

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

September 10, 2019

Willie Botha

Technical Director

International Auditing and Assurance Standards Board

International Federation of Accountants

529 Fifth Avenue, 6th Floor

New York, NY 10017

**KAASB's Comments on IAASB's Discussion Paper on Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs**

Dear Willie Botha,

The KAASB\* is pleased to have an opportunity to comment on the Discussion Paper (DP) issued by the International Auditing and Assurance Standards Board for Accountants (IAASB), regarding Audits of Less Complex Entities. The KAASB is a strong advocate of the IAASB for your relentless efforts to serve the public interest by setting high-quality international standards which are generally accepted worldwide.

\*Delegated by the Financial Services Commission, the Korean Auditing and Assurance Standards Board (KAASB) within the KICPA is responsible for the establishment and revision of auditing and assurance standards.

## **Korean Auditing and Assurance Standards Board (KAASB)**

<General Comment>

SMEs make a significant contribution to the Korean economy, just as they do to the world economy. Given that SMEs account for approximately 90% of the total employment and 53% of revenues in Korea, improving accounting transparency of SMEs is critical to a nation's economic growth, thereby reasonably increasing the importance of the application of auditing standards, impacting the audit quality of SMEs.

Korea has adopted the ISAs and develops standards for statutory audits based on the ISAs and applies a single set of auditing standards both to listed companies or unlisted SMEs, regardless of sizes and characteristics. Most of those auditing SMEs express complexities and difficulties in applying the ISAs. The difficulties are not just for those performing voluntary audits but for those auditing statutory audits as well.

Under this circumstance, it is timely to see that the IAASB identifies challenges faced by auditors of LCEs and tries to come up with measures to address such challenges, as we believe. We advocate the IAASB for its efforts to further enhance robustness of the ISAs and maintain high-quality of standards, while addressing challenges faced by practitioners in applying the ISAs.

Please see the below for our responses to the specific questions. We hope our responses would be helpful in the IAASB continuing to focus its efforts on improving the ISAs and developing practice in relation with audits of LCEs.

<Questions for Respondents>

- 1) *We are looking for views about how LCEs could be described (see page 4). In your view, is the description appropriate for the types of entities that would be the focus of our work in relation to audits of LCEs, and are there any other characteristics that should be included?*

We believe the current definition of a “smaller entity,” set out in the extant ISAs, provides sufficient characteristics, in general, of LCEs. We suggest further consideration be given into whether to include group audits and entities using service organizations.

In addition, the scope of LCEs will be eventually prescribed by each jurisdiction’s laws and regulations, but still it is necessary for the IAASB to provide a clear-cut definition on LCEs in the ISAs and relevant guidance, thereby making it possible for the ISAs to be consistently applied in the world.

- 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.*
  - 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?*

We believe the DP sufficiently deals with most of the challenges related to applying the ISAs in audits of LCEs. Among them, we would like to share our challenges considered most significant and their root cause as follow:

(1) Premise on entities subject to the ISAs

The ISAs are basically based on large entities containing characteristics of being generally subject to IFRS, operating internal control system in accordance with COSO's Framework and putting those charged with governance that are relatively more robust than their smaller counterparts. Reflecting these complex audit circumstances, the ISAs have developed requirements and application materials, thereby ending up with the ISAs being more voluminous and complex

As a result, auditors face challenges and spend lots of time and energy on clarifying which one is subject to the ISAs and which one is not, as for audits on non-large entities (quantitatively the majority of audits).

The ISAs have been developed into being scalable and proportionate, but deciding whether they are applicable to certain requirements or not and how they can be applied is never easy. Especially at a time when auditors' legal liability and regulatory scrutiny have gradually increased, it is difficult for auditors to exercise professional judgments as much as they could and apply certain requirements of the ISAs, in a scalable, proportionate manner, tailored to the context of individual audit circumstances.

We believe the difficulties stem from the ISAs focusing on engagements necessary for audits of large, complex entities and sticking to the principle-based approach to apply the ISAs to entities with a wide variety of nature and circumstances, thereby leaving the nature and extent of the required work unclear.

**(2) 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.

**(3) 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:

- 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)

- 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.
- 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 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.
- 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.
- 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 decreasing sample sizes tailored to the circumstance of respective entities, based on their professional judgments.
- For journal entry tests, the ISAs don't provide clear, specified descriptions, thereby

## **Korean Auditing and Assurance Standards Board (KAASB)**

driving global accounting firms to spend a substantial amount of time on conducting all of the procedures demanded by their respective guide.

- 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.

In order to address above challenges, the KICPA offers below supports to help SMPs, auditing LCEs, understand the ISAs and apply them in practice.

- Audit Manual designed to support the understanding of the ISAs and application in practice
- Working paper sample
- Examples on how to prepare working papers
- Examples on how to prepare audit reports
- Introduction of the IFAC Guide

- 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?*

Most of the factors suggested in the DP are important tasks standard-setting bodies at the respective jurisdictional level should conduct. Most of all, the development of a technical framework or methodology designed to support the ISA application in audit of LCEs should be high on the list of importance, along with provision of sufficient, effective education. In addition, in order to improve audit environments for LCEs, the public awareness of value of audit should be enhanced, while at the same time public expectation on audit being satisfied as well.

When performing audit procedures as set out in the ISAs, understanding and cooperation from management and stakeholders are critical. The lack of awareness of management and stakeholders on the value of audit could bring about auditors not receiving sufficient cooperation from entities' end, thereby creating unnecessary conflicts and increasing expectation gaps in applying the ISAs.

This DP does not deal with the value of audits, but we believe efforts to improve awareness of management and stakeholders on the value of audits should come first.



- 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)*
    - i. *Would be possible action appropriately address the challenges that have been identified?*
    - 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.*
  - b. *Are there any other possible actions that have not been identified that should be considered as progress our work on audits of LCEs?*
  - c. *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.*

The KAASB went thorough review on the possible actions, and came into conclusion that the IAASB needs to take dramatic steps, differentiated from the previous ones, to substantially address LCEs' audit-related challenges. The KAASB believes that maintaining the status quo ISAs with revising some parts of them and developing additional guidance is not enough to address current challenges, faced by auditors of LCEs. Instead, the KAASB supports the so-called "building-blocks approach" that restructures the current standards into more critical, simpler formats. The KAASB expects the "basic standards," developed from the "building-blocks approach," to serve as separate standards for audits of LCEs.

With this way, the IAASB will still be able to maintain the status quo of a single set of standards, continuing to hold the merits of ISAs' long-time principle and purpose. In

## **Korean Auditing and Assurance Standards Board (KAASB)**

addition, the “basic standards” will satisfy needs of separate standards for audits of LCEs, while laying a ground work for ISAs to be applied in a manner that is scalable and proportionate to the size and complexity of an entity.

The KAASB have minority opinions that separate standards for audits of LCEs need to be established to drastically address challenges and, going further, application of a different framework and development of standards based on it, instead of the risk-based approach, would be appropriate. The opinions are based on the assumption that public expectation on audits of LCEs is not high, thereby having no need for providing the same level of assurance with the ISAs, and maintenance of principle-based approach would make difficult for current challenges related to audits of LCEs to be solved.

Some of the KAASB express that improving considerations specific to audits of LCEs or provision of guidance (or both of them collectively) would be most realistic for a short term, as it would take much time to take other possible actions. This is because, it would be most critically necessary for the ISAs to provide clear explanations as to which requirements can be applied in a matter that is scalable and proportionate to audit of LCEs and how such requirements can be applied to their audits.

*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?*

Many of the KAASB believe that aside from possible actions above, the focus should be on the below matters to address challenges of audits of LCEs, and suggests that the IAASB take into account this.

- The ISAs designed to enable auditors to easily identify which requirements can be applied in a scalable and proportionate manner (i.e. which requirements can be decreased)
- The ISAs designed to provide specified and clear explanations on how relevant requirements can be applied in a scalable and proportionate manner, thereby making it possible for auditors to apply them without burdens.