

28 January 2022

Willie Botha
Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, 10017
USA

Dear Willie,

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

Thank you for the opportunity to comment on this exposure draft. We submit the feedback from the New Zealand Auditing and Assurance Standards Board (NZAuASB) to the specific questions raised in the ED-ISA for LCE in the attachment.

The External Reporting Board (XRB) is a Crown Entity responsible for developing and issuing accounting, climate and auditing and assurance standards, including professional and ethical standards, in New Zealand. The XRB's vision is that New Zealand prospers through effective decision making informed by high-quality, credible, integrated reporting. The XRB enables high quality, credible, and integrated reporting through the provision of robust frameworks and standards that are internationally credible, while being relevant to Aotearoa New Zealand so that reporting and assurance in New Zealand promotes trust, confidence, transparency and accountability. The NZAuASB has been delegated responsibility by the XRB for developing and issuing auditing and assurance standards.

In formulating this response, the NZAuASB sought input from a range of targeted New Zealand constituents. A webinar was held to provide an overview of the ED-ISA for LCE. Virtual feedback forums were held with a focus on smaller audit firms and sole practitioners, including the audit regulator, and separately to engage with users of audited financial statements. However, our outreach had limited user's representation. The NZAuASB also received submissions from New Zealand stakeholders, including from a professional accountancy body, audit practitioners, and the Auditing and Assurance Standards Committee of the Accounting and Finance Association of Australia and New Zealand (AFAANZ). Views were also sought from the XRB Audit Reference Group, comprising members with extensive technical knowledge and auditing experience, and from the External Reporting Advisory Panel, comprising members from a wide cross-section of the financial reporting community in New Zealand respectively. All feedback has helped inform the NZAuASB in developing its response, which reflects both the views of stakeholders (where identified as such) and the independently formed views of the NZAuASB itself.

We understand that the AFAANZ will be making a submission directly to the IAASB, but the NZAuASB found elements of the submission helpful and we have drawn on it as appropriate in this submission.

The NZAuASB is strongly supportive of the IAASB's effort in putting together a draft ED-ISA for LCE in a short period of time acknowledging the urgency to act to reduce the high risk of fragmentation of auditing standards at a global level. We also appreciate the IAASB's LCE working group efforts to working collaboratively with national standard setters, including provision of useful toolkits and materials to assist in our outreach to New Zealand stakeholders.

We thought it would be most helpful to the IAASB if our submission were to respond to the key questions posed by the IAASB from the New Zealand perspective as a small jurisdiction with particular characteristics, rather than to

provide technical comment on the drafting of the ED-ISA for LCE. The submission does not therefore address all questions raised by the IAASB.

Overarching comments

The NZAuASB highlights that the ED-ISA for LCE is an indictment on the scalability of the ISAs. The design of the proposed standard, which is based on the relevant audit requirements from the ISAs, highlights that the core audit requirements can be condensed into a much more readable and compact document, which is easier to navigate and understand. While we recognise the IAASB's effort in issuing electronic international standards to ease the navigation of the ISAs, we continue to urge the IAASB to rethink its approach to the ISAs, to start simple and build up progressively, rather than the other way around.

The NZAuASB is supportive of the IAASB's introduction of a separate standalone auditing standard for less complex entities at a global level. However, we consider that there will be limited use of the proposed standard in New Zealand, taking into consideration our views on the key areas where the IAASB may need to further reflect and refine the approach to the proposed standard.

In considering whether the proposed standard can, and will, be used in New Zealand, the NZAuASB assessed the following factors and relevant characteristics in our jurisdiction:

- There are a large number of private sector entities that would be characterised as less complex, including those which have a group structure;
- Relatively high statutory thresholds for the audit of non-regulated entities (in both the for-profit and not-for-profit sectors), but with strong traditions of audit as a means of assurance as reflected in many entities' constitutions, trust deeds, etc., and contractual audit requirements such as in funding agreements;
- In the public sector, large numbers of small and often less complex entities (such as small schools and locally based trusts and boards) are required by New Zealand law to be audited; and
- An auditing profession (which spans all sectors, including the public sector) which is largely competent in performing audits using the full suite of International Standards on Auditing (ISAs).

Stakeholder feedback and our own discussions indicate that the ED-ISA for LCE is unlikely to be applied by large and mid-tier audit firms which already have established methodologies for ISA-based audits, scalable for the audit of entities of all sizes and complexities. The ED-ISA for LCE is also unlikely to be applied to audits of regulated entities in New Zealand. Considering the relatively high statutory threshold for audits of non-regulated entities, many auditors of entities that might be characterised as less complex will not look to apply ED-ISA for LCE in New Zealand.

Nonetheless, the NZAuASB recognises that the proposed standard may be useful to small firms or sole practitioners given the nature of their clients and their auditing practice. In that respect, we believe the standard will be beneficial for audit efficiencies without impairing audit quality. The structure of the proposed standard, which follows the flow of an audit, will make it easier for practitioners to use and the condensed material makes the audit requirements easier to understand, which will enable auditors to focus on the relevant audit requirements to an LCE audit.

The NZAuASB considers that the current transition requirements from the ED-ISA for LCE to full ISAs, may be triggered more often than the IAASB may expect, and that more guidance is required in this area. In an increasingly complex environment, change is constant and might trigger a reassessment as to whether the ED-ISA for LCE remains appropriate more frequently than not. More flexibility in the transitioning provision requirements is needed to enhance the usability of the proposed standard.

We are also concerned that a separate standalone standard might signal that an LCE audit is less than an ISA audit, or imply a two-tier auditing environment. Given ED-ISA for LCE is based on relevant requirements from the current suite of ISAs, and similarly achieves the same level of assurance, separating it and labelling it as something different or "less" may cause reluctance in our ISA-capable profession to use ED-ISA for LCE due to potential misperception

by those charged with governance (TCWG) and users. Labelling the standard as a standalone International Standard on Auditing, while noting that it is an international standard on auditing, may help to address this risk. However, there is still a need to raise awareness, educate and engage with the TCWG and users for them to understand that the ED-ISA for LCE is similar to the ISAs, which provides reasonable assurance and is not a second-grade audit, to address the user perception issue of reduced work effort and/or audit quality.

On the scope of the ED-ISA for LCE, to enhance its usability and applicability in the New Zealand jurisdiction, we recommend that the IAASB include group audits depending on the complexity of the group. ISA-800 audits should also be included in the scope of the ED-ISA for LCE as it applies to entities that are largely less complex and auditors will therefore benefit from being allowed to make use of the proposed standard.

Should you have any queries concerning our submission please contact either myself at the address details provided below or Misha Pieters (misha.pieters@xrb.govt.nz).

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Robert Buchanan', with a horizontal line extending to the right.

Robert Buchanan
Chairman

Email: robert@buchananlaw.co.nz

Submission of the New Zealand Auditing and Assurance Standards Board

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

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

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?**

Response:

The NZAuASB acknowledges that the proposed separate standalone standard will be helpful in assisting practitioners in many jurisdictions to navigate and scale the full suite of International Standards on Auditing (ISAs) which have become increasingly lengthy and difficult to navigate. However, we express concerns that a standalone standard might signal that an LCE audit is less than an ISA audit, or imply a two-tier auditing environment.

The proposed standard contains the relevant requirements from the current suite of ISAs, and similarly achieves reasonable assurance. Separating it and labelling it as something different or “less” runs the risk of confusing and creating a perception problem, possibly causing reluctance to use the standard. This is exacerbated by the requirement that the LCE auditor’s report would need to identify that a different auditing standard has been applied in the audit of an entity, which risks confusing users as to the nature of the audit and the level of assurance being provided. There is a need for ongoing education to avoid this misperception.

Some stakeholders expressed concern that if audit practitioners primarily use the LCE standard once issued, they may no longer have the competency to conduct audits using the full ISAs. On this view, there may be some auditors or audit firms that will never do a full ISA audit due to its clients’ size and nature, therefore do not have the knowledge or ability to step up or transition if needed in the future. The NZAuASB doubts this is likely to be a problem in an ISA-capable profession such as New Zealand. However, we recommend that the IAASB consider the level of familiarity with the ISAs as a precondition prior to using the proposed standard. This is also important to enable auditors to adopt transition provisions correctly if there is a need to transition from the LCE standard to the full ISAs.

The NZAuASB is supportive of an approach which generally does not allow topping up with reference to the full ISAs. This avoids the issue of having to apply the LCE standard and refer to the ISAs if there were no relevant audit requirements included in the LCE standard.

- b) The title of the proposed standard.**

Response:

The NZAuASB has a concern that the title of the proposed standard, “International Standard on Auditing for Audits of Financial Statements of Less Complex Entities” might signal that an LCE audit is less than an ISA audit. The use of the term “less” in the title increases this risk.

The NZAuASB also has a concern that the title could prompt clients to request auditors to adopt LCE on the perception that it may require reduced audit work effort and hence could be cheaper. Labelling the standard as a standalone International Standard on Auditing, while noting that it is an international standard on auditing may help address this risk. However, there is still a need for ongoing education to avoid this misperception.

The key issue is around the messaging about the proposed standard, especially to the preparers and the users of the financial statements. It needs to be highlighted or strengthened that the level of assurance and audit quality under both the LCE standard and the ISAs is the same.

During our outreach, this concern was not shared by the sole practitioners or auditors from smaller audit firms we heard from, as the majority support the title of the standard. These stakeholders did not think that the words 'less complex' affect the perception of an LCE audit. They considered that an LCE audit still provides reasonable assurance, and that the title rather highlights that it is the "right" amount of audit for this type of entity. This view is also supported by the AFAANZ, who liked the title because it includes the nomenclature 'Less Complex Entities' which is consistent with the scope of the proposed standard. However, as mentioned our outreach had limited users' representation. Hence, the NZAuASB still believes that this could be a perception issue that should be addressed by the IAASB.

c) Any other matters related to ED-ISA for LCE as discussed in this section (Section 4A).

There is a need to raise awareness, educate and engage with those charged with governance (TCWG) and users to enable them to understand that the ED-ISA for LCE is similar to the ISAs, which still provides reasonable assurance and is not a second-grade audit. The user perception issue of reduced work effort and/or audit quality should also be addressed. It should be emphasized that the use of the ED-ISA for LCE will not result in substantially less audit testing procedures.

2) Do you agree with the proposed conforming amendments to the IAASB Preface (see paragraphs 39-40)? If not, why not, and what further changes may be needed?

Response:

The NZAuASB agrees with the proposed conforming amendments to the IAASB Preface.

Section 4B – Authority of the Standard

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?**
- b) **Are there unintended consequences that could arise that the IAASB has not yet considered?**
- c) **Are there specific areas within the Authority that are not clear?**
- d) **Will the Authority, as set out, achieve the intended objective of appropriately informing stakeholders about the scoping of the proposed standard?**
- e) **Is the proposed role of legislative or regulatory authorities or relevant local bodies with standard setting authority in individual jurisdictions clear and appropriate?**

Response:

a) Is the Authority as presented implementable? If not, why not?

The NZAuASB is concerned that the proposed prohibitions based on the Qualitative Characteristics (QCs) seem somewhat arbitrary and lack clarity (discussed further in Question 4 below) which could result in inconsistent application of the proposed standard and undermine its credibility.

We agree with the current proposed role for legislative or regulatory authorities or relevant local bodies with standard-setting authority to further refine the scope of the standard, and the firm's role in setting proper policies and procedures in the use of the proposed standard. However, we consider the proposed scoping approach at the engagement level, where the need for the exercise of audit practitioner's judgement in determining if an entity is an LCE, may have gone a bit too far.

An audit practitioner may justify applying ED-ISA for LCE even though the entity may not necessarily meet the LCE criteria, motivated by the potential misperception that a LCE audit would result in reduced work effort. Further, small firms or sole practitioners may not have firm level evaluation controls to ensure the appropriate scoping of the standard when in use. This could impair audit quality, or result in an inappropriate audit opinion being expressed due to the absence of relevant audit requirements relating to complex matters in the ED-ISA for LCE.

The NZAuASB supports the approach of not including any quantitative threshold for the scoping of the standard with ED-ISA for LCE, and agrees that it is appropriate for such thresholds to be established at a jurisdiction level and at a firm level. We agree that local national standard setters and firms play an active role in ensuring there are proper limitations being set, including quantitative limitations or qualitative characteristics specific to the jurisdiction's circumstances. The IAASB could also develop a "library" or checklist and implementation guide to work through the determination if classification as the LCE is appropriate, and provide further clarity on the QCs of complexity as discussed in Question 4, which would drive more consistency in use in practice.

b) Are there unintended consequences that could arise that the IAASB has not yet considered?

Applying the QCs in conjunction with the concept of 'if in doubt, you are out' should mean that auditors come to the same conclusion as to whether the LCE standard can be applied.

However, the extent of judgement involved in the consideration of the QCs by the firm or at the engagement level in the scoping of the standard might create inconsistency in practice whereby different auditors may arrive at different conclusions as to whether the same entity could qualify as an LCE. This could result in 'opinion shopping' by clients, especially if there is a misperception that LCE audits may cost less but achieve the same level of assurance, which is a fundamental perception issue. This perception risk should be addressed especially in light of the recent revision to the fee-related provisions of the IESBA Code of Ethics (the Code), that highlights that fee considerations also include factors such as cost of resources, duration and timing of audit as well as quality of management's record keeping and processes for financial statements preparation (Paragraph 410.23 A1 of the Code).

Alternatively, given that there are many specific prohibitions and QC considerations, it may be deemed safer to apply the full ISAs than risk having to transition to full ISAs mid-way through the audit. Auditors may naturally default to over auditing in order to minimise their liability risk. This reduces the attractiveness of the standard.

The current specific prohibitions also seem to have scoped out too many entities. The prohibition of groups could result in simple groups being excluded (these are being further discussed in Question 4 and Question 22 below) which limits the usefulness of the proposed standard.

c) Are there specific areas within the Authority that are not clear?

The Authority of the Standard, as currently set out, is clear in articulating the message it intends to deliver on the scoping of the standard.

However, we are concerned at the potential risk that the lack of clarity on the QCs would result in inconsistent application of the proposed standard and undermine its credibility. Refer to response in Question 4(b) for detailed discussion on the QCs.

d) Will the Authority, as set out, achieve the intended objective of appropriately informing stakeholders about the scoping of the proposed standard?

The NZAuASB is of the view that the Authority, as set out, achieves the intended objective of appropriately informing stakeholders about the scoping of the proposed standard.

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

The NZAuASB is of the view that the proposed role of legislative or regulatory authorities or relevant local bodies with standard setting authority in individual jurisdictions is clear and appropriate.

4) Do you agree with the proposed limitations relating to the use of ED-ISA for LCE? If not, why and what changes (clarifications, additions or other amendments) need to be made? Please distinguish your response between the:

Response:

a) Specific prohibitions

The NZAuASB considers the specific prohibitions in ED-ISA for LCE to be appropriate, except for the specific prohibition on group audits. The NZAuASB considers that there are group audits that are less complex in nature and should be permitted by the scoping of the proposed standard. Group audit considerations are discussed in Question 22 below.

b) Qualitative characteristics

In principle, the NZAuASB agrees with the proposed limitations relating to use of ED-ISA for LCE established by the QCs. However, the NZAuASB is of the view that the ED does not provide adequate application material for how auditors are to consider areas where an entity may exhibit characteristics that would make it inappropriate to use the proposed standard to audit the entity.

Overall, we are concerned at the potential risk that a lack of clarity on the QCs would result in inconsistent application of the proposed standard and undermine its credibility.

The NZAuASB recommends that the proposed standard provide further clarity on the characteristics that auditors would need to consider as QCs as identified below. The standard should either define blanket QCs that would apply to all areas or define QCs for each area (e.g., for structure, the degree of separation between owner and management, the degree of separation between TCWG of the entity and day to day

operations, etc.). It may also be helpful to consider including additional case studies of considerations where there are various QCs to consider with some complex and non-complex characteristics in determining if an entity is a LCE.

Subsequent to our outreach and in our own discussions, we also identified the following suggestions:

- Paragraph 28 of the Supplemental Guidance for Authority of the proposed standard does include examples of QCs that are commonly associated with an LCE or otherwise. However, the supplemental guidance is not authoritative. We recommend that information included in those paragraphs are essential explanatory material that should be included within the standard.
- Both the proposed standard and the supplemental guidance refer to quantifying adjectives of “few”, “multiple” and “many” (e.g., few employees vs many employees, few levels of management vs multiple levels of management, few products vs many products etc.). These may prove difficult to apply in practice. For example, when do few employees become many? What determines when there are “few” suppliers and when they become “many”? We recommend that the IAASB include more guidance or provide more clarity on how quantitative measures translate into the qualitative judgement that an entity is “less complex”, having regard also to other factors. This could either be suggesting a number range to define these terms and a consideration for firms to further define these when setting the firm’s policies and procedures in the scoping and use of the proposed standard.
- We recommend that the IAASB clarify and emphasize that examples of LCE common characteristics outlined in the Supplemental Guidance Authority in determining complexity of an entity is not a boilerplate template for the auditors to use and the exercise of judgement is crucial in reviewing the QCs. For example:
 - An entity who has few employees involved in its financial reporting or entity with no independent directors on a company’s board are commonly associated with an LCE. However, the entity may be inadequately resourcing its financial reporting function, and the absence of independent directors on a company’s board may be an indicator of deficient governance structure.
 - Entities in the start-up stage indicates that the entity is complex. However, we not consider that start-ups are necessarily complex. At the initial stage they may just incur expenses and nothing else, and therefore may be less complex.
- We also encourage the IAASB to consider if there are additional QCs or nuances to the QCs for public sector and not-for-profit entities.

5) Regarding the Authority Supplemental Guide:

a) Is the guide helpful in understanding the Authority? If not, why not?

Response:

The NZAuASB found the guide helpful to gain a better understanding of the Authority of the standard. The examples of QCs included in the supplemental guide should assist the firms and auditors in establishing policies and procedures, and in assessing if an entity could apply ED-LCE or otherwise. However as discussed in question 4 above, we are of the view that the examples of QCs included in the Supplemental Guide should instead be part of the proposed standard to provide more clarity about what the QC considerations are.

b) Are there other matters that should be included in the guide?

Response:

In our outreach, New Zealand stakeholders suggested the development of a “library” or checklist to work through to determine if classification as a LCE is appropriate. First time implementation guidance to facilitate consistent exercise of professional judgement would be especially helpful.

The NZAuASB did not identify other matters that should be included in the guide in relation to the Authority Supplemental Guide.

6) Are there any other matters related to the Authority that the IAASB should consider as it progresses ED-ISA for LCE to finalisation?

Response:

The NZAuASB does not have any further comments.

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

7) Views are sought on the key principles used in developing ED-ISA for LCE as set out in this Section 4C.

Response:

a) The approach to how the ISA requirements have been incorporated in the proposed standard (see paragraphs 74-77).

The NZAuASB considers that the IAASB’s key principles and overall approach is appropriate.

b) The approach to the objectives of each Part of the proposed standard (see paragraphs 78- 80).

The objectives in ED-ISA for LCE align, where appropriate, to the equivalent ISA objectives. However, given that the structure of the ED-ISA for LCE follows the flows of an audit, in each Part of the proposed standard there may be numerous topics where each have their own objective(s) in the full ISAs. Therefore, some of the objectives in ED-ISA for LCE may be more broadly stated than it would be in the ISAs. The NZAuASB considers that it is difficult to evaluate whether stating objectives in a broader way has an impact on their implementation. However, the overall approach seems reasonable and appropriate.

c) The principles in relation to professional scepticism and professional judgement, relevant ethical requirements and quality management (see paragraphs 81-84)

The NZAuASB is of the view that the proposed standard’s approach to professional scepticism and judgement, ethical requirements and quality management are appropriate, taking into consideration AFAANZ’s view. On the basis of the extant academic research, the AFAANZ is of the view that the coverage of material on relevant ethical requirements and firm level quality management (Section 1.2), as well as professional scepticism (Section 1.4.5 – 1.4.6), needs to be elaborated upon in order to reflect unique but important characteristics of less complex entity audits.

The NZAuASB recommends that the IAASB should liaise with the IESBA to consider the application of the International Code of Ethics for Professional Accountants (including International Independence Standards) (the Code) to less complex clients. It is recommended that the IAASB liaise with IESBA to consider giving greater attention to the unique independence issues that are present in audits of less complex entities.

- d) **The approach to EEM (see paragraphs 85–91) including:**
- i. **The content of the EEM, including whether it serves the purpose for which it is intended.**
 - ii. **The sufficiency of EEM.**
 - iii. **The way the EEM has been presented within the proposed standard.**

The NZAuASB considers the way the EEM has been presented within the proposed standard is appropriate, i.e., having the EEM throughout the standard, rather than as a separate section within the proposed standard, is helpful.

On the sufficiency of EEM, the NZAuASB is of the view that there is a risk that too much explanatory material might have been excluded. The included EEM may be inadequate for consistent application of the requirements in the proposed standard. For example, the proposed standard has excluded almost all the application material pertaining to the use of audit sampling. A similar lack of application material exists in relation to use of substantive analytical procedures.

In addition, while the IAASB indicated that additional supplemental guidance would be issued in the future, it is not feasible to assess the impact of such guidance at present. Also, excluded EEM is the primary reason for the proposed standard being shorter than the ISAs. This achievement is likely to be adversely affected by the need to add more supplemental guidance in the future, which will not be authoritative in nature.

Section 4E – Content of ED-ISA for LCE

- 10) **For Part 9, do you agree with the approach taken in ED-ISA for LCE with regard to auditor reporting requirements, including:**
- b) **The approach to include a specified format and content of an unmodified auditor’s report as a requirement?**

Response:

Given that ED-ISA for LCE contains the relevant audit requirements from the full ISAs and achieves similar assurance, the NZAuASB considers that reference to the ED-ISA for LCE in the LCE auditor’s report risks confusing users as to the nature of the audit and the level of assurance being provided. This will further exacerbate the potential misperception that the ED-ISA for LCE is *less* than the full ISAs, which is a fundamental perception issue.

We also note that the specific content and format of the auditors’ report would further complicate the transitioning provision requirements, as discussed in Question 13 below. The auditors’ report should be more flexible in stating the basis of auditing standards being used.

However, this concern is not shared by all stakeholders we engaged with. The smaller audit firms and sole practitioners do not think referencing ED-ISA for LCE in the auditor’s report will cause a concern to users of financial statements, as it provides the same level of assurance and improves the transparency of auditors’ reporting. These practitioners consider that users are primarily concerned with the audit opinion (unqualified or otherwise) and whether audit opinion provides the highest possible level of assurance, and less about which auditing standards that have been used. Furthermore, it might be self-evident to the users of such financial statement that the entity is less complex in nature and hence the use of ED-ISA for LCE will be understood as appropriate. It should be noted that however, our outreach had limited users’ representation. Hence, the NZAuASB still believes that this could be a perception issue that should be addressed by the IAASB. There is a need for ongoing education to avoid this misperception.

We consider that the use of the proposed standard should be communicated with TCWG. From our outreach, most participants considered it appropriate for auditors to determine and to communicate to TCWG which auditing standards will be used in the engagement letter, and many support the communication of the rationale for using the LCE standard to TCWG for transparency purposes. Some participants thought that the communication of the rationale to use LCE standard would be appropriate in the first year of use and then to communicate on exception basis if there has been changes in circumstances.

Section 4F – Other Matters

13) Please provide your views on transitioning:

- a) Are there any aspects of the proposed standard, further to what has been described above, that may create challenges for transitioning to the ISAs?**

Response:

The IAASB expects transitioning to only happen in rare circumstances. The NZAuASB however believes that the transition from ISA for LCE to the full ISAs may happen more often than the IAASB might anticipate.

Transitioning to the full ISAs mid-way through an audit would be an onerous task, particularly if the audit is almost complete. The NZAuASB considers that more flexibility in the transitioning provision is needed to avoid limiting the usability of the proposed standard. For example, transition requirements that allowed auditors to top up requirements based on full ISAs for an isolated complex matter in the financial year where they were identified, with a requirement for reassessment of the LCE determination for the following financial year. In these limited circumstances, the auditors' report should also be more flexible in stating the basis of auditing standards being used. This is a more efficient process than having to go back and re-do audit documentation and planning. Audit is, by nature, iterative and unexpected issues do arise.

When considering the QCs of an entity to determine if it is a LCE at the client acceptance/continuance phase, the assessment is usually made by way of review of prior year signed financial statements (if any), latest interim financial information, independence and background checks and/or discussion with management. Any reliance on superseded information or on management to provide information, carries a risk of omission of information that may undermine the evaluation of the complexity of the entity.

Feedback from smaller audit firms and sole practitioners in New Zealand, whose audit clients are small or micro charities, other not-for-profit entities or small private companies, agreed with the IAASB's view that the need to transition to full ISAs will be rare but possible. These auditors consider that the risk of needing to transition into full ISAs seems low as auditors would get an understanding of the entity at the start of the audit. They do not think that there will be a lot of changes to the entities that would trigger the need to transition to full ISAs. However, audit practitioners with larger less complex entity clients believed that it may not be uncommon.

The NZAuASB considers that in an increasingly complex environment, change is constant and it might trigger a reassessment as to whether ISA for LCE remains appropriate more frequently than not.

- b) What support materials would assist in addressing these challenges?**

Response:

The NZAuASB recommends that the IAASB look to develop guidance on the 'first time' adoption of ISA for LCE, for example guidance to ensure auditors ask the right questions at the client acceptance/continuance

phase to enable auditors to perform the assessment as to whether using ISA for LCE is appropriate, so that any indicators of complexity will be identified earlier, thus minimising the risk of transitioning too late to the full ISAs.

14) Do you agree with the proposed approach to the future updates and maintenance of the Standard and related supplemental guidance?

Response:

The NZAuASB considers the proposed approach to the future updates and maintenance of the Standard and related supplemental guidance to be appropriate, i.e., to update the ISA for LCE as and when there is a ISA revision on the same topic. This minimizes gaps in the mandatory requirements in both the ISA for LCE and the ISAs and promotes consistency of application and audit quality.

15) For any subsequent revisions to the standard once effective, should early adoption be allowed? If not, why not?

Response:

The NZAuASB agrees with the IAASB's view that early adoption should be allowed for any subsequent revisions to the standard once effective.

16) Should a separate Part on the ISA-800 series be included within ED-ISA for LCE? Please provide reasons for your response.

Response:

The NZAuASB recommends that requirements relating to the ISA 800-series should be included in the ISA for LCE. In New Zealand, only companies that meet the requirements of 'large' as defined by the Financial Reporting Act 2013 are required to be audited and prepare general purpose financial reports. This means that many entities that are not 'large' sit below the statutory audit threshold. However, some entities still require financial statements to be audited for different purposes, such as tax. These entities would prepare special purpose financial reports (SPFR) in accordance with minimum requirements set by Inland Revenue. Certain financial institutions also require SPFR financial statements to be prepared for banking and lending purposes. Although there are no requirements for these to be audited, there is an option to get these audited to provide assurance over the financial statements prepared. In many instances, ISA-800 audits might apply to entities that are less complex and auditors therefore might benefit from being allowed to make use of the proposed standard, with clear requirements outlined on the authority of ED-ISA for LCE for these audits.

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.

Response:

The NZAuASB considers that there will be limited use of the proposed standard in New Zealand taking into consideration our views on the key areas where the IAASB may need to further reflect and refine the approach to the proposed standard, as contemplated in our responses to specific questions.

In considering whether the proposed standard can, and will, be used in New Zealand, the NZAuASB assessed the following factors and relevant characteristics of entities our jurisdiction:

- There are a large number of private entities that could be characterised as less complex, including group entities;
- Relatively high statutory thresholds for audit of non-regulated entities (in both the for-profit and not-for-profit sectors), but with strong traditions of audit as a means of assurance as reflected in many entities' constitutions, trust deeds, etc, and contractual audit requirements such as in funding agreements;
- In the public sector, there are large numbers of small and often less complex entities (such as small schools and locally based trusts and boards) that are required by New Zealand law to be audited; and
- An auditing profession which is largely competent in performing audits using the full suite of ISAs spanning all sectors, including the public sector.

The NZAuASB notes that in general, large and mid-tier audit firms have established methodologies for ISA-based audits, scalable for the audit of entities of all sizes and complexities, and that these firms are likely to continue applying their audit methodology. They are therefore unlikely to apply the proposed standard. The proposed standard is also unlikely to be applied to audits of regulated entities in New Zealand.

The relatively high statutory threshold for audits of non-regulated entities results in large numbers of smaller sized entities that are not required to be audited. Further, the proposed standard, in its current form, does not include audit requirements relating to ISA-800 series (refer to Question 16 above) and specifically prohibits group audits from using the proposed standard. These further limits the potential uptake of the proposed standard in New Zealand.

However, the NZAuASB recognises that the proposed standard may be useful to small firms or sole practitioners given the nature of their clients, which are largely less complex in nature. Audit is commonly required contractually to meet funding contract commitments or for historical reasons where founding documents continue to require audit even if there is no statutory requirement to do so. Voluntary uptake of audit is of course in the public interest. We believe the standard will aid audit efficiencies without impairing audit quality. The structure of the proposed standard, which follows the flow of an audit, will make it easier for practitioners to use and the condensed material makes the audit requirements easier to understand, which will enable auditors to focus on the relevant audit requirements to an LCE audit.

The NZAuASB highlights the following key areas which the IAASB should consider to enhance the usability and applicability of the proposed standard, especially in a jurisdiction like New Zealand:

- Group audits should not be specifically prohibited from applying the proposed standard but rather based on the QCs of the group (see Question 22).
- Transition provisions to full ISAs should be more flexible (see Question 13).
- ISA-800 audits should be included in the scope of the proposed standard (see Question 16).
- A need to address potential misperception to TCWG and users that the proposed standard reduces work effort, is less than an ISA audit, or may imply a two-tier auditing environment.

b) Whether the proposed standard meets the needs of auditors, audited entities, users of audited financial statements and other stakeholders.

Response:

The NZAuASB highlights that the ED-ISA for LCE is an indictment on the scalability of the ISAs. The design of the proposed standard, which is based on the relevant audit requirements from the ISAs, highlights that the core audit requirements can be condensed into a much more readable and compact document, which is easier to navigate and understand. While we recognise the IAASB's effort in issuing electronic international

standards to ease the navigation of the ISAs, we continue to urge the IAASB to rethink its approach to the ISAs, to start simple and build up progressively, rather than the other way around.

The NZAuASB considers the proposed standard may meet the needs of a limited pool of New Zealand stakeholders, however not in its current form. Further refinement and enhancement of the proposed standard is required to enhance its usability and applicability in New Zealand for these stakeholders.

As discussed in Question 17(a) above, given our high statutory audit thresholds, an ISA-capable audit profession, and audit firms with established audit methodology that already caters for audits of entities of all sizes and complexity, we expect that the use of the proposed standard in New Zealand will be limited.

Further, given that both the ISA for LCE and the ISAs provide the same level of assurance, and ISA for LCE is based on relevant requirements from the current suite of ISAs, it may cause reluctance in practice to use the ISA for LCE. Given it is a 'simpler' version of the current suite of ISAs, with the same level of assurance, some questioned if this would meet the need of New Zealand stakeholders.

This is further exacerbated by the judgements involved in determining whether use of the LCE standard is appropriate and the transition provisions requiring auditors to transition to full the ISAs if there are matters that arise that render use of ISA for LCE as inappropriate. Auditors may deem it safer to apply the full ISAs than risk having to transition to the full ISAs mid-way through the audit. Auditors may naturally default to over auditing in order to minimise their liability risk. This reduces the attractiveness of the standard.

Nonetheless, the NZAuASB recognises that the ED-ISA for LCE might be useful to small firms or sole practitioners given the nature of their clients, which are largely less complex in nature. Those small firm practitioners or sole practitioners who participated in our outreach events thought that using the proposed standard would achieve audit efficiency as auditors only need to focus on matters and audit requirements that are relevant to an LCE audit. The proposed standard could be used for small or micro charities, school audits, companies that can opt out of audit or are not required to have an audit. Several participants also thought it could apply to larger charities and other public sectors audits. Most participants agreed that the LCE standard will be useful for their practice as they mainly deal with small not-for-profit audits.

We also note that banks are increasingly requiring more and more assurance (including audits) from their micro client lenders. Although the level and scope of such assurance would depend on the amount of lending, the risk profile of the client, the cost of the assurance engagement (vs the benefits it would convey) and other factors, there is an increasing demand in this market. ISA-800 audits (as discussed in Question 16 above), if included in the scope of LCE standard might increase its uptake of the standard in New Zealand.

We are also strongly of the view that group audits should not be specifically prohibited from applying the proposed standard but rather be scoped in based on the QCs of the group (see Question 22).

c) Whether there are aspects of the proposed standard that may create challenges for implementation (if so, how such challenges may be addressed).

Response:

As outlined in our responses to various questions together with our suggestions as to how these challenges may be addressed, the NZAuASB considers the amount of judgement involved in the scoping of proposed LCE standard, the uncertainty that might require a practitioner to transition to the full ISAs, and the perception of a two-tiered audit, are key challenges for implementation.

There is a need to raise awareness, educate and engage with TCWG and users to enable them to understand that the ISA for LCE is similar to the ISAs, which provides reasonable assurance and is not a second-grade audit. The user perception issue of reduced work effort and/or audit quality should also be addressed. First time implementation guide and flexibility on transitional provisions should also be considered to better facilitate the uptake of the standard.

- 18) Are there any other matters related to ED-ISA for LCE that the IAASB should consider as it progresses the proposed standard for finalisation?**

Response:

The NZAuASB does not have any further comments.

Section 4G - Approach to Consultation and Finalization

- 19) What support and guidance would be useful when implementing the proposed standard?**

Response:

The NZAuASB does not have any further comments other than those described in this submission.

- 20) Translations—recognizing that many respondents may intend to translate the final ISA for LCE in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing ED-ISA for LCE.**

Response:

The NZAuASB has no comments to add on translation.

- 21) Effective Date—Recognizing ISA for LCE is a new standard, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning at least 18 months after the approval of a final standard. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA for LCE.**

Response:

The NZAuASB believes the proposed effective date and permission for earlier application is appropriate.

Section 5 – Group Audits

- 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.**

Response:

The NZAuASB considers that there are group audits that are non-complex in nature and therefore there is significant concern regarding the blanket prohibition of group audits from applying the ED-ISA for LCE. The exclusion of groups could potentially impact the uptake of the standard once issued, undermining its usefulness and applicability in New Zealand.

For example, in the public sector, the exclusion of group audits would mean that schools that have a small fundraising trust as a controlled entity, would be prohibited from using ED-ISA for LCE. Other examples of non-

complex group structures that could fit the criteria of LCE include entities that have a subsidiary that trades or hold assets, smaller for-profit entities with dormant subsidiaries, investment holding parent with a trading subsidiary, etc.

Our stakeholder feedback also indicates that the LCE standard could be useful for the audit of Māori entities, which have become major players in the New Zealand economy since the settlement of indigenous grievances which began in the 1990s. Many of those entities have been giving careful consideration to how they report on their work (in both financial and non-financial terms) to their tribal members and other stakeholders, with assurance being an important element of their reporting. Most Māori entities have a group structure, for example having trading subsidiaries and charitable trusts sitting under a governing tribal council. The feedback suggested that it would be unfortunate if the LCE standard were not available for such groups where characteristics of complexity are not present.

The NZAuASB notes that the inclusion of groups would result in the proposed standard becoming longer to apply in practice. When a group needs to consolidate financial statements, the consolidation may also result in potentially complex issues. However, there is still a strong appeal for groups to be included in the scope of ED-ISA for LCE.

Most of the participants in our feedback forums held a similar concern and agreed that groups should not be excluded just because it is a group, but rather be based on the complexity of the group. However, the AFAANZ support the proposed standard for excluding group audits, but with an exception to allow group audits in cases where there are zero or immaterial involvement of component auditors.

- 23) Respondents in public practice are asked to share information about the impact of excluding group audits from the scope of ED-ISA for LCE on the use of the proposed standard. In particular:**
- a) Would you use the standard if group audits are excluded? If not, why not?**
 - b) Approximately what % of the audits within your firm or practice would be group audits that would likely be able to use ED-ISA for LCE (i.e., because it is likely that such group audits could be considered less complex entities for the purpose of the proposed standard) except for the specific exclusion?**
 - c) What common examples of group structures and circumstances within your practice would be considered a less complex group.**

Response:

Not applicable as NZAuASB is not a public practice.

- 24) If group audits are to be included in the scope of ED-ISA for LCE, 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.**

Response:

The NZAuASB considers that Option 2, where ISA for LCE sets out QCs for complexity specific to groups is more appropriate, to enable the auditor to exercise professional judgement as to whether groups can be scoped in as a LCE. At our outreach events, most participants also considered that QCs should be used to determine whether the proposed standard is appropriate to use for a group audit.

Option 1, including the proxies of complexities examples provided, although easier to apply in practice, carries the risk that the ability to use the standard could drive other decisions about the audit, such as whether component auditors are used or not. The use of component auditors does not necessarily mean the group is complex. We consider it is more relevant to consider the degree of involvement of component auditors in the group audit, which could indicate the degree of complexity of the group structure. However, it is conceptually inconsistent with the IAASB's position that it is the "complexity of the entity" and not the auditor's response that determines complexity. Adopting this approach would be a departure from this principle (i.e., whether component auditors are used (an audit response) determines whether the group is complex).

- 25) Are there other ways that group audits could be incorporated into the scope of the proposed standard that is not reflected in the alternatives described above? For example, are there proxies for complexity other than what is presented in paragraph 169 that the IAASB should consider?**

Response:

The NZAuASB considers that Option 2 is appropriate for the scoping of group audits. Auditors will be required to consider such QCs regardless of whether they are going to use component auditors.

- 26) If group audits are included in ED-ISA for LCE, how should the relevant requirements be presented within the proposed standard (please provide reasons for your preferred option):**
- a) Presenting all requirements pertaining to group audits in a separate Part; or**
 - b) Presenting the requirements pertaining to group audits within each relevant Part.**

Response:

The NZAuASB has mixed views as to whether group requirements should be presented in a separate Part or within each relevant Part of the Standard, with no strong preference either way. We have heard that the New Zealand professional body, has similarly heard mixed views on the preference of presentation of the group audit requirements.

From our outreach events with auditors, most participants preferred the presentation of group audit requirements as a separate part in the proposed standard, although most participants did not consider the placement of the group audit requirements in the proposed standard to be of significant importance.