

# Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges



The International Auditing and Assurance Standards Board (IAASB) is a global independent standard-setting body that serves the public interest by setting high-quality international standards which are generally accepted worldwide.

The IAASB follows a rigorous process in developing its standards, involving multi-stakeholder input, including from the IAASB's Consultative Advisory Group, the International Federation of Accountants' relevant committees and professional accountancy organizations, regulatory and oversight bodies, firms, governmental agencies, investors, preparers and the general public.

## Contents

▪ Chairman's Foreword.....	3
▪ The Purpose of this Discussion Paper.....	4
▪ What is a Less Complex Entity.....	5
▪ Section I - Background.....	6
▪ Section II - Issues and Challenges.....	11
▪ Section III - Possible Actions to be Explored.....	15

## Chairman's Foreword

The ongoing challenges faced by those auditing smaller entities is an area that is of particular importance to me as my term as Chairman of the IAASB comes to an end—smaller entities make a critical contribution to the world economy and quantitatively the majority of audits globally are audits of smaller entities. The strides that we have made in moving forward our exploration of what more can be done in relation to audits of smaller entities has culminated in this Discussion Paper, and I wish to emphasize the importance of hearing from those most affected by these challenges to be able to move forward on this topic.

We need to think more, and with an open mind, about actions that will result in solutions that will help not only those auditing smaller entities, but also those auditing entities where the nature and circumstances of the entity is less complex, which may be broader than just small- and medium-sized entities (SMEs) (hereafter we will refer to this as audits of less complex entities). We acknowledge the efforts of others in their activities to support auditors of less complex entities and have heeded the call for global action.

However, before committing to further actions, we need to consider whether we have a full understanding of the identified issues and challenges relating to audits of less complex entities to be able to appropriately address the issues and challenges identified. We also need to understand all of our stakeholders' views about different possible actions (including whether there are other actions that we have not yet considered), to be able to work out what is most appropriate and what will be most effective. We have to be mindful that any changes that we make may also have unintended consequences on audits other than those that are audits of less complex entities, and so must maintain the fine balance between competing needs. There is no easy 'fix,' and it will take time to progress global actions, but we are very mindful that more must be done to keep the ISAs relevant to those auditing less complex entities, even as our current work continues.

We remain committed to our work in actively further exploring and progressing our thinking in relation to audits of less complex entities, and look forward to hearing from all of our stakeholders about the matters set out in this Discussion Paper. A feedback statement from the input received will share with the world what we hear, and the IAASB will then deliberate about how to move forward.



Prof. Arnold Schilder

*IAASB Chairman*

## **The Purpose of this Discussion Paper**

As the global business environment continues to evolve, and stakeholders expectations change, the International Standards on Auditing (ISAs) have increased in length, and become more complex and more detailed. The IAASB has recognized that there are challenges in implementing the ISAs, in particular in engagements where the entity being audited is less complex.

This Discussion Paper (DP) focuses on audits of less complex entities (LCE's) using the ISAs, and sets out:

- Challenges and issues that have been identified in implementing the ISAs in an audit of a LCE.
- A number of possible actions that could be undertaken to address the identified challenges and issues.

Input on these matters will help the IAASB determine how it can best move forward.

## What is a Less Complex Entity?

***What do we mean by “less complex entity” and why does the IAASB focus on this rather than on an audit of a small-and medium-sized entity (SME)?***

The ISAs have been developed to apply to a wide range of entities, regardless of the nature and circumstances of an entity. However, the evolving environment is driving changes that are contributing to increasing complexity in the ISAs. This increasing complexity in the ISAs is however creating potential challenges and issues in applying the ISAs when the structures and transactions are straight-forward (i.e., nature and circumstances of the entity are less complex).

While the discussion has historically been around the difficulty in applying the ISAs to SMEs, as outlined by the Chairman in his Foreword, it is the complexity of the audited entity that is the major characteristic related to difficulty of application. Therefore the IAASB is of the view that it is appropriate to consider the qualitative characteristics of being less complex rather than only the size of an entity when considering possible actions to enable the IAASB’s standards to remain fit-for-purpose.

In considering how to describe a LCE, the IAASB has looked to its current definition of a smaller entity, which sets out many of the qualitative characteristics that could be attributable to a LCE:

*“An entity which typically possesses qualitative characteristics such as:*

- (a) Concentration of ownership and management in a small number of individuals (often a single individual – either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and*
- (b) One or more of the following:*
  - (i) Straightforward or uncomplicated transactions;*
  - (ii) Simple record-keeping;*
  - (iii) Few lines of business and few products within business lines;*
  - (iv) Few internal controls;*
  - (v) Few levels of management with responsibility for a broad range of controls; or*
  - (vi) Few personnel, many having a wide range of duties.*

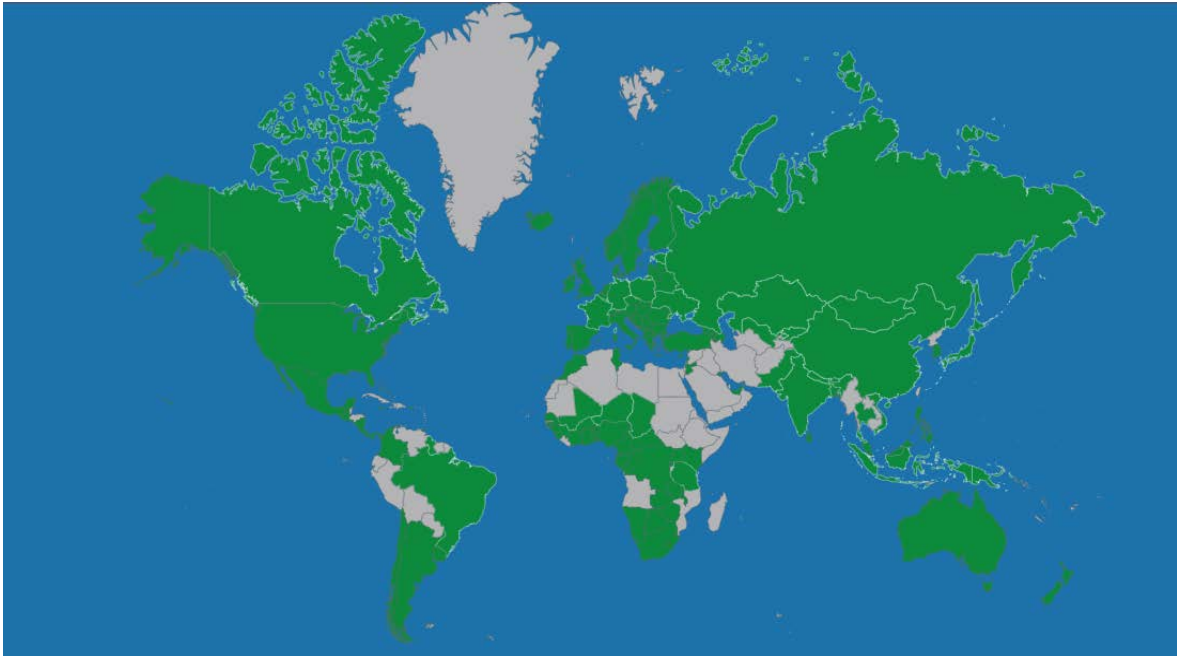
*These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all of these characteristics.”<sup>1</sup>*

As the IAASB moves forward in its work in this area, further consideration will be given to whether these qualitative characteristics appropriately describe the types of entities being considered in this initiative, or whether further changes are needed.

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<sup>1</sup> IAASB's Glossary of Terms

# I. Background



At present, 129 jurisdictions use, or are committed to using, the ISAs (up from some 90 countries in the mid-2000's) demonstrating the increasing importance the global community attaches to the ISAs. This widespread and continually growing international use of the ISAs underscores the importance of the IAASB continuing to focus its efforts on maintaining the quality and scalability of these standards, and to meeting the expectations that stakeholders have regarding their application.

The IAASB has always been mindful of the need for the ISAs to be able to be applied to a broad range of entities, from entities that have straightforward structures and transactions (i.e., LCEs) to those entities where the structures and transactions are complex. Although the IAASB has continued making efforts to keep the revised or developed standards operational and scalable, there has been growing concern about the increasing complexity and usability of the ISAs, in particular for LCEs. There have also been questions raised as to whether the ISAs remain fit-for-purpose for audits of smaller and less complex entities.

Implementation needs and challenges in using the ISAs differ, depending on a variety of factors. For example additional support may be needed when the ISAs are first adopted within a particular jurisdiction, or may vary based on the size of the audit practice,<sup>2</sup> the level of resources, the number of audit engagements undertaken by an auditor, and the nature and complexity of the firm's audit clients. As the IAASB revises its standards in the current environment this can also bring forward new, and sometimes additional, challenges.

The support available for implementation and ongoing guidance also varies between:

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<sup>2</sup> For example, a report from the UK's Financial Reporting Council, [Key Facts and Trends in the Accountancy Profession](#), notes that 5,351 out of 5,660 registered audit firms have 6 or less principals per firm, indicating that a large majority of firms in the UK are smaller.

- Jurisdictions—for example some jurisdictions have very active professional accountancy organizations providing substantial support, guidance and other related resources; and
- Firms—for example, some small and medium practices (SMPs) have less access to ongoing technical resources and other appropriate support, whereas those belonging to large international networks are generally better resourced and provide a greater level of implementation support.

## The Evolving World and the Impact on the ISAs

There are a number of influences driving changes to the environment in which auditors operate, including:

<b>The Evolving Business Environment</b>	<ul style="list-style-type: none"> <li>• The evolving business environment is driving increasingly complex structures and transactions.</li> <li>• Technology is advancing at a rapid pace, impacting how transactions are undertaken and how records are kept.</li> <li>• Law and regulation is changing, with enhanced and evolving reporting requirements, including in relation to non-financial reporting, which are driving different business and reporting decisions.</li> <li>• Audit regulators and oversight bodies have become more coordinated and are committed to driving audit quality, primarily through their audit inspection processes, including focusing on remedial action plans to address the root causes of deficiencies identified. This results, for example, in calls for more specificity in the requirements in the auditing standards against which the audits can be inspected.</li> <li>• Changing public interest —audits are under increasing scrutiny, with continued discussion of the expectation gap, the gap between what the auditor is required to do and what some stakeholders expect that the auditor should do.</li> </ul>
<b>Changing Financial and Non-Financial Reporting</b>	<ul style="list-style-type: none"> <li>• Financial reporting standards are continually being revised to address changes in the business environment, public expectations, and other influences, and also becoming more complex and lengthy.</li> <li>• Assurance needs related to non-financial reporting continue to evolve.</li> <li>• Increasing requirements for estimates using forward-looking information, which requires practitioners to apply heightened professional judgment and professional skepticism.</li> </ul>

The influences above are also seen to be contributing to more complexity in the ISAs that are revised to address these situations, which in turn is potentially impacting the audits of LCEs. This is giving rise to the following concerns being commonly expressed:

- The ISAs are increasing in length as more detail and guidance is added to address the increasingly complex environment. The increase in length can act as a barrier to auditors reading and understanding the ISAs, particularly for those auditors in situations where there is a lack of implementation and ongoing guidance.



- As the ISAs become more detailed, this can result in a perceived ‘checklist-approach,’ with a greater focus on compliance rather than applying judgment in the procedures undertaken.
- The more detailed ISAs can lead to increased documentation in audit files (with no perceived commensurate benefit).
- All of these factors can potentially lead to a reduction in the perceived value of an audit.

**Section II** describes the issues and challenges that have been identified relating to audits of LCEs.

## Others Have Reacted to the Evolving Environment and Growing Complexity of the ISAs

Others too have recognized that there are challenges with implementing the ISAs, in particular for audits of LCEs:

- At a global level, the International Federation of Accountants (IFAC) has developed a global ISA Guide for Audits of SME’s,<sup>3</sup> to assist with the implementation of the ISAs, and the Guide is now in its Fourth Edition.
- National Standard Setters (NSS) and others have also sought to develop solutions to help practitioners when undertaking audits in circumstances where the entity is less complex, including national guidance for audits of SME’s, information technology (IT) tools (such as electronic methodologies) and ISA manuals.
- Regional bodies, such as Accountancy Europe, have also engaged stakeholders on matters relating to simplifying auditing standards for small or non-complex entities through publications and events.

**Appendix 1** sets out examples of tools and resources developed by various jurisdictions.

More recently, there have also been various initiatives specifically targeted at audits of less complex (or smaller) entities, including:

- In June 2015, a consultation on a “[Nordic Standard for Audits of Small Entities](#)” was published. The draft standard was developed by the Nordic Federation of Public Accountants (NRF) for consultation in Sweden, Denmark, Finland, Iceland and Norway. Responses were received from all around the world, not only from the intended targeted countries. Respondents echoed the call for something to be done, but had mixed views about what this should be. One of the major messages from the responses that in order for this to be successful, an international rather than a regional response was required. In light of this, the NRF has continued to encourage the IAASB to focus efforts in this area.
- In 2018, Sri Lanka issued “[The Sri Lanka Auditing Standard for the Audits of Non-Specified Business Enterprises](#)” (SLAuS). The SLAuS was developed at the Institute of Chartered Accountants of Sri Lanka with the draft Nordic Standard being used in its development.
- 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 (may possibly be a simplified audit standard).
- Belgium – In 2018, a standard on contractual audits of SMEs was published (the definition of an SME is linked to the threshold for mandatory audits). This standard was developed at the explicit request of the Minister of Economy and does not apply if an entity is required to have a statutory audit (in

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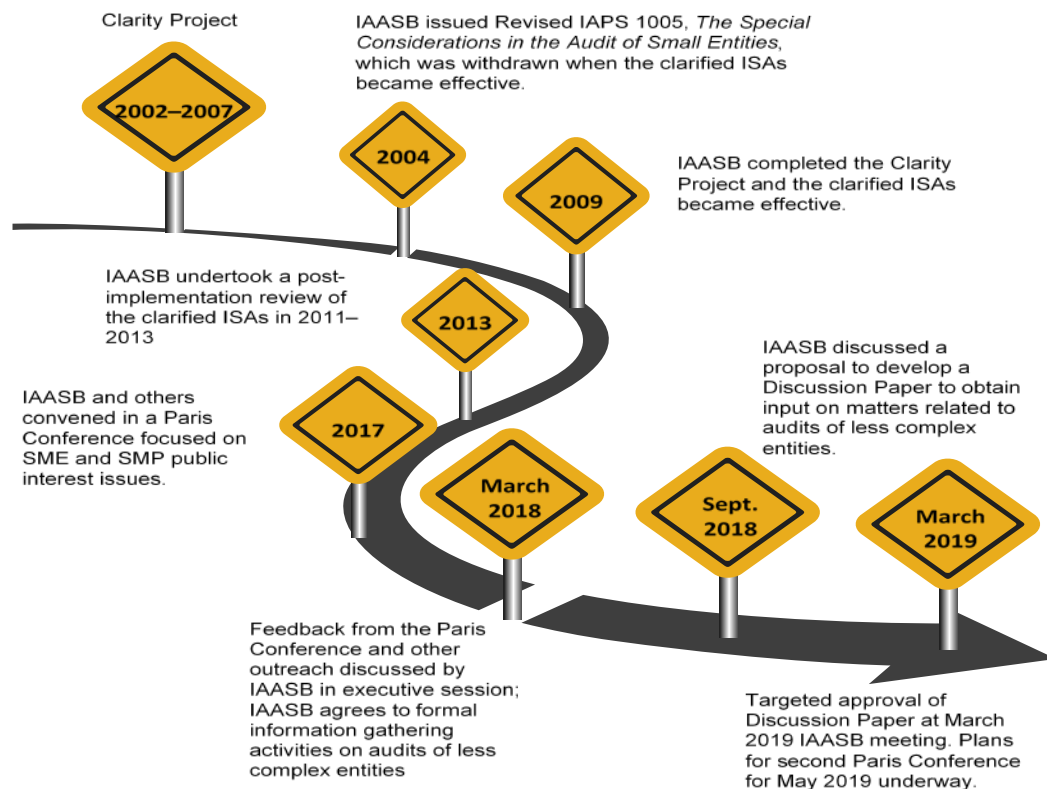
<sup>3</sup> IFAC’s [Guide to Using International Standards on Auditing in the Audits of Small- and Medium- Sized Entities](#)



which case the ISAs apply). When the SME is considered to be complex, the registered auditors will have to apply the ISAs.

The concerns being expressed and the initiatives being undertaken in different jurisdictions around the world signal that additional support is likely needed in the implementation of the ISAs for LCEs, as well as further consideration about the standards themselves. Notwithstanding that guidance and other support is being developed at a jurisdictional or regional level, pressure is increasing for a global solution, with similar challenges being identified in many jurisdictions regardless of the size or complexity of the local business environment. In light of these jurisdictional and regional developments, the IAASB remains mindful of the relevance of its standards in relation to audits of LCEs. <sup>4</sup>

### The IAASB's Journey...



The IAASB has also increased its focus on scalability/proportionality in its recent projects on ISA 540 (Revised) and ISA 315 (Revised). With regard to ISA 540 (Revised), the standard now includes a spectrum of inherent risk, with risks varying on a scale rather than a simple threshold, enhancing its scalability. ISA 315 (Revised) has also utilized the spectrum of risk concept, which has been supported by respondents to the exposure draft, as well as other proposed changes to enhance the scalability of the standard (see also “Continuing with Current Activities” on Page 21)

<sup>4</sup> IFAC has a policy position (no 2) that notes that the ISAs are designed for audits of entities of all sizes, and that their design enables them to be applied in a manner that is proportionate to the size and complexity of an entity, and therefore that it is in the public interest to have audits of SMEs performed using the same standards (i.e., as some would say “an audit is an audit”).

## The Paris SMP/SME Conference

Shaping the way forward...

In early 2017 the IAASB (together with the Compagnie Nationale des Commissaires aux Comptes (CNCC) / the Conseil Supérieur de l'Ordre des Experts-Comptables (CSOEC)) convened a conference in Paris, France, to further discuss the needs of SMPs and SMEs and help shape a way forward. The two-day conference was attended by over 100 stakeholders from all over the world, including many practitioners representing SMPs, with a focus on both audits of SME's and also other services performed by practitioners for SME's. Broadly, the discussions related to audit can be summarized as follows:

- A strong need was expressed for better support for audits of smaller entities and less complex entities.
- After a presentation on the draft Nordic Standard, mixed views were expressed about the need for a new separate standard.
- More needs to be done to understand the root-causes of the issues that have been identified relating to audits of smaller entities, for example, further considering whether there is a deficiency in the standards or whether it is more an issue in the execution when applying the standards.
- Some stakeholders encouraged the IAASB to “think simpler first” in the revisions that were underway at the time.
- It was emphasized that more thought was needed about how to utilize the advances in technology (by the IAASB and others).
- Further consideration was needed:
  - To bridge the ‘expectations gap’ between different stakeholders.
  - About how to better promote the value of an audit.

Attendees recognized that it was not only the IAASB that needed to action some of these matters.

After this conference, the IAASB started to more intently explore what actions may be required to address the concerns and issues that had been discussed at the conference. The timeline above illustrates the IAASB's activities in this area before and since this conference.

## Next Steps

The IAASB is receptive to feedback as to how the issues and challenges identified can be best addressed, and will seek to obtain information in order to make an informed decision as to its further actions in relation to audits of less complex entities, by both the IAASB and others. The possible actions identified to date are set out hereafter.



## II. Issues and Challenges

The IAASB and others have recognized the need for global solutions to address the issues and challenges in relation to audits of LCEs. However, as set out in Section I, there is a broad range of influences on the audit environment, and therefore there is not necessarily a one-size-fits-all solution.

Furthermore, any solution may not only lie with the IAASB, there will be action required by others too. Although recognizing that not all of the influences leading to challenges and issues are under the control of the IAASB or form part of the IAASB's considerations in relation to audits of LCEs, the IAASB is of the view that it is important to set out all of the relevant considerations so that it can be acknowledged that there are a suite of options, including actions that can be undertaken by others, that can address the issues and challenges.



This section first identifies those matters that are not within the scope of the IAASB's possible work on audits of LCEs, and then examines those that are within the scope of the IAASB remit on audits of LCEs, which will form the basis for the possible actions set out in Section III. The IAASB recognizes the important role it plays in relation to setting the standards and the influence it has, and is therefore committed to exploring what further can be done.

### Issues and Challenges Not Within the Scope of the IAASB's Work on Audits of LCEs

The following sets out identified issues and other matters impacting the audit environment for LCEs, but which does not fall within the IAASB's remit as an international standard-setter, or which the IAASB does not intend to consider because they are related to other than reasonable assurance engagements and are therefore not within scope when considering audits of LCEs. However, the IAASB may be in a position to further consider how it can best influence and encourage actions by others.

#### Not Within the Control of the IAASB

##### Legal and other Requirements for an Audit

- Social policy sets out the laws and regulations for the requirement for an audit. Some jurisdictions have audit exemption thresholds above which an audit is mandatory.
- The IAASB does not set the requirements for which entities require an audit as this is prescribed by each jurisdiction's laws or regulations or influence in any way where an entity voluntarily elects to have an audit undertaken. The IAASB is not, and cannot be expected to be, involved in such jurisdictional or entity level determinations.

*To illustrate the variation in practice of different jurisdictions using audit exemption thresholds, countries within the European Union continue to change their thresholds, with some member states (Cyprus, Estonia, Italy and Romania) having lowered their thresholds in the last two years, while two member states (Denmark and Ireland) have*

	<p>increased their thresholds in the last two years.<sup>5</sup> Italy has recently introduced mandatory audits for very small companies, which is effective at the end of 2019. Other jurisdictions in Europe, such as France, have recently introduced audit thresholds as a way of reducing the burden on smaller entities, and Australia has current proposals to double the current audit threshold (see Appendix). To further illustrate the point of jurisdictional mandate, an independent body of the Swedish parliament evaluated the impact of Sweden's 2010 reform that raised audit thresholds, and concluded that the costs to society outweighed the benefits, in particular that small companies competitiveness and growth was not enhanced by abolishing audits. Accordingly in 2017 Sweden did not further raise its audit threshold to respond to auditor general recommendations to change the audit exemption threshold. There are different views about introducing audit thresholds, and at what the limits should be, and although impacting the audit environment, the setting of thresholds are outside of the IAASB's remit.</p>
<b>Commercial Considerations Relating to an Audit</b>	<ul style="list-style-type: none"> <li>• Audit fee pressure, often driven by market forces and other environmental influences, may contribute to ethical issues and may lead to questions about the cost-benefit of complying with all of the requirements in the auditing standards and performing the required audit procedures.</li> <li>• The auditing standards do not address fees, rather the Ethics Code sets out considerations relating to fees (including independence and objectivity).<sup>6</sup></li> </ul>
<b>Technology / Methodology</b>	<ul style="list-style-type: none"> <li>• Access to global technology tools / methodologies that can be applied in an audit of a LCE may be limited, as well as incentives to use such tools. Although a helpful global solution, promoting technology or methodologies is not part of the remit of the IAASB.</li> </ul>
<b>Education</b>	<ul style="list-style-type: none"> <li>• Effective execution may relate to education of the auditors, ranging from not understanding the content of the ISAs to not understanding the content of new and revised standards.</li> <li>• The IAASB is responsible for developing auditing standards that are capable of being consistently and effectively implemented. There is an aspect of the development of implementation material and other guidance that is within the IAASB's remit, in particular when a new or revised standard is published. However, ongoing training and development of guidance is outside of the remit of the IAASB.</li> <li>• The ISAs set out the principles to be complied with in an audit, but do not prescribe how auditors are trained or how the requirements are implemented in the tools used by practitioners.</li> </ul>

<sup>5</sup> Source: Accountancy Europe's "Audit Exemption Thresholds in Europe – 2019 Update"

<sup>6</sup> The International Ethics Standards Board for Accountants (IESBA) issued a publication [Ethical Considerations Relating to Audit Fee Setting in the Context of Downward Fee Pressure](#) to highlight auditor's ethical obligations under the Code of Ethics for Professional Accountants.

## Scoped Out of Exploration Activities Related to Audits of LCEs

<b>Engagements Other than Audit</b>	<ul style="list-style-type: none"> <li>Although the IAASB's other standards (i.e., review, assurance and related services standards) may be appropriate alternatives in cases where an audit is not required or needed, the scope of this work on audits of LCEs excludes further consideration of engagements that are not audits.</li> </ul>
<b>Value of an Audit</b>	<ul style="list-style-type: none"> <li>Questions have been raised about the value of having an audit, including: <ul style="list-style-type: none"> <li>Trust in the audit process;</li> <li>Appropriate communication of information to support investment or funding decisions;</li> <li>Relevance of the information being reported on (e.g., backward-looking versus forward-looking);</li> <li>Using technology to execute better audits.</li> </ul> </li> </ul> <p>Although the changes to the standards may impact the matters influencing the value of an audit, and may disproportionately influence the value of the audit for LCEs, the objective of the work on audits of LCEs is not about exploring the value of an audit.</p>
<b>Expectation Gap</b>	<ul style="list-style-type: none"> <li>The expectation gap, the gap between what an auditor is required to do and what is expected of the auditor by some stakeholders, is changing, in particular as the standards become more complex to understand and use.</li> <li>The scope of this project is not intended to directly address the expectation gap, but by improving the application of ISAs to LCEs may indirectly help users of financial statements better understand the procedures undertaken in an audit.</li> </ul>

## Issues and Challenges Within the Scope of the IAASB's Work on Audits of LCE's

The objectives of the IAASB's Clarity Project<sup>7</sup> were to write the standards in a clear and concise way, with the requirements set out as principles, and application material to help explain how the requirements could be implemented. In the IAASB's view, a principles-based approach to the standards enables the application of the ISAs to entities with a wide variety of nature and circumstances.

The influences set out in Section I, and the IAASB's journey in thinking more about what can be done to improve the application of the ISAs for LCEs, have already driven changes in the current work practices of the IAASB as it revises some of its core ISAs, including a greater emphasis on scalability. However, ongoing concern and challenges with implementing the ISAs (or proposals) is continually being highlighted by the IAASB's stakeholders, in particular in relation to its recent exposure drafts. Many of the identified issues set out below are recurring themes of matters highlighted to the IAASB as being challenging, and have been

<sup>7</sup> In March 2009, the IAASB completed its Clarity Project, which had involved a comprehensive review of all the International Standards on Auditing (ISAs) to improve their clarity and thereby facilitate their consistent application. Approximately half of the clarified ISAs included substantive changes aimed at improving practice in a variety of respects.

reiterated recently in the responses to ED-315 as well as the responses that were received when ISA 540 (Revised) was an exposure draft. The major recurring and recent comments include:

<b>Language and Basic Approach to the Standards</b>	<ul style="list-style-type: none"> <li>• Some of the 'clarity' principles have been diminished, with the language becoming more complex and therefore more difficult to comprehend. This may also impact the translation of the standards.</li> <li>• The standards are being drafted to include the "how," i.e., the process to undertake the procedure which is resulting in more detailed requirements.</li> <li>• In some cases, there has been a move away from principles-based requirements.</li> <li>• The detail in the standards is driving auditors towards more of a 'compliance with the standards' approach rather than one that encourages the use of professional judgment in determining the most appropriate audit procedures for the specific circumstances.</li> <li>• The standards are difficult to navigate as they break up a continuous audit process into discrete elements, and are written in a linear way, but are iterative in nature. In addition, they are not electronic so navigating is done manually.</li> </ul>
<b>Length of the Standards</b>	<ul style="list-style-type: none"> <li>• ISAs are voluminous, which makes them difficult to read and determine what needs to be done, and which has the potential to discourage some auditors from reading all of the relevant and necessary matters.</li> <li>• Significant additional length is being added through recent revision processes of the core ISAs, in particular to add application material as the ISAs become more complex. Paradoxically, some of this additional length is to aid scalability of the ISAs.</li> </ul>
<b>Documentation</b>	<ul style="list-style-type: none"> <li>• Documentation requirements throughout the ISAs are extensive, and becoming more onerous.</li> <li>• In many cases it's not clear for LCEs as to what needs to be documented. This lack of clarity has sometimes resulted in: <ul style="list-style-type: none"> <li>○ Different interpretations about how certain matters need to be documented.</li> <li>○ Overdocumentation (for example, auditors of LCEs may include extensive documentation to justify what's not been done, which is seen as additional work that does not provide additional assurance).</li> </ul> </li> </ul>
<b>Lack of Clarity as to What Needs to be Done or Why</b>	<ul style="list-style-type: none"> <li>• In some cases, unnecessary procedures are being performed because when an auditor is faced with a specific set of circumstances, the standards are not clear about the nature and extent of the work required. In other circumstances, necessary procedures are not being performed because the application of the requirements to the circumstances are not clear.</li> </ul>



<p><b>Not Enough Guidance Within / Outside of the ISAs</b></p>	<ul style="list-style-type: none"> <li>• Paragraphs detailing <i>considerations for audits of smaller entities</i>, where they are presented within the ISAs, are not helpful in all cases to understand scalability and proportionality of the requirements.</li> <li>• There is insufficient guidance to aid the effective implementation of new and revised ISAs.</li> </ul>
<p><b>ISAs Noted as Particularly Problematic</b></p>	<ul style="list-style-type: none"> <li>• The work on understanding the entity's system of internal controls in accordance with ISA 315 (Revised)<sup>8</sup>—in particular where controls will not be relied on, this work is often considered unnecessary.</li> <li>• Risk identification and assessment—leading to an over-engineered risk assessment for entities in a non-complex environment. In particular, the changes proposed in ED-315<sup>9</sup> have been seen to add unnecessary complexity to the risk identification and assessment process.</li> <li>• The auditor's considerations in relation to fraud—the focus of the work to comply with the requirements of ISA 240<sup>10</sup> when auditing a LCE may be more onerous than what would be appropriate in the circumstances.</li> <li>• Auditing accounting estimates—some audit procedures required under ISA 540 (Revised)<sup>11</sup> have been noted as unnecessary, especially where the estimates do not involve complex fair values or significant forward-looking information, some audit procedures required under ISA 540 (Revised) have been noted as being unnecessary.</li> </ul>

### Questions for Respondents

1. Do the matters set out in Section II above that are within the scope of the IAASB's remit fairly describe the issues and challenges relating to audits of LCEs? Are there:
  - (a) Any other specific issues or challenges that should be considered?
  - (b) Are there any other ISAs that are particularly problematic, and if so, in what way?
2. With regard to the matters that are not within the IAASB's control, or have been scoped out of the IAASB's exploration activities, what more can be done in relation to these and by whom?

<sup>8</sup> ISA 15 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

<sup>9</sup> ED-315, Exposure Draft ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*

<sup>10</sup> ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

<sup>11</sup> ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*



### III. Possible Actions to be Explored

Actions at a global level will help promote:

- A common understanding of the procedures required in relation to an audit of a LCE.
- Consistency in application across entities and jurisdictions.

The IAASB has reflected on various possible actions that could be undertaken to address the issues that have been identified. In its deliberations, however, it has been recognized that there is no simple solution—a wide spectrum of audits are undertaken using the ISAs, ranging from large, complex public interest entities to small entities that are considerably less complex. There may also not only be one solution, and any actions may impact all stakeholders (positively or negatively), not only those interested in audits of LCEs.

The possible actions set out hereafter provide the IAASB's initial thoughts about what could be done, however further information gathering and deliberation are needed to better understand whether there is anything else and to properly scope any related future projects of the IAASB, once it has a clearer direction on its future work in this area.

There will likely be mixed views on some of these possible actions, and it is essential that the IAASB be informed as to the views of all of its stakeholders, including the rationale underpinning those views. In addition to this DP, the IAASB will also be undertaking various outreach activities to solicit responses from those affected by, and using, its standards.

The IAASB has identified the following possible actions, with each described further in this document<sup>12</sup>:



#### Standards-Based Actions

- Revising the suite of ISAs.
- Develop a separate auditing standard.

#### Outside of the Standards

- Developing guidance or other specific related actions for auditors of LCEs.
- Enhanced accessibility of the ISAs through technology.

#### Other

- Continuing with current efforts in relation to scalability and proportionality as ISAs are revised.

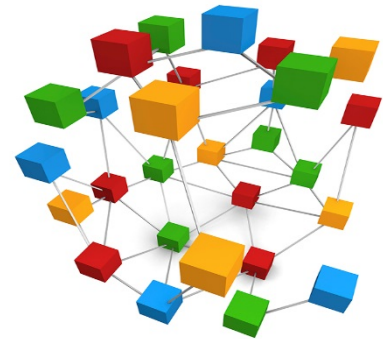
<sup>12</sup> The Accountancy Europe publication, [Simplifying Auditing Standards for Small or Non-Complex Entities](#), sets out Pros and Cons of various possible actions that have been explored in its publication.

## Revising the Suite of ISAs

The suite of ISAs could be comprehensively revised to make work effort clearer where the circumstances of the entity are less complex.

Broadly, this could involve one or more of the following:

- Revising the standards using clearer and understandable language.
- Focusing on principle-based requirement.
- Revising the application material to feature more scalability and proportionality considerations, e.g., providing examples of both simple and complex circumstances in order to contrast the differences.
- Using a building-block approach for the requirements (for example, setting out the basic requirements, then illustrating how this could be scaled down for less complex circumstances, and layering on what more needs to be done as the circumstances become more complex, as necessary).
- Better signposting within the ISAs about the audit procedures appropriate to audits of LCEs, to distinguish those procedures that are relevant for these entities. This could be done, for example, by enhancing the considerations specific to audits of LCEs (previously included in the standards as considerations for smaller entities) in a separate section within each ISA.



There are various ways in which the revision of the suite of ISAs could be undertaken:

- A substantial project to revise all of the ISAs at the same time.
- Revising the standards on a rolling basis, or as they are 'opened up' to be revised.
- Using a phased approach, such as selecting certain standards to be revised first, possibly those where the most issues and challenges for audits of LCEs have been identified.

If this action were to be undertaken, the exact approach as to how best to revise the standards would need to be determined by the IAASB, and further work would be undertaken to explore the most appropriate approach. Features of this option include:

- The requirements may be shorter and easier to understand.
- Requirements will be clearer which will likely promote consistency in application.
- The IAASB would be responsive, and would be seen to be responsive, to improving those standards about which the more significant concerns have been raised for audits of LCEs.

This option would result in a substantial project for the Board:

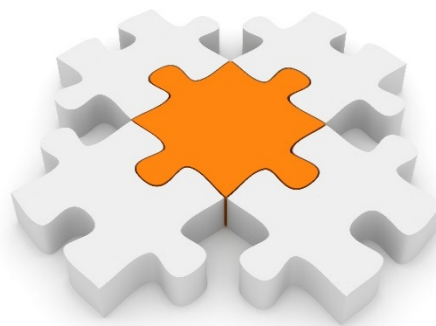
- It would likely consume a significant amount of the Board's capacity and resources.
- Such a revision may take a significant amount of time to complete (for example the last time all of the ISAs were revised was during the Clarity Project which took six years to complete).<sup>13</sup>
- If undertaken on a rolling basis there would be some standards that have been revised using the new format while others have not.

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<sup>13</sup> The IAASB has planned for the completion of its substantial ISA projects until early 2021, which is the time that a new substantial project could likely commence.

## Develop a Separate Auditing Standard

The development of a separate standard specifically for audits of smaller entities has been the subject of discussion internationally, with a number of jurisdictions having developed, or being in the process of developing, drafts or pronouncements. Therefore this is an option that should be explored for audits of LCEs.



The IAASB has not specifically discussed the content of such a standard, but recognizes the importance of outlining the key features of such a standard for its stakeholders in order for them to be able to provide informed responses about their views on the possible actions. The following has been developed using the context of existing drafts or work done by others in this area. More would need to be done to determine whether this is a feasible option, including an impact analysis, as well as considering how such a standard could be operationalized.

### *Possible Features of a Separate Auditing Standard based on the Existing ISA Framework*

Such a separate auditing standard could be based on the existing ISA framework, with the aim of achieving the same objectives as the ISAs. From outreach undertaken to date, it is clear that the level of assurance for the audit opinion for such a standard should be the same (i.e., reasonable assurance).

As with the ISAs, local laws and regulations would prescribe when such a standard could be used in a particular jurisdiction, such a standard would only describe when it would be appropriate to use or not (for example, it would not be appropriate for publicly listed entities).

- Other features: A 'filter' would need to be developed to determine the types of entities to which this standard would apply, but could, for example, equate to the qualitative characteristics used to describe a LCE (as set out on page 5).
- Such a standard could mirror the risk-based approach of the ISAs but be written in a more linear way to follow the work flow of an audit.
- The objective of the standard could address the whole audit, for example, to include gathering sufficient appropriate audit evidence to be able to conclude and form an opinion (including a written auditor's report).
- The requirements could focus on objectives (i.e., be outcomes-based rather than process oriented) for those requirements that would likely be relevant to audits of less complex entities.
- The use of professional judgment would be emphasized, rather than prescribing procedures.
- Quality management principles could also possibly be included, setting out requirements at the engagement level, for example a focus on the broad quality management principles such as the engagement partner's responsibilities.
- Similar to the ISAs, compliance with ISQC 1 (or the revised standard as applicable) and relevant ethical requirements would likely be required.
- Such a standard would also set out the basic requirements as to what constitutes audit evidence.
- Principle-based requirements, appropriate for audits of LCEs, could be developed addressing:

- Acceptance and continuance of an engagement.
- Planning.
- Materiality and evaluation of misstatements.
- Risk identification and assessment, including setting out what is necessary to obtain the necessary understanding to be able to respond to the assessed risks of material misstatement.
- The auditor's responses to assessed risks.
- Concluding and reporting, include the auditors' consideration of subsequent events.

Principle-based documentation requirements that align with the broader principles of ISA 230<sup>14</sup> could be developed, with consideration could be given to whether further specific requirements are needed

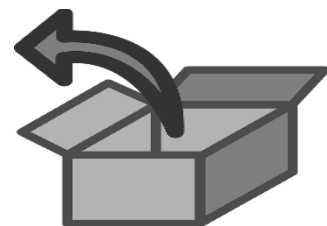
- Such a standard may not have application material, rather the development of supporting guidance could be left to others (such as NSS) to develop, or if based on the same principles and structure as the ISAs may reference the applicable parts of the ISAs (in a similar way that IFRS are referenced in the IFRS for SME standard).

From previous outreach (including the Paris conference), the IAASB has heard concerns from some stakeholders about the development of a separate standard for auditing LCEs (for example, it may create a two-tier profession). However, in light of developments in the environment where others are actively pursuing an alternative to the full suite of ISAs, and the commitment to exploring a global approach, the IAASB has the view that this is an option that should be further explored.

### Possible Features of a Separate Auditing Standard Developed Based on a Different Framework

The possible action described above focuses on the ISAs as a starting point and an overall framework for the development of a separate standard. An alternative is to explore the options of developing a standalone standard based on a different framework and set of principles than the current ISAs. Such a new standalone standard could, for example, be developed using different concepts to the ISAs, and would not necessarily need to be risk based and/or assertion based. Current innovations through digitalization, big-data and artificial intelligence may also help promote a different approach to the risk based-assertion-based audit.

However, such an option would likely take a significant amount of time to complete, because substantial research and information gathering activities would need to be undertaken to determine whether it would be a viable alternative. However, this may still be an option worth exploring in light of changes in the environment and technology.




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<sup>14</sup> ISA 230, *Audit Documentation*

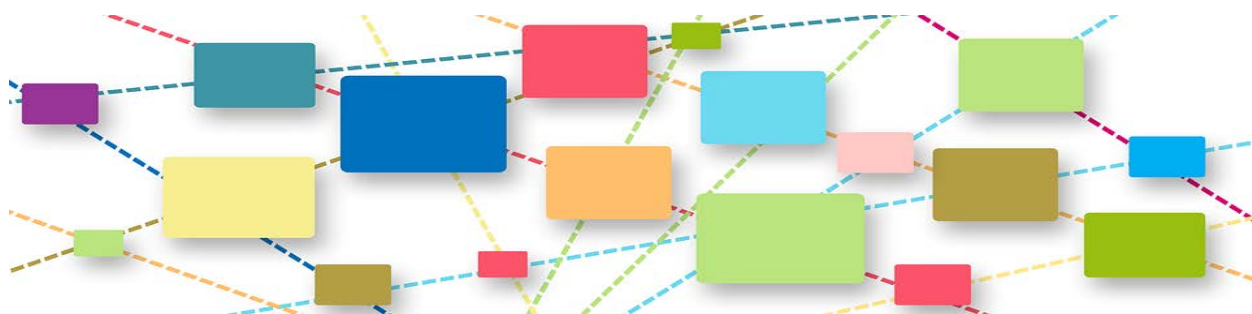
## Develop Guidance and Other Related Actions

There have been ongoing calls for more guidance, in particular a practical “how to” guide when approaching an audit of a LCE, as well as for specific areas within the ISAs. This section addresses guidance that is outside of the ISAs (i.e., not application material within the ISAs), so the nature of such material would be non-authoritative. Options for guidance could include:

- (a) *A comprehensive guide about how to apply the ISAs in circumstances where the nature and circumstance of the entity being audited are less complex.* A guide along these lines has already been developed by IFAC, which is intended to provide practical support when implementing the ISAs in audits of SMEs. The Guide is currently set out in two volumes, with Volume 1 covering the fundamental concepts of a risk-based approach, and Volume 2 setting out practical examples including illustrative case studies. The Guide has been translated into over 20 languages, and the latest version has been downloaded in more than 140 countries. Notwithstanding the broad downloading of the Guide, it is voluminous and there are many stakeholders still calling for more guidance.
- (b) *An International Auditing Practice Note (IAPN) for Audits of Less Complex Entities*—IAPNs do not impose additional requirements on auditors beyond those required by the ISAs, nor do they change the auditor’s responsibility to comply with all of the ISAs relevant to the audit being undertaken. They are intended to provide practical assistance to auditors. Such an IAPN would likely only cover specific areas where additional guidance is needed.
- (c) *Guidance for the implementation of specific areas within the ISAs*—for example, a guide specifically targeted at risk identification and assessment.
- (d) *Focused “implementation packs” for new and revised ISAs specifically for audits of LCEs*—including slide presentations, webinars and focused guidance about how to implement the revised or new ISA, to educate and assist once new or revised standards are published.

## Enhanced Accessibility of the ISAs

The current structure and length of the ISAs make it difficult for practitioners to navigate them, and there have been calls from a wide variety of stakeholders for more navigability or better signposting within the ISAs. This may involve the conversion of the ISAs to an online handbook with navigation and search tools (for example, embedded definitions and links between requirements and relevant application material).<sup>15</sup>



<sup>15</sup> In 2019 the IAASB plans to consider how the functionality of the handbook can be improved by commencing digitization of the ISAs, however more may need to be done to increase the functionality specific to audits of LCEs.

## **Continuing with Current Activities**

It is possible that based on the further outreach and research that the IAASB could decide to not undertake any of the possible actions set out in this DP, but could rather continue with its current approach of enhancing scalability and proportionality, including the introduction of concepts such as the spectrum of risk within its standards in its current ongoing projects, and developing implementation guidance on publication of new and revised standards. The IAASB's Consultation Paper on its [Strategy for 2020–2023 and Work Plan for 2020–2021](#), has highlighted the importance of developing ways to address complexity, while maintaining scalability and proportionality as a strategic focus in its future strategy period, as well as a greater focus on implementation support for recently completed projects to develop and revise new ISAs. If this option was agreed to, some aspects of the discussions about the other possible options, in particular in relation to revising the suite of ISAs, could be implemented on a more ad-hoc basis.

### **Questions for Respondents**

3. Do you agree that the work in this area should focus on entities that are less complex, not only SMEs
  - (a) If not, please explain what you would consider appropriate, and how this would be described.
  - (b) If yes, what are your views about the proposed way that LCEs could be described (see page 5).
4. Does Section III set out all of the options that the IAASB should be considering, or are there other possible actions that could be undertaken?
5. For each of the options set out above, please provide views about whether the option should be pursued, including why, or why not, as well as noting a preferred option.

### Standards, Guidance and Tools (Post 2016)

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2. Conseil Supérieur de l'Ordre des Experts-Comptables, 2017. *Professional Standard for the Audit Mission of Financial Statements in a Small Entity (NP 2910)*. [Online]  
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Available at: <https://www.ifac.org/publications-resources/guide-using-international-standards-auditing-audits-small-and-medium-sized-18>
6. Institut Österreichischer Wirtschaftsprüfer (Institute of Austrian Certified Public Accountants (IWP)), 2017. *Quality Assurance Handbook – Guidance No 27*. [Online]  
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7. Instituut van de Bedrijfsrevisoren - Institut des Réviseurs d'Entreprises (IBR-IRE), 2018. *Pack Petites Entités - Small Entities (PE-KE) version 4.0 and Case Study*. [Online]<sup>16</sup>  
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8. Instituut van de Bedrijfsrevisoren - Institut des Réviseurs d'Entreprises (IBR-IRE), 2017. *Technical note: Summary of the audit approach in non-complex entities*. [Online]  
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9. Instituut van de Bedrijfsrevisoren - Institut des Réviseurs d'Entreprises (IBR-IRE), 2016. *ISA Checklists and Templates*. [Online]  
Available at: <http://www.icci.be/fr/publicaties/downloads/Pages/listesdecontrole-matrices.aspx>

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<sup>16</sup> This tool was originally developed by Compagnie Nationale des Commissaires aux Comptes and is also in use in France and in many other countries



10. The Institute of Chartered Accountants of Sri Lanka, 2018. *Sri Lanka Auditing Standard (SLAuS) for the Audits of Non-Specified Business Enterprises (Non-SBEs)*. [Online]  
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[https://www.casrilanka.com/casl/images/stories/2017/2017\\_pdfs/sri\\_lanka\\_auditing\\_standard\\_slau\\_s\\_for\\_the\\_audits\\_of\\_non\\_specified\\_business\\_enterprises\\_non\\_sebs.pdf](https://www.casrilanka.com/casl/images/stories/2017/2017_pdfs/sri_lanka_auditing_standard_slau_s_for_the_audits_of_non_specified_business_enterprises_non_sebs.pdf)
11. Belgian Standard on Contractual Audits of Small and Medium Entities (Link to be provided)

#### Articles and Thought Leadership (Post 2016)<sup>17</sup>

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<sup>17</sup> IFAC Knowledge Gateway Audit & Assurance Section, which includes just under 100 articles and videos Available at:  
<http://www.ifac.org/global-knowledge-gateway/audit-assurance>

8. Chartered Accountants Australia and New Zealand, 2017. *Perspective: Are International Auditing Standards suitable for small audits?*. [Online]  
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