



International Organization of Securities Commissions  
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12 January 2022

Technical Director  
International Auditing and Assurance Standards Board  
545 Fifth Avenue, 14th Floor  
New York, NY 10017 U.S.A.

Our Ref: 2021/O/C1/IAASB/MS/185

**Subject Line: IAASB's Proposal: *Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE)***

Dear Sir: *Krilic*

The International Organization of Securities Commissions' Committee on Issuer Accounting, Audit and Disclosure (Committee 1) appreciates the opportunity to comment on the International Auditing and Assurance Standards Board's (the IAASB or the Board) proposed standard: *Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities* (the Paper). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through the promotion of high quality accounting, auditing and professional standards, and other pronouncements and statements.

Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting, disclosure and auditing concerns, and pursuit of improved global financial reporting. Unless otherwise noted, the comments we have provided herein reflect a general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.



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## Overall Comments

We strongly encourage the IAASB to pursue other solutions to the actual and/or perceived challenges of auditing less complex entities (LCEs) rather than adopting the proposals contained in the Paper. We believe that a single set of ISAs that are scalable, concise, and easier to understand is a more effective approach. In contrast, multiple sets of auditing standards create complexity, consistency challenges, and the need for the Board to devote limited resources to maintaining a new set of standards.

High quality financial reporting provides investors with decision-useful information. Consistent performance of high quality audits promotes investor confidence in financial reporting and the integrity of capital markets because it provides investors with independently verified information. In our view, establishing a separate set of International Standards on Auditing (ISAs) to govern audits for a subset of entities introduces challenges to consistency, perceptions about the level of assurance provided, and execution of high quality audits. In contrast, a single set of auditing standards applicable to and scalable for all audits benefits the public, auditors, companies, and investors alike.

Paragraph 8 of the Paper states: “*The ISAs were clarified and revised in 2005–2009 (the ‘Clarity Project’) with a view to being applied to audits of entities of all sizes and complexity*”. Given this universal applicability, we question whether the Paper is an indication that the principles of the Clarity Project are no longer being followed, whether the principles need revision, or whether the IAASB must start over with a new set of standards. We believe that the Board must carefully assess the underlying concerns with the continued application of the principles of Clarity Project prior to embarking on a far-reaching solution as proposed in the Paper. Having said that, we continue to believe that a new set of standards is not the appropriate solution.

Though some LCEs and auditors are encouraging the IAASB to adopt the proposals in the Paper, we note that the views of LCEs and auditors are *not* homogenous, as other LCEs and auditors do not support a separate set of auditing standards. Based on roundtable discussions, we understand that in addition to regulators, several participants are concerned about the adoption of a separate set of auditing standards for audits of LCEs. In addition, based on IOSCO member experience and feedback received from auditors of Small and Medium-Sized Entities (SMEs), some believe that an alternative approach is the IAASB improving and





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simplifying its “Guide to Using ISAs in the Audits of Small and Medium-Sized Entities.” Thus, we remind the IAASB that there is not universal support for the solution proposed in the Paper even from the entities and auditors that the Paper is designed to benefit.

### **Challenges with ISA Complexity**

The perceived complexity of current ISAs is the fundamental reason why the IAASB believes that LCEs need a separate set of auditing standards (see Executive Summary, p. 5). We believe that continuous improvements and enhancements following the objectives of the Clarity Project would better address the concerns raised by some about the complexity of ISAs. As noted in paragraph 16 of the Paper, “*The responses to the [Discussion Paper] also highlighted that many of the issues and challenges being experienced in audits of LCEs were not unique to LCEs, but could also apply more broadly to other audits. In particular, issues in applying the ISAs related to complexity, understandability, scalability and proportionality for all audits were highlighted.*” We see this as pivotal stakeholder feedback that should compel the Board to pursue increased understandability and scalability of auditing standards for audits of *all* companies rather than introducing a new set of auditing standards for audits of a subset of entities.

In light of the Complexity, Understandability, Scalability, and Proportionality (CUSP) project, we question the prudence of developing a separate set of auditing standards for audits of less complex entities. The CUSP working group of the IAASB is addressing many issues that the Paper attempts to address but in a more holistic approach. Because the Paper and the CUSP project are addressing overlapping issues, it appears that the IAASB may end up developing two different solutions for the same set of problems.

For these reasons, we strongly believe that the Paper should not be adopted but instead the principles and practices being developed by the CUSP working group should be considered more broadly across all ISAs as and when the Board has capacity to do so. We provide additional details for our views below.

### **ISA for LCE Consistency Challenges**

Paragraph 6 of the Paper states the following: “*Alternative standards in different jurisdictions for the same type of engagement (i.e., an audit of an LCE) may lead to inconsistencies in*



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*quality and cause confusion for users. It is therefore in the public interest that the IAASB take action to establish a high-quality standard that has global relevance.”*

We offer a different perspective to that of the IAASB. In our view, consistent outcomes are best achieved through the utilization of consistent auditing standards. Applying the same set of auditing standards for all audits that are properly scalable, regardless of the size or complexity of the company, will best serve the public interest. We believe that a separate set of auditing standards will introduce challenges and possible confusion for auditors, companies, and the public.

The Paper will likely require auditors and audit firms to decide whether to obtain expertise in two separate sets of auditing standards. Achieving expertise in one set of standards can be challenging, so becoming an expert in two sets of standards may produce unnecessary challenges for auditors or result in some audit firms pursuing expertise in only one set of standards. Because a company subject to audit may qualify as an LCE one year but not qualify as an LCE the following year, we foresee many auditors being compelled to develop and maintain expertise in two sets of standards or, alternatively, there will be situations where a company needs to change audit firms before or during an audit if their current auditor chooses only to maintain expertise in ISA for LCE. In addition, companies may face challenges and confusion if their audit is conducted using ISAs one year and ISA for LCE the following year (or vice versa). Since company management are not experts in auditing standards, they may not understand the nuanced differences between two sets of auditing standards.

In addition to companies and auditors facing difficulty with two sets of standards, we believe that maintaining and updating two sets of auditing standards creates challenges for the IAASB. A separate ISA for LCEs will require resources to maintain the new standard, which could result in fewer resources to develop and maintain ISAs and fewer resources for other IAASB priorities. At a minimum, because application guidance for ISAs would not apply to ISA for LCE, the IAASB would have to develop and maintain application guidance for two sets of standards. Given the finite resources of the IAASB, we believe that such resources should be used to provide the highest quality ISAs rather than allocating these resources over multiple sets of standards.





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## **ISA for LCE Audit Quality Challenges**

We believe that the public will have difficulty understanding the similarities and differences between two separate sets of auditing standards and the two corresponding auditor's reports, which are designed to achieve the same level of assurance over the financial statements. Given the auditing profession's historical struggle with the expectations gap, while we appreciate that the auditor's report includes reference to "ISA for LCE" as illustrated in paragraph 9.4 of the Paper, we anticipate further exacerbation of the expectations gap.

In addition, there are two distinct challenges related to audit quality that will likely arise. First, two sets of auditing standards has the potential to result in differences in audit quality, even when that is not the Board's intention. Second, we anticipate that some third parties will perceive differences in audit quality between audits performed pursuant to the two sets of standards. Thus, we suggest that it is highly improbable that two sets of auditing standards will achieve the same level of high audit quality *and* that third parties will view the level of audit quality between the two standards as equivalent. Additionally, where there are actual or perceived differences in audit quality, companies and auditors are exposed to additional litigation risk in some jurisdictions.

## **ISA for LCE Ongoing Challenges**

Based on paragraph 72, we observe the Board's intent that "...*the proposed standard can be applied to less complex entities with a wide range of circumstances and across sectors or industries*" (p. 24). If the IAASB currently has difficulty setting auditing standards applicable to a large range of entities (including LCEs), would the implementation of this Paper encounter the same challenges facing current ISAs?

Due to the maintenance of the standard as noted in paragraphs 142-149 of the Paper, ISA for LCE will naturally increase in length and complexity. Thus, there may be future calls for separate auditing standards for additional sub-groups of entities. The Paper sets a precedent that we believe should be avoided.

We emphasize that the maintenance of two sets of auditing standards will create audit quality and audit consistency challenges. Because auditing standards frequently change, concerns about quality differences and consistency will persist. Thus, we do not support the proposed



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solution for LCEs that creates ongoing challenges to companies, auditor, regulators, and the public.

### **Alternative Solution**

The more effective solution involves the project currently being conducted by the CUSP working group, so we encourage the IAASB to focus on CUSP rather than the proposal in the Paper. The IAASB should further commit to developing scalable ISAs that can be understood and applied to audits of all entities. We suggest that technology could be used to facilitate scalable ISAs that are easier to implement for entities of high complexity or low complexity. For example, scalable ISAs presented online with hyperlinks could allow auditors to “drill down” commensurate with the relevance of applicable parts of the standard because of the complexity of the entity subject to audit.

We agree with the IAASB that ISA revisions have caused “growing concern about the length, complexity, and understandability of these standard and their application to audits of LCEs” (paragraph 4). The prudent solution involves the IAASB using its limited resources to simplify and clarify ISAs that pose significant challenges to LCEs.

To the extent that the IAASB implements elements of the Paper despite our objections, we emphasize the need for clear limitations for the use of ISA for LCE, strengthening and expanding of audit planning, and clear and transparent identification in the auditor’s report of the framework under which the audit was conducted. We further note that two sets of auditing standards would create additional complexity for group audits particularly with consistency related to stand-alone reports. Specifically, we are concerned about consistency and quality due to the permissibility of ISA for LCE for component audits within a group audit (see paragraph 157). As a consequence, we believe that the Board will need to consider limitations for the use of ISA for LCE in group audits. It also is important for the Board to consider outreach and educational resources targeted to investors and other users of the financial statements.

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Thank you for the opportunity to comment on the Paper. If you have any questions or would like to further discuss these matters, please contact Nigel James at ph. +1 (202) 551-5394



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(email: [jamesn@sec.gov](mailto:jamesn@sec.gov)) or myself. In case of any written correspondence, please mark a copy to me.

Sincerely,

Makoto Sonoda  
Chair, Committee on Issuer Accounting, Audit and Disclosure  
International Organization of Securities Commissions