

IAASB PROJECT PROPOSAL—EXPLORING POSSIBLE ACTIONS FOR DEALING WITH THE PERCEIVED CHALLENGES OF CONDUCTING AUDITS OF LESS COMPLEX ENTITIES

Subject

1. This project proposal relates to:
 - (a) The development of a Discussion Paper (DP) to explore possible actions to address perceived challenges and issues when undertaking audits of less complex entities, and
 - (b) Developing recommendations based on the feedback from the consultation for IAASB consideration about the way forward.

Background

2. Jurisdictions differ globally as to whether there are requirements for a mandatory audit, with changes to audit thresholds continually being reconsidered.^{1,2} Even when there is not a statutory requirement for an audit, many small- and medium-sized entities (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. At present, [128 jurisdictions](#) use or are committed to using the International Standards on Auditing (ISAs), demonstrating the increasing importance the global community attaches to the ISAs. This widespread and continuously 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.

¹ For example, in the US most private companies (with some limited exceptions) are not subject to a statutory audit. In Europe, member states can impose a level of 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, 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 for 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 liabilities 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.

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. The clarified ISAs were developed and revised in 2005–2009 (the ‘Clarity Project’) ⁴ with a view to being applied to audits of all sizes.⁵ As part of the finalization of the Clarity Project, the IAASB agreed to undertake a post-implementation review to determine whether the IAASB’s 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 clarity 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, capable of being proportionately applied in an audit based on the size and complexity of the entity.
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. To further understand the perceived challenges and issues related to audits of SMEs, the IAASB has undertaken more specific outreach:

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
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⁴ In March 2009, the International Auditing and Assurance Standards Board (IAASB) completed its Clarity Project designed to improve the clarity and understandability of the International Standards on Auditing (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*

	those 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 its meeting. The IAASB also discussed a paper setting out possible actions for how scalability and proportionality could be incorporated into the IAASB’s extant auditing and related services standards.
June 2017	The challenge of auditing SMEs and less-complex entities was discussed at the annual National Standards Setters (NSS) meeting hosted by the IAASB. NSS outlined developments in their jurisdictions emphasizing efforts to modify audit threshold exemptions.
Summer 2017	An informal 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 perceived challenges and 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 to better understand the perceived challenges and issues that had been identified and to obtain stakeholder views on possible actions to address these perceived challenges and issues. For example, 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. 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	The challenge of auditing SMEs and less complex entities was further discussed at the annual NSS meeting hosted by the IAASB in light of evolving developments. A proposed consultation process to gain a better understanding of the perceived challenges and issues and possible solutions was outlined and support was expressed by the NSS for further work in this area.

9. In addition to the work noted above, the IAASB continues to coordinate with the SMP Committee on a regular basis. This coordination includes:

- Regular input to the IAASB’s ongoing projects through teleconferences with SMP Committee Task Forces, focused sessions with SMP Committee representatives on a specific topic, and

representation of SMP Committee representatives on select IAASB Task Forces.

- Updating the SMP Committee at their in-person meetings three times a year.
- Recognition at IAASB meetings of specific SMP matters raised in the quarterly letter from the SMP Committee sent to the IAASB.
- 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 business can continue to support and serve SMEs, including initiatives relating to audit (including guidance for audits of non-complex entities in various countries) as well as for 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 an audit 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 great number of responses, from a number different jurisdictions globally, which reflected the significant interest for further action in this area. This consultation also showed that for an initiative to be successful in this area an international response is needed.
 - Sri Lanka will shortly publish an approved "*Framework for Audits of Non-Specified Business Enterprises*," which is a stand-alone auditing standard, tailored specifically to audits of the financial statements of small entities. It is noted that the standard is applicable for audits of small- and medium-sized entities (that do not have public accountability and publish general purpose financial statements for external users) and are non-Specified Business Entities that follow the cost model for measurement of assets and liabilities.
 - France – in light of the considerations about introducing a minimum threshold for mandatory audits, further consideration is being given to a new 'pronouncement' for audits of entities that are not required to have an audit (may possibly be a simplified audit standard).
11. The 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 many jurisdictions, as well as the public sector, in implementing the ISAs.
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 for these types of entities. Furthermore, it has been recognized that some of the perceived challenges and issues may not be related to standard-setting and therefore would not be within the remit of the IAASB. However, in exploring the various possible actions, the IAASB may be well placed to help encourage other relevant stakeholders to pursue relevant possible actions.
13. This project proposal sets out the proposed activities for the Working Group to develop the DP, and develop recommendations for IAASB consideration from the responses to the DP.

Project Objectives, Scope and How it Serves the Public Interest

14. The project objectives are to:
- (a) Develop a DP for public consultation that sets out the perceived challenges and issues relating to an audit of a less complex entity using the ISAs, and explores possible actions, for stakeholder views.
 - (b) Develop recommendations for IAASB action based on the feedback from the consultation.

Project Scope

15. The project scope is to:
- (a) Confirm the identified perceived challenges and issues related to auditing a less complex entity using the ISAs, to further understand the ‘root causes’ (i.e., understand the real issues) leading to concerns about scalability or lack thereof, and explore possible solutions that are appropriate to the issues identified.
 - (b) Develop the DP for public consultation, including describing appropriate possible actions, to obtain stakeholder views.
 - (c) Analyze the feedback from the consultation, and develop and publish a feedback statement.
 - (d) Develop recommendations for the Board’s consideration, based on the responses to the DP and outreach, about possible IAASB actions. In addition, if possible actions by others are deemed relevant, encourage such actions as appropriate.
16. The focus of this project is on audits of less complex entities, but there will also be consideration of limited assurance engagements or other assurance solutions as an alternative to audit (where an audit is not mandatory), as this may be fundamentally linked to a possible solution(s).
17. As part of the matters for consideration, the Working Group will also explore how to articulate the types of entities that may be affected by this work (e.g., what ‘less complex entities’ means), in light of differing laws and regulations, and sizes of entities, globally.
18. Related outreach will encompass activities to provide additional input to the development of the DP (as described below), as well as outreach during the period that the DP is out for public consultation. It is intended that during this period the second working conference related to understanding the needs of SMPs when applying audit and non-audit IAASB standards to SMEs will serve as a roundtable to inform the responses to the DP. Consideration will also be given to whether additional roundtables, or other outreach, is needed.

How the Project Serves the Public Interest

19. SMEs 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).”
20. 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 in the public interest by:

- a) *Enhancing confidence in financial reporting of less complex entities*—SMEs 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 confidence and trust in this part of the economy.
- b) *Helping auditors of less complex entities 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 perceived implementation challenges, in particular relating to audits of less complex entities. Changes for auditors of less complex entities would therefore be responsive to a large number of stakeholders who have identified perceived challenges with implementing international standards, in particular for auditing and quality control.
- c) *Promoting a more consistent approach to audits of less complex entities*—A more consistent approach to audits of less complex entities will likely also assist with documentation relating to the audit that is more consistent, 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 less complex entities, it is expected that there will be an increased focus on whether an audit is the most appropriate engagement (where it is not mandatory). This may also assist less complex entities with identifying the most appropriate type of engagement, therefore making the financial reporting process more effective and efficient.

Outline of the Project

Major Issues that Will Be Addressed

21. The project will consider and explore:
 - (a) The view that ISAs are not “fit-for-purpose” for audits of less complex entities, which can be seen to inhibit audit quality. In particular, the 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 assurance and related services engagements related to financial reporting for less complex entities, in particular jurisdictional initiatives relating to the development of separate standards for audits of SMEs, and the possible impact on the IAASB’s international standards. As part of this, the Working Group will also explore the effect of changing audit thresholds globally, and whether more is needed in relation to other non-audit engagements to address some of the perceived challenges and issues identified.
 - (c) What the role of others may be in addressing the perceived challenges and issues that have been identified. For example, to what extent is technology addressing these challenges and

issues, and whether more can be done in this area for a global solution (e.g., whether technology-based methodologies and tools could help address the perceived volume and complexity of the standards in their application to audits of less complex entities).

22. Notwithstanding that there has already been substantial discussion about the perceived challenges and issues relating to audits of less complex entities,⁹ the Working Group is of the view that more specific information is needed to determine the most appropriate possible actions of the IAASB. This will help the Working Group more accurately articulate the identified perceived challenges and issues in the DP, as well as appropriate possible solutions to address these. Therefore, as part of its work, the Working Group plans to undertake further information gathering as follows:
- (a) An in-depth environmental scan to catalogue global developments and the effect of the changing environment through:
 - Working with academics to understand relevant academic literature relating to the perceived challenges and issues that have been identified.
 - Further outreach with national standards setters (e.g., through a survey) to understand developments in different jurisdictions to respond to the perceived challenges and issues for engagements relating to less complex entities.
 - Outreach with INTOSAI representatives to further understand the perceived challenges and issues in relation to the public sector with respect to the implementation of the ISAs, and any responses that have been developed to address these perceived challenges and issues.
 - (b) Consideration of undertaking a survey of small and medium practitioners to understand specific areas within the ISAs that are challenging, to provide factual information and evidence to support the perceived challenges and issues identified.
23. Stakeholder views on the perceived challenges and issues identified will also help the Working Group in making its recommendations to the IAASB regarding future possible actions. Accordingly, the Working Group is of the view that the DP could include a description of the possible solutions (including examples where appropriate) and ask for stakeholder views on these matters. This may include, but is not limited to:
- (a) Exploring whether there are alternative ways of providing a reasonable assurance audit opinion that is not an audit using the IAASB's ISAs.
 - (b) Exploring what more can be done within the ISAs to address complexity in the standards.
 - (c) Exploring possible content and presentation of a separate ISA for audits of less complex entities.
 - (d) Guidance for applying the ISAs to less complex entities.

⁹ For example, Accountancy Europe's 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 (including onerous documentation, over-engineered risk analysis, and extensive work on internal control) as some of the current difficulties in applying the ISAs.

Impact Analysis Considerations

24. The objective of this stage of the project is to obtain more information about the appropriate possible solution(s) to address the perceived challenges and issues relating to audits of less complex entities that will support future possible IAASB actions. Accordingly, the exact outcome relating to possible IAASB actions is not known at this stage, and therefore the impact is not determinable at this point.

Implications for any Specific Persons or Groups

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

Development Process, Project Timetable and Project Output

Development Process

26. The DP and recommendations for the IAASB will be developed by the Working Group. As the purpose of this stage of the project is to explore the most appropriate possible actions for the IAASB, there are no formal due process requirements. However, due to the importance of this initiative in the public interest, the 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.

Project Timeline

27. A targeted timeline for the project 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–June 2019</i>	Roundtables and other outreach as necessary
<i>September 2019</i>	IAASB to consider input to the DP and Working Group draft feedback statement, recommendations and possible future actions
<i>October 2019</i>	Feedback statement published

Project Output

28. The expected outputs of the project are:
- (a) A DP that will solicit contributions from stakeholders on issues identified and possible solutions to address them.

- (b) A feedback statement setting out a summary of the responses to the DP, in relation to the perceived challenges and issues identified as well as the possible solutions.
- (c) Recommendations of the Working Group in relation to further possible actions by the IAASB. Consideration will also be given to whether the future possible actions will also be set out in the Feedback Statement.

Resources Required

- 29. The Working Group will continue to undertake outreach as appropriate, and develop the DP and recommendations for the IAASB, supported by IAASB Staff as necessary. The complement of the Working Group will be supplemented by additional IAASB Board members, as well as possibly a representative from IFAC's SMP Committee.