

Mr. Thomas R. Seidenstein
Chair
International Auditing and Assurance Standards Board
529 Fifth Avenue
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USA

26 January 2022

RE: Proposed International Standard on Auditing (ISA) for Audits of Financial Statements of Less Complex Entities (LCE)

Dear Mr. Seidenstein

1. The Irish Auditing and Accounting Supervisory Authority (IAASA) 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.
2. IAASA is the independent statutory body in Ireland responsible for oversight of the audit profession and adoption of standards on auditing, professional ethics and internal quality control, as well as the inspection and promotion of improvements in the quality of audits of public interest entities.
3. IAASA is committed to improving audit quality through the adoption of high-quality auditing and professional standards. In addition, IAASA seeks to ensure that audits appropriately meet the needs of the market.

OVERALL COMMENTS

4. The creation of a separate standard for LCE audits that aims to provide the same level of assurance as the complete suite of ISAs has the potential to cause confusion among auditors and users of financial statements, such as the examples listed below.
 - The LCE standard may create the perception that two different categories of audit exist, with different levels of assurance and different performance standards, therefore fragmenting the audit market.
 - Whether applying the ISA for LCE will result in a consistent level of assurance compared to applying the full suite of ISAs.
 - The proposal in the Exposure Draft to require an audit opinion that references use of the ISA for LCE raises additional questions with regards to the value of the auditor's opinion when applying the proposed standard.

5. Less complex/smaller entities make a major contribution to the global economy and represent a high proportion of audits performed. Solutions are needed to reduce the expectation gap between auditors' responsibilities and stakeholders' expectations. One of our main concerns is that the confusion resulting from the issuing of a standard for audits of LCE may widen the expectation gap and decrease confidence in audits.
6. In addition, we would question the potential attractiveness for auditors of applying the ISA for LCE given that it is based on the core requirements of the ISAs and so is unlikely to result in a substantive reduction in the audit work performed and documented.

Scalability of the current ISAs

7. The proposal to issue a separate standard for the audits of LCE could be considered to be at odds with the IAASB's longstanding premise that the ISAs are scalable. In particular, the recent standards (ISA 540, ISA 315 and the International Standards on Quality Management) contain some provisions regarding application of the standards in the case of LCE.
8. As stated in the background material, it is estimated that over 99% of entities in the European Union are small and medium sized entities. The IAASB's decision to issue a separate LCE standard could be interpreted to suggest that the current ISAs are not fit for purpose for the majority of audits.

Complexity, Understandability, Scalability and Proportionality

9. Two different work streams were originally proposed for this project i.e. a standard for audits of LCE and to address complexity, understandability, scalability, and proportionality (CUSP) in the ISAs more broadly.
10. Paragraph 101 of the explanatory memorandum to the Exposure Draft states that ISA for LCE "would present requirements for an audit of an LCE based on the core requirements of the ISAs but drafted and presented in a more understandable and straightforward way" which is also part of the CUSP project. In addition, the IAASB has acknowledged that the CUSP project addresses many of the same issues and challenges and that the two work streams are being run in parallel.
11. We encourage the IAASB to continue with the CUSP project so that standards are proportionate to the audit of all types of entities. As we suggested in our previous letter, more focus on clear language and understandability can contribute to auditors being better able to apply the standards to different situations and entities without a separate standard. The CUSP work stream should be progressed further before determining which is the best way to address challenges regarding the audits of LCE.

Adequacy of standalone ISA for LCE

12. The proposed new standard does not provide enough guidance to auditors and could therefore result in a deterioration of audit quality. Paragraph 19 of ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing states that "the auditor shall have an understanding of the entire text of an ISA, including its application and other explanatory material, to understand its objectives and to apply its requirements properly." This is explained further in paragraph A59 of that standard. The application and other explanatory material may "explain more precisely what a

requirement means or is intended to cover.” Our concerns on the stand-alone nature of the ISA for LCE include:

- How an auditor of an LCE will be able to understand and apply the ISA for LCE without a full understanding of all ISAs. For practitioners that decide to focus exclusively on audits of LCE, their knowledge of the full suite of ISAs is likely to decline over time. While the requirements of the ISAs have largely been included in the ISA for LCE, they are presented in a different format and exclude large portions of the related application and other explanatory material. One example is the exclusion of the application guidance on substantive analytical procedures. These are an area where auditors have experienced challenges, and it is unclear why this additional application guidance is not considered necessary for auditors using the ISA for LCE to understand the objective, apply the requirements properly, and provide the same of level of assurance as the full ISAs.
- A professional accountant is required to comply with the principle of professional competence and due care. This requires accountants to attain and maintain their professional knowledge and skills at the level needed to ensure that they provide competent professional services, based on current technical and professional standards. There is a risk that the proposed standard will undermine these professional responsibilities, as auditors of LCE may believe they only need to maintain professional competence based on the ISA for LCE. This may have a negative impact on the ability of practitioners in smaller firms to perform quality audits.
- The auditor is required to determine that the use of ISA for LCE is appropriate for the audit engagement. If it is found that the ISA for LCE is not appropriate during the audit because complexities regarding the audited entity not contemplated by the proposed standard have arisen, then a transition to the use of the ISAs is required. For example, the auditor will need to reassess the appropriateness of the use of the ISA for LCE when a material uncertainty related to going concern exists or when potential fraud activities are detected (since in these situations the risk can increase in various areas). We are concerned that auditors will not be able to identify such situations if they have focused their training and experience on the ISA for LCE and do not have an understanding of the full ISAs. A related concern is that switching to the ISAs part-way through an audit might be difficult and may lead to additional time when compared to applying ISAs from the outset of the audit. Auditors may also be reluctant to transition to a full ISA audit due to the increased costs and time required.

Auditor training and experience

13. Another drawback of having a separate standard for audits of LCE is that competent authorities may be unwilling to authorise an individual as an auditor if all their experience and training relates to LCE audits.

Scope

14. The scope of the ISA for LCE is subjective and likely to lead to inconsistent use of the standard. The provisions contained in the exposure draft leave room for the auditor to evaluate whether the standard is applicable to an audit, and this could lead to situations where different auditors, firms and/or jurisdictions may interpret the acceptability of using the ISA for LCE differently for entities that exhibit similar

characteristics. This may contribute to confusion for users of financial statements and undermine the objective of achieving global consistency.

15. Further, the lack of objective criteria in the ISA for LCE to determine its suitable application may lead to possible bias by auditors in their qualitative analysis in order to apply this standard. It may even lead auditors to compete on whether or not an audit may be performed under the ISA for LCE, determining an inappropriate application of the standard and preventing auditors applying the full ISAs if needed. The lack of objective criteria could also lead to pressure by some entities on the auditor to apply the ISA for LCE with a view to reducing costs which may also reduce audit quality.
16. It would also be a challenge for oversight bodies to assess and enforce whether the use of the standard is appropriate or not based on the current criteria.

Group Audits

17. The proposal to exclude groups from the scope of the ISA for LCE will limit its applicability as it is common for business to be structured across a number of separate corporate entities. The following could be indicators of a group being less complex:
 - All financial statements and accounting records prepared by a single accounting team
 - Limited international operations, which reduces issues re currency conversion, different legal requirements etc
 - Use of component auditors not required
 - Limited number of intra group transactions

Volume of the standard and accompanying documents

18. One of the IAASB's objectives was to issue a concise standard. Given the volume of materials issued (the draft standard, supplemental guidance for authority, supplemental guidance for auditor reporting and glossary of terms) it appears that this objective has not been met. This highlights our concern regarding whether a separate standard for LCE is appropriate.
19. Moreover, the different authority of these various materials may be a source of difficulties for auditors of LCE. For example, the format and content for an unmodified auditor's report is included in the standard, while the format and content for an auditor's report containing a qualified opinion, emphasis of matter paragraph and/or other matter paragraph is set out in the non-authoritative supplemental guidance.

Maintenance of the ISA for LCE

20. The IAASB's 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 requires further clarification.
21. If updates are 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 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.

Other potential solutions

22. Providing additional scalability guidance for the requirements of the ISAs where auditors face challenges or issuing other explanatory material to support auditors in effectively applying the ISAs may be more appropriate. The work done by the IAASB on the LCE project may provide a basis for issuing guidelines for auditors of LCE, as a supplement to the ISAs.

SPECIFIC COMMENTS ON THE EXPOSURE DRAFT'S CONTENT

23. As detailed above, we have significant concerns as to whether the proposed ISA for LCE will be helpful for auditors, users and regulators. However, if the IAASB decides to continue this project notwithstanding our comments, we have provided below some further items for consideration in relation to the content of the proposed standard.

Provisions applicable to LCE audits

24. We question why auditors should not be required to apply certain ISAs in full when auditing LCE. 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.
25. If the IAASB wants to pursue a separate ISA for LCE, it is essential that the standard ensures audit quality in respect LCE and avoids any unclear areas or requirements that lack sufficient details and/or guidance for auditors to perform audit procedures to a high standard.

Characteristics of "less complex entities"

26. There is an inconsistency in paragraph A9. The first line states that the ISA for LCE is inappropriate for an audit if an entity exhibits "one or more" of the characteristics listed in paragraph A9. 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.
27. The essential explanatory material (EEM) to paragraph 1.2.1 states that if an Engagement Quality Review (EQR) is required, ISQM2 will be applicable. We question whether the requirement for an EQR indicates that use of the LCE standard may not be appropriate. Usually, if the audit firm decides to have an EQR on a voluntary basis, it is 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

28. In section 1.2, the statement that ISQM1, or national requirements that are at least as demanding, applies to all firms performing audits should be a requirement rather than essential explanatory material.

Acceptance and continuance

29. 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 also has to consider whether this is permitted by local law and whether the engagement is still an audit.

Audit procedures - sampling

30. The proposed standard provides no guidance on how to determine sample sizes. In contrast, appendixes 2 and 3 of ISA 530 list the factors that can influence sampling size. Adding guidance within paragraph 7.3.5 on audit sampling would be useful to help the auditor when determining sample sizes.

Going concern

31. We consider that a material uncertainty related to going concern may be an indicator of complexity. This could be added to the list of indicators that the auditor should take into consideration when assessing if the use of the ISA for LCE is appropriate.

Transitioning between ISA for LCE and other ISAs

32. While the standard 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 it is not.

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

Conforming amendments

34. If the ISA for LCE is adopted, then conforming amendments may be required to the ISAs. For example, the group auditor is ultimately responsible for ensuring the group audit engagement has been performed in accordance with the ISAs. 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. If the IAASB proceeds with the ISA for LCE, they will need to consider the necessary conforming amendments to ISA 600 (revised), Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors).

Supplementary guidance for the authority of the standard


35. 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 included in the standard.

CONCLUSION

36. If the IAASB proceeds to issue a separate standard, the scope of the standard should be clearly stated to ensure consistent application in practice. The authority of the materials provided along with the separate standard should also be clarified to avoid any confusion among auditors on their applicability. However, we are of the view that, in lieu of issuing a separate LCE standard, the IAASB should utilise its work on understanding and considering issues that have been raised in various jurisdictions in relation to audits of LCE to identify alternative solutions, such as issuing scalability guidance for audits of LCE.

Please do not hesitate to contact us to discuss any of our comments.

Yours sincerely



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