

Via IAASB website

**EXPOSURE DRAFT, PROPOSED INTERNATIONAL STANDARD ON AUDITING
OF FINANCIAL STATEMENTS OF LESS COMPLEX ENTITIES**

**A CONSULTATION SUBMISSION FROM
THE ASSOCIATION OF PRACTISING ACCOUNTANTS**

Introduction

We welcome the opportunity to respond to the exposure draft, Proposed International Standard on Auditing of Financial Statements of Less Complex Entities issued by the IAASB.

The Association of Practicing Accountants is a group of 19 leading professional service firms with a combined turnover of £600m of which £125m comes from audit fees. We advise and audit well over 14,000 businesses across the real economy from SMEs to the AIM market as well as PIE's. Our clients are major employers and drivers of growth.

Although we welcome the exposure draft, we are concerned there is insufficient difference in these proposals to current International Auditing Standards to warrant firms to adopt in a number of cases – particularly given the additional costs to develop audit methodology tailored to the standard and provide additional training etc. The exclusion of groups is also likely to deter firms from adoption, particularly in the UK, where there are a number of group companies, which might otherwise fall into the category of less complex entity.

In our opinion, a bottom up approach which examined what audit work needs to be completed for a good quality audit of a less complex entity rather than which requirements from the existing standard could be dropped, may have yielded a better outcome – not least because it is harder to justify removing requirements than adding them. That said we are supportive of anything that makes progress here and see the proposal as a step in the right direction.

Over the years the main auditing standards have become significantly more complex with many additional requirements. A lot of these changes were made to address issues that had been identified on audit failures of public interest entities without adequate consideration given to the impact on the audits of non-PIEs and in particular less complex entities.

Current International Auditing Standards are not scalable or proportionate for the audits of less complex entities as there are a significant number of requirements that relate to a regulatory environment which is focused more on more complex or listed entities. As a result audit firms spend time on LCE audits documenting why certain requirements are not applicable and considering points which do not impact or add value to the audit. This leads to a checklist mentality that is neither proportionate to the entity or a good driver of audit quality.

The proposed LCE Standard is significantly shorter, however this is due to the removal of the guidance as the actual requirements are very similar to the main

ISAs. That means the proposed new Standard is unlikely to significantly change the audit methodology or volume of work required. Moreover this lack of guidance means that in some areas there is a lack of clarity around what is intended.

We like the fact that it is a self-contained Standard, but it should also incorporate the ethical standard as applied to LCE's as well, even if certain jurisdictions want to add further requirements.

There may be some benefit to this standard in a number of years if a careful review is undertaken so that changes to the main standards are not automatically adopted within the LCE standard. The LCE standard should only be changed where there is a justification that the requirements will improve the quality for an audit of an LCE.

In summary, we are supportive of the idea but do not believe the IAASB have fully considered the requirements of an LCE when drafting this Standard. There are a number of key changes that the IAASB need to address that will make it more relevant and therefore more likely to be adopted by firms. Key points to note here include removal of the exclusion of groups and reducing work in regard to risk assessments and systems and controls. We believe the IAASB can address these points and still issue the Standard so that vital momentum is not lost here. Feedback can then be used to drive further improvements and revisions over time.

We have included our specific responses to exposure draft questions below:

Specific Questions

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

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: It makes sense for the standard to be standalone, and hopefully will ensure that there is not scope creep from regulators in individual jurisdictions through "best practice" requirements which do not form part of the standard itself. However, the authority needs to be clearer as to when this standard can be applied as the standalone nature of this standard does make transition very difficult during an audit if complexities were to arise which meant this standard may no longer be appropriate.

- (b) The title of the proposed standard.

Response: This seems appropriate.

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

Response: There are some concerns based on this current draft that it will create a further divide in the audit profession, but with little benefit. Although the standard is significantly shorter, as

noted in our introduction, this is mainly as a result of the removal of guidance rather than requirements. This will not significantly change the work involved but could increase the costs for firms in having to purchase two different methodologies and provide additional training etc.

There is also a risk that the main standards become more prescriptive and expensive when trying to address quality issues with PIEs and other larger entities because there is no longer a need for a one size fits all approach which has been a constraining force here.

This standard may be more beneficial over time if future changes to the main ISA's are not automatically adopted within the LCE standard. Additional requirements should only be added where there is a clear indication that they address an audit weakness relevant to the audits of less complex entities.

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: These amendments seem reasonable based on the current drafting of this standard.

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: The authority as presented could be implemented, however there are a number of concerns that will impact implementation. These are discussed in more detail in our responses below but the key areas are:

- The exclusion of all groups is inappropriate and will impact firms using this standard (see further details below)
- Concern that the authority is not sufficiently prescriptive and therefore open to different interpretations between firms and regulators.

The guidance needs to be very clear and provide specific examples as to when it would be appropriate to use the draft Standard and when not. Otherwise the risk is it becomes too time consuming at the planning stage to ensure you have categorised whether it was appropriate to use it or not – something that will deter people from adopting the standard i.e. if you end up having to switch between this standard and the main standards it will increase the time and cost, as firms will need to redo engagement letters, revise fee quote, reconsider planning etc.

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

Response: There is the concern that the market place will perceive this as a lower quality product or that it will significantly reduce the work involved, when in reality neither is the case. This could lead to clients having an unrealistic expectation that this will be a significant reduction in cost leading to an expectation gap in the market.

This could lead to a two tier profession and make it more difficult for auditors to move from firms that may only audit LCE's. In addition, there is insufficient information as to whether the different software providers will be able to provide for the two different systems as well as enabling firms to switch easily from one method to the other if an entity was to move from being less complex to complex.

This will lead to additional training and methodology costs for firms which will ultimately have to be met by their clients.

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

Response: It is unclear whether pension scheme audits would be able to apply this standard as they may fall within the definition of – “an entity whose function is to provide post-retirement benefits”. A number of small pension scheme audits within the UK would be less complex and should not be excluded from adopting this standard.

There are also a number of instances within the qualitative characteristics where the wording is contradictory / confusing - we have provided some examples below:

Paragraph A8 starts by explicitly stating that using the LCE standard would be inappropriate if an entity exhibits the bulleted characteristics, but ends by stating that the bullets are merely indicators of, or proxies for, issues the ISA for LCE was not designed to address. It is also unclear whether the two bullets in this paragraph are to be taken together or individually (worth inserting ‘and’ or ‘or’ after the first bullet).

Paragraph A9 also starts by explicitly stating that the ISA for LCE is inappropriate if an entity exhibits one or more of the characteristics listed, but ends by saying that each of these characteristics may on its own not be sufficient to determine whether ISA for LCE is appropriate or not, and also that the presence of one characteristic exhibited by an entity does not necessarily exclude the use of ISA for LCE for that entity.

In A9, at the 7th bullet point it refers to “complex methods” with accounting estimates. There could be a number of different interpretations of the types of accounting estimates which would meet that definition, as different firms / audit engagement partners may classify “complex methods” differently. Something that may be seen as complex to one audit partner may seem less complex to someone who specialises in a particular area.

It is also unclear whether this standard could be adopted for charities and academies based on the current drafting e.g academies usually have defined benefit pension schemes.

There can also be accounting estimates which have a higher degree of uncertainty, however we do not believe that in itself should mean that this draft standard could not be applied. Although there is the supplementary guidance that has been issued there would be real merit in more specific examples, for instance on investment property valuation, or share option schemes, defined benefit pension schemes - some very simple companies may have these.

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

Response: No. We do not believe that it is sufficiently informative for stakeholders, who need to understand its implications. At the moment the draft remains unclear in a number of areas as highlighted earlier in our response.

(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: Yes. Although there seems to be a reluctance on the part of the UK regulator to engage on this and it is therefore unclear as to whether it will be an option within the UK and if what thresholds might be introduced.

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: As previously noted we do not think that groups should be excluded. There are a number of less complex groups within the UK including charities with trading subsidiaries, and simple group structures where you have a holding company and a number of less complex subsidiaries.

As noted above the qualitative characteristics are not clear enough and therefore could lead to challenge from regulators.

Audit clients could see this as a way of reducing audit costs and therefore may push to use this standard when it may not be appropriate. Its intended scope needs to be made very clear so they auditors and their clients can understand when it can and cannot be used.

Key areas as noted above is around the accounting estimates.

5. Regarding the Authority Supplemental Guide:

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

Response: The guide is helpful but could be improved with more specific examples – at the moment it will be difficult to be able to document the justification for the use of this standard,

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

Response: Specific examples for accounting estimates.

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: Nothing specific to add here.

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: In our opinion, a bottom up approach which examined what audit work needs to be completed for a good quality audit of a less complex entity rather than which requirements from the existing standard could be dropped may have yielded a better outcome – not least because it is harder to justify removing requirements than adding them. This has meant that some requirements which are not relevant to a quality audit for an LCE are still included. As a result there is often insufficient difference between the requirements of the main standards and the LCE standard which will deter a number of firms from adopting it.

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

Response: Generally the objectives are clear.

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

Response: It would be improved if the ethical standard as appropriate to LCE audits were fully included within the standard. Local jurisdictions could add additional requirements, but within the acceptance stage the main requirements which should always be considered in regard to independence should be included.

- (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: Nothing specific to add here.

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: The structure of the standard is easy to follow and is generally logical, however the language could still be improved. A lot of the guidance has been removed which will need to be developed. The complexity of the mapping documents means that they are not that easy to follow when trying to get from the LCE to the ISA's. Generally, it should be written in a more positive way with less risk of ambiguity and interpretation.

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: Acceptance – as noted above the key ethical requirements should be included within this standard.

Risk Assessment – there are still a number of requirements which are left within this standard which are not relevant to less complex entities. For example less complex entities will not carry out or consider the same level of risk assessments.

The requirements on systems and controls could also be simplified and reduced for those not seeking to rely on them which will be the case for most less complex entities. We agree you need a level of understanding of the system to determine the best audit approach, however you do not need detailed understanding of the controls when not seeking to rely on them.

Insufficient consideration has been given to reliance on service providers, in particular the use of type 1 or 2 reports which can be beneficial to a number of LCE audits.

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: Overall this section seems to be more complicated than may be needed, particularly in relation to the audit report.

11. With regard to the Reporting Supplemental Guide:

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

Response: Nothing specific to add here.

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

Response: No other matters we wish to raise on this matter.

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 would observe that in Part 8 there is little difference in practical terms in relation to the audit work to be undertaken and therefore little incentive to drive adoption.

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: This will depend largely on how software systems will be able to cope with transitioning. It should be possible but some less flexible software systems may make this more difficult to implement. To manage this risk there needs to be a wider discussion with a number of alternative well established software providers to look at the practical implications of the standard and how these might be addressed.

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

Response: Specific details of what exactly firms will be required to do if there is the requirement to transition from the LCE standard to the main ISA's.

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

Response: Yes every three years would give sufficient time to properly consider whether the amendments need to be made to the LCE standard and ensure only appropriate changes are adopted. This will also necessitate an upto date transparent and publicly available mapping document which show the differences between the LCE and main ISA's.

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

Response: Yes early adoption should be allowed.

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

Response: We think this should be considered over time and added. Within the UK we do report under ISA-800 for a number of LCE's and therefore for this to be an option would be beneficial.

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: The regulator in the UK has been quite negative in regard to this standard and therefore there is concern as to whether we will be able to implement it. We are also concerned that the IAASB needs to make it clear that this standard is still robust and provides a good quality audit but is tailored to LCE's i.e. this is not about a reduction in audit quality. With the current focus on audit quality in the UK and in particular the need to shore up the current audit model there is a risk that this standard could be seen as going against the grain unless there is clear communication and support from the regulator.

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

Response: At the moment it does not fully meet our needs. It has not been tailored sufficiently for LCE's as there are still too many requirements which are not relevant to the audit of an LCE. Therefore it is difficult to justify the costs of implementation. However this may change over time, in that if care is taken when amendments are made to the full ISA's these are not automatically introduced within the LCE standard increasing benefit from adoption could accrue over time.

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

Response: The key areas are the regulatory support and also clarity around the authority as to when this standard can be used for a particular audit. Other challenges are likely to arise in regard to the methodology providers and software providers and how easy it would be to move from LCE to full ISA's if required.

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: Communication with stakeholders, making it clear this is not about reducing work or quality but about having a standard which is tailored towards less complex entities will be important. It will also be important to ensure effective guidance on when it is appropriate to use the standard / when an audit client should transition to the existing standards.

Section 4G - Approach to Consultation and Finalization

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

Response: As noted earlier clearer guidance on the authority of the standard. Clearer notes on the differences between the LCE and the IAS's.

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: Nothing specific to add here.

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: This approach seems appropriate, as a minimum time

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: Group audits should not be excluded. The firms within the APA audit a number of groups where the parent and all of the subsidiaries individually would meet the definition of being less complex and where the consolidation is not complex therefore it doesn't make sense to exclude all groups from using this standard.

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: If groups are excluded it will impact firms' decisions as to whether to adopt this standard, as inadvertently it may also impact on whether they would adopt it on subsidiaries within the group if they had to consider whether that created extra work for the group audit. In order to use this standard firms will need to be comfortable that there will be sufficient numbers of clients that they can apply it to and that it is sufficiently different from the main ISA's to justify the extra indirect costs in terms of audit methodology and training etc.

(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 are unable to capture a reliable figure.

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

Response: Where the different entities within the group all meet the characteristics of less complex entities including:

Parent company with trading subsidiaries – just different trades, or working in different areas.

Charity with trading subsidiary.

Entities which are less complex and are all audited by the same firm (no component auditors).

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: As noted above this should be adopted where all of the different entities within the group meet the existing definition of being less complex, and there are no particular complexities for the consolidation.

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: Nothing specific to add here.

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: We would prefer option (a) - having them within a separate part but being clear as to what is required at the various different stages of the engagement process and ensuring requirements are only included where they are relevant to less complex groups should yield a better outcome.