



September 12, 2019

Mr. Willie Botha
Technical Director
International Auditing and Assurance Standards Board
529 Fifth Avenue
New York, NY 10017

Re: Discussion Paper: *Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs*

Dear Mr. Botha:

The American Institute of Certified Public Accountants (AICPA) Auditing Standards Board (ASB) is pleased to respond to the International Auditing and Assurance Standards Board's (IAASB) above referenced discussion paper. The AICPA's Technical Issues Committee (TIC), a committee of CPA practitioners working to represent the views of local CPA firms who typically perform audits of less complex private entities, provided valuable contributions to this letter.

The AICPA is the world's largest member association representing the accounting profession, with more than 657,000 members in 143 countries and a history of serving the public interest since 1887. AICPA members represent many areas of practice, including business and industry, public practice, government, education, and consulting. Among other things, the ASB sets quality control standards (Statements on Quality Control Standards [SQCSs]), auditing standards (Statements on Auditing Standards [SASs]), and attestation standards (Statements on Standards for Attestation Engagements [SSAEs]); for private companies, nonprofit organizations, and federal, state and local governments (nonissuers). A key strategic objective of the ASB is to converge with International Standards on Auditing (ISAs) issued by the IAASB.

We strongly support the IAASB's efforts to address the challenges of applying the ISAs in audits of less complex entities (LCEs) and further considerations related to the overall approach to standard-setting. As a service performed in the public interest, an auditor must, regardless of the standards used or the size or complexity of the entity being audited, continually strive to exercise professional skepticism and apply professional judgment in obtaining sufficient appropriate audit evidence to support the issuance of the auditor's opinion. The audit evidence obtained must provide the auditor with reasonable assurance that the financial statements are not materially misstated. Reasonable assurance is a high, but not absolute, level of assurance.

Over the years, the ISAs and U.S. Auditing Standards have become increasingly complex in order to address user expectations and the changing business models and technology advances impacting financial reporting. We recognize that the increases in the complexity of auditing standards has been a necessary response to the increase in the nature and complexity of transactions included in the financial statements of many audited entities. However, these types of transactions are often less common in LCEs and, therefore, the quality of LCE audits has not been commensurately enhanced by the substantial increase in the complexity of the auditing standards.

We believe that audit requirements and related application guidance can be developed and presented in a way that is less detailed and complex and still provide an auditor with the necessary guidance to perform an effective high-quality audit of an LCE. Our view is that it is less important to agree on a global definition of an LCE, since we think the use of LCE-based standards, once developed, will largely be determined at the local jurisdiction level. Accordingly, the first step in this process should be to identify the requirements necessary for audits of LCEs and those that are more likely not to be relevant in an LCE audit.

We believe the complexity of the standards has been a contributing factor in driving certain auditors to overly focus on compliance with performance, including those that are not relevant to many LCE audits, and documentation requirements that are not enhance to the quality in an audit of an LCE. In fact, it is possible that these circumstances may negatively impact execution of the requirements directly relevant to the audit of an LCE.

In order to determine which areas first need focus and how best to address this issue, the IAASB might consider developing a framework similar to what the Financial Accounting Standards Board (FASB) and its Private Company Decision-Making Framework (PCDMF)¹ has done in the U.S.. That framework aims to set clear expectations and rationale where there could be differences in measurement and disclosure in the financial statements of public and private companies. This is discussed further in our response to question 4.

We also believe a key aspect of developing an alternative, or adjusted, set of standards is to address potential stakeholder perceptions that an audit performed under standards designed for an LCE is of lower quality than an audit of a complex or public interest entity. In the U.S., the Public Company Accounting Oversight Board (PCAOB) and the Securities and Exchange Commission (SEC) set standards for auditors of public companies. The ASB sets auditing standards for auditors of private companies. At the time of the PCAOB's formation, there were a number of stakeholders who believed that a PCAOB audit would be looked at as higher quality than a U.S. generally accepted auditing standards (U.S. GAAS) audit (i.e., an audit conducted under ASB standards)

¹ The full text of the PCDMF can be found here:
https://www.fasb.org/cs/ContentServer?c=Document_C&cid=1176163703583&d=Touch&pagename=FASB%2FDocument_C%2FDocumentPage

and that, eventually, users would want audits of non-issuers performed under PCAOB standards. That concern never materialized and today an audit using U.S. GAAS is viewed as being of the same quality as an audit using PCAOB standards. The changes in the U.S. jurisdiction have demonstrated that whether an auditor uses one set of standards or another isn't really the issue; the issue is whether the (i) the standards set out an appropriate framework, and (ii) the auditor is able to clearly follow the requirements and apply them in a manner that leads to obtaining reasonable assurance.

We recognize that the above recommendations with respect to developing a framework for LCE audits will take time. We also recognize the urgency in addressing the risks to audit quality and efficiency that may be driven by the complexity in recently issued and proposed standards. As such, in the interim, we encourage the IAASB to work with third parties to develop companion guidance (perhaps, similar to audit guides that have been developed in the U.S.) to the current ISAs that would expand upon how the requirements can be applied in an audit of an LCE. We would recommend that any guidance be properly vetted to ensure it still complies with what is intended by the ISAs.

The following provides answers to the specific questions asked in the discussion paper.

Question 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 agree with the notion of using complexity rather than entity size. Additionally, as noted above, while we agree that developing the characteristics of an LCE is an important part in scoping the potential changes or development of audit standards for those entities, an exact global definition is not as critical as first determining what aspects of the standards are more challenging for LCEs to apply. If the term Less Complex Entity is used, it should be consistently used in all ISA standards and guidance.

In addition to the characteristics listed on Page 4 of the discussion paper, possible additional characteristics include:

- Involvement of the owner and/or manager in day to day operations.
- There are a limited number of accounting estimates and they are not complex or highly subjective.

Question 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.***

As previously noted, the overall body of ISAs has grown substantially and some of the more recently adopted and proposed standards are voluminous and complex. Recent attempts to address scalability have been useful, but the effort is still being evaluated. The auditor of an LCE has to read all of the requirements and application paragraphs to determine and document what is not applicable and how to scale the standards based on specific circumstances.

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.

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.

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.

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 that one of the underlying causes over the past several years is the focus on regulatory inspections and the key topics noted in those findings. While efforts to enhance audit quality in those areas is of critical importance to listed entities in particular, developing new standards for audits of all entities based on those findings does create challenges in scalability and relevance.

We note an additional challenge is the effort required to add the documentation as discussed in 2a. Such documentation does not add to the quality of the audit but, rather, just poses onerous requirements on the auditor with little to no value. In fact, the focus on creating documentation that adds little or no value can detract from the audit and reduce quality.

Question 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 perceived value of an audit is an issue with audits of LCEs. Robust standards are written to help ensure quality audits are performed, that apply to all entities, requiring extensive documentation requirements. We suggest that an analysis of the time and effort required to implement the standards be considered when writing new or revised auditing standards.

While the standards refer to scalability, guidance related to scaling the requirements, and more particularly the documentation required when scaling for an LCE, is limited. However, we do caution that scalability guidance, in and of itself, without meaningful revision of the nature and extent of the requirements for certain standards, will not address the complexity issues for LCE audits. Therefore, in an audit of an LCE, there are considerations and documentation that likely do not add quality or value. While fee pressure shouldn't be an overriding concern, the lack of effective scalability complicates this matter, causing a much greater proportionate economic impact on smaller, less complex entities.

In addition, in the U.S., there are third party providers that develop various additional implementation guidance and examples for practitioners. Perhaps the IAASB could work with other international bodies or groups to develop non-authoritative guidance that would assist auditors in understanding how the standards apply to LCEs, focusing on the key areas of the standards that seem to present more issues for LCEs than others.

Question 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?

Each of the three possible actions suggested in the discussion paper could help address the issues, each with its own pros and cons. We believe a combination of two of the three suggested approaches may provide more timely relief to auditors of LCEs, while also providing a long-term solution.

Perhaps the most effective long-term approach would be to first develop a framework for determining when there might be justifiable differences for LCEs versus other entities and apply that framework to all of the existing standards. However, we understand that this approach likely would take years and many deliberations to develop and would involve revisiting all of the standards in their entirety which is likely not a feasible solution for the short term.

The most practical version of this approach would be to identify the two or three sections of the standards that offer the greatest opportunity for meaningful relief and focus on revising just those sections. Then, as other sections of the standards are undergoing revisions in the normal course of time, a review of how those standards measure up to the framework and whether LCEs should be afforded some relief or additional clarifying implementation guidance can be applied at that point.

Developing separate auditing standards for audits of LCEs also could be a viable solution, provided the alternate standards require the auditor to obtain reasonable assurance and the audit is not perceived by users as a ‘lesser audit.’ The advantage to this solution is a very clear, shorter, less complex set of standards. It could result in certain requirements and guidance related to complex risk assessment procedures, auditing estimates, and requirements related to those charged with governance being modified or removed and, therefore, less documentation requirements for items that are not applicable or do not result in a change to the audit approach. However, there is a risk with this approach that it may be perceived as something less than reasonable assurance. An additional concern with this option is that the criteria to determine if the auditor should use the separate standard(s) will be much more challenging to apply. Overall, many auditees could be considered less complex but have one area or transaction that is more complex. For example, one year an LCE goes through a complex derivatives transaction that perhaps causes them to “fall out of” the scope of the LCE standard, while other areas of the operations could be more akin to those of an LCE. The “all or nothing” approach may not afford these entities any relief.

Developing additional guidance for auditors of LCEs based on the existing standards may help the auditor in applying the ISAs to an LCE and may be the most expedient method in addressing the issues. However, there still will be a standard that a reader, or other oversight organization, could interpret as being applicable despite the information in the non-authoritative guidance. In addition, this approach still would have to link back to the existing standards and, therefore, may not result in as much true relief from work efforts as constituents might want. Also, we note that there already exists extensive guidance for auditors of LCEs issued by IFAC and others which apparently has not satisfied stakeholders on how to scale ISA requirements for audits of LCEs.

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.

We believe the results of the possible actions discussed herein, if done properly, will be more effective and cost-efficient audits of LCEs.

Are there any other possible actions that have not been identified that should be considered as we progress our work on audits of LCEs?

At this time, we do not have other actions to propose that would be in addition to those posed in the discussion paper and in this letter. We believe the IAASB outreach including regular interaction with National Standard Setters is important to understand actions being contemplated or adopted in jurisdictions to address the complexity and costs of LCE audits and the AICPA stands ready to assist in these efforts.

Mr. Willie Botha
September 12, 2019

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.

We recommend that the first priority should be developing a framework to guide the adaptation of ISAs for LCEs. For example, in the U.S., the FASB has developed a PCDMF that includes considerations for differences in accounting and financial reporting for private companies versus public business entities. Every time the Private Company Council reviews an issue, this framework is referenced to see if considering differences can be supported by the PCDMF. Perhaps the IAASB could develop a similar decision-making framework for audits of LCEs as a starting point for this project.

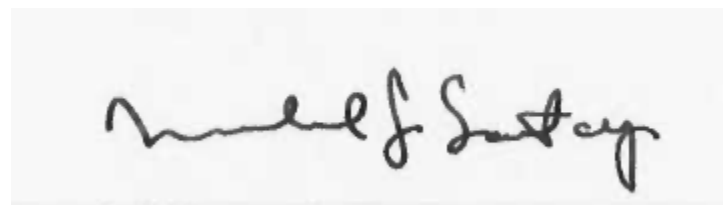
The framework should be specific as to the expected outcome and methods to achieve true scalability. That framework can then be used in the development of new ISAs, guidance material, and revision of existing ISAs in order to achieve consistency, expedite the necessary actions, and assure that the effort to adapt ISAs for LCEs is successful.

Question 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 note that there is a sense of urgency on the part of stakeholders around which this consultation has been published and, therefore, urge a timely response. As stated previously, the AICPA is happy to assist with any outreach our consultation efforts.

Thank you for the opportunity to comment on this discussion paper. If you have any questions regarding the comments in this comment letter, please contact me at Mike.Santay@us.gt.com or Mike Glynn at mike.glynn@aicpa-cima.com.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Michael J. Santay". The signature is written in a cursive, flowing style.

Michael J. Santay, Chair

On Behalf of the Auditing Standards Board