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International Auditing and Assurance Standard Board  
No. 529,  
Fifth Avenue,  
New York  
NY 10017

Dear Prof. Schilder

**Discussion Paper- Audits of Less Complex Entities**

We thank you for the opportunity to provide comments on this Discussion Paper.

We are pleased to submit our Comments on the above Discussion Paper on behalf of the Institute of Chartered Accountants of Sri Lanka.

For your information, Auditing Standards Committee of Sri Lanka has been established under the regulation titled; 'Sri Lanka Accounting and Auditing Standards Act No 15 of 1995' and recommends adoption of Sri Lanka Auditing Standards to the Council of the Institute of Chartered Accountants of Sri Lanka.

If you require further information on the views expressed in this submission, please contact Ms. Madushanika Padukkage, Manager - Technical of CA Sri Lanka or the undersigned.

Yours sincerely,

Suren Rajakarier  
**Chairman – Auditing Standards Committee**

## Question 1

We are looking for views about how LCEs could be described. 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?

“An entity which typically possesses qualitative characteristics such as:

- a. Concentration of ownership and management in a small number of individuals (often a single individual – either a natural person or another enterprise that owns the entity, provided the owner exhibits the relevant qualitative characteristics); and
- b. One or more of the following:
  - i. Straightforward or uncomplicated transactions;
  - ii. Simple record keeping;
  - iii. Few lines of business and few products within business lines;
  - iv. Few internal controls;
  - v. Few levels of management with responsibility for a broad range of controls; or
  - vi. Few personnel, many having a wide range of duties.

### Our Response:

1. We agree with the proposed definition. However, CA Sri Lanka suggests including a list of entities which cannot apply the proposed International Standard on Auditing for Less Complex Entities (“Proposed LCE Standard”).  
Eg: We propose the following entities should be excluded, despite they may fit into the qualitative characteristics of Question 1 b., above.
  - All Listed Entities  
These are entities whose shares, stock or debt are quoted or listed on a recognised stock exchange or are marketed under the regulations of a recognised Stock Exchange or other equivalent body.
  - Any entity defined by regulation or legislation as a Public Interest Entity.
2. It is to be noted that the definition includes wordings such as “few” and “simple”. These words are subjective and do not provide narrative explanations. Therefore, it is advisable to provide global examples for these two words and based on that each country can agree with their own thresholds in this regard.
3. Following factors which also affect the applicability of specific ISA and the extent to which those are applicable for an auditee, could be factored in to the LCE attributes explained in Question 1 b.
  - Accounting framework and mainly the accounting policies adopted/policy choices made by an entity.

E.g. If a company has adopted complex accounting policies such as hedge accounting, fair value measurement of other than level 1 financial instruments including but not limited to biological assets and investment property, auditing of such entities become inadvertently complex. In addition, use of complex estimations in financial reporting by entities also render auditing of such entities complex.

- Extent of use of Information Technology (IT) in business – existence of complex IT systems and/or extensive use of IT in business may require the auditor to adopt IT controls reliance-based audit approach that necessitates use of experts by the auditor. Accordingly, use by the entity of complex IT environments would make auditing of such entities, complex. However, in addressing this qualitative aspect, we need to also keep in mind that in today’s context even the companies that have the most simple business models may use IT resources which are mobile applications based and cloud dependent technologies deploying third party IT services extensively.
- Level of use of service organizations and subcontracting of certain functions – many entities may obtain services of external service providers in order to reduce the operational burden and to overcome initial capital requirements. This is a normal way of doing business by many start-ups and small and medium size entities. As the use of service organizations by entities may impact the audit strategy, appropriate explanation of to what extent the attributes of LCEs to be assessed given such conditions should be further expanded.

## 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:

- 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.

### Response

Current ISA standards have been written in a way presuming that entities have proper controls and strong governance structures. In the case of LCEs, most of them have vulnerable controls and governing structures that are not based on best-practices. Therefore, complying with each aspect of ISA as currently written, is difficult as there is no scalability of ISAs evident clearly for LCEs.

In addition, we believe, current ISAs use the words such as 'professional judgement' and 'judgment' excessively in the explanatory material as well as in the body of the ISAs. The Proposed LCE Standard should include clearly worded guidance on how to apply professional judgement instead of being silent on its application of 'professional judgement' and 'judgment'.

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

Name of the ISA	Comments
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

Name of the ISA	Comments
	<p>proceeds are seen in practice.</p> <p>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.</p>
ISA 230	<p>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.</p>
ISA 240	<p>Providing procedures to ensure the completeness aspect is covered, will be welcome by the auditors of LCE.</p>
ISA 265	<p>Giving an option to communicate the deficiencies in Internal Control to the management is appropriate.</p>
ISA 300	<p>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.</p>
ISA 315	<p>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.</p>
ISA 320	<p>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.</p> <p>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.</p>
ISA 330	<p>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.</p> <p>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.</p>
ISA 402	<p>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.</p>

Name of the ISA	Comments
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.
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 .
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.
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.
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.
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.
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.
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.
ISA 600	LCEs are usually not featured as groups.
ISA 700, ISA 705, ISA 706	We suggest to refer to the illustrative audit reports included in our SLAuS for Non SBEs.

Name of the ISA	Comments
ISA 720	The application of ISA 720 in the case of LCEs.

(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?

### Response

- Legal and Other Requirements for an Audit

In Sri Lanka, all companies must prepare audited financial statements as per the Companies Act. Further, as per the Inland Revenue Act, all the sole proprietors and partnerships have to prepare financial statements for taxation purpose. Therefore, in Sri Lanka there is no specific audit exemption threshold applicable.

Sri Lanka has two auditing standards; Sri Lanka Auditing Standards (SLAuS) and Sri Lanka Auditing Standard for the Audits of Non- Specified Business Enterprises (SLAuS for Non- SBEs). The SLAuS for Non SBEs can be applied for audits of general-purpose financial statements published by small and medium sized entities which do not have public accountability and are Non-Specified Business Entities that follow the cost model for measurement of assets and liabilities.

- Commercial Considerations Relating to an Audit

As auditing standards do not address audit fees, Sri Lanka follow the requirements laid down from Code of Ethics in consideration of the fees. In addition, CA Sri Lanka has issued the “Guidelines on Minimum Recommended Scale of Fees in Audit Services provided by the Practicing Chartered Accountants in Sri Lanka”.

Reference-

[https://www.casrilanka.com/casl/index.php?option=com\\_content&view=article&id=2658&Itemid=516&Itemid=64&lang=en](https://www.casrilanka.com/casl/index.php?option=com_content&view=article&id=2658&Itemid=516&Itemid=64&lang=en)

- Technology/ Methodology

In Sri Lanka, mostly LCE audits are carried out by Small and Medium-sized Practitioners (SMPs). Almost 75% of practitioners in Sri Lanka are sole practitioners. Most SMPs have limited ability to access the technology and methodologies, as they are costly when compared with audit fees.

CA Sri Lanka developed Small- and Medium-Sized Entity Audit Templates (SMET) referring the manual issued by IFAC for SME audits to support SMPs to document audit work that provide a sufficient and appropriate record of the basis for the auditor’s report; and evidence that the audit was planned and performed in accordance with the Sri Lanka Auditing Standards and applicable legal and regulatory requirements. Several case study based training programs have been conducted focusing on the practical application of revised ISAs for SME audits.

In addition, CA Sri Lanka is in the process of developing an automated tool kit for SMP audits. This will help to comply with the regulatory requirements such as mandatory compliance along with relevant accounting and auditing standard frameworks in order to enhance the quality of the audits and the transparency of financial reporting, to gear up the SMPs to the next level of development in order to compete in the market, to ensure better documentation

in order to safeguard practitioners through quality audit and to facilitate training requirements of the staff of firms to attract and retain talented staff.

- Education and People

As mentioned in the discussion paper, qualifications of the auditors are not prescribed in the SLAuSs.

- However, as per the Companies Act No. 7 of 2007 in Sri Lanka, qualifications of auditors are recognized as member of the Institute of Chartered Accountants of Sri Lanka; or is a registered auditor.
- The Inland Revenue Act 24 of 2017 requires that, a person engaged in business or investment activity shall have accounts prepared by an approved accountant and the form by which an approved accountant shall attest to the accuracy and completeness of the accounts prepared shall be prescribed by regulations.

- As per the Act of Incorporation and Regulations of The Institute of Chartered Accountants of Sri Lanka, no person who is a member of the Institute or is a partner of any such firm of accountants shall practice as an Accountant unless he is the holder of a certificate to practice which is for the time being in force. Further, CA Sri Lanka members are expected to cover the requirements of CPD, i.e. a minimum of 20 CPD hours every year and a minimum of 120 CPD hours in every rolling 3- years period of which 60 hours or equivalent learning units should be verifiable.

- Engagements other than Audit

This discussion paper excludes the consideration of engagements that are non-audits. But less complex entities are also required services other than audits such as review, compilation and agreed upon procedures.

- Enhanced Accessibility of the ISAs

NA

- Value of an Audit

Value of the audits for LCEs cannot be disregarded. At the same time a practitioner of audits of LCEs cannot be expected to have the level of proficiency in all relevant standards as the auditor of a large, publicly listed entity. Keeping up with changing requirements and maintaining the required knowledge base can be challenging for a SMP. Whereas Small businesses tend to have particular characteristics that require increased attention, such as, fewer financial controls, more related-party transactions, lower capacity to close the books, and can be subject to some complex taxation requirements.

Therefore, when changes happen, practitioners get confused by different requirements and an apparent difference of rigor, both leading to the same audit comfort. Therefore, the Institute organized several round table discussions to obtain inputs and provide awareness on this standard.

- Public expectation

NA

### **Challenges within the scope of IAASB's work on Audits of LCEs**

- language and basic approach to the standards

- length of the standards
- documentation
- lack of clarity as to what needs to be done or why
- not enough guidance within/ outside of the ISAs
- ISAs noted as particularly problematic expectations

### **How CA Sri Lanka mitigates those challenges?**

Principle based nature and the limited guidance available within ISAs for the application of the requirements to smaller/noncomplex entities are the key limitations. CA Sri Lanka has developed a standard for the audits of Non Specified Business Enterprises. This standard is a 60 page document that has 6 chapters with following simplifications.

- Relies more on Substantive audit procedures
- Simple benchmarks on materiality for the financial statements as a whole
- Less stringent Quality Control requirements and responsibility towards detecting frauds & NOCLAR
- Simplification over the planning sections
- Simplification on the reporting section

SLAuS for Non SBEs can be applied for audits of general-purpose financial statements published by small and medium sized entities that do not have public accountability which are Non-Specified Business Entities that follow the cost model for measurement of assets and liabilities. The financial reporting frameworks that could be applied for the purpose of this Standard are either Sri Lanka Accounting Standard for Small and Medium- Sized Entities (SLFRS for SMEs) or SLFRS for Smaller Entities.

### **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?

#### **Response**

- Purpose of the preparation of financial statements:  
In most less complex entities, financial statements are prepared for tax purposes. However, accounting standards are written keeping in mind primary users such as investors and other creditors. Therefore there is a requirement to re-address the general purpose financial statements of a LCE given the absence of all users other than tax authorities.
- Legal and other requirements for an audit:  
It is advisable to collaborate with regulators to come to a consensus with the definition of LCE, so that regulators' requirements relating to audit and audit documentations can be addressed in the context of an LCE.
- Commercial considerations relating to an audit:  
It is advisable to issue further guidance notes on charging fees for the audit and assurance services by the practicing accountants.



#### 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?

#### Response

Challenge to be addressed	Way forward Action- Revising the ISAs	Way forward Action- Developing a Separate Auditing Standard for Audits of LCEs	Way forward Action- Developing Guidance for Auditors of LCEs or Other Related Actions
Clarity of the principles have diminished with the language becoming more complex and therefore more difficult to comprehend.	Greater focus on more clearly setting out what the auditor needs to do (i.e., focusing on the way the requirements have been articulated using clear and understandable language) with appropriate application material to support such requirements effectively and efficiently.	This can be addressed as the new standard can be written in simple language.	This can be addressed as the guideline can be written in simple language.
The detailed requirements entailed in the process may result in moving away from principle-based requirements.	Adopting an approach of revising the standards by setting out the basic requirements for all audits and then expanding as needed in order to address more complex circumstances.	Retaining principle-based requirements appropriate for audits of LCEs that allow the auditor to use their professional judgment to focus on the objectives to be achieved by the auditor developed based on the existing ISAs where relevant for LCEs.	The guideline can be developed by addressing the principle based requirements.
Direct the auditors towards more of a 'compliance with the standards' approach rather than an approach that encourages the use of professional judgment in determining the	Not addressed	Retaining principle-based requirements appropriate for audits of LCEs that allow the auditor to use their professional judgment in focusing on the achievement of the objectives developed based on the existing	Cannot be addressed as the guideline might become a checklist.

Challenge to be addressed	Way forward Action- Revising the ISAs	Way forward Action- Developing a Separate Auditing Standard for Audits of LCEs	Way forward Action- Developing Guidance for Auditors of LCEs or Other Related Actions
most appropriate audit procedures for the specific circumstances.		ISAs where relevant for LCEs.	
Difficult to navigate as they break the continuous audit process into discrete elements, and have been written in a linear way, but the audit process is iterative in nature.	Not addressed	Mirroring the risk-based approach of the ISAs but be presented in a way that follows the work flow of an audit.	Cannot be addressed
ISAs are voluminous, which can make them difficult to read and determine what needs to be done, and which has the potential to discourage some auditors from reading all the relevant and necessary material.	Adopting an approach of revising the standards by setting out the basic requirements that are common for all audits, then expanding as needed to address more complex circumstances.	More appropriately focused on being outcomes-based in the circumstances of LCEs and refraining from including specific procedures and processes.	Guidance also can be a voluminous as per the Guide has already been developed by IFAC (the Guide to Using ISAs in Audits of SMEs).
Significant materials are added through recent revision processes of the core ISAs, in particular, to add application material as the ISAs become more complex;	Better signposting within the application material about how to apply the requirements that are relevant to audits of LCEs. This could be done, for example, by enhancing the considerations specific to audits of LCEs (previously included in the standards as considerations specific to smaller entities) in a separate section within each ISA.	As the standard would be based on the ISAs, it may not require to have a complete set of specific application material and supporting guidance.	Not applicable
Unnecessary procedures are being performed because when an	Greater focus on more clearly setting out what the auditor needs to do (i.e., focusing on the way the requirements have	Standalone standard encompasses all the relevant requirement for an audit of an LCE.	Can be addressed by encompassing all the required audit procedures that is to be performed.

<b>Challenge to be addressed</b>	<b>Way forward Action- Revising the ISAs</b>	<b>Way forward Action- Developing a Separate Auditing Standard for Audits of LCEs</b>	<b>Way forward Action- Developing Guidance for Auditors of LCEs or Other Related Actions</b>
auditor is faced with a specific set of circumstances, the standards are not clear about the nature and extent of the work required.	been articulated using clearer and understandable language), with appropriate application material to support applying the requirements effectively and efficiently.		
Paragraphs detailing considerations specific to smaller entities, where they are presented within the ISAs, which are not helpful in all cases to understand scalability and proportionality of the requirements.	Considering how the application material could feature more scalability and proportionality considerations, e.g., providing examples of both simple and complex circumstances in order to contrast the differences.	Not applicable	Not applicable
There is insufficient supporting material to aid the effective application of the ISAs.	Better signposting within the application material about how to apply the requirements that are relevant to audits of LCEs. This could be done, for example, by enhancing the considerations specific to audits of LCEs (previously included in the standards as considerations specific to smaller entities) in a separate section within each ISA.	Not applicable	Not applicable

- 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.

#### **Response**

<b>Implication</b>	<b>Why significant</b>
Revising the ISAs	This might lead to the redrafting of all the ISAs, and there will be a tendency to become complex. Languages written will not satisfy requirement of SMPs.
	This will be a time consuming task.

Implication	Why significant
	It will create instability in the ISAs which will keep on changing.
	If additional material is developed, there is a risk that standard becomes very long and complex which hinders its usefulness for practitioners.
Developing a Separate Auditing Standard for Audits of LCEs	Practitioners have become confused by different requirements and an apparent difference of rigor, both leading to the same audit comfort. Though it has identified the scope of application, it may be challenging to differentiate when such a standalone standard can be applied and when the application of the full ISA is necessary.
	A set of standards that contains fewer requirements may be more challenging for audit regulators to enforce. Regulators would need to be involved in discussing possible solutions.
	Awareness for all stakeholders.
Developing Guidance for Auditors of LCEs or Other Related Actions	Guidance can be lengthy as ISAs.
	This will be a time consuming task.
	Since it will not be mandatory, the practitioners might not use it for their routine audits.

(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?

**Response**

It is important to develop training tools such as case studies to help practitioners gain a thorough understanding of the Proposed LCE Standard.

(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.

**Response**

Priority should be given to the second possible action of developing a separate Auditing Standard for Audits of LCEs.

As this possible action is covered, most of the challenges could be overcome with regard to the LCE audits and that will have limited implications. (refer 4 (a)(i) and 4 (a)(ii)).

**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?

**Response**

No.