

12 September 2019

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On-line submission

Dear Willie

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

CPA Australia represents the diverse interests of 164,000 members working in 150 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

CPA Australia welcomes the IAASB Discussion Paper (DP) on audits of less complex entities, as the challenges raised in the DP are having a significant impact on auditors of LCEs. We strongly support the IAASB's intention to address these challenges as we consider that doing so will be critical in supporting LCE audit quality and ensuring that the IAASB's standards are fit for purpose for all types of audits into the future.

We have conducted wide outreach to our members and encouraged responses to both the IAASB survey and the Australian-specific AUASB survey on the DP. In developing this response we have considered feedback directly from members and the AUASB's survey findings regarding the challenges and merits of potential actions. The responses to that outreach consistently agreed with the challenges identified in the DP and overwhelmingly supported the need for action to address them. However, more varied views were expressed on what that action should be.

On balance, we recommend a long-term solution, along with a short to medium term solution, to address the immediate needs of auditors of LCEs, encompassing:

- Long-term: Restructuring of the existing auditing standards, in particular using plain English ("articulated using clearer and understandable language") with basic requirements as a base (the "building-blocks approach"), as well as utilizing diagrams, flowcharts and hyperlinks to better structure and navigate the standards.
- Short/medium term: Guidance that identifies the key auditing requirements applicable to LCEs and provides a roadmap of the relevant requirements; again, using flowcharts or diagrams, hyperlinks to the relevant ISAs and plain English explanations of how to apply the standards to audits of LCEs.

We also suggest exploration of the value of other forms of assurance for LCEs, even though the DP has limited its discussion to audits. This could take the form of developing more comprehensive standards for the conduct of review engagements, to better articulate the work effort, and to explore a clearer expression of the conclusion, perhaps in a positive form, which may be better understood by

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users. Alternatively, another kind of assurance service might be developed to better meet the needs of LCEs, including micro entities.

If a standard for LCE audits was the IAASB's chosen solution, even though it is not our preferred action, we would support it if the existing auditing framework was applied. The outcome in this case would be that an audit under the new standard would be consistent with the ISAs and, as the same approach was being applied, if increased complexity arose over time seamless transition to the ISAs could be effected. We do not support, however, the development of a new framework for LCE audits, as we suggest all audits should be equivalent to ensure that users are not confused or misled.

In the attachment to this letter, we have provided responses to the specific questions raised in the DP for consideration by the IAASB. If you require further information on the views expressed in this submission, please contact Claire Grayston, Policy Adviser – Audit & Assurance, on +61 3 9606 5183 or at claire.grayston@cpaaustralia.com.au.

Yours sincerely



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ATTACHMENT

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 consider that the purpose of providing a definition of LCE should be to help direct the auditor to the pronouncements which would be of most use to them, but not to mandate which are applicable. We suggest that the nature of an audit should remain consistent whether the entity is an LCE or a very complex entity. The difference between these engagements should be the complexity or sophistication of the audit response necessary to obtain sufficient appropriate audit evidence given the characteristics of the entity. The auditor should be able to use a pronouncement for LCEs to guide their audit engagement, but if they find a more complex issue arises or the entity's activities or structure become more complex over time, they can seamlessly transition to apply either the full suite of auditing standards or relevant standards. We suggest that the outcomes of the audit should be the same whether the LCE pronouncement is applied or the full suite of auditing standards. As a consequence, the definition should provide guidance rather than a definitive cutoff between LCEs and non-LCEs.

One difficulty which may arise is if the assessment of whether an entity is an LCE differs between the auditor and a regulator. Applying any pronouncement/s applicable to LCEs may not necessitate documentation to justify whether the requirements of each ISA are relevant or have been met. Consequently, if the LCE definition is likely to be used by regulators to mandate applicability of ISAs or any LCE pronouncements, consideration would need to be given to whether consistent application requires the definition to be more quantitative than qualitative.

If the definition is only guidance, we support the qualitative characteristics suggested by the IAASB to identify an LCE. With regards to b(iii), however, we doubt that the criterion "few lines of and few products within business lines" necessarily defines an LCE given that a large complex business may in fact provide only one dominant product and/or service. Further, we are concerned that the feature "few personnel, many having a wide range of duties" may be inappropriate, given that the ongoing advancement of emerging technologies, such as Artificial Intelligence (AI), Robotic Process Automation (RPA) and Blockchain Technology (BT). may lead to a reduced number of personnel responsible for certain tasks or processes.

CPA Australia emphasises that the range of characteristics may vary in different countries: what may be considered as *less complex* in the United States, may be considered *complex* in Australia. Hence, due to the differences of economic factors among countries, setting quantitative measures at a global scale to determine the complexity of entities might be misleading. We suggest determining quantitative factors taking into consideration economic factors relevant for the specific country context.

Further, CPA Australia believes that the definition of LCE should be sector-neutral and therefore needs to also include the "characteristics" of Not-for-Profit entities (NFPs). Lastly, CPA Australia emphasises that ultimately, what counts is not necessarily the development of a clear-cut definition of the features of LCEs, but the importance of re-emphasis that regardless of the complexity of the entity, the audit needs to provide a consistent level of assurance.

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.**

We agree with the challenges identified in the DP. Overall the sheer length of many of the standards and their verbose style can make it difficult to grasp their practical application.

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

- i. 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.
 - ii. 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.
 - iii. ISA 540, *Auditing Accounting Estimates and Related Disclosures* requires certain audit procedures which are unnecessary for estimates which are not complex.
- 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?**

The challenges identified regarding the overly complex language used in the standards, as well as the level of prescription with which principles are outlined, stem from efforts to be exacting and precise in meaning. The underlying cause of length, complexity and prescription may also be due to attempts to cover all possible situations within the standards. For example, ISA 540 contains requirements not necessarily relevant for LCEs. In contrast, the "building block" approach would provide the core requirements applicable to all circumstances and then allow for scaling up for greater complexity. This approach would not seek to address all circumstances in the core requirements.

The length and number of audit standards, along with their verbose style, makes them laborious to navigate. We suggest that the cause is the failure to embrace more contemporary communication styles and tools. Consequently, we agree that the language and terms used in the standards need to be simplified, the length of the more voluminous standards needs to be reduced, and procedures and guidance need to be set out in plain English. However, as ISAs have been redrafted for broad application, irrespective of the size of the entity, we have not identified any specific amendments to the standards. Nevertheless, we agree that the usability of the Standards need to be improved to make them more scalable for audits of LCEs. More precisely, the detailed composition of the individual standards does not necessarily bear relevance for LCEs and should therefore be brought into simpler form. We suggest that including comprehension aids such as flowcharts and diagrams or even tables, that clearly set

out the requirements and help to visualise the linkages between those requirements, would assist auditors of LCEs. Moreover, the inclusion of hyperlinks that help with navigating within and between standards would assist in the usability of the standards. The underlying cause of these issues is the overall way the standards are presented. In essence, it is a communication issue. This is further elaborated in **Question 4**.

3. With regard to the factors driving challenges that are not within our control, or have been scoped out for 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?

A number of the challenges identified as not being in the IAASB's control, are issues which can be addressed at the national level by government policy-makers, regulators and professional accountancy organisations. However, the IAASB could support these efforts in a number of ways:

1. Legal and other requirements for audit

The IAASB could provide guidance for those setting audit requirements, including government policy-makers, regulators and industry bodies to clarify when an audit is appropriate and how the audit scope might meet different objectives; as well as when other assurance engagements may be more suitable. Australia has a myriad of Commonwealth, state and territory audit requirements, which are, in many cases, inconsistent between the Commonwealth, states and territories and can be inconsistent with the auditing standards.

CPA Australia supports our members in conducting audits for LCEs under these varied requirements by publishing a Small Entities Audit Manual (SEAM) which addresses the key engagements and how to meet those statutory and regulatory requirements and is widely used.

2. Commercial considerations

We acknowledge that the IAASB cannot directly alleviate fee pressure. However, indirectly any actions to support the value of audit beyond perceptions of audit as a mere compliance exercise and how those charged with governance, particularly audit committees, can support audit quality may assist.

3. Technology/Methodology

Technology has the capacity to improve the efficiency and effectiveness of audits. However, the tools and methodologies which are currently available are not adequately accommodated in the standards. This is inhibiting implementation of technology in the audit and restricting innovation, which the IAASB could alleviate by explicitly allowing for these technologies in the standards.

4. Education and People

Often LCEs are audited by practitioners in small firms or sole practitioners, which are not supported by a technical team and have limited time to update themselves on the latest developments in the standards. Consequently, the accessibility and understandability of the standards—i.e., the way they are presented, how clear the key requirements are set out and other tools, such as diagrams and hyperlinks—can have a much more significant impact on audit quality than would be the case in larger firms. Whether the IAASB chooses to develop guidance, revise the ISAs or issue an LCE-specific stand-alone standard, any of these actions should support and enhance the quality of the work conducted by auditors of LCEs.

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 the 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 we 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.

Our views on the possible actions presented in the DP, which we consider would be most effective in supporting LCE audits, are:

A. Revising the ISAs: We recommend that this should be the long-term goal as we believe that revising ISA Standards could bring them into closer alignment with LCE-specific needs. While being our favoured outcome we recognise this is not achievable in the short term. Current ISAs are predominantly focused on audits of large entities, but we recognise that the IAASB should, to a certain extent, shift its focus towards LCEs. To achieve Standards applicable to audits of all entities, we suggest that the IAASB determine which core requirements clearly apply to any entity regardless of size. The requirements can then be scaled up for more complex entities or accounts, which the DP refers to as the “building-block” approach. The IAASB could make the core requirements more concise than the existing ISAs and easier to identify, even if the overall length of the standards was not reduced.

Navigability within and between standards and readability of those standards would need to be addressed in these revisions. As mentioned above, diagrams, flowcharts, tables or other tools to depict the core requirements and their relationship to more detailed requirements for complex circumstances, to relevant application material and to other standards would be important features in revised standards, to enhance their navigability. Plain English and a clear contemporary communication style would also be welcomed. However, as this process would be very involved and time-consuming we suggest this is the long-term goal. Therefore, we support the development of guidance for auditors of LCEs in the short to medium term to meet the immediate need of LCE auditors.

B. Developing a Separate Auditing Standard for Audits of LCEs: Developing a separate standard for LCE audits is not our preferred option as there is the risk of divergence in approach over time as revisions to the ISAs or the LCE standard are made. We are of the view that the audit product needs to be consistent between any sized entity. It is only that the procedures necessary in an LCE audit may be simpler and less extensive due to less complexity, but the audit should still result in sufficient appropriate audit evidence so that the auditor can reach reasonable assurance. For this same reason we do not consider that a new framework be developed for LCE audits. We suggest that this would create

misunderstanding and confusion for users. If a different product is needed for LCEs then it should not be called an audit.

C. Developing Guidance for Auditors of LCEs or Other Related Actions: In the short to medium term, CPA Australia favours the development of guidance for auditors undertaking audits of LCEs. This guidance could be developed more expeditiously to alleviate the current concerns. It could highlight the core requirements relevant to LCE audits and refer the auditor back to the ISAs if matters of increased complexity arose, to allow the auditor to follow the relevant requirements and application material.

Again, we strongly support the inclusion of hyperlinks both within the guidance and to refer to the requirements in the ISAs that auditors must meet when undertaking audits of LCEs, as well as related application material. We also suggest diagrams or flowcharts, that can make relevant requirements more accessible and understandable and the linkages between different standards more comprehensible. While we prioritise the development of guidance for auditors of LCEs, revision of the ISAs can commence in parallel.

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?

We acknowledge that the DP has explicitly limited its discussion to audits, but nevertheless we recommend that the IAASB explores the value of other forms of assurance for LCEs. For example, this could lead to development of more comprehensive standards for the conduct of review engagements, to better articulate the work effort and to explore a clearer expression of conclusion, perhaps in a positive form, which may be better understood by users. Review standards which are clearer about the work effort and outcomes of the engagement may encourage their use more widely by policy makers, in place of audits for LCEs. Alternatively, another kind of assurance service could be developed to better meet the needs of LCEs, including micro entities.