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Dear Sir or Madame,

Response to the Discussion Paper (DP), Supporting Credibility and Trust in Emerging Forms of External Reporting: Ten Key Challenges for Assurance Engagements

EFAA commends the IAASB on the consultation on supporting credibility and trust in emerging forms of external reporting (EER). The IRWG has developed a comprehensive and well-articulated DP. EFAA agrees that EER are still evolving and supports the initiative to better understand the developments and the challenges being encountered by professional service providers. We are pleased to provide our comments below, both 'General Observations' as well as comments on the questions posed in the DP. As the project is in its infancy our response is primarily limited to high level points. These comments have been compiled by EFAA's Audit Expert Group with input from selected experts, most notably ISO and SME expert Lynn Johannson. We look forward to providing more input as the project progresses.

About EFAA

The European Federation of Accountants and Auditors for SMEs ("EFAA") represents accountants and auditors providing professional services primarily to small and medium-sized entities ("SMEs") both within the European Union and Europe as a whole. Constituents are mainly small practitioners ("SMPs"), including a significant number of sole practitioners. EFAA's members, therefore, are SMEs themselves, and provide a range of professional services (e.g. audit, accounting, bookkeeping, tax and business advice) to SMEs. EFAA represents 17 national accounting, auditing and tax advisor organisations with more than 370,000 individual members.

General Observations

Motivation for EER

SMEs are closely woven into local communities. As such SMEs are typically interested in maintaining a positive community image that provides an impetus for social and environmental responsibility. More generally there is a growing demand for, and in turn assurance on, non-financial information, and a recognition that such information is as important as financial information in appraising the performance, position and prospects of an organisation. Some commentators, such as Baruch Lev, question whether the relevance of financial reporting given company value is increasingly driven by intangibles that fail to get recognised. The [IFAC paper](#) on environmental, social and governance (ESG)

disclosures looks at this issue. Many SMEs are almost totally dependent on intangible assets and SME stakeholders are increasingly seeking non-financial information.

SMEs are generally motivated to report non-financial information to satisfy the demands of customers and providers of credit but are much less keen to do additional reporting where the source of the request is a government agency or regulator. One of the largest costs to SMEs, and some argue the second biggest barrier to innovation, is the cost of compliance with government red tape. It is necessary for SMEs to be convinced that the improved business performance – competitiveness, access to finance etc. - derived from providing better financial / non-financial information exceed the costs of preparation and assurance.

The drivers for reporting, and the assurance or other services thereon, by SMEs, especially those at the smaller end of the size spectrum, may differ from those of larger or medium-sized entities. Reporting and assurance for larger entities is often driven by the need to satisfy investors or meet government regulatory demands. The motivation for reporting for SMEs, especially the smaller owner-manager ones, is largely the desire to satisfy customers and improve business performance. For medium-sized businesses the motivation falls somewhere in between. Hence, in respect of Integrated Reporting (<IR>) SMEs are likely to be interested in the thinking it demands rather than the 'end of pipe' reporting and assurance or other service thereon. Medium-sized entities that have ambitions to grow and a desire to demonstrate that they can compete and be measured alongside larger entities may be more favorably inclined towards reporting.

SMEs, like SMPs, face intense resource constraints - time, knowledge, human resources and money. Three questions must be addressed for any change to have traction amongst SMEs - as follows, and in this order: what's in it for me; what will it cost me; and now, what is it? For many, if not most, SMEs the only reporting requirement is in relation to tax. SMEs are not likely to be receptive to providing reports that simply ends up on going to a government department or agency, which are often not held in high regard nor trusted. The DP states that further work will be done by the IRWG in respect to SMP perspectives. As this work progresses the IRWG needs to be particularly sensitive to the cost-benefit considerations of implementing new and additional organisational reporting requirements for SMEs.

Scalability

In view of the acute cost-benefit concerns it's vital that the IAASB keeps proportionality / scalability front of mind as it goes about deciding the way forward. The recently revised [PPP8 on Enhanced Organizational Reporting](#) stresses the need for proportionality (page 4). This extends to assurance or other services on such reporting. There is the risk of trickle-down whereby a requirement appropriate for larger entities and practices cascades down to SMEs and SMPs. Hence in thinking about the appropriate services, and the requirements for performing them, care needs to be taken to anticipate the possibility of such eventually getting imposed on SMEs and SMPs. There is some evidence of this happening with IFRS as research undertaken by EFAA testifies (due for publication in March 2017).

Integrated Thinking and Reporting

As mentioned above, EFAA believes there may be merit in SMEs, especially medium-sized businesses, pursuing integrated thinking, and a corresponding opportunity for SMPs to provide related business

advisory services. In 2015 we issued a [paper](#) explaining why it might be suited to SMEs and what are the benefits, including facilitating access to finance.

IAASB Standards

Notwithstanding the above, most SMEs are only just embarking on the EER journey and their appetite varies and depends on various factors, such as industry sector. Hence, EFAA sees little, if any, need for the IAASB's International Standards to extend to cover a broader range of engagements. We also agree that it is likely too early to develop a subject-matter specific assurance engagement standard on EER. While new standards may not assist SMPs to engage SMEs on EER there may be a case for additional guidance on how to use the existing standards on EER engagements. EFAA also supports greater promotion of the scope, benefits and limitations of the IAASB's non-audit standards and monitoring their adoption and use.

Engaging SMEs

The IAASB has undertaken significant outreach, and we wonder whether sufficient outreach has been undertaken with the SME sector, their representatives or those with expert knowledge of this sector. All except one of the stakeholders listed on page 31 of the Supplemental Information to the DP are those steeped in formal organisational cultures of larger entities. The SME sector comprises over 90% of business entities by number and accounts for most private sector employment, GDP and social and environmental impact. This impact makes the case for the IAASB's EER activities to extend to, and increase engagement with, the SME sector. For example, by reaching out to the likes of [UEAPME](#), the voice of SMEs in Europe, on this and similar IAASB consultations. EFAA would gladly facilitate outreach to such organisations. In sum, we strongly encourage the IRWG to be sensitive to the potential impact on any future developments on SMEs and to ensure its proposals are proportional.

Credibility and Trust

Q1 Section III describes factors [sound reporting framework, strong governance, consistent wider information and external professional services reports] that enhance the credibility of EER reports and engender user trust.

a. Are there any other factors that need to be considered by the IAASB?

b. If so, what are they?

While the list appears complete we encourage the IAASB to consider the addition of 'informed market participants' as another factor. Both professional service firms, or others, providing services and business and their stakeholders demanding / requesting services need to be sufficiently well informed as to what can be offered and the value of such offerings. As things stand many firms do not realize how they might leverage the existing standards and their expertise in this area and there's a corresponding lack of awareness amongst business and their stakeholders as to what firms can or could offer. We suspect this lack of awareness and understanding is most acute amongst SMEs and their advisors, SMPs included.

Q2 Sections II and IV describe different types of professional services that are either currently performed or could be useful in enhancing credibility and trust.

a. Are there other types of professional services the IAASB needs to consider, that are, or may in future be, relevant in enhancing credibility and trust?

This appears to be a comprehensive list. We have no other types of services to suggest. It is vital that professional services directed at the SME sector are simple and low cost.

b. If so, what are they?

Not applicable.

Q3 Paragraphs 23–26 of Section II describe the responsibilities of the auditor of the financial statements under ISA 720 (Revised) with respect to the other information included in the annual report.

a. Is this sufficient when EER information is included in the annual report; or

This appears to be sufficient in the context of SMEs. We have no comments.

b. Is there a need for assurance or other professional services, or for further enhancement of the responsibilities of the financial statement auditor, to enhance credibility and trust when EER information is in the annual report?

Presently there is no such need for SMEs, especially those that are small informal owner-managed ones, but this may evolve over time.

Scope of the IAASB's International Standards and Related Guidance

Q4 Section IV describes the different types of engagements covered by the IAASB's International Standards and Section V suggests that the most effective way to begin to address these challenges would be to explore guidance to support practitioners in applying the existing International Standards for EER assurance engagements.

a. Do you agree?

We agree but urge care in ensuring that guidance stresses the proportional application of such standards.

b. If so, should the IAASB also explore whether such guidance should be extended to assist practitioners in applying the requirements of any other International Standards (agreed-upon procedures or compilation engagements) and, if so, in what areas? (For assurance engagements, see Q6-7)

Yes – both compilation and AUP merit supporting guidance but, as stated above, this needs to stress the proportional application of such standards not least because such engagements may be more relevant than assurance engagements for SMEs. For example, compilation engagements for <IR> and AUP that an <IR> report uses the IIRC Framework. The IAASB may benefit from national standard setter (NSS) initiatives especially as an interim measure pending and / or as the basis for international guidance or standard.

c. If you disagree, please provide the reasons why and describe what other action(s) you believe the IAASB should take.

For SMEs assurance, especially reasonable, may be excessive and too costly. Hence, we'd encourage initial focus on non-assurance.

Q5 The IAASB would like to understand the usefulness of subject-matter specific assurance standards. ISAE 3410, a subject matter specific standard for assurance engagements relating to Greenhouse Gas Statements, was issued in 2013.

a. Please indicate the extent to which assurance reports under ISAE 3410 engagements are being obtained, issued or used in practice by your organization.

There is limited demand for such engagements by SMEs unless there is pressure to do so through the supply chain or by financiers.

b. If not to any great extent, why not and what other form of pronouncement from the IAASB might be useful?

As stated above, we are not aware of any unsatisfied for such engagements but if there were, it would be for something simple and low cost.

Q6 Section V suggests it may be too early to develop a subject-matter specific assurance engagement standard on EER or particular EER frameworks due to the current stage of development of EER frameworks and related standards. Do you agree or disagree and why?

In the case of SMEs at least we agree. In the case of larger entities there might be a case for one on <IR> not least because that would be in lock step with IFAC revision of PPP8 (see 'General Observations' above) which now explicitly promotes <IR> as the primary vehicle for enhanced organisational reporting.

Ten Key Challenges in Relation to EER Assurance Engagements

Q7 Section V describes assurance engagements and the Ten Key Challenges we have identified in addressing EER in such engagements [scoping EER assurance engagements; suitability of criteria; materiality; building assertions in planning and performing the engagement; maturity of governance and internal control processes; narrative information; future-oriented information; professional skepticism and professional judgment; competence of practitioners performing the engagement; and form of the assurance report] and suggests that the most effective way to begin to address these challenges would be to explore guidance to support practitioners in applying the IAASB's existing International Standards to EER assurance engagements.

a. Do you agree with our analysis of the key challenges?

Yes, though we suspect that a further challenge, and one we highlight above under 'General Observations', is that of ensuring proportionality / scalability, which the revised PPP8 stresses. In the 'General Observations' we also stress the risk of trickle-down, whereby a requirement appropriate for larger entities and practices cascades down to SMEs and SMPs. Hence in thinking about the appropriate services, and the requirements for performing them, care needs to be taken to anticipate the possibility of such eventually getting imposed on SMEs and SMPs. There is some evidence of this happening with IFRS as some research EFAA has undertaken testifies.

b. For each key challenge in Section V, do you agree that guidance may be helpful in addressing the challenge?

Guidance might be useful, especially in relation to ensuring proportionality of application, but such guidance needs to be proportional and concise itself.

c. If so, what priority should the IAASB give to addressing each key challenge and why?

No comments.

d. If not, why and describe any other actions that you believe the IAASB should take.

Not applicable.

e. Are there any other key challenges that need to be addressed by the IAASB's International Standards or new guidance and, if so, what are they, and why?

No comments.

Q8 The IAASB wishes to understand the impact on potential demand for assurance engagements, if the Ten Key Challenges we have identified can be addressed appropriately, and in particular whether:

- Doing so would enhance the usefulness of EER assurance engagements for users
- Such demand would come from internal or external users or both
- There are barriers to such demand and alternative approaches should be considered.

a. Do you believe that there is likely to be substantial user demand for EER assurance engagements if the key challenges can be appropriately addressed?

Yes, though we suspect that this demand will be confined to larger entities and some medium-sized ones such as those referred in the 'General Observations'.

b. If so, do you believe such demand:

i. Will come from internal or external users or both?

In the case of larger entities primarily external but for SMEs any demand is more likely to come from internal users, such as the business owner, customers, and the providers of finance such as banks.

ii. Will lead to more EER assurance engagements being obtained voluntarily or that this outcome would require legal or regulatory requirements?

In Europe we predict it will lead to more EER assurance engagements being obtained voluntarily.

c. If not, is your reasoning that:

i. EER frameworks and governance will first need to mature further?

Some EER frameworks, such as that of GRI, have been around for some time and have sufficiently matured. Other more recent established ones, such as the <IR> Framework, are principles-based and as such unlikely to need to mature further.

ii. Users would prefer other type(s) of professional services or external inputs (if so, what type(s) – see box below for examples of possible types)?

iii. There are cost-benefit or other reasons (please explain)?

- Further enhanced responsibilities for financial statement auditors under ISA 720?
- Agreed-upon procedures reports?
- Compilation reports?
- Other types of professional services or other external inputs (please indicate what type of service or input and whether you believe the IAASB should consider developing related standards or guidance)?

In the case of SMEs, and similar to conventional financial reporting in accordance with frameworks like IFRS, compilation reports and / or AUP reports, for example on preparation of <IR> in accordance with the <IR> Framework, will likely prove more popular and appropriate on grounds of proportionality and cost. There might be a case for guidance on application of compilation and AUP standards to EER of SMEs.

Q9 The IAASB would like to understand stakeholder views on areas where the IAASB should be collaborating with other organizations in relation to EER reporting. For which actions would collaboration with, or actions by, other organizations also be needed?

As we state at the outset there is a need for greater engagement with the SME community and their representative bodies like UEAPME.

I trust that the above is comprehensive but should you have any questions on our comments, please do not hesitate to contact me.

Yours faithfully,



Bodo Richardt

President