



AUDITS OF LESS COMPLEX ENTITIES: EXPLORING POSSIBLE OPTIONS TO ADDRESS THE CHALLENGES IN APPLYING THE ISAS

Issued 12 September 2019

ICAEW welcomes the opportunity to comment on the IAASB's Discussion Paper (DP) *Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs*, published in April 2019, a copy of which is available from this [link](#).

ICAEW has supported IAASB's global auditing standard-setting activities for many years. We will CONTINUE to do so. We believe that the economic contribution of smaller entities to the world's economy make LCE audits a public interest issue. IAASB and its predecessor bodies have spent 40 years building a global set of auditing standards. That is a substantial achievement and one that we do not want to see lost for want of foresight and flexibility. We believe that it is in the public interest, globally, that IAASB should remain the auditing standard-setter for all audits. But for that to happen, its standards need to facilitate high quality, efficient and effective audits for less complex entities, regardless of the size of firm performing them. At present, they do not.

A parallel is often drawn between auditing and accounting standards: why, if there are accounting standards for SMEs, can there not be auditing standards for SMEs? While we acknowledge the fact that the parallel is far from exact, we believe that IAASB has to be pragmatic. Many of the objections to a separate auditing standard were raised when proposals were first developed for a separate accounting standard. And far from debasing the currency of IFRS, in some ways the IFRS for SMEs has in fact guaranteed the survival of IFRS. It is hard, when so much work has gone into the development of standards, to accept that *in some cases*, much of the output may be unnecessary, irrelevant or simply unhelpful. But to assert that taking material out of the ISAs will necessarily, and of itself, mean that the result cannot be called an audit, is increasingly hard to justify.

IAASB is at a crucial juncture in its development. It is a mature standard-setter and to retain its global reach and standing it needs to change the way it sets standards in some significant respects. Its standards have become longer and more complex in an attempt to keep up with technological change, changes in the business environment and developments in the regulatory approach to the audits of large, listed companies. But its basic approach to standard-setting has not changed in substance for many years, despite a number of re-organisations. In this response, we address what IAASB needs to do to modernise its approach, future-proof its standard-setting activities and secure its own long-term future. This includes:

- making long-term structural changes to the ISAs, including developing a new framework for drafting;
- making changes now to the way in which IAASB uses language in the ISAs;

- exploring the possibility of developing a separate standard for the audit of LCEs, aligned with the ISAs, on a 'bottom-up' rather than an 'ISA-minus' basis.

ICAEW is currently under significant pressure as a result of the three major regulatory reviews currently under way. Despite this, we took time at our recent Council conference to discuss LCE audits, we have consulted more widely than usual on this important discussion paper and we have taken particular care to reflect all of the areas of concern expressed by respondents.

IAASB has the opportunity to re-invigorate LCE audits and to inject a renewed sense of purpose into their performance. It should not pass over this opportunity. LCE audits matter.

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KEY POINTS

Welcome for the proposals

1. We welcome the opportunity to comment on this important discussion paper (DP) and we are encouraged by IAASB's decision to take action on less complex entity (LCE) audits. We have been calling for change in this area for some time. We have expressed concern about the lack of scalability of auditing standards in many of our responses in recent years, as well as the risks associated with IAASB not being seen as sufficiently responsive to the issue. There is a real risk that governments, regulators and professional bodies will go their own way if ISAs cannot be made to work in a proportionate, efficient and effective manner for smaller firms conducting smaller audits. While this has started to happen, as IAASB acknowledges, we believe that IAASB can and should act now to retain control over standards governing LCE audits by listening and responding quickly and decisively.
2. Far from being an administrative burden as they are sometimes portrayed, LCE audits are greatly valued by the many audit exempt entities who choose to have them, as well as by those for whom they are mandated. LCE audits, when performed properly, represent excellent value in terms of the discipline and insights auditors bring to many businesses. They are widely acknowledged to serve as an unparalleled training ground for professional accountants, and audits of LCEs often result in significant changes to the financial statements.
3. An LCE audit involves understanding how less complex businesses work, gaining exposure to different types of business and accounting systems and considering what can go wrong. It involves risk assessment, determining where to focus audit effort, designing and performing audit procedures, and investigating issues arising. All of this involves thought and engagement at every level, which is often absent in larger audits.
4. The holistic nature of LCE audits has been eroded by compliance requirements that are more relevant to larger audits. Fragmentation of insight sometimes follows and some LCE audits are now in some respects worrisome compliance exercises. LCE audits have, sadly, been tainted by larger audit failures.
5. The DP covers the issues well. However, the overall impression given is that while IAASB is genuinely concerned about LCE audits, it has not really understood the strength of feeling in some quarters, and believes that the problem may in fact lie somewhere other than in its standards.
6. On the face of it, there appears to be very little SMP representation either on the Board or on its working parties which makes it difficult for the Board to understand the issues faced by SMPs. IAASB needs to address this perception - regardless of whether it believes it is true or not - if it is to have credibility with SMPs. Given the economic significance of the SMEs globally we believe that the interests of the SMPs who serve them can and should be better reflected in the standard- setting process. LCE audits are a public interest issue, and it is in the public interest that IAASB continues to set auditing standards globally for LCE audits.

Long-term structural changes to ISAs are needed

7. We do not believe that there is any realistic prospect in the short or medium term of rewriting the ISAs on a retrospective, principles, 'building blocks', 'think less complex first' or similar basis, although in an ideal world, that would clearly be the best way forward. IAASB does, however, need to change the way it writes standards going forward. The changes that need to be made are structural and deep. A new framework for drafting will take time to develop and implement if changes are to be credible and lasting. The clarity project in 2010 was a bold attempt at structural change but the timescale for the project was, for reasons beyond

- IAASB's control, shortened from 7+ years to three years. There was value in the changes that were made but many of the issues arising now are a direct result of that foreshortening.
8. Among the structural changes that need to be addressed in a framework for drafting is greater clarity about the proper home for documentation requirements, and the nature and extent of documentation required for judgemental matters and thought processes. A somewhat haphazard mix of requirements in standards generally, and in ISA 230 in particular, has developed over time and caused confusion among practitioners and regulators alike, and unnecessary conflict between them. This is an issue in audits of all sizes but it affects LCE audits disproportionately. Regardless of ISA requirements, many LCE auditors believe that they have no choice but to spend unnecessary time documenting why they have not done things, simply to avoid regulatory censure, where the reason is obvious and should not require documentation.
 9. Greater clarity is also needed about the nature of objectives, how they differ from requirements, and how auditors are supposed to demonstrate that they have been achieved, other than by complying with the requirements. Too many are simply summaries of requirements. There are also inconsistencies in the regulatory approach to the status of requirements and application material, as well as a lack of a clear demarcation of substance between the two, despite the clarity project.
 10. IAASB is aware of these issues, which are not unusual or unique for a mature standard-setting body. While they were once of technical interest only, their magnitude and impact is now such that IAASB should not delay further in addressing them. They will take time to resolve. While we are encouraged by the consideration of the 'what, why and how' approach being used on an experimental basis in ISA 315, we do not think that this approach has to date had anything like the rigour needed in its development to represent a long-term structural solution. It needs more detailed consideration before it is adopted more widely. A lack of understanding of the clarity principles, and a lack of depth therein, contributed to the limited success of the clarity project and taking time to plan the long-term structural changes that are needed now will pay dividends later.

Needed sooner: changes to the way IAASB uses language and the exploration of an auditing standard for LCEs

11. In the short term, to retain its position as the standard-setter for all audits, and to prevent fragmentation in standard-setting, IAASB needs to do two things: it needs to address its use of language in ISAs and it needs to explore the development of a standard, or standards, for the audit of LCEs.
12. **Changing the way IAASB uses language in the ISAs:** some of the structural issues referred to above relate to the use of language and need to be addressed in a framework for drafting. IAASB's drafting style and conventions have not changed for many years. They were designed for a much smaller body of standards and systematic consideration of how language is used within the standards for a technical, international audience is, of itself, long overdue. Even native English speakers with the relevant specialist expertise have struggled to understand some recent exposure drafts. Consideration should be given to a style of writing that is different to the current somewhat one-dimensional prose style used for objectives, requirements and application material including, potentially, the use of summaries - such as executive summaries that could be comprehensively linked to the objectives and requirements. The style of wording currently used has quasi-legalistic and methodological aspects, it lacks accessibility and user-friendliness and begs for summarisation in the manner commonly used in slide presentations on training courses - i.e. executive

summarisation. Comprehensive links to objectives and requirements would ensure that the risk of the summary being read in isolation would be reduced.

13. Systematic consideration also needs to be given to the manner in which IAASB deals with the increasingly iterative nature of all elements of the audit - driven in many respects by technology. The linearity of ISAs, particularly in the absence of an electronically linked version, seems increasingly outmoded and disconnected from 'real' audits and we are therefore encouraged to note a digitisation project in IAASB's draft work program. In theory, this should only affect how auditors access and navigate the ISAs. In practice, it may lead to drafting and other structural improvements arising from the elimination of repetition, for example.
14. We believe that better, more skilful use of clear English by IAASB for an international audience would result in enhanced clarity of thought among working groups, better standards, better translations, less confusion and conflict among and between auditors and regulators and improved audit quality. But there are many non-technical aspects of IAASB's use of language that could be addressed in the short term and the benefits to auditors of LCEs would be particularly marked.
15. Unnecessarily cumbersome drafting could be addressed by dealing with simple issues, such as guidelines for words counts within sentences and paragraphs, guidelines for the use of passive and active constructions, and the use of abbreviations rather than the endless repetition of lengthy phrases, just for the avoidance of doubt. Other issues include the need for guidelines on the avoidance of duplication and overlap with other standards more generally during the drafting process, and the need for the systematic involvement of skilled translators, also during the drafting process, and not, as at present, on an ad hoc basis when individual IAASB members raise a particular translation issue. IAASB should give strong consideration to employing experts in this field.
16. **Exploring an auditing standard for LCEs:** Option B has given some commentators pause for thought. Faced with the real prospect of a separate standard for LCE audits and all that entails, some have reconsidered their previous support for a separate standard. In their view, if any separate standard is not tightly linked to ISAs, firms with only a few PIE audits - and there are many such firms - may wonder whether they still want to be in that market. There are also implications for the training, methodology and software providers who service them, for mobility within the profession, its attractiveness more widely, and the attractiveness of SMPs to small but ambitious start-ups. These issues point to the need for any new standard to be closely tied to the ISAs.
17. However, in the minds of others, we already have a two-tier profession given the gulf between larger firms and others. Furthermore, the obvious solution to increasing levels of over-engineering in standards for many, despite the reservations noted above, is a separate standard or standards for LCE audits. Some who have opposed a separate standard in the past have also changed their minds, and have come to believe that ISAs can no longer realistically be expected to cover audits at both ends of the spectrum. Not all of these commentators are from smaller firms who have few, if any, PIE audits or audits that can realistically be described as complex, and some are from larger firms. They note that similar fears were expressed when the IFRS for SMEs was first mooted and that few would now claim that much damage has been caused by that standard.

What should IAASB do next?

18. **If IAASB does not develop a separate standard for LCEs, the likely long term outcome is a fragmented, ad hoc set of dissimilar national standards, with varying, hard-to-**

measure degrees of linkage to the ISAs, applied to different categories of audits in different jurisdictions.

19. **In an ideal world, IAASB would revise all of the ISAs on a retrospective basis rather than develop a separate standard, but we do not believe that IAASB is willing or able to do this.**
20. **A separate standard is not a perfect solution and there will undoubtedly be implementation challenges and unintended consequences, including the application of the standard to entities for which it was not intended, differences of opinion regarding which entities it should apply to, and the standard becoming the 'new normal' over time.**
21. **On balance, we believe that the overriding concern is the need for high quality auditing standards for LCEs and the avoidance of fragmentation globally. IAASB must therefore seek to develop a global standard for the audit of LCEs, aligned with the ISAs, on a 'bottom-up' rather than 'ISA-minus' basis.**
22. We strongly suggest that IAASB seeks to work with those national standard-setters who already use a separate standard or are in the process of developing one. But we caution against any attempt to drive the project on the basis of the length or size of any new standard.
23. We do not believe that there is any alternative to such a standard being closely tied to the ISAs, but we do not agree with the implication in the DP that a risk-based and a fully substantive approach are mutually exclusive. A risk-based fully substantive approach is one that IAASB should explore.
24. We see no alternative to determining the range of audits to which a separate standard might apply at a national level. Many commentators had significant concerns about this and pointed out, rightly, that local scoping has implications for any separate standard. However, trying to deal with such implementation issues at this stage is a recipe for doing nothing and, on balance, we do not believe that a lack of clarity regarding scoping is a proper reason to avoid consideration of a separate standard. Nevertheless, significant flexibility at a national level as to which audits a separate standard might apply to might well lead to the application of a separate standard to more complex or larger audits than intended. IAASB therefore needs to consider whether it should address, in general terms, the linkage of the application of any standard to audit exemption limits by audit regulators.
25. We note an underlying fear that a separate standard might, over time, become the 'new normal'. This might be because of scope creep, whereby more and more entities were determined to be less complex, or because the LCE standard might be viewed as the better quality or more effective standard, reflecting poorly on the existing suite of ISAs. Provided IAASB takes the long view and addresses the structural defects in the ISAs in a robust manner, this should not happen.
26. Doing nothing is no longer an option if IAASB is to retain its status as the global standard-setter for all audits. The world is watching and national standard-setters will conclude that if little changes as a result of this DP, the opportunity will not arise again, and that if something is to be done they will have to do it themselves.

ANSWERS TO SPECIFIC QUESTIONS

Question 1. We are looking for views about how LCEs could be described (see page 4). In your view, is the description appropriate for the types of entities that would be the focus of our work in relation to audits of LCEs, and are there any other characteristics that should be included?

27. We note in our main points above the need for the range of audits to which a separate standard might apply to be determined at a national level and we support a good quality definition of a less complex entity in qualitative terms.
28. Any description of an LCE is subject to varying interpretation but we do not believe that this should be a bar to the pursuit of any of the options noted. We agree that the key to scoping is, of necessity, the characteristic of complexity rather than size, although the two are often closely related.
29. Nevertheless, significant concerns have been expressed about the scoping of any new standard. In practice it seems likely that some regulators will consider the imposition of financial and other criteria, in addition to the criteria set out by IAASB. Alternatively, or additionally, the market and users, particularly banks, may well impact scoping and some might in principle be satisfied with an 'LCE audit' for any unlisted entity. We do not believe that this issue should, of itself; be a bar to the exploration of a separate standard.
30. Significant concerns have also been expressed about how auditors might deal with borderline and emergent cases, i.e. entities that are less complex but are likely to quickly become more complex, and entities that appear at first sight to be less complex but turn out to be more complex. We believe that it should be possible to deal with some of these concerns by noting that if particular issues arise, a specific ISA should be consulted. An electronically linked version of the ISAs would make this much easier.
31. The description set out on page 4 of the DP has stood the test of time but improvements can be made. The words 'qualitative characteristics' are at odds with the references to 'few' business lines, internal controls, layers of management and personnel, for example. It might therefore be better to refer to 'uncomplicated' or 'straightforward' business lines, products and internal controls. For management and personnel, reference could be made to an uncomplicated management and personnel structure with managers and personnel having a wide range of responsibilities and duties.
32. In addition to a lack of complexity in transactions and record-keeping, reference could be made to a lack of complexity in the associated accounting policies, accounting treatments and only straightforward judgements being required. This is already implied but it might be useful to spell it out.
33. We note an emphasis on 'concentration of ownership'. In addition to size criteria, regulators might also apply additional qualitative criteria, and equate 'close company' status (where owners and managers are the same people) with concentration of ownership.
34. It will be important for IAASB to distinguish carefully between factors which make the *entity* more complex, and circumstances or factors which make the *audit* more complex or involve a higher level of risk - although they overlap. For example, any new standard would also be less suitable for the audit of an entity with a history of fraud, unsympathetic or critical external stakeholders, or controversial or difficult accounting or other issues such as conflicts between various levels of management and questions over management's competence. An additional characteristic might therefore be considered: the entity should be free of complexity or significant irregularity in its audit and other compliance, administrative and governance arrangements, and the audit should not involve a high level of assessed risk - based on the auditor's previous experience of the audit or preliminary understanding

obtained as part of acceptance procedures. Examples similar to those noted above might be given.

35. IAASB should seek to address fears about very large entities being classified as less complex in the description of LCEs. One possible way of doing this would be to suggest that if an entity is listed, or classified as large under local laws and regulation, then it would be unlikely to have the other characteristics set out in the description. Circumscribing the description, with reference to what an LCE is not, may be helpful.
36. It has been suggested that the term 'less complex entity' is a relative term and that the more absolute description 'entity of low complexity' might be operationalised more consistently. This suggestion is worthy of consideration.

Question 2. Section II describes challenges related to audits of LCEs, including those challenges that are within the scope of our work in relation to audits of LCEs. In relation to the challenges that we are looking to address:

- a. What are the particular aspects of the ISAs that are difficult to apply? It would be most helpful if your answer includes references to the specific ISAs and the particular requirements in these ISAs that are most problematic in an audit of an LCE.**
- b. In relation to 2a above, what, in your view, is the underlying cause(s) of these challenges and how have you managed or addressed these challenges? Are there any other broad challenges that have not been identified that should be considered as we progress our work on audits of LCEs?**

37. While we agree that some ISAs create more problems than others, dealing with the issues of LCE audits on a piecemeal basis is not the best approach. IAASB has asked what particular aspects of ISAs are problematic many times before and has received little in the way of response, because it is the wrong question. Taken individually, there are few requirements that are just 'too difficult' for LCE audits, or are 'always irrelevant' and might therefore be 'taken away' to make life easier. It is the interaction of unnecessarily complex, duplicative and overlapping requirements, and the overall length and wordiness of ISAs that cause the problem. IAASB is well aware that the particular categories of issues that cause problems include the required work on internal controls and documentation, because it has already highlighted those in the DP. All of our recent responses to IAASB consultations, and those of other respondents, highlight such issues.
38. We fear that this question demonstrates a lack of belief in the future of smaller or less complex audits, as well as a lack of understanding. Audits become too difficult to perform well, efficiently, which contributes to audit exemption limits being raised, and standard-setters are then persuaded not to pay too much heed to the needs of SME auditors because of the very exemption limits the standard-setter helped raise.
39. This question also implies that any separate standard would inevitably involve a 'what can be taken away' or 'ISA-minus' approach which we believe is wrong, in principle. A 'bottom-up' approach is needed to determine what should be included, not what should be excluded. An appropriate starting point might be to identify and articulate audit objectives that are of universal application. If such an approach affects the main body of ISAs, it will be no bad thing, as some objectives as they stand are indistinguishable from requirements.
40. The underlying causes of these challenges include the lack of a framework for drafting referred to elsewhere in this response. We note in our main points above the failure of the clarity project to clearly separate requirements that are in fact applicable in virtually all cases, from those that are not, or to produce meaningful objectives. IAASB itself acknowledges the increasing levels of prescription in ISAs and we urge it to consider the development of a simple framework for drafting ISAs both in the short and long term.

41. While we are encouraged by the consideration of the 'what, why and how' approach being used on an experimental basis in ISA 315, we do not think that this approach has had anything like the rigour needed in its development to represent a long-term structural solution. It needs careful, detailed consideration and some experimentation to refine it before it is adopted more widely. A lack of understanding of the clarity principles, and a lack of depth therein, contributed to the limited success of the clarity project. Taking time to plan the long-term structural changes that are needed now will pay dividends in the future.
42. We expand on some specific aspects of ISAs highlighted by IAASB as creating problems below. While addressing these issues robustly will go some way to alleviate the LCE audits problem - particularly the internal control issues within ISA 315 - any response focused on these issues alone, in the absence of proper consideration of the broader structural problems, will ultimately be ineffective. IAASB should not waste the opportunity it has created with this DP by getting bogged down in detail at this point.
- ISA 315: the processes for risk identification and obtaining an understanding of internal control do not seem proportionate to the simplicity of many LCEs which do not have formal risk assessment processes. The basic premise of ISA 315 is that they do.
 - ISA 540: the statement in paragraph 3 of this ISA to the effect that risk assessment procedures for certain types of lower risk estimates need not be extensive is helpful, but not adequate in the face of the highly detailed requirements that follow, particularly those relating to controls, and in the light of the earlier attempts by IAASB (which we wholeheartedly supported) to distinguish between complex and less complex estimates in drafting. Most estimates do not have the complexity of fair value assessments or forward-looking information but many of the requirements, while in theory relevant to all estimates, are only applicable at such a high level to simpler estimates that they often seem peripheral.
 - ISA 320: in the case of voluntary audits, the ISAs should provide guidance on considerations for those LCEs where 'users of financial statements' and 'economic decision making' are likely to mean something very different to those applicable to larger more complex entities.
 - ISA 600: in less complex audits where the parent company and subsidiaries have all been audited by the same firm, the 'top-down' risk-based approach required by ISA 315 can result in duplication of effort and documentation when combined with the ISA 600 'bottom-up' style approach. The interaction of ISA 315 and ISA 600 could be much clearer for simple audits in which one firm audits all of the group companies in a single jurisdiction.
 - ISAs 230 and 500: We note elsewhere in this response a lack of coherence in the documentation requirements which have been added piecemeal to the ISAs over many years. These have long been onerous, as well as a source of conflict between practitioners and audit regulators. Regardless of what ISAs say about the application of ISAs and requirements that are not relevant to the audit, many LCE auditors, particularly SMPs, believe that they have no choice but to spend unnecessary time documenting why they have not done things, simply to avoid regulatory censure, where the reason is obvious and should not require documentation. Over-documentation of what has not been done affects the overall value and efficiency of audit as perceived by the market. We note the work being performed by IAASB on the nature of audit evidence and how it should be documented more generally in its project on ISA 500 and we encourage IAASB to address this issue specifically in the context of less complex audits as a priority.

Question 3. With regard to the factors driving challenges that are not within our control, or have been scoped out of our exploratory information gathering activities (as set out in Section II), if the IAASB were to focus on encouraging others to act, where should this focus be, and why?

43. There are three areas in which IAASB should, working with IFAC, encourage others to act:
- Articulating and demonstrating the value of audit for LCEs, particularly those undertaking a voluntary audit. This is a public interest issue that IAASB needs to consider in terms of its own long term strategic planning. The market is becoming increasingly cynical about the value of audit overall.
 - Promoting the scalability and the use of technology in the audit of LCEs, in terms of audit quality and value.
 - Encouraging jurisdictions to review and monitor audit exemption thresholds and criteria, as well as considering alternative forms of assurance and related services.
44. The regulatory approach to LCE audits is important. We therefore encourage IAASB to engage closely with regulators with responsibility for LCE audits to establish what it is about the regulatory approach that can hamper an effective LCE audit.
45. IAASB should seek to engage with providers of software, training, and methodology, both within firms and those operating independently, because the quality of a methodology has a profound impact on the implementation of the ISAs and perceptions of their effectiveness. Software and methodology providers would have to operationalise any new standard and it would need to be aligned with the ISAs to avoid the need to rewrite methodologies. Providers are positive about the opportunity a new standard provides for eliminating an unnecessary burden of documentation on LCE audits that seemingly consists of endless checklists explaining why things have not been done. Interestingly, they also note in many cases the helpfulness of application material and the relative unhelpfulness of requirements, and they question the value of the distinction.

Question 4. To be able to develop an appropriate way forward, it is important that we understand our stakeholders' views about each of the possible actions. In relation to the potential possible actions that may be undertaken as set out in Section III:

a. For each of the possible actions (either individually or in combination):

- **Would the possible action appropriately address the challenges that have been identified?**
- **What could the implications or consequences be if the possible action(s) is undertaken? This may include if, in your view, it would not be appropriate to pursue a particular possible action, and why.**

b. Are there any other possible actions that have not been identified that should be considered as we progress our work on audits of LCEs?

c. In your view, what possible actions should be pursued by us as a priority, and why? This may include one or more of the possible actions, or aspects of those actions, set out in Section III, or noted in response to 4b above.

Option A

46. Most commentators believe that the proper way to write auditing standards is (and always was) to adopt a 'building blocks' approach starting with basic requirements, ring-fencing them and adding more for more complex audits. In an ideal world, this should be IAASB's

approach but we do not believe that it has the appetite or resources to do this on a retrospective basis.

47. Clarification in 2010 was supposed to do something like this but a very conservative approach was taken, leading to many - too many – ‘present tense’ statements that had to be divided into requirements and application material - being included in the ‘virtually all cases’ bucket, i.e. as requirements, rather than as application material.
48. By its own admission, IAASB's standards have become even more prescriptive since then. IAASB needs to try again with this. Re-clarification is needed.
49. It should not be attempted for the entire corpus of ISAs in one go, retrospectively, as it was in 2010, but rather on a *prospective* basis, as new ISAs are developed and existing ISAs are revised. Dealing with a system accommodating different styles of drafting for a few years is not beyond IAASB, practitioners, or regulators. If IAASB decides to issue a separate standard for the audit of LCEs, that might be used as a starting point for a ‘building blocks’ approach to the revision of other standards.

Drafting going forward needs to be based on a new framework of deep structural changes

50. Among other things, structural changes need to address:
 - the holistic and iterative nature of modern audits;
 - clarity regarding nature of audit evidence, the proper home for documentation requirements, and the nature and extent of documentation required, particularly for judgemental areas and thought processes;
 - a clear understanding of what an objective is supposed to be, how it differs from the requirements, and how auditors are supposed to demonstrate that it has been achieved, other than by complying with the requirements;
 - a much clearer demarcation between requirements and application material, clearly identifying requirements for LCEs and requirements for more complex entities.
51. IAASB is aware of these issues which are not unusual for a mature standard-setting body. While they were once of technical interest only, their magnitude and impact is now such that IAASB should not delay further in addressing them.

Option B

52. We note in our main points above that this option has given some commentators pause for thought. Faced with the real prospect of a separate standard for LCE audits and all that entails, some have reconsidered their previous support for a separate standard. They believe that if a separate standard is not tightly linked to ISAs, firms with only a few PIE audits - and there are many such firms - may wonder whether they still want to be in the market for PIE audits. Firms may find dealing with two parallel methodologies to be cumbersome and administratively awkward. Firms, governments, PAOs and audit regulators would also need to reconsider the training requirements for those with little or no exposure to larger, PIE or more complex audits.
53. One result of a separate standard might be barriers to mobility within the profession, which could have a knock-on effect on the ability of firms to attract talent, and to compete. A lack of competition and choice is an important issue in many jurisdictions, including the UK, and IAASB must not be seen to be exacerbating the problem. SMPs are concerned that trainees given a choice between a firm that performs ‘real’ audits and a firm that only performs a ‘truncated’ version may lead them to losing the best candidates to larger firms. They also note increasing difficulties with the transition from senior manager to ‘Responsible Individual’. All of these concerns, and concerns about the level of assurance provided and the potential

for creating other, 'experience and knowledge' gaps, should be considered. They also point to the need for any new standard to be closely tied to the ISAs.

54. However, we also note in our main points above a belief among other commentators that the profession is already divided, that many of the issues noted above are not new, that the SMP sector is healthy, that similar fears relating to the introduction of the IFRS for SMEs turned out to be unfounded, and that the obvious solution to increasing levels of over-engineering in standards, despite the reservations noted above, is a separate standard or standards for LCE audits.
55. Some who have resisted the idea of a separate standard in the past have also changed their minds, and have come to believe that ISAs can no longer realistically be expected to cover audits at both ends of the spectrum. Not all of these commentators are from smaller firms who have few if any PIE audits or audits that can realistically be described as complex. Some are from larger firms.
56. **On a short term basis, we believe that IAASB should explore a separate standard or standards for the audit of LCEs because, on balance, we believe that this is the better option. A well-understood global standard for the audit of LCEs, based on ISAs, even if applied to different categories of smaller audits in different jurisdictions would be better than the alternative, which is a fragmented, ad-hoc set of dissimilar national standards for the audit of LCEs, with varying, hard-to-measure degrees of linkage to the ISAs. The latter is the likely long term outcome if IAASB does not develop a separate standard.**
57. The use of any new standard should of course be optional.
58. We do not believe that IAASB has much choice in this issue if it wishes to continue to claim credibly that its standards facilitate high quality, efficient and effective audits for entities of all sizes. IAASB has no copyright over the words 'audit', or 'auditing standards' and if it passes this opportunity over, national standard-setters will regard the opportunity as lost for a generation and will go their own way.
59. We strongly suggest that IAASB works with those national standard-setters who already use a separate standard or are in the process of developing one. IAASB should also engage with training, software and methodology providers both within firms, and those who operate as independent commercial organisations.
60. We do not believe that there is any alternative to any such standard being closely aligned with the ISAs, but we do not agree with the implication in the DP that a risk-based and a fully substantive audit approach are mutually exclusive. Such an approach is one that IAASB should explore.
61. While we believe a separate standard should be closely aligned with the ISAs, it is critical that the approach starts with what is required, with some better quality objectives of universal application, rather than going through each of the existing standards to consider what can be removed.
62. We also believe that IAASB should address the easier short term drafting issues, as set out in our main points above. IAASB's drafting style has not changed for many years and was designed for a smaller body of standards. Systematic consideration of how language is used within the standards for a technical, international audience is overdue. Better, more skilful use of clear English by IAASB for an international audience would result in enhanced clarity of thought within working groups, better standards, better translations, less confusion and conflict among and between auditors and regulators and improved audit quality. Consideration should be given to the use of summaries, as well as the prose style currently used in blanket fashion for objectives, requirements and application material. Executive summaries could be comprehensively linked to the objectives and requirements. The style of

wording currently used lacks accessibility and begs for summarisation in the manner commonly used in slide presentations on training courses. Comprehensive links to objectives and requirements would ensure that the risk of the summary being read in isolation would be reduced. The benefits to auditors of LCEs would be particularly marked.

63. Unnecessarily cumbersome drafting could be addressed in the short term by dealing with simple issues, such as:
- guidelines for words counts within sentences and paragraphs;
 - guidelines for the use of passive and active constructions;
 - the use of abbreviations rather than the endless repetition of lengthy phrases, just for the avoidance of doubt.¹
64. Other issues include the need for guidelines on the avoidance of duplication and overlap with other standards more generally during the drafting process. They include the need for the systematic involvement of skilled translators, also during the drafting process and not, as at present, on an ad hoc basis when individual IAASB members raise a particular translation issue. IAASB should give strong consideration to employing experts in this field.
65. Standards of drafting have a direct impact on option B: on the one hand it will be hard to write a high quality and effective standard for the audit of LCEs if the standards on which it is based are poorly drafted. However, this is also an argument in support of option B, to the extent that attempts to develop a standard for LCE audits tied to the ISAs may well show up fault lines currently masked by poor drafting.
66. IAASB should seek to engage with the training, software and methodology providers on any new standard both within firms and those operating as independent commercial organisations. Firstly, the quality of a methodology has a profound impact on the implementation of the ISAs and perceptions of their effectiveness. IAASB therefore has an interest, at the very least, in understanding those aspects of the ISAs that create particular implementation problems in software and methodologies. Secondly, by engaging with providers in this way, IAASB may be able to experiment with different alternative approaches to a separate standard for LCEs. Software and methodology providers would have to operationalise any new standard and they are clear that it would need to be aligned with the ISAs to avoid the need to rewrite methodologies. But they are positive about the opportunity a new standard provides for eliminating the burden of unnecessary documentation on LCE audits. Finally, working with providers will help overcome any fears about potential difficulties associated with working with two parallel methodologies, and barriers to mobility within the profession.

Option C

67. We do not believe that option C alone represents an adequate solution. It represents little more than the status quo. The additional guidance which already exists has clearly failed to address the scalability issue. Nevertheless, additional guidance is needed to supplement the ISAs from time to time and we believe IAASB could be much bolder than it has been in the past on this issue. High quality guidance material can have a marked effect on the quality of implementation and IAASB should not seek to avoid implementation guidance simply because it is a standard-setter, as it has on occasion in the past. For example, guidance on the scope of any new standard, and on how to proceed in borderline or emergent cases as described elsewhere in this response, would be particularly helpful.

¹ We note in our recent response to IAASB on its quality management proposals the repetition of the words 'system of quality management' over 170 times in proposed ISQM 1 alone, where a clearly defined abbreviation would work just as well.

68. In our recent response to IAASB's proposed quality management standards, we note IAASB's dilemma: inclusion of additional material renders standards unwieldy and onerous, giving a more elevated status to some material than is warranted. Exclusion creates a need to cross-reference, difficulties in determining where the additional material should go and uncertainty over status, because anything IAASB issues, regardless of its actual status, is treated by some regulators as having greater authority than is intended. This hampers attempts by IAASB to innovate in terms of the types of publications it issues.
69. To escape this impasse we suggested that IAASB must make it clearer than it does now that each audit, each firm, and set of circumstances is unique, and that it is inappropriate to treat non-authoritative material - examples, in particular - as authoritative or as best practice to be applied in all cases, because examples can never reflect the full circumstances of the firm or audit. Communicating the status of non-authoritative material – ie, the fact that examples, FAQs and similar material are just that, and are not applicable in all cases - will be key in helping to ensure that new IAASB publications are not misunderstood or misused by government, regulators, PAOs or others.
70. We believe IAASB should actively consider how its process for developing guidance could be streamlined and expedited. It should also consider issuing targeted non-authoritative material directly related to different types of firm, such as SMPs.

Question 5. Are there any other matters that should be considered?

71. Going forward, IAASB should consider carefully the composition of any working group exploring the possibility of a standard for LCE audits. That group should have, and be seen to have, adequate SMP representation. Any perception, however erroneous, of inadequate SMP representation risks compromising the credibility of IAASB itself, and not just this project.
72. IAASB should consider particularly carefully the applicability of ISQM 1 and 2, and the interaction with the IESBA Code of Ethics, to auditors applying any new standard for LCE audits.
73. The DP is based on the presumption that the only alternatives are limited assurance or audit. There is a significant gulf between the two and we believe that some consideration might be given to the practice in an increasing number of jurisdictions of providing limited assurance, largely based on analytical procedures, and a number of additional, sometimes codified, agreed-upon procedures or limited assurance activities in areas such as receivables and inventory. These practices have developed because of market demand and IAASB should not ignore these trends.