

12 September 2019

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

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

Dear Mr. Botha

General Comments:

In general we support the IAASB's efforts to reduce the complexity of audits of less complex entities (LCEs) while maintaining the effectiveness and high regard of an audit. We are happy and appreciative of the IAASB's outreach. Overall, we believe that exercising professional skepticism regardless of the standards used or the size of the entity is fundamental to the audit profession and public interest. By using professional skepticism, audit evidence obtained must provide the auditor with reasonable assurance, which is a high, but not absolute, level of assurance.

Therefore, we believe the primary focus should be issuing standards with less complex requirements, that are shorter in length, to enable the LCE auditor to obtain reasonable assurance. Or more clearly stated, we believe that the ability of an LCE auditor to obtain reasonable assurance would be enhanced by less complex, easier to understand auditing standards that allow professional judgement in applying the requirements.

We believe the ultimate goal and results should be developing ***what*** audit procedures should be required in an LCE audit to obtain reasonable assurance. Should this result in new ISAs, a separate auditing standard for LCEs, or a practice guide, is the question. We will provide some commentary on each. Above all, the goal is to develop the requirements and then eventually the procedures.

Because the standards are so complex, in many cases they are perceived to be counter intuitive to what may be necessary to perform an audit of a less complex entity. This complexity has driven auditors to focus too much on compliance with the standards and documentation requirements rather than focusing on the audit risks and the corresponding audit areas that truly warrant attention.

Although, building a set of standards from the ground up would be a good approach to reduce complexity allowing auditors of LCEs to focus on the real risks of material misstatement in the financial statements of these entities, we understand that this will take time. Considering the technological revolution and fast changing pace of the world we live in, this could also result in eventually having outdated standards.

The starting point, perhaps should be to change the way IAASB use language in the ISAs on a prospective basis, at the same time, selecting current ISAs that are primary (e.g. risk assessment, audit documentation), and either writing new standards for LCEs related to these or drafting practical guidance to be used by the LCE auditor. We will comment on our preferred method below.

The following provides answers to the specific questions asked in the ITC.

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?

For LCE's the ITC refers to "qualitative characteristics," however then uses the term "few" business lines, internal controls, layers of management and personnel. Few indicates a "quantitative measurement" as opposed to a qualitative measurement. We suggest using terms like "simple," "uncomplicated," "basic," to describe business lines, internal controls, layers of management and personnel, for example.

It will be important for IAASB to distinguish factors which make the **entity** more complex versus the audit more complex. For example, a past history of fraud or problems with the audit, a history of controversial or difficult issues arising (including conflicts between various levels of management), questions over management's competence, or the involvement of unsympathetic or critical external stakeholders can make the audit of a less complex entity more complex. A reference in the new standards, might preclude application to a particularly complex **audit**.

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.***

The application of ISA 315, and in particular ED ISA 315, is problematic to audits of LCE's due to the length and its difficulty to read. For example, smaller entities may find that certain types of control activities are not necessary because of 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. When internal controls do not have an impact on the risk of material misstatement because they are not being tested for operating effectiveness, we believe the effort to document design and implementation might not add value or quality to an audit. When applying ISA 540, many audit procedures are unnecessary where estimates do not have the complexity of fair value assessments or forward-looking information

For many LCEs, the only items carried at fair value on the balance sheet might be investments held by a third party, whereby those fair values can easily be confirmed at the balance sheet date. In addition, other estimates including valuation allowances, fixed asset impairments, or allowance for doubtful accounts are fairly straight forward and can be backed by historical data and supporting documentation. However, this standard is written to also apply to extremely complex transactions including financial instruments, hedging transactions, and stock compensation, to name just a few. For the very reason that are considered an LCE, many do not have these complex estimates and, therefore, a lot of the information in this standard would not apply.

- a. 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?***

As noted earlier, a common characteristic of an LCE is a system of internal control that is informal with limited documentation and the most important control is the control environment created by the involvement and oversight of the owner/manager. The ISAs as currently drafted do not start from this point.

We comment later on the cumbersome language used in the ISAs, which makes them difficult to absorb and understand even for technical specialists, and also note some structural issues where a standard doesn't clearly separate requirements relating to more complex issues from those relevant to all audits.

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?

First, we suggest a cost benefit analysis be performed for new, or revised, auditing standards. Consideration of this impact may assist in producing robust standards that are not outweighed by the costs to implement the audit standard. 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.

Other Areas of Focus:

1. Articulating and demonstrating the value of audit for LCEs, particularly those undertaking a voluntary audit. This is a public interest issue and an issue IAASB needs to consider in terms of its own long term strategic planning. The market is becoming increasingly cynical about the value of audit overall.
2. Promoting the scalability and use of technology in the audit of LCEs, in terms of both audit quality and audit value.
3. Encouraging jurisdictions to review and monitor audit exemption thresholds and criteria, as well as considering alternative forms of assurance and related services.

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?***
 - 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.

We believe a combination of approaches may provide more timely relief to auditors of LCEs, while also providing a long-term solution. While our preferred approach would be to revisit the ISAs building from a “ground-up” approach whereby the requirements for LCEs are a starting point as addressed earlier in this letter, we understand that this approach would likely take years and many deliberations to develop.

Developing a separate auditing standard for audits of LCEs would be a good solution, as long as the resulting auditor’s report provides the same level of assurance as any other audit report. The standards could be written in a very clear, shorter, less complex manner and easy for auditors of LCEs to follow. Focusing on improving complex risk assessment procedures and auditing estimates would be helpful.

There is also a belief among others that the profession is already divided, that many of the issues noted above are not new, that the SMP sector is healthy, that the introduction of the IFRS for SMEs did not result in these barriers appearing (also feared at the time), and that the obvious solution to increasing levels of over-engineering in standards, despite the reservations noted above, is a separate standard or standards for LCE audits.

While we believe that a new set of standards should be closely tied to the ISAs, it is critical that the approach to the standard is based on principles, and starts with what is required, rather than going through each of the existing standards to consider what can be removed. This circles back to our overall comment: We believe a focus should be made on what procedures ***should be*** required in an LCE audit to obtain reasonable assurance.

Other issues include the need for guidelines on the avoidance of duplication and overlap with other standards more generally during the drafting process, and the need for the systematic involvement of skilled translators, also during the drafting process, and not, as at present, on an ad hoc basis when individual IAASB members raise a particular translation issue.

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?

Performing outreach to the users of LCE financial statements might help guide the path forward to ensure that, no matter which path is taken, users do not feel that what they are getting is something less than the typical audit of which they have become accustomed.

On the other hand, we do not believe the IAASB should ignore possible market demands on what the users of LCE financial statements might desire in the future. Considering the enormous difference between a limited assurance engagement and an audit, this might bring to light a focus on limited assurance engagements, largely based on analytical procedures, and a number of additional, sometimes codified, agreed-upon procedures or limited assurance activities in areas such as receivables and inventory.

Yours sincerely,



Mohammed Yaqoob

Audit Director