a whole. Several of these concerns are interlinked and arise from an overall lack of clarity as to the nature of the entities for which the LCE ISA is considered appropriate, as well as how an audit conducted in accordance with this standard would actually differ from an audit of an LCE conducted in accordance with the full-scope ISAs. We set out these concerns in more detail below, in the section entitled *Concerns Regarding Approach Taken to Development of the LCE ISA*.

As a result of the significance of these concerns, we strongly encourage the IAASB to take the necessary time to appropriately address these matters prior to issuance of the LCE ISA by taking one or, ideally, both of the following courses of action:

1. Include significantly more application guidance within the standard itself, having conducted a thorough review of where this is needed. This would provide context and clarify how the requirements are expected to be applied when conducting an LCE audit, along the lines of the material included within the full-scope ISAs. We do recognise that such application guidance is likely to extend the length of the standard significantly, however, we consider that, without such guidance, the LCE ISA would not be sufficiently robust to drive consistency in its application and to support audit quality across the profession; and/or
2. Consider further refining and narrowing the authority of the standard by:
 - a) Explicitly identifying, within the authority section of the standard where “proxies for complexity” within the audit are described, other specific aspects of the entity, in addition to those currently identified by the IAASB, which may involve complexity, such as matters that may give rise to significant risks and/or require the auditor to exercise significant professional judgement (refer to our examples set out in our response to Question 3c) in Appendix 2 of this letter). When matters of this nature are likely to be present and involve complexity, the auditor should conclude that it is not appropriate to conduct the audit in accordance with the LCE ISA and instead use the full-scope ISAs.

Furthermore, we recommend that the IAASB scale the related LCE ISA requirements accordingly, by removing requirements intended to address complexity relating to such matters; and/or
 - b) Further restricting the authority of the standard so that it can only be applied to “small” entities that are also likely to be less complex.

We suggest, therefore, that the IAASB place a more active responsibility on national standard setters/regulators to formally approve the standard, and as part of this approval process, to establish size criteria for entry into the standard, as appropriate to their jurisdictions. These thresholds could be expressed in terms of ranges, rather than absolute figures, to help avoid the situation whereby entities may fall within the scope of the standard in certain years, and outside the scope of the standard in other years, which would clearly not be desirable.

We consider that the establishment of such size thresholds is particularly important if the IAASB decides to proceed to issue the LCE ISA in its current form, i.e. without including substantially more essential explanatory material (“EEM”) as we set out in option 1) above, and/or without further restricting the authority of the standard by identifying other specific areas as proxies for complexity, in addition to those currently described by the IAASB, as we set out in option 2a) above.

Concerns Regarding Approach Taken to Development of the LCE ISA

Lack of Clarity as to Difference to Full-Scope ISAs at a Requirements Level

The content of the LCE ISA is closely aligned with the requirements of the full-scope ISAs and a detailed review of the mapping analysis appears to indicate that an audit performed in accordance with the LCE ISA should achieve a very similar outcome to that of using the full-scope ISAs scaled as relevant to an entity that is an LCE as described in the ED, from the perspective of relevant requirements.

This makes it challenging to understand, at a conceptual level, the overall purpose/nature of the standard and how an audit performed in accordance with this standard actually differs to an audit performed in accordance with the full-scope ISAs. As a result, it is difficult to respond meaningfully to certain questions of the IAASB, in particular, with respect to the authority of the standard; its positioning on a standalone basis; the requirement to specifically identify, in the auditor's report, that the audit has been performed in accordance with the LCE ISA, as well as the approach taken to prohibit "topping up" and to require a transition to the full-scope ISAs in certain circumstances.

Removal/Reduction of Application Guidance and the IAASB's Intentions

We consider that the principal difference between the LCE ISA and the full-scope ISAs appears to be that the IAASB has removed most of the application material that is an integral part of the full-scope ISAs and instead has included only very high-level EEM within the ED. The IAASB has also developed supplementary guidance in respect of certain key aspects of the standard, which is placed outside the standard itself and is non-authoritative. We believe this approach has been taken principally to shorten the standard with the aim of making this easier to use/navigate for LCE auditors.

If this assumption is correct, we consider this overriding objective of shortening the standard *per se* to be unhelpful to auditors and potentially other stakeholders, e.g., regulators, who would have a very limited framework/ basis against which to perform their quality inspections. We have significant concerns that without adding substantially more application guidance there could be unintended consequences. In particular, there could be significant inconsistency and divergence in practice, as a result of different interpretations amongst auditors as to what would be appropriate without the additional context and the "guardrails" of more detailed application material. Inconsistency may arise within particular jurisdictions, and also across different jurisdictions, if local regulators take different views in the absence of detailed application guidance, leading to divergence in practice. Furthermore, we do not consider that rearrangement of elements of important guidance into supplementary materials makes the LCE ISA any easier to understand/ navigate, and the fact that the supplemental materials are also identified as non-authoritative is likely to cause confusion with respect to application. We suggest that the IAASB perform detailed

outreach with regulatory bodies from a wide range of jurisdictions, to understand whether they have any concerns regarding the lack of EEM.

We also believe that this inconsistency in practice is likely to worsen over time, as the understanding of the full-scope ISAs by practising auditors may degrade over time, and future auditors may not receive training or gain experience of applying the full-scope ISAs. Although we recognise that the lower complexity of the entities subject to audit as contemplated by this standard somewhat reduces the risks associated with providing less application guidance, we highlight that one of the IAASB's key objectives is to drive global consistency in application of auditing standards, and removal of the majority of the application material risks undermining this key objective, which we do not consider to be in the public interest.

Lack of Clarity as to Nature of an Engagement Performed in Accordance with the Standard

We are concerned that there is potential for confusion for users of auditor's reports/ other stakeholders, as to the nature of an audit engagement conducted in accordance with this standard and how this compares to/differs from an audit performed in accordance with the full-scope ISAs. We note the current "expectation gap" regarding public perception as to what an audit is and is not, and we are concerned that issuance of this LCE ISA could add to confusion and misunderstanding in the marketplace and potentially widen this gap.

This is a concern because, as we highlight above, we believe that the key difference between the LCE ISA and the full-scope ISAs resides in the lack of application material and the "flexibility" to exercise a greater degree of professional judgement in determining how to execute requirements that may result from this for auditors. However, the IAASB does not articulate this and since, at an objectives and requirements level, the relevant requirements are expected to be nearly the same as applying the full-scope ISAs, appropriately scaled, we believe that, without clarification from the IAASB as to where the difference lies, this could cause confusion in both the marketplace and for the profession. We understand that there has been discussion among various stakeholders who may have an initial perception that this is a different level of assurance to an "ISA audit", being somewhere between such an audit and a review.

We are also concerned that, in being described as an audit, but with a perceived lesser work-effort than an audit performed in accordance with the full-scope ISAs, this may serve to undermine other services performed in accordance with the IAASB's standards, in particular, full-scope ISA audits. Therefore, issuance of this standard, without clearer articulation by the IAASB of the differences between this standard and the full-scope ISAs, could have significant implications for the audit profession as a whole, including for networks/firms which may be reluctant to use this standard without this clarification.

Risk of Commercial Pressure to Apply Standard

We are concerned that the standard may be understood by stakeholders to be simpler and with a perceived lesser and more efficient work-effort than an audit performed in accordance with the full-scope ISAs, which may give rise to commercial pressure from certain stakeholders for auditors to reduce fees/cost when using this standard. This could have a negative impact on audit quality for such LCE auditors as we believe the standard would drive the same work-effort since it has the same objectives and requirements (although with less consistency in execution due to significant reduction in application material) as the full-scope ISAs when appropriately scaled for a less complex entity.

Similarly, we are concerned that there may also be commercial pressure from stakeholders for auditors to perform an audit in accordance with the LCE ISA rather than the full-scope ISAs, as they may view this as a less costly way to obtain an ISA audit opinion. Decisions regarding use of this standard involve a degree of subjectivity/judgement on the part of the auditor when assessing the qualitative characteristics of an LCE, and there may therefore be pressures to reach an inappropriate decision.

Accordingly, we highlight that it is critical for the IAASB to clarify and clearly articulate the differences between the two frameworks so that auditors can address any misunderstandings/inappropriate perceptions from other stakeholders, as well as to include sufficient and appropriate application guidance to drive consistency of application and audit quality, as we describe at Option 1 in the section entitled *Recommended Courses of Action to Address Concerns with the LCE ISA*.

Please also refer to our recommendations set out in Options 2a) and 2b) in the section entitled *Recommended Courses of Action to Address Concerns with the LCE ISA*, regarding further restricting the intended use of the standard, within the authority section, to explicitly identify additional potential sources of complexity in the audit and/or to consider the establishment of size thresholds to focus the scope of the standard on small and clearly non-complex entities, which we believe was the original intent of this standard. We consider that such measures would significantly reduce the inherent subjectivity in determining whether it would be appropriate to use this standard, and would also, therefore, alleviate the likelihood of commercial pressure to apply the standard.

Authority of the Standard

Despite the efforts of the IAASB in describing in detail the authority of the standard, we believe there is still scope for differing interpretation regarding its application, both in terms of differences in practice/ interpretation as a result of the inherent subjectivity in determining whether an entity has the qualitative characteristics of an LCE as envisaged by this standard, as well as for inconsistent interpretation/application across

jurisdictions. We highlight that this is different to all other standards of the IAASB (audit, review, assurance etc.), use of which is determined at a jurisdictional level and does not rely on subjective characteristics.

We note that the IAASB has specifically identified complex financing arrangements; complex transactions, and accounting estimates that are subject to a higher degree of estimation uncertainty, or when the measurement basis requires complex methods, as “proxies for complexity” that would preclude use of this standard. We understand the IAASB intends for the term ‘complexity’¹ to be interpreted somewhat broadly, as we describe in our response to Question 3c, in Appendix 2 of this letter), which we believe could encompass most, if not all, matters that could be assessed as significant risks and/or require the auditor to exercise significant professional judgement². We are concerned that by not explicitly identifying these additional, specific matters in the authority section as potential sources of complexity, and by retaining applicable requirements relating to these matters from the full-scope ISAs, this could result in significant uncertainty (and differing interpretations) as to whether, and under what circumstances, it is appropriate to conduct an audit using the LCE ISA when one or more of these matters arise.

We recommend, therefore, as we describe at Option 2a) in the section entitled *Recommended Courses of Action to Address Concerns with the LCE ISA*, the additional, specific identification of such areas within the authority section of the standard as potential sources of complexity. We believe that this would also assist the auditor in applying the overriding principle underpinning the authority section (i.e. “if in doubt you are out”).

We highlight that the inherent subjectivity of some of the qualitative characteristics may also be further exacerbated by the fact that the scope of entities which were originally envisaged as falling within the scope of this standard has broadened as the project has progressed, from the small and clearly not complex, to those further along the spectrum of complexity. We believe this broadening in scope is a key driver of our concerns related to the LCE ISA, and we recommend, therefore, the consideration of size thresholds as we describe at Option 2b) in the section entitled *Recommended Courses of Action to Address Concerns with the LCE ISA*.

Transition to Full-Scope ISAs

We are concerned that the broadening, as the project has progressed, of the scope of the standard to permit use on entities that may have somewhat greater complexity, as well as to entities that are larger, may, as a result, give rise to an increased likelihood of situations arising that require the auditor to transition out of the LCE ISA to use the full-scope ISAs. We suggest, therefore, that the IAASB consider further restricting the intended use of the standard, within the authority section, to explicitly identify additional potential sources of complexity in the audit and/or to consider the establishment of size

¹ We set out our assumptions regarding the IAASB’s intentions in using the term “complexity” in Appendix 1 to this comment letter.

² We set out examples of these matters in our response to Question 3c), in Appendix 2 to this comment letter.

thresholds to focus the scope of the standard on small and clearly non-complex entities, which we believe was the original intent of this standard. Refer to Options 2a) and 2b) in the section entitled *Recommended Courses of Action to Address Concerns with the LCE ISA*. We believe this would substantially reduce the likelihood that a transition to the full-scope ISAs would be necessary.

We are also concerned that it is unclear as to what the work-effort would be in relation to a transition out of the LCE ISA and into the full-scope ISAs, and how this would be executed. We believe that the IAASB does not intend for auditors that have transitioned to the full-scope ISAs to perform specific, additional procedures in the discrete area that has given rise to the need for the transition, but rather would require auditors to reconsider and possibly perform additional procedures across the audit as a whole, including in respect of other areas of the audit that have not driven the increased complexity that underpins the need for transition. Since the requirements of the LCE ISA and the full-scope ISAs are closely aligned, but the IAASB has removed much of the application material in developing the LCE ISA, auditors would have applied these requirements as they considered appropriate when performing the audit in accordance with the LCE ISA and, therefore, we assume transition would involve re-considering all work performed with reference to the full-scope ISAs application material to fulfil the requirements in a more prescriptive way. We believe such an exercise would be extremely challenging, in practice.

We also refer to our comments elsewhere in this letter that over time certain auditors may no longer have sufficient knowledge and experience in dealing with full-scope ISAs. As a result, they may be less equipped to identify scenarios that would require transition. Furthermore, they may not have sufficient understanding of the differences between the LCE ISA and the full-scope ISAs to be able to design and perform audit procedures to appropriately transition.

Longer-Term Implications for the Audit Profession

We believe it is important to consider the potential longer-term implications for the audit profession as a result of this standard, in particular, in respect of the following:

- Whether auditors that only conduct audits using the LCE ISA will obtain the same professional qualifications and receive training equivalent to auditors that conduct audits using the full-scope ISAs, or whether professional qualifications and training programmes may diverge over time.

We highlight that the former may seem burdensome and unnecessarily costly if such auditors are not expected to apply both sets of standards, and this may appear to undermine the objectives of the IAASB.

However, the latter approach would give rise to concerns that if an auditor only trains/updates their knowledge regarding the LCE ISA, their knowledge of the full-scope ISAs will be lost over time or may never be established. This could increase the risk of inappropriately determining whether an audit should be “in” or “out” of

this new standard; a failure, when using this standard, to recognise a situation that indicates it is necessary to transition out of this standard to the full-scope ISAs, e.g. due to the existence of additional requirements addressing complexity in the relevant ISA, and a reduced ability to identify and perform the procedures necessary to appropriately transition.

Separation of training/qualification and ongoing professional development could create a two-tier audit profession, both within firms and across the broader profession. We recommend that the IAASB fully explore these considerations, which are particularly important in light of discussions in certain jurisdictions, e.g., in the UK, in which the Brydon Report recommends the creation of distinct professions of “corporate auditor” versus “statutory auditor”;

- Any decision by auditors/firms to conduct audits in accordance with both sets of standards would likely have cost implications, as well as placing additional demands on their System of Quality Management and compliance with ISQM 1, which could be onerous/burdensome when compared to only conducting audits using the full-scope ISAs.

Group Audits

We propose that group audits be scoped into the LCE ISA, as we believe there are groups that are not “complex”, with few components and which are located in a single jurisdiction, and exclusion of such groups from the standard may significantly reduce the population of entities to which the LCE ISA can be applied. We believe that much of the potential complexity in conducting a group audit, which ISA 600 is designed to address, is in connection with the use of component auditors, i.e., instructing them; being involved in their work; communicating with them, and reviewing their work.

Accordingly, we recommend that group audits be included within the scope of the standard, by establishing a clear boundary that scopes out group audits when component auditors would be used, but scopes these in otherwise, subject to the other qualitative characteristics that are proxies for complexity. These characteristics could also be strengthened in the standard to refer to examples of group-specific matters that are additional “proxies for complexity” and which underpin decisions by group auditors to use the work of component auditors, such as the number and location of components; whether components are located in jurisdictions which have different language, culture, business practices, fraud risks, and the complexity of the consolidation etc. Such strengthening to drive appropriate application would be expected to address any concern that auditors may attempt to avoid use of component auditors simply to stay within the scope of this standard.

Other Solutions to Address Scalability Challenges

CUSP Project and Proposal for Electronic Solution

We encourage the IAASB to give significant focus to addressing the challenges of scalability through the separate IAASB CUSP project, and we consider that appropriate

solutions developed following that project would likely be very useful to the audit profession, including auditors of LCEs.

In connection with this, we note that there are challenges in applying certain ISAs, in particular, in terms of their understandability/ application in practice across different entity types and engagement circumstances. Accordingly, whilst auditors of LCEs may face such challenges to a disproportionate extent, these challenges exist across the spectrum of size and complexity of the entity subject to audit and therefore we believe that optimal solution(s) will assist all auditors in addressing these important issues.

We highlighted in our response to the previous DP that we believe the development of an electronic solution would be the most helpful solution in terms of scaling the ISAs, especially for small auditors. We would like to re-iterate this point, especially given that the development of the LCE ISA appears to result in a very similar outcome to scaling of the full-scope ISAs for an LCE audit, at an objectives/requirements level, and in general the approach taken in developing this standard appears to have primarily involved removal of requirements that clearly would not apply to an LCE audit (e.g. listed entity requirements). We consider that an electronic scaling tool would also be able to achieve this form of scaling without the need for sophisticated functionality or significant professional judgement, as scaling would be based on factual gating questions, with binary yes/no answers. An electronic tool may also be capable of a significantly greater degree/specificity of scaling, as it could also exclude requirements that are conditional and are less likely to arise when performing an audit of an LCE, and only scale these in when the conditions which they are intended to address arise (e.g., audit procedures when non-compliance with laws and regulations is identified). It would also be able to scale the entire suite of ISAs, without the need for the removal of selected requirements that may be “proxies for complexity”, and, as a result, remove the need for a complex, and potentially subjective, set of considerations in terms of the authority/entry-point to the LCE ISA.

Other IAASB Standards - Education of Stakeholders

We highlighted in our response to the previous IAASB DP that a consistent theme throughout the IAASB’s research at that time was that many regulators require an audit, and many users request an audit in the absence of such requirements, whilst finding this solution not to be cost-effective, and therefore creating fee pressure.

As we highlighted in that response, we continue to believe that the IAASB’s suite of auditing, assurance and related services standards currently supports a wide range of deliverables, which meet different user needs, ranging from a full-scope audit in accordance with the ISAs, through to non-assurance engagements such as compilations and agreed-upon procedures engagements.

As a result, we suggested in our response to the DP to explore in more depth as to why regulators require/user groups request an audit, and whether an alternative service performed in accordance with other IAASB standards may better meet their needs, in a cost-effective and efficient manner and we would like to re-iterate that recommendation here. We note that such standards are based on similar principles to those underlying

the ISAs, as relevant, including ethical requirements, and pervasive principles such as the exercise of professional scepticism and professional judgement, and may therefore form a more appropriate basis to deliver services to LCEs as an alternative to an ISA audit. For example, they may provide a lower level of assurance than an audit, which may be appropriate to the users' needs, e.g. a review engagement; provide a means to focus on a specific subject matter with either reasonable or limited assurance provided; or may involve the performance of particular procedures which are agreed upon by the user and the auditor, in order to meet the user's needs. Such services could also be performed together, e.g. a review engagement with additional agreed-upon procedures to address particular matters.

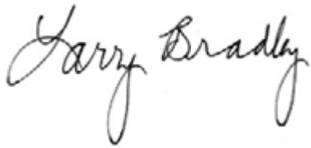
Accordingly, we suggest that the IAASB work with others, e.g. regulators, National Standard Setters (NSSs) and others to explore user needs more fully and to educate user groups as to the availability of such other services and the value of these.

Liaising with Global Bodies

We note that, if the IAASB does proceed to issue this standard, then to be truly effective, solutions should be capable of global implementation, and therefore the IAASB needs to reach out and work closely with a number of other bodies/ parties, in particular, national regulators, national standard setters and regional bodies e.g., the EU, to socialise this proposed standard and to drive adoption/ application of the standard, emphasising the benefits of using this single standard on a global basis. In this regard, we highlight that the standard, although much shorter than the full-scope ISAs, is still relatively long, especially when considered together with supplementary material and the fact that the IAASB states that more guidance will be needed to drive successful implementation/ application. We also highlight above that we consider that significantly more application guidance will need to be included within the LCE ISA in order to ensure that this standard is sufficiently robust to drive audit quality, especially if it is issued without further restricting the entry-point, which would further lengthen the standard. Some jurisdictions ultimately may consider that a much shorter standard, along prescriptive lines rather than being principles-based, is what is needed, and may continue to aim to develop such a solution, which could undermine the IAASB's objectives. The IAASB would need to educate these bodies as to why the LCE ISA is a more robust audit solution, that would drive audit quality and maintain confidence in audits of LCEs.

Please contact Sheri Anderson at sranderson@kpmg.com if you wish to discuss any of the issues raised in this letter.

Yours sincerely

A handwritten signature in black ink that reads 'Larry Bradley'.

Larry Bradley
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KPMG International Ltd

Appendix 1

Our Assumptions in Responding to the ED

In responding to the ED, we make the following assumptions to enable us to provide meaningful input. If these assumptions are not appropriate this will affect our response and we note in the detailed responses to the questions posed by the IAASB when this may apply.

- The LCE is a standalone standard, as described, and all necessary material to interpret and apply the standard is set out within the standard itself, or within the accompanying supplementary materials, which are non-authoritative;
- As this is a standalone standard, auditors do not need, and are not expected, to refer to the guidance set out in the full-scope ISAs when applying this standard;
- Although the outcome is an audit/ reasonable assurance, this is an entirely separate and distinct product which is different in nature, and with a different work-effort, to an audit performed in accordance with the full-scope ISAs. It is not simply a scaled version of the full-scope ISAs as appropriate to an LCE. For example, the standard makes clear that a full-scope ISA audit opinion is not appropriate when using this standard, and instead the opinion is to make specific reference to the LCE ISA. Additionally, the standard is intended to be standalone, and cannot be “topped up” or bridged to the full-scope ISAs in any way, i.e., as a whole, it drives a separate and distinct work-effort across all aspects of the audit, from start to finish;
- Application of this standard to the audit of an LCE that meets the criteria to use the LCE ISA is expected to result in substantially the same relevant requirements being applicable as an audit that is conducted using the full-scope ISAs;
- Any difference in outcome (which is to be expected because this is a separate standard) resides in the fact that most of the application material has been removed as compared to the full-scope ISAs, which enables an auditor to execute the requirements differently to an audit performed in accordance with the full-scope ISAs. This appears also to be a deliberate decision of the IAASB, to allow the auditor to interpret and apply the requirements using their knowledge and judgement without the more prescriptive “guardrails” of the application material set out within the full-scope ISAs;
- A primary driver in developing the LCE ISA is to shorten the standard as the IAASB considers this will make it easier to read/navigate for a “typical” LCE;
- The requirements/ principles related to the authority of the standard will be applied as intended by the IAASB, including the use of the qualitative characteristics, and the use of the “if in doubt, you are out” principle;
- In using the term “complexity” when referring to qualitative characteristics which increase or indicate the presence of complexity (also described by the IAASB as “proxies for complexity”), we understand that the IAASB intends for the term

complexity to be interpreted somewhat broadly, as indicated by the fact that one of the characteristics of complexity in A9 is that the entity's accounting estimates are subject to a higher degree of estimation uncertainty (and the Supplemental Guidance for the Authority of the Standard notes that accounting estimates that do not require significant judgments are less complex, the implication being that estimates with significant judgements are considered complex). This indicates that factors such as subjectivity, [estimation] uncertainty and susceptibility to management bias are also considered proxies for "complexity". Consequently, the term complexity appears to include most, if not all, matters that could be assessed as significant risks and/or require the auditor to exercise significant professional judgement. This would include matters where there is an element of inherent subjectivity in measuring or evaluating information, or where expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence;

- Auditors using this standard only will not be expected to qualify in, train in or otherwise maintain their knowledge of the full-scope ISAs.

Appendix 2 – Specific Questions Posed by IAASB

Respondents are asked to comment on the clarity, understandability and practicality of application of ED ISA for LCE. In this regard, comments will be most helpful if specific aspects of ED-ISA for LCE are identified and the reasons for any concern about clarity, understandability and practicality of application, along with suggestions for improvement, are included. Specific suggestions for any proposed changes to wording in ED-ISA for LCE are also welcome.

Respondents are free to address only questions relevant to them, or all questions. When a respondent agrees with the proposals in ED-ISA for LCE, it will be helpful for the IAASB to be made aware of this view as support for the IAASB's proposals cannot always be inferred when not explicitly stated.

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

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?**

We recognise the IAASB's rationale for developing the LCE ISA as a separate and standalone standard. However, we are concerned that there is potential for confusion for users of auditor's reports/ other stakeholders, as to the nature of an audit engagement conducted in accordance with this standard and how this compares to/differs from an audit performed in accordance with the full-scope ISAs. This is a particular concern given the current "expectation gap" regarding public perception as to what an audit is and is not and we are concerned that issuance of this LCE ISA could add to confusion and misunderstanding in the marketplace and potentially widen this gap.

Lack of Clarity as to Overall Objective/Purpose of the Standard

The content of the LCE ISA is closely aligned with the requirements of the full-scope ISAs, as these have been used as the starting point for development of this standard, and the objectives and principles of the full-scope ISAs have been retained.

A detailed review of the mapping analysis appears to indicate that an audit performed in accordance with the LCE ISA should achieve a very similar outcome to that of using the full-scope ISAs scaled as relevant to an entity that is an LCE as described in the ED, from the perspective of relevant requirements. The IAASB makes reference to the retention of "core requirements" but does not attempt to articulate where differences in the work that would be performed in an audit of an LCE when using the LCE ISA, versus using the full-scope ISAs, appropriately scaled for an LCE, actually lie, at a requirements level.

This makes it challenging to understand, at a conceptual level, the overall purpose/nature of the standard and how an audit performed in accordance with this

standard actually differs to an audit performed in accordance with the full-scope ISAs. As a result, it is difficult to respond meaningfully to certain questions of the IAASB, in particular, with respect to the authority of the standard; its positioning on a standalone basis; the requirement to specifically identify, in the auditor's report, that the audit has been performed in accordance with the LCE ISA, as well as the approach taken to prohibit "topping up" and to require a transition to the full-scope ISAs in certain circumstances.

We believe that the principal difference between the LCE ISA and the full-scope ISAs appears to be that the IAASB has removed most of the application material that is an integral part of the full-scope ISAs and instead has included only very high-level EEM within the ED, which appears to envisage auditors exercising a significantly greater degree of professional judgement in determining how to execute requirements. However, the IAASB does not articulate this and since, at an objectives and requirements level, the relevant requirements are expected to be nearly the same as applying the full-scope ISAs, appropriately scaled, we believe that, without clarification from the IAASB as to where the difference lies, this could cause confusion in both the marketplace and for the profession. We understand that there has been discussion among various stakeholders who may have an initial perception that this is a different level of assurance to an "ISA audit", i.e. an audit performed in accordance with the full-scope ISAs, being somewhere between such an audit and a review.

We are also concerned that, in being described as an audit, but with a perceived lesser work-effort than an audit performed in accordance with the full-scope ISAs (a perception that is likely to be reinforced by the fact that the LCE ISA is substantially shorter in length than the full-scope ISAs), this may create confusion and potentially undermine other services performed in accordance with the IAASB's standards, in particular, full-scope ISA audits. Therefore, issuance of this standard, without clearer articulation by the IAASB of the differences between this standard and the full-scope ISAs, could have significant implications for the audit profession as a whole, including for networks/firms which may actually plan not to use this standard.

Risk of Commercial Pressure to Apply Standard

We are concerned that the standard may be understood by stakeholders to be simpler and with a perceived lesser and more efficient work-effort than an audit performed in accordance with the full-scope ISAs, which may give rise to commercial pressure from certain stakeholders for auditors to reduce fees/cost when using this standard. This could have a negative impact on audit quality for such LCE auditors as we believe the standard would drive the same work-effort since it has the same objectives and requirements (although with less consistency in execution due to the significant reduction in application material) as the full-scope ISAs when appropriately scaled for a less complex entity.

We are also concerned that there may be commercial pressure from stakeholders for auditors to perform an audit in accordance with the LCE ISA rather than the full-scope ISAs, as they may view this as a less costly way to obtain an ISA audit opinion. Decisions regarding use of this standard involve a degree of subjectivity/judgement on the part of the auditor when assessing the qualitative characteristics of an LCE, and there may therefore be pressures to reach an inappropriate decision.

Please also refer to our recommendations set out in our response to Question 3c), regarding further restricting the use of the standard, within the authority section, to focus the scope of the standard on small and clearly non-complex entities, which we believe was the original intent of this standard. We consider that such measures would significantly reduce the inherent subjectivity in determining whether it would be appropriate to use this standard, and would also, therefore, alleviate the likelihood of commercial pressure to apply the standard.

Longer-Term Implications for the Audit Profession

It is also important to consider other potential consequences of this standalone approach and how this is to be operationalised by auditors in terms of the potential longer-term implications for the profession.

We assume that auditors using only the LCE ISA would not need to maintain their knowledge of the full-scope ISAs and, as a consequence, professional qualification and training programmes may diverge over time. This may have long-term implications as follows:

- Requiring professionals to undertake training that enables them to conduct audits in accordance with both the full-scope ISAs and the LCE ISA may seem burdensome and unnecessarily costly if certain audit professionals are not expected to apply both sets of standards. Such a requirement may undermine the objectives of the IAASB to help smaller auditors.

Having said this, if an auditor only trains/updates certain audit professionals on the LCE ISA, their knowledge of the full-scope ISAs will be lost over time or may never be established.

We are concerned that this may increase the risk of inappropriately determining whether an audit should be “in” or “out” of this new standard; a failure, when using this standard, to recognise a situation that indicates it is necessary to transition out of this standard to the full-scope ISAs, e.g. due to the existence of additional requirements addressing complexity in the relevant ISA, and a reduced ability to identify and perform the procedures necessary to appropriately transition.

The IAASB acknowledges that transition could be challenging, however, it does not discuss solutions in more detail, noting only that it envisages that such transition should be rare. Given the challenges involved, we recommend that the IAASB consider the implications in more depth, and provide clear

guidance to auditors regarding such a transition – please see also above regarding “topping up” and transition to the full-scope ISAs.

- Furthermore, if training/qualification and ongoing professional development do diverge over-time, this could create a two-tier audit profession, both within firms and across the broader profession. We recommend that the IAASB fully explore these considerations, which are particularly important in light of discussions in certain jurisdictions, e.g., in the UK, in which the Brydon Report recommends the creation of distinct professions of “corporate auditor” versus “statutory auditor”.
- Lastly, if auditors/firms decide to conduct audits in accordance with both sets of standards, they will need to develop, implement and maintain methodologies, workflows/workpaper templates and training to perform engagements in accordance with both sets of standards, including in respect of transitioning between the LCE ISA and full-scope ISAs. This could be very burdensome and would also create a significant quality management and compliance challenge with respect to compliance with ISQM 1. This would be the case, in particular, as the timing of certain changes to the LCE ISA may not be fully aligned to those of the full-scope ISAs, as described by the IAASB, and therefore the two may diverge over time or for periods of time. This may ultimately encourage auditors/firms to only conduct audits in accordance with ‘one or the other’ and discourage use of the LCE ISA due to an inability to transition.

Please also see our comments in our response to Question 13 regarding challenges when applying the LCE ISA when auditing components in a group audit scenario, in which the group auditor is required to use the full-scope ISAs.

(b) The title of the proposed standard.

We consider the title of the proposed standard to be clear and appropriate, based on the IAASB’s stated intention that this is a standalone standard that is designed to set out requirements that will result in a reasonable assurance conclusion, in the form of an audit opinion.

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

We do not have any other comments on the matters discussed in Section 4A.

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?

Section 4B – Authority of the Standard

We consider the proposed conforming amendments to the IAASB Preface to be appropriate.

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?

In light of the IAASB's intention that this is a standalone auditing standard, we believe it is critical that the authority regarding the use of the standard is clear, is capable of appropriate implementation and also takes account of different legal and regulatory environments in different jurisdictions.

We note that the considerations are complex and we welcome the improvements in clarity of the ED issued over previous drafts, as well as the issuance of the supplementary guidance. We believe that the approach taken, in respect of the inclusion of explicit prohibitions and qualitative characteristics that serve as proxies for complexity, together with the supplementary guidance, as well as a role for local jurisdictions to make further refinements to the authority of the standard, is appropriate. Please see our responses to parts b), c), d) and e) of this question, for further details regarding whether we consider that the authority as presented is implementable and our recommendations for improvements.

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

We note that the definitions set out in the authority section focus on characteristics of the entity, however, situations may arise that are not entity-specific matters and which are not within the control of the entity. For example, a matter may be related to the entity's environment, e.g., an entity may have relatively simple estimates in most years, but during times of economic uncertainty/ volatility, e.g. as a result of the COVID-19 pandemic, complexity may be introduced to the estimation process. Such an entity may therefore meet the criteria to be an LCE in some years, but not in others, which would not be a desirable outcome and could place entities and auditors under significant pressure in terms of additional work needed to transition in and out of the LCE ISA over time.

In describing pervasive risks, these are linked to entity characteristics, such as the entity's business model, or the jurisdictions in which it operates. However, pervasive risks may also be affected by matters external to the entity and therefore outside of the entity's control, e.g., going concern risk may be driven more by the economic environment in which the entity operates, even though this significantly interacts with entity-specific characteristics in addition. However, as drafted, the authority of the standard would not necessarily steer an auditor to use the full-scope ISAs in the event that an LCE faced complexity with respect to the going concern assessment. (Refer to our comments in response to Question 3c).

Furthermore, if the auditor were to decide that it would be more appropriate to use the full-scope ISAs because of matters such as potentially complex going concern assessments during times of economic volatility, this could cause confusion for users of the financial statements who may not understand the underlying reasons

for the transition, and may have a perception that the change in risk is greater than it really is. This could cause confusion in the marketplace, when the driver is not related to the entity specifically, as well as potentially placing the auditor in a difficult situation, e.g., if there were to be pressure from management not to use the full-scope ISAs to avoid creating an impression that complexity and risks relating to the entity are greater than they perhaps are.

Regarding terminology used in the Authority, we suggest that the IAASB work closely with the IESBA in terms of the IESBA project to consider the global definition of PIEs. Alignment to the IESBA PIE definition would remove some of the subjectivity whilst still taking account of jurisdictional differences, quantitative thresholds etc. as these factors are also under consideration by the IESBA and it would be preferable to have both a globally consistent baseline as well as alignment in terms of qualitative principles.

We also note the IESBA considerations in respect of the definition of a listed entity, with the intention to broaden this out from its current anchoring to a “recognised stock exchange”. We suggest that the IAASB work closely with the IESBA in this regard. However, as we noted in our respond to the IESBA following its consultation in this area, we believe it is important to establish a global baseline as far as is possible, and we note concerns with reliance on jurisdictional regulators/ standard-setters to establish additional parameters to make this workable in practice, as they may not do so and this could lead to inconsistency and potentially have unintended consequences. Please also refer to our response to part c) below, which we also consider may give rise to unintended consequences.

We also note the following suggestion for further clarification/ consideration: certain aspects of the scoping decisions focus on the “main purpose” of the business, however, the intention behind describing these characteristics may also be important for other entities engaging in these activities, even if this is not their main purpose. We suggest the IAASB consider describing entities that engage in these activities to a *significant extent*, but not necessarily being the main purpose.

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

Despite the efforts of the IAASB in describing in detail the authority of the standard, we believe there is still scope for differing interpretation regarding its application, both in terms of differences in practice/ interpretation as a result of the inherent subjectivity in determining whether an entity has the qualitative characteristics of an LCE as envisaged by this standard, as well as for inconsistent interpretation/application across jurisdictions. The IAASB has attempted to address this via the “if in doubt, you are out” overriding principle, but the inclusion of qualitative factors in the entry point to the standard inevitably results in some subjectivity.

We highlight that this is different to all other standards of the IAASB (audit, review, assurance etc.), use of which is determined at a jurisdictional level and does not rely on subjective characteristics. We also refer to our comments in our response

to Questions 1a) and 13a) that, over time, certain auditors may no longer be sufficiently familiar with the full-scope ISAs to be able to make appropriate scoping determinations, as well as to our comments in our response to Question 1a) that auditors may be subject to commercial pressure to use this standard when it may not be appropriate to do so.

This subjectivity is also exacerbated by the fact that the IAASB describes, at paragraph A9, that the list of characteristics is not exhaustive, and notes that characteristics on their own may not be sufficient to enable a determination to be made.

In connection with this, we note that the IAASB has specifically identified, within the authority section of the standard, certain characteristics which are considered to involve complexity³, such as complex financing arrangements; complex transactions, and accounting estimates that are subject to a higher degree of estimation uncertainty, or when the measurement basis requires complex methods, as “proxies for complexity”. We understand the IAASB intends for the term “complexity” to be interpreted somewhat broadly, as indicated by the fact that one of the characteristics of complexity in A9 is that the entity’s accounting estimates are subject to a higher degree of estimation uncertainty (and the Supplemental Guidance for the Authority of the Standard notes that accounting estimates that do not require significant judgments are less complex, the implication being that estimates with significant judgments are considered complex). This indicates that factors such as subjectivity, [estimation] uncertainty and susceptibility to management bias are also considered proxies for “complexity”. Consequently, the term complexity appears to encompass most, if not all, matters that could be assessed as significant risks and/or require the auditor to exercise significant professional judgement. Therefore, we question why other areas, in addition to those specifically identified by the IAASB, where there are matters that may give rise to “complexity” in the audit are not also explicitly described. For example, the following could also involve complexity:

- significant risks relating to matters other than complex financing arrangements, complex transactions and complex estimates, including fraud risks;
- management’s going concern assessment when events or conditions that may cast significant doubt on an entity’s ability to continue as a going concern have been identified;
- significant unusual transactions outside the normal course of business;
- application of the applicable financial reporting framework to accounting matters that are contentious or highly subjective, or

³ We set out our assumptions regarding the IAASB’s intentions in using the term “complexity” in Appendix 1 to this comment letter.

- matters for which management has involved a management's expert, and matters for which the auditor determines they need an auditor's expert.

We believe it would be unusual for the above matters to arise on an audit and not involve a reasonable degree of complexity. We are concerned that by not explicitly identifying these matters in the authority section as potential sources of complexity, and by retaining applicable requirements relating to these matters from the full-scope ISAs, this could result in significant uncertainty (and differing interpretations) as to whether, and under what circumstances, it is appropriate to conduct an audit using the LCE ISA when one or more of these matters arises.

Additionally, we note that in scoping out estimates that are subject to a higher degree of estimation uncertainty or when the measurement basis requires complex methods as a proxy for complexity, the IAASB has consequently not included certain requirements from the full-scope ISAs that address such estimates within the LCE ISA, since auditors would be expected to use the full-scope ISAs and not the LCE ISA in this scenario. However, since the IAASB has not specifically identified complexity arising from the matters listed above as potential barriers to entry to the standard and has included applicable requirements from the full-scope ISAs in respect of these areas, we believe this could lead an auditor to conclude that, even where complexity arising from these matters does exist, the LCE ISA is still intended to address these matters, and it is therefore appropriate to apply this standard. We consider this interpretation to be inherently inconsistent with the underlying principles regarding use of this standard. Furthermore, the current lack of EEM to provide context and guidance in performing audit procedures in relation to these matters exacerbates the risks of inconsistent application and reduced audit quality should the auditor conclude that the LCE ISA can be applied to address such matters when they involve complexity, which would not be in the public interest.

We therefore recommend that the IAASB further refine and narrows the entry point to this standard by explicitly requiring auditors to consider other aspects of the entity which may involve complexity, such as matters that may give rise to significant risks and/or require the auditor to exercise significant professional judgement (see the examples listed above), as proxies for complexity within the authority section of the standard. We believe explicit inclusion of these additional matters would assist the auditor in applying the overriding principle underpinning the authority (i.e. "if in doubt you are out"). We also believe they could reduce the judgment required with respect to application of paragraph A9, as we describe above. Accordingly, when matters of this nature are likely to be present and involve complexity, the auditor should conclude that it is not appropriate to conduct the audit in accordance with the LCE ISA and instead use the full-scope ISAs. Furthermore, we suggest that the IAASB scale the related LCE ISA requirements accordingly, so that any requirements specifically intended to address complexity relating to these matters are removed. We also recommend that consideration be given to whether matters that give rise to significant risks or significant unusual

transactions would likely ever not involve a reasonable degree of complexity. If the conclusion is that this would be rare, then consideration should be given to excluding requirements that address responding to these risks altogether, and instead make it clear that when risks of this nature are identified, it is no longer appropriate to apply the LCE ISA.

We also recommend that the IAASB include additional EEM in the LCE ISAs for the above matters if they do arise but do not involve “complexity”. This EEM would also provide helpful context to give the auditor greater confidence as to whether they should be conducting the audit using the LCE ISA or not.

We recognise that, as a result of these proposals, auditors would need to develop a sufficient understanding of the entity, upfront, to be able to determine whether such matters are present or are likely to arise and involve complexity and therefore whether it would be appropriate to use the LCE ISA. To obtain sufficient understanding would likely necessitate performing certain risk assessment procedures. However, we consider that this would be necessary to enable the auditor to reach appropriate conclusions regarding whether it is appropriate to use the LCE ISA or not. We believe that these recommendations would also help to reduce the likelihood that a transition to the full-scope ISAs may be needed during the audit, as only entities with characteristics that indicate that they are clearly at the lower end of the complexity spectrum would likely initially meet the criteria to use the LCE ISA, and thus give the auditor sufficient confidence that the conclusion that the LCE ISA is appropriate to use is highly unlikely to change as the audit progresses.

We highlight that the inherent subjectivity of some of the qualitative characteristics described above may also be further exacerbated by the fact that the scope of entities originally envisaged as falling within the scope of this standard has broadened as the project has progressed from the small and clearly not complex, to those further along the spectrum of complexity, i.e. which are *less complex* [emphasis added] but still may contain elements of complexity and may not be small at all. We believe this broadening in scope is a key driver of several of our concerns related to the LCE ISA, e.g. in respect of the subjectivity regarding the entry point to the standard; commercial pressure to apply the standard; an increased likelihood in terms of the need to transition to the full-scope ISAs; more complex reporting considerations, as well as our view that there is a need for significantly more EEM to provide context and guidance to auditors.

We suggest, therefore, that the IAASB consider further restricting the authority of the standard so that it can only be applied to less complex entities that also meet size thresholds to be considered small. We believe this could be achieved by the provision of further guidance for national standard setters/regulators regarding the establishment of size criteria for entry into the standard. Such size thresholds could be expressed in terms of ranges, rather than absolute figures, to help avoid the situation whereby entities may fall within the scope of the standard in certain

years, and outside the scope of the standard in other years, which would clearly not be desirable.

We consider that the establishment of such size thresholds is particularly important if the IAASB decides to proceed to issue the LCE ISA in its current form, i.e. without including substantially more EEM and/or without further restricting the authority of the standard to identify other specific areas as proxies for complexity, in addition to those currently described by the IAASB, as this could lead to inconsistency in practice and reduced audit quality, as we describe elsewhere in this letter. Whilst we agree with the IAASB in principle that a large entity may nevertheless not be complex, size is still an, albeit imperfect, proxy for complexity, and we are concerned that the risks in relation to inconsistency in practice and reduced audit quality as a result of using this standard may be more consequential if the standard can be used to conduct audits of larger entities. Although sub-optimal outcomes would clearly not be desirable in respect of an audit of any entity, we consider that restricting use of the LCE ISA to the small and clearly non-complex entities originally contemplated at the outset of this project would substantially reduce the occurrence and potential impact of such outcomes and therefore we believe this course of action would be in the public interest.

Whilst including size thresholds in the standard itself is unlikely to be practicable, the IAASB could achieve the desired outcome by describing in the authority section of the LCE ISA that use of the standard is only permitted when the appropriate body in the particular jurisdiction has formally approved the standard for use. This would place an active responsibility on such bodies regarding approval and avoid the outcome that, as a result of inaction by such bodies, the standard could be used when in fact it would be inappropriate to do so. We recommend that the IAASB provide guidance to strongly encourage such bodies to establish size thresholds appropriate to their respective jurisdictions as part of their approval process.

We also highlight the following internal inconsistency within paragraph A9:

Paragraph A.9 of the proposed standard states the following:

“In accordance with paragraph A.8., the [draft] ISA for LCE is inappropriate for the audit of the financial statements if an entity exhibits one or more of the following characteristics:

- *The entity’s business activities, business model or the industry in which the entity operates results in pervasive risks that increase the complexity of the audit, such as when the entity operates in new or emerging markets, or entities in the development stage.*

—

This list is not exhaustive and other relevant matters may also need to be considered. Each of the qualitative characteristics may on its own not be sufficient to determine whether the [draft] ISA for LCE is appropriate or not in the

circumstances, therefore the matters described in the list are intended to be considered both individually and in combination.”

The first paragraph precludes use of the standard if the entity exhibits one or more characteristics, however, the closing paragraph of this section appears to contradict this. We consider that the IAASB needs to address this inconsistency.

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

As we note above, in our responses to the earlier parts of this question, we believe that, despite the efforts of the IAASB in describing in detail the authority of the standard, there is still scope for jurisdictional difference in terms of its application as well as differences in practice as a result of the inherent subjectivity in determining whether an entity has the qualitative characteristics of an LCE as envisaged by this standard. We also have concerns that auditors who are no longer sufficiently familiar with the full-scope ISAs may make inappropriate determinations regarding use of the LCE ISA, and/or may be subject to commercial pressure to do so.

We do not believe that less informed stakeholders will necessarily understand the scoping of the proposed LCE ISA and/or the differences between an audit performed in accordance with this ISA versus an audit performed in accordance with the full-scope ISAs, based on the Authority. Accordingly, we consider it critical that IAASB provide more clarity in this area.

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

We believe their proposed role is appropriate, although we consider it inevitable that jurisdictional differences in interpretation and application of the standard will arise.

As we set out in our response to part c) of this Question, we encourage the IAASB to reconsider establishing size thresholds for use of the standard, which would be particularly important in the event that the IAASB does not implement our recommendations in respect of inclusion of a much more substantial body of application guidance within the standard, as described in our response to Question 7d) and/or our recommendations regarding further restricting the authority of the standard by explicit identification of areas of the audit where there are specific matters, in addition to those currently described by the IAASB, which may give rise to complexity in the audit, as described in our response to part c) of this Question. In these circumstances we would consider it important that a more active responsibility is placed on jurisdictional bodies to formally approve the standard for use, to avoid the outcome that, as a result of inaction by such bodies, the standard could be used when in fact it would be inappropriate to do so. We recommend that

the IAASB provide guidance to such bodies to establish appropriate size thresholds in their respective jurisdictions as part of their approval process.

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

We agree with the specific prohibitions proposed by the IAASB as we consider that entities exhibiting these attributes should not be considered to be LCEs for purposes of application of this standard. Refer to our comments in Section 5 regarding group audits.

(b) Qualitative characteristics.

We are generally supportive of the approach to qualitative characteristics described in the standard, and we agree that these would constitute proxies for complexity and that it would be inappropriate to apply the standard in respect of entities with such characteristics. We also welcome the ability of jurisdictional standard-setters/ regulators to refine scoping decisions for certain sub-classes of entities with these characteristics, or to further establish characteristics that are proxies for complexity applicable in their jurisdictions.

Please also refer to our comments in response to Question 3c) regarding our concerns that:

- certain matters, such as complex financing arrangements; complex transactions, and complex accounting estimates, are specifically identified as proxies for complexity within the authority section of the standard, whilst other areas where there are matters that may involve complexity, such as matters that could be assessed as significant risks and/or require the auditor to exercise significant professional judgement, including the matters listed in our response to Question 3c) are not also explicitly identified as potential sources of complexity; and
- the characteristics described are entity-specific, however, complexity may be driven by factors that are external to the entity, e.g. the macro-economic environment, which the standard does not currently address.

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.

Please refer to our comments in response to Question 3b) and 3c).

5. Regarding the Authority Supplemental Guide:

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

We consider the content of the Authority Supplemental Guide to be helpful in understanding the Authority. However, we note that the specific reference to the guide from paragraph A4 of the standard may call into question the authority of the guide, as the IAASB does not usually refer to non-authoritative guidance in authoritative standards, so some may feel compelled to act as if the guidance is authoritative, despite the fact that it is explicitly identified as being non-authoritative.

We believe certain elements of application material have been placed in Supplemental Guides with the primary aim of shortening the standard. However, we consider this overriding objective of shortening the standard *per se* to be unhelpful to auditors and potentially other stakeholders. We do not consider that rearrangement of elements of important guidance into supplementary materials makes the LCE ISA any easier to understand/ navigate, and it also creates confusion regarding the authority of such guidance, as we note above.

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

We do not have additional matters to raise for inclusion in the guide.

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

Please see our responses to Question 3 above.

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

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 response as follows:

(a) The approach to how the ISA requirements have been incorporated in the proposed standard (see paragraphs 74-77).

We are supportive of the key principles used in developing the LCE ISA, given the IAASB's stated intention that this is a separate, standalone standard, that is designed to set out requirements that will result in a reasonable assurance conclusion, in the form of an audit opinion. Accordingly, we welcome the inclusion of objectives; the core ISA requirements and concepts; the need to obtain sufficient appropriate audit evidence to support the audit opinion; the use of materiality, and the use of the audit risk model.

We are supportive of the approach taken to the inclusion of requirements, which have been replicated from the full-scope ISAs, where appropriate, and in other cases included with adaptations commensurate with an LCE audit, such as simplification of language and/or presentation.

Please refer to our response to Question 12, regarding additional requirements from the full-scope ISAs that we consider would be appropriate to include within the LCE ISA, and certain requirements that we suggest the IAASB consider

excluding. Please also refer to our response to Question 3c) regarding our suggestion that the IAASB scale the LCE ISA requirements such that requirements specifically intended to address complexity relating to the matters described in that Question as additional, potential sources of complexity are removed. We also recommend in that response that consideration be given to whether matters that give rise to significant risks or significant unusual transactions would likely ever not involve a reasonable degree of complexity. If the conclusion is that this would be rare, then consideration should be given to excluding requirements that address responding to these risks altogether, and instead make it clear that when risks of this nature are identified, it is no longer appropriate to apply the LCE ISA.

(b) The approach to the objectives of each Part of the proposed standard (see paragraphs 78-80).

We are supportive of the approach taken by the IAASB in respect of the objectives of each Part of the proposed standard.

(c) The principles in relation to professional skepticism and professional judgement, relevant ethical requirements and quality management (see paragraphs 81-84).

We are supportive of the approach taken by the IAASB in relation to the core principles of professional skepticism and professional judgement, relevant ethical requirements and quality management. We believe these principles are foundational to an audit and we consider the approach taken by the IAASB to include these is appropriate.

(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.

We believe that the approach to remove/reduce the EEM to such a significant degree appears to have been a decision taken principally to shorten the standard with the aim of making this easier to use/navigate for LCE auditors. We note that initially this standard was developed with no application material, although the IAASB reconsidered this approach and introduced this high-level EEM as the project developed. It appears that the positioning of several aspects of guidance within non-authoritative supplementary materials rather than as part of the standard itself appears to have been done with the same objective in mind. i.e. to reduce the overall length of the standard.

If our understanding is correct, we consider this overriding objective of shortening the standard *per se* to be unhelpful to auditors and potentially other stakeholders. We also do not consider that rearrangement of elements of important guidance into supplementary materials makes the LCE ISA any easier to understand/ navigate,

and the fact that the supplemental materials are identified as non-authoritative, but cross referred to from the standard, is likely to create confusion as to the authority of such guidance.

For example, the reporting section of the LCE ISA is focused on the unmodified auditor's report, with only very brief guidance regarding modifications. Much of the guidance regarding such modifications is included within the Auditor Reporting Supplemental Guide, which is described as non-authoritative, although it is clearly cross-referenced from the standard. We believe the authority status of the material in the supplemental guide is therefore unclear, which could cause confusion/challenges for auditors and potentially other stakeholders. We believe the IAASB's objectives may be better achieved by placing such material in an Appendix, within the LCE ISA itself, or in a separate standard on reporting for LCEs, noting that this material is authoritative in the full-scope ISAs. We highlight that the auditor's report is the external deliverable resulting from the performance of an audit, and, as such, material addressing reporting should be afforded the appropriate authority status and given sufficient prominence, and should not be de-emphasised in any way.

We have significant concerns that without adding substantially more application guidance there could be unintended consequences, in particular, that there could be significant inconsistency and divergence in practice, as a result of different interpretations amongst auditors as to what would be appropriate without the additional context as well as the "guardrails" of more detailed application material. This inconsistency in practice is likely to worsen over time, as auditors' knowledge of the full-scope ISAs is lost/ new auditors are not trained in the full-scope ISAs. Such inconsistency may arise within particular jurisdictions, and also across different jurisdictions, if local regulators take different views in the absence of detailed application guidance, leading to divergence in practice. We suggest that the IAASB perform detailed outreach with regulatory bodies from a wide range of jurisdictions, to understand whether they have any concerns regarding the lack of EEM.

We highlight that auditors and other stakeholders may look to the supplementary guidance as a basis for interpreting the requirements. However, the supplementary guidance is substantially less comprehensive than the full-scope ISAs and is described as non-authoritative. This may, in turn, result in auditors (and other stakeholders) reverting to the application material in the full-scope ISAs, which would undermine the intentions of the IAASB in developing this standard.

Although we recognise that the lower complexity of the entities subject to audit as contemplated by this standard somewhat reduces the risks associated with providing less application guidance, we highlight that one of the IAASB's key objectives is to drive global consistency in application of auditing standards, and removal of the majority of the application material risks undermining this key objective. We also highlight earlier that, over time, the scope of entities which were originally envisaged as falling within the scope of this standard has broadened as

the project has progressed, from the small and clearly not complex, to those further along the spectrum of complexity, and which may not be small at all.

Please refer to Appendix 3 for a more detailed example of the importance of application material when applying ISA requirements.

We note that the inconsistency that we believe will arise, when formalised across different jurisdictions, would also likely create challenges for multi-jurisdictional networks in developing a consistent methodology for use by all its member firms and could either discourage uptake of the standard entirely by such networks, or would result in the network needing to make “higher of” interpretations to accommodate different jurisdictional interpretations (and the views of the different regulators). This would be challenging and we believe would likely result in the use of the full-scope ISAs by default, which would undermine the objectives of the IAASB.

We recommend, therefore, that a much more substantial body of application guidance be developed by the IAASB to clarify how the requirements are expected to be applied when conducting an LCE Audit, within the standard itself, in order to drive consistency of application in practice, and to support audit quality.

We also recommend, as we describe in our response to Question 3c), further restricting the authority of the standard by explicit identification of areas of the audit where there are specific matters which are potential sources of complexity, in addition to those currently described by the IAASB, which may give rise to complexity in the audit, and, furthermore, that the IAASB scale the LCE ISA requirements accordingly, by removing requirements specifically designed to address complexity in relation to such matters. Clearly, if the IAASB were to implement this recommendation, certain elements of the EEM in respect of these matters would also not need to be included in the LCE ISA.

In the event that the IAASB does not implement the above recommendations, we consider it particularly important that the IAASB implements our recommendations set out in our response to Question 3c) to further restrict the authority of the standard by placing a more active responsibility on jurisdictional bodies to formally approve the standard, and as part of this approval process, to establish size thresholds appropriate to their jurisdictions, to ensure this standard is only applied to audits of entities that are small and more likely to be non-complex.

We recognise that in removing most of the application material, the IAASB may, in fact, deliberately intend a much greater degree of flexibility for the auditor, in terms of their ability to interpret and apply the requirements of the standard as they believe to be appropriate, and this may be the intended key difference between an audit performed in accordance with this standard and an audit performed in accordance with the full-scope ISAs, appropriately scaled for an LCE.

If this is the intent, it is unclear whether, in removing all guidance except what is considered to be essential, the IAASB’s expectation is that successful application

presumes auditor knowledge of and experience in applying the full-scope ISAs, which will be brought to bear when using this standard, or whether the IAASB believes it has, in fact, included all relevant application material for a less complex audit and, if incremental application material in the full ISAs is considered to be necessary/relevant, whether this is an indicator that the LCE ISA should not be used and instead the full-scope ISAs should be applied.

Notwithstanding our recommendation above to include substantially more application material, we highlight to the IAASB that it is important that they explicitly clarify their intentions, within the standard itself, both in terms of envisaging the auditor exercising a significantly greater degree of professional judgment when interpreting what is sufficient to address relevant requirements, as well as to explicitly clarify that, regardless of their intentions, as a standalone standard, there is neither a requirement, nor an expectation, that an auditor needs to refer to the application guidance in the full-scope ISAs in order to conduct an engagement in accordance with the LCE ISA.

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

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).

We believe the overall design and structure of the LCE ISA is appropriate, based on the IAASB's stated intentions in respect of the standard, and our assumptions set out in Appendix 1 to this response.

Whilst we are generally supportive of the linear approach taken to the development of the LCE ISA, with requirements placed throughout the proposed standard, in line with the overall audit flow, rather than being grouped in topic-specific sections, we highlight that in certain instances this may not drive auditors to consider topics such as fraud, going concern, related parties etc. holistically, and ensure that responses overall are appropriate. Accordingly, we suggest that the IAASB consider whether such areas could be better linked together, without changing the overall structure, e.g. by colour-coding such requirements to demonstrate that they form part of a cohesive topic area, and also showing how certain related requirements across different topic areas link to one another.

We also refer to our recommendations set out in our response to Question 3c) that the IAASB further restrict the authority of the standard by explicit identification of areas where there are matters that may give rise to significant complexity in the audit as additional potential sources of complexity within the authority section of the standard. Furthermore, we suggest that the IAASB scale the LCE ISA requirements accordingly, by removing requirements specifically designed to address complexity in relation to such matters. If the IAASB implements these recommendations, this would alleviate the issue of certain significant topics, e.g. fraud, being interspersed throughout the LCE ISA.

Section 4E – Content of ED-ISA for LCE

- 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.**

We believe the content of each of the Parts is appropriate, given the IAASB's stated intention in respect of the standard and our assumptions set out in Appendix 1 to this response. Please refer to our responses to other questions, in particular, Question 7d) regarding the EEM and Question 12) regarding other matters that we believe would be appropriate to address within the standard.

- 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.**

We believe this approach will be responsive to the majority of LCE audits and avoid unnecessary clutter/ confusion. We also welcome the development of the non-authoritative Supplementary Guidance-Reporting to provide further guidance and examples on modifications to the auditor's report, including illustrative reports.

However, similar to the supplementary guidance regarding the Authority of the standard, we consider that there may be scope for confusion as to the authority of this material, as the IAASB does not usually refer to non-authoritative guidance in authoritative standards, so some may interpret this to mean that it is authoritative. We believe certain elements of application material have been placed in Supplemental Guides with the primary aim of shortening the standard. However, we consider this overriding objective of shortening the standard *per se* to be unhelpful to auditors and potentially other stakeholders. We do not consider that rearrangement of elements of important guidance into supplementary materials makes the LCE ISA any easier to understand/ navigate, and it also calls into question the authority of such guidance.

We believe the IAASB's objectives may be better achieved by placing such material in an Appendix, within the LCE ISA itself, or in a separate standard on reporting for LCEs, noting that this material is authoritative in the full-scope ISAs. We highlight that the auditor's report is the external deliverable resulting from the performance of an audit, and, as such, material addressing reporting should be afforded the appropriate authority status and given sufficient prominence, and should not be de-emphasised in any way.

- 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?**

We believe this material will be helpful. Please refer to our responses to Questions 13, regarding transitioning from the LCE ISA to the full-scope ISAs, and reporting in accordance with the LCE ISA in one period, and with the full-scope ISAs in the following period, as well as group audit scenarios in which the group auditor is required to use the full-scope ISAs, whereas component auditors may use the LCE ISA for the statutory audit of a component, as we believe clarification regarding reporting in these scenarios is necessary.

- 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. Section 4F – Other Matters**

In addition to the matters described elsewhere in this letter, we note that requirements are included in respect of Engagement Quality Control Reviews, however, we question the inclusion of these requirements, as our view is that the need to perform such a review is a response to complexity in the audit, and therefore an example of a “proxy for complexity”, and in such situations we would recommend that the full-scope ISAs are used.

We also recognise the Board’s view that use of internal audit is a proxy for complexity and therefore material from ISA 610 has not been included. However, we note that, in practice, internal audit functions may be deployed across a group regarding activities at a subsidiary entity that itself is an LCE, which may be used by an auditor when performing an audit over that entity’s statutory financial statements. Accordingly, we recommend that the Board re-consider inclusion of such material.

Similarly, we recommend that the Board re-consider inclusion of material in respect of “simple” service organisations, which are common and may be used by a number of entities, including group entities. (Please refer also to our response to Question 22, regarding our recommendation to include group audits within the scope of this standard.)

We also highlight that the Subsequent Events Section, at 8.4, does not address the procedures to be performed by the auditor when facts become known to the auditor after the financial statements have been issued (including material misstatements that may be identified, e.g. when performing the audit of the financial statements for the subsequent period) and management amends the financial statements. Additionally, the LCE ISA does not address this scenario in the event that management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation and does not amend the financial statements in circumstances where the auditor believes they need to be amended. ISA 560 addresses these situations

explicitly via requirements and related guidance. Without these additional requirements/ guidance, auditors may not respond appropriately, or may consider that they need to transition to the full-scope ISAs in this scenario, since the IAASB does not permit specific “top-up” procedures to be performed in respect of individual matters, which would seem unnecessary/impracticable when the audit has already been completed. We note that the IAASB states at paragraph 106(c) of the Explanatory Memorandum that it expects such scenarios to be rare, however, we suggest that the IAASB consider inclusion of the full set of relevant requirements/guidance in this area, as we believe such subsequent events in respect of misstatements identified as part of a subsequent audit may not be as rare for small and less complex entities as the IAASB appears to anticipate.

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?

We recognise that the IAASB intends this to be a standalone standard, and that an audit performed in accordance with this standard is a distinct level of service, identified specifically as such in the auditor’s report. Accordingly, we acknowledge the IAASB’s rationale in not permitting auditors to “top up” this LCE ISA if circumstances change in respect of whether an entity meets the criteria to be an LCE (i.e., to perform additional procedures, in discrete areas, by reference to the full-scope ISAs, whilst still remaining in, and reporting in accordance with, the LCE ISA) and instead, in such cases, there is a requirement to transition in entirety to the full-scope ISAs instead.

We also recognise that the detailed material on the authority of the standard is intended to ensure that engagement teams make the right decision upfront in terms of whether they are able to use this standard, with an “if in doubt, you are out” principle being applied. It is considered unlikely by the IAASB that, having made an initial decision to use the standard, teams would need to transition out of this to full-scope ISAs to perform their audit. The exception to this, noted by the Board, is in relation to estimates, e.g., the entity may enter into new transactions that result in complex accounting estimates.

We understand the intention that, in the event that a transition needs to take place, the engagement team needs to re-establish terms of engagement, evaluate whether sufficient work has been performed and design and perform additional procedures to comply with all applicable requirements of the full-scope ISAs.

However, we are concerned that it is unclear as to what the transition work-effort would actually be, and how this would be executed. We believe that the IAASB does not intend for auditors that have transitioned to the full-scope ISAs to perform specific, additional procedures in the discrete area that has given rise to the need for the transition, but rather would require auditors to reconsider and possibly perform additional procedures across the audit as a whole, including in respect of other areas of the audit that have not driven the increased complexity that

underpins the need for transition. Since the requirements of the LCE ISA and the full-scope ISAs are closely aligned, but the IAASB has removed much of the application material in developing the LCE ISA, auditors would have applied these requirements as they considered appropriate when performing the audit in accordance with the LCE ISA and, therefore, we assume transition would involve re-considering all work performed with reference to the full-scope ISAs application material to fulfil the requirements in a more prescriptive way. We believe such an exercise would be extremely challenging, in practice.

We also refer to our comments elsewhere in this letter that over time certain auditors may no longer have sufficient knowledge and experience in dealing with full-scope ISAs. As a result, they may be less equipped to identify scenarios that would require transition. Furthermore, they may not have sufficient understanding of the differences between the LCE ISA and the full-scope ISAs to be able to design and perform audit procedures to appropriately transition. Since we believe these differences primarily reside within the application material, an auditor would need to have a very detailed/granular knowledge of the full-scope ISAs to be able to identify such differences. The IAASB itself acknowledges that firms using both sets of standards will need to have an understanding of the differences to be able to navigate this situation and perform any additional work necessary. As a result, such audits may need to be transitioned from one engagement team to another within the same firm, or even to a different firm/ auditor altogether if that firm/auditor normally only conducts LCE audits. This could present audit quality challenges as well as creating deadline pressures – especially if the circumstances driving the need for transition are identified late in the audit process. These challenges may also create pressures for the auditor to attempt to remain within the scope of the LCE ISA when this would be inappropriate.

We also highlight that transition could give rise to reporting challenges if the audit opinion for each year needs to refer to different auditing standards, for example, we believe an Other Matter paragraph may be necessary to provide explanation to users. The IAASB recognises that such a situation could arise and plans to issue guidance and illustrative reports to address these circumstances as part of implementation material.

We are also concerned that there is a lack of clarity regarding situations where a component may meet the criteria to be considered an LCE in accordance with this standard, and the component auditors would plan to use this standard when performing the statutory audit at the component, however, the group entity is not an LCE and the group auditor would need to use the full-scope ISAs. In this scenario, and in the absence of any GAAP differences, it is unclear, when the group auditor instructs the component auditor to perform an “audit” over the component financial information, whether it would be acceptable for the group auditor to use the work of the component auditor that is performed in accordance with the LCE ISA, and if not, what additional “top up” or transition work the group engagement team would instruct the component auditor to perform to enable them

to assert, at a group level, that they have conducted an audit in accordance with the full-scope ISAs. We understand this is under consideration by the IAASB.

The IAASB acknowledges that transition could be challenging, however, it does not discuss solutions in more detail, noting only that it envisages that such transition should be rare. Given the challenges involved, we recommend that the IAASB consider the implications in more depth and provide clear guidance to auditors regarding such a transition.

Finally, we highlight that the broadening of the scope of the standard, as the project has progressed, to include entities beyond those which were originally envisaged as falling within the scope of the standard, from the small and clearly not complex, to those further along the spectrum of complexity, i.e. which are *less* complex [emphasis added] but still may contain elements of complexity, and may not be small at all, may, as a result, also give rise to an increased likelihood of situations arising that require the auditor to transition out of the standard, to use the full-scope ISAs. We suggest, therefore, that the IAASB consider further restricting the intended use of the standard, within the authority section, to require the auditor to explicitly consider other potential sources of complexity in the audit, in addition to those already described therein by the IAASB, and/or to consider the establishment of size thresholds. Refer to our response to Question 3c. We believe this would substantially reduce the likelihood that a transition to the full-scope ISAs would be necessary.

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

We recommend that the IAASB provide clear guidance regarding what a transition is expected to involve, and how, from a practical perspective, this would be achieved. As we state above in our response to part a) of this question, we believe it would be very challenging, in practice, to execute a transition.

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

We recognise that the IAASB proposes to amend/update the LCE ISA periodically, when projects to revise the full-scope ISAs are undertaken, but with explicit consideration of conforming amendments to be made on a case-by-case basis. More urgent narrow-scope amendments would be made as needed. This approach recognises that the content of the standard is intrinsically linked with the full-scope ISAs, and would balance the need for a high-quality standard (with alignment of core requirements with the full-scope ISAs as far as possible, avoiding time differences between implementation/ effective dates, which could give rise to confusion) with the need for a stable platform whilst the standard is understood and implemented.

We support the IAASB's view in terms of striking an appropriate balance between ensuring the standard remains of a high quality, whilst maintaining a stable platform. We agree with their view that amendments to the full-scope ISAs are

usually aimed at issues that are frequently identified through inspections, which mainly occur at entities with significant public interest characteristics and which therefore have less relevance/urgency in terms of LCEs. However, we believe the standards should be converged and changes adopted concurrently, where reasonable, to avoid unnecessary confusion and to ease the burden on firms maintaining two sets of methodologies, training etc. Accordingly, we recommend that future EDs of full-scope ISAs are specifically considered by the IAASB in terms of whether conforming amendments should also be made to the LCE ISA.

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

We consider it appropriate that early adoption be permitted, consistent with the approach taken for the full-scope ISAs.

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

We recognise that the IAASB does not propose to include core requirements from the ISA 800 series in the LCE ISA, as the LCE ISA is aimed at “typical” LCEs that request an audit of a complete set of general-purpose financial statements.

We acknowledge the Board’s rationale regarding the ISA 800-series, however, we recommend inclusion of these core requirements, perhaps in the medium term, recognising that an entity may use a special purpose framework because it is a less complex entity and such a framework may be more suited to the users’ needs. Accordingly, we believe it would be helpful for the standard to include relevant requirements, however, we note that these could be set out within a separate section of the standard, to avoid clutter.

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.

We believe this question would best be answered by National Standard Setters (NSS) across different jurisdictions.

(b) Whether the proposed standard meets the needs of auditors, audited entities, users of audited financial statements and other stakeholders.

In addition to our concerns described elsewhere in this letter, our overall view is that, in terms of developing a more scalable solution for auditing an LCE, the approach taken to developing the LCE ISA, which essentially retains nearly all applicable ISA requirements other than for the ISAs scoped out by the authority criteria but eliminates much of the application material (including material relevant to LCE audits), is an opportunity missed. We believe that LCE auditors would

greatly benefit from clear guidance as to how to achieve compliance with ISA requirements in an appropriately scaled way for an LCE, e.g., how to approach risk identification and assessment, and through such guidance, have greater confidence that they can perform certain procedures differently/ to a lesser extent than for a more complex entity and/or to reduce related audit documentation. We believe that these key challenges have not been addressed in developing the LCE ISA, and instead, by removal of the majority of the application guidance, the auditors of LCEs will be required to develop their own interpretations in terms of how to comply with the requirements, which could lead to inconsistency in application and may have a detrimental effect on audit quality.

We note that a particular challenge that may disproportionately affect LCE auditors is a lack of clarity regarding the extent of documentation that is necessary to meet the requirement for this to be “sufficient” for an experienced auditor to understand. We believe that many auditors would welcome application material to address what are perceived to be overly burdensome/onerous documentation requirements for LCE audits, such as the extent to which auditors need to document judgements made and factors considered when obtaining an understanding sufficient to identify and assess the risks of material misstatement on an LCE audit.

Accordingly, we recommend that additional guidance be developed to provide further detail as to how requirements could be operationalised when auditing an LCE as opposed to a more complex entity, with worked examples including comparing and contrasting examples for audits conducted in accordance with the full-scope ISAs versus the LCE ISA. We also suggest that content from the IFAC *Guide to Using ISAs in the Audits of SMEs*, which is intended to explain fundamental principles and provide practical support, could be repurposed to help achieve this objective. We recommend that the IAASB consider this as part of their CUSP documentation workstream more fully.

Other Solutions to Address Scalability Challenges

CUSP Project and Proposal for Electronic Solution

We also encourage the IAASB to give significant focus to addressing the challenges of scalability through the separate IAASB CUSP project, and we consider that appropriate solutions developed following that project would likely be very useful to the audit profession, including auditors of LCEs.

In connection with this, we note that there are challenges in applying certain ISAs, in particular, in terms of their understandability/ application in practice across different entity types and engagement circumstances. Accordingly, whilst auditors of LCEs may face such challenges to a disproportionate extent, these challenges exist across the spectrum of size and complexity of the entity subject to audit and therefore we believe that optimal solution(s) will assist all auditors in addressing these important issues.

We highlighted in our response to the previous DP that we believe the development of an electronic solution would be the most helpful solution in terms of scaling the ISAs, especially for small auditors. We would like to re-iterate this point, especially given that the development of the LCE ISA appears to result in a very similar outcome to scaling of the full-scope ISAs for an LCE audit, at an objectives/requirements level, and in general the approach taken in developing this standard appears to have primarily involved removal of requirements that clearly would not apply to an LCE audit (e.g. listed entity requirements). We consider that an electronic scaling tool would also be able to achieve this form of scaling without the need for sophisticated functionality or significant professional judgement, as scaling would be based on factual gating questions, with binary yes/no answers. An electronic tool may also be capable of a significantly greater degree/specificity of scaling, as it could also exclude requirements that are conditional and are less likely to arise when performing an audit of an LCE, and only scale these in when the conditions which they are intended to address arise (e.g., audit procedures when non-compliance with laws and regulations is identified). It would also be able to scale the entire suite of ISAs, without the need for the removal of selected requirements that may be “proxies for complexity”, and, as a result, remove the need for a complex, and potentially subjective, set of considerations in terms of the authority/entry-point to the LCE ISA.

Other IAASB Standards - Education of Stakeholders

We also highlighted in our response to the previous IAASB DP that a consistent theme throughout the IAASB’s research at that time was that many regulators require an audit, and many users request an audit in the absence of such requirements, whilst finding this solution not to be cost-effective, and therefore creating fee pressure.

As we highlighted in that response, we continue to believe that the IAASB’s suite of auditing, assurance and related services standards currently supports a wide range of deliverables, which meet different user needs, ranging from a full-scope audit in accordance with the ISAs, through to non-assurance engagements such as compilations and agreed-upon procedures engagements.

As a result, we suggested in our response to the DP to explore in more depth as to why regulators require/user groups request an audit, and whether an alternative service performed in accordance with other IAASB standards may better meet their needs, in a cost-effective and efficient manner and we would like to re-iterate that recommendation here. We note that such standards are based on similar principles to those underlying the ISAs, as relevant, including ethical requirements, and pervasive principles such as the exercise of professional scepticism and professional judgement, and may therefore form a more appropriate basis to deliver services to LCEs as an alternative to an ISA audit. For example, they may provide a lower level of assurance than an audit, which may be appropriate to the users’ needs, e.g. a review engagement; provide a means to focus on a specific subject matter with either reasonable or limited assurance provided; or may involve

the performance of particular procedures which are agreed upon by the user and the auditor, in order to meet the user's needs. Such services could also be performed together, e.g. a review engagement with additional agreed-upon procedures to address particular matters.

Accordingly, we suggest that the IAASB work with others, e.g. regulators, National Standard Setters (NSSs) and others to explore user needs more fully and to educate user groups as to the availability of such other services and the value of these.

(c) Whether there are aspects of the proposed standard that may create challenges for implementation (if so, how such challenges may be addressed).

We have several concerns regarding implementation challenges which we describe elsewhere in this letter. Please refer, in particular, to our responses to Questions 1a), 3c), 7d), and 13.

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?

We do not have any additional comments to raise.

Section 4G - Approach to Consultation and Finalization

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

Please refer to our responses to other questions in which we recommend development of guidance regarding specific challenges/ areas of concern.

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.

We are not aware of any translation issues.

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.

We believe this proposed timeframe could be challenging, in particular, for firms which would need to develop two sets of methodologies, workflows, training processes, and which would need to implement ISQM 1 policies and procedures in connection with the two sets of standards. We therefore recommend a longer implementation period and would suggest a minimum of two years, whilst permitting firms which consider they are ready to use the standard to early adopt.

Section 5 – Group Audits

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.

We understand the IAASB’s basis for initially concluding that being a group is a proxy for complexity and therefore why it has excluded group audits from the scope of this ISA. However, we welcome the fact that the Board is open to including groups within the scope of the standard.

We propose that group audits be scoped into the LCE ISA, subject to the other qualitative characteristics that are proxies for complexity, as we believe there are groups that are not “complex”, with few components and which are located in a single jurisdiction, and exclusion of such groups from the standard may significantly reduce the population of entities to which this can be applied. We consider that much of the potential complexity in conducting a group audit, which ISA 600 is designed to address, is in connection with the use of component auditors, i.e., instructing them; being involved in their work; communicating with them, and reviewing their work.

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:

- (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?**
- (c) What common examples of group structures and circumstances within your practice would be considered a less complex group.**

As we note in our answer to part (a), we believe there are groups that are not “complex”, with few components and which are located in a single jurisdiction, and it is unhelpful to exclude such groups from the standard. We believe that exclusion of such groups from the standard may significantly reduce the population of entities to which this can be applied. We recommend that the IAASB perform outreach with the LCE Reference Group to obtain greater clarity regarding the population of groups which are otherwise LCEs.

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.

We believe that much of the complexity regarding ISA 600 is in connection with the use of component auditors, i.e., in assessing their competence and capabilities upfront, instructing them and communicating with them, being involved in their work, and evaluating their work.

Accordingly, we recommend that group audits be included within the scope of the standard, in accordance with IAASB's proposed Option 1 with a proxy for complexity that hinges on whether or not the group engagement team plans to request a component auditor to perform work on the financial information of a component. This would establish a clear boundary that scopes out group audits when component auditors would be used. Additionally, as we note earlier, there is likely to be differing interpretation and application of the LCE ISA, in practice, across different jurisdictions, which would be incompatible with the consistency in approach that would be required in order to perform a cross-border group audit.

However, we consider that group audits could be scoped in otherwise, subject to the other qualitative characteristics that are proxies for complexity. We suggest that these characteristics could also be strengthened in the standard to refer to examples of group-specific matters that are additional "proxies for complexity" and which underpin decisions by group auditors to use the work of component auditors, such as the number of components; location of operations; whether components are located in jurisdictions which have different language, culture, business practices and fraud risks; the complexity of the consolidation (judgments with respect to boundaries of the group, cross holdings, foreign currency translation, hedging, transfer pricing, complexity with intercompany transactions and eliminations) etc. Such strengthening to drive appropriate application would be expected to address any concern that auditors may attempt to avoid use of component auditors simply to stay within the scope of this standard. Under this approach, the material to include regarding group audits would be relatively limited as it would not address component auditors, and therefore would avoid adding to the length of this standard unnecessarily.

We would be concerned that option 2, whilst allowing for more flexibility, as many factors affect the complexity of a group audit and these will vary between group audits, would involve greater use of professional judgement by users of the standard, with consideration of qualitative factors being more subjective. This could lead to inconsistency in practice. We also note that all core requirements of ISA 600 would need to be included in the LCE ISA, which would drive increased length of the standard.

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?

We believe the options presented by the IAASB are the most appropriate ways to incorporate group audits within the scope of the proposed standard. Please see our response to question 24 which sets out our suggestions to enhance the “proxies for complexity” specifically in respect of group audits.

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.**

We suggest that the requirements be included throughout the standard, in line with the overall flow of the standard, which would be consistent with the approach taken for the standard as a whole and would therefore ensure that material is more directly accessible and user-friendly. We highlight that this approach is facilitated by using “Option 1”, hinging on whether or not component auditors are used since the material for inclusion within the LCE ISA would be limited, given that most of ISA 600 is designed to address the involvement of component auditors.

We suggest that the group audit material that is interspersed throughout the LCE ISA be distinguished from other content of the LCE ISA, e.g. by inclusion in separate boxes, for ease of use by auditors who are not auditing a group.

Appendix 3 – Example of Difference in Application Material Between LCE ISA and Full-Scope ISAs

Materiality

ISA 320 application material provides context and guidance regarding the concept of materiality and how to apply this. For example, A1 explains how this relates to audit risk and when the concept is applied during an audit; A4 describes the use of benchmarks in determining materiality, as well as examples of factors that may affect the identification of an appropriate benchmark; A9 addresses considerations specific to smaller entities when profit before tax may be nominal because an owner takes much of the profit before tax as remuneration and therefore a benchmark of profit before remuneration and tax may be more appropriate; A11 discusses materiality level(s) for particular classes of transactions, account balances or disclosures, and A13 describes the concept of performance materiality, the concept of aggregation risk and how performance materiality reduces aggregation risk to an appropriate level.

The LCE ISA contains much more limited guidance, with only very high-level context regarding the concept of materiality; it does not describe the factors that may affect the identification of an appropriate benchmark; it does not discuss the considerations for smaller entities; it does not provide any guidance regarding materiality level(s) for particular classes of transactions, account balances or disclosures, and it only states that performance materiality should be set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected amounts exceeds materiality, without any further guidance, including the clarification set out in ISA 320 that this is not a simple mechanical calculation and that it involves professional judgement.

Accordingly, without the additional context, clarification and guidance provided by the application material set out in the full-scope ISAs, we are concerned that inappropriate decisions in respect of materiality and performance materiality could be made when performing an audit in accordance with the LCE ISA. We note that aggregation risk may actually be higher in respect of a less complex entity as a result of a less sophisticated and robust control environment. We also note that without an adequate framework to guide the considerations made in determining materiality and performance materiality, decisions may not be appropriate.