



4 December 2020

Tom Seidenstein, Chair
International Auditing and Assurance Standards Board
529 5th Avenue
New York
New York 10017

By email

Dear Tom

LESS COMPLEX ENTITY AUDITS

I am writing on behalf of ICAEW to reiterate our support for IAASB's less complex entity (LCE) audits project and to set out:

- why IAASB must prioritise the development of a new standard for LCE audits; and
- five things IAASB needs to do to help ensure that the new standard is genuinely workable, widely adopted and delivered on a timely basis.

The LCE audits project is not a concession to smaller businesses and audit firms or less developed jurisdictions. Nor is it about doing less work or lowering audit quality. It is about providing a workable and effective means of delivering reasonable assurance to the world's small and medium sized entities (SMEs).

The success of this project is critical to IAASB's continued locus as the world's auditing standard-setter. ICAEW and other loyal IFAC members have supported IAASB in its mission despite growing concerns about the scalability of International Standards on Auditing (ISAs). We urge IAASB to act decisively now, and deliver this new standard quickly, to prevent the disintegration of the remarkable global consensus on auditing standards it has so painstakingly built over forty years.

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Prioritising IAASB's standard for LCE audits in the public interest

IAASB should be confident in clearly articulating and promoting the benefits of a new standard, in the public interest, to all stakeholders including audit regulators, national standard-setters and other bodies who require the use of international standards.

IAASB's public interest mandate derives from the widespread use of ISAs in audits of entities of all sizes

IAASB is like no other auditing standard setter. It must serve the needs of many jurisdictions, not just one, and serve all of the entities in many of those jurisdictions, including many smaller entities. IAASB's current work on group audits, audit evidence, fraud and going concern are clearly in the public interest, but they are less urgent for most of the world's auditors than a standard for LCE audits.

Many jurisdictions using ISAs have no choice

ISAs are vital public goods in the many jurisdictions that do not have the resources to set their own standards. No jurisdiction that adopted international standards in good faith thirty years ago and reaped the benefits of improved corporate reporting should now have to abandon those standards, because the gold standard of audit has been re-engineered to meet the needs of much larger entities.

ISAs are embedded in global economic activity

The use of ISAs is embedded in national legislation and legally binding contracts. ISAs are the benchmarks used by the European Union, the World Bank, regional development banks and global not-for-profits and grant making bodies. None of this is easily changed, nor should it be. The suggestion that these bodies should rewrite their requirements, or that audit exemption limits should be raised if auditors of smaller entities struggle with an ISA audit, seems disrespectful. Support for standards that render LCE audits inefficient, ineffective or too expensive is increasingly hard to justify. To secure its future as the global auditing standard setter, IAASB must ensure that ISAs continue to work for the world's SMEs.

Strengthening the ISA brand

Experience suggests that acceptance of a new standard will be less of a challenge than some fear. Far from damaging the IFRS brand, the IFRS for SMEs enhanced it. There has been no confusion in the market that we are aware of, or misuse of the standard by entities for which it was not designed, and we believe that a standard for LCE audits will strengthen the ISA brand.

Five things IAASB needs to do now

ICAEW recognises the challenges associated with delivering a new standard at pace. We set out below five things we believe IAASB needs to do to ensure the success of this project.

1. Develop a professional user product

The standard for LCE audits should be written as a professional user product, to be used by those already experienced in auditing. This is different to the approach to the development of ISAs which are more of a 'how to' guide. The focus should be on practical requirements - on what auditors need to do.

IAASB should make it clear that practitioners are both entitled and obliged to exercise their professional judgement in using the new standard. They should refer to the full suite of ISAs where necessary, be prepared to defend their use of it when challenged, and not use the standard as a defensive shield.

The IFRS for SMEs was initially developed by an experienced practitioner with a sound knowledge of IFRS, with the standards to hand. A similar approach should be considered by IAASB.

2. Focus on developing requirements rather than defining LCEs

The standard for LCE audits will in practice be used primarily for SMEs, the majority of which are not complex. IAASB does not legislate and has no need of a precise definition of an LCE before it can proceed. Application of the standard will be determined locally and very likely on a highly conservative basis, at least initially.

IAASB's current deliberations about definitions and scope are a distraction from the more important objective of developing a workable standard. IAASB needs to scope LCE audits at a high level only and leave it to individual jurisdictions to determine to which entities it should apply. Entities eligible to use the IFRS for SMEs might be an easily understandable starting point.

3. Articulate requirements clearly

IAASB's current focus should be on developing requirements that are relevant to LCEs and articulating those requirements in less complex and clearer terms to improve accessibility. Both should enhance audit quality.

IAASB must cut away the accretion of unnecessarily complex and lengthy forms of words that have grown over the years and obscure the basics of simple audits. The 'lift and drop' approach currently being discussed makes no attempt to deal with these issues and will perpetuate the accessibility problem.

Simpler, less exact constructions should be used which means that the requirements must be rewritten. This can be achieved without losing the essential link to the main body of ISAs by means of referencing.

Drafting criteria for the standard for LCE audits need to focus on:

- avoiding repetition;
- targets for the total word count and sentence length;
- keeping the English plain.

IAASB should engage with plain language experts and set targets for the length of the standard, the length of sentences, and comprehensibility scores. This is critical for an organisation relying on translation - it needs to reduce vocabulary and avoid nuance.

IAASB should avoid the default assumption evident in the clarity project that when in doubt, include, and adopt instead the principle of, 'when in doubt, leave it out'. Not including an audit procedure does not mean auditors cannot, will not or should not perform that procedure.

Many current requirements only make sense if they are supplemented by explanatory application material. Requirements in the standard for LCE audits should be developed from a mixture of existing requirements and application material.

It may be necessary to decouple the standard for LCE audits from the Comprehensibility, Understandability, Scalability and Proportionality (CUSP) project, which is more relevant to the overhaul of the main body of ISAs for more complex audits, and which will take time. Auditors who use the main body of ISAs for more complex audits are not about to defect, and lessons from the LCE audits project can feed into the CUSP project.

4. Deal with requirements relating to internal controls more realistically

The single most frustrating aspect of ISAs for many smaller firms is the requirements relating to internal controls. Attempts to make these requirements scalable for smaller audits have not succeeded to date because of the painful level of artifice involved in trying to make sophisticated internal control frameworks work for very small audits.

This area requires careful consideration by experienced practitioners from smaller firms with extensive experience of very small audits to deal with the fundamentally different approach to the necessary understanding of controls, documentation, segregation of duties and management override.

5. Make due process the servant of the public interest

IAASB's due process is a means to an end and necessary for the public interest to be served. However, it may not be sufficient and IAASB may need to do more to ensure that the new standard is workable and not over-engineered.

Concluding comments

The one-size fits all, single set of auditing standards model is no longer sustainable. There are fundamentally different markets for IAASB's output, which demand different products. Developing a standard for LCE audits will also help IAASB focus the main body of ISAs on the growing needs of larger and more complex entities, which is also in the public interest.

Please get in touch with me or my staff at ICAEW if you would like to discuss the detail of this letter in more detail. We would be pleased to consider any requests you may have for ICAEW to provide additional support for this project.

Yours sincerely

A handwritten signature in black ink that reads "Michael Izza". The signature is written in a cursive style with a large initial 'M'.

Michael D M Izza
Chief Executive