

12 September 2019

Mr. Tom Seidenstein  
International Auditing and Assurance Standards Board  
International Federation of Accountants  
529 Fifth Avenue, 6th Floor  
New York, NY 10017

Dear Tom Seidenstein

Deloitte Touche Tohmatsu Limited (DTTL) is pleased to have the opportunity to provide comments on the Discussion Paper, *Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs* issued by the International Auditing and Assurance Standards Board (IAASB) in April 2019.

### **Overall comments**

DTTL supports the IAASB's continued work and actions towards finding solutions that will help those performing audits of Less Complex Entities (LCEs). The demand for attention in this area continues to grow and DTTL believes that global action is required to ensure alignment across countries and audit firms. DTTL refers to Appendix I for detailed comments on each of the IAASB questions set out in the discussion paper.

DTTL has the following key observations and concerns pertaining to the following:

### **Preferred way forward**

DTTL recommends that the IAASB develops Guidance and Examples<sup>1</sup> to help clarify how to apply the ISAs on audits of LCEs and, as noted in Question 4 in Appendix I, at the same time begins the work of revising the ISAs to make them more scalable for audits of LCEs. The IAASB should prioritize this work by addressing the most problematic ISAs first, as discussed in Question 2 in Appendix I.

### ***Definition of an audit of an LCE***

DTTL does not agree with using the current definition of a smaller entity as the definition of an LCE. DTTL believes that in order to drive the necessary change in perception from focus on size to focus on complexity, a significant change in the definition is required. Secondly, DTTL does not agree with concentration of ownership being such a prominent factor when assessing an entity's complexity. Refer to Appendix II with suggestions on defining an audit of an LCE and to Question 1 in Appendix I for further commentary. It is imperative that the definition of an audit of an LCE includes sufficient and transparent Guidance and Examples.

### ***Urgent action***

The need for action is now, and depending on the option(s) selected, a solution could be several years in the future. DTTL encourages the IAASB to not only consider a long-term solution, but also

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<sup>1</sup> 'Guidance and Examples' is used as a generic term for describing both guidance and examples in relation to a) the definition on an audit of an LCE and b) any aspects of the requirements within the ISAs. Guidance and examples could be contained within the ISAs themselves or in other publications issued by the IAASB.

to consider a short-term solution to meet the current demands. For example, Guidance and Examples can be issued in the short-term on how to apply the ISAs on audits of LCEs, while simultaneously working on revising the ISAs as further commented in Question 4 in Appendix I.

DTTL further believes that swift action on a short-term solution is important to accommodate stakeholders' ask for results and to avert local standard setters from further developing and deploying local materials that will likely impact a continued divergence across regions and countries. DTTL believes that a global set of standards is an imperative and if the issue is not addressed adequately, both in the short- and long-term, that there will continue to be divergence in this area.

The IAASB can deliver a clear and strong message that action is being taken by issuing Guidance and Examples as the first short-term activity. However, DTTL also emphasizes that Guidance and Examples does not completely address the call to action. The long-term vision must include a more fundamental change, making the ISAs scalable by drafting them with a 'building block approach' in mind, starting with the requirements for audits of LCEs, and adding incremental requirements for more complex entities.

### **Technology**

As further commented in Question 3 in Appendix I, technology plays a crucial role in the way forward, in particular on the topic of analytics. Although this does not only apply to audits of LCEs, it is especially interesting in audits of LCEs, as the data available is inherently less complex and therefore simpler analytics may be adequate and possible to perform using less complex and more accessible tools. It is the opinion of DTTL that an increased focus on the use of technology by practitioners performing audits of LCEs is an imperative and DTTL does not agree with the IAASB that technology in the space for audits of LCEs is limited.

DTTL expects that technology will play a significant role in audits going forward, and in particular in audits of LCEs, and DTTL believes that it is an imperative that the IAASB recognizes and responds to this development. By staying abreast of technology developments, the IAASB can ensure that the standards remain relevant to auditors performing audits using these new technologies.

### **Conclusion**

DTTL is very supportive of the work the IAASB has undertaken and believes that the definition of an audit of an LCE should be revisited and focused more on complexity, rather than size. This definition needs to be supported with specific Guidance and Examples to provide greater global consistency in defining an audit of an LCE. As the preferred way forward addressing the challenges related to audits of LCEs, DTTL recommends that the IAASB work towards revising the ISAs supported, in the short-term, by additional Guidance and Examples. The recommendations articulated in this letter are provided to assist the IAASB as it continues its work related to audits of LCEs.

DTTL appreciates the opportunity to provide perspectives on the LCE discussion paper and would be pleased to discuss this letter with you or your staff at your convenience. If you have any questions, please contact me via email (<mailto:cbuss@deloitte.ca>) or at +1 604 640 3313.

Very truly yours,



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## **Appendix I – specific 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?**

DTTL does not agree with applying the current definition used for smaller entities to define an audit of an LCE. Based on the following aspects, DTTL is in favor of a revised definition.

- i) It is DTTL's view that in order to drive the desired change in focus from size to complexity, a change in the definition is required. Keeping the current definition may result in stakeholders not sufficiently understanding that the focus has changed.
- ii) When assessing the relevant criteria defining an audit of a less complex entity, the definition should not give too much prominence to one single factor, as one factor on its own should not preclude an entity from being viewed as less complex.
- iii) Any criteria defining an audit of a less complex entity should come with supporting Guidance and Examples to drive global alignment and consistency and dissuade local standard setters from issuing local guidance on how to interpret the criteria.

DTTL believes that there are factors related to both the entity and the audit and that these should be collectively considered in defining an "Audit of a less complex entity." It is furthermore DTTL's opinion that the current definition is not appropriately focused on complexity and has a too prominent focus on factors that are indicative of size, rather than complexity. DTTL therefore suggests a revised definition as set out in Appendix II, which is more appropriate and provides a higher degree of focus on factors related to complexity of an audit of an LCE rather than size.

However, DTTL also believes it is important to consider that, even though focus should be on characteristics related to complexity and not size, it should also be noted that size itself can contribute to increased complexity, and that an increase in size, at some point inevitably will result in an entity being inherently more complex.

### **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.**

DTTL agrees with the IAASB on noting ISA 240, 315, and 540 as particular problematic when auditing LCEs and agrees with the specific observations as well, with the following additions and considerations:

#### ***ISA 240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements***

DTTL agrees with the comments from the IAASB that the requirements of ISA 240, in some circumstances, are more onerous than what would be appropriate when auditing LCEs.

However, as fraud is a topic of special considerations and already is a matter of wide misunderstanding between the auditor's role and the public's expectations, DTTL is hesitant to recommend removing or 'relaxing' requirements for LCEs in this area.

DTTL also notices that, even though substantive procedures in the very small entities and less complex audits may cover all, or almost all, journal entries, testing them with focus on the ISA 240 objectives and requirements may result in a different outcome and as such is equally relevant for audits of LCEs.

It is DTTL's view that practical Guidance and Examples to illustrate the required level of documentation in regard to the work performed on ISA 240 on audits of LCEs, would be beneficial for practitioners. For example, some of the required communications for those charged with governance (often the owner) occur verbally, as opposed to being a formal written communication.

DTTL suggests that practical Guidance and Examples in regard to illustrating the required level of documentation on audits of LCEs to demonstrate how it may be simpler and less extensive, are accomplished by comparing examples of documentation under various scenarios of two audits, one of an LCE and one of a more complex entity.

*ISA 315, Identifying and assessing the risks of material misstatement through understanding the entity and its environment*

DTTL agrees with the comments from the IAASB that the proposals in the ISA 315 exposure draft may lead to an over-engineered risk assessment for entities in a less complex environment.

It is DTTL's view that identifying and assessing the risks of material misstatement through obtaining an understanding of an LCE ought to be a relatively simple and straightforward process when compared to a more complex entity. Primarily this is because the amount of data and information is inherently less and the auditor should therefore, in most cases, be able to obtain the necessary understanding and perform a sufficient risk assessment of an LCE through performing fewer and simpler procedures. However, due to the current and proposed requirements set out in ISA 315, the process is (or is interpreted as being) inherently complex, even for an audit of an LCE.

In regard to the ongoing project related to revising ISA 315, DTTL encourages the IAASB to consider the needs for LCEs now to avoid duplication of effort in the future, by having to reopen ISA 315 to address the audits of LCEs.

*ISA 540, Auditing accounting estimates, including fair value accounting estimates, and related disclosures*

DTTL agrees that some of the audit procedures that are required under ISA 540 (Revised) in most circumstances are unnecessary due to the simple nature of audits of LCEs and the majority of estimates herein.

However, DTTL also believes that audits of LCEs, in some circumstances, can have complex and significant estimates, and still be defined as an audit of an LCE. The building block approach would allow the auditor to scale up their response for the more complex area only, without having to determine the entire entity as being more complex.

**Other primary problematic ISAs**

In addition to the ISAs already identified as problematic by the IAASB, DTTL believes that the following ISAs should also be considered when assessing the primary problematic ISAs related to audits of LCEs:

ISA 230, Audit documentation and ISA 500, Audit evidence

DTTL feels that one of the biggest 'pain points' for auditors is identifying the required level of documentation on audits of LCEs, especially for auditors also working on audits of more-complex entities, given the tendency to default to include the same level of documentation on their audits of LCEs as they do on their audits of more-complex entities.

DTTL therefore believes that there is a need for more clarity on what is required to be documented and how the level of documentation varies with level of complexity. This could be achieved by the IAASB providing auditors with illustrative examples showing the variability in levels of documentation based on the level of complexity within the entity.

It is DTTL's opinion that such practical examples will go a long way in helping auditors apply the ISAs in a scalable and consistent matter.

As commented in regard to ISA 240, DTTL believes that practical Guidance and Examples in regard to illustrating the required level of documentation on audits of LCEs should illustrate how the robustness of documentation may be simpler and less extensive and that this can be accomplished by comparing, under various scenarios, examples of documentation of two audits, one of an LCE and one of a more complex entity.

ISA 600, Special considerations - Audits of group financial statements (including the work of component auditors)

It is DTTL's view that there are requirements within the current standard for group audits that are not necessary for less complex groups.

Many small and simple groups are only established as a group for tax or other non-business-related reasons (e.g., estate planning). These groups may, by all accounts, be just as simple as any standalone LCE. It is therefore DTTL's view that understanding the group and its components should be as simple a process as for less complex groups as the process of understanding a standalone LCE.

In DTTL's view, the current ISA 600 includes requirements related to the communication, monitoring, and supervision of component auditors that goes beyond what is necessary for a less complex group, as the inherent simple nature of components of a less complex group should mean that the required monitoring and supervision of the component auditor can be less frequent and extensive.

The current requirements result in long and complex instructions needed for even the simplest of entities, which may not be appropriate.

DTTL acknowledges the fact that a project on ISA 600 is ongoing and encourages the IAASB to consider the needs for the auditors of LCEs in regard to ISA 600 for the ongoing project, to avoid duplication of effort in the future, by having to reopen ISA 600 to address the audits 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?**

It is DTTL's view that the underlying causes of the identified challenges are pervasive across the problematic ISAs, although for certain ISAs, some causes are more prominent than others.

DTTL believes that the main underlying causes of the challenges are related to 'Documentation,' 'Lack of Clarity as to What Needs to be Done and Why,' and 'Not Enough Guidance Within/Outside of the ISAs.'

It is DTTL's view that the challenge related to Documentation, and the challenge on Lack of Clarity as to What Needs to be Done and Why are closely related, and that both challenges may be addressed through an adequate response to the last challenge, related to Not Enough Guidance Within/Outside of the ISAs. However, DTTL also believes that Guidance and Examples are not sufficient in the long-term as the only responses to these challenges. As stated in Question 4, DTTL believes that the long-term solution should include revising the ISAs.

#### Documentation

DTTL agrees with the IAASB that the documentation requirements are becoming more onerous and in some circumstances are more than what would be appropriate for auditing LCEs. DTTL believes there is potential for improvement, especially with regard to the point of overdocumentation and documenting what has not been performed.

#### Lack of Clarity as to What Needs to be Done and Why

This is not a challenge isolated to audits of LCEs, however, the challenge when performing audits of LCEs tends to relate to unnecessary procedures being performed for less-riskier areas, potentially resulting in the riskier areas not receiving proportionately more focus.

#### Not Enough Guidance Within/Outside of the ISAs

DTTL agrees with the IAASB that currently there is not enough Guidance and Examples to support auditors performing audits of LCEs and for the Guidance and Examples that do exist, they are not always sufficient in demonstrating the scalability of the practical application of the ISA requirement(s) and the resultant levels of documentation.

This results in various interpretations and guidance being issued by stakeholders such as large firms and regulatory bodies, potentially leading to inconsistencies and misapplication of some standards.

### **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?**

DTTL agrees with the IAASB on the identified challenges and believes that the primary focus from the IAASB should be focused on the following challenges:

#### Technology/Methodology

DTTL acknowledges and agrees that developing or promoting technology tools is not part of the remit of the IAASB as standard-setters. However, DTTL does not agree with the IAASB's view that access to technology to support audit firms performing audits of LCEs is limited, as many "off-the-shelf" products already exist in the current market, and the trend is pointing in the direction of even more products in this space going forward. DTTL further believes that analytics, in some circumstances, may be easier to apply, as simpler tools may be adequate for audits of LCEs than for audits of other more complex entities.

In regard to use of analytics in the audit, DTTL encourages the IAASB to provide more clarity on the level of understanding (and where appropriate testing is required) of GITCs that is necessary when

using simple analytics based on non-complex data in the audit of an LCE and to provide Guidance and Examples on this.

Related to the length/volume and the basic approach of the standards, it is DTTL's recommendation that the IAASB explore leveraging some of the currently available 'document management' technologies when publishing the ISAs so that practitioners can utilize these technologies and are able to focus on those aspects of the standards that are applicable to their engagements. Using existing technologies available, the IAASB could, for example, author the ISAs in a way where an auditor could answer a set of upfront 'tailoring/profiling' questions related to the entity and the audit to be performed, and thereby only be presented with the ISAs and/or sections/paragraphs within the ISAs that are relevant to those circumstances.

### Education and People

DTTL believes that Education and People is a key aspect to consider. If action is taken towards creating a new and separate auditing standard for audits of LCEs it will be especially important for the IAASB to consider the following questions:

- What is the impact of two different sets of standards?
- How can we educate people to audit both less complex, and more complex, entities in an efficient and effective way?
- How can we mitigate the risk that those who audit under both sets of standards simply default to auditing to the requirements of one set of standards on all audits – potentially doing either too much work for LCEs or not enough work for more complex entities?

As per our response in question 4, DTTL does not believe that working towards a separate auditing standard for audits of LCEs is the right approach, mainly due to the implications and consequences on the subject of Education and People and the practical challenges for those practicing in both spaces. In DTTL's view, there are a number of risks and issues:

- i) What constitutes an LCE will always be subject to some professional judgment, and if there is an entirely separate set of standards, it may create challenges if practitioners apply the wrong set of standards.
- ii) Learning time required to equip practitioners may be significantly increased where individual practitioners need to learn multiple sets of standards.
- iii) Practical approaches to learning may result in practitioners learning one set of standards and then building their knowledge by focusing on the areas of difference in the second set. This creates the risk that practitioners may not robustly or fully learn the requirements of the second set of standards. This challenge already exists for those working on both ISA and PCAOB audits.
- iv) There is a risk that over time the quality of work performed on LCEs will decline as the talent pool serving those engagements become increasingly disconnected from more challenging and developmental audit work required to deliver the audits of more complex entities.

One of the objectives of the IAASB is to strengthen public confidence in the profession and developing separate standards for LCE may hinder this objective as it may create a perception of a lesser quality audit. If audits of LCEs are regarded as a lesser quality product, and the ability of auditors to 'scale up' to audits of more complex entities is inhibited through establishment of separate standards this may in turn also create issues recruiting and retaining the right quality of talent to serve audits in the LCE space.

It is therefore also important to address the expectation gap between auditors and stakeholders, including standard setters. Education will in DTTL's view be a crucial aspect on this, especially if in the future there will be a difference in the audit of LCEs when compared to more-complex entities.

#### Other challenges, for secondary assessment

Secondarily, DTTL would also recommend the IAASB to revisit their influence on the challenges related to legal and other requirements for an audit.

In that regard, DTTL would like to encourage the IAASB to continue to engage with 'local' standard setters, regarding the ongoing process and the need for addressing the issues related to audits of LCEs, in order to mitigate the risk of those standard setters adding requirements "back in" through supplementation, because of specific local issues.

#### **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.**

With the following considerations in mind, it is DTTL's view that the ideal solution is working towards revising the ISAs in combination with developing Guidance and Examples in the short-term. DTTL also notes that this is not "the easy" solution, as it requires a significant change to the ISAs rewriting many of the ISAs from the bottom up and starting with requirements for LCEs and thereafter adding requirements for more complex entities.

#### Revising the ISAs

DTTL is in favor of working on a solution of revising the current ISAs, mainly focused on the ones identified in Question 2a. DTTL suggests working towards a building block approach of starting out with requirements for audits of LCEs with additional and incremental requirements as complexity increases. This results in auditors' ability to follow a common set of standard and to identify the incremental requirements applicable as complexity increases.

A building block approach would also allow audits of entities that are considered less complex, but with one or two complex aspects, to still be defined as an LCE. For that one or two more complex areas, auditors can add in the "next step(s)" in the ISAs to cover the complex aspect(s) and not have to then 'move' to an entirely different set of standards.

For example, an audit of an entity that owns one property, with one (or few) tenants, would probably by all accounts be considered as an audit of an LCE, except for the fact that the entity may account for the property at fair value. If there were a separate set of ISAs for audits of LCEs, which does not deal with complex accounting estimates, this entity would have to apply the ISAs for more complex entities. Whereas by introducing a building block approach, this one isolated complex aspect of an otherwise less complex entity could be dealt with by the auditor through "stepping up" in the building blocks of ISA 540 in this specific example.

Furthermore, in the above example, by continuously operating with only one set of ISAs, it limits the risks of auditors not being fully aware of the other set of standards, and therefore not knowing exactly when to apply one set of standards over the other.



### Developing a Separate Auditing Standard for Auditors of LCEs

Developing a separate auditing standard for auditors of LCEs could theoretically be an appropriate response to the identified challenges. However, it is DTTL's view that the potential consequences of introducing a separate auditing standard for auditors of LCE outweighs the potential benefits. It may actually result in a reduction in audit quality, if misapplied, and as such DTTL does not view this solution as ideal.

It is DTTL's view that this solution may lead to the following implications and consequences:

- i) How would LCE auditors know when an entity becomes more complex and they should switch standards, and would they then have the necessary expertise to audit the more complex entity?
- ii) There is a risk of effectively creating two classes of auditors, one that audits LCEs and one that audits more-complex entities, which may also result in reduced public confidence in the profession.
- iii) Having two sets of standards will require dual maintenance and increased costs of keeping up-to-date for both the IAASB and for the audit firms

### Developing Guidance for Auditors of LCEs or Other Related Actions

In DTTL's opinion, guidance is a critical part of the solution, but not sufficient on its own. Guidance should also include illustrative examples on what is sufficient and provide specific and adequate examples of documentation on the particular ISAs that are causing challenges.

#### **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?**

In assessing possible actions, DTTL did not identify any other potential actions to bring to your attention for consideration.

#### **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.**

It is DTTL's view that the IAASB should pursue the action of Revising the ISAs with the supporting action of Developing Guidance for Auditors performing audits of LCEs.

DTTL recommends that the work related to Developing Guidance is supplemented with examples of documentation (for example, by issuing Practice Notes or something similar). It is important that the IAASB clearly sets the level of authority of any Guidance and Examples provided. Guidance and Examples may also be an appropriate way of delivering an intermediate solution to meet the demand from auditors performing audits of LCEs. Revising the ISAs may be a long-term vision and will require more work to fully assess the problematic areas and underlying causes before beginning the work of revising them. Thus, the timeline for revising the ISAs could potentially be many years. It may be easier to develop and deliver useful Guidance and Examples in the short-term, and could be considered as a first step in the right direction by stakeholders, also keeping local standard setters from continuing working on developing local responses.

#### **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?**

DTTL did not identify any other matters.

## **Appendix II – DTTL’s suggestion for a definition of an audit of a less complex entity**

DTTL suggest the following definition of an audit of a less complex entity:

### **Audit of a Less Complex Entity**

An audit of an entity that is less complex in nature, which exhibits some or all of the following characteristics related to the entity and to the audit.

### **Less complex characteristics related to the entity**

An entity is typically less complex in nature when possessing some or all of the following qualitative characteristics:

- Typically private\*
- Does not operate in a complex or highly regulated industry
- Simple business (e.g., few lines of business, no complex derivatives, structuring arrangements and with a limited number of transactions with group entities)
- Has a simple IT environment
- Limited number of locations

### **Less complex characteristics related to the audit**

An audit is typically less complex in nature when possessing some or all of the following qualitative characteristics:

- Engagement likely to be exempt from the firms EQCR requirements
- Little or no involvement of specialists on the audit
- Limited number of significant risks are expected to be identified
- Typically, a limited control-reliance (i.e., limited to certain select areas / accounts) or a non-control reliance approach is adopted
- No intended reliance on the work of the internal audit function, if an internal audit function exists
- Typically a limited number of engagement team members
- The mix of the engagement team members is typically such that there is a higher proportion of less experienced/less-senior members on the engagement

The less complex characteristics are not exhaustive, they are not exclusive to less complex entities, and less complex entities do not necessarily need to display all characteristics.

\* The presumption is that any non-private entities are more complex in nature, however there are limited circumstances where a non-private entity can be less complex, for example listed debt entities, simple non-for-profit organizations, and other simple government and public sector entities, that otherwise meets the criteria’s of being less complex.

## **Guidance**

The suggested definition is illustrative and DTTL believes that in order to enable auditors to appropriately apply, the definition should be supported by illustrative Guidance and Examples to reinforce the characteristics.

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