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Response to the Discussion Paper on the Audits of Less Complex Entities (LEC)

The South African Institute of Professional Accountants (SAIPA) thank the International Auditing and Assurance Standards Board for the opportunity to provide our input on this important Discussion Paper. SAIPA is one of the leading accountancy institute representing suitably qualified Professional Accountant (SA), in practice, commerce and industry, academia and the public sector.

For 37 years, SAIPA has been a pioneer in the South African economy, contributing to the advancement of the accountancy profession, influencing legislation and constantly transforming to keep abreast of business, financial and social developments in the country and internationally.

SAIPA leads the way in forging a new and dynamic role for the Professional Accountant (SA) to fulfil the escalating demands made by business in South Africa's growing economy by equipping members with the latest knowledge, techniques and accreditation in the increasingly advanced services they render. Most of SAIPA's members in practice are Small and Medium sized Practitioners and service the SME sector.

Our Responses

1. *Is the description appropriate for the types of entities that would be the focus of our work in relation to audits of LECs, and are there any other characteristics that should be included?*

The term Less Complex Entities could cause confusion as it is not a definitive term. Whilst we understand that the IAASB was proposing the use of LEC rather than Small and Medium Sized Entities, we find the term more confusing as who determines that this is Complex or Less complex. There could be unintended consequences of entities that should be falling into full ISAS justifying their position as “Less Complex”.

It is our view that the Discussion Paper (DP) and the proposed intervention be clearly termed as Small and Medium sized Entities which is commonly known and understood. This still fits the descriptors that the IAASB has given on page 4 of the DP.

2. *Section II describes challenges related to audits of LCEs, including those challenges that are within the scope of our work in relation to audits of LCEs. In relation to the challenges that we are looking to address:*

- a. *What are the particular aspects of the ISAs that are difficult to apply? It would be most helpful if your answer includes references to the specific ISAs and the particular requirements in these ISAs that are most problematic in an audit of an LCE.*

It is our view that ISA's are written for entities that are high public interest. These in the main are big corporates and public companies. The standards are cumbersome and for the LECs/SMEs do not or provides little benefit compared to the costs involved. A number of the LECs do not meet the full requirements of the ISAs but are still expected to comply with all irrespective of the benefits thereof. Even where scalability is permitted we still find the full ISAs not fit for the purpose.

The LECs/SMEs are mainly audited by Small and Medium sized Practitioners (SMPs) who are adequately qualified on all audit standards and requirements, however due to the size of their firms/practices they tend to find difficulty in applying and complying with all the ISAs of non public interest entities. Whilst the standards have the scalability up or down they are still cumbersome, proportionality attempts to reduce but it is still a huge challenge.

b. *In relation to 2a above, what, in your view, is the underlying cause(s) of these challenges and how have you managed or addressed these challenges? Are there any other broad challenges that have not been identified that should be considered as we progress our work on audits of LCEs?*

In some jurisdictions all companies irrespective of size require an audit, this put tremendous pressure on the LEC/SMEs that are to comply with the jurisdiction's requirements since there is one set of Auditing standards which are meant to fit all entities. South Africa in trying to reduce this burden distinguished by providing an option for Private Companies that have a Public Interest Score (PIS) below the set threshold to only have their Annual Financial Statements (AFS) Independently Reviewed rather than audited. There are still shortcomings in this option since public companies do not have this option. They are required to have their AFS audited without taking into consideration the size/complexity of the entity.

The clarity project made a significant contribution in trying to simplify the ISAs and making them more concise. This however was short-lived as the amendments and new standards that are often necessitated by some crisis that has come up takes the standards back to being complex and cumbersome particularly for the SME sector. The DP has articulated the challenges that the SMPs are experiencing in using the ISAs for audits.

3. *With regard to the factors driving challenges that are not within our control, or have been scoped out of our exploratory information gathering activities (as set out in Section II), if the IAASB were to focus on encouraging others to act, where should this focus be, and why?*

The objective of this project must be to improve the cost-benefit of the SME/LCE audit, and this requires that there is focus on enhancing the benefits not just the cost of performing LCE audits. The LCE audit standards should cover the audit of the main elements of an entity, which if left untouched would pose significant risks to the entity, its stakeholders and the users of its AFS.

4. To be able to develop an appropriate way forward, it is important that we understand our stakeholders' views about each of the possible actions. In relation to the potential possible actions that may be undertaken as set out in Section III:

a. For each of the possible actions (either individually or in combination):

A. Revising the ISAs

i. *Would the possible action appropriately address the challenges that have been identified?*

It is our view that revising the ISAs in favour of the LCEs will be to the detriment of the bigger corporates and public interest entities. It will dilute and cause confusion to the users of the audited financial statements.

ii. *What could the implications or consequences be if the possible action(s) is undertaken? This may include if, in your view, it would not be appropriate to pursue a particular possible action, and why*

The unintended consequences could be PIE being let of the hook because of the standard trying to accommodate the LCE/SME. The opposite is also possible where the SME will be burdened with long and complex standard requirement where the view has been to keep the standard at a level relevant for the large entity.

B. Developing a separate Auditing Standard for Audits of LECs

i. *Would the possible action appropriately address the challenges that have been identified?*

We believe that a standard dedicated to the LECs/SMEs is more ideal to achieve the objective of this project. This will ensure that the standard is completely tailor-made for this sector and will not cause any ambiguity. The standard will also be fit for the SMPs and they will in our view enhance the completeness and set at the level of the sector.

ii. *What could the implications or consequences be if the possible action(s) is undertaken? This may include if, in your view, it would not be appropriate to pursue a particular possible action, and why*

Developing a new standard altogether will take time and effort. But we believe that this will be compensated by the cost benefit of the standard that is fit for purpose.

C. Developing Guidance for auditors of LCEs or other related actions

The problem with guidance is that it sits on top of a cumbersome base which is the ISAs, it sometimes lead to further complications where the guidance and the underlying standard do not match.

b. *In your view, what possible actions should be pursued by us as a priority, and why? This may include one or more of the possible actions, or aspects of those actions, set out in Section III, or noted in response to 4b above.*

This project is critical and long overdue, it will be appreciated if the IAASB will work on the new standard with speed so that we can have a standard that is relevant and serve the purpose for which it is aimed in the LEC/SMEs.

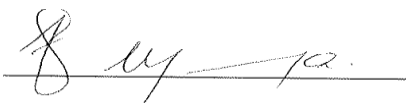
5. Are there any other matters that should be considered by us as we deliberate on the way forward in relation to audits of LCEs?

The other alternative is for the IAASB considering to elevate the understanding of the Independent Reviews (IR) and placing it at an equivalent level as the Audit but in this case being targeted at the LEC/SMEs. We find that the IR is seen as an inferior form of assurance and even in jurisdictions where it has been legislated as an option, most stakeholders still prefer audits.

Conclusion

As the profession we are encouraged by this project as it is an important area that has been neglected for considerable time. We appreciate that the IAASB is realizing that the concept of “an audit, is an audit” does not hold much value. As the matters of size and complexity of the entity are equally important in determining the form of assurance necessary for the entity.

Yours faithfully



Faith Ngwenya

Technical & Standards Executive