

27 January 2022

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Technical Director
International Auditing and Assurance Standards Board
529 Fifth Avenue
New York, NY 10017
USA

Dear Sir,

RESPONSE TO THE INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD'S (IAASB) EXPOSURE DRAFT (ED) ON PROPOSED INTERNATIONAL STANDARD ON AUDITING FOR AUDITS OF FINANCIAL STATEMENTS OF LESS COMPLEX ENTITIES (ISA FOR LCE)

The Institute of Singapore Chartered Accountants (ISCA) appreciates the opportunity to comment on the above ED issued by the IAASB in July 2021.

To solicit meaningful feedback for the topic, ISCA undertook the following initiatives to seek views from key stakeholders:

- (i) Conducted a one-month public consultation to seek feedback from its members;
- (ii) Solicited feedback on the ED from members of the ISCA Auditing and Assurance Standards Committee;
- (iii) Organised a focus group to engage auditors to obtain their views on the feasibility of ISA for LCE. The participants were mainly practitioners from small and medium-sized audit firms, which would potentially be the most impacted by ISA for LCE, since small and medium-sized enterprises make up the majority of the client portfolios of these firms; and
- (iv) Reached out to a limited number of stakeholders such as users and management/preparers of financial statements to hear their views on whether they would be comfortable to rely on a set of financial statements audited under ISA for LCE and for their entities to be audited under ISA for LCE respectively.

We would like to commend the IAASB for working on this initiative which is critical given the attention surrounding the scalability of auditing standards in recent years.

Through our outreach activities, we have received mixed views from the profession on the ISA for LCE.

No clear distinction between ISAs and ISA for LCE

Auditors who are not supportive of ISA for LCE do not see the need for a separate standard as they do not see a clear difference between ISAs and ISA for LCE since both frameworks are based on the same principles and are designed to ultimately achieve the same level of reasonable assurance. Consequently, they are not sure if there would be any reduction in audit efforts under the ISA for LCE framework, considering that the amount and quality of audit procedures and audit evidence required are expected to be similar as those under the ISAs since the same audit opinion should be reached under either framework. Furthermore, if auditors adopt ISA for LCE, clients may have the wrong impression that there was a reduction in audit efforts and question the adequacy of audit work performed. As such, there does not appear to be a strong impetus or incentive for auditors to adopt ISA for LCE.

This apparent lack of clear distinction has further implications which we have elaborated in our responses for Questions 7 and 9.

Notwithstanding the above, proponents of the standard expect a more efficient audit, especially with documentation being more focused and relevant to the nature of a less complex entity. For example, ISA for LCE recognises that some less complex entities, particularly owner-managed entities, may have less structured processes and systems. Hence, the risk assessment procedures in the ISAs have been tailored in ISA for LCE to suit a less complex environment. This reduces the need for auditors to consider and document why certain requirements in ISAs are not applicable to the entity due to its less complex nature. Hence, a more efficient audit process is welcomed by stakeholders, as shared in our response for Question 17.

Some auditors also feel that this could be an opportunity for firms to relook at their audit methodology, instead of mechanically following templates and checklists or prior year work papers which may include considerations which are not directly relevant to LCEs.

Furthermore, in a bigger audit firm with a mixture of larger and smaller clients, some proponents feel that the introduction of ISA for LCE could be a structured way in which firms can first train newer staff to work on smaller entities audited under ISCA for LCE to gain experience, before moving them to take on bigger audits under the ISAs.

Possibility of low adoption rate

There are concerns about the potential low adoption rate of ISA for LCE as audit firms may not want to deviate from the current standards which they have been using all along. A comparison is drawn with the financial reporting standards, International Financial Reporting Standard for Small and Medium-sized Entities/Singapore Financial Reporting Standard for Small Entities, which are not widely used in Singapore.

In addition, we hear concerns that efficiencies achieved from using ISA for LCE may be marginal, especially for existing clients where audit templates and documentation have already been set up. Coupled with potential practical implementation challenges such as confusion among the

audit staff over two sets of standards, especially during the transition period, this makes adopting ISA for LCE less attractive. Other challenges are further elaborated in our response for Question 17.

Our comments to certain specific questions in the ED are as follows:

Section 4A – Overarching Positioning of ED-ISA for LCE

Question 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?

We agree with IAASB's current approach in positioning ISA for LCE as a standalone standard as it would be more concise, and easier to read and apply. Currently, there is no option in ISA for LCE to refer back to the ISAs. This is good as allowing any such option will cause confusion in application as auditors will grapple with the question when they should refer to ISAs instead of ISA for LCE.

However, one concern that auditors have in relation to a standalone standard is the risk of having to change to applying the full suite of ISAs during the course of an audit arising from changes in the circumstances of the audited entity. For example, when the audited entity enters into complex transactions that were not made known to the auditor during the planning phase. Implications arising from this could include disruptions or delays to the audit timeline due to top-up procedures having to be performed and client dissatisfaction. While we note the IAASB's view that such situations of switching to ISAs may be uncommon, some guidance on how auditors can identify and deal with such scenarios could be helpful.

Section 4B – Authority of the Standard

Question 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?
- (e) Is the proposed role of legislative or regulatory authorities or relevant local bodies with standard setting authority in individual jurisdictions clear and appropriate?

Question 5

Regarding the Authority Supplemental Guide:

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

The Authority as presented is generally clear and implementable. We agree that the specific prohibitions for the use of ISA for LCE (for example, listed entities, entities with public interest characteristics, etc) are appropriate. We also agree that regulators/standard-setters of individual jurisdictions should have the flexibility to decree jurisdiction-specific criteria, as different countries can have unique circumstances. This has been clearly indicated in ISA for LCE.

Quantitative Criteria

The ED currently only considers specific prohibitions and qualitative characteristics in determining whether an entity is an LCE. In considering whether quantitative criteria should be included as part of the Authority of ISA for LCE to set out the scope of the standard, we note that many jurisdictions apply a set of quantitative criteria when determining qualification for audit exemption. While quantitative criteria could be viewed as more transparent and easier to apply as it involves less judgement (in the context of assessing if the entity meets the quantitative criteria to qualify as a less complex entity), we are supportive of IAASB's approach of focusing on qualitative criteria as quantum may not be indicative of complexity. Jurisdictions which prefer to include quantitative criteria can develop these on their own, which is allowable under ISA for LCE.

Accounting Estimates

More guidance and examples on assessing the complexity of accounting estimates would be useful (i.e. what are considered complex accounting estimates). For instance, it can be common for entities with simple structures and transactions to hold investment properties or investments in derivatives, and it may be difficult to assess whether the valuation of these investments would be considered as complex accounting estimates.

Section 4C – Key Principles Used in Developing ED-ISA for LCE

Question 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).

Transition from ISA for LCE to ISAs

If it is determined that ISA for LCE is no longer appropriate for use in an audit engagement, paragraph 139(d) of the ED requires the auditor to consider whether there are any additional procedures required on opening balances. More clarity and explanations should be provided by the IAASB on the timing and rationale for additional procedures on opening balances to be considered. In essence, the prior year audit performed under ISA for LCE should have been sufficient for the purpose of the entity in ascertaining its opening balances as it had qualified as an LCE then.

The requirement to consider additional procedures on opening balances somewhat contradicts the principle that both ISA for LCE and ISAs will arrive at the same level of reasonable assurance.

It also alludes to the fact that the ISA for LCE may not have been adequate and so additional procedures would have to be carried out if ISAs were applied instead. This should not be the case since ISA for LCE was designed to leave out those requirements which are not relevant for LCE.

Essential Explanatory Material (EEM)

We agree with the approach to include the EEM in the body of the proposed standard as it would be easier to read and more reader-friendly. We also agree with the approach to limit the EEM to where it is essential to understanding or applying a requirement(s) to keep it succinct for the purpose of LCE audits. The manner in which the EEM has been presented is also clear (i.e. presented in italics in separate blue boxes).

Section 4E – Content of ED-ISA for LCE

Question 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.

Differences between ISAs and ISA for LCE

From the mapping document provided to illustrate how the requirements from the ISAs have, or have not, been incorporated in ISA for LCE, it is not clear how ISA for LCE is significantly different from ISAs, except that most of the application material has been removed.

Since both standards are based on the same principles and ultimately would achieve the same level of reasonable assurance, it is difficult for auditors to appreciate if there are any substantive differences between ISA for LCE and ISAs, apart from possibly reduced documentation. It would be even harder for stakeholders who are non-auditors to understand the differences. As a result, auditors and stakeholders will find it challenging to appreciate the benefits of ISA for LCE or consider its usage.

Additionally, opponents to ISA for LCE argue that at the moment, firms are already incorporating scalability in their audit approach to cater to different levels of complexity (for example, an audit of a large multinational company vs a small private company). If there is no clear distinction between ISA for LCE audits and those under the ISAs, they suggest that instead of introducing a separate auditing framework, an alternative could be to increase the scalability in the existing ISAs by segmenting the standards into sections that would be applicable to all entities and sections that would only apply for more complex situations.

Hence, it would be essential for the IAASB to provide clarifications on the differences between ISA for LCE and ISAs, as auditors that perform audits under both sets of standards need to have a clear understanding of the differences to properly navigate the transition from ISA for LCE to ISAs (or vice versa). This would alleviate one of the key concerns that audit firms have in terms of training their staff on two sets of standards as mentioned in our opening comments of this letter.

Section 4F – Other Matters

Question 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.
- (b) Whether the proposed standard meets the needs of auditors, audited entities, users of audited financial statements and other stakeholders.
- (c) Whether there are aspects of the proposed standard that may create challenges for implementation (if so, how such challenges may be addressed).

Whether ISA for LCE meets the needs of stakeholders

In principle, ISA for LCE would meet the needs of stakeholders since it allows auditors to provide a reasonable assurance opinion, consistent with an audit performed under ISAs.

Based on users of financial statements who responded to our outreach, they are comfortable relying on a set of financial statements audited under ISA for LCE, given that the underlying concepts of the audit performed and level of assurance achieved is the same as a set of financial statements audited under ISAs. From the perspective of management/preparers of financial statements, they welcome a more efficient audit process and expect that this will translate to less time spent dealing with auditors.

However, some users expressed concerns over whether there will be sufficient safeguards in place to ensure that ISA for LCE is rightfully applied to only in-scope entities, so that the rigour and quality of audit is not compromised as a result of applying ISA for LCE incorrectly (i.e. on non-LCEs). A suggestion is for the justification that the audited entity qualifies as an LCE to be made clear and agreed between the audited entity and the auditors. This could include, among others, representation by those charged with governance (TCWG).

Users of financial statements who are not supportive of ISA for LCE also perceive the standard to be of lower quality, leading to a less robust audit. This would create the misconception that there are two different tiers of audit opinion and that there would be issues with comparability. This could widen the expectation gap, which will not be in the public interest.

Challenges auditors may face when deciding to use ISA for LCE

Consistent with the misconception by users of the financial statements, one of the concerns that auditors have is whether they will be able to convince TCWG of the audited entity and users of the audited financial statements (such as banks, creditors and suppliers) that an audit conducted using ISA for LCE is equally robust. If the misconceptions are not rectified, TCWG or management

of the audited entity may not want their auditors to use ISA for LCE or the auditors themselves may not be keen to use the standard as well.

In this regard, regulators and standard-setters could help to communicate to stakeholders and deliver the message that both ISAs and ISA for LCE would result in equally robust audits to dispel any misconceptions. As the international auditing standard-setter, IAASB could lend a strong voice to this with a statement to that effect. However, before this can happen, we wish to reiterate the importance of IAASB clarifying the differences between ISA for LCE and the ISAs. Without clear distinction, it would be confusing for the stakeholders as the output (i.e. a reasonable assurance audit opinion) is the same.

Another challenge, as described earlier, is the risk of having to change to applying ISAs during the course of an audit due to the standalone nature of the standard. Weighing the implications arising from this, auditors may choose not to adopt the standard at all.

Regulatory perspective

As auditing is a highly regulated profession, introducing a separate and new auditing framework would have an impact on the regulatory environment. Questions would arise on whether there would be any differences in how inspections would be conducted for audits under ISA for LCE vis-à-vis those under ISAs. For example, given that audits under ISA for LCE also provide reasonable assurance, it is not certain if regulators will accept reduced levels of documentation under the new standard. The adoption of ISA for LCE may necessitate corresponding adjustments to the inspection framework. Hence, it is critical for standard-setters to work closely with the regulators during the adoption stage of ISA for LCE.

Section 5 – Group Audits

Question 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.

Question 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.

In our view, group audits should be included in the scope of ISA for LCE, as they may not always be complex. It is not uncommon to see groups which are not complex, for example, where all entities are within the same jurisdiction and separate entities are set up for mostly inter-company transactions or for administrative reasons. For example, a group that consist of a holding company that manufactures goods and sells 100% of the goods to its subsidiary (which acts as

a marketing/distribution channel) may not be considered complex. In such situations, although the business is structured in a few legal entities, the group as a whole may be in substance, an LCE.

Some considerations when determining if a group is complex could include:

- Whether the group would qualify as an LCE, if it had been structured as one legal entity
- Whether there are subsidiaries located in other jurisdictions
- Whether there is involvement of component auditors

Similar to a standalone entity, ISA for LCE should allow the auditor to exercise judgement in assessing the complexity of the group based on qualitative characteristics.

If there are concerns that groups are inherently complex, one approach that IAASB could undertake is to monitor the application of ISA for LCE in audits of standalone entities first before deciding whether to extend the application to group audits.

Should you require any further clarification, please feel free to contact:

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Yours faithfully,



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