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IFAC SMALL AND MEDIUM PRACTICES (SMP) COMMITTEE POSITION PAPER ON AUDITING STANDARDS

1 Introduction

- 1.1 This document sets out the views, position statements, of the Small and Medium Practices (SMP) Committee on a range of issues related to the application of International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB) from the perspective of a small- and medium-sized practitioner (SMP). In quantum, this paper serves as the SMP Committee's position paper on auditing standards.
- 1.2 The central problems posed when setting international standards of auditing (ISAs) is one of their applicability to small- and medium-sized entity (SME) audits and the capacity of SMPs to apply them. This is fast becoming a critical international issue as an increasing number of jurisdictions seek to converge on ISAs. There are concerns that the increasing complexity of the standards may undermine the commercial viability of an SME audit and prompt SMPs to withdraw from the audit market thereby limiting audit choice.
- 1.3 Fortunately, the Clarity project promises to resolve most of our concerns by ensuring ISAs are drafted in a way that makes them easier to understand. The redrafted ISAs represent a marked improvement on the old versions from an SME/SMP perspective. They are clear and understandable. Clarified ISAs should quell many, if not most, of the complaints emanating from the SMP/SME constituency.
- 1.4 This position paper¹ is intended to be used in both advocacy and representation activities as well as to help ensure that the SMP Committee is consistent when developing responses to requests for input from the IAASB and others.
- 1.5 The paper is structured as follows. First, the scale and nature of the problems faced by SMPs in applying and converging on auditing standards are explained. Second, key definitions of SME and SMP are provided. Third, the SMP Committee's strategy for resolving these problems is outlined. Finally, the paper sets out the SMP Committee's position statements on various matters - including applicability of ISAs, Clarity, quality control, documentation, alternatives to audit, and the process of ensuring SMP/SME considerations are incorporated into ISAs. These position statements are shown in *italics*.

2 General

Convergence and SMP/SME

- 2.1 As national jurisdictions converge on uniform international standards, it is becoming increasingly vital to ensure that these are relevant and applicable to SMEs and SMPs as well as their larger counterparts. The development of such standards, however, poses a significant challenge. This has been recognized in IFAC's report "Challenges and

¹ Given the purpose of this paper and the desire to ensure it does not date too quickly specific examples and references are avoided as far as possible; these will be included in comment letters on IAASB projects.

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Successes in Implementing International Standards: Achieving Convergence to IFRSs and ISAs” (the Wong Report)².

2.2 This report’s objective was to identify the challenges to adopting and implementing IFRS and ISAs. It indicated that, while there are compelling reasons for international convergence of auditing standards, challenges to that convergence are formidable. Of special relevance to SMEs and SMPs are:

1. Length and complexity of the international standards;
2. Inconsistent application of the international standards;
3. Lack of sufficient SME and SMP representation on the international standard-setting boards; and
4. Perceived focus on large-entity issues.

2.3 In addition, the Report states, “virtually all participants raised issues concerning the relevancy and appropriateness of the international standards to small and medium-sized entities and accounting firms.” The Report contained many recommendations, aimed at the different parties having an interest in financial reporting and auditing. For standard-setters and SMPs, these included:

- The importance of standard setters bearing the needs of SMEs and SMPs in mind;
- The need to involve SME and SMP representatives in the standard-setting process;
- The desirability of considering different forms of reporting for SMEs and SMPs; and
- The need for SMPs to devote sufficient attention to training.

2.4 The SMP Committee has analyzed the evidence and concluded that there are two main problems in relation to SME audits. First, there is the relevance problem. ISAs are written with the audit of larger listed and other public interest entities primarily in mind. This has eroded the relevance of ISAs to SME audits. The complexity and large entity bias of ISAs makes them difficult, and hence costly, to apply on SME audits. However, we are pleased to note that the Clarity project will go a long way towards easing this problem.

2.5 Second, there is the capacity problem. SMPs have a limited capacity to understand, use and comply with ISAs. SMPs often lack the requisite in-house technical resources and suffer from professional isolation. In addition, many markets are too small to support the commercial development of products to help SMPs and the member bodies unable to fill the vacuum.

SMP Committee’s Approach to Solving the SME Audit Problems

2.6 The SMP Committee’s solution, which in effect is the strategy that underpins much of our work program, is a two-pronged approach to solving the SME audit problems,

² http://www.ifac.org/Members/Source_Files/Other_Publications/Wong_Report_Final.pdf

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thereby ensuring practitioners can converge and comply with International Standards on Auditing (ISAs). First, we are helping to shape the form and content of ISAs through our input to the IAASB's standard-setting process. This should help solve the relevance problem. Second, we intend helping SMPs to understand, use and comply with ISAs through the provision of practical support, for example explanatory guidance material and the provision of web-based information resources. This should help solve the capacity problem.

3 Definition of SMP and SME

SMP Committee's Constituents

- 3.1 The SMP Committee's terms of reference defines its constituents as "SMPs who provide accounting and assurance services principally but not exclusively to clients who are small and medium-sized enterprises (SMEs). In so far as they provide services to SMEs, other professional accountants are included as constituents."
- 3.2 This definition places even a large audit firm as a constituent of the SMP Committee in so far as they provide accounting and assurance services to SMEs. Practices of all sizes are faced with the problem of the application of ISAs to SME clients.
- 3.3 The SMP Committee does not consider precise definitions of SMP and SME as critical to its mission to serving the interests of its constituents. However, we do consider it useful to have some guiding principles in mind to provide a frame of reference for its work and to help clarify its objectives in the eyes of others.

Small- and Medium-sized Entities

- 3.4 The SMP Committee notes a tendency to want a specific definition of what constitutes an SME and the existence of many definitions of an SME for determining whether an audit is required. It should also be noted that what is considered a SME differs from country to country. The SMP Committee does not believe it is practical to have one precise definition of an SME from an audit perspective and that it is best left to each national jurisdiction.
- 3.5 We do feel, however, that the determination of whether an entity is an SME should be driven by qualitative characteristics and that the primary qualitative characteristic should be the level of public interest of the entity. SMEs will be entities of low public interest³.
- 3.6 In addition, other qualitative factors can help distinguish an SME including *one or more* of the following⁴:

³ IESBA defines entities of significant public interest as: "those which, because of the nature of their business, their size or their numbers of employees, have a wide range of stakeholders. Entities of significant public interest will normally include banks, insurance companies and other regulated financial institutions, and may, depending on their size, include pension funds, government-owned entities and not-for-profit entities such as large charitable organizations."

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- Fewer lines of business and fewer products within lines;
- Concentration of marketing focus, by channel or geography;
- Leadership by management with significant ownership interest or rights;
- Fewer levels of management with wider spans of control;
- Less complex transaction processing systems and control;
- Fewer personnel, many having a wider range of duties; and
- Limited ability to maintain deep resources in line and support staff positions such as legal, human resources, accounting and internal auditing.

3.7 In some countries, the scope of all entities considered to be SME for audit purposes is defined by statute or regulation. In the absence of such a definition, member bodies should determine the types of entity that are not of significant public interest and exhibit one or more of the attributes described above.

Small- and Medium-Sized Practices

3.8 For similar reasons to SMEs, the SMP Committee sees little point trying to arrive at a precise definition for SMPs and prefer this left to national jurisdictions. That said we do believe in having some general guiding principles to help determine what constitutes an SMP. An SMP is a small business and so some of the SME criteria outlined above may apply to SMPs. In addition, an SMP will demonstrate *one or more* of the following attributes peculiar to audit practices:

- Most of its clients are SMEs and it ordinarily does not audit the accounts of listed entities;
- External sources used to supplement limited in-house technical resources;
- Majority of client work may be non-assurance services;
- Limited number of professional staff; and
- Less formal quality control procedures.

4 Applicability of Standards

4.1 *An audit is an audit*

4.2 We believe an audit is an audit. The reason is this. The objective of an audit is to enable the auditor to express an opinion as to whether the financial statements give a true and fair view, or are presented fairly, in all material respects in accordance with an applicable financial reporting framework. The auditor undertakes processes and procedures in accordance with auditing standards to collect sufficient evidence to be able to draw

⁴ These are taken from *Guidance for Smaller Public Companies Reporting on Internal Control over Financial Reporting (2006)*, The Committee of Sponsoring Organizations of the Treadway Commission at <http://www.ic.coso.org/>

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reasonable conclusions on which to base their opinion. This same objective applies to all audits – it does not vary, regardless of the size or type of entity being audited.

- 4.3 *A single set of auditing standards based on a conceptual framework that includes a set of fundamental principles and takes a “think small first” approach*
- 4.4 We believe in a single set of auditing standards based on a conceptual framework which includes a set of fundamental principles⁵ and takes a “think small first” approach. We see considerable merit in a “think small first” approach to writing standards. We take this to mean developing standards a core set of requirements and corresponding guidance that applies to all entities and then extra requirements for larger public interest entities however defined. We do not take this to mean having a lighter set of requirements for SME audits, for example relief or exemptions from certain requirements.
- 4.5 A single set of standards using a “think small first” approach is preferable to having a lighter set of standards for SMEs (the so-called ISA lite) or building in exemptions and reliefs within the ISAs for SMEs. This is because exemptions give the impression that SMEs are subject to a less rigorous and lower quality audit. “Think small first” on the other hand will tend to convey the fact that a certain minority of entities, public interest ones, are subject to additional requirements over and above those applicable to all other entities by virtue of their having significant public interest. Some of the redrafted ISAs already adopt elements of a “think small first” approach.
- 4.6 The SMP Committee does *not* believe in having differential standards for auditing. There are many reasons for having a single set of auditing standards. The main one is comparability. In analyzing the audit reports on the financial statements of different entities, users rely on the audits of those financial statements being comparable. A single set of auditing standards enables auditors to conduct each audit so that the objective of an audit is achieved in a similar manner. This demonstrates to users that all audits have the same objective, and facilitates the comparability of audit reports.
- 4.7 The SMP Committee is concerned that if separate standards were to be developed for smaller entities then users might think this set of standards would result in a different level of assurance and may be confused as to what an audit is. This would be detrimental to the public interest. Furthermore, a single set of standards should maintain the quality of SME audits and preserve the brand image of an audit. A two tier approach may also result in the emergence, in the eyes of stakeholders, first and second class engagements and first and second class auditors.
- 4.8 A differential ISA structure would also create practical difficulties. First, there is the issue of defining SMEs for determining which entities can make use of the SME standards. Second, the cost of developing and maintaining a separate set of auditing standards is substantial. Finally, many firms would need to train their staff to use

⁵ In this paper ‘objectives’ are taken to mean the objectives as referred to and defined by the Clarity project while ‘fundamental principles’ refer to high level broad guiding principles which the SMP Committee would eventually like to see developed.

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different sets of standards, and correspondingly different audit approaches. This would damage the fundamental objective of harmonization around ISAs.

- 4.9 *The purpose of auditing standards is to provide requirements and guidance for the auditor's work in fulfilling the audit objective*
- 4.10 The SMP Committee sees the purpose of auditing standards as providing requirements and guidance for the auditor's work in fulfilling the audit objective. The auditor should apply the requirements of an auditing standard in all cases where they are relevant in the circumstances of the audit. In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement by performing alternative audit procedures in order to achieve the aim of that requirement. This recognizes that some requirements may not be relevant to or that different processes or procedures may be more effective for the audits of some entities, for example the audits of SMEs.
- 4.11 *Auditing standards should ensure the auditor flexibility to exercise their professional judgment as to what procedures they employ to achieve the audit objective*
- 4.12 Auditing standards should be high level and objectives-based and, in so doing, give the auditor flexibility to exercise their professional judgment as to what procedures they employ to achieve the audit objective. It is inappropriate for standards to prescribe a 'one size fits all' audit approach, methodology and set of procedures. The objectives and fundamental principles should be the same for all audits, but the work required to achieve them, beyond generally applicable requirements, should vary in certain respects depending on the size and type of entity being audited and the size of the practice undertaking the audit.

5 Clarity

General

- 5.1 *The Clarity project should greatly improve the understandability and usability of ISAs to SMP/SME but is not the complete solution to the SME audit problems*
- 5.2 The Clarity project is a key project for SME/SMP. It should greatly improve the understandability and usability of ISAs. In so doing, it should significantly increase the relevance of ISAs to SME audits and make ISAs easier to use by SMPs. Not surprisingly, the project gains our full support and we are committed to helping realize its full potential. We are also highly encouraged by the general direction it is presently taking. Early redrafts of ISAs using the new drafting convention represent a significant improvement on the old versions and adequately address many of the aforementioned points on applicability. Nevertheless, it is not the complete solution. It will go a long way, but not the whole way, to solving the SME audit problems.

Objectives

- 5.3 *Objectives should be mandatory but written so as to be high level and generic so as to leave room for the exercise of professional judgement as to exactly how they are achieved*

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- 5.4 We believe that the objectives should be applicable to *all* audits. Therefore, we consider it appropriate to require the auditor to achieve all the objectives except where the circumstances prevented them from doing so. In order to arrive at the appropriate audit opinion the auditor needs to be satisfied that he/she has achieved all the objectives that apply in the circumstances. To preserve some flexibility for the exercise of professional judgement in determining the exact procedures to be followed the objectives need to be high level and generic so that the requirements that follow from them are generally applicable.
- 5.5 The SMP Committee supports the idea of having a set of objectives which take a “top down” approach with the objective of the audit at the top cascading down to objectives for each of the ISAs as portrayed in the exhibit below.
- 5.6 While we believe these objectives should be mandatory they ought to be used primarily to help stress to the auditor the purpose of individual ISAs and to provide a framework for helping to determine requirements. There should be limited documentation requirements in connection with the auditor’s consideration and achievement of the objectives.
- 5.7 We also believe that the objectives should be written so they can be used by the auditor to communicate the value and purpose of an audit and its key elements to users of financial statements. This means drafting the objectives so as to be understood by the reasonably informed user. The objectives as presently being discussed appear to meet this criterion.

Grouping	
Overall Objective of the Audit	
Overall objectives of the Auditor	
General Responsibilities:	Further Considerations:
To be carried out on all audit engagements (say ISAs 200-499, 700-799)	To be carried out in relation to specific topics (say ISAs 500-699)

Guidelines for Requirements

- 5.8 *Standards should have a single level of requirement, designated by the use of ‘shall’, which are not excessive in number*
- 5.9 The SMP Committee agrees that there should be a single level of requirement. These requirements should be applicable to all audits irrespective of the size of client or the size of the auditor; there should be no differential requirements within the standards. This

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makes it clear what is required of the auditor. We are pleased to note this is a key element of the Clarity project.

- 5.10 An excessive number of requirements may render an audit less effective by directing work effort towards the execution of potentially unnecessary procedures and/or replacing auditor judgment as to how best to attain objectives in the individual circumstances pertaining to SME audits. In addition, the burden of the requirements should be proportional to their benefits. This is crucial to the viability of SME audits.
- 5.11 The SMP Committee feels that the proposed guidelines for classifying the present tense are generally appropriate and should result in a suitable set of generally applicable requirements that are not excessively burdensome. Indeed, their application on early drafts has resulted in the successful elimination of the present tense. The burden of the requirements is about right. We feel that the concept of proportionality should be afforded a high degree of prominence when specifying requirements to avoid SME audits becoming uneconomic.
- 5.12 To avoid inappropriate elevations of the present tense and alleviate the risk of ending up with an excessive number of requirements, and requirements which are not proportional, when redrafting future ISAs the SMP Committee suggests the inclusion of a test that needs to be applied when considering whether to elevate material to a requirement is: is this essential to ensuring a high quality audit in virtually all cases? Alternatively, the corresponding rule that could be introduced would be that where there is doubt as to whether the material in question satisfies the criteria for classification as a requirement then the material should constitute application material.

Presentation of Requirements

- 5.13 *ISAs should be structured to clearly distinguish between requirements and application material*
- 5.14 The key issue from an SMP/SME perspective is that the ‘clarified’ ISAs be clearer and easier to use than their predecessors. The SMP Committee believes that the clear separation of requirements from application material will help achieve this aim and will more likely to lead to the consistent application of the standards. In addition, any difficulty encountered by the auditor move back and forth within the text of the ISA could be resolved by way of electronic versions of ISAs with hyperlinks inserted within the text for any cross-referencing.

Presentation of Application Material Pertaining to SMP/SME

- 5.15 *SMP/SME considerations should be included throughout the application material*
- 5.16 The SMP Committee feels it is more logical and practical to locate guidance on “considerations specific to smaller entities” at relevant points throughout the application material, sign-posted using sub-headings, as opposed to presented separately.
- 5.17 The main issue is whether the ISAs explain adequately in the application material that the work effort in meeting the requirements will be different depending on the size and

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complexity of an entity, and describe ways these requirements can be met efficiently and effectively in an SME audit.

- 5.18 While the SMP Committee is of the view that most SMP/SME considerations will relate to the engagement, and so essentially focus on the audited entity, there may be certain circumstances where guidance is appropriate for SMPs for example, in the area of quality control.

Departure Condition

- 5.19 *Departure from a requirement should be permitted where the requirement relates to a specific procedure and that procedure would be ineffective*
- 5.20 The SMP Committee believes, just as the proposed preface states, that departure from a requirement should be permitted where the requirement relates to a specific procedure and that procedure would be ineffective. We consider it appropriate for all auditors to apply professional judgment to improve audit effectiveness in those situations where it is appropriate.
- 5.21 *Departures from requirements should be documented but reasons for departures only given where not obvious*
- 5.22 The SMP Committee believes that departures should be documented. This will serve to reinforce the seriousness of the consideration needed for such departures. Departures should be exceptional and as such warrant documentation. We believe, however, that the reasons for the departure should only be documented where they are not obvious.
- 5.23 *Requirements that are not relevant should not be treated as departures from requirements and as such should be excluded from the need to document*
- 5.24 The SMP Committee is concerned that despite considerable efforts to ensure the generic relevance of requirements to all types of audits there may be instances where a specific requirement is redundant or not relevant in a SME context. Requirements that are not relevant should not be treated as a departure and, therefore, excluded from the need for any documentation.
- 5.25 We believe that the practitioner needs to have a degree of latitude when exercising their professional judgment in the determination of whether a requirement is not relevant. This will avoid inappropriate burdensome requirements for SME audits. This latitude needs to be carefully and clearly defined so that the SME auditor has a supportive framework within which to exercise their professional judgment in this context.
- 5.26 The SMP Committee would like to suggest that the following guidelines serve as a basis for determining when a requirement is **not** relevant:

*“A requirement is **not** relevant when either:*

- 1. The Standard containing the requirement is not relevant; or*
- 2. The Standard is relevant but either:*

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- a. *The individual requirement is not factually relevant because the circumstances do not fall within the scope of the circumstances defined as being the pre-requisite for the requirement being relevant (such a pre-requisite may either occur through an explicit or implicit “if-then” statement within the requirement); or*
- b. *The matter in question is, in the judgment of the auditor, not “material” to the audit (having regard to qualitative and quantitative factors).”*

We note that the proposed preface includes 1 and 2a.

- 5.27 We suggest that when a requirement is considered **not** relevant because of 1 or 2a above then there should be no documentation requirement. For example, if there is no internal audit function (case 1) then this need not be documented, or, if the audit is performed by one person (case 2a) then one need not document to explain why there was no discussion by the audit team. However, when the auditor uses their judgment to determine that a requirement is not relevant in so far as it relates to a matter they consider is not “material” (2b), then we believe that the auditor should document their reasoning, having regard to the quantitative and qualitative factors taken into account.
- 5.28 Finally, we suggest the inclusion, in the requirements section of each ISA, of an unequivocal statement that requirements may not always be relevant but that non-relevant requirements should be quite rare.

Implementation Timetable

- 5.29 *The IAASB should aim to complete the Clarity project and issue all the newly clarified ISAs together with the same effective date as soon as possible*
- 5.30 While the SMP Committee recognizes the difficulties faced by the IAASB in expediting the clarification of ISAs, it supports the accelerated redrafting timetable and hopes all the newly clarified ISAs taking effect at the same time, possibly sometime in 2009.

6 Documentation

- 6.1 *Documentation requirements should focus primarily on those that will drive audit quality*
- 6.2 The SMP Committee believes that sufficient documentation is the key to audit quality, since it helps focus the auditor’s attention. Documentation requirements need to focus on those that are likely to drive and motivate the execution of a high quality audit in virtually all cases.
- 6.3 *Documentation requirements should stress the need to be concise and reflect the level of public interest of the audited entity*
- 6.4 Despite the fact that there will typically be less to document when auditing smaller and less sophisticated entities, we are still concerned that the present documentation requirements may prove too onerous for some SME audits.
- 6.5 Documentation needs to be concise and to reflect the level of public interest of the audited entity. We believe this can most effectively be achieved by adopting a “think

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small first” approach, that is first identify the basic requirements for a high quality audit and then the determine the additional requirements for public interest entities. A “think small first” approach is preferred to having specified exemptions/relief for SME audits since the latter approach risks giving the impression that SME audits are inferior.

- 6.7 An important issue to consider in the context of documentation requirements is the needs of ‘peer reviewers’ if the concept of all audit firms being reviewed progresses and becomes a requirement in more jurisdictions.
- 6.8 The ISA Guide (see below) will contain some explanatory guidance on how to implement the documentation requirements contained within ISAs and so help clarify the nature and extent of documentation. This will help ease concerns over the documentation burden.

7 Quality Control

- 7.1 *Quality control is vital but the new requirements may render some SME audits cost prohibitive*
- 7.2 The SMP Committee believes all audits and all audit practices must be subject to a high minimum level of quality control. This is crucial to the integrity of the audit opinion and public confidence in the audit. That said, enhanced quality control procedures as enshrined in International Standard on Quality Control (ISQC) 1 might make SME audits cost prohibitive. This could prompt SMPs to withdraw from the audit market thereby limiting the audit choice of SMEs.
- 7.3 We believe that ISQC 1 is written primarily with large firms in mind. This may have made it difficult for an SMP to comply with all of the requirements. This large firm bias is evident in a number of sections including the introductory section, such as the definitions; elements of a quality control system, leadership and responsibilities for quality, independence, and human resources.
- 7.4 Certain areas are likely to present a particular problem for SMPs. First, SMPs may lack a qualified person to undertake the engagement quality control review. Paragraph 72 suggests that a suitably qualified external person may be contracted to perform quality control reviews for SMPs. Other firms may be willing to perform such a review for an SMP but, for legal reasons, may be less inclined to issue reports on the quality control review. As a result, compliance with the documentation requirement of the engagement quality control review by persons external (paragraph 73) may prove problematic. In addition, external review places SMPs at a disadvantage to large firms, which can typically resolve matters internally, and could leave the SMP vulnerable to having its clients poached. Similar problems may arise in respect of monitoring (paragraph 80) and complaints and allegations (paragraph 92).
- 7.5 Another area that may present a particular difficulty for SMPs is the requirement to carry out consultation (paragraphs 51 and 56). Where an SMP relies on another firm to complete the required consultations, the firm being consulted may be reluctant, for various reasons including legal ones, to agree or “sign-off” the documentation of the consultations, the decisions taken and how they were implemented.

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- 7.6 *Quality control procedures should reflect the level of public interest of a firm's clients*
- 7.7 We believe that the enhancements to quality control, as with ethical rules and documentation, are desirable for larger public interest entities. However, the cost of complying with all of the quality control procedures may make it uneconomic for many firms, especially SMPs, to continue conducting SME audits. Accordingly, we suggest that quality control procedures reflect the level of public interest of a firm's clients.
- 7.8 *ISQC 1 needs redrafting using a "think small first" approach as soon as possible*
- 7.9 We hope that ISQC 1 is redrafted using the clarity format in the near future. This will present an opportunity to address the above problems by embracing a "think small first" approach.
- 7.10 The ISA Guide (see below) will contain some explanatory guidance on how to implement the quality control requirements at the engagement level. In addition, the SMP Committee is hoping to develop a quality control guide to help ease concerns over the burden of the new quality control procedures. This guide will assist practitioners, especially SMPs, in implementing ISQC 1. We are planning to issue a request for proposal by the year-end and, subject to finding a suitable solution at reasonable cost, publish the guide in the first quarter of 2008.

8 Alternatives to an Audit

- 8.1 *Reviews or similar assurance service, or compilations may be suitable alternatives to SME audits*
- 8.2 The SMP Committee values the role of an audit in lending credibility to SME financial statements and so we are not advocating replacing audits for SMEs. We recognize, however, the argument that if an audit is too expensive or too much of a burden for an SME, these entities should be relieved from audit requirements. We also recognize that many countries either have or are considering changes to legislation to allow this, typically by way of audit thresholds that exempt certain entities from the need for an audit. The trend appears to be towards allowing the market to determine whether an SME should have an audit, an alternative to an audit, or nothing at all.
- 8.3 Some countries, for various reasons, wish to retain a requirement for some level of assurance for their SMEs and may be more satisfied with a lower level of assurance to that of an audit, such as that obtained from a review. We suspect that some countries are not considering limited assurance for SMEs because they lack the necessary standards/guidance for such engagements. Such countries are likely to find a comprehensive review standard(s) particularly useful. Likewise, countries content to remove the assurance requirement for SMEs altogether may wish to promote or require compilation reports, and hence seek a suitable international standard.
- 8.4 *An investigation into alternatives to audit needs to be undertaken*
- 8.5 Many delegates at the IFAC SMP Forum of July 2006 and the IFAC SME/SMP and Developing Nations Consultative Conference of March 2005 believe that the IAASB

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standards for review engagements (International Standard on Review Engagements (ISRE) 2400, *Engagements to Review Financial Statements*) and compilations (International Standard on Related Services 4410, *Engagements to Compile Financial Statements*) need updating. Therefore, we suggest that the IAASB consider the case for revising these standards.

- 8.6 We are considering various ways of assisting the IAASB including a global fact finding survey to gauge the potential role of alternatives to audit⁶ including the likely demand for revised international standards/guidance. We are not, however, advocating a third level of assurance that sits between an audit and a review since this may confuse the market and undermine the audit brand.

9 Means of SMP/SME Input to IAASB Standard-Setting

- 9.1 *Inputting to IAASB standard-setting will continue being a major focus of our activities*
- 9.2 One of the main reasons for forming the SMP Committee was to help ensure SMP/SME considerations and the requisite guidance is incorporated into these standards. Presently a major part of the SMP Committee's work program is on providing SMP/SME specific input to the IAASB's standard-setting process. This input addresses the relevance problem as described previously.
- 9.3 We input to IAASB standard-setting, largely in the form of comment letters, at all key stages of the development of an ISA from project proposal through to draft exposure draft ('ED'). Occasionally we will comment on the ED itself. The input process is well established and operates efficiently.
- 9.4 The SMP Committee is pleased to note that the IAASB values our input and, moreover, there are a number of instances where draft ISAs have been amended to reflect our comments. This suggests that the inputting is proving effective. Today we track practically every ISA project and this practice is likely to continue.
- 9.5 *SMP/SME input to standard-setting needs to be multi-faceted*
- 9.6 Comment letters alone will not be sufficient to ensure the relevance of ISAs to SME audits. Hence, we are providing input in a variety of ways. Aside from inputting via comment letters, the SMP Committee inputs, directly and indirectly, to the IAASB in the following ways; SMP Committee members serving on IAASB project task forces – presently Service Organizations, Clarity, and Experts; representation at IAASB Consultative Advisory Group meetings; and liaising with the SMP members serving on the IAASB.
- 9.7 We would like it to become a matter of policy for an SMP representative to be appointed to each new IAASB project task force. We maintain a short list of suitable candidates for

⁶ A recent Institute of Chartered Accountants in Australia (ICAA) discussion paper entitled "Differential Auditing Standards provides a good summary of the advantages and disadvantages of reviews and compilations. See [http://www.icaa.org.au/upload/download/Institute_Dif_Audit_Stds_sc\(27072006\).pdf](http://www.icaa.org.au/upload/download/Institute_Dif_Audit_Stds_sc(27072006).pdf)

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IAASB project task forces. This list includes SMP Committee members as well as their technical advisors and persons recommended by them.

- 9.8 The SMP Committee has sent a representative to every IAASB CAG meeting. These representatives have enjoyed observer status with full speaking rights. We will continue this practice and as such become a permanent observer.
- 9.9 The effectiveness of our input rests on our ability to organize these various ways of inputting. Accordingly, we are putting in place procedures to help ensure coordination of our various ways of inputting.
- 9.10 *Systematic feedback on how our comments have been disposed of should be provided by the IAASB*
- 9.11 Systematic feedback on how the IAASB disposed of its comments would help improve the effectiveness of SMP Committee input and present an opportunity for the IAASB to help SMPs understand why their comments were not be accommodated.

10 The Need for Practical Assistance

- 10.1 *SMPs urgently need practical support to help build their capacity to understand, implement and comply with IAASB standards*
- 10.2 The SMP Committee believes that the provision of practical support to SMPs will increase their capacity to implement and comply with ISAs. SMPs often lack the internal technical resources of large practices. Large firms make use of tools, often developed internally, such as technical guides, manuals and software to enable the execution of high quality cost effective audits. We feel, therefore, that there is a strong case for providing SMPs with explanatory guidance materials and information resource(s).
- 10.3 *An ISA Guide will greatly help SMPs apply ISAs on SME audits*
- 10.4 A key element of our strategy to enhance the capacity of SMPs is commissioning the development of an explanatory guide to ISAs. The ISA Guide will help practitioners, especially SMPs and those forming part of the developing profession, to understand, implement and comply with these standards when performing SME audits. As such it will be non-authoritative implementation guidance; it will *not* constitute a standard.
- 10.5 We see it helping to build a bridge between increasingly complex standards and the capacity of SMPs to implement them. It will also create a 'platform' upon which IFAC, its member bodies or others could develop derivative products such as checklists, questionnaires, forms, training materials, practice aids, and software. The ISA Guide will be published in Q2 2007 and the first update, based on the newly clarified ISAs, published in 2009.
- 10.6 IFAC will assume full copyright in the ISA Guide and an electronic version distributed to all IFAC member bodies free of charge. Member bodies will be able to use the content of the ISA Guide to develop their own localized variants of the guide and derivative products. The ISA Guide will be an IFAC SMP Committee publication. It will not be

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approved or endorsed by the IAASB. In short, the ISA Guide will be a tool designed to help practitioners conduct effective and efficient SME audits.

10.7 *IFAC has a role to play in the development of derivatives and other explanatory guides*

10.8 We suspect that practitioners will ultimately find derivatives to be more useful than the ISA Guide itself. We are, however, unsure as to whether we should be directly involved, by commissioning the development of such products, or indirectly involved, by simply facilitating the market to develop and disseminate suitable products at affordable prices. We are leaning towards the latter but we have yet to agree the nature of the facilitation.

10.10 We have visions of developing, subject to the availability of resources, a suite of explanatory guidance made available to our member bodies free of charge in due course.

10.11 *The IFAC KnowledgeNet will help provide SMPs with pertinent information*

10.12 The IFAC KnowledgeNet will also help build the capacity of SMPs, and hence their ability to deliver high quality services, by bringing together quality information produced by IFAC and its member bodies through a freely accessible online resource. This will initially be targeted at professional accountants in business and then expanded to cater for SMPs in early 2007.

10.13 *Practical support is no substitute for addressing the applicability of ISAs to SME audits*

10.14 Practical support is not a substitute for tackling the problem of applicability of ISAs to SME audits. Such support can only address the symptoms of SME audit problems rather than tackle the root cause.