

January 28, 2022

International Auditing and Assurance Standards Board

To: Mr. Thomas R. Seidenstein (Chair)

529 Fifth Avenue

New York, NY 10017

USA

Subject: Comment on the IAASB Proposed International Standard on Auditing (ISA) for Audits of Financial Statements of Less Complex Entities (LCE)

Dear Mr. Seidenstein,

1. The International Forum of Independent Audit Regulators (IFIAR) appreciates the opportunity to comment on the International Auditing and Assurance Standards Board (IAASB) request for comments on its Exposure Draft, Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE or Exposure Draft). As an international organisation of independent audit oversight regulators that share the goal of serving the public interest and enhancing investor protection, IFIAR is committed to improving audit quality globally through the promotion of high-quality auditing and professional standards, as well as other pronouncements and statements.
2. IFIAR's objectives are as follows:
 - Sharing knowledge of the audit market environment and practical experience of independent audit regulatory activity, with a focus on inspections of auditors and audit firms.
 - Promoting collaboration and consistency in regulatory activity.
 - Initiating and leading dialogue with other policymakers and organisations that have an interest in audit quality.
 - Forming common and consistent views or positions on matters of importance to its members, while considering the legal mandates and missions of individual members.
3. The comments we provide in this letter reflect the views expressed by many, but not necessarily all the members of IFIAR. However, the comments are not intended to include, or reflect, all the views that might be provided by individual members on behalf of their respective organisations.
4. Where we did not comment on certain specific matters, this should not be interpreted as either approval or disapproval by IFIAR.

Overarching comments

5. In the letter issued by IFIAR in September 2019 regarding the LCE project, we acknowledged that auditors of LCE have often cited challenges they face in the application of ISAs. We encouraged the IAASB to identify the reasons behind the challenges and substantive issues that led to dissatisfaction among auditors. Based on the Exposure Draft, it remains unclear how the IAASB concluded that the issuance of a separate standard for the audits of LCE is necessary.
6. The creation of a separate standard for LCE that aims to provide the same level of assurance may cause more confusion among auditors and users of financial statements. One of our main concerns is that it could lead to an increase in the expectation gap while decreasing confidence in audits. Some examples include:
 - Whether applying the ISA for LCEs will always result in a consistent level of assurance as compared to applying the full suite of ISAs for non-LCE entities.
 - The standard may create the perception that two different audit categories exist, with different levels of assurance, therefore fragmenting the audit market.
 - The proposal in the Exposure Draft to issue an opinion by reference to the use of ISA for LCE, and not by reference to the use of ISAs, raises additional questions with regards to the value of the opinion(s).
7. The longstanding premise of the ISAs has been that the standards are scalable. The issuance of a separate standard for the audits of LCE is a contradiction of this longstanding premise.
8. The background material in section 1, cites that more than 90% of entities across the world are small and medium-sized entities with some regions estimating that the percentage could be higher, such as the European Union where it is estimated that over 99% of entities are small and medium sized entities. This backdrop for why such urgent action was necessary could be interpreted to suggest that the ISAs as currently drafted are not fit for purpose for more than 90% of the audits that are currently conducted in the world and the ISAs for LCE could be the standard used for most audits once finalized.

Adequacy of standalone ISA for LCE

9. The proposed new standard does not provide enough guidance to auditors and will therefore result in a deterioration of audit quality. Paragraph 19 of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing* (ISA 200), states that “the auditor shall have an understanding of the entire text of an ISA, including its application and other explanatory material, to understand its objectives and to apply its requirements properly.” This is explained further in A61 of that standard. The application and other explanatory material may “explain more precisely what a requirement means or is intended to cover.” Our concerns on the stand-alone nature of the ISA for LCE include:

- How an auditor of an LCE will be able to understand and apply the ISA for LCE without a full understanding of the ISAs. For practitioners that decide to focus on the audits of LCE exclusively, their knowledge of the ISAs may decline over time. The requirements in the ISAs have been included almost in their entirety in the ISA for LCE, but they are presented in a different format and exclude large portions of the application and other explanatory material. One example is the exclusion of the application guidance from the ISAs on substantive analytical procedures. Substantive analytical procedures are an area where auditors have experienced challenges, and it is unclear why this additional application guidance is not necessary for auditors using the ISA for LCE to understand the objective, apply the requirements properly, and provide the same of level of assurance as the ISAs.
- A professional accountant is required to comply with the principle of professional competence and due care, which requires the accountant to attain and maintain professional knowledge and skills at the level required to ensure that they provide competent professional services, based on current technical and professional standards. There is a risk that the issuance of the ISA for LCE undermines these professional responsibilities, as auditors of LCE may believe they only need to maintain professional competence based on the ISA for LCE. This may have a negative impact on the ability of practitioners in smaller firms to perform quality audits.
- The auditor is required to determine that the use of ISA for LCE is appropriate for the audit engagement, and, if it is found that the ISA for LCE is not appropriate during the audit because complexities regarding the audited entity not contemplated by the proposed standard have arisen, then a transition to the use of the ISAs or other applicable auditing standards is required. For example, the auditor will need to reassess the appropriateness of the use of the ISA for LCE when a material uncertainty related to going concern exists and when potential fraud activities are detected (since in these situations the risk can increase in various areas). We are also concerned that auditors will not be able to identify such situations without an understanding of the ISAs if they have focused their training and experience only on the ISA for LCE. A related concern is that switching to the ISAs part-way through an audit might be difficult and may lead to additional time when compared to applying ISAs at the outset of the audit.
- The use of ISA for LCE for component audits in group audits conducted under full ISAs should be clarified. The group auditor is ultimately responsible and accountable for ensuring the group audit engagement has been performed in accordance with the ISAs. If the IAASB proceeds with the ISA for LCE, they will need to consider the necessary conforming amendments to ISA 600 (revised), *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*.

Scope of the standard

10. The scope of the ISA for LCE is unclear. We encourage the IAASB to ensure that the scope of the ISA for LCE is precise and limited. The provisions contained in the exposure draft leave room for the auditor to evaluate whether the standard is applicable to an audit, and this could lead to situations where different auditors, firms and/or jurisdictions may interpret the acceptability of using the ISA for LCE differently for entities that exhibit similar characteristics. This may contribute to confusion for users of the financial statements and undermine the objective of achieving global consistency. Therefore, the scope of the separate standard should be clearly stated if the ISA for LCE is adopted.
11. One of the objectives of the IAASB was to issue a standard that is concise and limited in volume. In this regard, given the amount of the materials issued by IAASB (the draft standard, the supplemental guidance for authority, the supplemental guidance for auditor reporting, the glossary of terms to be included as an appendix to the separate standard) it appears that this objective has not been met. This highlights our concern about whether a separate standard for LCE is appropriate. Moreover, the different authority in these various materials may also be a source of difficulties for auditors of LCE. We would like to understand the reasoning behind why the format and content for an unmodified auditor's report is included in the standard, while the format and content for an auditor's report containing a qualified opinion, emphasis of matter paragraph and/or other matter paragraph is included within illustrative auditor's reports in the non-authoritative supplemental guidance.

Complexity, Understandability, Scalability and Proportionality (CUSP) project

12. Two different workstreams were proposed in the origin of this project: (1) to issue a separate standard on audits of LCE, and (2) to address issues related to complexity, understandability, scalability, and proportionality in the ISAs more broadly (the CUSP project). The ISAs that have been recently issued by the IAASB (e.g., ISA 315, ISA 540, ISQMs) contain some provisions regarding the graduation of the application of the standards in the case of LCE. In addition, it has been IAASB's longstanding premise that a risk-based audit is scalable; therefore, the audit effort can be scaled up or down (e.g., less complex entities or areas of lesser risks of material misstatements). This premise calls into question the need for a stand alone standard applicable to LCE.

Paragraph 101 of the explanatory memorandum of the Exposure Draft states that ISA for LCE "would present requirements for an audit of an LCE based on the core requirements of the ISAs but drafted and presented in a more understandable and straightforward way . . .," which is also currently part of the CUSP project.

13. Many regulators hear comments on the increasing complexity of the standards, and, as such, this is not a problem limited to audits of LCE. We believe that the use of complex language may contribute to the perception that the standards are overly complex.

14. The IAASB has acknowledged that the CUSP project addresses many of the same issues and challenges as the audits of LCE project, and that the two workstreams are running parallel. Applying and building on the existing objectives in the CUSP project, with additional focus on the understandability of the proposed standards, may contribute towards improving the quality of audits by enhancing the scalability of the standards (because of greater understanding), thereby eliminating the need to have a separate standard for audits of LCE. We encourage the IAASB to extend work on the CUSP project to incorporate LCE considerations, rather than issuing a separate standard.

Other potential solutions

15. Providing additional scalability guidance for the requirements where auditors were facing challenges or issuing other explanatory material to support auditors in effectively applying the ISAs may be more appropriate. The work done by the IAASB in the LCE project may provide a basis for issuing guidelines for auditors of LCE, as a supplement to ISAs. In addition, in order to provide the appropriate ISA content relevant to the user, a technology-based solution could be utilized to allow users to more easily navigate to applicable requirements and guidance.

Conclusion

16. If the IAASB proceeds to issue a separate standard, the scope of applicability of the standard should be clearly stated to ensure consistent application in practice. The authority of the materials provided along with the separate standard should also be clarified to avoid any confusion among auditors on their applicability. However, we continue to believe that, in lieu of issuing a separate LCE standard, the IAASB should utilize its work on understanding and considering issues that have been raised in various jurisdictions in relation to audits of LCE to identify alternative solutions, such as issuing scalability guidance for audits of LCE.

Please do not hesitate to contact me or Martijn Duffels, Chair of the IFIAR Standards Coordination Working Group (SCWG), to discuss any of our comments.

Yours Faithfully,



Duane DesParte, IFIAR Chair

Cc: Takashi Nagaoka, IFIAR Vice Chair
Martijn Duffels, SCWG Chair,
Carl Renner, Executive Director