



IAASB - International Auditing and Assurance Standards Board  
529 Fifth Avenue  
New York, 10017  
USA

January 24<sup>th</sup>, 2022

**Subject: Comment letter relating to the Exposure Draft of the International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ED ISA for LCE)**

Dear Sirs and Madams,

1. The CEAOB appreciates the opportunity to comment on the IAASB's Exposure Draft of the International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE) issued in July 2021. As the organisation representing the audit regulators of the European Union and the European Economic Area, the CEAOB encourages and supports continuing improvement of professional standards for the audit profession.
2. The content of this letter has been prepared by the International Auditing Standards Subgroup and has been adopted by the CEAOB. The comments raised in this letter reflect matters agreed within the CEAOB. It is not intended, however, to include all comments that might be provided by the individual regulators that are members of the CEAOB and their respective jurisdictions.
3. Regulators are concerned not only with audit quality and the quality of auditors' opinions on financial statements, but also with ensuring that audits appropriately meet the needs of the market.

**OVERALL COMMENTS**

4. We support the IAASB initiative and efforts to understand and consider issues regarding the audit of smaller or less complex entities that have been raised by auditors in various jurisdictions. The audit of less complex entities merits attention, since it is relevant not only for auditors who are in charge of performing those audits, but also for a broad range of stakeholders. In several countries, work has been undertaken on this topic, sometimes based on particular provisions of different national laws related to certain types of entities. The exposure draft submitted by the IAASB on this topic however raises a number of concerns that the CEAOB has listed hereafter.





### Adaptation already embedded in the current ISAs

5. As we indicated in the letter that was sent to the IAASB on the 30<sup>th</sup> September 2019 in the initial stages of this project, the adaptation of the audit approach to the size of entities and the complexity of their operations is already embedded in the International Standards on Auditing (ISAs) framework and, in particular, graduation mechanisms have been included in the ISAs recently issued by the IAASB (ISA 540, ISA 315) and in the International Standards on Quality Management (ISQM1, ISQM2).
6. Therefore, we encourage the IAASB to continue with the CUSP (Complexity, Understandability, Scalability and Proportionality) project to define clear guidelines for the drafting of the standards so that they can be proportionate to all kind of entities: As we suggested in our previous letter, more focus on clear language and understandability can contribute to auditors better being able to apply the standards in different situations and in respect of different entities without developing a separate standard. This CUSP workstream was presented by the IAASB and should be carried out and driven further before determining which is the best way to address the concerns regarding the audits of LCE.

### Risk of creating two different types of audits

7. We remain uncertain as to the benefits of establishing a separate standard for audits of LCE, since this would create two different categories of audits, thereby fragmenting the audit market, and it may create the impression that a different type of assurance is provided when this standard is applied. In this regard, insufficient information has been provided on the actions carried out by the IAASB to conclude that issuing a separate standard is the most appropriate way forward. We would recommend considering the issuance of guidelines for LCE audits, as a supplement to ISAs instead of a standalone ISA for LCE.
8. We believe that the co-existence of two “sets” of auditing standards would raise the question of the respective “value” of an opinion, the one based on ISA for LCE compared to an opinion based on the full set of ISAs. We stress that the proposal to issue an opinion by reference to the use of ISA for LCE in the ED ISA for LCE, and not by reference to the use of ISAs, raises additional questions with regards to the value of the opinion(s). Is it really the same level of assurance for audits of LCE when the ISA for LCE, instead of the ISAs, is referred to in the report?

### Provisions applicable to LCE audits

9. In general, we question why, when auditing a less complex entity, auditors should not be required to apply certain ISAs in full. For example, when the auditor decides to apply sampling or substantive analytical procedures, the fact that the auditor is auditing a less complex entity does not justify the omission of guidance, application material or requirements from ISA 520 and ISA 530 in the draft standard. To us such guidance and requirements apply regardless of the complexity of the audited entity.
10. In general, the principle of proportionality is considered to be implicit in the ISAs. However, if the IAASB wants to pursue a separate ISA for LCE, despite the comments included in this letter and the concerns raised regarding the fact that we do not see the need and the justification to issue this separate standard, we strongly urge the IAASB to





ensure that this standard helps achieve the quality objective of an audit for LCE, and to avoid any grey or unclear areas in the draft standard and requirements that lack details and/or guidance that are sufficient for auditors to perform audit procedures without going back and consulting the full ISAs. The ISA for LCE should be applicable on a standalone basis.

#### Competence for LCE vs other audits

11. Another drawback of having a separate standard for audits of LCE is that while auditors are currently familiar with the ISAs there is a likelihood that, in jurisdictions where use of the ISA for LCE would be permitted, some auditors would only perform audits of LCEs. There is a risk that if it is no longer appropriate to apply the ISA for LCE to one of those audits, auditors may no longer have the necessary knowledge and competence to perform a quality audit in accordance with the full set of ISAs. This could also create another problem if an individual only receives practical training on LCE audits, as this might prevent the competent authority from authorizing this individual as auditor if all the experience that he or she has is in LCE audits.

#### Difficulties identified in the scope for applicability of the standard

12. One of our main concerns is that the application of the LCE standard would ultimately be subject to the auditor's professional judgment. The ISA for LCE contains a lot of details on the qualitative criteria, either in the standard itself or in the supplemental guidance for its authority. However, the choice to apply the LCE standard is still subject to professional judgments and to subjectivity, leading certainly to a lack of consistency within the market as this could lead to situations where the same entity under the same circumstances could be audited according to the ISAs or according to the ISA for LCE, depending on the auditor's decision.
13. For example, it should be noted that defining whether the audit may not be performed using the ISA for LCE if an entity meets the qualitative characteristics set out in paragraph A8 could require the exercise of a lot of judgment and this could result in an inconsistent application of the standard.
14. The lack of objective criteria included in the ISA for LCE to determine its suitable application may lead to possible bias by auditors in the qualitative analysis, in order to apply this standard and may even lead auditors to compete on whether or not an audit could be performed under the ISA for LCE, determining an inappropriate application of the standard and preventing auditors from changing to a full ISA audit if needed. The lack of indisputable criteria could also lead to some pressure by entities on the auditor to carry out an audit applying the ISA for LCE, with a perspective to reduce costs and audit quality.
15. We would encourage the IAASB to clearly state in the ISA for LCE its scope of application. The option included in the standard and in the supplemental material for the regulatory or legislative bodies in different jurisdictions to determine whether this standard is applicable to certain entities or not would lead to a lack of harmonized approach. Additional provisions should be included in the ISA for LCE to ensure a consistent scope of entities in or out, based on objective criteria. It is important that this is clearly stated in the ISA itself and not in the non-authoritative material that IAASB may issue, to ensure a harmonized approach.





### Volume of the standard and accompanying documents

16. Another concern that we would like to raise is that one of the objectives that the IAASB has expressed throughout this project is that they wanted to keep the standard simple and concise and to reduce complexity. Considering the amount of material that has been finally issued with the ED including the ISA for LCE, the supplemental material on auditor's reporting and the supplemental material on the authority of the standard, we doubt whether the proposed objective of the IAASB has been achieved.
17. On the other hand, the IAASB has tried to keep the essential explanatory material as limited as possible. As a result of this approach, the ISA for LCE summarizes the requirements from the ISAs without the full context that it is provided in the ISAs by the explanatory material in the ISAs. As such, the proposal could be a useful guide that may help auditors in their application of the ISAs, rather than a separate standard.

### Authority of the accompanying documents

18. Besides, considering the different level of authority of these materials provided with the ED (in particular, part 9 of the ISA for LCE regarding reporting and the supplemental material on auditor's reporting which has a non-authoritative nature), we fear that, on one hand, auditors might face certain difficulties applying all these materials and, on the other hand, oversight bodies will also face some difficulties to assess and enforce their proper application by auditors.
19. Regarding the supplemental material provided alongside the draft ISA for LCE and considering their differing roles and responsibilities, we would advise that the supplementary guidance for the authority of the standard should be split more clearly between the guidance for national standard setters (NSS) and that for auditors. In particular, the guidance for NSS primarily relates to first time adoption of the standard, while that for auditors will be relevant on an ongoing basis and could be inside the standard.

### Maintenance of the ISA for LCE over time

20. We also remain uncertain as how the ISA for LCE is going to be maintained. The way the IAASB has explained its intention to update the ISA for LCE (including the necessity to continue to update the mapping made available for the consultation and the supplemental material) when ISAs are revised remains too vague and unclear.
21. If the update is not carried out in a reasonable timeframe, we risk having long delays in the adaptation of the ISA for LCE. This could lead to this ISA always being outdated compared to the full ISAs. This could imply that auditors would need to refer back to the ISAs and would end with the proposed intention of the IAASB that this is a standalone standard. This inconsistency is also likely to widen the expectation gap as users are likely to expect that any changes to the ISAs apply to all audits.

### Transitioning between ISA for LCE and other ISA

22. Another concern that we would like to highlight is that while the ISA for LCE requires the auditor to consider whether the use of the ISA for LCE continues to be appropriate, it does not state what action is required where the auditor concludes that use of the ISA for LCE is no longer appropriate.



23. Further while some detail is provided in the explanatory memorandum on transitioning between the ISA for LCE and the ISAs, this should be developed further to provide clear information to auditors on the work required of them in this situation. In particular, in case of a change in the auditor by the audited entity when the new auditor decides to move to the full set of ISAs instead of applying the ISA for LCE. It is not clear what action is required in the audit of opening balances.

## **SPECIFIC COMMENTS ON THE CONTENT OF THE STANDARD**

24. Given the previous comments mentioned in this letter, we have serious concerns on whether the proposals set out in the ED ISA for LCE are really helpful for auditors, for users and for regulators. However, if the IAASB decides to further develop this project despite our comments, we have provided without being exhaustive, some items for consideration in relation to the content of the standard bellow.

### Characteristics of “less complex entities”

25. There is an inconsistency in paragraph A9. The first line of this paragraph states that the ISA for LCE is inappropriate for the audit if an entity exhibits “one or more” of the characteristics listed in this paragraph. However, the wording beneath the bullet points seems to contradict this as it states that “The presence of one characteristic exhibited by an entity does not necessarily exclude the use of the [draft] ISA for LCE for that entity.’ It is our view that the standard should not be used where one or more of the characteristics listed is present.
26. In the essential explanatory material (EEM) to paragraph 1.2.1, it is mentioned that if an Engagement Quality Review (EQR) is required, ISQM2 will be applicable. We question whether having an EQR indicates that this draft standard may not be appropriate. Usually, if the audit firm decides on a voluntary basis to have an EQR, it could be because a particular risk has been identified resulting from the complexity of the audit, as illustrated by the examples provided in paragraph A134 of ISQM 1. Therefore, having an EQR could be added to the list of indicators that the auditor should take into consideration when identifying if the use of the ISA for LCE is or remains appropriate.

### Relevant Firm-Level Quality Management

27. Additionally, the statement that ISQM1 (or national requirements that are at least as demanding) applies to all firms that perform audits should be a requirement of the standard rather than essential explanatory material in section 1.2.

### Acceptance and continuance

28. Regarding the Acceptance and Continuance section, in paragraph 4.5.4 when the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so, it should be added that the auditor has to consider whether this is permitted by local law or regulation. The auditor must also consider whether the engagement is still an audit.



### Audit procedures - sampling

29. There is no guidance on the way to determine the size of the samples, whereas in ISA 530, appendixes 2 and 3 list the factors that can influence the sample size. Adding guidance within paragraph 7.3.5 on audit sampling on that matter seems useful to help the auditor determining the size of the samples.

### Going concern

30. In paragraph 7.4.5 related to going concern: We consider that a material uncertainty related to going concern may in certain circumstances be an indicator of complexity. Therefore, factors related to going concern issues could be added to the list of indicators that the auditor should take into consideration when identifying if the use of the ISA for LCE is or remains appropriate.

31. A description of the going concern aspects specific to LCEs should be included in the Appendices section, given the importance of this subject matter.

### Comment on the location of a specific provision

32. Paragraph 7.4.22 regarding litigation and claims deals with the identification and assessment of risks rather than to responding to those risks, therefore this could be moved to section 6 of the separate standard.

### Objective of the concluding section

33. In the Concluding section, the objective in paragraph 8.1.1 is not consistent with the introduction to this section and, therefore, should be completed by including a new bullet point d) to cover the performance of other concluding activities such as the consideration of the effect of subsequent events, obtaining written representations and performing concluding analytical procedures.

### Conforming amendments

34. If the ISA for LCEs is adopted, then conforming amendments may be required to the ISAs. For example, paragraph 157 of the explanatory memorandum states that the group auditor will need to determine whether the use of the ISA for LCE in a component is sufficient for their purposes. This requirement will need to mirror with provisions of ISA 600.

We remain at your disposal to provide any further information or to discuss our concerns.

Yours sincerely,

Patrick Parent  
Chairman

