

December 15, 2020

Mr. Tom Seidenstein
Chair
International Auditing and
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by email: tomseidenstein@iaasb.org

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Re: Audits of Less Complex Entities

Dear Tom,

We are writing this letter to you to reemphasize the IDW's support for the IAASB's ongoing initiative to write a separate auditing standard for "Audits of Less Complex Entities". The IDW is committed to addressing the needs of auditors of financial statements of smaller and medium sized entities, such that this significant sector can (and – equally importantly – can be seen by other stakeholders, including regulators and legislators to) perform high quality audits for their less complex audit clients in a practical and effective manner.

To this end, and as previously advised, the IDW initiated its own project this year to explore how a viable solution based on the ISAs as adopted in Germany might be developed for the audit of entities other than PIEs. Although our primary objective is to assist German practitioners without further undue delay, we firmly believe that an international solution is urgently needed. As our project progresses, we believe it could be of mutual value if our team were able to contribute the expertise it has gained in its work to the IAASB's development of an international auditing standard for LCEs.

We would like to draw your attention to a number of issues of importance in relation to the audits of LCEs and their treatment in the environment in which the IAASB operates.

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Daniela Kelm, RA LL.M.;
Melanie Sack, WP StB

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The reputational need for action by the IAASB

In our comment letter dated 12 September 2019 in response to the IAASB Discussion Paper “Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs”, we had noted that capital markets and prudential regulators, and audit regulators, interested primarily in the audits of entities subject to these regulators, are engaged in an exercise to fundamentally change what an audit means in terms of scope and depth to serve their purposes – not only for audits within the noted regulatory space, but by extension also for both statutorily required and voluntary audits of financial statements of other entities. The impact is greatest on the LCE community and their auditors. In many jurisdictions, audits of LCEs were required by legislators and contractual parties a long time ago based upon a common understanding of what an audit entailed at the time the legislation was written or the contracts signed.

As a result of these developments, there are clear indications that the suite of ISAs is becoming overly-complex for application in audits of the financial statements of smaller entities. Individual auditors are struggling to scale the full suite of ISAs to the individual circumstances of their audit clients, such that for many audits around the world, the resources and time spent in scaling the work effort may detract from performing needed audit procedures, or the audit work performed may be excessive and not appropriately focused on the specific circumstances.

The magnitude of the economic contribution of smaller and less complex entities to the world’s economy demands they receive high quality audit services from our profession. Hence, from a public interest perspective, a workable international solution for high quality LCE audits has become essential.

Consequently, progressing its initiative to write a separate standard for the audits of LCEs is also clearly crucial to the IAASB’s own reputation as an international standard setter dealing with audits and assurance engagements for all types of entities worldwide.

We therefore underline the need for the IAASB to continue to accord this project with the importance it requires in the public interest.

The IAASB’s past and future focus LCE auditing issues

As you are aware, the Monitoring Group has issued new proposals for further reforms aimed at strengthening the international audit and ethics standard-

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setting system, the implementation of which is currently subject to discussion between the various parties involved, including with you as Chair of the IAASB.

Under these new proposals, the level of practitioner expertise (i.e., from firms of all sizes) on both the IAASB and IESBA is set to be reduced further. At the same time, the MG continues to insist that the current remit of both Boards remains unchanged.

We are extremely concerned as to the diminishing future potential of either Board to be fully cognizant of the issues involved in an LCE audit environment.

You may recall that in our afore-mentioned comment letter, amongst other things we had concluded that the current malaise in auditing standard setting for the ISAs in the context of smaller entities results from fundamental changes in how ISAs are being written due to changes in the composition of the IAASB and its due process, most notable over the last five years. Specifically, we noted that these changes appear to stem from the Monitoring Group's increasing influence on the composition of the IAASB, its due process, and the content of auditing standards.

We urge you to find an appropriate solution to address issues of board composition, the source of support staff, and the equal treatment in the due process of comment letters in the ongoing negotiations with IFAC and the MG pertaining to the future IAASB.

Usability of an LCE auditing standard

The aim of an LCE standard should be to support auditors faced with otherwise having to expend disproportionate effort to scale the requirements of the suite of ISAs to each LCE audit on an individual basis. Many smaller non-PIE entities are less complex and there is a public perception that a full ISA audit would be over engineered for their circumstances. This perception is likely exacerbated by recent revisions to ISAs 540 and 315, in particular.

An LCE standard therefore needs to include essential requirements and guidance but not detailed reasoning behind the requirements, as it should not serve as a textbook. Practitioners will use professional judgement in designing their audit procedures and can use non-authoritative guidance in doing so. The drafting style and language need to be less complex, less repetitive, and generally less verbose, while remaining technically accurate and consistent.

A crucial message the LCE standard needs to convey is the intended difference between audits performed in compliance with the LCE standard and the full

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suite of ISAs. Clarification of the extent to which the reasonable assurance obtained by an auditor applying the LCE standard differs will allay fears that an audit performed in accordance with the LCE standard is of inferior quality and reduce the risk that the full suite is not applied when appropriate.

The importance of timeliness

For many years now, there have been concerns that ISAs are overly complex and lack scalability for application in audits of smaller or less complex entities. Not only, but certainly SMPs have consistently informed the IAASB that this is an issue and one that, more recently, is ever increasing.

The IAASB's lack of progress in the past in addressing the concerns of many practitioners and other interested parties about the complexity of the ISAs for application in an LCE audit environment have led to the development of an increasing number of jurisdictional solutions.

In this context, we are pleased that the IAASB approved a project proposal to develop a separate standard for audits of less complex entities during its virtual meeting last week and urge the IAASB to now continue to move quickly on this very important issue.

We would be pleased to discuss the contents of this letter with you at your convenience, including how sharing the experiences our mutual projects at staff level might be of mutual benefit.

Yours truly,

Klaus-Peter Naumann
CEO

Melanie Sack
Executive Director

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