

Meeting: IAASB Consultative Advisory Group (CAG)
Meeting Location: New York, USA
Meeting Date: March 10–11, 2020

Agenda Item

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Audits of Less Complex Entities – Cover and Report Back

Objectives of Agenda Item

1. The objective of this agenda item is to:
 - (a) Provide an overview of the feedback received to date related to audits of Less Complex Entities (LCE's), including from the Discussion Paper (DP), [*Audits of Less Complex Entities \(LCEs\): Exploring Possible Options to Address the Challenges in Applying the ISAs*](#), and related [*Feedback Statement*](#); and
 - (b) Provide an update on the work being undertaken by the LCE Working Group in relation to the way forward for IAASB action in relation to Audits of LCEs.

Project Status – What Have We Done Since We Last Met?

2. The IAASB published the DP, with comments due by September 12, 2019 and presented to the IAASB at its December 2019 meeting an overview of feedback received to date related to audits of LCEs including a proposed direction for the way forward (see [Agenda Item 6](#) and related papers). A short summary of this feedback will be presented to CAG Representatives.
3. Following the December 2019 IAASB discussion, and in order to keep stakeholders informed of its progress in relation to audits of LCEs, a [Feedback Statement](#) was published mid-December 2019 detailing what the IAASB has heard from the consultation.
4. **Agenda Item N.2** (the IAASB's issues paper for this topic for discussion in March 2020) sets out work being undertaken by the LCE Working Group with regard to the way forward for IAASB action in relation to Audits of LCEs. It is expected that the IAASB will make a decision on the way forward at its June 2020 meeting.
5. **Appendix A** to this paper provides a history of previous discussions with the IAASB CAG and IAASB on this topic, including links to the relevant IAASB CAG documentation.

Matters for IAASB CAG Consideration with Respect to the Draft Discussion Paper

6. The IAASB CAG is asked to provide feedback about the Board's possible direction to address the issues and challenges relating to audits of LCEs as set out in the presentation to this agenda item.

Material Presented – IAASB CAG Papers

Agenda Item N.1	Audits of Less Complex Entities—Presentation
Agenda Item N.2	IAASB Issues Paper—Audits of Less Complex Entities (March 2020)

Feedback – What Did We Hear Last Time We Met?

7. Extracts from the minutes of the March 2019¹ IAASB CAG meeting, as well as an indication of how the Less Complex Entities (LCE) Working Group or IAASB has responded to the Representatives' comments, are included in the table below.

Representatives' Comments	Working Group/IAASB Response
GENERAL	
With regard to recent initiatives targeted at audits of less complex (or smaller) entities, Mr. Dalkin suggested that the IAASB learn from the Nordic Federation of Public Accountants (NRF's) experiences in developing its proposals (for example, using simpler language and less complexity in the standards), which may prove useful in developing standards not just for LCEs but for all stakeholders. Messrs. Pavas and Fortin also suggested that the IAASB draw from the experience of the International Accounting Standards Board (IASB) with respect to its project on a separate "IFRS for SMEs." As an advocate for "developing a separate auditing standard," Mr. Pavas pointed out that it had also been considered a contentious issue for the IASB to develop a separate "IFRS for SMEs," but noted that the IASB had seen the need and developed its separate standard. Mr. Fortin noted that it is incumbent upon the LCE Working Group to draw lessons from the IASB's experience to have a better and informed judgment as to why a separate auditing standard would be an appropriate or an inappropriate response to the issues and challenges in the audits of LCEs.	<p>Points noted. While developing proposed actions focusing on audits of LCEs, the LCE Working Group has explored relevant considerations for developing a separate standard, including:</p> <ul style="list-style-type: none"> (a) Analysis of various jurisdictions or regional initiatives targeted at audits of less complex (or smaller) entities; (b) Initiatives undertaken by other standard setting board, such as the experiences of the International Accounting Standards Board (IASB) while developing the International Financial Reporting Standard for Small and Medium-Sized Entities (IFRS for SME); and (c) Exploring previous work undertaken in early 2018, by an informal working group of the IAASB that prepared an example of what a standard for Audits of LCEs (i.e., "LCE Specific Standard"). <p>Further analysis of these initiatives and the valuable lessons learned from the analysis undertaken by the LCE Working Group are summarized in the accompanying Agenda Item N.2.</p>

¹ There was no discussion in respect of Audits of LCE's during the September 2019 CAG Meeting.

Representatives' Comments	Working Group/IAASB Response
<p>Representatives were supportive of the IAASB's proposed DP, and several Representatives, including Messrs. Yurdakul and Hirai, were pleased about the progress made by the IAASB to progress its work in relation to audits of LCEs through the proposed DP. Mr. Fortin also recognized the LCE Working Group's efforts to approach this project with an open mind. Ms. McGeachy and Mr. Hansen highlighted the urgency, timeliness and importance of the project. Ms. McGeachy noted that until the IAASB formulates a global solution that is fit-for-purpose with respect to audits of LCEs, national standard setters may be inclined to develop their own solutions.</p>	<p>Support noted. The LCE Working Group have also acknowledged the urgency and timeliness of work in this area, and it is expected that a decision on a way forward will be made by the IAASB in June 2020.</p>
DISCUSSION PAPER – CONCERNS WITH DISTINGUISHING LCE'S	
<p>Messrs. Dalkin and Hansen noted that there may be many areas where the requirements would be applicable regardless of whether the entity is an LCE or not (e.g., ISA 540 (Revised)) and cautioned against an approach where applicable requirements may not be included.</p>	<p>Prof. Simnett acknowledged this as one of the challenges related to finding a suitable action to address issues and challenges related to auditing LCEs. He added one of the considerations would be to develop requirements that are appropriate and clear, and it is expected that the LCE Working Group will be considering this at the appropriate time.</p>
<p>Mr. Pavas cautioned that users of financial statements still wanted an audit, with the same audit opinion regardless of size of the entity. However, he encouraged the IAASB to develop standards that are proportionate to the type of entity being audited.</p>	<p>In its deliberations on the most appropriate approach for developing a separate standard, the LCE Working Group has been mindful of the need for the level of assurance provided by a separate standard to be the same as the ISAs, i.e., reasonable assurance. In addition, it is the LCE Working Group view that should a separate standard be developed, it should fall within the risk-based, principles framework (consistent with extant ISAs), and retain the same robustness as ISAs. As well as considerations with regard to a separate standard, the IAASB is also considering the most appropriate actions with regard to enhancing scalability and proportionality within the existing standards.</p> <p>Further considerations on the proposed actions of the LCE Working Group in respect of a</p>

Representatives' Comments	Working Group/IAASB Response
	separate standard for audits of LCEs is included in the accompanying Agenda Item N.2 .
Mr. Yurdakul was concerned that the use of the term LCE may cause the IAASB to lose sight of small- and medium-sized entities (SMEs). It was also highlighted that determining an entity as less complex would also likely involve significant judgment on the part of auditors in considering whether the qualitative characteristics of SMEs qualify or disqualify the entity as an LCE. While the evolving business environment is driving increasingly complex structures and transactions (e.g., fair value estimates, impairment), Mr. Hansen was also concerned that determining whether an entity is simple or complex under the current definition of the term LCE may be oversimplifying the issues and challenges with respect to audits of LCEs. Ms. Robert suggested a question on the qualitative characteristics of LCEs in the proposed DP.	<p>Prof. Simnett acknowledged the challenge of using 'less complex' versus "smaller" entities, noting that further consideration will be given to this.</p> <p>Ms. Bahlmann emphasized that while the discussion has historically been around the difficulty in applying the ISAs to SMEs, 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. Ms. Bahlmann also noted that the proposed DP included questions to obtain stakeholders' views about the proposed way that LCEs could be described (i.e., qualitative characteristics of LCEs).</p>
Mr. Hirai noted that the proposed DP only highlighted disadvantages for the possible action "revising the suite of ISAs," which in his view, may create the perception that the IAASB is leaning towards developing a separate auditing standard. In the interest of presenting a more balance information in the proposed DP, Mr. Hirai suggested to present both pros and cons of "possible actions to be explored," where appropriate.	Prof. Simnett agreed and noted that further consideration would be given to providing both the benefits and the pitfalls.
SUGGESTIONS FOR FURTHER IAASB CONSIDERATION	
In light of cited key statistics within the DP, Mr. Fortin suggested that it would be useful for the IAASB to gather information about the number of audits of LCEs around the world to help support the IAASB's work in this area.	Point noted. However, as it is likely that the designation as an LCE will be qualitative (and judgmental) it would be difficult to quantify the numbers of LCE's globally.

Representatives' Comments	Working Group/IAASB Response
<p>Ms. McGeachy suggested clarifying the definition of the term LCE by making clear whether the term also applies to not-for-profit entities or micro public sector entities. She noted that stakeholders, who may not be fully informed about the project, may not be able to infer that the term LCE also applies to such types of entities.</p>	<p>Point noted. The LCE Working Group acknowledges that should development of a separate standard be decided as the possible approach forward, then sufficient consideration would need to be dedicated to clarifying the description of an LCE as well as the scope of the entities who would be subject to the separate standard for audits of LCEs (for example, whether certain entities would be excluded from its application such as listed entities and those with public accountability) and that this would be consulted on as the work progresses.</p>
<p>Ms. McGeachy suggested enhancing the proposed DP with an acknowledgement that most professional accountancy organizations use “cookie-cutter” checklists to comply with requirements of the ISAs, which may not be fit-for-purpose for auditing all types of LCEs. She added that in most cases, small- and medium-sized practitioners (SMPs) do not have the resources to tailor such checklists, which further supports the need for less complex standards for audits of LCEs. However, while recognizing the concerns about checklists, Mr. Hansen expressed that his view was that checklists are important in the audits of LCEs (for example, as a memory jogger).</p>	<p>Points noted. The LCE Working Group had discussed, that as part of its future information gathering activities in respect of Audits of LCEs, the following work would be undertaken to further inform in this area:</p> <ul style="list-style-type: none"> • Undertake further exploratory work to understand the linkages and relationship between audit documentation and audit performance, as well as the association between volume of audit documentation relative to audit quality. • Undertake further work to understand from those who have developed ISA documentation methodologies for audits of ‘smaller’ entities (for example Big 4 accounting firms as appropriate) including how these documentation methodologies were developed.
<p>Ms. Robert and Mr. Dalkin suggested that the IAASB undertake further research activities for additional possible solutions other than developing a separate auditing standard, for example exploring other solutions that have been developed by some jurisdictions (e.g., the ‘extended review,’ or other types of engagements developed by Denmark or Switzerland) It was highlighted that the IAASB may</p>	<p>Point noted. However, the focus of the IAASB's work is on audits of LCE's. The IAASB will continue to monitor the environment and emerging needs in light of the suite of standards that are currently effective.</p>

Representatives' Comments	Working Group/IAASB Response
find it useful to consider whether such other solutions can be fit-for-purpose globally.	
Ms. Robert suggested that the IAASB reach out to regulators and policy makers. Ms. Robert noted that the " <i>Nordic Standard for Audits of Small Entities</i> " was not implemented because regulators and policy makers would not adopt such a standard. Therefore, the views of regulators and policy makers would help the IAASB understand the viability of future possible actions.	Point noted. In developing new or revised pronouncements, the IAASB undertakes regular and ongoing consultations with its stakeholders, including regulators and audit oversight bodies, to obtain views on matters being explored.
Mr. Fortin also noted the importance of outreach in emerging economies in Asia and Africa, where the issues and challenges in the audits of LCEs are particularly relevant (i.e., there are a significant number of LCEs in emerging economies).	<p>Since March 2019, the LCE Working Group has performed extensive outreach, including (see Agenda Item 6 of the December 2019 IAASB Meeting):</p> <ul style="list-style-type: none"> • In May 2019, the IAASB together with others, convened a second working conference in Paris, France. The two-day conference was a valuable opportunity to gather inputs and views from participants informing the IAASB on the questions raised in the DP. • Three webinars in English, French and Spanish were delivered in July 2019 to create awareness relating to the Discussion Paper, and encouraging participants to respond to the DP or the IFAC survey (which was also provided in English, Spanish and French). • The IAASB also undertakes a significant outreach program, with focused interaction with certain stakeholder groups such as IFAC's SMP Committee. In addition, a regional event in Costa Rica included roundtables focused on matters related to audits of LCEs and was facilitated by the IAASB. During January 2020, the LCE Working Group representatives, including the Chair Prof. Simnett, met in Bangkok with representatives from the Thai SEC and also engaged in an outreach event supported by the Thai SEC with approximately 250 participants, including directors, audit committee members, preparers, firms,

Representatives' Comments	Working Group/IAASB Response
	<p>practitioners and others, to discuss specific issues and challenges with ISAs in many areas, including audits of LCE's.</p> <ul style="list-style-type: none"> • Various surveys, including the IFAC's online survey were conducted, gathering responses from 2,362 stakeholders in total, covering a broad constituency (including academia, preparers, IFAC member organizations, users, NSS, regulators and public practice). These surveys provided valuable insight to the IAASB as it provides inputs from diverse stakeholder constituencies including those who would not necessarily respond to the formal consultation. <p>Ms. Bahlmann also noted that the LCE Working Group conducted roundtable discussions with SMPs in South America and Hong Kong to hear and understand their views relevant to the audits of LCEs. The LCE Working Group will also consider conducting outreach activities in emerging economies.</p>
POSSIBLE ACTIONS TO BE EXPLORED	
<p>With regard to revising the suite of ISAs—Mr. Yurdakul expressed concerns about separate sections with considerations for LCEs within the ISAs, noting that the extant considerations were not properly used.</p>	<p>Point noted. Ms. Bahlmann emphasized that the IAASB has not committed to any particular course of action, but noted that it is rather exploring a range of possible actions, and is looking for input to obtain stakeholders' views about these possible actions through the consultation process. Ms. Bahlmann also articulated the LCE Working Group's thinking to be neutral in developing the proposed DP, and that it had been mindful of including sufficient and balanced information for context in order to elicit informed feedback about the potential courses of action for the IAASB.</p>
<p>With regard to developing a separate auditing standard—Messrs. Yurdakul expressed support for the option of “developing a separate auditing standard.” Messrs. Hirai and Hansen expressed strong concerns about developing a separate auditing</p>	<p>Points noted. In considering the various options and what may be most effective, the LCE Working group remained mindful that the audit opinion from the work performed using the separate standard would need to be a reasonable assurance opinion.</p>

Representatives' Comments	Working Group/IAASB Response
<p>standard as it may not be in the public interest. It was noted that a separate auditing standard for LCEs may be perceived by stakeholders as a different type of audit (i.e., it may create a two-tier profession or a "second class" audit) even if it is designed to provide the same level of assurance (i.e., reasonable assurance). However, if the IAASB did develop a separate auditing standard for auditing LCEs, Mr. Hirai expressed support for the "possible features" of a separate auditing standard based on the existing ISA framework as outlined in the proposed DP.</p>	<p>Accordingly, linking to the existing ISAs in some way would make it easier to develop the standard that would result in a reasonable assurance opinion. A reconciliation back to the ISAs would also enable stakeholders to assess that the work performed using the separate standard would provide the same level of assurance as the ISAs (i.e., reasonable assurance).</p> <p>Further information in respect of this matter is included in the accompanying Agenda Item N.2.</p>
<p>Mr. Hirai expressed support for developing guidance or other specific related actions for auditors of LCEs in light of his concerns about the development of a separate audit standard.</p>	<p>Point noted. It is noted that respondents to the DP had the view that guidance is useful and complementary to the other options presented in the DP, but is not a sufficient solution on its own to address the issues with audits of LCEs and should rather be used to supplement both other options within the DP (i.e., developing a separate standard or revising the ISAs).</p>

Appendix A

Project Details and History

Project: Audits of Less Complex Entities

Link to IAASB Project Page: [Audits of Less Complex Entities Project Page](#)

Working Group Members

The LCE Working Group comprises:

- Roger Simnett, IAASB Member and Task Force Chair
- Chun Wee Chiew, IAASB Member and IFAC SMP Committee Liaison
- Kai Morten Hagen, IAASB Member
- Rich Sharko, IAASB Member
- Isabelle Tracq-Sengeissen, IAASB Member and IFAC SMP Committee Liaison
- Brendan Murtagh, Past IAASB Member
- Gordon Cummings, CPA Canada, past member of Canadian Auditing and Assurance Standards Board
- Christopher Arnold – IFAC SMP Committee Representative

Summary

	IAASB CAG Meeting	IAASB Meeting
Project commencement and preliminary discussions on audit issues relevant to Audits of Less Complex Entities	March 2017 September 2017	March 2017 March 2018 (Executive session)
Discussion on the proposal to undertake work to develop a Discussion Paper to obtain stakeholder views on matters related to issues and challenges when auditing less complex entities	September 2018	September 2018
Discussion on the IAASB's proposed Discussion Paper, <i>Audits of Less Complex Entities: Exploring Possible Actions to Address the Challenges</i> .	March 2019	March 2019
Audit of Less Complex Entities – Discussion on way forward regarding audits of less complex entities	March 2020	December 2019 March 2020

IAASB CAG Discussions: Detailed References

Information gathering	<p><u>March 2017</u></p> <p>See IAASB CAG meeting material (Agenda Item G) and meeting minutes: https://www.iaasb.org/cag/meetings/iaasb-cag-meeting</p> <p><u>September 2017</u></p> <p>See IAASB CAG meeting material (Agenda Item C) and meeting minutes: https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-madrid-spain</p>
Work Proposal	<p><u>September 2018</u></p> <p>See IAASB CAG meeting material (Agenda Item I) and meeting minutes (Agenda Item A) http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-0</p>
Discussion of IAASB's proposed Discussion Paper, Audits of Less Complex Entities: Exploring Possible Actions to Address the Challenges	<p><u>March 2019</u></p> <p>See IAASB CAG meeting material (Agenda Item E) and meeting minutes: https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-1</p>
Discussion of feedback received to date, including from the Discussion Paper and further information on work undertaken by the LCE Working Group to inform the way forward for IAASB action in relation to Audits of LCEs	<p><u>March 2020</u></p> <p>See IAASB CAG meeting material (Agenda Item N) https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-3</p>