

Tom Seidenstein
Chair
IAASB
529 Fifth Avenue
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17 December 2021

Dear Tom,

Exposure Draft—Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ED-ISA for LCE)

The Financial Reporting Council (FRC) welcomes the opportunity to respond to this Request for Comment. As the UK's Competent Authority for Audit, our mandate includes: the setting of auditing, assurance and ethical standards; inspection of public interest entity audits and enforcement action against auditors. We also oversee the accountancy profession in regulation of its members and take public interest misconduct cases where conduct falls below expected standards (e.g., where practitioners fail to comply with the fundamental principles and requirements set out in the Code of Ethics). The FRC also is responsible for setting the UK Corporate Governance Code and its associated guidance.

The UK has a statutory audit exemption threshold which applies to a significant proportion of the entities likely to fall within the scope of this new LCE standard. On that basis alone the FRC does not see grounds for adoption in the UK, a matter we discussed at the event in London hosted by the ICAEW in November. Nevertheless, we have some high-level observations on the exposure draft.

The FRC strongly supports the IAASB continuing to focus its efforts on maintaining the quality and operability of ISAs for audits of entities of all sizes and complexity, which we believe supports the consistent performance of high-quality audits. We welcome the IAASB's ambition to address the matter of complexity of those ISAs, particularly through the Complexity, Understandability, Scalability and Proportionality (CUSP) project, and we believe that benefits could be delivered by the IAASB adopting the clearer, crisper and more concise language used in this Exposure Draft when it drafts new or revised standards. We were, therefore, disappointed that the IAASB decided to develop a separate standard for auditing LCEs, irrespective of concerns raised by a number of stakeholders.

Relevance of the ED-ISA for LCE to UK audits

The UK Government has taken steps to address regulatory burdens on small and less complex entities by removing auditing requirements for certain categories of businesses. This means that companies which fall below specific thresholds for net assets, number of employees and turnover are exempt from having a statutory audit.¹ However, in order to strike

¹ Companies which fall below two of the following thresholds do not require an audit: an annual turnover of no more than £10.2 million; assets worth no more than £5.1 million; 50 or fewer employees on average.

an appropriate balance between a lighter touch regulatory regime and public accountability, more complex entities, such as smaller banks and insurers, and other entities that are of public interest, such as charities, are still subject to statutory audit requirements or have lower exemption thresholds. A survey commissioned by the Department for Business, Energy and Industrial Strategy (BEIS) in 2017², highlighted that a significant proportion of UK businesses³ were likely to have benefited from such audit exemptions.

A number of entities not required to have a statutory audit, may voluntarily choose to have an audit, for instance to meet funding requirements from lenders, or membership obligations. We also question the value of this ED being used for such engagements, as we see there being a significant risk that the users of those financial statements may view them with less confidence if they perceive they have been delivered to a lower standard than an ISA audit. Indeed, I recall at the November event that we both spoke at, there were a number of questions about how this ED might reduce cost and work effort. I welcomed the statements both you and Kai made to correct this misunderstanding, nevertheless, it shows the risks that this ED brings.

Accordingly, given the nature of businesses in the UK that are exempt from audit, when compared to the scope of entities described in the proposed standard, the FRC does not intend to adopt the LCE standard in the UK based on the proposals the IAASB has consulted on.

Other comments

Notwithstanding adoption status in the UK, we have concerns about the development of a separate standard for audits of LCEs. The FRC believes that a single set of standards designed to be applied to a wide variety of entities with differing circumstances and sizes, supports the consistent performance of quality audits. For reasons set out below, we are concerned that over time the application of the ED-ISA for LCE could undermine consistency in performance and result in a greater number of poorer-quality audits.

Scope and Authority of the ED-ISA for LCE

The FRC believes the scope and authority of the ED-ISA for LCE is too loosely defined. In particular, the qualitative characteristics allow too much scope for auditor judgement as to whether the use of this standard is appropriate in the circumstances. If practitioners apply the wrong set of standards, reasonable assurance will not be obtained. In addition, the interpretation of the qualitative characteristics by auditors may be difficult when entities are at the threshold of being less complex and will lead to inconsistent practice, both locally and internationally.

Structure and content of the ED-ISA for LCE

The FRC understands that the ED-ISA for LCE is based on the core requirements for an audit within the ISAs, although some of those core requirements have been modified. The IAASB nevertheless proposes an entirely separate standard with no requirement to directly reference back to the application material in the ISAs in its implementation. This approach, in our view, could adversely affect both audit quality and market consistency.

We believe, and as noted in ISA 200 paragraph 19, that to understand the objectives and apply the requirements of the auditing standards properly, the auditor should have a full understanding of the ISAs including the application and other explanatory material. In this

² [The Impact of Exempting Small Companies From Statutory Audit, BEIS Research Paper, January 2017.](#)

³ Up to 90% of all UK registered companies in 2015.

regard, we find it difficult to envisage that the ED-ISA for LCE provides a basis for reasonable assurance.

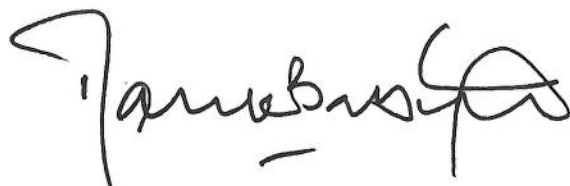
We believe that over time the competency and capabilities of auditors in the profession could be negatively affected, as certain auditors may only obtain or retain experience of performing audits under the ED-ISA for LCE. These circumstances could create a 'two-tier' audit profession. At a time, when we in the UK are looking at measures to strengthen the diversity of the audit market and encourage more audit firms to engage in the audit of Public Interest Entities, we believe this ED will undermine that objective.

Further, we are concerned that when an entity subject to audit under the ED-ISA for LCE has evolved to become a more complex entity, their auditors may only focus on learning and applying what they believe to be the areas of difference between the LCE standard and the ISAs. Practitioners may not therefore obtain an appropriate understanding of the ISAs necessary to obtain reasonable assurance in the audit of the more complex entity.

We recommend that instead of continuing the development of the LCE standard, that the IAASB focusses its efforts, under the umbrella of the CUSP project, to continuing to maintain a single set of auditing standards applicable to all audits and the development of non-authoritative guidance to help clarify how to apply the ISAs on audits of LCEs.

If you have any questions about our response, or wish to discuss any of our observations in more detail please contact me directly, or James Ferris, Director of UK Auditing and Assurance Standards, Financial Reporting Council on j.ferris@frc.org.uk or +44 (0)20 7492 2412.

With best wishes for Christmas and for 2022!



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