

International Auditing and Assurance Standards Board
529 Fifth Avenue
New York, NY
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31 January 2022

Dear Sirs

Response Letter: Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities

PKF International Limited (“PKFI”), administers the PKF network of legally independent member firms. The PKF International network consists of member firms operating in over 100 countries providing assurance, taxation and business advisory services. PKF International Limited is a member of the Forum of Firms and is dedicated to consistent and high-quality standards of financial reporting and auditing practices worldwide. This letter represents the observations of PKF International Limited, but not necessarily the views of any specific member firm or individual.

We welcome the opportunity to comment on the International Auditing and Assurance Standards Board’s (IAASB’s) Exposure Draft International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ED-ISA for LCE). We are supportive of the IAASB’s efforts to respond to the needs of LCEs and the users of their financial statements by addressing the complexity, understandability, scalability and proportionality in the ISAs as they relate to LCEs audits. We agree with the IAASB that there is an urgent need for the development of a standards which addresses these needs.

As noted in the general comments section of Appendix 1 to this letter, we have a concern over the potential for an expectation gap which could develop following the publication of the proposed standard. In our view, there is a risk that users of the ED-ISA for LCE and other stakeholders in an LCE audit may form unrealistic expectations that the application of the ED-ISA for LCE will result in greater efficiency gains in the audit process than may be achievable in practice. We believe that the IAASB should respond through carefully designed learning resources and application guidance which have a specific focus on managing this potential expectation gap.

Our individual responses to the IAASB’s request for comments are set out in Appendix 1. We would like to thank the IAASB for the considerable efforts and wide-ranging consultation process undertaken in developing the exposure draft.

Yours faithfully



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Appendix 1

Request for comments

General Comments on Proposed ISA for LCE

While we are supportive of the need for a standard that is dedicated to LCE audits, and are generally supportive of the ED, we have a concern about the risks of an expectation gap which could arise following the publication of the proposed standard.

The ISAs have continued to develop over several years. During this period many constituents of the LCE audit community (including LCEs, their owners and investors, their employees, and their auditors) have developed a perception that, in context of an LCE audit, the ISAs can be overly complex and are disproportionately onerous compared to the level of audit work which should be sufficient and appropriate to be able to form an audit opinion on certain LCE engagements. Such a perception may be particularly evident where LCE audits are toward the simplest end of the scale of complexity.

In our view, there is a possibility that the approach taken to design the ED-ISA for LCE may not have produced a standard which is sufficiently different to the ISAs to satisfy the needs and expectations of such stakeholders – in other words, the proposed standard does not go far enough to help reduce the burden of the effort required to complete the simplest, most straightforward, and lowest risk audits. There is a potential for prospective users of the ED-ISA for LCE and other stakeholders in an LCE audit, to assume incorrectly that the application of the ED-ISA for LCE will result in greater efficiency gains in the audit process than may be achievable once the final version of the standard is issued and applied in practice.

It is our view that if this potential expectation gap is not anticipated and properly addressed it will ultimately contribute to an erosion in the quality of audit engagements performed under the scope of the proposed standard.

We understand the IAASB's position for the decisions that have been made in developing the structure and overall approach to the ED-ISA for LCE, and we do not propose any fundamental changes in our response letter in relation to this specific concern. However, in response to the potential risk of an expectation gap we encourage the IAASB to develop learning resources and application materials and provide these as part of its communications and roll-out strategy for the final standard. Such materials and resources should include a specific focus on managing expectations through clear articulation of:

- the major differences and the similarities between applying full ISAs versus the ED-ISA for LCE, and
- how the differences affect both the overall scope of an ED-ISA for LCE engagement, and the audit effort required to complete it.

Specific Questions

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?

Response:

We agree that the ED-ISA for LCE should be presented as a standalone standard.

(b) The title of the proposed standard.

Response:

We agree the words “entity” and “complex” both have relevance to the overall scope and objectives of the standard. However, regardless of their relevance, in our view these words are not sufficiently precise in context of the broader nature of the standard. Consequently, they may cause some users to infer that the standard has a narrower scope than it actually does.

Complexities which affect an audit may arise from the wider circumstances of the engagement as a whole, rather than exclusively arising from the entity. This point becomes more relevant when considered in conjunction with the responses we have provided on the Authority of the standard (see Question 4 below). For example, in our view a first-year audit can create additional complexity and could be a relevant circumstance to consider when setting the scope of the standard. Furthermore, a first year-audit is a circumstance which is not directly connected to the audit entity, rather it is a feature of the broader engagement circumstances.

Similarly, we note that the scope of the standard, as currently presented, is not driven exclusively by considerations of complexity. For example, when applying the Authority of the standard the auditor will also consider the level of public interest of the entity regardless of the level of complexity from the entity.

The phrase “less complex” infers a relative scale of complexity, but it begs the question “less complex than what?”: The title provides little indication to the user as to where about on the scale of complexity the standard is intending with the phrase “less complex”. This is an important point because many entities and their auditors can have strongly held views that the entity’s audit is “less complex” and based on their interpretation of “less complex” they may simply assume that the ED-ISA for LCE can validly be applied.

The concerns we have with using the words “less complex entity” are compounded by the absence of a definition of the phrase “less complex entity” within the proposed standard or within the glossary to the proposed standard.

In our view, the title of an ISA should be precise and should convey a clear indication as to its scope. The accuracy and pertinence of the title is particularly necessary in conveying useful information to first-time users of the standard. In our view, a more precise and apt title could more accurately convey the full nature and scope of the proposed standard.

Should “Less Complex Entity” continue to be applied in the title of the proposed standard, we encourage the IAASB to consider including this term within the glossary to the proposed standard, which could be an opportunity to clarify more precisely what is meant by the phrase.

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

Response:

We have no further comments on 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?

Response:

We have no matters to note on this point.

Section 4B – Authority of the Standard

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?

Response:

In our view the Authority is implementable.

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

Response:

In our view, the judgements needed to apply the qualitative characteristics, as set out in the Authority, will lead to inconsistencies in application among users of the proposed standard. To help reduce this risk, the IAASB could consider a longer list of prohibitions and reduce the list of qualitative characteristics.

In developing a longer list of prohibitions, we recommend that the IAASB also consider criteria that go beyond the complexity associated with the entity to recognise that the wider complexities affecting an audit engagement can arise from the broader nature of the engagement itself (as we have suggested elsewhere within this response).

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

Response:

In our view, specific areas within the Authority which are not clear are as follows:

Changes subsequent to acceptance and continuance (transition to full ISAs)

We are concerned that there is insufficient requirements and guidance on how to apply the Authority in the scenario where there are relevant changes to the circumstances or conditions of an audit engagement subsequent to the performance initial engagement activities including the acceptance or continuance procedures. Specifically, we are concerned that the user of the standard is not provided with any guidance in the Authority as to the implications and consequent requirements if subsequent changes in conditions would necessitate the user to transition the engagement from the ED-ISA for LCE to the full ISAs.

In our view Section A would benefit from the inclusion of enhanced guidance and requirements on how the engagement team should consider and respond to changes in circumstances and conditions which are identified subsequent to the performance of engagement acceptance or continuance procedures, including specific guidance on the need to transition to the ISAs and how the auditor should approach the transition.

We note that the Explanatory Memorandum to the ED-ISA for LCE includes references to the term “transition” in the context of the circumstances which would cause an auditor to need to switch from the proposed standard to the full ISAs. In our view, the main body of the proposed standard could incorporate similar wording as guidance or preferably as an explicit requirement.

Paragraph A.5 (Specific Prohibitions)

Paragraph A.5 within the Specific Prohibitions of ED-ISA for LCE does not appear to serve a clear purpose of its own and, in our view, it may result in confusion.

Paragraph A.5 specifies that entities that have public interest characteristics could embody a level of complexity in fact or appearance and are specifically prohibited from using the [draft] ISA for

LCE. Within the Specific Prohibitions section of Part A there is no apparent explanation on the relevance of A.5 to the requirements of paragraph A.7 which, in our view, will cause confusion as to how users should apply the requirements in A.5 in context of applying the requirements of A.7.

There is no cross-reference back to paragraph A.5 elsewhere within ED-ISA for LCE, which leaves the paragraph hanging within this section of the Authority without a clear indication to the user as to how to interpret and apply it.

Given the clear functions and the self-contained nature of paragraphs A.7 and A.6 we believe there is a risk that Paragraph A.5 is redundant to this section's overall purpose of setting out the specific prohibitions of using ED-ISA for LCE. This problem is compounded by the lack of any further direct explanation or definition in the main body of the proposed standard by the term "public interest characteristics" which is used in paragraph A.5.

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

Response:

In our view, the Authority, as currently drafted, will achieve the intended objective of appropriately informing stakeholders about the scoping of the proposed standard.

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

Response:

We have no comments on whether the proposed role of legislative or regulatory authorities or relevant local bodies with standard setting authority in individual jurisdictions is clear and appropriate.

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

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

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

Response:

Further to our comments in 3(b) above, there are four additional scenarios which we believe the IAASB should consider for possible inclusion as a specific prohibition in ED-ISA for LCE:

1. The engagement is a first-year audit of the entity
2. The audit engagement team determines that it needs to use the work of an auditor's expert
3. There is a material uncertainty over going concern (including where identified as part of the initial engagement activities)
4. The engagement requires an Engagement Quality Control Reviewer

Each of 1 – 4 above are common matters which we expect will affect many engagements performed under the proposed standard. Each would lead to additional complexity for an audit, including complexity in terms of the underlying circumstances and conditions of the audit, as well

as increased complexity due to the additional audit procedures and audit file documentation that will be necessary to respond to each of these circumstances.

On item 1 above - for a first-year audit, there may be complexities affecting the entity and the audit which are not fully apparent to the engagement team until an audit has been completed. In our view, it would be appropriate to restrict the use of ED-ISA for LCE on a first-year client engagement until at least one audit engagement has been performed for that entity. Such a delay should enhance the engagement team's ability to form an appropriate understanding of the circumstances affecting the complexity affecting the engagement.

On item 2 above - our concern is that the need to utilize an auditor's expert may demonstrate that the engagement causes a level of complexity which exceeds the core competencies of the engagement team. The additional audit effort and documentation requirements in such a circumstance also add to the overall level of complexity of the engagement.

On item 3 above – where a material uncertainty due to going concern has been identified during the audit process, there is a significantly higher likelihood of more complex procedures being required, including review of forecasts and estimates, a deeper level of understanding of funding and loan covenants and greater levels of judgement and scepticism will likely need to be applied.

On item 4 above – where a firm has appointed an Engagement Quality Control Reviewer (EQCR) to an engagement, this can be indicative of a higher level of complexity in the audit engagement compared to other audit engagements which don't require appointment of an EQCR.

5. Regarding the Authority Supplemental Guide:

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

Response:

The Authority Supplemental Guide is helpful in understanding the authority. However, the extent of the volume of detail in the guide highlights that the qualitative characteristics set out in the Authority require the application of significant judgement. We note that no other ISA has such lengthy guidance to explain its scope: it seems unfortunate that an auditing standard on the audit of a less complex entity, should have a more complex scope than any other ISA.

Assuming that the IAASB does not make any significant changes to the qualitative characteristics set out in the ED-ISA for LCE, in our view the guide will still be a helpful way for users of the standard interpret the qualitative characteristics and it will help to promote a level of consistency in the standard's application. Notwithstanding the helpful nature of the Supplemental Guide, our concern remains that the qualitative characteristics, as currently presented, will still cause a degree of inconsistency of application of the proposed standard.

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

Response:

There are no other matters that we suggest 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?

Response:

We have no other comments in this regard.

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).

Response:

We generally support the approach taken to incorporate the ISA requirements in the proposed standard.

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

Response:

We support the approach taken on 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).

Response:

We support the principles applied in relation to professional scepticism and professional judgement, relevant ethical requirements and quality management.

- (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.

Response:

We are generally supportive of the approach taken on EEM.

However, with regard to point (iii) above, in our view each EEM paragraph should be assigned a paragraph reference number. We agree that the current approach of shading the EEM paragraphs in blue is somewhat helpful. However, the contents of the proposed standard will be even easier to search for, and to make reference to (for example, within audit programs) if each EEM paragraph were provided with a unique reference number.

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).

Response:

We support the overall design and structure of ED-ISA for LCE.

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.

Response:

We do not have any comments regarding the completeness of the content in parts 1 through 8.

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.

Response:

We are in agreement with each of these aspects of Part 9.

11. With regard to the Reporting Supplemental Guide:

- (a) Is the support material helpful, and if not, why not?

Response:

The Reporting Supplemental Guide is helpful.

- (b) Are there any other matters that should be included in relation to reporting?

Response:

We have no further comments on this point.

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.

Response:

We have no further comments on this point.

Section 4F – Other Matters

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?

Response:

Please see Question 3(c) above for our comments on Transitioning to the ISAs.

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

Response:

We do not believe significant support materials are required to address the matters we have raised. However, we do encourage the IAASB to consider including additional requirements or EEM to help address the matters we have noted in response to Question 3(c) above.

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

Response:

We agree with the proposed approach to the future updates and maintenance of the Standard and related supplemental guidance.

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

Response:

In our view, early adoption should be allowed for any subsequent revisions to the standard, once effective, early adoption.

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

Response:

In our view, a separate Part on the ISA-800 series should not be included within ED-ISA for LCE as the types of engagements to which the ISA-800 series applies have the potential for increasing the complexity of the underlying engagement.

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.

Response:

In our view, the proposed standard will be used in the majority of jurisdictions in which our member firms operate.

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

Response:

In our view there will be an expectation gap, particularly for those entities that are very small and with a very limited degree of complexity. We set out further comments on our concerns about the expectation gap in our 'General response' above.

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

Response:

In our view, the key challenges to implementation of the proposed standard will include:

- how users interpret and apply the Authority (see our response to Question 3 above); and
- how users identify any changes in circumstances of the audited entity or the engagement which may result in the ED-ISA for LCE no longer being the appropriate standard to use for the engagement and which may necessitate transition to full ISAs (see our response to Question 3(c) above).

In our view, the key challenges for the above areas will arise from their inconsistent application by users of the standard.

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?

Response:

We have no further comments to make.

Section 4G - Approach to Consultation and Finalization

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

Response:

In our view, a range of learning webinars similar to the IAASB's recent series of Quality Management webinars would provide useful support. A Frequently Asked Questions document would also be helpful.

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.

Response:

We have no comments on this point.

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.

Response:

In our view, 18 months is an appropriate period between the approval date of the final version of the standard and its effective date, particularly if early application is permitted.

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.

Response:

In our view, group audits should be excluded from the scope of the ED-ISA for LCE.

Group audits create additional complexity in several areas of an audit which would not otherwise be present in a non-group audit. In our view, if the IAASB were to consider publishing ISA requirements on group audit in context of a less complex audit engagement, we would encourage the IAASB to consider the benefits of a stand-alone ISA for less complex groups. In our view, a separate ISA for less complex groups could form a complimentary suite of “Less Complex ISAs” alongside the ED-ISA for LCE.

We believe that further time and due process is required in order to properly develop an appropriate ISA for Less Complex Groups. If the IAASB does proceed with an ISA for Less Complex groups, we would encourage the IAASB to publish the final ISA for LCE in the meantime, with group audits being excluded from its scope.

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?

Response:

We anticipate that PKF member firms will use the standard if group audits are excluded.

- (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?

Response:

We do not have accurate data to share on point (b) covering the PKF network.

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

Response:

We do not encourage the IAASB to include any form of group audit within the scope of the proposed standard. However, if the IAASB does take such an approach we believe the following features should be apparent in a less complex group:

- the group audit engagement does not require a component auditor,
- the preparation of the individual financial reporting information for all group entities is a direct responsibility of the group parent entity,
- all component entities use the same functional currency,
- all group entities are located within the same jurisdiction of the group parent entity, and
- the group entities do not meet any of the other specific criteria and qualitative prohibitions in the Authority of the proposed standard.

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.

Response:

Please see our response in 22 above for our preferred method of presenting ISA requirements on audits of Less Complex Groups within a stand-alone ISA.

Notwithstanding this preference, in our view option (a) above, would lead to more consistent application of the group audit requirements, with option (b) being the more likely of the two options to be susceptible to varying interpretations in the exercise of the auditor's judgement.

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?

Response:

Please see our response to 22 above, which summarises our preferred method of presenting ISA requirements on audits of Less Complex Groups, within a separate ISA.

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.

Response:

In our view, neither option above is preferable. Please see our response in 22 above, which summarises our preferred method of developing ISA requirements for less complex groups.