

PROPOSAL FOR IAASB ACTION TO DEVELOP A DISCUSSION PAPER AND RECOMMENDATIONS FOR FUTURE POSSIBLE ACTIONS RELATING TO AUDITS OF LESS COMPLEX ENTITIES (For Reference)

This proposal sets out the IAASB's activities to develop a Discussion Paper related to audits of less complex entities (LCEs), with the purpose of informing the IAASB's further deliberations about the most appropriate possible actions relating to audits of LCEs. This proposal sets out the IAASB's understanding of the issues identified to date, as well as areas that will be further explored as part of this process.

Subject

1. This proposal relates to:
 - (a) The development of a Discussion Paper (DP) for public consultation to explore possible actions to address issues identified by stakeholders in undertaking audits of LCEs; and
 - (b) Developing recommendations for the most appropriate way forward for IAASB consideration.

Background

2. At present, 128 jurisdictions use or are committed to using the International Standards on Auditing (ISAs) (up from some 90 countries using or committed to using the ISAs in 2006). Such use commonly applies to audits of entities of all sizes and complexity, mostly when such audits are mandated by law or regulation by a jurisdiction. However, there are differences across the jurisdictions as to how and for which entities there is a statutory requirement for an audit, with, for example, audit thresholds commonly being used (predominantly on a size characteristic) to limit those entities to which statutory audit requirements apply, with changes to these thresholds continually being reconsidered.^{1,2} Even when there is not a statutory requirement for an audit, many small- and medium-sized entities

¹ For example, in the US private companies (with some limited exceptions) are not subject to a statutory audit. In Europe, member states can impose a threshold for audit for entities that are not public interest entities, medium or large entities (and the thresholds vary across the various member states). In France, there are currently no thresholds for a Société Anonyme, but they are in the process of considering the introduction of audit thresholds in the near future. In India, there is a statutory requirement for all unlisted entities to have an audit under their Companies Act annually. In Mexico, there is no requirement for an audit of non-listed entities. In Canada, business corporations that are privately owned are exempted from an audit if all shareholders consent in writing to the exemption in respect of that year. In Australia, there is a size threshold that exempts certain entities from a mandatory audit. In New Zealand, large New Zealand companies that are not Financial Market Conduct reporting entities have certain 'opt out' provisions where an audit may not be required.

² In 2010 in Sweden, the regulatory requirement for an audit was abolished for small limited liability companies. However, the Swedish National Audit Office has recently published a report, [Abolition of audit obligation of small limited companies – a reform where costs outweigh the benefits](#) where it cites numerous downsides to abolishing the SME audit obligation.

(SMEs)³ are either required to have an audit for a reason other than a statutory requirement, or still choose to have an audit, notwithstanding the ongoing debate about the cost versus benefits of an audit.

3. The widespread and continually growing international use of the ISAs underscores the importance the global community attaches to the ISAs and the importance of the IAASB continuing to focus its efforts on maintaining the quality and operability of these standards for audits of entities of all sizes and complexity, and on meeting the expectations that stakeholders have regarding their application.
4. The ISAs were clarified and revised in 2005–2009 (the ‘Clarity Project’) ⁴ with a view to being applied to audits of entities of all sizes and complexity.⁵ As part of the finalization of the Clarity Project, the IAASB agreed to undertake a post-implementation review to determine whether its objectives in revising the ISAs had been achieved.
5. The post-implementation review was carried out in two phases. One of the key findings from Phase One of the review was that there was some concern about the application of the ISAs to smaller entities, notably whether they can be applied in a cost-effective manner. Accordingly, it was agreed that specific consideration would be given to this issue in Phase Two of the post-implementation review.
6. The IAASB completed its post-implementation review of the clarified ISAs in 2013. As part of Phase Two, the IAASB conducted an annual survey of small and medium practices (SMPs) on audits of SMEs from a range of countries that had implemented the clarified ISAs, over the two years after implementation of the clarified standards. The findings from the surveys included:
 - A call from respondents to further demonstrate the scalability of the requirements.
 - Concern about the documentation requirements, with some respondents calling for more guidance about the nature and extent of documentation required.
 - Issues around implementing certain standards (particularly ISA 260 (Revised),⁶ ISA 540⁷ and ISA 550)⁸ in an SME environment.
7. In considering the findings from the post-implementation review, the IAASB acknowledged that the volume and complexity of the standards may result in challenges for audits of entities that are less complex. Accordingly, the IAASB recognized in its *Strategy for 2015–2019* that, in order to achieve effective implementation globally, its standards need to be, and be seen to be, proportionate and scalable for audits of all sizes and complexity.

³ There is no global definition for a ‘small- or medium-sized entity,’ and use and meaning of the term may differ substantially in different jurisdictions.

⁴ In March 2009, the IAASB completed its Clarity Project designed to improve the clarity and understandability of the ISAs and International Standard on Quality Control (ISQC) 1 and, thereby, facilitate their consistent application

⁵ An IAASB Staff publication was issued in August 2009 to explain how the ISAs can be applied to audits on a proportional basis, [*Applying ISAs Proportionately with the Size and Complexity of an Entity*](#).

⁶ ISA 260 (Revised), Communication with Those Charged with Governance

⁷ ISA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

⁸ ISA 550, Related Parties

8. In addition to a focus on scalability in its projects to revise key ISAs in 2015–2019, the IAASB also recognized that more may be needed. IAASB activities in exploring this issue in 2017–2018 include:

January 2017	The IAASB, together with the Compagnie Nationale des Commissaires aux Comptes (CNCC) and the Conseil Supérieur de l'Ordre des Experts-Comptables (CSOEC), held a two-day working conference in Paris, focused on understanding the needs of SMPs when applying audit and non-audit IAASB standards to SMEs. There was overall support from attendees for the IAASB to explore what further possible actions are needed, although there were mixed views about what the most appropriate possible actions should be. For example, some attendees supported the development of a single standard (such as the draft Nordic Standard for Audits of Small Entities (see paragraph 10)), others were supportive of a “building block” approach and phased adoption, while others supported the development of more guidance and implementation activities.
March 2017	The IAASB received feedback from the January 2017 Paris conference and from discussion with the International Federation of Accountants (IFAC) SMP Committee at the March 2017 IAASB meeting. The IAASB also discussed a paper setting out possible actions for how scalability and proportionality could be incorporated into the IAASB's standards, in particular the ISAs.
June 2017	The challenge of auditing SMEs and LCEs was discussed at the annual National Standards Setters (NSS) meeting hosted by the IAASB. NSS outlined developments in their jurisdictions emphasizing efforts to modify thresholds for audit exemptions.
Summer 2017	An informal working group (the Working Group) was established by the IAASB to consider the issues raised with a view to advising the Board on an appropriate way forward in response to the views expressed by stakeholders at both the Paris conference and the NSS meeting. The group met twice, and developed an issues paper and a possible draft of a standard to be discussed with the IAASB.
March 2018	The IAASB discussed, in an executive session, a paper highlighting the identified issues, and agreed with the recommendation that a global consultation on these matters was appropriate. To this end, the IAASB agreed that a DP would help the IAASB consolidate the work that has been undertaken in this area to date, better understand the issues that had been identified, and obtain stakeholder views on the most appropriate possible actions to address these issues with an open mind. For example, in addition to considering how the ISAs are structured and drafted, this could include (but is not limited to) understanding whether there was a need for, and whether it was feasible to develop, (a) separate standard(s) for audits of smaller and less complex entities, as suggested by some stakeholders. The Board supported the Working Group continuing its work to develop the DP and make recommendations for possible IAASB actions after consideration of the feedback from the planned consultation.

May 2018	In light of evolving developments, the challenge of auditing SMEs and LCEs was further discussed at the annual NSS meeting hosted by the IAASB. A proposed consultation process to gain a better understanding of the issues and possible solutions was outlined and support was expressed by the NSS for further work in this area.
September 2018	The IAASB discussed an initial draft of a proposal for the activities of the LCE Working Group (previously the Working Group) in developing a DP for IAASB discussion in March 2019.

9. In addition to the work noted above, the IAASB continues to coordinate with the IFAC SMP Committee on a regular basis. This coordination includes:
- Regular input to the IAASB's ongoing projects through teleconferences with IFAC SMP Committee Task Forces, focused sessions with IFAC SMP Committee representatives on a specific topic, and representation of IFAC SMP Committee representatives on select IAASB Task Forces.
 - Updating the IFAC SMP Committee at their in-person meetings three times a year.
 - Recognition at IAASB meetings of specific SMP matters raised in the quarterly comment letter from the IFAC SMP Committee sent to the IAASB with regard to specific Agenda Papers, with further Task Force consideration of these matters.
 - Other interactions as necessary as the IAASB continues to progress its work.

Other Relevant Developments

10. Against this background, various jurisdictions or bodies have been exploring initiatives about how professional accountants in practice can continue to serve SMEs, including initiatives relating to audit (including guidance for audits of non-complex entities in various countries) and alternative service offerings beside for statutory audits. For example:
- Draft Nordic [*Standard for Audits of Small Entities*](#) (SASE) – in 2015 the Nordic Federation released, for consultation, a stand-alone draft of a standard for audits of small entities. The draft standard was developed based on the same audit principles as the ISA's but was specifically tailored to audits of small entities. The consultation received a large number of responses, from a number of different jurisdictions globally, reflecting the significant interest for further action in this area. This consultation, and the widespread international interest also demonstrated that for an initiative to be successful in this area, an international response is needed.
 - Sri Lanka – published an approved “*Framework for Audits of Non-Specified Business Enterprises*,” which is a stand-alone standard, tailored specifically to audits of small entities.
 - France – in considering the introduction of a minimum threshold for mandatory audits, consideration is being given to a new ‘pronouncement’ for audits that would fall below the threshold but where the entity may voluntarily seek an audit.
11. The IFAC SMP Committee has published its updated *Guide to Using International Standards on Auditing in the Audits of Small- and Medium-Sized Entities* in July 2018 to reflect the changes to the

IAASB's Auditor Reporting and related standards. This guide is used by practitioners in various jurisdictions, including public sector auditors, in implementing the ISAs, but is voluminous as well.

12. Notwithstanding the various activities noted above, there is agreement that a global solution would be in the public interest to ensure consistency of application of the standards in an audit, as well as a common understanding of the procedures undertaken for an audit, thus maintaining the value of an audit of LCEs.
13. Furthermore, it has been recognized that there may be ways of addressing some of the issues identified by stakeholders through approaches other than standard-setting, and therefore doing so may not be within the remit of the IAASB. However, in exploring the various possible actions of the IAASB, it would be beneficial to explore the range of possible actions, including those actions where it would be more appropriate for others to undertake the work. This approach will also serve to reinforce clarity around the IAASB's remit, with recognition that the IAASB may be well placed to help encourage other relevant stakeholders to pursue relevant possible actions to address such issues.
14. This proposal sets out the activities for the LCE Working Group to develop the DP and recommendations for possible actions for IAASB consideration, taking into account the responses to the DP.

Objective, Scope and How the Work Serves the Public Interest

15. The objective of the work is to gather further evidence as the basis for IAASB discussion about the most appropriate way forward in relation to audits of LCEs.

Scope of the Work to be Undertaken

16. The focus of the work to be undertaken is to:
 - (a) Gather further information from stakeholders to better understand:
 - (i) The nature of the issues faced in using the ISAs in an audit of a LCE (including those communicated by stakeholders to the IAASB to date);
 - (ii) The causes of the issues including whether, in an audit of a LCE, the work effort required by the ISAs varies enough relative to the size and complexity of the entity, or is disproportionate to the public interest benefits of that work; and
 - (iii) Stakeholder views about possible standard-setting or other actions that may be appropriate to address the issues identified.
 - (b) Develop the DP for public consultation relating to the matters set out in (a) above, including describing in the DP the issues faced when using the ISAs in an audit of a LCE, many of which have been previously communicated to the IAASB, and possible actions to address the issues.
 - (c) Develop plans for related outreach (which may include webinars, roundtables and targeted presentations).
 - (d) Analyze the feedback from the consultation and related outreach, and develop and publish a feedback statement.

- (e) Develop recommendations for possible actions that are within the remit of the IAASB for the Board's consideration, based on the responses to the DP and outreach, including further information gathering to support analysis of the impact of such actions. In addition, identify any other possible actions for which it may be appropriate for the Board to encourage others to take.
17. In order to focus on audits of LCEs, and what would be within the IAASB's remit, the DP will make clear that certain matters will not form part of the scope of the work. However, the DP will still recognize other types of engagements that may be suitable alternatives to an audit of LCEs (such as limited assurance engagements or other types of assurance engagements), as well as any other actions that may also impact the issues identified, but are not under control of the IAASB (such as audit thresholds, methodologies/technologies, education). The DP will make clear that these are scoped out of the work to be undertaken, but will still acknowledge, as needed, the IAASB's consideration of the most appropriate way forward (or not) in the areas not within the IAASB's remit.
 18. As part of the matters for consideration, the LCE Working Group will also explore how best to articulate the types of entities that may be affected by this work (i.e., what "less complex entities" means), in light of differing laws and regulations globally, including different thresholds for audits of entities.
 19. Related outreach will encompass activities to provide additional input to the development of the DP, as well as outreach during the period that the DP is out for public consultation. It is intended that during this period the second SMP working conference⁹ will be held in Paris and will serve as a roundtable to inform the responses to the DP. Consideration will also be given to how best to work with other groups, such as NSS, IFAC member bodies, and IFAC SMP Committee, as well as whether additional roundtables, or other outreach, are needed.

How this Work Serves the Public Interest

20. SMEs¹⁰ make a critical contribution to the world economy. Quantitatively, the majority of audits globally are audits of SMEs. Although there are no specific statistics on the number of audits performed globally, or for which types of entities, the World Trade Organization's [*World Trade Report 2016*](#) notes that "micro firms and SMEs account for the majority of firms in most countries (95% on average)."
21. Although audit findings or failures in audits of SMEs may not be perceived by some as being as critical as for larger, listed entities, the importance of high-quality audits (or other engagements, as appropriate) is nevertheless still significant to the global economy because of the sheer number of audits performed for this sector. As a result, any changes made to facilitate effective and cost-efficient engagements for these types of entities would be serve the public interest by:
 - a) *Enhancing confidence in financial reporting of LCEs*—SMEs and other entities that are less complex are a critical source of employment and innovation and are embedded in local communities. Therefore, it is in the public interest to have high-quality audits that instill

⁹ Although previously referred to as the "SMP" working conference, this will be renamed as appropriate to reflect the consideration of the issues related to audits of LCEs.

¹⁰ Although we refer to SME's, the matters noted above may also apply to LCE's that are not SME's.

confidence and trust in this part of the economy.

- b) *Helping auditors of LCEs to undertake effective and efficient audits*—In recent years, the ISAs have become increasingly complex as the global environment has evolved. In addition, there has been an increasing focus on protecting the capital markets. As a result, there has been an increasing number of requirements and volume of material incorporated into the ISAs, which has resulted in implementation issues, in particular relating to audits of LCEs, being identified by many stakeholders. Considering the need for changes in standard-setting, for audits of LCEs would therefore be responsive to those stakeholders who have identified challenges with implementing international standards, in particular for auditing and quality control.
- c) *Promoting a more consistent application of the auditing standards to audits of LCEs*—More consistent application of the ISAs to audits of LCEs will be in the public interest, and will likely improve the consistency of audit documentation, which in turn will assist audit regulators when inspecting how the standards have been applied.
- d) *Fit for purpose*—In addition to further consideration about how the auditing standards can be more effectively and efficiently applied to audits of LCEs, it is expected that there will be an increased focus on whether an audit undertaken in accordance with the ISAs is the most appropriate engagement. This may also assist LCEs with identifying the most appropriate type of engagement, therefore making the financial reporting process more effective and efficient.

Outline of the Work to be Undertaken

Major Issues that Will Be Addressed

22. The work will consider and explore:

- (a) The view expressed by some stakeholders that ISAs are not “fit-for-purpose” for audits of LCEs, which can be seen to inhibit audit quality. In particular, the LCE Working Group will develop matters for consultation about the specific aspects of the ISAs that are seen to be driving these views.
- (b) The evolving environment for audits, in particular in relation to audits of LCEs, and including jurisdictional initiatives relating to the development of separate standards for audits of SMEs, and the possible impact on the ISAs.
- (c) What is in scope for the IAASB, and what the role of others is in addressing the issues identified by stakeholders. For example, in relation to technology, what can the IAASB do using technology (e.g., digitizing the IAASB handbook to make the standards easier to use) versus technology-based methodologies and tools developed by others that would not be within the IAASB’s remit.

23. Notwithstanding that there has already been substantial discussion about the issues relating to audits of LCEs,¹¹ the LCE Working Group is of the view that more specific information is needed to

¹¹ For example, Accountancy Europe’s 2018 publication, [Simplifying Auditing Standards for Smaller or Non-Complex Entities](#), has identified the voluminous maze of requirements and application material, limited scalability and proportionality in practice

determine the most appropriate possible actions for further IAASB consideration. This will help the LCE Working Group more accurately articulate the identified issues in the DP and appropriate possible solutions to address them. Therefore, as part of its work, the LCE Working Group plans to continue undertaking an in-depth environmental scan to catalogue global developments and the effect of the changing environment through:

- (a) Working with the academic community to identify and synthesize relevant academic literature relating to the issues that have been identified.
 - (b) Further outreach with NSS to understand developments in different jurisdictions to respond to the issues for engagements relating to less complex entities.
 - (c) Outreach with International Organization of Supreme Audit Institutions (INTOSAI) representatives to further understand public sector issues in relation to the implementation of the ISAs, and any responses that have been developed.
24. Stakeholder views on the issues identified will also help the LCE Working Group in making its recommendations to the IAASB regarding future possible actions (as appropriate, including whether no further action is required). Accordingly, the LCE Working Group is of the view that the DP should include a description of the possible actions (described concisely, but with sufficient information that the respondent can make an informed assessment about the impact of the possible action, including examples where appropriate) and ask for stakeholder views on these, as well as whether there are any other possible suggested actions. Such possible actions may include, but are not limited to:
- (a) The actions that could be taken within the ISAs to address concerns about the application of the ISAs to LCEs, for example further consideration about how the ISAs are written or presented, the use of specific paragraphs to provide specific guidance for LCEs, etc.
 - (b) The development of a separate ISA for audits of less complex entities.
 - (c) Exploring whether there are alternative ways of providing a reasonable assurance audit opinion for less complex entities, other than the ISAs (but without reducing the level of assurance).
 - (d) The development of guidance outside of the standards for applying the ISAs to LCEs.
25. The IAASB will also further consider changing its handbook to a digital platform, allowing easier operability and navigation by the users of the IAASB handbook.¹²

Impact Analysis Considerations

26. The objective of this work is to obtain more information about the most appropriate possible actions to address the issues identified by stakeholders. This proposal will therefore likely:
- (a) Create an awareness of the environment among those who are taking action, in particular NSS.
 - (b) Create an awareness among the IAASB's stakeholders that the IAASB is undertaking work in this area; and
 - (c) Highlights the IAASB's acknowledgement that more need to be done and its commitment to

(including onerous documentation, over-engineered risk analysis, and extensive work on internal control) as some of the current difficulties in applying the ISAs.

¹² In 2019, the IAASB Staff will be working on an initiative to consider digital changes to the IAASB Handbook.

further exploring the issues.

Implications for any Specific Persons or Groups

27. The implications of this initial consultation will result in action by the IAASB and others, as appropriate, in relation to audits of LCEs. This will likely have the most significant impact on the auditors of these types of entities, as well as the LCEs themselves.

Development Process, Timetable and Output

Development Process

28. The DP and recommendations for the IAASB will be developed by the LCE Working Group. As the purpose at this stage is to explore the most appropriate possible actions to recommend for further IAASB consideration, there are no formal due process requirements. However, due to the importance of this initiative in the public interest, the LCE Working Group will continue to approach the work performed in the same way as an approved project of the IAASB, by undertaking public consultation and other outreach as appropriate, and discussing matters of relevance with the IAASB in its public meetings.

Timeline

29. A targeted timeline is set out below:

Timing	Action
<i>July 2018–March 2019</i>	Undertake targeted outreach with identified stakeholders for the development of a robust and comprehensive DP
<i>March 2019</i>	IAASB to consider and approve the DP for public consultation
<i>April 2019</i>	Publication of the DP for a 120-day comment period
<i>May–August 2019</i>	Roundtables and other outreach as necessary
<i>September–December 2019</i>	Working Group to provide feedback from the responses to the DP to the IAASB, as well as present a draft feedback statement for IAASB consideration
<i>Early 2020</i>	Feedback statement on the responses to the DP published

Outputs

30. The expected outputs from this work are:
- (a) A DP that will solicit stakeholder views on the issues in using the ISAs in an audit of a LCE, and possible actions to address them.
 - (b) A feedback statement setting out a summary of the responses to the DP.
 - (c) Recommendations for IAASB consideration about the most appropriate possible actions to

address the issues that have been identified.

31. After this information gathering process is complete and the IAASB has deliberated about the most appropriate possible actions, if the IAASB agrees to a specific way forward, a project proposal setting out the IAASB's activities at that stage will be presented to the IAASB for approval in accordance with the IAASB's due process.

Resources Required

32. The Working Group will be supported by IAASB Staff as necessary. The complement of the LCE Working Group has been supplemented by additional IAASB Board members, as well as a representative from IFAC's SMP Committee.