

## Audit Scotland response to IAASB ED-ISA for LCE

Audit Scotland is pleased to present its comments on the IAASB consultation on the Exposure Draft of ISA for Less Complex Entities. We hope you find our responses to your questions helpful. We have also provided a brief overview of public audit in Scotland for the context in which we operate.

### Public audit in Scotland - overview

[Audit Scotland](#), working closely with the Auditor General and the Accounts Commission, is responsible for the audit of over 200 bodies in the Scottish public sector with total audit fees of over £20 million.

Public bodies in Scotland within our audit regime include central government bodies, councils, health boards, and colleges, as well as more diverse entities such as charities, companies limited by guarantee, and public interest entities. Collectively these bodies spend over £40 billion of public money each year. Some of the larger more significant bodies include the Scottish Government (£34 billion net expenditure), NHS Greater Glasgow & Clyde (£4.6 billion gross expenditure), Glasgow City Council (£2.7 billion gross expenditure), Scottish Water (£1.4 billion revenue). Conversely there are over 55 bodies with annual gross expenditure below £10 million with some reporting less than £250,000.

Auditors are appointed to audit these public bodies by the Auditor General and by the Accounts Commission, supported by Audit Scotland. In most cases, staff in Audit Scotland's inhouse audit practice are appointed as auditor but private sector accountancy firms are appointed to around a third of the bodies.

All audits are governed by a Code of Audit Practice which requires the audit of the financial statements to be undertaken in accordance with international standards on auditing in the UK (ISAs). Auditors are also required to follow practice note 10 which applies certain ISAs in a public sector context. The Auditor General and the Accounts Commission determine the standards to apply to audit work and are not bound by the Financial Reporting Council.

However, the responsibilities of auditors under the Code go beyond identifying misstatements in the financial statements and include considering and reporting conclusions on the arrangements for financial sustainability, governance and transparency, value for money, and financial management.

### ISA for Less Complex Entities

Audit Scotland has followed the development of the proposed standard for Less Complex Entities with interest. We recognise the challenges of scaling ISAs to less complex entities and agree that a standalone ISA for less complex entities is an appropriate way to address those.

The ED-ISA for LCE does not deliver the benefits that earlier publications led us to expect. The principal problem is that the work of an auditor using the ISA for LCE would not be materially different than if the auditor were scaling ISAs as already possible on an audit that met the criteria for using it. If the ISA for LCE does not materially change the work of an auditor, then it serves little useful purpose.

The approach appears to have been to reorganise the ISAs that were applicable to an audit of less complex entities with minimal consideration of appropriateness. A more ambitious approach would have started with the objectives of the applicable ISAs and considered how those objectives could be met in the context of a less complex entity. This approach would have provided an opportunity to focus on the principles and could have delivered substantial assurance while also providing more appropriate scaling.

We understand that the Financial Reporting Council has indicated a lack of interest in adopting the proposed ISA for LCE in the UK. Although this would not prevent the Auditor General and Accounts Commission from adopting such a standard, we are conscious that UK accounting firms, which are responsible for a third of Scottish public sector audits, may be less interested in using a standard that is not used elsewhere in the UK.

As currently drafted, we see little if any benefit to a firm creating a bespoke audit methodology to apply the ED-ISA for LCEs. We could not recommend that the Auditor General and Accounts Commission adopt the ISA for LCEs as currently drafted.

We note that there is a relationship between the complexity of the accounting framework used, even by the smallest bodies, and the corresponding complexity of the auditing framework. If a smaller body reporting regime were available there would be significantly greater scope for a correspondingly scaled auditing framework.

Please find below our responses to each of your specific questions.

## **Contact**

If you would find further information useful, please contact John Gilchrist – [jjgilchrist@audit-scotland.gov.uk](mailto:jjgilchrist@audit-scotland.gov.uk)

## 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:

*A standalone standard is the right approach to setting proportionate auditing standards for audits of less complex entities.*

(b) The title of the proposed standard.

Response:

*The title is appropriate.*

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

Response:

*Please see the introductory text.*

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:

*The conforming amendments are appropriate.*

## 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 is implementable.*

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

Response:

*No.*

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

Response:

*No.*

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

Response:

Yes.

(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. In Scottish public sector audit, the term “audit” is not well defined in legislation. This means that the commissioners of public sector audit (the Auditor General for Scotland and the Accounts Commission) define their requirements in a Code of Audit Practice. As such, the Auditor General for Scotland and Accounts Commission would act as “a legislative or regulatory authority or relevant local body with standard setting authority in the jurisdiction” in determining if any classes of entities should be excluded from the scope of the ISA for LCEs.*

**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:

Yes.

**5.** Regarding the Authority Supplemental Guide:

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

Response:

Yes.

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

Response:

No.

**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:

No.

## 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:

*It is evident from the mapping of ISAs to the proposed ISA for LCE that the work of an auditor using the ISA for LCE would not be materially different than if the auditor were using ISAs properly on an audit that met the criteria for using it. This calls into question the value that the ISA for LCE provides.*

*This demonstrates the ISA for LCE will enable the auditor to issue a reasonable assurance opinion. But it means that it is not “proportionate to the nature and circumstances that would be typical of an audit of a less complex entity” and is too onerous to be “used effectively and efficiently in those typical circumstances to obtain sufficient appropriate audit evidence to support a reasonable assurance audit opinion.” This is because there is insufficient scope to achieve the objectives and principles of the audit in less prescriptive ways.*

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

Response:

*The approach to the objectives of each Part is appropriate.*

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

Response:

*The principles in relation to professional scepticism and professional judgement, relevant ethical requirements and quality management are appropriate.*

(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:

*Audit Assertions are described in Appendix 4, but their authority derives from EEM at paragraph 6.4.1. Regulatory oversight has resulted in audit assertions being effectively a required part of any audit. It therefore would seem more appropriate for audit assertions to be in the body of the ISA for LCEs rather than indirectly through EEM.*

## 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 organisation of the ISA for LCEs to follow the flow of an audit engagement makes it more accessible and removes some unnecessary duplication that is in ISAs.*

*The drafting principles have been met but those at paragraphs 100 and 101 mean that there was no scope for any more holistic consideration of how to meet the objectives of the ISAs in drafting the ISA for LCEs in a way that is more proportionate and able to meet the nature and circumstances that would be typical of an audit of a less complex entity.*

## 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:

*Based on the response to 7 (a), no specific comments are made about the content of Parts 1 through 8 of the standard.*

**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:

*The specified format is written from a private sector perspective, using "the Company" for the entity. This should be in square brackets to recognise that "the Company" will often not be the appropriate descriptor in the public sector and may not in all cases be appropriate in the private sector.*

*Paragraph 9.4.12 (a) should include reference to additional auditors' opinions that may be required, which go beyond the "compliance with law or regulation, including when law or regulation prescribes the layout or wording of the auditor's report." An example in many UK public sector bodies is the regularity opinion.*

*The approach of specifying the content and format of the auditor's report may not be compatible with some jurisdictions. In Scotland, legislation stipulates that the Accounts Commission specifies the form of the auditor's opinion for local government bodies.*

*The format and content of auditor's reports change frequently, even if the essential elements remain. Updating the specified format and content of an unmodified auditor's report is more difficult if it is included in the standard itself.*

**11.** With regard to the Reporting Supplemental Guide:

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

Response:

*The illustrative auditor's reports are helpful.*

*The content in section "II. The Auditor's Report" would more usefully be included in the ISA for LCEs in place of the specified format and content of an unmodified auditor's report as currently drafted. This would avoid some of the difficulties inherent in including the specified format and content in the standard itself.*

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

Response:

*No.*

**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:

*Based on the response to 7 (a), no specific comments are made about improvements to Parts 1-9 of the standard.*

## **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:

*No.*

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

Response:

*No comment.*

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

Response:

*Yes.*

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

Response:



Yes.

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

Response:

*No comment.*

**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 proposed standard could be used in the Scottish public sector. As explained in the response to question 7 (a), it is likely that the work of an auditor using the ISA for LCE would not be materially different than if the auditor were using ISAs properly on an audit that met the criteria for using it. On that basis it is unlikely that the standard would be used.*

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

Response:

*If the standard does not materially change the work of an auditor using the ISA for LCE compared to if the auditor were using ISAs, it does not meet the needs of auditors. If the work is not materially changed, the fees will not materially change so it would not meet the needs of audited entities.*

*It does ensure that the auditor is able to provide reasonable assurance, so it would meet the needs of users of the financial statements.*

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

Response:

*There would be no commercial benefit to a firm adopting the proposed standard if they are already auditing under ISAs.*

**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:

*No.*

## **Section 4G - Approach to Consultation and Finalization**

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

Response:



*No comment.*

**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:

*No comment.*

**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:

*The proposed effective date provides sufficient time to adopt appropriate procedures.*

## **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:

*Groups may be simple or complex. Simple groups do not generate a significant audit burden so the standard could be written to reflect the complexity of group arrangements rather than having an outright exclusion.*

**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:

*The inclusion or exclusion of groups would not be a significant factor in whether we used the proposed standard.*

(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:

*Of approximately 224 Scottish public sector bodies, approximately 55 may be able to use the ED-ISA for LCE. Only one of those bodies has a group.*

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

Response:

*Public sector bodies occasionally have wholly owned subsidiary trading companies that may use the parent entity's own premises. These would be considered a less complex group where they meet the requirement for consolidation but do not significantly alter the financial presentation of the body.*

**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:

*Option 2 would be favoured because it would be more consistent with the basic premise of ED-ISA for LCE.*

**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:

*No response.*

**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:

*If group audits are included in the ED-ISA for LCE, the requirements pertaining to group audits should be presented within each relevant Part. To do otherwise would run counter to the valuable approach of organising the ISA for LCEs to follow the flow of an audit engagement.*