

Consultation Response

Proposed ISA for Less Complex Entities

27/02/2025

1. Do you agree with the potential benefits and costs/risks as outlined? Are there other benefits or costs and risks to consider? How might the issues identified be mitigated?

We largely agree with the potential benefits and costs/risks as outlined in the consultation document. The consultation online sessions indicated strong support amongst the small to medium sized audit practices. We acknowledge that a small audit practice with only less complex clients could benefit from a simplified audit standard. However, as a medium to large sized international network audit firm we'd like to focus our feedback on issues relevant to us.

For this question, one of the key risks for us is the auditor judgement required in applying the LCE Standard. Our individual firms within NZ generally have a diverse client base. The Standard requires an auditor to apply qualitative, rather than quantitative, criteria. While these criteria are described within the Standard, there is potential significant judgement in "borderline" cases. Our concern is that the auditor will be held liable for judgement calls on these where external regulators determine that the auditor reached the incorrect judgement. We note what Misha stated in the online discussions: "if in doubt, you're out", however there may be circumstances where a particular auditor makes a judgement and does not see their judgement as having any doubt, but others would disagree.

In the NZ context we already have a degree of complexity in financial reporting due to the large number of frameworks available. There is already increased compliance costs associated with transitioning between different tiers when circumstances change for clients. Adding the risk of transitioning in and out of the LCE based on the circumstances of the client is yet another layer of costs and complexity. We note that our Global network raised this specific point in its consultation response in 2022 to the IAASB. We quote from that consultation: "The main challenge will arise in instances where during one period the entity is out of scope of the LCE standard because of a one-off transaction (e.g., an estimate with high estimation uncertainty) that cannot be comprehensively audited without also performing procedures that would be required under the full suite of ISAs, especially where this is identified partway through the audit.

We also believe that if estimates with high estimation uncertainty remain in the qualitative characteristics of complexity, the need to transition to full ISAs may arise quite frequently - particularly as facts and circumstances change. It may not be practical for engagement teams to 'switch over' to a full ISA audit mid-way through the engagement as that may require switching to another automated auditing tool where the full ISA methodology is housed. As relevant ISA requirements are virtually the same in the full suite of ISAs and the ISA for LCE, it is not a productive use of time to replicate or move documentation from a LCE automated tool to the 'full ISA' version."

2. Do you consider that the benefits of adopting the ISA for LCE in New Zealand outweigh the costs and risks of doing so? Why?

We consider one of the key risks being one of perception. If the firm is known to widely apply the LCE Standard, will they be considered a "tier 2" type audit firm? Will personnel within these firms consider that LCE clients are low risk clients and inadvertently apply a lesser standard of quality to these clients? If these firms start losing skills for more complex audits as a result of both client perception as well as extensive use of the LCE Standard, would the audit market become separated into larger vs small audit firms?

Noting that this standard still requires reasonable assurance, we expect that we will still be performing a similar level of work and do not expect significant efficiencies. This is primarily because all our firms in the NZ network have clients in both the LCE space and normal ISA's. Therefore, there is not the ability to uniformly apply the LCE Standard in any of our firms. Our audit teams will still need to be able to audit under both frameworks.

Within our network, we audit clients across all PBE and for-profit accounting frameworks along with special purpose reporters. As it stands, we have a significant number of templates that require customisation for each type of client and their engagement type. For example, engagement letters must specify the reporting framework adopted, whether the entity is a group, the legal structure of the entity etc. Adding in yet more customisation to our suite of templates, both increases costs, as well as the risk of incorrect templates being used.

While others have noted that there may not be a significant amount of training required for this, we disagree and point out the additional layer of complexity and how this adds to the training requirements for new graduates as well as existing staff. It also adds to the risks that staff may not be fully conversant with all the reporting and auditing requirements within NZ as it is nearly impossible as is for everyone to be conversant with everything. See discussion above for this risk of specialisation and concentration of skills/knowledge in a few firms.

3. Will you or your firm use the ISA (NZ) for LCE? When? Please provide your rationale.

While we don't support the new Standard, we acknowledge that there is likely to be some application of this across our firms in NZ. Smaller, regional firms would possibly utilise this should BDO NZ receive international support. We cannot definitively state at this point whether we will use this Standard or not.

There is also the risk that the international network does not fully embrace this Standard, and therefore the associated software and technical support to NZ will not be forthcoming. It is compulsory that we use the existing auditing software provided by our international network.

4. Does the timing of the maintenance of the ISA for LCE affect your view on its adoption? Why?

We agree that there needs to be stability in the short term over the maintenance of the ISA for LCE. As pointed out in the Panel discussion, there must also be a mechanism to allow early adoption of any significant changes to other ISA's where they are applicable to LCE's.

5. Do you agree that FMC reporting entities with higher levels of public accountability should be prohibited from being audited under the ISA (NZ) for LCE?

Yes, it is only natural that these entities are audited under the full set of ISA's due to their level of public accountability.

6. Do you agree that we do not specifically prohibit FMC reporting entities with lower levels of public accountability from being audited under the ISA (NZ) for LCE?

Yes, as the qualitative criteria for applying the LCE Standard can be applicable to them depending on their unique structure and operations.

7. Are there any other entity types that you believe that we should specifically prohibit to ensure appropriate safeguards exist around the use of the ISA for LCE in New Zealand?

None noted

8. Do you agree with the XRB's position not to have a quantitative threshold within the Authority section of the ISA (NZ) for LCE? If not, what thresholds would you suggest and why?

Yes we agree. The numbers presented in financial statements only tell part of the story of an entity's operations and associated complexity. For example, significant estimates in valuation may not be material from a numerical perspective as presented in the financials, but should the underlying assumptions, estimates, judgements be significantly wrong, the impact could be material.

9. Do you support the addition of Part 11 in the ISA (NZ) for LCE to enable the audit of SPI?

Yes we do. Considering the LCE Standard incorporates all the other ISA's, it would not make sense to then have to refer to the NZ AS 1.

10. Are the requirements in Part 11 appropriately tailored for LCEs? Are there requirements in Parts 1-10 that would be difficult to apply and should be refined? If so, how?

We welcome any effort to streamline or simplify the process of auditing SPI. However, we note that the same level of assurance will still need to be obtained no matter how simplified Part 11 is or could be. We have encountered significant challenges in auditing SPI, as has the rest of the industry. It's an ongoing challenge and obtaining reasonable assurance has proved difficult for a number of our clients.

11. Do you agree that the EEM (Essential Explanatory Material) included in Part 11 is appropriate? If not, what do you recommend?

Yes, no particular feedback. Explanatory material is generally useful in the other ISA's.

12. What requirements in proposed ISA (NZ) for LCE could cause challenges for SPI? Do you have any suggestions on how to mitigate these challenges?

No particular feedback here.

13. Do you have any comments on the proposed New Zealand specific amendments or the Conforming amendments arising from the ISA (NZ) for LCE?

No particular feedback here.

14. Do you agree with the proposed application date of periods beginning on or after 15 December 2025? If not, why not?

We do not. There is not enough time to train our audit teams, communicate with our clients and update our audit tools and software to be ready to implement by the application date.

15. Do you have any other comments on the proposed standard?

None noted.