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ED-ISA for Less Complex Entities

Dear Mr. Seidenstein,

Thank you for giving us the opportunity to express our opinion on the proposal of Standard on auditing for audit of financial statements of less complex entities.

First of all, we would like to emphasize that this is considered as a first step in the right direction for the audit of SMEs.

As mentioned in the Executive Summary, smaller entities (LCEs) count for the great majority of the audits nowadays. Globally > 90% are SME's and in Europe even > 99%. Specifically in Belgium also 98 to 99% of the enterprises are SMEs. The thresholds for the audit are also relatively low. Because of these low thresholds, most of the audits concern SME's. This is the reason why there is also a standard for the audit of SMEs without the ISAs being applicable, as mentioned in Appendix 1 of the Explanatory Memorandum. This standard has been issued on the principle of 'bottom up'. And not the 'top down' principle.

Reading this proposal for a standard, the starting point has clearly been the ISAs, which are more suited for PIEs and large companies. As indicated in the Explanatory Memorandum, in the ED and in the Draft Supplemental Guidance of July 2021, certain types of SMEs are still considered to be "complex entities", even if they are "less" complex than PIEs or large companies, and are therefore excluded of the authority of this ED.

Because of the fact stated in the Executive Summary that over 99% of the European entities are SMEs, the authority of the standard should be as broad as possible. However, the combination of the concept “*if in doubt, you are out*”¹, with the exclusion of different categories of audits², such as group audits, and an extensive list of characteristics which are alleged to be associated with more complex entities³, limit the authority of this ED severely.

This begs the question: What is 'less complex'? Following characteristics have been described as commonly associated with “more complex entities” and are therefore excluded from the authority of the ED:⁴

- Entities in the development stage;

- Entities in new or emerging markets;

- Audits of Group Financial Statements;⁵

We suggest that these exclusions be dropped by leaving it to the discretion of the country.⁶ Specifically regarding group audits, if the consolidation makes these companies large, then there already is no choice.

It would be better to limit the use of "less complex" instead of “SME” when the country has defined its own qualitative and quantitative thresholds of audit that sufficiently delimit small and medium-sized entities.

In Belgium, the thresholds of audit (see also above) are already low enough that this division makes things unnecessarily complicated. So let each country decide for itself, according to its own wisdom and knowledge of the market.

I therefore suggest that the exclusion of group audits be dropped by leaving it to the discretion of the country. If the consolidation makes these companies large, then the choice is quickly

¹ § 134 Explanatory Memorandum.

² § 51 Explanatory Memorandum.

³ Table in § 28 of the Supplemental Guidance for the Authority of the [Draft] Standard of July 2021.

⁴ § 28, p. 7 of the Supplemental Guidance for the Authority of the [Draft] Standard of July 2021.

⁵ Item 62 ff. (page 21) Why is an 'Exclusion of Audits of Group Financial Statements'. If there are 2 small companies associated, is it excluded? If there are 3? If there are 4? Even if the consolidation of these companies together is still small?

⁶ Item 155 (page 44): One speaks of 'inherently exhibit characteristics of complexity'. Where does this statement come from? On what scientific basis was it concluded?

Item 163 (page 45): mentions 'some jurisdictions could potentially not adopt the standard (if groups were to be included)'. On what scientific basis was this concluded? One could also state the opposite. By excluding these groups (even if they remain small), some countries will not accept this standard.



made. But again, this depends on the regulations (including thresholds) of a country. But should small groups be completely excluded for that reason? A wrong vision from which to start drawing up this standard. Or as I mentioned: not 'bottom-up' but 'top down' reasoning.

This is aggravated by the fact that there are no other Standards to “top-up” the provisions of this ED, if the circumstances require it to audit a SME.

This is our conclusion after reading these documents and the constant references to the ISAs, including what needs to be done to transition from this ED to the full ISAs in § 139 of the Explanatory Memorandum.

ISAs are designed for a wide variety of entities ranging from LCEs to more complex. However, recently objections were made concerning the lack of scalability. Many have noticed that the applicability of the current ISAs is better suited for PIEs and larger entities. It is not a good idea to impose a standard that applies to 1-2% of all companies and impose it on the other 98%.⁷

According to us it would be better to start from the point of view of the small company (SMEs) and what is needed there to be able to carry out an audit and thereafter build up to something larger for the complex and big entities. This standard is based on the core requirements of the ISAs which makes it easier to understand and use for those who already know and apply the full ISAs but not for others. One must already have knowledge of the ISAs to apply this standard.⁸

⁷ I would like to reproduce some sentences, which give the feeling of contradiction between a “bottom up” approach and a “top down” approach:

Item 26 (page 14): “The proposed **standard is separate from the ISAs** with no intended need to directly reference back to de requirements of application material in the ISAs in its application. “

Item 78 (page 25): ... the proposed standard is principles-based, **similar to the ISAs....**

Item 106 (page 31): There are **many differences** between the ISAs and ED-ISA for LCE...

Item 119 (page 35): Consistent with **the approach** of using the ISAs **as a base for** developing ED-ISA for LCE.

Item 146 (page 41): **are not substantially different** between ED-ISE for LCE and the ISAs.

⁸ The reference to isa 540 (revised) as an example

Item 102 a-b-c: Why refer to –SA 501 - 701 / ISA 610 / ISA 600. This is against the principle of top down

Item 104 c i: again, reference to ISA 501

Item 105: reference to ISA 540 – 315 – 220

Item 113-114-115 (page 34): reference to ISA 315

Item 117 (page 35): reference to ISA 240 – 250 – 540 – 550 – 402

Item 138 (page 39): reference to ISA 540

Item 140 (page 40): reference to ISA 710

Item 150 (page 42): reference to ISA 800

Item 173 (page 47): reference to ISA 600

Item 180 (page 48): reference to ISA 600

Item 181 (page 49): reference to ISA 600

Item 38 (page 16): Why would the outcome of an audit under this proposal be less than an audit under ISAs? Initially, we can follow the reasoning. But it seems that the authors of the text have not conducted an audit of SMEs. After all, it is the outcome that counts. There are far fewer audits to be carried out in a truly small company (where, for example, only the director works without staff) than in a large company. But is the outcome less because of that? Does it affect the security offered? This does not seem to be the case at all.



The inclusion of “essential explanatory material” (EEM) is insufficient to remedy this.⁹

Furthermore, the concepts and principles already used in an ISA audit are applied in the ED. Many of the basic concepts of ISAs for a risk-based approach are in this ED. ISA 315 revised is largely contained! Every time ISAs are revised, this standard will also be revised. On the other hand, when a circumstance that is not contemplated in de ISA for LCE occurs, relevant ISA requirements cannot be used to top-up this standard. As mentioned above, neither are there any other standards that can provide these requirements.

Moreover, concerning documentation requirements and the planning of the audit, the ED specifies that the same approach to documentation must be followed as in the ISAs, and that the audit must be planned in the same manner as the ISAs.¹⁰ This is very unfortunate, because one of the main complaints concerning the ISAs are the onerous nature of the documentation and planning. At the event “*Simplifying auditing standards for small or non-complex entities*” of the 30th of May 2018, of the participants 76% expressed the opinion that the documentation requirements of the ISAs are too demanding and 62% has difficulty in determining the extent of work required.¹¹

Administrative complexity and costs involved have a major impact on the competitiveness of companies. This is specifically the case for small and medium-sized entities. The audit must strike a balance between the interests of stakeholders and the administrative burden on the company.

To achieve a – for SMEs much needed - administrative simplification and to avoid excessive administrative burdens, standards should be made taking the SME as starting point and should be tailored to their size. The question should be what procedure would be necessary to achieve an effective audit for SMEs, rather than which procedures for complex entities are superfluous for SMEs. We should be starting with small companies and going up to something larger, being the medium-sized entity. This is the implementation of the building-block approach. This ED would function as a basic standard for all entities. The requirements of this ED would be topped-up with more detailed requirements from future EDs concerning gradually more complex entities. Thus, it can be avoided that the auditor can only choose between this ED – without the possibility of “topping-up” when the circumstances demand it - and the full ISAs as they are today.

Item A.9. (Page 65): ‘when the entity operates in new OR...’ This leads to the conclusion that a new segment in the small market is already excluded. Why is ‘new’ excluded? I understand the intention, but it should be worded differently.

⁹ § 85–91 Explanatory Memorandum.

¹⁰ § 109-112 Explanatory Memorandum.

¹¹ <https://www.accountancyeurope.eu/wp-content/uploads/180530-Event-Simplifying-auditing-standards-for-small-or-non-complex-entities-call-for-action-1-1.pdf>



Comparing our Belgian standard for SMEs with this proposal for a standard for less complex entities, ITAA feels little enthusiasm for replacing this standard by the new proposal.

We would also like to point out the importance of acknowledging the differences that exist in different countries that will have to apply this standard. For example, some countries have different thresholds for audits than others.

Does this standard really have the flexibility that is necessary for the application in local or regional context?

On page 66 - point A.11, legislative or regulatory authorities of relevant local bodies with standard-setting authorities obtain some freedom to take into account their local regulation and situation. However, this flexibility is very limited!

We must also view this in the context of applicability. You can draft a great standard. You can have a wonderful text. But will one be able to apply it in all its aspects? Has this standard been tested on different SMEs for its applicability? How much time was spent per audit? How much will an average audit according to this standard cost?

And so, the big question is: at whom and how many companies has this been carried out and what is the average time spent? Is this standard feasible for the largest group of companies in the world? Perhaps field testing would point out the current flaws of this ED.

The answers to these questions should be the only reason why countries should decide to apply this standard.

Giving certainty to the public is the starting point, we 100% agree on that. But you must also be able to use a standard in practice, otherwise these requirements remain hollow phrases.

Conclusion:

Instead of starting with a blank sheet and developing a real stand-alone standard for 99% of the audits and which is easily “understandable”, “practical” and “applicable” in audits for SMEs, this ED is a decoction of the ISAs that are subject to criticism because they are not scalable enough and only become longer, more complex, and less understandable because of the different revisions already done and still to come. Referring, copying, and linking a new standard to this ignores and goes beyond the reasons and purpose to create a standard specifically for less complex audits.

The current ED has a too limited authority because of the concept “*if in doubt, you are out*”, diverse exclusions – e.g., group audits - and an extensive list of characteristics which are




alleged to be associated with more complex entities. A standard for over 90% of the worlds entities, SMEs, should have an authority that is as broad as possible.

Moreover, the concept of LCE should only apply in jurisdictions that lack proper quantitative and/or qualitative criteria for SMEs, such as thresholds. The authority of the standard should be defined by the national regulators.

The ED should have SME-specific requirements concerning planning and documentation instead of using the same approach as the ISAs.

Furthermore, a pure stand-alone standard should be abandoned. An alternative would be a building-block approach where this ED would function as containing the basic principles for the audit of all types of entities. The requirements of this ED could be topped-up with specific requirements from additional – future – standards, to address the circumstances for more complex entities. This remedies the current dualism that exists between this ED and the ISAs.



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