



SME AUDIT MARKET STUDY EMERGING FINDINGS

Issued 17 October 2025

ICAEW welcomes the opportunity to comment on the SME Audit Market Study Emerging Findings published by Financial Reporting Council (FRC) on 17 July 2025, a copy of which is available from this [link](#).

For questions on this response, please contact the ICAEW Audit and Assurance Faculty at tdaf@icaew.com quoting REP 89/25.

This response of 17 October 2025 has been prepared by the ICAEW Audit and Assurance Faculty. Recognised internationally as a leading authority and source of expertise on audit and assurance issues, the faculty is responsible for audit and assurance submissions on behalf of ICAEW. The faculty has around 28,000 members drawn from practising firms and organisations of all sizes in the private and public sectors.

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ICAEW

Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
T +44 (0)1908 248 250 F +44 (0)20 7920 0547 icaew.com

The Institute of Chartered Accountants in England and Wales (ICAEW) incorporated by Royal Charter (RC000246)
Registered office: Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK

Key points

1. We welcome the opportunity to respond to this consultation. We fully agree with some of the findings, particularly findings 1 (scalability), 2 (regulatory expectations) and 5 (SME understanding of audit). We offer alternative views of findings 3 (over-reliance on technology) and 4 (proportionate assurance). The extensive work performed by the FRC as part of its year-long campaign is commendable but there are no surprises in any of the findings.
2. There is, however, a lack of coherence in proposed responses and we are not confident that, even taken together, they will move the dial on SME audits. Findings 4 and 5 relating to proportionate assurance and educating SMEs have been tried several times in the last two decades with limited, if any, effect. We are disappointed that the series of 'myth-busting' publications about audit for SMEs themselves promised by the FRC itself at the outset of the campaign appears to have been abandoned and replaced with a call for the RSBs to engage with SMEs. Most recommendations consist of more engagement and education - on the part of stakeholders other than the FRC itself - and we struggled to find any real enthusiasm for these initiatives among those they are intended to help.
3. The response to Finding 1 – a lack of scalability in the ISAs – makes little sense. The FRC's own engagement shows that there is no stakeholder group, other than the FRC itself, that believes that the ISAs are still scalable without considerable difficulty and artifice. Cumulative revisions over the last 25 years have quadrupled the length of the ISAs. The revisions are in part revisions by the International Auditing and Assurance Standards Board (IAASB), but also FRC revisions in the form of UK pluses. The ISAs are no longer scalable or proportionate for smaller audits which is recognised by the IAASB and is why it developed the ISA for LCE. The revision of PN 26 in response to this finding rests on the assumption that the ISAs are in fact scalable and proportionate, which contradicts the FRC's own findings.
4. Furthermore, those we consulted were unclear about how the market study has informed the FRC's decision to release the ED, or its content. More broadly, disappointment has been expressed about the FRC's dismissal of the standard for LCE, the limitations of the ED, and the limited scope of the Future of Audit Supervision (FASS) review. The FASS review does not address the need for further cultural change at the FRC, particularly at the inspection level, to better reflect the FRC's improvement role.
5. We note in our response to the FRC on the proposed Practice Note that we disagree with FRC's assertions that:
 - there is no case for consideration of the ISA for LCE in the UK
 - there is no support for it in the UK, or globally
 - that it is only intended to apply to micro-entities.

We provide more detail in that response supporting those views. For the year-long SME audit campaign to be successful, the FRC must commence a proper, open and full discussion of how the ISA for LCE might be adapted for use in the UK. That discussion will take time and resource and we stand willing to contribute. In our response on the proposed Practice Note, we outline six areas that the discussion might initially cover.

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6. ICAEW and other UK RSBs are all members of IFAC. IFAC's Membership Obligations require us to '...identify and undertake actions to have the IAASB standards adopted and implemented in their jurisdictions.' The Obligations state that where members have no responsibility for standards adopted in their jurisdiction, they 'shall use their best endeavors' to encourage those responsible for the requirements to follow the relevant SMO - i.e., adopt and implement the ISAs and assist in the implementation where appropriate. Previously, such as in the case of the ISA 700 series, the FRC issued a written statement explaining its decision and setting out what it intended to do instead. No such written statement has been made in the context of the ISA for LCE.
7. A more innovative approach is needed to SME audits. Neither PN 26 nor the ISA for LCE are silver bullets and neither is fit for purpose in the UK as it stands. Further work is needed on both, including further innovation and engagement by the FRC itself, if the UK SME audit market is to remain healthy in the UK. We therefore welcome the FRC's recently announced innovation and improvement hub, and its initiative to support the development of small audit firms looking to enter the PIE audit market.

Question 1: Do you agree with our emerging findings? Please explain.

8. We agree with findings 1, 2 and 5 and we offer alternative views of findings 3 and 4. The extensive work performed by the FRC as part of its year-long campaign is commendable but there are no surprises in the findings. However, we do not agree with many of the recommendations. We make specific comments on the recommendations under each finding, below.
9. The FRC has asserted in recent webinars that the ISAs are being 'gold plated' by SME auditors and technology providers. We disagree. We accept that auditors in firms of all sizes are sometimes inefficient, but we see no evidence that either they or technology providers gold plate the ISAs - technology providers simply replicate the requirements of the ISAs. The FRC provides no examples of gold plating in this consultation or elsewhere, in the form of procedures being performed to comply with the requirements of ISAs that are not relevant to SME audits. Examples of gold plating provided by the FRC would be of value, because they would satisfy long standing calls for examples of what auditors do *not* need to do in SME audits. We do not believe that regulatory aversion to this idea can be justified. To the extent that any gold plating exists, it derives from the FRC itself through the approach of its inspectorate and the ISAs themselves to which the FRC has added pluses. Some UK pluses added by the FRC take the UK requirements far beyond those required by the IAASB ISAs.

Finding 1: Lack of scalability in auditing and ethical standards

10. While we agree with this finding, we neither understand nor agree with either of the FRC's recommendations. It makes no sense if most stakeholders, other than the FRC, believe that ISAs are no longer scalable, to embark on a campaign of education to explain how they are scalable. The responses do not address the root cause of the issue which is the current lack of scalability of the ISAs. A Practice Note cannot make the ISAs scalable as it cannot remove any requirements, nor render requirements designed for much larger entities coherent or relevant for a smaller entity without considerable artifice – in relation to controls, for example. As it stands, we do not believe that the updated Practice Note will change auditor behaviour and there is some scepticism about whether even if improved, it would change behaviour.
11. The proposed Practice Note does not address a significant number of areas. We have set these out in more detail in our specific response to the FRC thereon which also highlights critical areas which lacks examples. UK ISAs and quality management standards ran to some 300 pages in the year 2000. They now run to over 1,000 pages, which helps explain why the FRC is struggling to obtain and provide good quality examples of scalability. Among others, ISAs 230, 320, 315, 330, 540, 570 and 600, all of which have been substantially revised over that period, are particularly hard to scale based, as they necessarily are, on the structure of very large companies with global reach.
12. The logical response to the finding that the Ethical Standard (ES) restricts choice and the provision of services to SMEs that are disproportionate to the risk, is for the FRC to consider

changes to the ethical standard, or to clarify the application thereof. Further extension of the provisions in section 6 of the ethical standard should be considered by the FRC.

13. Actions by the RSBs to improve the application of the ES will have no impact on audit behaviour if practitioners fear regulatory censure. Supporting and educational material and examples must be issued or approved by the FRC if they are to change behaviour.

Finding 2: Regulators require more of SME auditors than is necessary

14. We agree that consistent, proportionate regulation is critical, and that regulators sometimes require more of auditors than is necessary. The FRC's regulatory approach and the behaviour of its inspectors have a significant effect on how RSB audits are conducted because the approach of RSB inspectors reflects the FRC's culture. We are disappointed that FASS review does not address regulatory culture.
15. The fear of regulatory censure is real and affects auditor behaviour. We hear that FRC inspectors intentionally or unintentionally, sometimes ask for more than the firm believes is required by the standards. Examples of this provided to us include:
 - statements by inspectors that requirements applying to PIE audits should be applied across all audits, and more general suggestions by inspectors that the firm might emulate other, often larger, firms
 - an assumption among inspectors that the various stand-backs required by the ISAs should always result in additional procedures
 - as noted in our recent response to the FRC on its FASS Review, an expectation of documentation not only for things that have been done, but for all things that have not been done with justification, which is disproportionate for smaller and less complex audits
16. We also understand and acknowledge that firms may sometimes *believe* that they have been told that they must follow a particular course of action when that was not intended. But perceptions matter and a widespread perception of 'soft' gold plating by FRC inspectors remains. It is therefore important that inspectors are clearer than they are now about the impact of their suggestions, formal and informal, and particularly about the need for clarity about what is required in order to comply, and what *might* simply be a better way to go about something. Grey areas should be avoided.
17. The recommendation that there should be discussions with RSBs and audit firms about a more proportionate supervisory approach to SME audits and how best to achieve them consistently will only be effective if the approach of FRC inspectors also changes. We suggest that the first step is for the FRC and RSBs to explore their common understanding of audit quality for the purposes of audit regulation. Changing hearts and minds at the FRC to focus on improvement rather than fault finding, will take time.
18. Paragraph 37 of the consultation states that the FRC is '....interested in exploring whether exempting non-statutory audits from the scope of audit inspections carried out by RSBs would aid the market.' Our current understanding is that (a) non-statutory audits are not within the scope of inspections carried out by RSBs and (b) very few genuinely non-statutory audits exist because most audits performed on smaller entities are statutory audits performed on companies that have not taken advantage of audit exemption. This may be because companies are advised to do this because it is more straightforward for firms to perform audits and have them inspected under the audit regime, than it is for them to be taken out of the regime. Nevertheless, we support further exploration of this area in the context of a wider discussion around how the ISA for LCE might be adapted for use in the UK.

Finding 3: Over-reliance on third party technology

19. We agree that smaller audit firms may lack the resources and technical knowledge to implement and customise technology, but we are not persuaded that any problems that this creates warrant the solution proposed by the FRC, and we do not agree that smaller firms are overly reliant on third party technology. There is a mature market in the UK for a range of audit

technologies. Like most markets, this market is far from perfect but there is innovation in that market, and we do not believe that smaller firms are being held back by a lack of innovation.

20. The finding and recommendation appear to be based on the assumption that the sort of investment in technology by larger firms is both necessary for and will benefit smaller firms - neither of which is necessarily true - and the FRC provides no evidence of this. Such technology is needed less on SME audits. We have noted in previous consultations that smaller firms should not be treated simply as scaled down versions of larger firms. Smaller firms need more confidence that the output of such investments will not be dismissed by regulators because they cannot absorb the costs in the same way as larger firms.
21. The FRC states that it plans to facilitate conversations between smaller audit firms, RSBs and technology developers to discuss these issues. We understand that software and methodology providers have a good relationship with the QAD, but that they have no established and on-going relationship with the FRC. We believe that a direct and on-going relationship between the software and methodology providers and the FRC itself is key to establishing expectations.
22. Technology providers will need to be persuaded that there is a business case to embed the Practice Note into their systems. That, in turn will require confidence that the FRC's inspectors will not challenge the applicability of the Practice Note to a particular audit, in the same way as inspectors have in the past challenged the applicability of smaller audit systems. We are doubtful that the necessary level of confidence can be generated to support the business case.
23. A distinction needs to be made between the basic audit software that drives all audits, and widely available additional functionality facilitating enhanced analytics and other higher level processes. Additional software can be fully integrated into the basic software, or it can be an add on. We do not agree that technology providers are gold plating the basic audit software which necessarily, and faithfully, follows the ISA requirements. Inefficiency in these systems is a result of inefficiencies in the ISAs themselves.
24. It is important to acknowledge that SME audits and auditors often lack the budgetary flex available to larger firms and audits that permit speculative investment in technology add-ons. Much of the additional technology permitting enhanced analytics and other high level processes is a 'nice to have' for SMEs and SMPs, particularly given perceptions of regulatory suspicion of such technology. While we appreciate that firms sometimes fail to question the technology they use to produce audit evidence, we still hear, too often, of firms doing things the 'old way' as well as the 'new way' because the 'old way' is questioned less by audit inspectors. Smaller firms, and their smaller audit clients simply cannot afford this, or the dedicated technical teams employed by larger firms to argue their case with the FRC.
25. The checklist driven approach referred to does indeed disincentivise proportionate approaches to SME audits, but this is driven by the ISAs themselves. We note in this context a suggestion in the proposed Practice Note that auditors might produce planning documents starting with a blank sheet of paper. Respondents suggested that this is now wholly unrealistic given the level of complexity in ISAs. As we note in our main points above, all stakeholders in SME audits would benefit from an understanding of what the FRC thinks firms are doing that they do not need to do. Simply facilitating conversations between firms and technology providers is not enough – and these conversations have in any case already taken place. ICAEW meetings with training, software and methodology providers suggest that cost, a return on which cannot be guaranteed in terms of audit efficiency, remains a significant barrier to the adoption of non-essential technology. See also our answer to Question 5, below.

Finding 4: Proportionate assurance for SMEs other than audit

26. We agree that audits can offer value to SMEs. We also agree that they do not always represent the most proportionate course of action for all SMEs, but only because the ISAs themselves are not proportionate. There is no alternative to audit for the large number of SME audits conducted for group audit purposes and there is no evidence to suggest that there is a market for alternative assurance services more widely.

27. The FRC's own predecessor board, the Auditing Practices Board, invested considerable resources into the development of Independent Professional Review (IPR) for smaller companies over 20 years ago. That project was abandoned. The ICAEW's review assurance service developed in 2013 has also failed to gain traction and we think it very unlikely that any similar project would be successful now. See also our answer to question 6, below.

Finding 5: Understanding of audit varies in SME audit market

28. We note in our main points above our disappointment that the series of 'myth-busting' publications about audit for SMEs promised by the FRC at the outset of this campaign appears to have been replaced with a call for the RSBs to engage with SMEs. Two short 'myth busting' publications on the nature of an audit for SMEs, focusing heavily on technical issues, were issued by the FRC.
29. Attempts to promote the value of an audit to this constituency have been undermined by successive increases in the audit exemption limit, and by the ISAs themselves, whose increasing complexity has rendered the audit unnecessarily complex and bureaucratic for SMEs. Asking RSBs to educate SMEs about audit is unlikely to have value if the audit does not work properly for such entities. There are many 'value of an audit' publications and it would be better for both the FRC and the RSBs to provide SME directors with a succinct reminder of their duties, and guidance on how to prepare for an audit.

Question 2: In light of our emerging findings, are there any additional actions – beyond those already proposed – that warrant further exploration?

Question 3: In instances where we have identified the potential for additional supporting materials for both SMEs and audit firms, what topics or areas should these proposed materials prioritise?

Question 4: Do you have any views or suggestions on how the supervisory approach to SME audits could be adapted, both in respect of quality assurance and the Ethical Standard?

Additional actions beyond those proposed

30. Additional actions beyond those proposed include provision, by the FRC, of specific examples of what it considers to be gold plating by practitioners and methodology and software providers. In our response to the FRC on the proposed Practice Note, we have identified a raft of areas that the PN needs to cover if it is to stand a chance of improving SME audits.

Additional supporting materials

31. There are two areas in which the FRC has explicitly identified a potential need for additional supporting materials. The remainder of the recommendations are for further engagement. We are not convinced that further engagement is necessary or useful as the issues are already well rehearsed and widely understood. The two areas are:
- Materials to address knowledge gaps in the SME audit market to include guidance or case studies, targeted at SMEs, to enhance the effectiveness and efficiency of SME audits. Supporting materials, prepared by the FRC, directed at SME directors, covering what a good impairment and going concern assessments look like would be helpful. In practice, SMEs rely on their auditors for help in these demanding areas which creates independence issues.
 - We note in our main points above our disappointment at the FRC's 'myth-busting publications'. Two technical publications were issued by the FRC and we are not aware of the extent of their distribution. The FRC appears to have abandoned these publications and is now calling for firms and the RSBs to issue them instead. Existing publications by both the RSBs and firms have failed to undo perceptions of the audit as a burden to be SMEs. The burden is largely a result of the exponential growth in the length and complexity of ISAs over the last 25 years for which the FRC is responsible, and until the FRC addresses that issue, educational efforts are likely to have limited effect.

- Materials for auditors, including practical examples, to increase understanding and application of the Ethical Standard. We agree that these materials are needed but they need to come from the FRC itself to have an effect on auditor behaviour. The fear of regulatory censure in relation to the ES has an even more profound effect on auditor behaviour than in relation to the ISAs. Changes to the ES should also be considered by the FRC, particularly in the areas of non-audit services and long association. As a minimum, the FRC should consider (a) issuing guidance on long association and rotation in the context of 2 or 3 partner firms and (b) providing examples of how firms can mitigate the self-review threat in the context of non-audit services when the firm has one or two partners.

32. Some of the PASE provisions for audits of smaller entities are now encapsulated in Section 6 of the Ethical Standard, particularly the self-review section. Some firms do not use it because it is not in accordance with the IESBA Code, but many would be much more likely to use it - and RSBs would be more likely to promote it - if the FRC extended it to, for example, the provision of off the shelf packages to audit clients.

Supervisory approach to SME audits

33. The supervisory approach to the audit is critical, particularly when it comes to attracting more firms into the PIE audit market. We therefore welcome the FRC's Scalebox SoQM initiative. ICAEW work on the reluctance of firms to enter this market clearly shows that regulatory risk is a principal cause of firm aversion to engagement with the FRC. The FRC's regulatory accommodations during the first two years of participation are therefore important.

34. The FRC's four faces now include an 'improvement' face. This is clearly understood among senior FRC staff but changing hearts and minds throughout any organisation takes time. Efforts to sustain this aspect of the FRC's regulation need to be maintained to embed it at the inspectorate level, and thereby to affect the RSBs' approach.

Question 4: We have heard that smaller audit firms face challenges in deploying innovative technology. What additional measures, if any, could be implemented to help address these challenges?

35. The principal barrier to the performance of efficient SME audits is not the inability or unwillingness of smaller firms to invest in analytics products above and beyond those already widely available, but the auditing standards for which the FRC is responsible, underlying the methodologies that they use.
36. The value of innovative technology to SME auditors is limited, not because such technologies do not provide additional insight to audit clients, but because the benefit of the technology to the audit itself is more limited. For SME audit clients, cost is an issue. There is currently no real need for such technologies in many SME audits. Excel may not be widely regarded as an innovative technology, but its functionality can provide audit clients with plenty of insights as it stands. The return on additional investment in innovative technology is highly uncertain, particularly for very small firms where the incremental cost is much higher. The perceived expectation of the FRC that that smaller firms should invest in analytics in the same way as larger firms, displays a lack of understanding of (a) the business model of SMPs, and (b) the deterrent effect to smaller firms arising from regulatory challenge to the use of such technology.
37. The principal additional measure that would help promote the use of technology by auditors across the piece, would be greater engagement by the FRC itself in discussions with software and methodology providers – and not simply facilitating discussions among others. The time and effort involved in dealing with regulatory challenge to the use of technology is a significant barrier to firms seeking to innovate, particularly smaller firms without the resources to engage technical staff who are capable of challenging audit inspectors when they question the technology adopted.

38. These issues have been discussed at length at ICAEW's mid-tier tech forum and ICAEW intends to develop an article on the tools currently available to SMEs.

Question 5: To the extent that you agree an audit may not always represent a proportionate approach for an SME (and where an audit is not statutorily required), what alternative assurance or contractually agreed mechanisms may be suitable? How would any alternatives meet the needs of SMEs and their stakeholders

39. Respondents made suggestions regarding alternatives to audit focused on parts of the audit that clients particularly value, such as attendance at stock-takes and work on receivables. These can and are occasionally performed as bespoke engagements, often as agreed-upon procedures. No action on the part of the FRC or RSBs is needed in respect of such straightforward engagements.
40. We also note however a long and unsuccessful history of attempts to develop alternative assurance services to audit in the form of review engagements. The Auditing Practices Board (APB) was the UK's auditing standard-setter until the role was taken over by the FRC. A major project by the APB in the early 2000s attempted to develop an '[Independent Professional Review](#)' (IPR). This extensive project included field testing of the product with 20 firms who performed both an audit and an IPR on one client. While it showed some promise in development, results were mixed and it was abandoned.
41. Some years later, ICAEW developed an [Assurance Review Engagement](#) product, embodied in Tech 09/13. As with the IPR, while the product had some limited success among the clients of firms involved in its development, it has not been widely adopted.
42. In both cases, there were limited cost savings, but they were insufficient to distinguish the product properly from the audit. The FRC's focus should be on the audit for SMEs, because if an SME is looking for assurance, audit is what most SMEs want, and what the market understands.