Audits of Less Complex Entities

Q2 (a) Aspects of ISAs that are difficult to apply with LCE audits

Q2 (a) Risk assessment (ISA 315)

3. National Audit Standards Setters

American Institute of Certified Public Accountants (AICPA) - 27

We have noted continued auditor performance issues regarding the understanding and application of the risk assessment requirements set forth in AU-C 315 (based substantially on ISA 315) as an example. We believe proposed ISA 315 (Revised) will also be challenging to apply to audits of LCEs. Even though substantial work has been devoted to make the standard scalable, it still is long and certain aspects of the proposed changes may be difficult to apply. We recognize the IAASB is planning an implementation guide; however, we anticipate, based on previous experience, that such guidance is not always helpful for audits of LCEs. It may be difficult for practitioners at small and medium sized firms to apply the standard and several have expressed views that they do not believe they will realize a commensurate increase in audit quality after applying the proposed requirements. In particular, the understanding, evaluation, and documentation of the design and implementation of internal control is an area that auditors of LCEs find challenging and/or question the value to audit quality.

What makes an LCE audit different is that the auditor typically focuses on the transaction level controls in certain areas. For example, an important control activity is usually around cash disbursement processing or similar basic controls over cash transactions. Since the LCEs usually are using an out of the box basic general ledger software package, the control activities are typically around the movement of cash and the general ledger system dictates the level of detail that is provided for the transactions. Generally, LCEs do not utilize Enterprise Resource Planning (ERP) systems that document the controls throughout the workflow like larger, more complex entities.

Further, LCEs may find that certain types of control activities are not necessary or cost effective because of monitoring controls applied by management. For example, management's sole authority for granting credit to customers and approving significant purchases can provide effective control over important account balances and transactions, lessening or removing the need for the auditor to understand control activities in those areas.

Due to this more simplistic system of internal control, generally, auditors design more substantive procedures in order to obtain reasonable assurance due to the inability to efficiently or effectively test controls or because this is just deemed to be more effective given the client's control environment. However, because many LCEs do not have formal process or control documentation, it falls on the auditor to create all of the documentation of the design of the client's controls for work paper purposes only.

Australian Auditing and Assurance Standards Board - 73

In Australia 35% of survey respondents viewed ISA 315 as the standard which was the most difficult to apply, followed by the ISAs in the 500 series (25%), in particular ISA 540.

ISA 315 – Understanding and documenting control activities relevant to the audit, especially obtaining audit evidence of the control environment as smaller entities often do not formally document controls.
Austrian Chamber of Tax Advisors and Public Accountants (KSW) - 20

Documentation Related to Internal Controls in LCE Audits

LCEs may not have strong internal controls in place. Therefore, the auditor may choose a full substantive approach, without relying on any internal controls. For this reason, it seems disproportionate to require the auditor to identify and assess the risk of material misstatement in the financial statements through understanding the entity’s internal control and documenting it as required by ISA 315.

Canadian Auditing and Assurance Standards Board - 81

ISA 315 - Identifying and assessing the risks of material misstatement through understanding the entity and its environment

Preliminary Analytical Review – ISA 315.6(b) – This paragraph requires the auditor to perform analytical procedures as a risk assessment procedure. Stakeholders indicated that such a procedure is often not effective for an audit where the financial information of the entity requires year-end adjustments (e.g. cut-off adjustments, amortization, etc.) to comply with the applicable financial reporting framework. While stakeholders acknowledged that the guidance in ISA 315.A17 provides considerations specific to smaller entities, they felt that it does not allow enough flexibility for the auditor to decide not to perform the procedure or decide to combine the procedure with final analytical procedures.

Risk assessment procedures – ISA 315.13 – This paragraph requires the auditor to perform procedures in addition to inquiry, when obtaining an understanding of controls relevant to the audit. Stakeholders thought that inquiry alone should be sufficient to obtain this understanding when taking a fully substantive audit approach.

Understanding internal controls – ISA 315.14-.19 and .22-.24 – These paragraphs require the auditor to obtain an understanding of the components of internal control. Stakeholders thought that the understanding required in this section is too granular and not reflective of a less complex environment. Such an environment is typically less formal and more focused on monitoring and oversight controls than on process controls. Further, stakeholders thought that this section seems onerous in circumstances where a fully substantive approach is taken.

Responding to risks arising from IT – ISA 315.18 and ISA 315.21 – These paragraphs require the auditor to obtain an understanding of the information system and related controls relevant to financial reporting. Stakeholders thought that the standard is not clear as to the extent of work required when the auditor decides that certain controls over IT applications will not be relevant to the audit. For example, IT risks for an entity using “off-the-shelf” commercial accounting packages that cannot be changed by the entity should present a low risk to financial reporting, but practitioners struggle in understanding what evidence is needed to support this judgement.

CNCC & CSOEC - 61

ISA 315 – Identifying and assessing the risks of material misstatement through understanding the entity and its environment

The concept of “relevant to the audit” appears difficult to understand and difficult to address for the practitioners, especially in the audit of SMEs.

Hong Kong Institute of Certified Public Accountants - 74

ISAs - ISA 300, Planning an Audit of Financial Statements,
ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment

Problematic requirements and underlying cause(s) - Under ISA 300, the auditor shall develop an audit plan that shall include a description of the nature, timing and extent of planned risk assessment procedures, as determined under HKSA 315 (Revised).

Under ISA 315 (Revised), the auditor shall perform and document risk assessment procedures and understanding of the entity's internal control for designing and implementing responses to the assessed risks of material misstatement.

For LCEs, they typically have uncomplicated transactions and few internal controls, the requirements on risk assessment procedures and documentation of internal controls would be too onerous and ineffective. Extensive documentation is made even when some requirements are not applicable for audits of LCEs in order to justify what has not been done.

Korean Auditing and Assurance Standards Board (KAASB) - 23

The ISA 315 requires auditors to understand entities’ internal controls and document them accordingly, despite that they have few internal controls and do not rely on them. The requirement increases time spent for formality of documentation (designed to comply with the ISA), which raises a question over the increase will contribute to improving audit quality.

LCEs have inherited limits on human resources to perform financial reporting procedures and segregate duties, but the ISAs don’t have sufficient practical guidance on separate considerations for audits of LCEs in response to such limits.

Challenges in relation with certain ISAs and requirements

Related with the above (1) and (2), we face one of the most challenges in applying the ISAs 240, 315, and 540, and please refer to details as below:

Malaysian Institute of Accountants (MIA) - 30

ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment

Challenges: This ISA requires the auditors to document the risk assessment procedures performed and the information obtained regarding the entity, its environment and its internal controls components.

The internal controls in an LCE are mostly unstructured and there may be limited/no audit trail available for the auditors to evaluate its design and implementation appropriately. In addition, with limited personnel in LCEs, there is often insufficient segregation and allocation of duties for a control reliance audit approach. This is a challenge to the auditors of LCEs, as the required information is usually not readily available for LCE.

Furthermore, it may not be cost effective for the auditors of LCEs to perform detailed risk assessment as the financial statements are straightforward and not complicated.

We found the following ISAs and its aspects are challenging:

New Zealand Auditing and Assurance Standards Board - 53

In the NZAuASB outreach to its constituency the following examples were noted:
Lack of clarity how a requirement may apply in the audit of an LCE. For example, paragraph A57 of ISA 315 (Revised) explains that a more effective oversight by an owner-manager may compensate for the generally more limited opportunities for segregation of duties in a smaller entity. Paragraph A58 adds that the owner-manager may be more able to override controls because the system of internal control is less structured. It is unclear how these two characteristics with opposing impacts on reliability of an entity’s system of internal controls should inform auditors’ risk assessment and work effort. Also, it is very hard to objectively evaluate management’s effective oversight (especially given the often informal and undocumented nature of such oversight), which means it is unlikely auditors would place reliance on this feature when considering whether internal controls can reduce the risk of material misstatements. At the same time, given paragraph A58, the auditor of an LCE can reasonably be expected to elevate the management risk of override of controls.

The business risk approach may not be an efficient way to conduct an LCE audit. The entity structure, management practices and systems are not a good match for a business risk approach. The auditor may need to increase their effort to somehow fit the entity into the business risk framework underlying ISA 315.

The Japanese Institute of Certified Public Accountants - 41

We believe that obtaining an understanding of the system of internal control in the proposed ISA 315 (Revised) “Identifying and Assessing the Risks of Material Misstatement” (“ED-315”) is most problematic in an audit of an LCE. The audits of LCEs are conducted within tight time constraints, and there are calls for more scalability in the standards so that the auditor can allocate more audit time to risk response (especially to substantive procedures) than to risk assessment. In LCEs, it is expected that only one or a few management grasp the entire business and that they also conduct ongoing monitoring activities. Therefore, an inquiry of management should be emphasized among the auditor’s risk assessment procedures. In combination with inquiry of management, analytical procedures and inspection of related materials, we believe that the auditor can identify and evaluate risks of material misstatement as a basis for further audit procedures.

On the other hand, it should be noted, that the extent to which process-level internal control (i.e., control activities) needs to be understood largely depends on the size of the entities being defined as LCEs. In the audits of micro-sized entities, for example, the auditors may be able to perform substantive procedures for all transactions without evaluating the design of controls and determining whether they have been implemented. However, if the entity has a certain volume of transactions, we believe that it is necessary for the auditor to evaluate the design of controls and determine whether they have been implemented even though the entity’s transactions are simple.

4. Accounting Firms

Baker Tilly International - 43

• ISA 315 - The required level of documentation of the control environment is not consistent with the concept of an LCE and we believe that this aspect of the Risk Assessment standards should be significantly revised for the “LCE audit” approach. By the very definition of an LCE, it is highly unlikely that the entity would have a complex control environment which maps to the elements of the COSO Framework and many such entities would not have, for example, documented Risk Assessment Processes etc.

• ISA 315 – We believe that the extent of work required and the associated documentation in the extant standards is appropriate for listed entities and other more complex entities. However, notwithstanding comments in the application material around scalability for smaller entities, the extant standards are overly onerous for many LCE audits. As a result, many firms and software providers have tried to develop means
of streamlining the documentation of the risk assessment for such entities. These approaches run the risk of auditors not fully complying with the extant standards. For example, the application of the COSO Framework in establishing a control environment at LCEs is much less likely and goes beyond merely having “informal” and undocumented arrangements in many of the areas considered by ISA 315. The Risk Assessment is an area where either a “building blocks” or “modular” approach may be most effective.

- ISA 315 - The statement that there may be increased risks in smaller entities, whilst true in some cases, is not guidance which assists the auditor perform a more efficient audit. In fact, this “guidance” on the face of it creates greater work for audits which are already under significant fee pressure, given the need to apply the full extant standards to LCEs. The current guidance is not helpful in the audit of LCEs, and further indicates the need for the standards to be built from a set of core minimum requirements rather than the highest level of requirements. Further, the requirement that audit evidence is obtained from a combination of enquiries and other procedures such as observation, with the acknowledgement that smaller entities or LCE may have limited documentation of, say, the control environment makes it difficult to define how much evidence an auditor can take from inquiry alone.

**BDO International - 60**

One of the main aspects of the ISAs that is, and will continue to be, difficult to apply is that of identifying and assessing the risks of material misstatement, (ISA 315 Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment). As outlined in BDO’s comment letter to proposed ISA 315 (Revised) dated 1 November 2018, we identified a number of concerns that some of the requirements are overly complicated and possibly onerous to apply to smaller, less complex entities. Specifically, the following elements of ED 315 are of concern:

- The extent of work and documentation required with respect to assessing design and implementation of controls when one plans a purely substantive audit and has no intention of relying on controls (which is quite common for audits of LCEs)

- Due to the complexity of the standard, the focus on controls relevant to the audit has diminished the focus on understanding the information systems resulting in inadequate risk identification for all entities, including LCEs

- Guidance on the minimum documentation to meet the requirements relating to controls (notably in paragraphs 38, 39 and 42) would be beneficial. Excessive documentation in an area with little to no impact on the audit can pose as a threat to audit quality as it moves focus and resources away from important engagement risks (e.g. going concern or related parties)

- ED 315 is more complex than the extant standard, as shown through the multiple flowcharts needed to illustrate the risk assessment process. This is partly due to the definitions and requirements related to inherent risk, control risk and risk of material misstatement.

**Crowe Global - 86**

With regard to the conduct of the audit:

**Application of ISA 315**

The application of the extant ISA 315 and its proposed replacement are regarded as demanding and not necessarily consistent with the understanding of the business and identification of risk in a less complex environment. The application of COSO principles is appropriate in the full standard, but has to be
challenged when looking at the audit of LCEs. There is the opportunity to look at other ways to address the understanding of the business and identification of significant risk.

Understanding Systems & Internal Control

The requirements of the full ISAs with regard to the understanding of systems and the assessment of internal control are seen as demanding and not necessarily applicable to the LCE environment. LCEs do have internal controls (such as authorisation) and do have simple transaction cycles. These could be relied upon. However, a different way has to be found to express this.

Dailamipour and Co. - 31

Problematic ISAs in LCEs audit arise from applying, ISA 315 & ISA 330, Identifying and assessing risk of material misstatement,

Deloitte Touche Tohmatsu Limited - 46

ISA 315, Identifying and assessing the risks of material misstatement through understanding the entity and its environment

DTTL agrees with the comments from the IAASB that the proposals in the ISA 315 exposure draft may lead to an over-engineered risk assessment for entities in a less complex environment.

It is DTTL’s view that identifying and assessing the risks of material misstatement through obtaining an understanding of an LCE ought to be a relatively simple and straightforward process when compared to a more complex entity. Primarily this is because the amount of data and information is inherently less and the auditor should therefore, in most cases, be able to obtain the necessary understanding and perform a sufficient risk assessment of an LCE through performing fewer and simpler procedures. However, due to the current and proposed requirements set out in ISA 315, the process is (or is interpreted as being) inherently complex, even for an audit of an LCE.

In regard to the ongoing project related to revising ISA 315, DTTL encourages the IAASB to consider the needs for LCEs now to avoid duplication of effort in the future, by having to reopen ISA 315 to address the audits of LCEs.

Duncan & Toplis Limited - 15

We would agree with the ISAs identified in the report as being those that pose the greatest issues. Particularly ED-315 and ISA 540 (revised). Although both revised standards suggest that they are scalable, this needs significant clarification. Simply saying that they are scalable is not considered to be sufficient for the user.

Ernst & Young Global Limited - 25

ISA 315 has been a standard with specific challenges for audits of LCEs and we acknowledge the IAASB efforts to address those challenges, especially around the IT environments of LCEs in the current draft of ISA 315 (Revised). We also believe that the new drafting conventions and scalability considerations sections in ISA 315 (Revised) will help address the challenges for audits of LCEs. We view these efforts by the IAASB as a step forward in making the ISAs more “user-friendly” for LCE audits.

Grant Thornton International Limited - 62

ISA 315 (Revised)
Lack of clarity of the impact on the audit of certain requirements, i.e., ‘why’ the procedure is required. In particular, understanding internal control, especially the control activities, is often regarded as a disproportionate requirement for an LCE.

Segregation of duties is often an issue in the audit of an LCE. Often the risk associated with a lack of segregation of duties can be mitigated by higher-level controls performed by management. However, there is a lack of clarity between ISA 315 (Revised), ISA 265 and ISA 330 about whether the auditor can reduce control risk if the auditor plans to test such higher-level controls. ISA 265 paragraph A3, which provides an example of such a higher level control and ISA 315, paragraph A105, through reference to ‘strong control … lessening or removing the need for more detailed control activities,’ suggests that it is possible to reduce control risk by testing higher-level controls. Conversely, ISA 315, paragraph 13 suggests the contrary by requiring the evaluation of the design of controls as a precondition to testing. Further even if the auditor tests the higher-level controls fulfilling the requirements of ISA 330 paragraph 10 may be challenging given these higher-level controls are often not formal or not documented.

Risk assessment analytics are often merely a documentation exercise on the smaller LCEs for the following reasons:

The initial trial balance on which the risk assessment analytics are performed is often subject to many adjustments as the financial statements are finalised.

The financial statements may be very simple, for example, may comprise of a single asset or of only a few classes of transactions and account balances.

HW Fisher - 17

There are numerous cases where the ISAs assume a level of internal control which less complex entities are unlikely to apply. While we accept that all businesses are likely to apply some level of internal control, such controls are often not susceptible to testing and cannot therefore be relied on in the work undertaken.

KPMG IFRG Limited - 72

ISA 315, Identifying And Assessing the Risks Of Material Misstatement Through Understanding The Entity And Its Environment

We consider ISA 315 to be particularly challenging, as this standard addresses the auditor’s risk identification and assessment, which forms the foundation for the entire audit and therefore if this is not carried out appropriately the audit procedures performed in response may not be necessary/appropriate. There are specific challenges in understanding the requirements of this standard and in executing these, in terms of clarity of the intention of the IAASB as to why certain procedures need to be performed, how these are intended to be performed, and how this will assist an auditor in gaining sufficient appropriate audit evidence. We believe that such a lack of understanding may drive an auditor to carry out more work than is necessary, including in relation to evaluating IT systems.

We raised concerns in our comment letter on ED: ISA 315 (Revised), dated 2 November 2018, as we believed that the IAASB’s attempts to introduce clarity in the standard did not go far enough to address challenges in this area, for example, we noted in our comment letter:

“We have a number of significant concerns relating to certain aspects of the “understanding” section of the ED, which we believe may continue to give rise to confusion and inconsistency in application.”

“Our interpretation of the requirements [of the ED] is that the auditor is required to obtain an understanding of the Control Environment, the entity’s Risk Assessment Process, the entity’s Process to Monitor the
System of Internal Control, and the Information System and Communication components of the entity's system of internal control by performing the procedures set out in the standard but that this understanding does not involve identifying controls, and nor does it involve evaluating the design and implementation of such controls within these components at this point.”

We noted that we welcomed the “differentiation introduced between “understanding” each of the components of the system of internal control, and “evaluating the design and implementation of controls relevant to the audit”, however we raised concerns regarding apparent contradictions in the standard, which also refer to “developing an understanding of a component by identifying controls relevant to the audit and evaluating their design and implementation”.

These concerns are mirrored when addressing obtaining an understanding of the entity’s IT system as the ED appeared to establish requirements to evaluate the design of the IT system controls relevant to financial reporting. In particular, the standard appeared to suggest that the auditor is required to obtain an understanding of all IT applications and IT infrastructures relevant to financial reporting and all the related IT processes. We suggested that the IAASB clarify the intention of such requirements, and “whether a higher-level understanding of the IT environment is intended, focused on matters such as whether the IT environment is appropriate to the size and complexity of the entity”.

In terms of individual ISAs that may present particular challenges, we also agree with the IAASB’s observations on page 13, in particular, regarding extant ISA 315, Identifying And Assessing the Risks Of Material Misstatement Through Understanding The Entity And Its Environment (and the expected revised standard).

**MGI Worldwide - 18**

Specific ISAs that cause problems for audits of LCEs in our experience include:

ISA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment – this standard is so long and detailed that many SMPs fail to document their understanding of the client. There can also be a tendency to document information in a permanent section of the audit file and fail to update this appropriately when required (maybe because of time / fee pressures but also because teams do not link the different “phases” of the audit documentation together). A key area which is generally poorly executed is the understanding of the internal control components (other than control activities) as this is often informal and not documented in LCEs. This also leads to a failure to adequately assess the design and implementation of relevant controls and to consider any IT / communication systems in use. Some firms are asking for guidance on how to address the understanding of the control components better, including through specific training events.

**NEXIA International - 52**

The application of ISA 315, and in particular ED ISA 315, is problematic to audits of LCE’s due to the length and its difficulty to read. For example, smaller entities may find that certain types of control activities are not necessary because of controls applied by management. For example, management's sole authority for granting credit to customers and approving significant purchases can provide effective control over important account balances and transactions. When internal controls do not have an impact on the risk of material misstatement because they are not being tested for operating effectiveness, we believe the effort to document design and implementation might not add value or quality to an audit.

**Pitcher Partners - 7**

ISA Reference: ISA 315 para A49
Cause of difficulty

The statement that there may be increased risks in smaller entities, while true is not guidance which assists the auditor perform a more efficient audit. In fact, the "guidance" creates work for audits which are already under the greatest of fee pressure. This consideration does not assist the auditor of an LCE, nor does it help address this other than to say there are more risks, which logically means there is more work to do. This risk assessment issue outlines clearly that the current guidance is not assisting in the audit of LCE, and further indicates the need for the standards to build from the minimum requirements rather than the top or a middle ground position.

ISA Reference: ISA 315 para A79 and A85-87

Cause of difficulty

The requirement that audit evidence is obtained from a combination of enquiries and other procedures such as observation, with the acknowledgement that smaller entities or LCE may have no written code, how should this be documented and how much evidence can an auditor take from this particularly as inquiry alone is insufficient.

PKF International Limited - 69

ISA 315 (Revised) - Identifying and assessing the risks of material misstatement through understanding the entity and its environment – para 14 requires the auditor to understand the control environment and whether management has created and maintained a culture of honesty and ethical behavior and whether the control environment elements provide an appropriate foundation for the other components of internal control. For owner managed entities, obtaining evidence of how a culture of honesty and ethical behavior can be significantly more challenging compared to a larger entity which maintains a stronger audit trail of verifiable evidence in this regard. For smaller entities it is usually based on management's representation that a culture of honesty and ethical behavior is promoted and maintained. This feature of a smaller entity audit can often lead the engagement team to an assessment of the control environment as “weak” and often done so at the frustration of the client. In these minimal control environments in smaller entities and LCEs, there can be compromised controls (such as the bookkeeper who prepares bank reconciliations, writes cheques and posts journal entries), the auditor is aware control deficiencies before an overall assessment of the system of internal control and control activities are performed. To execute the entire risk assessment process is onerous. Revising the extent and scope of several of these extant ISA requirements for a smaller and/or LCE audit would help mitigate the existing and realistic risk that documentation is included in the audit file purely for compliance with the audit requirements as opposed to it providing meaningful insight and value into the engagement team's risk assessment process.

The audit of “smaller entities” have their own challenges reflecting circumstances more often apparent at a smaller entity rather than in a larger entity. Such circumstances include limited or non-existent formalized policies and procedures (thereby creating a perceived weak internal control), an amplified risk of management override, higher frequency in the occurrence of errors within the financial reporting environment and an overall weak audit trail.

Collectively, these circumstances can create inefficiencies for the audit engagement, with little opportunity for the provision of perceived value-add benefits to the client as an output of the audit process. As audit fees tend to be lower for smaller entities, all of these circumstances can collectively make it extremely difficult for practitioners to achieve an acceptable level of profitability when conducting an ISA-compliant audit on a smaller entity.
ISA 315 paragraphs 11-24 - There are challenges in determining the appropriate extent of understanding of the system of internal control, in particular evaluating design and implementation of relevant control activities and General IT controls, especially when the entity’s system of internal control and information system is non-complex (e.g., an off-the-shelf system) and when there is limited formal documentation supporting relevant controls.

ISA 315: LCEs often have a lack of a documented and robust control environment because, by their nature, these businesses are run on a more informal basis than larger enterprises. Auditors can easily default to a substantive approach and sometimes do not see the relevance of assessing an informal internal control system as a risk assessment procedure.

We have addressed this by providing simplified documentation for auditors of LCEs in this area, but this is not seen as a full response to the challenge that the work required provides little comfort.

We support the analysis included in Section II of the Discussion Paper, noting that we would like to draw attention to the use of soft controls and standards 315 and 330.

5. Public Sector Organizations

Wales Audit Office - 40

We believe that ISA 315 (and to a lesser extent ISA 240) are major challenges for the audit of LCEs. These standards are complex, difficult to interpret and place quite demanding requirements on the auditors of small bodies and LCEs, which are difficult to scale for LCEs.

6. Member Bodies and Other Professional Organizations

Accountancy Europe - 83

Internal controls in LCEs

The internal controls in place in LCEs are intended to be proportionate to the size and complexity of their business and activities and are generally appropriate. However, it may not be formalised to provide enough comfort to rely on for the audit. For this reason and for these entities, it seems disproportionate to require the auditor to identify and assess the risks of material misstatement in the financial statements through understanding the entity’s internal control and documenting this, as currently proposed in ED ISA 315 (Revised).

We agree that there is a need to understand certain controls as part of obtaining an understanding of the entity and identifying risks of material misstatement, but what is currently required in the ISAs is disproportionate to the simplicity of many LCEs.

ASSIREVI - 3

We concur on the major challenges described in the Discussion Paper. We believe that the following are specifically relevant in the audit of LCEs:

- Risk identification and assessment;
In our view, the analysis and evaluation of the internal control is the broad challenge in the audit of LCEs. As a matter of facts, LCEs status implies less sophisticated system of internal control and insufficient segregation of duties.

**Belgium Institute of Registered Auditors (IBR-IRE) - 11**

Documentation related to internal controls in LCEs

ISA 315 (Revised) requires to understand internal control relevant to the audit. The “Guide to Using ISAs in the Audits of Small and Medium-Sized entities” develops in Chapter 11 (11.1) this approach and mentions: “The auditor is required to obtain an understanding of the internal control elements as set out above (where they exist) on all audit engagements. This applies to any size of entity. It assists the auditor in determining whether there are any other risks to consider arising from possible control deficiencies. This understanding is required even when the auditor intends to take a substantive approach to the audit.”

Additional guidance would be helpful as to the extent of this understanding and the auditor’s documentation thereof in a LCE environment.

**California Society of CPAs - 14**

315 Risk Assessment – We need a better approach when the auditor knows from the get-go that control risk will be assessed at maximum. The amount of time required for the extant procedures is simply overkill.

Contributing factors include –

315 – In many, if not most, LCE, a real system of internal control is absent because the owner fills the role absent staffing that enables meaningful segregation of duties.

**Cayman Islands Institute of Professional Accountants (CIIPA) - 9**

2.a. For LCEs there is usually a very unsophisticated internal control environment. During the risk assessment process and documenting our understanding of management’s response to identified risks, most of the time there are inadequate controls in place to address these risks due to the simplicity of the entity as well as the limited number of staff. Often this technically results in significant control deficiencies which requires communicating in writing to those charged with governance (ISA 265 para 9).

**Chartered Accountants Australia and New Zealand (CA ANZ) and ACCA - 51**

ISA 315

ISA 315 also presents a challenge for auditors of LCEs. The risk assessment process is not well designed for audits of LCEs with the ‘why’ not being sufficiently clear, resulting in a ‘tick-box’ exercise with no clear understanding of its value added. In the case of LCEs, they are often lacking in controls or the required information on systems and controls may not be available, so auditors are likely to need to use a substantive approach. There is a need for the standard to be clearer on how, for example, the lack of controls may impact the risks and the substantive approach taken so that practitioners can easily understand what they are required to do for risk assessment in these audits, rather than just moving to a substantive approach with limited documentation.

**Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili - 34**

The main difficulty refers to the reliance on the internal control system for audit purposes. Based on the underlying characteristics of LCEs as specified above (i.e. internal control system often based on unwritten procedures and characterized by a low level of segregation of duties), and although the requirements of ISA
315 on the understanding of the internal control system need to be complied with, the related reliance on the internal controls by the auditor as specified in ISA 330 is generally difficult to apply in an LCE. In practice, a substantive approach is often preferred when performing the audit of an LCE.

The fact that, in general, within LCEs, the assessment of the reliability of the internal control system, required by ISA 315, is unlikely to be positive (also considering that the segregation of duties and related responsibilities is rarely applicable) has a series of consequences on the application of many other ISAs that should, therefore, be appropriately integrated with specific considerations concerning the audit of LCEs.

We refer in particular to:

ISA 315: When it deals with the assessment of the internal control system and the results of this assessment on audit planning. Consequently, ISAs 265 and 330 should be revised for the same reason, as well as ISA 230 with reference to the documentation to be collected to support the assessments made on the internal control system itself.

CPA Australia - 67

ED ISA 315, Identifying and Assessing the Risks of Material Misstatement requires an over-engineered risk assessment for entities in a non-complex environment as well as an understanding of each of the control components even if controls are not well documented and the control environment cannot not be relied on, which may be the case in an LCE.

The standards which have been identified in the DP are those presenting the greatest challenges currently or in the case of ED ISA 315, is expected to provide challenges.

CPA Ireland - 70

ISA 315

It is felt that the sheer length of ISA 315 makes the standard difficult to read and to determine what the auditor needs to do.

The complex language throughout the standard make it difficult to apply to an LCE, for example the consideration of an LCE’s “control environment” can often be difficult to consider in terms of the systems of an LCE, which are often very basic in nature but perhaps sufficiently appropriate to record the activities of a less complex entity.

European Federation of Accountants and Auditors for SMEs (EFEAA) - 38

Hence, this DP question could be interpreted as ‘which piece(s) of straw broke the camel’s back?’ There is no easy answer. We accept that certain ISAs and requirements pose greater burden than others – risk identification and assessment (ISA 315), auditing accounting estimates (ISA 540) and documentation (ISA 230) are commonly, and rightly, cited – but the real problem is the cumulative weight, number and specificity of requirements.

Institute of Certified Public Accountants of Uganda - 55

ISA 315 (Revised): Identifying and assessing the risks of material misstatement through understanding the entity and its environment.

Understanding the entity, its mode of operations and real owners might be a challenge for the type of entities described as LCEs. In addition where internal controls may not be relied upon, some respondents
expressed that the audit evidence obtained from understanding the client’s internal controls does not contribute to the auditor’s overall conclusion or opinion.

**Institute of Chartered Accountants of England and Wales (ICAEW) - 24**

ISA 315: the processes for risk identification and obtaining an understanding of internal control do not seem proportionate to the simplicity of many LCEs which do not have formal risk assessment processes. The basic premise of ISA 315 is that they do.

**Institute of Chartered Accountants of Pakistan - 64**

Identifying and assessing the risks of material misstatements needs more guidance/application material for situations where the LCE lacks internal control system and resultant impact on the nature, timing and extent of substantive procedures (detailed and analytical both) and other general audit procedures not attributable therefore the auditor is unable to perform enquiries and other analytical procedures.

**Institute of Chartered Accountants of Scotland (ICAS) - 28**

A further challenge in the application of ISAs in the LCE environment is that, in many of these entities, there may be little in the way of formal or structured internal controls in operation on which the auditor can place reliance. This is primarily because such a formal control environment may not be warranted in such entities. As a result, the auditor will undertake more substantive procedures which often involve excessive sample sizes and documentation requirements relative to the size of the entity.

**Institute of Chartered Accountants of Sri Lanka - 92**

ISA 315

This standard is not developed in a way that it addresses the characteristics of owner-managed and less complex entities. For example, basic human resource activities, proper budgetary controls, and process level controls hardly exist in LCE. Therefore, it is difficult to apply the requirements in the ISA 315 in the absence of a strong control environment.

**Institute of Independent Auditors of Brazil (IBRACON) - 75**

ISAs 315, 240 and 540, mainly in relation to the extent of work and documentation required.

**Institute of Public Accountants of Australia (IPA) - 91**

Internal Controls – both the existing and proposed ISA 315 place significant emphasis on obtaining and understanding of internal controls. For most auditors of LCEs this is considered a waste of time as such entities usually have poor segregation of duties and high degrees of management/owner override and the auditor from the outset intends to adopt a substantive audit approach and not undertake tests of controls (TOCs). The IPA is sympathetic to this view; however, the IPA is concerned this underplays the risk of misstatement through error or fraud. In addition, the IPA is concerned that by overlooking controls auditors are not obtaining sufficient knowledge of the information systems that have input into the financial reporting process.

IT General Controls – ISA 315 guidance on consideration of IT general controls is significantly lacking and does not consider the impacts of cloud based IT solutions and the poor segregation of duties. The IPA is also concerned the undue reliance on management/owner involvement as a mitigating factor is reinforced by the existing guidance (IAS 315.A112). It is the IPA’s view that this assumes a level of IT knowledge that is often absent as well as an understanding of financial outcomes that are not always evident in owner-mangers.
We hear from our stakeholders that, while they appreciate the design and the principles-based approach of the ISAs, the perception is that the ISAs are designed with large and complex audits in mind. This consequently results in a long list of requirements which auditors may not consider to be necessary or applicable for less complex audits.

In certain LCEs, particularly owner-managed entities, weak control environment and the risk of management override of controls are common. In such entities, it is not unusual to see factors which increase the risk of material misstatement due to fraud or error. Such factors include a low emphasis on governance, lack of segregation of duties and relatively weak finance department. Unlike larger corporations, there may not be adequate factors to constrain improper conduct by the owner-manager. Such entities may therefore be more vulnerable to incidences of misappropriation of assets and both intentional and unintentional misstatement or omission. In such entities, the lines between the entity’s and owner’s interests also tend to be blurry.

With little structure, weak control environment and relatively high risk of management override of controls, auditors may find it challenging to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. In such audits, auditors will typically take a full substantive testing approach. However, there are limitations to this approach in addressing certain assertions such as completeness of revenue, liabilities and records (for e.g. owner-manager may omit sales transactions to reduce earnings to minimise tax or omit recording certain liabilities to inflate earnings to secure bank financing or unqualified finance personnel may provide auditors with inaccurate or incomplete explanation/information). This may pose a challenge for an auditor in obtaining reasonable assurance about whether the financial statements are free from material misstatement, whether due to fraud or error, as required under ISA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing and as stated as the auditor’s responsibilities in the auditor’s report based on the requirements of ISA 700 Forming an Opinion and Reporting on Financial Statements. Given the nature of such entities, there may be limited additional procedures that the auditor could perform.

Another example where certain ISA requirements may not be seen as particularly useful in audits of LCEs is Para 22 of ISA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment which states:

‘The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting, including those related to those control activities relevant to the audit, and how the entity initiates remedial actions to deficiencies in its controls.’

In the case of certain LCEs as described above, compliance with the requirements of Para 22 above may appear as not particularly useful and performed only for the sake of compliance. In such LCE audits, auditors may have already decided that they will not rely on the LCE’s controls after obtaining an understanding of the relevant controls and control environment under Para 12 to 21 of ISA 315. Thereafter, they may not see the need to further understand the entity’s monitoring of controls. It is worth noting that, in LCEs which are less structured and with weak control environment, obtaining understanding of such major activities or controls may not always be straightforward as auditors may face situations where management may not be able to explain the relevant activities or controls involved or remedial actions. There may also be inconsistency in the management’s practices or actions.

To help deal with the lengthy requirements of the ISAs, it is common to hear auditors adopting a ‘checklist approach’. On one hand, many lament the need for such an approach as lengthy checklists coupled with
time pressure result in little in-depth considerations and lack of critical thinking. On the other hand, auditors are concerned that, without checklists, audit teams may miss out on certain procedures or requirements. Another concern is that it may be challenging for auditors to demonstrate that they have considered all the requirements of the standards without such checklists.

**Instituto de Censores Jurados de Cuentas de España - 22**

Internal controls. Most of times, as it is stated in the proposed definition of what is a LCE, internal controls in place in this kind of entities are very simple and they are not formalized in a way that allows the application of ISA 315 (Revised) in a proportionate way.

**Instituto Mexicano de Contadores Públicos, A.C. - 37**

In our opinion, the follow aspects are considered difficult to apply in the Mexico audit practices:

The overall risk-based audit approach (Assessment and response), especially in the following ISAs

ISA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment

ISA 320, Materiality in Planning and Performing an Audit

ISA 330, The Auditor’s Responses to Assessed Risks

In general terms audit practices in México have difficulties in determining how the entities internal control affect the overall risk assessment and responses for the audit work as sometimes are considered to be subjective or complex to apply for some firms or practitioners.

**Inter-American Accounting Association (IAA) - 47**

In fact, several rules are difficult to apply in an audit to less complex entities, but in particular ISA 315 it is difficult to apply due to the characteristics of the LCE, specifically the recent modifications introduced, such as Big Data and Data Analytic; and as a logical consequence, it is also difficult to apply ISA 330 to respond to assessed risks. Similar difficulty arises in the application of ISA 570 with the modifications introduced as a result of the entry into force of ISA 701.

**Malaysian Institute of Public Accountants (MICPA) - 10**

The discussion paper has identified various challenges in applying ISAs. We concur with the challenges as identified in the discussion paper, particularly:

Documentation requirements

Lack of clarity as what needs to be done and why

Application of ISA 315 and ISA 240.

**South African Institute of Chartered Accountants (SAICA) - 63**

ED-ISA 315 (Revised)

During our outreach the complexity of the proposed standard was raised with specific reference to the difficulty to read and navigate through the standard. Due to the length of the standard a concern was also expressed in determining what is applicable and what not.
Although the standard provides for reduced documentation, a concern was raised that it is not clear what is meant by reduced documentation and how much should be included. This is very open for interpretation and guidance is needed to ensure consistent application.

Inconsistency was also noted in documenting and understanding the relevant controls, as well as in judging what is relevant and what is not.

General

The identification and assessment of risk is sometimes a challenge. There is uncertainty whether the assessment of risks of material misstatement at the assertion level means that the assessment has to be performed for each assertion for all material classes of transactions, account balances and disclosures. The root cause of this is that the standard is not clear on what is the actual requirement here. Based on reading the application material provided in paragraph A129 of ISA 315 (Revised), it can be assumed that when identifying and assessing risk of material misstatement at assertion level each individual assertion must be considered. The preference is for the requirements of the standard to be sufficiently clear in this regard, with the application material only used to expand on the individual assertions.

Question 2(a) of the Discussion paper request particular aspects of the ISAs that are difficult to apply. The SAICA task group and SAICA survey respondents indicated the following:

The Institute of Chartered Accountants of Ghana - 71

Internal controls – In understanding the system of internal control of entities, requirements of ISA 315 (Revised) involves complexities that may not be applicable to LCEs. This makes application of the ISAs difficult, particularly on the extent and nature of audit evidence required to conclude on the design, implementation and effectiveness of such controls.

7. Academics

Hunter College - 68

Risk identification and assessment

We are supportive of the IAASB’s project to enhance the auditor’s risk assessment process. Risk assessment is an integral part to an auditor understanding and assessing the risks of material misstatement. However, we believe ED-315 proposals regarding testing the design and implementation of internal controls is unnecessary both from an Auditor point of view and cost/benefit analysis from the viewpoint of the LCE client. For LCEs and complex entities, we should understand the purpose of these controls. Risks should be assessed at the account level. However, characteristics that define LCE’s are few levels of management with responsibility for a broad range of controls. Therefore, understanding the design and implementation as set out in paragraph 26 is necessary to identify and assess the potential risks of material misstatement in the financial statements. Further we are concerned that regulators will expect the design and implementation of internal control requirements to be followed regardless of their appropriateness.

8. Individuals and Others

Cristian Munarriz - 93

Documentation for understanding of entity and its environment (ISA 315): the extent of documentation is not clear.
Q2 (a) Estimates (ISA 540)

3. National Audit Standards Setters

American Institute of Certified Public Accountants (AICPA) - 27

For many LCEs, estimates including valuation allowances, fixed asset impairments, and the allowance for doubtful accounts are fairly straightforward and are supported by historical data and supporting documentation for key assumptions. However, ISA 540 is written to also apply to extremely complex transactions with high estimation uncertainty, including expected credit losses, financial instruments, hedging transactions, and stock compensation, to name just a few. Many LCEs do not have these complex estimates and, therefore, many of the considerations related to risk assessment and expanded responses to risk required by this standard would not apply.

Australian Auditing and Assurance Standards Board - 73

In Australia 35% of survey respondents viewed ISA 315 as the standard which was the most difficult to apply, followed by the ISAs in the 500 series (25%), in particular ISA 540.

ISA 540 – Extent of work for more routine estimates which are not a significant risk.

CNCC & CSOE - 61

ISA 540 (revised) – Auditing accounting estimates and related disclosures

The revised standard is still complex, despite the efforts done to develop specific support tools, i.e. 2 flowcharts and 1 diagram, to respectively explicit the flow of the requirements in the standards, provide an overview of the key requirements relating to the three testing approaches, including their linkages and explain the linkages between ISA 540 (revised) and other ISAs. The need for support tools to explain the standard may question the clarity and the understandability of the standard.

Hong Kong Institute of Certified Public Accountants - 74

ISAs - ISA 540 (Revised), Auditing Accounting Estimates and Related Disclosures

Problematic requirements and underlying cause(s) - Under ISA 540 (Revised), the objective of the auditor is to obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures in the financial statements are reasonable in the context of the applicable financial reporting framework.

In order to meet the objective, the auditor is required to perform and document the risk assessment procedures and audit procedures as stated in the standard.

Based on our practice reviews, many deficiencies identified in auditing accounting estimates. The key challenge for the auditors of LCEs is the increasing complexity of the accounting standards and the difficulty in understanding them. This resulted in insufficient or inappropriate audit work on management assumptions and appropriateness of accounting estimates.

Korean Auditing and Assurance Standards Board (KAASB) - 23

Challenges in relation with certain ISAs and requirements

Related with the above (1) and (2), we face one of the most challenges in applying the ISAs 240, 315, and 540, and please refer to details as below:

In relation with the ISA 540, it is difficult for auditors to satisfy documentation requirements just as required by the ISA, given that LCEs, in general, don’t have sophisticated processes and controls on accounting
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estimates. Moreover, it is not certain whether such requirements are necessary to obtain assurance. “Considerations specific to smaller entities” in the ISAs don’t also provide clear description, thereby making it difficult to understand what and how to do.

Malaysian Institute of Accountants (MIA) - 30

ISA 540 (Revised), Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

Challenges: Generally, LCEs have no or few estimates. For the latter, the estimates may be not complex but the requirement of the standard is onerous in particular the application of paragraphs 22 to 36. This has often led to significant time being spent in the area, especially in challenging management assumptions, for example, the reasonableness of the discount rate.

Management of LCEs generally lacks skills in making such estimates. Significant time is also spent to educate the LCEs on the need to do so. In most cases, LCEs fail to appreciate such a process and view it as non-beneficial.

Certain LCEs would require forward-looking information in making the estimates, for example impairment assessment. The requirements of this standard would necessitate the auditors to develop auditor’s range which is very challenging to the auditors of LCEs, mainly due to the non-available of ready information or the excessive time and cost that it takes to acquire such information.

The Japanese Institute of Certified Public Accountants - 41

ISA 540 (Revised): Given the definition of LCEs, the application of ISA 540 (Revised) in an audit of LCE is less problematic because complex accounting estimates are not normally included in the financial statements of the LCE.

4. Accounting Firms

Baker Tilly International - 43

• ISA 540 (Revised) – In previous consultations and other forums, many commentators have expressed concern over the increased complexity of the requirements for auditing estimates. While for Listed/PIE and more complex entities this may be reasonable, it is likely that an overly onerous set of requirements for even the more straightforward estimates may adversely impact on the audit of LCEs.

BDO International - 60

• ISA 540 (Revised) Auditing Accounting Estimates and Related Disclosures - The nature and extent of audit procedures to be performed in auditing estimates (including obtaining relevant understanding of the entity) in the context of LCEs are onerous which is not commensurate with the degree of complexity (or simplicity) of the financial statements of LCEs.

Dailamipour and Co. – 31

ISA 540, auditing accounting estimates including fair values (specially fair values due to relying on assessor work, in most cases),

Deloitte Touche Tohmatsu Limited - 46

ISA 540, Auditing accounting estimates, including fair value accounting estimates, and related disclosures
DTTL agrees that some of the audit procedures that are required under ISA 540 (Revised) in most circumstances are unnecessary due to the simple nature of audits of LCEs and the majority of estimates herein.

However, DTTL also believes that audits of LCEs, in some circumstances, can have complex and significant estimates, and still be defined as an audit of an LCE. The building block approach would allow the auditor to scale up their response for the more complex area only, without having to determine the entire entity as being more complex.

**Duncan & Toplis Limited - 15**

We would agree with the ISAs identified in the report as being those that pose the greatest issues. Particularly ED-315 and ISA 540 (revised). Although both revised standards suggest that they are scalable, this needs significant clarification. Simply saying that they are scalable is not considered to be sufficient for the user.

**Ernst & Young Global Limited - 25**

Estimates - The length and volume of the requirements for estimates in ISA 540 (Revised) may be difficult to scale to audits of LCEs. For example, the details around understanding and testing management’s process for making accounting estimates may be very straightforward in LCEs and the requirements do not reflect this. Additionally, we believe that the references in the application material that relate to the scalability of the revised ISA lack detail as to how a scalable approach for ISA 540 (Revised) may be applied in the audit of an LCE. We believe more guidance is needed to implement ISA 540 (Revised) when auditing LCEs.

**Grant Thornton International Limited - 62**

ISA 540 (Revised)

The revised standard includes requirements to perform audit procedures that are not necessarily needed for simple estimates. For example, some LCEs do not have a formal process for making estimates and the elements of estimation uncertainty are less important given the straightforward nature of the estimate. In such situations, the requirement to understand management’s process becomes difficult to apply. Also performing a retrospective review on a simple estimate may not be needed to perform appropriate risk assessment procedures.

**HW Fisher - 17**

The requirements in relation to accounting estimates place too much emphasis on the auditing of a process to establish the estimates. In practice in many audits a review of what actually happened post-balance sheet and simply the reasonableness of the estimates will be the most effective approach.

**KPMG IFRG Limited - 72**

ISA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, And Related Disclosures

As above, the concerns identified by the IAASB do not particularly resonate with us as we consider that this standard contains clear links to the risk assessment process and therefore the procedures required by ISA 540 in response to such risks are less in scope when an estimate is less complex and there is a lesser degree of estimation uncertainty. The standard specifically addresses substantive procedures that may be performed up to the date of the auditor’s report. However, we do note that further clarity would be helpful.
regarding the scaling of the standard to very simple estimates and, in particular, we would welcome a broader range of examples of simple estimates in the application material to the standard.

**MGI Worldwide - 18**

ISA 540 Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures – as noted in the Discussion Paper, the requirements around accounting estimates are unwieldy for many LCE audit clients. Most firms in our experience do not understand the retrospective review of the prior year accounting estimates and what it is designed to achieve. In some cases, the accounting estimates are calculated by the SMP as part of an accountancy service. The risk here is low but the documentation required again results in auditing to the standard. Where there are significant risks arising from accounting estimates (such as slow-moving inventory provisions for instance), teams are missing / not aware of the additional requirements for auditing such estimates.

**MNP LLP - 8**

Estimates

ISA 540 presents difficulties for audits of LCEs in two ways. The first way is that management of LCEs are often inexperienced in accounting and as such, may lack the ability to prepare and document a sophisticated estimate. The second way is that an LCE may be an LCE because it is an operation with very limited transactions, it is relatively newly established, or in an industry with little comparative market information. These scenarios all increase the difficulty in management being able to create and auditors being able to audit an estimate as a lack of information exists to be able to create and verify assumptions.

In our view, the following ISAs are difficult to apply:

**NEXIA International - 52**

When applying ISA 540, many audit procedures are unnecessary where estimates do not have the complexity of fair value assessments or forward-looking information.

For many LCEs, the only items carried at fair value on the balance sheet might be investments held by a third party, whereby those fair values can easily be confirmed at the balance sheet date. In addition, other estimates including valuation allowances, fixed asset impairments, or allowance for doubtful accounts are fairly straightforward and can be backed by historical data and supporting documentation. However, this standard is written to also apply to extremely complex transactions including financial instruments, hedging transactions, and stock compensation, to name just a few. For the very reason that are considered an LCE, many do not have these complex estimates and, therefore, a lot of the information in this standard would not apply.

**PwC - 84**

ISA 540 (Revised) - In planning for our Network implementation of ISA 540 (Revised), when considering simpler, lower risk estimates, the work effort related to the risk assessment and documentation requirements seem disproportionate and outweigh the perceived benefits to audit quality for LCE audits. Further guidance and/or illustrative examples on how ISA 540 can be applied in a more scalable manner would be helpful.

**RSM International Limited - 65**

ISA 540: Some auditors take the view that this adds complexity to the audit because it seems to have been developed to address the issues with the audit of complex forward-looking estimates (such as impairment
tests or loan loss provisions) without taking into consideration that many estimates are simple and unlikely to have a complex or rigorous process behind them (such as inventory obsolescence in an LCE, or provision for a legal claim). However, we do recognise that this is more driven by accounting standards and that entities with more complex accounting estimates, such as valuation of intangibles, might not qualify as LCEs anyway.

6. Member Bodies and Other Professional Organizations

ASSIREVI - 3

- Auditing accounting estimates.

Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili - 34

ISA 540: Accounting estimates typically represent an area of risk for audit purposes. All the more so in LCEs, where the figure of the entrepreneur is dominant and there are other aspects that can affect the reliability of the accounting data (poor internal control, a limited number of staff with a limited allocation of tasks due to a low level of segregation of duties, etc.), evaluating the estimates is a key issue that deserves the auditor's full attention. The audit standard under consideration should therefore encourage the auditor to strengthen his/her own control through detailed guidance requiring specific questionnaires, memorandum, etc., on the tests and verifications to be carried out.

CPA Australia - 67

ISA 540, Auditing Accounting Estimates and Related Disclosures requires certain audit procedures which are unnecessary for estimates which are not complex.

European Federation of Accountants and Auditors for SMEs (EFEAA) - 38

Hence, this DP question could be interpreted as 'which piece(s) of straw broke the camel's back?' There is no easy answer. We accept that certain ISAs and requirements pose greater burden than others – risk identification and assessment (ISA 315), auditing accounting estimates (ISA 540) and documentation (ISA 230) are commonly, and rightly, cited – but the real problem is the cumulative weight, number and specificity of requirements.

Institute of Certified Public Accountants of Uganda - 55

ISA 540: Auditing accounting estimates, including fair value accounting estimates and related disclosures.

The auditing of accounting estimates is always problematic even in other types of audits because it involves significant use of professional judgment.

Institute of Chartered Accountants of England and Wales (ICAEW) - 24

ISA 540: the statement in paragraph 3 of this ISA to the effect that risk assessment procedures for certain types of lower risk estimates need not be extensive is helpful, but not adequate in the face of the highly detailed requirements that follow, particularly those relating to controls, and in the light of the earlier attempts by IAASB (which we wholeheartedly supported) to distinguish between complex and less complex estimates in drafting. Most estimates do not have the complexity of fair value assessments or forward-looking information but many of the requirements, while in theory relevant to all estimates, are only applicable at such a high level to simpler estimates that they often seem peripheral.

Institute of Chartered Accountants of Nigeria - 6

ISA 540- Auditing Accounting Estimates, Par. A128
Additional guidance should be provided to the following:
evaluation of management bias; and
eamples of point and range estimates to challenge the reasonableness of estimates made by management.

Institute of Chartered Accountants of Sri Lanka - 92
ISA 540
In LCE it is presumed that most of the assets are recorded at cost; therefore, this standard might not be applicable as its written with complex estimates in mind. When the ISA has been drafted in that way, the application of the same in the case of LCE becomes non-user-friendly.

Institute of Independent Auditors of Brazil (IBRACON) - 75
ISAs 315, 240 and 540, mainly in relation to the extent of work and documentation required.

Institute of Singapore Chartered Accountants - 54
Applying ISA 540 Auditing Accounting Estimates and Related Disclosures is also challenging in certain LCE audits as such LCEs may not have adequate internal expertise or process for making accounting estimates. Para A31 of ISA 540 highlights certain circumstances which auditors may consider that increase the likelihood that management needs to engage an expert. While Para A31 highlights estimates of specialized nature (such as mineral or hydrocarbon reserves) and models of complex nature, certain LCEs may even find difficulties in estimates which are less complex as they may not have the expertise to determine an appropriate approach/model and the necessary key inputs (such as WACC). Such LCEs may also not be willing to incur resources in engaging external experts. There may also be an expectation for auditors to advise on the appropriate adjustment to the estimates recorded. This could result in the burden of ensuring the appropriateness of the estimates to fall on the auditor’s shoulders. Consequently, auditors may find themselves in a tricky position of potentially compromising independence requirements for assuming management's responsibilities.

South African Institute of Chartered Accountants (SAICA) - 63
ISA 540 (Revised)
Limited guidance is provided in the standard when considering management bias for a smaller/less complex entity.

8. Individuals and Others
Cristian Munarriz - 93
Extent of understanding of internal control (ISA 315/ISA 402): it is not clear the effort needed when the auditors assess control risk at the maximum. In my view, the understanding of internal control is relevant in those cases only to the extent that potential internal control deficiencies may be considered to affect inherent risk by creating opportunities for fraud (i.e. if there are not adequate controls regarding safeguarding of assets that are easy to be misappropriated, the fraud risk will increase because of the higher opportunities for misappropriation of assets) or affect compliance with laws and regulations with material effect to financial statements. Understanding controls relevant to significant risks not related to the before mentioned cases should not be required if a substantive approach is followed unless the potential control deficiencies may raise or increase fraud risk or affect compliance with laws and regulations with
material effect to financial statements. It is also challenging to document some aspects of internal control which are generally informal in less complex entities (not only small entities) so guidance may be helpful (i.e. control environment and monitoring of controls).

Extent of work required for simple accounting estimates (ISA 540): it is not practicable to perform all the work required in ISA 540 for simple accounting estimates. Focus should be made on estimates susceptible to management bias (i.e. retrospective review should only be required to that estimates).

**Q2 (a) Fraud (ISA 240)**

3. National Audit Standards Setters

**Australian Auditing and Assurance Standards Board - 73**

The standards and aspects of the standards that Australian stakeholders raised as most challenging when auditing an LCE included:

ISA 240 – Journal entry testing and the presumption of a significant revenue risk due to fraud.

**Canadian Auditing and Assurance Standards Board - 81**

ISA 240 - The auditor's responsibilities relating to fraud in an audit of financial statements

Identification and response to fraud risk – ISA 240.27 – This paragraph includes a presumption that there is always a risk of material misstatement due to fraud related to revenue recognition. Stakeholders indicated that this requirement is challenging to apply to audits of entities that have a single source of revenue (e.g. government grant) that is not susceptible to fraudulent financial reporting. Although rebuttal of the presumed risk of fraud is permitted, the work effort to support and document the rebuttal is not well understood and believed by some to be a high hurdle to meet.

Incorporate an element of unpredictability in the selection of procedures – ISA 240.30(c) – This paragraph requires the auditor to incorporate an element of unpredictability in the design and selection of the nature, timing and extent of audit procedures. Stakeholders indicated that this can be challenging when taking a fully substantive audit approach, where many (if not all) transactions and balances are examined. In such circumstances, it can be difficult to determine what may be an effective unpredictability procedure.

Journal Entry Testing – ISA 240.33(a) – This paragraph requires the auditor to design and perform procedures to test the appropriateness of journal entries, both at period end and throughout the period. Stakeholders indicated that this requirement is not well understood when a fully substantive audit approach is taken. For example, when many of the entity's journal entries have already been tested in a substantive audit approach, it is not clear how much additional testing is required.

**Hong Kong Institute of Certified Public Accountants - 74**

ISAs - ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

Problematic requirements and underlying cause(s) - Under ISA 240, when identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

The standard gives an example that the presumption of fraud risk in revenue recognition may be rebutted where the client undertakes a single type of simple revenue transactions (e.g. property rental). Where the
revenue transactions are more complex, auditors should always treat revenue recognition as a significant risk and design appropriate audit work. As a result of this presumption, the auditors of LCEs are required to perform extensive testing and documentation even when the assessed risks of fraud are considered to be low.

The following reflect the comments solicited from local SMPs:

**Korean Auditing and Assurance Standards Board (KAASB) - 23**

For journal entry tests, the ISAs don’t provide clear, specified descriptions, thereby driving global accounting firms to spend a substantial amount of time on conducting all of the procedures demanded by their respective guide.

The ISA 240 requires excessive and unnecessary assessments, procedures and documentations in audits of LCEs, and ISA's considerations on smaller entities are not specified and clear. In other words, guidance does not provide detailed explanations on to which extent substantive procedures have to be performed to obtain reasonable assurance, under a circumstance where processes and controls are not sufficiently in place to identify fraud risks. (for one, audit procedures responsive to risks related to management override of controls)

**Malaysian Institute of Accountants (MIA) - 30**

ISA 240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

Challenges: The set-up of the LCEs themselves (which are typically family owned, owner-managed or have concentration of control of few individuals) coupled with the lack of appropriate governance structure have resulted in the impracticability in the application of ISA 240. Management of an LCE may not have structured assessment of risks related to fraud in the entity or even processes for identifying and responding to fraud risk. This imposes a challenge on the auditors to respond to the assessed risk of material misstatement due to fraud. In addition, effective communication of identified fraud may be challenging for auditors of LCEs due to the cost-benefit assessment of obtaining legal advice as suggested in paragraph A65 of ISA 240.

**New Zealand Auditing and Assurance Standards Board - 53**

Many practitioners questioned the value of testing general journals as a method to address risk of material misstatement due to fraud. This is especially the case in audits of LCEs where the auditor is likely to be able to fully scan the reconciliation of all material balance sheet balances and identify unusual or suspicious items when performing substantive tests of details on these material balances.

The auditor’s responsibilities relating to fraud in an audit of financial statements are disproportionately difficult to apply for audits of LCEs. For example, ISA 240 (Revised) includes examples of incentives for financial reporting fraud by an owner-manager because their personal financial situation may be threatened by the entity's adverse financial performance (e.g. when the owner-manager has provided a personal guarantee for a bank loan). The standard also describes opportunities for an owner-manager to commit fraud, including that there is no monitoring of the owner-manager (as there is no one to monitor them), and that there are internal controls deficiencies (e.g. heightened risk of management override of controls in an owner-managed entity).

**The Japanese Institute of Certified Public Accountants - 41**

In addition to ED-315, DP also noted ISA 540 (Revised) "Auditing Accounting Estimate and Related Disclosures" and ISA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial
Statements" as ISAs that are particularly problematic. The following are our observations on these standards.

ISA 240: Compared to ED-315, we believe there are fewer challenges in the application of ISA 240. However, we believe there are some aspects in the current ISA 240 in which scenarios for risk responses are required to be determined not by the degree of the risk of fraud, but by whether or not such a risk exists. For example, it is assumed that a risk of management override of controls is presented in all entities, and testing of the appropriateness of journal entries and other adjustments is required regardless of the degree of the risk (paragraphs 32 to 34 of ISA 240). It is not clear from the requirements how the auditor can determine the nature, timing and scope of the required procedures for this testing in a scalable manner in response to the degree of risk. Therefore, some application issues may arise in an audit of LCE in designing procedures that meet the requirements of ISA 240.

4. Accounting Firms

Baker Tilly International - 43

• ISA 240.27 – LCEs may often have few or no significant risks of material misstatement relating to fraud in revenue recognition. The current examples in the standards for rebuttal of the presumption of fraud in revenue recognition are restrictive and may need revision in the context of LCEs.

BDO International - 60

• ISA 240 The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements – The extent of work required to respond to management override and test journal entries does not appear scalable.

Other ISAs which pose difficulties in applying to audits of LCEs include:

Deloitte Touche Tohmatsu Limited - 46

DTTL agrees with the IAASB on noting ISA 240, 315, and 540 as particular problematic when auditing LCEs and agrees with the specific observations as well, with the following additions and considerations:

ISA 240 The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements

DTTL agrees with the comments from the IAASB that the requirements of ISA 240, in some circumstances, are more onerous than what would be appropriate when auditing LCEs.

However, as fraud is a topic of special considerations and already is a matter of wide misunderstanding between the auditor’s role and the public’s expectations, DTTL is hesitant to recommend removing or ‘relaxing’ requirements for LCEs in this area.

DTTL also notices that, even though substantive procedures in the very small entities and less complex audits may cover all, or almost all, journal entries, testing them with focus on the ISA 240 objectives and requirements may result in a different outcome and as such is equally relevant for audits of LCEs.

It is DTTL’s view that practical Guidance and Examples to illustrate the required level of documentation in regard to the work performed on ISA 240 on audits of LCEs, would be beneficial for practitioners. For example, some of the required communications for those charged with governance (often the owner) occur verbally, as opposed to being a formal written communication.

DTTL suggests that practical Guidance and Examples in regard to illustrating the required level of documentation on audits of LCEs to demonstrate how it may be simpler and less extensive, are
accomplished by comparing examples of documentation under various scenarios of two audits, one of an LCE and one of a more complex entity.

**KPMG IFRG Limited - 72**

ISA 240, The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements

We believe this standard is generally drafted in a way that it is scalable, with the application material providing guidance to auditors as to how to scale the requirements to the size and nature of the entity.

**MGI Worldwide - 18**

ISA 240 The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements – the effectively mandatory expectation that there are significant fraud risks for management override of controls and revenue recognition causes further issues for audits of LCEs. In an owner-managed business, many firms rebut the management override risk inappropriately as they assess the actual risk to their client as low. The audit of journals is often weakly (or not) performed as a result and in LCE audits, the accounting estimates arising are often basic and not always material. Some firms will focus on “management” overriding controls, not picking up that finance staff in key positions (especially in smaller clients with less segregation of duties) can also override controls in place. We have witnessed files which explain that there is no risk as the owner-manager is hands off in relation to the accounting, but then indicate what the bookkeeper can do in relation to, say, expense approval and payment. In relation to revenue, we see firms either adopt an approach that Completeness is always the fraud risk (without justification) or that all assertions are affected. Audit teams know that there should be a significant risk here so are then auditing to the standards, rather than employing their knowledge and judgment to form an appropriate risk assessment.

**MNP LLP - 8**

Journal Entries

ISA 240 requires the testing of the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. Due to the nature of an LCE, practitioners struggle with applying the requirement to a relatively simplistic scenario. This may result in the testing of a significant portion of journal entries with a negligible reduction in overall audit risk. Further guidance on the extent of work required for journal entry testing for LCEs would be beneficial in creating consistencies in the amount of work performed on audits of similar types of entities.

Unpredictability

ISA 240 requires the auditor to incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures. This can be difficult to do with entities that have simple or limited transactions and are not complex in nature. Further guidance is needed on what constitutes “unpredictable” audit procedures in a non-complex situation.

**Pitcher Partners - 7**

ISA Reference: ISA 240 para 27 and A30

Cause of difficulty

Regulatory attitudes to examples in guidance being treated as rules

LCEs would frequently have few or no risks of material misstatement due to revenue recognition
PwC - 84

Where applicable, potential ISA guidance clarifications that might be helpful are noted for consideration:

ISA 240 paragraph 33(a) - It can be challenging to determine an appropriate extent of journal entries testing in LCE audits when there are limited fraud risk criteria identified and non-complex systems are used. Additional guidance and/or illustrative examples would be helpful when non-complex systems are used by the entity and all journal entries are treated as manual.

RSM International Limited - 65

ISA 240: The close involvement of owners in the financial aspects of an LCE mean that some of the inquiries suggested and required by ISA 240 (for example those in paragraph 17 and 18) appear burdensome in entities with few employees.

Other than indicative guidance within our audit software, we have not substantially addressed this challenge.

6. Member Bodies and Other Professional Organizations

ASSIREVI - 3

The auditor’s considerations in relation to fraud;

Chartered Accountants Australia and New Zealand (CA ANZ) and ACCA - 51

ISA 240

Paragraph 240.32(a) requires that, irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. However, audits of LCEs often take a substantive approach due to lack of controls and would include journal entry testing as part of their substantive procedures. For this reason, practitioners find that the requirement to perform and document additional mandatory journal entry testing adds very little, if any, value. The IAASB should ensure that the ‘why’ of performing certain audit procedures is better articulated, allowing practitioners to recognise the value added and to conduct their work in the right spirit rather than by performing ‘tick-box’ procedures with a compliance mindset. This will also ensure that the principles-based nature of the IAASB standards is followed. Consideration needs to be given as to whether the same mandatory procedures are appropriate for less complex engagements.

CPA Australia - 67

ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements requires a presumption of fraud risk in revenue recognition that may be more onerous than necessary for an LCE audit.

Examples of aspects within those standards which may be challenging for LCE audits are:

CPA Ireland - 70

ISA 240

Difficulty can also be experienced by the auditor of an LCE when it comes to the auditor's assessment of ISA 240. Again, it is the use of the complex language in the standard that can make it difficult to identify and apply to the more simplistic controls of an LCE.
Institute of Certified Public Accountants of Uganda - 55

ICPAU’s comment on this question is based on the feedback from members who participated in the survey. 73% of the survey respondents stated that the following as the particularly difficult aspects of the ISAs to apply:

ISA 240: The Auditor's responsibilities relating to Fraud in an Audit of Financial Statements. The respondents believed that the extent and nature of work relating to fraud most particularly rebutting the presumption that there is always a risk of material misstatement due to fraud related to revenue recognition and developing relevant testing of journal entries to meet the prescribed requirements when the risk of management override of controls is assessed as being low.

Institute of Chartered Accountants of Sri Lanka - 92

ISA 240

Providing procedures to ensure the completeness aspect is covered, will be welcome by the auditors of LCE.

Institute of Independent Auditors of Brazil (IBRACON) - 75

ISAs 315, 240 and 540, mainly in relation to the extent of work and documentation required.

Institute of Public Accountants of Australia (IPA) - 91

Fraud – The CP appropriately recognises that ISA 240 “The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report” as an area of difficulty for the audit of LCEs. The IPA is of the view that ISA 240 does not address the specific issues relating to LCEs including the poor segregation of duties and management override. ISA 240 is focused on a rigorous fraud risk assessment process by the client which is often not present. As noted above the IPA is uncomfortable with auditors placing undue reliance on manager/owner oversight as in practice the manager/owner may not necessarily have the skills required to exercise effective oversight. Finally, the IPA believes ISA 240 needs to address the issue of manager/owner fraud such as wage theft (i.e. underpayment of employees and non payment of entitlements such as superannuation) and non disclosure of revenue for LCEs.

Malaysian Institute of Public Accountants (MICPA) - 10

The discussion paper has identified various challenges in applying ISAs. We concur with the challenges as identified in the discussion paper, particularly:

Documentation requirements

Lack of clarity as what needs to be done and why

Application of ISA 315 and ISA 240.

South African Institute of Chartered Accountants (SAICA) - 63

ISA 240

There is a significant risk of management override of controls in smaller entities. This is only addressed briefly in the application material of the standard, where examples of techniques that can be used to commit fraud are provided. Further guidance is required specific to smaller/less complex entities.
The Institute of Chartered Accountants of Ghana - 71

Whilst ISA 240 (Fraud) appears to be the most significant standard, and as such there is so much documentation and procedures required, we have to wonder what are the basic requirements for an LCE in order to proceed. It's a matter of determining how much effort to employ.

The auditor’s considerations in relation to fraud—complying with the requirements of ISA 240 when auditing involves a lot of effort. The standard does not provide a clear guidance on the level of work to be performed for audit of LCEs. Since LCEs have less complex transactions, structure or reporting lines, a lot of time and effort may be spent by auditors when auditing LCEs in other to comply with the requirement of the standard than what would be appropriate in the circumstances.

8. Individuals and Others

Alla Ejova - 42

Another aspect of MSA that is causing difficulties for auditors when auditing MSO – compliance with the requirements of standard ISA 240 in identifying fraud activities. In LCE as a rule, the owner and the head of management is one person, the corporate structure allowing to reveal fraud, is absent, authorization of operations is carried out by the same person, often without having formal traces. In this case, the auditor can only obtain written representations from management provided for in paragraph 39 of ISA 240, which are formal in nature and indicate the absence of any unfair practices. Thus, the auditor relies on statements of those persons who are interested in concealment of unfair actions.

Cristian Munarriz - 93

For less complex entities, a relevant factor may be risk of management override of controls. Guidance may be helpful to an effective application of requirements in ISA 240, paragraph 32 (i.e. journal entries testing).

Vera Massarygina - 48

Some requirements of the ISAs are too vague. For example:

ISA 240 para.13 requires that the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor’s past experience of the honesty and integrity of the entity’s management and those charged with governance.

What actions should the auditor fulfill to prove that he really used professional skepticism throughout the audit? Maintaining professional skepticism is an overall requirement of the ISA 200 and the Code of Ethics and is it really necessary to repeat such statements in several standards?

ISA 240 para.32 do not include any requirement at all and could not be fulfilled.

Q2 (a) Documentation (ISA 230)

3. National Audit Standards Setters

Austrian Chamber of Tax Advisors and Public Accountants (KSW) - 20

Documentation, Lack of Clarity as to What Needs to be Done or Why
Auditors see it as a burden to document why they have not performed certain audit procedures linked to requirements of ISAs. The practice of documenting reasons why a required procedure does not apply or was not performed has lead that audits of LCEs are compliance exercises.

In addition, the lack of clarity on what needs to be done drive regulators’ expectations and demands when it comes to audit procedures and documentation. To avoid such unnecessary documentation, it would be very helpful to clearly state in the ISAs (ISA 200 and 230) that if the auditor has evaluated a requirement not to be applicable in an audit, the auditor does not to have to document this assessment. The auditor should apply professional judgment and document what he considers necessary in the circumstances.

CNCC & CSOEC - 61

ISA 230 – Audit documentation

The ambiguity of the audit documentation requirements and application material in the ISAs and its implications in practice on auditor’s behavior.

Auditors see it as a burden to document why they have not carried out an audit procedure linked to a requirement included in the ISAs. The practice of documenting the reasons why a requirement does not apply has created a compliance approach for ISA audits. Moreover, the lack of clarity on what needs to be done, especially when a requirement is not applicable, drives regulators’ expectations and demands when they come to audit procedures and documentation. These expectations and demands seem to be disproportionate, especially for LCE audits. However, to avoid findings during the inspections, auditors often end up documenting more than necessary. To avoid such excessive documentation, it would be helpful to clearly state in the ISAs that the auditor does not have to document a requirement if it is not applicable in a particular audit. The ISAs should also state that it is not because something has not been documented that it has not been done. It is important in the context of an audit of LCE to provide a relief to the auditor on audit documentation requirements. All the time spent documenting is not spent gathering audit evidence. The auditor should be required to document the evidence that allowed him/her to obtain reasonable assurance and express his/her audit opinion, not to document compliance with the ISAs.

Korean Auditing and Assurance Standards Board (KAASB) - 23

Documentation

Many point out documentation requirements throughout the ISAs as one of the most onerous tasks. The ISAs seem to require auditors to perform audit procedures in response to results of risk assessment, which means that auditors can decide to decrease audit procedures based on their professional judgments, regarding matters that are considered to have a low risk. However, the ISAs require over documentation to justify such decision during which process auditors spend excessive time and energy in extensive documentation, thereby inviting a concern that the extensive works would compromise efforts to perform practical audit procedures and exercise professional skepticism.

Malaysian Institute of Accountants (MIA) - 30

The challenges highlighted above in each ISA would then relate to the challenges in applying ISA 230 Audit Documentation which requires the auditor to prepare documentation that provides sufficient and appropriate record of the basis for the auditor’s report as well as evidence that the audit was planned and performed in accordance with ISAs and applicable legal and regulatory requirements.

New Zealand Auditing and Assurance Standards Board - 53
Documentation is another challenging area. There is a general view that in auditing LCEs, the auditor needs to go through a process of elimination to determine which requirements do not apply, and to document why they may not be applicable. This can be time consuming, depending on the audit tools available to the auditors. The expectations of monitoring bodies’ inspectors are that the audit file clearly demonstrates that the auditor has gone through this process.

4. Accounting Firms

Baker Tilly International - 43

ISA 300.21 - The level of documentation expected and required for a “LCE audit” may be different to that for a “full audit”. Regulatory expectations appear to be considerably higher than audit professionals consider appropriate in some cases and the extant standard does not provide sufficient examples or guidance as to what is considered acceptable, primarily due to the lack of clarity of what the minimum requirements are.

Crowe Global - 86

Documentation

The application of ISA 230 gives rise to concerns about the documentation requirements of ISAs. We consider the documentation of the performance of the audit to be critical in demonstrating that the auditor has applied standards, as well as applicable laws and regulations, and is acting in the public interest. However, the LCEs project presents an opportunity for a discussion about “how much is enough” in the context of the documentation of a lower risk audit such as an LCE.

Deloitte Touche Tohmatsu Limited - 46

Other primary problematic ISAs

In addition to the ISAs already identified as problematic by the IAASB, DTTL believes that the following ISAs should also be considered when assessing the primary problematic ISAs related to audits of LCEs:

ISA 230, Audit documentation and ISA 500, Audit evidence

DTTL feels that one of the biggest ‘pain points’ for auditors is identifying the required level of documentation on audits of LCEs, especially for auditors also working on audits of more-complex entities, given the tendency to default to include the same level of documentation on their audits of LCEs as they do on their audits of more-complex entities.

DTTL therefore believes that there is a need for more clarity on what is required to be documented and how the level of documentation varies with level of complexity. This could be achieved by the IAASB providing auditors with illustrative examples showing the variability in levels of documentation based on the level of complexity within the entity.

It is DTTL’s opinion that such practical examples will go a long way in helping auditors apply the ISAs in a scalable and consistent matter.

As commented in regard to ISA 240, DTTL believes that practical Guidance and Examples in regard to illustrating the required level of documentation on audits of LCEs should illustrate how the robustness of documentation may be simpler and less extensive and that this can be accomplished by comparing, under various scenarios, examples of documentation of two audits, one of an LCE and one of a more complex entity.

Ernst & Young Global Limited - 25
Level of Documentation – ISA 230 requires that audit documentation shall be sufficient to enable an experienced auditor to understand the audit procedures performed, the audit evidence obtained, and any significant judgment applied. Individual ISAs then require specific documentation. We believe that the documentation requirements within the ISAs are more geared towards audits of larger entities and are not tailored to audits of LCEs. Additionally, the extent of documentation for an LCE is an issue as the documentation requirements throughout the ISAs are very extensive. As a result, we believe that auditors spend a significant amount of time documenting why certain audit procedures have not been performed when auditing an LCE. We also believe that auditors struggle with regulators’ expectations related to documentation.

Areas where documentation is particularly challenging include: documentation around understanding the entity and its environment, entity-level controls (i.e., control environment, the entity’s risk assessment process, and the entity’s process to monitor the system of internal control), and estimates. Specifically, we believe that ISA 540 (Revised) has moved away from a principles-based approach and as a result it is introducing new challenges to documenting the procedures performed around estimates at an LCE.

GGI Practice Group of Auditing Reporting and Compliance - 29

We prefer to speak about SMEs than LCEs (see question 1).

When applying the ISAs to the SMEs, we find that the requirements in terms of documentation are disproportionate, including when the non-applicability of some procedures must be documented. Another way would be better in our view: some procedures should be deemed as required in principle (and then any deviation should be documented), and some additional procedures should be put in place only when a risk in that field has been positively identified.

Grant Thornton International Limited - 62

Documentation

There is a lack of clarity, and also inconsistency across the ISAs, on the extent of documentation needed for the audits of LCEs. Additionally, as it is not always clear which of the requirements are applicable to audits of LCEs, auditors are focusing efforts on considering and on documenting why they believe specific requirements are not applicable to the audit of a specific entity. This is further exacerbated by different interpretations of the documentation requirements by regulators. This lack of clarity and consistency may lead to unnecessary audit documentation.

HW Fisher - 17

Other standards whose requirements cause particular difficulties for less complex entities and for which a more proportionate approach should be considered include:

i) ISA230 audit documentation – documenting the audit work;

KPMG IFRG Limited - 72

Documentation

We believe that concerns primarily relate to the requirement at ISA 230.8 for the auditor to prepare audit documentation that is “sufficient to enable an experienced auditor… to understand: a) the nature, timing and extent of audit procedures performed to comply with the ISAs…b) the results of the audit procedures performed and the audit evidence obtained and c) significant matters arising during the audit, the conclusions reached and significant professional judgements made.”
We consider that this requirement, in conjunction with regulatory oversight in some jurisdictions, may lead LCE auditors to prepare extensive and unnecessary documentation as to, for example, why a matter is not considered to be significant; why a particular course of action was not taken by the auditor, including how the auditor exercised professional scepticism and professional judgement in connection with these determinations.

In relation to this, there is a lack of clarity as to the meaning of “experienced auditor… to understand”, in terms of whether documentation should be sufficiently extensive to enable another auditor to replicate the audit entirely, or rather to obtain a higher level understanding of the procedures actually performed and the results of such procedures.

We also highlight that there have been incremental documentation requirements in recent years, with several ISAs now establishing additional, specific documentation requirements, which may be onerous for auditors of LCEs, and may also lead to unnecessary documentation.

We suggest that the IAASB provide clarity as to the extent of documentation that an LCE auditor is expected to produce, and the purpose of this in the context of enabling an “experienced practitioner to understand…”, in particular when an audit consists primarily of substantive procedures.

**PKF South Africa - 82**

Whilst we do not have any specific ISAs that we believe are most difficult to apply in the audit of less complex entities, we believe that the documentation required to ensure that the requirements of ISA 230, specifically paragraphs 8 and 9, are met, results in auditors losing sight of the big picture, especially with regards to less complex entities.

**RSM International Limited - 65**

Particular ISAs which tend to be challenging on audits of LCEs are:

ISA 230: Due to the complexity of the ISAs, the extent of the documentation required can be burdensome for auditors of LCEs. In the current regulatory environment, reducing documentation can be difficult but auditors of LCEs sometimes use a memo approach for documentation, rather than giving specific answers to questions on a checklist which can be time consuming. This brings a further challenge in that the auditor still has to ensure that the memo addresses all of the ISA requirements.

6. Member Bodies and Other Professional Organizations

**Accountancy Europe - 83**

To avoid such unnecessary documentation, it would be helpful to clearly state in the ISAs that where the auditor has evaluated a requirement not to be applicable in a particular audit, the auditor does not have to document every such assessment. Instead, the auditor should apply professional judgement and document, if deemed necessary, in the particular circumstances. This could be stated, for example, in ISA 200 as well as ISA 230. Currently, paragraph 22 and 23 of ISA 200 state that the auditor has to comply with each ISA requirement unless it is conditional; this would need to be revised. In addition, it would be helpful to add a general statement in ISA 230 clarifying what has to be and what does not have to be documented. More generally, and drawing on the root causes explained above, there is a need for the IAASB to review the documentation requirements and rationalise what the auditor has to document or not.
California Society of CPAs - 14

Documentation has also become an issue. The extant standards have moved away from auditor judgment towards more proscriptive requirements. It seems intuitive that the documentation needed when auditing an LCE would be less robust than when auditing an entity that is not an LCE.

Chartered Accountants Australia and New Zealand (CA ANZ) and ACCA - 51

Documentation

Under the existing standards, auditors experience challenges in determining how much to document in their audits, particularly when the value of audit procedures performed such as the examples mentioned above regarding ISA 240 and ISA 315 are not clear. This risks regulators expecting extensive and non-value adding documentation, and auditors, in response, "over-documenting" to avoid the risk of regulatory criticism or penalty. This is an unfortunate outcome given that the objectives of regulators and the audit profession in relation to achieving high audit quality should be aligned.

CPA Ireland - 70

ISA 230

One of the key challenges cited by respondents to the survey were around the extensive documentation requirements of the ISAs.

In particular the appendix to the standard, which sets out the relevant requirements, could be afforded greater prominence and detail. Improvements in the navigation from ISA 230 to these relevant sections would aid an auditor's consideration of the adequacy of their documentation. This is an area where additional guidance would be beneficial.

European Federation of Accountants and Auditors for SMEs (EFEAA) - 38

Hence, this DP question could be interpreted as 'which piece(s) of straw broke the camel's back?' There is no easy answer. We accept that certain ISAs and requirements pose greater burden than others – risk identification and assessment (ISA 315), auditing accounting estimates (ISA 540) and documentation (ISA 230) are commonly, and rightly, cited – but the real problem is the cumulative weight, number and specificity of requirements.

Institute of Chartered Accountants of England and Wales (ICAEW) - 24

ISAs 230 and 500: We note elsewhere in this response a lack of coherence in the documentation requirements which have been added piecemeal to the ISAs over many years. These have long been onerous, as well as a source of conflict between practitioners and audit regulators. Regardless of what ISAs say about the application of ISAs and requirements that are not relevant to the audit, many LCE auditors, particularly SMPs, believe that they have no choice but to spend unnecessary time documenting why they have not done things, simply to avoid regulatory censure, where the reason is obvious and should not require documentation. Over-documentation of what has not been done affects the overall value and efficiency of audit as perceived by the market. We note the work being performed by IAASB on the nature of audit evidence and how it should be documented more generally in its project on ISA 500 and we encourage IAASB to address this issue specifically in the context of less complex audits as a priority.
Institute of Chartered Accountants of Pakistan - 64

Similar to global concerns, practitioners in Pakistan face a challenge of carrying out effective efficient and cost effective audit under ISAs, especially with regard to LCEs. There are concerns that ISAs in present form and structure are difficult to scale and apply on the LCE audits.

We believe that the following aspects of ISAs have some challenges in their application on the audits of LCEs, for instance:

Audit documentation requirements are detailed and time consuming for audit procedures on certain areas not directly attributable to any significant account balance or the classes of transactions of audit clients that are less complex in nature. For instance, assessing the internal control environment, fraud risk assessments, going concern assessments, related party transactions testing, use of experts, audit on the risk of management's override of controls, use of management estimates and judgements, etc.). These are those procedures performed under various ISAs such as ISA 240, 300, 315, 540, 550, 570, etc. Accordingly, we believe there should be lesser need for extensive documentation in LCE audits and therefore explicit guidance on those areas as mentioned above.

Institute of Chartered Accountants of Scotland (ICAS) - 28

We believe that many of the difficulties experienced in the application of the ISAs for audits of LCEs relate to what are perceived to be onerous documentation requirements, particularly at the planning and completion stages. For example, the need under ISA 230 Audit Documentation, for the auditor to document why a specific audit procedure has not been performed is considered excessive, as it requires consideration and documentation of all such audit procedures and is more representative of a compliance-based approach.

Paragraph A16 of the application material of ISA 230 states that ‘The audit documentation for the audit of a smaller entity is generally less extensive than that for the audit of a larger entity’, but there is no further guidance in this respect. As a result, it is not clear as to the extent of audit documentation required and raises the risk of either insufficient documentation or too much documentation. Neither of these situations is ideal; the former runs the risk of regulatory challenge and the latter risks inefficiencies as a result of over-auditing.

Institute of Chartered Accountants of Sri Lanka - 92

ISA 230

The Proposed LCE Standard should provide a checklist on what are the procedures to be performed in the context of an LCE, given the current ISA 230 is difficult to scale into an LCE.

Malaysian Institute of Public Accountants (MICPA) - 10

The discussion paper has identified various challenges in applying ISAs. We concur with the challenges as identified in the discussion paper, particularly:

Documentation requirements

Lack of clarity as what needs to be done and why

Application of ISA 315 and ISA 240.

Nordic Federation of Public Accountants - 58

In our view, ISA 200 paragraphs 22 and 23 are good examples of the overall challenges of applying the standards on audits of LCEs, as these paragraphs capture the essence of the above-mentioned challenges.
of length, complexity and scalability. They also indirectly affect how the documentation requirements are being perceived and applied.

**South African Institute of Chartered Accountants (SAICA) - 63**

Certain procedures undertaken in an audit can be seen to not add value or enhance audit quality, but rather as exercises to satisfy regulators of compliance with the standards. There can be a perceived interpretation gap between regulators/inspectors, auditors and the intention of the standard. To this point, an example was given by the SAICA task group members:

ISA 230 paragraph 3 states that audit documentation serves the purpose to enable the conduct of external inspections in accordance with applicable legal, regulatory and other requirements.

ISA 230 paragraph 8 states that the auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit to understand:

The nature, timing and extent of the audit procedures performed to comply with the ISAs and applicable legal and regulatory requirements;

The results of the audit procedures performed, and the audit evidence obtained; and

Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions.

Interpretation/judgement differences arise where inspectors and regulators report that the standard is not followed (if a requirement is merely not documented), if it is not applicable in an LCE audit.

Another point raised by members of the task group was that of an experienced auditor as defined in the “Glossary of Terms” and referred to in ISA 230 paragraph 8.

**8. Individuals and Others**

**Cristian Munarriz - 93**

The ISAs and ISAs requirements that are most difficult to apply are:

Extent of audit documentation (not specifically related to ISA 230, but to many ISAs). For example, many ISAs require documentation of discussion of significant matters to management and TCWG, and documentation of significant judgments and conclusions, creating the feeling that you need to document these issues in different working papers. It might be helpful to include all communications and documentation requirements in a single standard.

**Q2 (a) Auditors responses to assessed risks (ISA 330)**

**3. National Audit Standards Setters**

**Australian Auditing and Assurance Standards Board - 73**

ISA 330 – Testing a material balance even if there is no risk of material misstatement.

**New Zealand Auditing and Assurance Standards Board - 53**

In audits of LCEs the auditor may have an overall expectation of a primarily substantive approach to reduce audit risk to an acceptable level. This is due to impracticability of use of substantive analytical procedures and reliance on internal controls (either due to fundamental deficiencies in the internal controls or lack of
documentation of controls in a retrospectively assessable manner). Under such circumstances, it is not always clear what controls are relevant to the audit and why the auditor is still required to evaluate their design and test their implementation. The outcome of such evaluation does not affect auditors’ risk assessment (as they will need to test their operating effectiveness to be able to reduce risk to a lower level if controls are found to be effective), does not impact their procedures to obtain evidence to reduce audit risk, etc.

4. Accounting Firms

Dailamipour and Co. - 31

Problematic ISAs in LCEs audit arise from applying, ISA 315 & ISA 330, Identifying and assessing risk of material misstatement,

Grant Thornton International Limited - 62

ISA 330

Many smaller entities have simple standardised accounting environments, for example, many such entities will use standardised accounting packages, which enables extensive use of whole population data analysis. This is not acknowledged or taken into account by the ISAs.

Pitcher Partners - 7

ISA Reference: ISA 330 para 18

Cause of difficulty

Obligation to test a material balance even if there are considered to be no risks of material misstatement in the judgement of the auditor

PKF International Limited - 69

ISA 330 The auditor’s responses to assessed risks – because of the control environment classification and limited control activities identified and tested, the auditor ultimately concludes that a fully substantive approach is taken to complete the audit. This means a testing strategy which uses larger sample sizes for test of details, as opposed to other alternative testing strategies which may, in theory, be more efficient.

PwC - 84

ISA 330 paragraph 10(b) - It can be difficult to determine the appropriate nature and extent of testing of “indirect” General IT controls, especially when the entity uses non-complex ‘off-the-shelf’ systems that they cannot modify. More guidance and examples may be helpful to clarify the nature and extent of tests of controls for entities that use packaged software applications (off-the-shelf systems).

Shahedan and Co - 80

The main challenge in the audit of LCEs is to define the scope of exemptions and/or simplifications of parts of ISAs.

An option could be, in determining the Risk of Material Misstatements (RMM), assessing the Risk of Control as high, without performing the test of controls and focus on analytical procedures and test of details.

SRA - 21

We support the analysis included in Section II of the Discussion Paper, noting that we would like to draw attention to the use of soft controls and standards 315 and 330.
6. Member Bodies and Other Professional Organizations

Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili - 34

ISA 330: In light of the observations made on the assessment of the reliability of the internal control system, ISA 330 should be complemented keeping in mind that, when LCEs are audited, it is more likely for the auditor to choose an audit strategy including substantive procedures and tests of details, rather than tests of control, as general audit responses.

CPA Ireland - 70

ISA 330

Much of the same commentary can be attributed to the requirements of ISA 330 in terms of the difficulty applying the complex language and requirements of ISA 330 to an entity with basic internal processes.

Institute of Chartered Accountants of Sri Lanka - 92

ISA 330

LCE’s when challenged by management override, given many LCEs have the presence of owner manager aspects, the expectation from the Proposed LCE Standard will be to have clearly laid down guidance in such a case. Further, when there are LCEs that are technology enabled businesses the Proposed LCE Standard should provide guidance when the auditor decided to adopt a substantive approach due to reasons of efficiency and audit cost.

Further, when the management override is in place and by default significant risk is applied, the standard shall provide the guidance on what procedures are to be applied.

Instituto Mexicano de Contadores Públicos, A.C. - 37

In our opinion, the follow aspects are considered difficult to apply in the Mexico audit practices:

The overall risk-based audit approach (Assessment and response), especially in the following ISAs

ISA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment

ISA 320, Materiality in Planning and Performing an Audit

ISA 330, The Auditor's Responses to Assessed Risks

In general terms audit practices in México have difficulties in determining how the entities internal control affect the overall risk assessment and responses for the audit work as sometimes are considered to be subjective or complex to apply for some firms or practitioners.

8. Individuals and Others

Alla Ejova - 42

In an LCE audit, a lot of time is spent on planning, which should not be complicated. It can be difficult to apply the requirements of paragraphs 9 of ISA 300 the Auditor should develop an audit plan that includes a description of: The nature, timing and extent of planned risk assessment procedures at the prerequisite level, as defined in ISA 330; 5 and 6 ISA 330 The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level, the auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level.
The auditor often spends more time on the formalization of procedures than on their implementation. For an audit by a working group, careful planning is an urgent necessity that determines the work of each member, but for an auditor who conducts an MSO audit often alone, documenting the planning procedures in terms of its scope can be time-consuming and impractical, since further audit papers show how much of the procedures were performed to obtain proper audit evidence.

**Audit Assistant Limited - 33**

My discussion with and review of work done by many of our smaller user firms confirms that:

Identification, assessment and evaluation of risk in relationship to materiality is a significant problem (ISA NZ 320).

Then tying that assessment into responding to those risks with appropriate tests to reduce the risk of material misstatement, (ISA NZ 330) including tying risk in a meaningful way back to how much reliance to place on TOD (tests of details), OSP (other substantive procedures), SAP (substantive analytical procedures) (ISA NZ 530 etc) is not often well done or documented.

The standards give little concise practical guidance on these points.

**Q2 (a) Audit evidence (ISA 500)**

3. National Audit Standards Setters

**Malaysian Institute of Accountants (MIA) - 30**

ISA 580 Written Representations and ISA 500 Audit Evidence

Challenges: ISA 580 states that the written representations on its own does not provide sufficient appropriate audit evidence. However, due to the nature of LCEs, there may be lack of documentary evidence put in place by the management and therefore the auditors of LCE may find it challenging to corroborate the management representation to other source of information, for example in determining the fair value of a simple investment in non-quoted entities whereby information may be limited and if information is available, the exercise may not be cost-beneficial. This poses challenges to the practitioner to obtain sufficient appropriate audit evidence as required by ISA 500.

Paragraph 4 of ISA 580 states that written representations do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Notwithstanding the guidance available, an exemption to paragraph 4 in limited circumstances, for example, when an entity can prove that cost of preparing such documentary evidence would outweigh the benefits, would be helpful.

**New Zealand Auditing and Assurance Standards Board - 53**

It is often impractical or inefficient to use substantive analytical procedures as a method to obtain audit evidence. For example, there is often very limited information that can be obtained from independent sources outside of the entity. Consequently, auditors of LCEs may be restricted to use information prepared by the entity. To evaluate reliability of the data used in a substantive analytical procedure under these circumstances, the auditor’s primary source of evidence is obtained from testing the operating effectiveness of controls over preparation of the information by the entity. However, the entity’s control environment may have significant deficiencies (e.g. domination of management by a single individual increasing risk of management override of controls (Para A28 of ISA 240), the extent to which controls are documented by an entity in a verifiable manner may be limited (Para A18 ISA 330).
4. Accounting Firms

Baker Tilly International - 43

• ISA 500 and Data Analytics – Data Analytics and similar technologies may provide high quality audit evidence for all entities, including LCEs, in an efficient manner. However, there is currently a lack of clarity around whether data analytics techniques provide substantive audit evidence or are merely risk assessment tools which may be useful in identifying transactions at greater risk. The IAASB and others (e.g. standard setters and regulators) need to provide greater clarity over the evidence which analytical techniques provide to enable the audit profession to move forward in this area.

• Information Provided by the Entity (IPE) - There is currently only limited coverage of IPE in the extant standards. However, the generation and potential “manipulation” of such information is an area of audit risk for all entities. Greater clarity over the work required to enable the auditor to place reliance on IPE would be helpful for all audits, but especially for LCE which may utilise more “off the shelf” accounting products or perhaps even rudimentary systems for recording financial information (e.g. Excel spreadsheets).

Crowe Global - 86

Audit Assertions

The audit assertions are important but often not understood properly by the auditor. This means that there is the possibility that not all the assertions are properly addressed. We understand that the IAASB may review the assertions in the Audit Evidence project. The LCEs project also presents an opportunity to explore the application of the audit assertions and their application in collecting meaningful audit evidence.

Pitcher Partners - 7

There is one area which does not get direct attention from the auditing standards and that is information prepared or amended by the client, i.e. there is an expectation of work being performed on the General Information Technology Controls “GITC”, but that report is then handled by the client in many instances prior to being presented to the auditor. What extent of work is expected to address this risk? Further associated with this is the use of client portals to obtain information in advance which means that some of the traditional checks such as observing the report being run are no longer practical as the client will run and lodge the report in the portal without any auditor observation.

ISA Reference: ISA 500 para 6 and A10

Cause of difficulty

Inability to use advanced data analytics tools as audit evidence as they do not meet the definition of audit evidence under ISA 500. This is a significant barrier to efficient and effective audit of all entities but in particular LCEs.

PKF International Limited - 69

On that prelude, we have noted a few ISA requirements that present challenges when performing an engagement for these types of entities:

ISA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing – para 15 and 16 require the auditor to exercise and document both the application of professional skepticism and professional judgement. For smaller entities, obtaining corroborative evidence can be very challenging. Poor audit trails and a lack of re-performable evidence limits the reliance on management’s representation. Based on current ISA requirements in this area, in
applying professional judgement in order to rely on a non-formalized policy or procedure, requires a greater extent of audit justification when compared to a formalized policy or procedure, which in turn is more likely to require more experienced (and therefore more expensive) members of the engagement to have a direct involvement.

5. Public Sector Organizations

U.S. Government Accountability Office (GAO) - 45

We believe that ensuring the consistent application of the audit evidence standard is particularly important for LCEs. Specifically, obtaining sufficient appropriate audit evidence is important for auditing LCEs, as there would potentially be an insufficient amount of audit evidence obtained to address the audit risk.

6. Member Bodies and Other Professional Organizations

Institute of Certified Public Accountants of Uganda - 55

ISA 500: Audit evidence.

The procedures for obtaining audit evidence required by ISA 500 are cumbersome for the audits of LCEs.

Institute of Chartered Accountants of England and Wales (ICAEW) - 24

Over-documentation of what has not been done affects the overall value and efficiency of audit as perceived by the market. We note the work being performed by IAASB on the nature of audit evidence and how it should be documented more generally in its project on ISA 500 and we encourage IAASB to address this issue specifically in the context of less complex audits as a priority.

Institute of Chartered Accountants of Sri Lanka - 92

ISA 500

In practice the control environment is assessed by referring to the attitude of the management. The key evidence in ensuring the completeness of transactions is the management representation. Therefore, the Proposed LCE Standard should provide guidance as to whether the management representation can become the key evidence for the risk of completeness of transactions, when other sufficient appropriate audit evidence are absent.

South African Institute of Chartered Accountants (SAICA) - 63

ISA 500 and ISA 530

Audit sampling techniques and procedures are similar for both LCEs and larger entity audits. A question was raised if this is appropriate and if different techniques should be considered for LCEs.

Q2 (a) Communicating with TCWG (ISA 260 & ISA 265)

3. National Audit Standards Setters

American Institute of Certified Public Accountants (AICPA) - 27

Other standards that we believe might be able to be scaled down for LCEs include required communications with those charged with governance and the group audit standards. Overall, we would not foresee changes to the overall framework of the audit approach being necessary but, rather, recommend taking a more
targeted approach similar to what has been done by the FASB Private Company Council here in the U.S. as discussed earlier.

**Canadian Auditing and Assurance Standards Board - 81**

ISA 260 - Communication with those charged with governance

Frequency and substance of communications – ISA 260.14 -.17 – These paragraphs list matters that the practitioner is required to communicate with those charged with governance. Stakeholders indicated that they are sometimes challenged in complying with the requirements to communicate specific matters throughout the audit in less formal oversight structures, where a board of directors does not exist or meets infrequently.

**Korean Auditing and Assurance Standards Board (KAASB) - 23**

As for the ISA 260, it would be difficult to decide to which matters communication has to be made when, it is fair to say, LCEs don’t have those charged with governance. Definitions on those charged with governance and matters that can be actually communicated should be supplemented.

### 4. Accounting Firms

**BDO International - 60**

- ISA 260 Communications with those Charged with Governance - The extent of communication to be performed in the context of LCEs are extensive and does not account for the circumstances that LCEs often only have a one-tier management structure with minimal consequence to users of the financial statements (who may be owner-managers as well).

**Grant Thornton International Limited - 62**

ISA 260 (Revised) paragraph A40, which allows communication to those charged with governance for smaller entities to be less structured than those for larger or listed entities, lacks clarity as to how this actually adapts the requirements.

We have identified the following ISAs and aspects of ISAs that are difficult to apply in audits of LCEs:

**KPMG IFRG Limited - 72**

Communication with Management / Those Charged With Governance

We note that the formality of communications with management/those charged with governance across various standards may be overly formalised/ unnecessarily complex and we recommend that such requirements are simplified, with inbuilt scaling solutions, as well as providing clarification as to what would be considered to be sufficient appropriate documentation to evidence communications that are made orally.

### 6. Member Bodies and Other Professional Organizations

**Institute of Certified Public Accountants of Uganda - 55**

ISA 265: Communicating deficiencies in internal control to those charged with governance and management because these entities usually have no or very weak internal control systems.

**Institute of Chartered Accountants of Sri Lanka - 92**

ISA 265

Giving an option to communicate the deficiencies in Internal Control to the management is appropriate.
The Institute of Chartered Accountants of Ghana - 71

ISA 260 also requires further clarification. Which engagements is this standard absolutely required? The requirements of this standard are not applicable in about 95% of engagements. ISA 265 should have been combined with ISA 260.

8. Individuals and Others

Cristian Munarriz - 93

Enquiries: many ISAs require enquiries to management and TCWG. If the result of these enquiries is documented in engagement letter or representation letter, it is not helpful to document the same thing in specific working papers (i.e. fraud and NOCLAR enquiries) unless it is considered necessary to do so.

Communications to TCWG (not limited to ISA 260): the extent of required communications is generally excessive not only for small audits but also to large audits where there is significant concentration of ownership, and owners also manage the business (i.e. family businesses). Some communications add little value and easily misunderstood because of the technical nature (i.e. planning communications and views about accounting practices). It should be permitted communications to be made be agreed upon the parties when agreeing the terms of the engagement assuming some conditions are met (i.e. no opposition from stakeholders and the entity is not a public interest entity).

Communications of significant deficiencies in internal control (ISA 265): the requirement to communicate in writing is excessive as significant deficiencies will generally be documented in the working papers and written communications add little value. Oral communication should be permitted.

Q2 (a) Planning (ISA 300)

3. National Audit Standards Setters

Hong Kong Institute of Certified Public Accountants - 74

ISAs - ISA 300, Planning an Audit of Financial Statements,

ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment

Problematic requirements and underlying cause(s) - Under ISA 300, the auditor shall develop an audit plan that shall include a description of the nature, timing and extent of planned risk assessment procedures, as determined under HKSA 315 (Revised).

Under ISA 315 (Revised), the auditor shall perform and document risk assessment procedures and understanding of the entity's internal control for designing and implementing responses to the assessed risks of material misstatement.

For LCEs, they typically have uncomplicated transactions and few internal controls, the requirements on risk assessment procedures and documentation of internal controls would be too onerous and ineffective. Extensive documentation is made even when some requirements are not applicable for audits of LCEs in order to justify what has not been done.
4. Accounting Firms

Grant Thornton International Limited - 62

ISA 300 paragraph A11; the application for smaller entities of the requirement to establish an overall strategy could be simplified by allowing for a memorandum prepared at the completion of the previous audit, updated as necessary for discussion with the owner-manager, to serve as the documented audit strategy. Such a memorandum would include issues identified during the previous audit and address the specific matters in paragraph 8 of ISA 300.

HW Fisher - 17

ii) ISA300 Planning – documenting the audit plan; and

Pitcher Partners - 7

ISA Reference: ISA 300 par 21 and A107-109

Cause of difficulty

The level of documentation actually expected and required for the audit of an LCE. Regulatory expectations appear to be considerably higher than audit professionals would consider appropriate in some cases and the extant standard does not provide sufficient examples or guidance as to what is considered acceptable, primarily due to the lack of clarity of what is the minimum requirements.

6. Member Bodies and Other Professional Organizations

CPA Ireland - 70

Audit Planning

The planning stages of the audit were identified by practitioners as a particularly challenging point of the audit of an LCE. The extensive planning requirements of ISA 300, 315 and 330 were cited as being overly burdensome for such client types.

Institute of Certified Public Accountants of Uganda - 55

Overall the respondents believed that challenges in applying the ISAs occur most commonly in the planning phase of the audit and often relate to determining the applicability or scalability of the requirements in the respective applicable ISAs to an entity at hand.

Institute of Chartered Accountants of Sri Lanka - 92

ISA 300

In an audit of an LCE, to carry out an efficient audit we suggest to give more focus to the detail audit plan rather than to the overall audit strategy. The Proposed LCE Standard should provide an activity based list to follow by the auditor, which explains the main procedures to be done. For documentation purpose, a checklist can be included.

The Institute of Chartered Accountants of Ghana - 71

ISA 300 is the most vital ISA. The guidance makes reference to simplification in the preparation of a memo, however, it would be beneficial if an example of such a memo was provided for LCE. The main thing is to provide more guidance to simplify key ISAs.
8. Individuals and Others

Alla Ejova - 42

In an LCE audit, a lot of time is spent on planning, which should not be complicated. It can be difficult to apply the requirements of paragraphs 9 of ISA 300 the Auditor should develop an audit plan that includes a description of: The nature, timing and extent of planned risk assessment procedures at the prerequisite level, as defined in ISA 330; 5 and 6 ISA 330 The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level, the auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level.

The auditor often spends more time on the formalization of procedures than on their implementation. For an audit by a working group, careful planning is an urgent necessity that determines the work of each member, but for an auditor who conducts an MSO audit often alone, documenting the planning procedures in terms of its scope can be time-consuming and impractical, since further audit papers show how much of the procedures were performed to obtain proper audit evidence.

Q2 (a) Sampling (ISA 530)

3. National Audit Standards Setters

Hong Kong Institute of Certified Public Accountants - 74

ISAs - ISA 320, Materiality in Planning and Performing an Audit

ISA 530, Audit Sampling

Problematic requirements and underlying cause(s) - Under ISA 320, the auditor shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures. Performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.

Under ISA 530, the auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

The determination of materiality and sample size for audit testing both involve the use of professional judgment. For audits of LCEs, the extent of audit testing tends to be more judgmental. As LCEs generally have less transactions or account balances, auditors found it more efficient to perform audit testing judgmentally based on past experience or their understanding of the LCEs rather than reference to a pre-set materiality or sample size.

Korean Auditing and Assurance Standards Board (KAASB) - 23

The ISAs don't describe specified requirements on sample sizes, thus the policy on sample sizes varies from firms to firms. Audits failing to meet the sample sizes demanded by respective accounting firms' internal guide might be found out problematic in regulatory review, which hinders auditors from deceasing sample sizes tailored to the circumstance of respective entities, based on their professional judgments.
4. Accounting Firms

Baker Tilly International - 43

ISA 530 – The extant guidance and standards in relation to Audit Sampling are relatively high level and it is left to audit firms to develop their own methodology for sampling, be that using statistical or non-statistical techniques. For audits of LCEs, it may be possible to provide greater clarity over the appropriate extent of work to be undertaken when using sampling. Indeed, given that many firms around the world are known to use certain sample sizes (e.g. 10 or 20), if a different form of assurance were to be adopted, it may be appropriate to establish “normal” sample sizes for use in such situations.

Ernst & Young Global Limited - 25

We have identified areas of the ISAs where scalability challenges exist in applying them to the audits where their nature and circumstances are less complex. Areas identified are as follows:

Sampling – ISA 530 indicates that when the circumstances are similar, the effect on sample size of identified factors such as those identified in Appendices 2 and 3 will be similar regardless of whether a statistical or non-statistical approach is chosen. We believe this statement in ISA 530 may imply that the auditor needs to reconcile between the two approaches. Additional application guidance on how to develop judgmental sample sizes would be beneficial for audits of LCEs, for which judgmental sampling may be a more efficient approach in many cases. We believe that when using judgmental sampling, professional judgment should be able to be applied, along with consideration of such factors as our understanding of the entity’s business, risk assessments, and the characteristics of the population tested to determine an appropriate sample size to understand the population and conclude that a material misstatement does not exist.

Grant Thornton International Limited - 62

ISA 320 and ISA 530

These standards include broad requirements for the auditor to determine materiality and, where sampling is employed as an audit procedure, to determine a sufficient sample of items to test. Absent further standardisation applying these requirements in a manner that achieves a high-quality, yet an efficient audit is particularly difficult in audits of LCEs.

HW Fisher - 17

iii) ISA530 audit sampling – justifying sample sizes and sampling techniques.

6. Member Bodies and Other Professional Organizations

Institute of Chartered Accountants of Pakistan - 64

Audit sampling methods need further guidance due to less technology available with the auditors (i.e. SMPs) generally auditing LCEs.

Institute of Chartered Accountants of Sri Lanka - 92

ISA 530

Application of judgements shall be limited when it comes to the LCEs and the standard needs to provide easily executable audit procedures that needs to be performed.
Audit of Less Complex Entities—Nvivo Report Q2 (a)
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South African Institute of Chartered Accountants (SAICA) - 63
ISA 500 and ISA 530
Audit sampling techniques and procedures are similar for both LCEs and larger entity audits. A question was raised if this is appropriate and if different techniques should be considered for LCEs.

Q2 (a) Materiality (ISA 320)

3. National Audit Standards Setters
Hong Kong Institute of Certified Public Accountants - 74
ISAs - ISA 320, Materiality in Planning and Performing an Audit
ISA 530, Audit Sampling
Problematic requirements and underlying cause(s) - Under ISA 320, the auditor shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures. Performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.
Under ISA 530, the auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.
The determination of materiality and sample size for audit testing both involve the use of professional judgment. For audits of LCEs, the extent of audit testing tends to be more judgmental. As LCEs generally have less transactions or account balances, auditors found it more efficient to perform audit testing judgmentally based on past experience or their understanding of the LCEs rather than reference to a pre-set materiality or sample size.

4. Accounting Firms
PwC - 84
ISA 320 paragraph 10 (and paragraph 4) - There appears to be diversity in practice when determining materiality benchmarks and rules of thumb in LCE audits. Additional guidance and/or illustrative examples would be helpful to acknowledge how users of the financial statements may differ, and how this may affect judgments about materiality in those audits. For example, additional application guidance to address circumstances where there are a very limited number of users of the financial information (e.g., local authorities and management) would address a very common circumstance.

6. Member Bodies and Other Professional Organizations
Institute of Certified Public Accountants of Uganda - 55
ISA 320: Materiality in planning and performing an audit.
Determining levels of materiality and sample sizes is always a challenge in most audits.
Institute of Chartered Accountants of England and Wales (ICAEW) - 24
ISA 320: in the case of voluntary audits, the ISAs should provide guidance on considerations for those LCEs where ‘users of financial statements’ and ‘economic decision making’ are likely to mean something very different to those applicable to larger more complex entities.

Institute of Chartered Accountants of Sri Lanka - 92
ISA 320
It is difficult to apply the materiality concept as professional judgement is needed to be exercised in all cases. The Proposed LCE Standard should provide a basic method of calculating materiality for LCEs without depending too much on the professional judgment in each case.
Furthermore, most of the LCE audits are done for the purpose of taxation authorities. Therefore, such matter should be included in the discussion of computing the materiality in the case of an LCE.

Instituto Mexicano de Contadores Públicos, A.C. - 37
In our opinion, the follow aspects are considered difficult to apply in the Mexico audit practices:
The overall risk-based audit approach (Assessment and response), especially in the following ISAs
ISA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment
ISA 320, Materiality in Planning and Performing an Audit
ISA 330, The Auditor’s Responses to Assessed Risks
In general terms audit practices in México have difficulties in determining how the entities internal control affect the overall risk assessment and responses for the audit work as sometimes are considered to be subjective or complex to apply for some firms or practitioners.

8. Individuals and Others
Audit Assistant Limited - 33
My discussion with and review of work done by many of our smaller user firms confirms that:
Identification, assessment and evaluation of risk in relationship to materiality is a significant problem (ISA NZ 320).

Q2 (a) Analytical procedures (ISA 520)
3. National Audit Standards Setters
Australian Auditing and Assurance Standards Board - 73
ISA 520 – Determining the acceptable difference from expected values which does not require further investigation.

Hong Kong Institute of Certified Public Accountants - 74
ISAs - ISA 520, Analytical Procedures
Problematic requirements and underlying cause(s) - Under ISA 520, when designing and performing substantive analytical procedures, the auditor shall develop an expectation of recorded amounts or ratios
and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

It is difficult for auditors of LCEs to develop and evaluate the expectation of recorded amounts or ratios, as the market indexes or information are usually not relevant to the LCEs.

4. Accounting Firms

Grant Thornton International Limited - 62

ISA 520

Audits of LCEs should be prime candidates for using analytical procedures because of the simplicity of transactions. However, in our experience, analytical procedures are not generally used in audits of LCEs because the requirements are viewed as too onerous to comply with. For example:

Obtaining appropriate audit evidence relevant to management’s response when investigating differences – it can be challenging to corroborate management’s responses when those responses result from management’s involvement in the day-to-day operations, rather than from a formal process.

MGI Worldwide - 18

ISA 520 Analytical Procedures – auditing using analytical procedures is poorly executed. Preliminary analytical procedures are often not linked to the risk assessment or audit work but are merely on file as the audit program requires them. Substantive analytical review is not generally understood by SMPs – a trend analysis of balances from prior year is a useful risk assessment tool but many firms try and use this as substantive evidence and they do not refer to the requirements of the standard, which require significantly more documentation (an independent expectation and substantive corroboration). This misunderstanding of what a substantive analytical review can be for an LCE also can lead to inappropriately reducing sample sizes for substantive tests of detail.

Pitcher Partners - 7

ISA Reference: ISA 520 para 5(d) and A16

Cause of difficulty

While A16 relates the amount of difference from the expectation that can be accepted without further investigation to materiality. It is unclear whether the threshold is limited to materiality. The size of the threshold is a significant factor in whether Substantive Analytical Procedures can be used to provide sufficient appropriate audit evidence in compliance with ISA 520.

6. Member Bodies and Other Professional Organizations

Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili - 34

ISA 520: the application of substantive analytical procedures in LCEs to identify the areas of risk for the audit, may not be easy due to the lack of accounting data that are complete and consistent with comparative data of prior periods. In an environment with poor internal controls, such as an LCE, such lack is very likely to occur – accordingly, ISA 520 should highlight the need to prepare comprehensive accounting data for a proper application of the substantive analytical procedure.

Institute of Chartered Accountants of Sri Lanka - 92

ISA 520
Adoption of substantive analytical reviews are difficult, given the limited ability of the LCE auditor to develop detail expectation of trend and relationships of financial statement amounts.

**Q2 (a) Going concern (ISA 570)**

3. National Audit Standards Setters

**New Zealand Auditing and Assurance Standards Board - 53**

In many instances, the management of smaller entities do have not prepare a detailed assessment of the entity’s ability to continue as a going concern. The auditor is put in a difficult situation where they need to compensate for lack of management capabilities to assess the entity's ability to remain going concern.

4. Accounting Firms

**Baker Tilly International - 43**

- ISA 570 – the requirement to evaluate management’s assessment of the entity’s ability to continue as a going concern. This assumes that the entity has the capability and capacity to make a going concern assessment which may not always be the case for LCEs.

**MGI Worldwide - 18**

ISA 570 Going Concern— for many LCE audits, a client may not have formal forecasts and budgets to support the directors’ assessment of going concern. As a result, audit teams can fail to adequately probe the risks here or will rely simply on verbal representations from the directors as there is a lack of other evidence. Greater guidance on the level of work required when going concern is NOT identified as a heightened risk would be useful across all audits.

6. Member Bodies and Other Professional Organizations

**Institute of Certified Public Accountants of Uganda - 55**

ISA 570: Going concern.

Assessment of going concern in these types of entities with very weak structures is difficult since their survival tends to depend on the availability of the owners.

**Institute of Chartered Accountants of Nigeria - 6**

ISA 570- Going Concern Determination, Par. A13

The Board should consider additional criteria that Auditors of LCEs can apply in evaluating management assessment of the LCE’s ability to continue as a going concern.

We have identified certain ISA topics we believe the Board will need to provide further clarifications to help simplify the audits of LCEs. The referenced ISA topics and the specific requirements of those topics are summarised below:

**Institute of Chartered Accountants of Sri Lanka - 92**

ISA 570

This is a ‘theoretical’ standard when it comes to LCEs. Most of the time, the management intention of LCEs is to continue the business, unless expressed otherwise. Therefore, obtaining a comfort letter from the
parent company and management representation inquiring of any intention to discontinue is a simple procedures that can be performed by LCE auditors.

**Q2 (a) Using a service organization (ISA 402)**

**4. Accounting Firms**

**MGI Worldwide - 18**

ISA 500 Audit Evidence / ISA 402 Audit Considerations Relating To An Entity Using A Service Organisation – where substantial amounts of year-end accountancy work is undertaken or the audit practice undertakes outsourcing functions (bookkeeping / management accounts / payroll), firms struggle to consider how to integrate and document any assurances already gained into their audit file and generally what audit approach to take. Plus whilst accountancy work may, for example, help to give assurances over one audit assertion, it may very well be irrelevant to others, and firms often fail to realise this.

**PKF International Limited - 69**

ISA 402 Audit Considerations Relating to an Entity Using a Service Organisation – many smaller entities use outsourced service providers for their payroll and secretarial functions. Para 16 addresses the expectation that controls at the service organisation are operating effectively. The requirements then set out are often burdensome and very onerous, especially when a type 2 report is not available. As the use of external providers of IT solutions including cloud based services will undoubtedly increase for smaller entities, we believe that this is a specific area where the onerous requirements of ISA 402 will become even more extensive with respect to the relative impact they have on the audit of a smaller entity.

**6. Member Bodies and Other Professional Organizations**

**Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili - 34**

ISA 402: If bookkeeping/accounting activities are outsourced, in compliance with ISA 402 the auditor also needs to obtain an understanding of the internal control system of the external accountant and of the interactions between the audited company and the service provider. Consequently, the auditor documents his/her intention to rely or not to rely on the internal control system for audit purposes.

**Institute of Chartered Accountants of Sri Lanka - 92**

ISA 402

Mostly in LCEs, chances of using shared services centers can vary and the LCEs tend to outsource certain services to a person rather than to a center. This concern must be addressed when drafting a standard or guideline to LCEs.

**8. Individuals and Others**

**Audit Assistant Limited - 33**

Service Performance auditing is also presenting significant challenges to many of our users (we now have our own standard for this - NZ AS 1).
Q2 (a) Related parties (ISA 550)

3. National Audit Standards Setters

CNCC & CSOEC - 61

ISA 550 – Related parties

ISA 550 is difficult to apply, especially in a context of small entities. As a matter of fact, the concept of “related parties” is defined by IAS 24. Other accounting standards and especially the French commercial code also refer to the definition provided by the IFRS. This is an issue for entities that do not use and, therefore, do not have not a good knowledge of IFRS.

4. Accounting Firms

Dailamipour and Co. - 31

ISA 550, related party transactions, which in fact they do not occur in a normal course of business in my jurisdiction!

HW Fisher - 17

One very specific example of an assumption made by an ISA which is not in practice correct is the assumption in section 13 of ISA 550 that management will have identified the entity’s related parties, their relationships with the entity, and the transactions with them. The further assumption in s14 of ISA 550 is that they will have established controls to ensure that this information is complete. Section A11 of ISA 550 says that in the context of the requirements of many financial reporting frameworks: “Management is therefore likely to have a comprehensive list of related parties …”, in our experience this is seldom true. Management will be able to identify disclosable transactions and balances, but the starting point would not be the establishment of a full list of related parties.

While the ISA does accept that such information will not always be readily available the assumption of the ISA is still that obtaining a complete list of related parties will be the starting point of the relevant audit work. In practice a more efficient approach would be to focus on transactions which may not have been concluded under normal commercial terms and then consider whether such transactions may have been with related parties.

MGI Worldwide - 18

ISA 550 Related Parties - problems here have been exacerbated by the issue of accounting standards for smaller entities in the UK, which reduce the amount of related party transactions which need to be disclosed. Firms now focus more than ever on the disclosure requirements, failing to fully identify / document all related party transactions. Additionally, the commerciality and purpose of transactions is often not fully assessed linking back to inadequate consideration of fraud.

6. Member Bodies and Other Professional Organizations

Institute of Chartered Accountants of Sri Lanka - 92

ISA 550

LCEs’ most of the time have the attribute of being owned by a few. Given that it is normal for LCEs to do transactions with related parties. The fact that it is normal to have related party transactions in an LCE, questions why there should be a special focus on related party transactions, as it is arguably a matter of concern morefully in public interest entities rather than in an LCE. The current ISA 550 is written with the
notion that related party transactions are non-good-governance-friendly in all entities. Therefore, the expectation from an auditor of an LCE is to audit related party transactions with the same rigor when public interest entities are audited. Such a requirement is harmful for professional relationship which an auditor has in an LCE that is owned by a few individuals. Therefore we believe addressing this matter in a more precise and contextual way for an LCE is beneficial to foster correct application of ISA 550.

8. Individuals and Others

Cristian Munarriz - 93

Related parties (ISA 550): audit of related parties transactions is generally challenging in less complex entities because they typically have many transactions with related parties.

Q2 (a) Consideration of laws and regulations (ISA 250)

4. Accounting Firms

BDO International - 60

• ISA 250 Consideration of Laws and Regulations in an Audit of Financial Statements - The nature and extent of audit procedures to be performed in identifying instances of non-compliance with laws and regulations in the context of LCEs are extensive and does not appear scalable.

MGI Worldwide - 18

ISA 250 Consideration of Laws and Regulations in an Audit of Financial Statements – understanding the risks apparent from laws and regulations for an LCE is often poorly executed, either too much detail (including copies of the related regulations) or only very high-level identification of standard regulations. There are two fundamental failings: staff undertaking this work don’t have adequate knowledge of laws and regulations in general terms or specifically to the sector in which the client operates; and staff are unable to identify which of the laws or regulations create a relevant audit risk. Thus the work becomes generic and unfocused. This is often more of an issue in owner managed businesses as larger businesses might have a legal team or a compliance function etc., whereas, smaller businesses are sometimes not even aware of key legislation that is relevant to their operations.

This is often a documentation exercise not frequently revisited and then not linked into the audit work / considerations during the fieldwork. LCEs will often operate in a non-complex regulatory environment and the standard should provide guidance on a suitable level of documentation to be applied to such files.

6. Member Bodies and Other Professional Organizations

The Institute of Chartered Accountants of Ghana - 71

ISA 250 is another problematic standard. When/how does an auditor decide that this is significant for the audit?
Q2 (a) Group audits (ISA 600)

3. National Audit Standards Setters

American Institute of Certified Public Accountants (AICPA) - 27

Other standards that we believe might be able to be scaled down for LCEs include required communications with those charged with governance and the group audit standards. Overall, we would not foresee changes to the overall framework of the audit approach being necessary but, rather, recommend taking a more targeted approach similar to what has been done by the FASB Private Company Council here in the U.S. as discussed earlier.

4. Accounting Firms

Deloitte Touche Tohmatsu Limited - 46

ISA 600, Special considerations - Audits of group financial statements (including the work of component auditors)

It is DTTL’s view that there are requirements within the current standard for group audits that are not necessary for less complex groups.

Many small and simple groups are only established as a group for tax or other non-business-related reasons (e.g., estate planning). These groups may, by all accounts, be just as simple as any standalone LCE. It is therefore DTTL’s view that understanding the group and its components should be as simple a process as for less complex groups as the process of understanding a standalone LCE.

In DTTL’s view, the current ISA 600 includes requirements related to the communication, monitoring, and supervision of component auditors that goes beyond what is necessary for a less complex group, as the inherent simple nature of components of a less complex group should mean that the required monitoring and supervision of the component auditor can be less frequent and extensive.

The current requirements result in long and complex instructions needed for even the simplest of entities, which may not be appropriate.

DTTL acknowledges the fact that a project on ISA 600 is ongoing and encourages the IAASB to consider the needs for the auditors of LCEs in regard to ISA 600 for the ongoing project, to avoid duplication of effort in the future, by having to reopen ISA 600 to address the audits of LCEs.

6. Member Bodies and Other Professional Organizations

Institute of Chartered Accountants of England and Wales (ICAEW) - 24

ISA 600: in less complex audits where the parent company and subsidiaries have all been audited by the same firm, the ‘top-down’ risk-based approach required by ISA 315 can result in duplication of effort and documentation when combined with the ISA 600 ‘bottom-up’ style approach. The interaction of ISA 315 and ISA 600 could be much clearer for simple audits in which one firm audits all of the group companies in a single jurisdiction.

Institute of Chartered Accountants of Sri Lanka - 92

ISA 600

LCEs are usually not featured as groups.
Q2 (a) Quality control (ISQC 1)

4. Accounting Firms

KPMG IFRG Limited - 72

ISQC 1

We note that this standard may present challenges to small practices in terms of developing scaling solutions that are appropriate to the size of the practice, recognising that many policies and procedures will be less formal.

We note that ISQM 1 and ISQM 2 aim to address scalability concerns and we encourage the IAASB to consider these as the standards are finalised.

Other ISAs

6. Member Bodies and Other Professional Organizations

Chartered Accountants Australia and New Zealand (CA ANZ) and ACCA - 51

Specific ISAs and requirements

ED-ISQM1

Although we recognise the task force's efforts to incorporate scalability considerations, most of the guidance for small practices is included at the end of the Application Material. This means that smaller firms will have to navigate through what they will perceive as complex requirements and guidance, with the hope of 'seeing the light' only right at the end (e.g. requirements to establish structure and reporting lines; the need to conduct periodic evaluation; etc.). We believe that in order to overcome this issue, the standards should start small and scale up as complexity increases, allowing smaller practices to quickly navigate through what is applicable to them and what is not. As discussed in our response to part (b), we believe the Board's approach to standards should be to write the base requirements for simple audits and then add additional requirements to address complexity.

If the decision is made to develop a single standard for the audits of LCEs, consideration will also need to be given to how that standard interacts with the quality management standards and whether a more streamlined approach to quality management may be appropriate for assurance practices that only perform LCE audits.

Q2 (a) Auditor reporting standards

6. Member Bodies and Other Professional Organizations

Institute of Certified Public Accountants of Uganda - 55

ISA 700 (Revised): Forming an opinion and reporting on financial statements.

There is a high risk of type II error when forming an opinion during the audits of these entities.

Institute of Chartered Accountants of Sri Lanka - 92

ISA 700, ISA 705, ISA 706

We suggest to refer to the illustrative audit reports included in our SLAuS for Non SBEs.
ISA 720

The application of ISA 720 in the case of LCEs.

8. Individuals and Others

Audit Assistant Limited - 33

One of the problems our users seem to comment on regularly is the increasing complexity of the audit report, and understanding the need for four standards around reporting (ISA 700, 701, 705, 706).

The complexity of the audit report flows across to more complex engagement letter and other communication requirements.

Simplified reporting for LCEs would be a cheap and effective “win”.

Simplified reporting for LCEs would also help to make audit reports and associated communications more accessible to end users, who in general tend to be less sophisticated in their understanding of audit and financial reporting than those of larger/more complex entities.

Feedback I have is that overly complex audit reports for LCEs do not add to the perception that the audit is useful or providing value.

Readers of reports for LCEs need Plain-English reporting. Again an easy and cheap “win”.

Q2 (a) ISAs usually not applicable to LCEs

4. Accounting Firms

KPMG IFRG Limited - 72

In accordance with their development as a single set of standards, the ISAs are inherently self-scaling. ISA 200.22 states that “the auditor shall comply with each requirement of an ISA, unless, in the circumstances of the audit: a) the entire ISA is not relevant; or b) the requirement is not relevant because it is conditional and the condition does not exist.”

When examining the implications of this statement for audits of LCEs, we note that several ISAs likely would be determined not to be applicable in their entirety, whilst the auditor would likely determine that specific aspects of other ISAs are not applicable, for example:

- ISA 600, Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors); ISA 610, Using the Work of Internal Auditors; ISA 620, Using the Work Of An Auditor’s Expert, and ISA 720, The Auditor’s Responsibilities Relating to Other Information would be unlikely to be relevant;

- Similarly, ISA 701, Communicating Key Audit Matters In The Independent Auditor’s Report, and specific aspects of the new Quality Management standards, including ISQM 2, Engagement Quality Reviews, would likely not be relevant, as these are directed principally at listed entities, or other “higher risk” entities with a similar profile;

- ISA 500, Audit Evidence, paragraph 8, is unlikely to be applicable, as we would not expect that management at an LCE has used a management’s expert. Similarly, much of the context of ISA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, And Related Disclosures relates to auditing of complex estimates, and is unlikely to be applicable to an LCE audit, (although, as we note
earlier, further clarity would be helpful regarding the scaling of the standard to very simple estimates and, in particular, we would welcome a broader range of examples of simple estimates in the application material to the standard);

- Requirements throughout the standards regarding communication with those charged with governance would not be applicable, or would be adapted to the LCE circumstances, to focus on management.

### 6. Member Bodies and Other Professional Organizations

#### Instituto Mexicano de Contadores Públicos, A.C. - 37

Examples of some ISAs that could not be fully applicable to LCE are the following:

- ISA 402 “Audit Considerations Relating to an Entity Using a Service Organization.
- ISA 610 “ Using the Work of Internal Auditors”
- ISA 620 " Using the Work of An Auditor’s Expert
- ISA 701 “Communicating Key Audit Matters in The Independent Auditor’s Report”
- ISA 720 “The Auditor’s Responsibilities Relating to Other Information

### Q2 (a) External Confirmations

6. Member Bodies and Other Professional Organizations

#### Institute of Certified Public Accountants of Uganda - 55

ISA 505: External confirmations.

Most external confirmations are not responded to and the performance of alternative procedures as required by the standard in this case does not usually provide the audit evidence the auditor requires.

#### Institute of Chartered Accountants of Sri Lanka - 92

ISA 505

Alternative audit evidence may be more effective in the case of LCEs and there is an expectation that the Proposed LCE Standard will provide clear guidance on this. (E.g. subsequent settlements Vs external confirmation). In LCEs, given the inherent limitations in the environment, the ability of the auditor of an LCE to rely on the processes is lower. For debtors, it is impractical to send negative confirmations even though it has been discussed in the current ISAs.

### Q2 (a) Other standards and concerns

1. Monitoring Group

#### IFIAR - 88

Further research regarding challenges in using ISAs

6. IFIAR acknowledges that auditors of less complex entities have often cited challenges they face in the application of ISAs. Therefore, it would be useful to identify more specifically the reasons behind the challenges and substantive issues that lead to dissatisfaction among auditors in this regard. We encourage
the IAASB to understand the challenges and analyse further the underlying causes of the challenges faced, in order to identify appropriate solutions. We therefore suggest the IAASB continue its efforts and use the results of this consultation process to conduct further research and information gathering with a wide range of stakeholders.

3. National Audit Standards Setters

**Australian Auditing and Assurance Standards Board - 73**

ISA 620 – Criteria for reliance on a specialist.

ISA 500 – Information produced by a management's expert.

**Canadian Auditing and Assurance Standards Board - 81**

In our consultations, very few practitioners cited specific ISAs when discussing the challenges they encounter in performing audits. Most practitioners perform audits using methodologies and tools, rather than referring directly to the ISAs. Consequently, we collected their comments and linked them to the relevant ISAs.

While our consultations focused on audits of LCEs, we are of the view that the challenges identified are not unique to those entities. Such challenges can occur in audits of entities described as complex, much the same as they can occur in audits of less complex entities.

4. Accounting Firms

**HLB International - 57**

We greatly appreciate that standard setters are trying to act in the interest of practitioners by including scalability, but feedback from our member firms shows that they find it complex to apply in practice through checklists. This can pose particular difficulties for SMPs as they may be more reliant on checklists to implement the ISAs than their counterparts in larger organisations.

We also appreciate that standard setters are trying their utmost to act in the public interest, particularly as far as the enhanced exercise of professional scepticism by practitioners is concerned. However, the longer and more complex the ISAs, the more there is scope for potential application difficulties. We fear that very important goals like enhancing the exercise of professional scepticism might easily be lost in checklists and concerns about local regulatory compliance, which in turn would not be in the public interest or in the interest of increasing audit quality.

**KPMG IFRG Limited - 72**

ISAs that Present Particular Challenges

We share the IAASB’s concerns that specific aspects of certain ISAs, in particular, may present challenges in terms of their understandability. We believe that, in essence, these involve a lack of clarity as to the IAASB’s intentions in establishing certain requirements, and therefore an auditor faces difficulty in understanding why they are required to perform certain procedures, and how this assists them in obtaining sufficient, appropriate audit evidence or contributes to audit quality. As a result auditors face challenges in determining how to properly perform such procedures across different entity types and engagement circumstances. Auditors of LCEs may face particular challenges in terms of determining whether and how they may scale such requirements, and may be driven to perform unnecessary work, with the aim of complying with such requirements.
These challenges exist across the spectrum of size and complexity of the entity subject to audit, and therefore we believe that the optimal solution(s) will assist all auditors in addressing these important issues. However, we recognise that scalability challenges may disproportionately impact the work effort of LCE auditors, in particular.

5. Public Sector Organizations

U.S. Government Accountability Office (GAO) - 45

The potential for threats to an auditor’s independence may arise because of a perception that an LCE audit may be less time-consuming and costly to an entity, so entities may try to shop for an auditor that will provide an LCE audit with less concern over audit quality.

We believe that for LCE audit the IAASB should consider an engagement similar to a review attestation engagement (limited assurance engagement), which would provide less assurance than a full audit. If this type of engagement would be considered, it would need to be clear in the report the level of assurance provided.

Finally, the topic of reporting for an LCE audit should be addressed, as reporting consistent with a non-LCE audit may not be appropriate. At the same time, an audit report that distinguishes an LCE audit may create a view that it is not the same quality as a non-LCE audit or may confuse users.

In addition, we have concerns about peer review and the engagement quality review process. Specifically, creating an LCE audit area, particularly by the creation of an LCE audit standard, may introduce additional risks to the review of an LCE audit. In the event of a peer review, the peer reviewer may not reach the same conclusion regarding whether the auditor’s decision to apply the LCE standard was appropriate, which raises concerns about whether the audit opinion should be continued to be relied upon.

6. Member Bodies and Other Professional Organizations

Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili - 34

ISA 510: In case of first audit engagement in LCEs, the audit work on the opening data and information becomes more complex due to an environment with poor internal control. Therefore, the audit standard under consideration should provide guidance to the auditor of LCEs to identify and assess the potential risks of prior periods material misstatements through questions and inspections focused on the detection of any such risks.

Federación Argentina de Consejos Profesionales (FACPCE) - 76

2. One of the problems that can be observed in the design and consequent drafting of the international auditing standards is that many aspects that are specific to the subject in question are included within the normative part and are or should have been included in the accountant's university training.

We suggest that the norm for less complex entities:

to. must be written based on defined principles and objectives and not casuistry,

b. from a design for this type of entity

c. changing the current way of starting from the most complex entity and then trying to adapt it to the less complex entity with the addition of a few paragraphs

d. created and designed by people who have practical experience in performing audits of less complex entities, and
It starts from the premise of the quality of previous knowledge that is required for an audit and the need for continuous training and write it considering that an accountant already has the necessary knowledge to perform the task.

**Institute of Chartered Accountants of England and Wales (ICAEW) - 24**

We expand on some specific aspects of ISAs highlighted by IAASB as creating problems below. While addressing these issues robustly will go some way to alleviate the LCE audits problem - particularly the internal control issues within ISA 315 - any response focused on these issues alone, in the absence of proper consideration of the broader structural problems, will ultimately be ineffective. IAASB should not waste the opportunity it has created with this DP by getting bogged down in detail at this point.

While we agree that some ISAs create more problems than others, dealing with the issues of LCE audits on a piecemeal basis is not the best approach. IAASB has asked what particular aspects of ISAs are problematic many times before and has received little in the way of response, because it is the wrong question. Taken individually, there are few requirements that are just ‘too difficult’ for LCE audits, or are ‘always irrelevant’ and might therefore be ‘taken away’ to make life easier. It is the interaction of unnecessarily complex, duplicative and overlapping requirements, and the overall length and wordiness of ISAs that cause the problem. IAASB is well aware that the particular categories of issues that cause problems include the required work on internal controls and documentation, because it has already highlighted those in the DP. All of our recent responses to IAASB consultations, and those of other respondents, highlight such issues.

We fear that this question demonstrates a lack of belief in the future of smaller or less complex audits, as well as a lack of understanding. Audits become too difficult to perform well, efficiently, which contributes to audit exemption limits being raised, and standard-setters are then persuaded not to pay too much heed to the needs of SME auditors because of the very exemption limits the standard-setter helped raise.

This question also implies that any separate standard would inevitably involve a ‘what can be taken away’ or ‘ISA-minus’ approach which we believe is wrong, in principle. A ‘bottom-up’ approach is needed to determine what should be included, not what should be excluded. An appropriate starting point might be to identify and articulate audit objectives that are of universal application. If such an approach affects the main body of ISAs, it will be no bad thing, as some objectives as they stand are indistinguishable from requirements.

**Institute of Chartered Accountants of Sri Lanka - 92**

ISA 580

Generally, LCE auditors place higher reliance on the management representation. In doing LCE audits, obtaining verbal representations is usually practiced. Such matter should be addressed in the Proposed LCE Standard.

Areas that can be improved in the current ISAs for the less complex entities are as follows.

ISA 200

Addressing the completeness aspect of financial statement assertion and elements is usually a challenge to the auditor. For example, in some cases, evidences of avoiding taxes fraudulently by not recording all revenues and proceeds are seen in practice.

Accordingly, the Proposed LCE Standard should provide some safeguards against the auditors of LCEs when it is difficult to perform other audit procedures to address the completeness assertion.
comprehensively, other than by resorting to management representation on completeness of all transactions.

8. Individuals and Others
Cristian Munarriz - 93

It is generally not clear the relevant issues to be considered when the auditor also performs material bookkeeping services.

Q2 (a) None

2. Regulators and Audit Oversight Authorities
Canadian Public Accountability Board - 5
Committee of European Auditing Oversight Bodies - 90
Czech Republic Public Audit Oversight Board - 89
Independent Regulatory Board for Auditors (IRBA) - 35

Question 2(a): No particular issues to raise of relevance to this consultation, other than the above;
Irish Auditing and Accounting Supervisory Authority (IAASA) - 36

3. National Audit Standards Setters
Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India - 12
Brazilian Federal Accounting Council (CFC) - 44
Institut der Wirtschaftspruefer in Deutschland e.V. (IDW) - 49
Royal Netherlands Institute of Chartered Accountants (NBA) - 85

4. Accounting Firms
Adrian & Partners AB - 26
Moore Global - 78
Rymand&co - 87

6. Member Bodies and Other Professional Organizations
Belgium Institute for Tax Advisors and Accountants (ITAA) - 59
EXPERTsuisse - 50
IFAC - 4
IFAC SMPC - 77
Instituto Mexicano de Contadores Publicos A.C. (Audit and Assurance Standards Commission) - 39
South African Institute of Professional Accountants (SAIPA) - 56
Union of Chambers of Certified Public Accountants of Turkey (TURMOB) - 79

8. Individuals and Others
Adele Driscoll - 2
Ali Sarehraz - 32
Chartered Accountants Academy - 66
Gabriel Yepez - 13
Gary Young - 19
Michel Maher - 16
SAMantilla - 1