



20 December 2021

Mr Bill Edge
Chair
Australian Auditing Standards Board
PO Box 204
Collins St West Victoria 8007
AUSTRALIA

Dear Mr Edge

Consultation Paper – Exposure of the IAASB’s *Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE)*; and Consideration of Possible alternative options for Australian LCE audits

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on the AUASB’s consultation paper regarding the IAASB’s exposure of the ISA for LCE and the possible alternative options for Australian LCE audits. The views expressed in this submission represent those of all Australian members of ACAG.

ACAG has concerns that audit offices may be unable to apply the proposed standalone standard for less complex entities based on the specific prohibitions including: audits of entities that have public interest characteristics; group audits; and an audit where additional complexity occurs after determining that the LCE standard will be applied.

ACAG does not expect there to be a reduction in the audit effort to obtain sufficient appropriate audit evidence to issue a reasonable assurance opinion. However, ACAG has concerns that an expectation gap between cost and quality may occur. ACAG offices have scalable methodologies to support audits of less complex entities. However, stakeholders may expect a reduction in audit effort and audit fees for an audit conducted under the ED ISA - LCE. This expectation gap would need to be managed to reduce the risk the auditor undertakes a low quality or non-compliant audit in response to pressure from the clients.

A significant barrier for ACAG offices to adopt the ED ISA - LCE would be the initial set-up and ongoing costs to develop a new methodology, templates, training, and communication with clients and key stakeholders.

Notwithstanding ACAG’s concerns, there may be merit for small audit firms or sole audit practitioners who provide services to the not-for-profit, charitable, sporting associations or similar sectors to adopt the proposed LCE standard.

The attachment to this letter addresses the AUASB’s questions set out in the Consultation Paper.

ACAG appreciates the opportunity to comment and trusts the attached comments are useful.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Richardson', written over a white background.

Andrew Richardson
Chairman
ACAG Auditing Standards Committee

ACAG Responses to AUASB request for comments**Appendix 1 – Questions on Consultation****Questions of ED ISA - LCE**

ACAG's overall response reflects our individual mandate as public sector auditors.

ACAG has concerns that audit offices may be unable to apply the ED ISA - LCE based on certain specific prohibitions within it. The ED ISA - LCE states that it cannot be applied to audits:

- where entities have public interest characteristics.

It can be argued that Audit office mandates are legislated only to audit in the public interest. Clearly defining what a public interest characteristic is for the purpose of the standard will be important. A consequence of the term 'public interest characteristics' not being clearly defined is the automatic exclusion of public sector entities.

- of groups.

Whole of government accounts are prepared in each ACAG jurisdiction and represent a group audit. This will immediately exclude the application to the majority of state and territory public sector entities.

There are other examples of group audits such as within health sector entities, and local governments that have consolidated controlled entities. ACAG has scenarios where an audit of a public sector entity under the proposed ED ISA - LCE would be consolidated into a reporting entity audited under the full suite of ASAs. Such an audit may not satisfy the ASA group audit requirements.

- where additional complexity occurs after determining an audit under the LCE will be applied.

Most ACAG offices will have LCE within their audit portfolio. However, public sector entities are inherently subject to once-off complex transactions, often with little notice. Significant audit effort could be expended applying the ED LCE only to determine at a late stage that additional ASA's require application.

Therefore, a combined summarised and simplified standard on audits of less complex entities (LCEs) may be of limited application for ACAG offices.

Notwithstanding ACAG's concerns, there may be merit for small audit firms or sole audit practitioners who provide services to the not-for-profit, charitable, sporting associations or similar sectors to adopt the LCE standard as their framework.

Overarching

1. Does the standard meet your needs for an engagement that enables the auditor to obtain reasonable assurance to express an audit opinion? If not, why not?
2. Is the separate standard for use in Australia an appropriate solution? Please explain your response.

No, the standard would generally not meet ACAG offices needs to obtain reasonable assurance.

Most of our audit clients prepare general purpose financial reports, or reduced disclosure general purpose financial reports. The complexity of our client’s public reporting requires ACAG offices to undertake audits in full compliance with the Australian Auditing Standards (ASAs). Consequently, we provide training and support to our staff and audit service providers in auditing public sector entities.

ACAG agrees that some less complex public sector entities could apply the standard. However, this benefit is outweighed by the additional effort required to apply the standard within our methodologies, toolkits, and training programs. A new standard with new reporting requirements would create an additional overhead and burden to develop a new methodology, new templates, and new training programs. ACAG offices train our staff appropriately to audit under the full suite of ASAs and have developed methodologies to allow audits to be acquitted in accordance with ASAs. Methodologies have been designed to be scalable for low risk and low complex entities while still complying with ASAs.

ACAG offices considers there is a risk in applying one combined standard on LCEs, when a lower risk audit client encounters a complex transaction and will therefore require the auditor to undertake detailed audit procedures to address the risk.

Some ACAG offices have legislative provisions to exempt small and low risk clients from audit by their Auditor-General, but still require an audit to be undertaken. These clients may suit an audit under the ED ISA - LCE. A separate standard may be appropriate for small audit service providers in the private sector however ACAG’s response doesn’t address this scenario.

3. Do you support the adoption of ED ISA – LCE? Please explain your response.

ACAG offices are unlikely to adopt the ED ISA - LCE, however may support the adoption of the ED ISA - LCE by our audit service providers in limited circumstances on small and low risk audits. However, we note two key risks:

1. Audit quality challenges
2. Educating users of financial statements about what an audit report under an LCE arrangement means, and minimising any expectation gap

Also see our response to Questions 8 and 9 on reporting.

4. Do stakeholders support that the proposed standard is to be implemented without additional reference to the full suite of standards? That is, where a more complex area arises, auditors do not ‘dip in to’ the full suite of standards to understand additional audit procedures. Please detail any areas of concern.

Yes, the rationale outlined in paragraphs 26-30, in particular paragraph 28 of the ED ISA - LCE is sound.

ACAG notes that this proposal would further reduce its application to public sector entities because of the regular occurrence of once-off complex issues within LCEs.

To allow greater adoption of ED ISA - LCE there is scope to reconsider some public sector reporting requirements. For example, is it appropriate to measure certain non-current assets under level 3 of the fair value hierarchy or would users of the financial statements receive similarly valuable information if these assets were to be held at cost? For some

entities, the fair-value measurement of assets would be the primary reason their audit would need to be undertaken under the full suite of ASA.

5.

Do stakeholders expect there to be a reduction in audit effort as a result of using the LCE Standard?

ACAG does not expect there to be a reduction in the audit effort to obtain sufficient appropriate audit evidence to issue a reasonable assurance opinion.

ACAG offices already have scalable methodologies to support audits of less complex entities. However, stakeholders may expect a reduction in audit effort and audit fees for an audit conducted under the ED ISA - LCE. This expectation gap would need to be managed to reduce the risk the auditor undertakes a low quality or non-compliant audit in response to pressure from the client.

A significant barrier for ACAG offices would be the initial set-up and ongoing costs to develop a new methodology to comply with the ED ISA - LCE, templates, training, and communication with clients and key stakeholders.

Authority of the standard

6. Is the Authority of the standard able to be implemented? If not, why not?

This answer is dependent on how, if at all, the *Corporations Act 2001* is amended to support the introduction of the ED ISA - LCE in the broader Australian context.

The *Corporations Act 2001* requirements notwithstanding, the Authority of the standard is principles based which creates the risk of inconsistent application unless supporting guidance and legislative provisions are sufficiently specific.

ACAG offices variously have their own legislative mandates that would also need to consider the application of ED ISA - LCE.

7. Do you agree with the proposed limitations relating to the use of ED ISA – LCE? Are there specific types of entities or industries in Australia that should be specifically allowed to, or prohibited explicitly from using such a standard (in addition to the prohibitions suggested by the IAASB)?

The intent of the limitations appears aimed to reduce the risk of inappropriate application of the ED ISA - LCE but may inadvertently result in scenarios where the application is appropriate but not available. ACAG refers to the impact of the prohibitions in its opening response.

Setting specific prohibitions detracts from using judgement in determining whether an entity is LCE.

8. Are there any specific thresholds or criteria that would be appropriate to establish in Australia for when such a proposed standard may be used?

Linking the ED ISA - LCE to quantitative provisions (e.g definition of size of entities) in the *Corporations Act 2001* and associated qualitative considerations may assist in consistency in application.

Essential Explanatory Material

9. Do you support the approach to Essential Explanatory Material (EEM) including the content and sufficiency thereof? Specifically, is there sufficient EEM to help an auditor who does not regularly use the full suite of ASAs to perform a high-quality audit?

ACAG supports the approach to EEM and make no comments as to the content and sufficiency. ACAG sees merit in the EEM to help small audit firms or sole audit practitioners undertake quality audits.

However, ACAG offices use the full suite of ASAs and will have regard to the current guidance in those ASAs. Training and guidance to ACAG auditors would continue to be based on the full suite of ASAs.

Auditor Reporting

10. Do you support the approach taken in relation to auditor reporting including the approach to including a specified format and content of an unmodified report as a requirement?

ACAG offices continually undertake education campaigns with our key stakeholder groups to explain our various audit products and opinions, and what they mean. Stakeholder's understanding is frequently low. This presents a concern that introducing a new audit framework and reporting format would add to the expectation gap and uncertainty in the purpose of an audit.

Also see our response to Question 9.

11. Do you support the auditor's report referring to the ISA – LCE? Do you believe there may be a change in the users' perception of the level of assurance provided in an audit performed using the proposed standard?

ACAG considers the adverse outcomes outweigh the benefits to transparently reporting the audit was undertaken under the ED ISA - LCE.

By referring to this standard, ACAG considers there is a risk that the users' perception of the level of assurance provided under the ED ISA - LCE is less than that provided under the full suite of ASAs.

It may be appropriate not to include an explicit reference to the ED ISA - LCE. Assuming the ED ISA - LCE becomes an Australian auditing standard, our view is that an audit has still been undertaken in compliance with Australian auditing standards to give a reasonable assurance opinion on the financial statements.

Regardless of whether the auditor's report refers to an audit standard for LCEs, the explanation of what an audit under the ED ISA - LCE means would need to be carefully and clearly communicated in various forums. In particular, the challenge of explaining the 'so what' for 'reasonable assurance' under the ED ISA - LCE compared to the full suite of ASAs.

Also see our response to Question 8.

For this reason, ACAG audits would generally continue to be delivered under the full suite of ASAs. The responsibility for educating users of the financial report should not fall to audit firms or ACAG offices.

Group Audits

12. Should group audits be excluded from the scope of ED ISA – LCE? Please provide reasons for response.

In the opening response, ACAG refers to Whole-of-government accounting which is essentially the group audit for each state, territory or commonwealth finances.

Group audits generally have a level of complexity that require an audit under the full suite of standards. Scoping them out of this standard may reduce the expectation gap risk that may be created between parent and subsidiary audits, and users' understanding of what the independent audit report is communicating.

That aside, by applying materiality there may be merit in allowing an entity which has a reasonable assurance audit under the ED ISA - LCE to be consolidated into a parent that has an audit under the full suite of ASAs.

13. If group audits are to be included in ED ISA – LCE, should all requirements pertaining to group audits be in a separate part or should requirements be contained within each relevant part of the standard?

ACAG offices have no firm view as the desired outcome could be achieved under either approach.

Appendix 2 – Questions on Australian options to further explore

All questions relate to paragraph 26 of this Consultation Paper

General

1. Besides the matters identified in paragraph 26 of this Consultation Paper, what other options or matters, should the AUASB should consider as it deliberates the direction of its work in this area?

ACAG offices are concerned about the relevance to the Australian context, the risks to audit quality and the overheads of maintaining two audit support systems to support both the ASA standards and the ED ISA - LCE.

The AUASB could consider improving education around the current scalability of the ASAs to guide an efficient and effective audit approach. There is a further risk that the introduction of the ED ISA - LCE will limit the portability of skills between different audit engagements, creating a two-tier audit resource market.

The ED is not clear as to how the AUASB would define success in implementing the ED ISA - LCE. There may therefore be benefit in clarifying the policy objective, outlining how it would assess the benefits realisation, and when it would undertake a review.

2. If the most appropriate way forward is a combination of options, how should the AUASB prioritise them?

In paragraph 26 the AUASB has identified several risks to audit quality, resource availability (e.g. availability of RCAs) and activities to address those risks. Improved education, guidance and registration status of auditors undertaking certain types of audits are worthy of consideration.

In undertaking this work the AUASB needs to ensure trust and integrity of audit opinions is maintained in practice and in perception.

Standard-Setting Activities - AUASB

3. Please rank the relative importance of the topics outlined in paragraph 26 (a) of this discussion paper (with 1 being the highest priority). Please provide your rationale and views on the needs and interests that would be served by undertaking such work, why certain topics are relatively more important to you or your organisation and any other relevant information to the AUASB.

ACAG offices believe that increased education and engagement with auditors and users will better support the work we undertake for our respective parliaments. Introducing the

ED ISA – LCE will create an unnecessary overhead and risks creating a two-tiered audit system that results in the unintended outcome of reduced audit quality and misunderstanding of the level of assurance provided.

Listed in order of priority:

1. Education regarding review and multi-scope type engagements
2. Revision of the Review Standard
3. Limited targeted revisions to the ASAs subject to the compelling reason test. ACAG notes this may be a time intensive task for the AUASB, and should be undertaken in conjunction with NZAuASB to support the continued harmonisation of auditing standards
4. Adopt the ED ISA – LCE

4. Do you consider making limited, targeted revisions to the ASAs, specific to LCEs, is an appropriate possible solution? If yes, please provide specific reference to specific requirements within the standards where attention is needed (i.e. standard x, paragraph y). Please explain your reasoning.

This proposal has merit though ACAG notes that where a current standard is not applicable to an audit, only limited work is required to demonstrate it is not applicable.

Guidance in standards will always have aspects that are applicable and scalable, but further guidance in what the auditor needs to do as a minimum response would be beneficial. This would support current risk-based methodologies and help provide consistency in interpretation.

Standards related to planning an audit could have improved guidance and FAQs or worked examples on how to scale the application to LCEs.

5. Do you consider developing targeted non-authoritative guidance, specific to LCEs, is an appropriate solution? If yes, please provide specific details as to the form and required content of such guides.

Yes, this would be consistent with our responses to other questions. Providing greater clarity on the scalability of the current auditing standards is regarded as an acceptable solution.

6. Recognising the AUASB standards currently facilitate reasonable assurance, limited assurance and agreed-upon procedures engagements, do you consider users, including legislators, understand the range of services that can be provided? If not, what can be done to assist users in understanding the 'right service'?

ACAG's experience is that the level of understanding of audit and assurance engagements by users and legislators varies. This is demonstrated in the various requirements granting bodies, funding bodies, regulators and boards require when requesting audit services to be provided to support funding acquittals or 'investigations', for example when requesting agreed-upon-procedures over a topic matter.

ACAG offices provide public factsheets and guidance on the audit services provided, communicate the level of assurance provided to clients in writing with client deliverables, and meet with stakeholders to discuss audit services.

Should the ED ISA - LCE be adopted in Australia, the AUASB should consider refreshing the guidance and advice in plain English on the range of audit services able to be provided. This could include targeted communication in a variety of mediums aimed at those most

likely to request an audit service including boards, regulators, legislators and granting and funding bodies.

Other Activities with a linkage to AUASB standards

7. Please rank the relative importance of the topics outlined in paragraph 26 (b) of this discussion paper (with 1 being the highest priority). Please provide your rationale and views on the needs and interests that would be served by undertaking such work, why certain topics are relatively more important to you or your organisation and any other relevant information to the AUASB.

ACAG offices have differing mandates but generally provide a full range of audit and assurance services, including grant acquittals and agreed-upon-procedures.

Introducing a product with an additional level of assurance is not supported. There already is a level of misunderstanding about the level of assurance provided in various audit products. Introducing another level would add to that misunderstanding and be difficult to introduce in practice, and may result in adverse outcomes.

Listed in order of priority:

1. Education and training of complex standards
2. Developing (or supporting other groups in developing) targeted non-authoritative guidance to assist practitioners in applying the ASAs to LCE
3. Investigation of a new / different level of assurance product, something more than limited assurance but not as high as reasonable assurance

8. Do you consider developing specific industry guides / practice aids, work programs, templates, software solutions, specific to LCEs, is an appropriate solution? If yes, please provide specific details as to the form and required content of such guides as well as the bodies that should be involved in undertaking such work.

ACAG considers this approach has merit as it would help audit firms deliver efficient quality audits to LCEs while using the current full suite of ASAs.

Not all users and stakeholder groups understand or have developed a risk-based lens to audit even though audit standards have evolved to be less prescriptive and more principles based.

Public sector focus areas include assessing and addressing:

- ITGC risk
- Fair-value valuation of assets
- Going concern issues
- Appropriate levels of documentation across all areas of an audit file considering the risk being assessed and responded to.

It would be appropriate to engage with key stakeholders in developing guidance notes and FAQs in written and visual forms. Stakeholders include ACAG sub-committees, directly with ACAG offices, our audit service providers, entities we engage to undertake quality assurance reviews – such as ASIC – and member organisations such as CAANZ and CPA.

9. Do you consider education and understanding of the scalability of the ASAs impacts LCE auditors? If yes, what form of education would be beneficial?

Yes, ACAG agrees that practical examples to demonstrate how to efficiently plan and execute an audit of an LCE under the current ASAs would be beneficial.

Various mediums should be considered to aid different learning styles. On-demand learning modules that include visual and graphical presentations with worked examples would be beneficial.

10. The AUASB standards provide for a reasonable and limited assurance engagements. Should a different tier of assurance should be further explored?

No, ACAG considers that this would add to confusion and expectation gaps.

Educating those who request audits – such as parliaments, granting bodies and statutory boards – would be more beneficial. This would allow them to target their requests based on the level of assurance they require.

Activities outside of standard setting

11. Please rank the relative importance of the topics outlined in paragraph 26 (c) of this discussion paper (with 1 being the highest priority). Please provide your rationale and views on the needs and interests that would be served by undertaking such work, why certain topics are relatively more important to you or your organisation and any other relevant information to the AUASB.

ACAG provides these comments based on our current experiences in delivering a wide variety of public sector audit and assurance opinions. For every topic ranked it would be important to understand the underlying policy objectives and potential adverse consequences of each activity proposed, and develop a benefits realisation plan to assess success.

Maintaining trust in an audit is a key component in supporting a functioning economy and is also essential to ensuring the ongoing viability of the profession. Reducing requirements risks quality and incorrect audit opinions being issued.

Introducing a new level of audit practitioner would require appropriate support and oversight to ensure quality is maintained.

Tiering audit requirements to align with accounting thresholds has pros and cons and would require further analysis. Audit activity should always be risk-based.

Listed in order of priority (paraphrased):

1. Engage with those responsible for drafting legislation at Commonwealth and State levels to consider the needs of users in specific market segments. This is an important first step to ensure a targeted response is proportional to the need.
2. Consider introducing a level of audit practitioner other than a Registered Company Auditor. This has pros and cons to it and would need to be carefully planned and managed to ensure integrity and trust in auditing is maintained.
3. Consider further revision or introduction of new auditing or assurance reporting thresholds / consideration of alignment with some accounting framework thresholds. This is rated lowest priority as the risk of creating expectation gaps and misunderstanding is highest with changes to standards.