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Tom Seidenstein
Chairman
International Auditing and Assurance Standards Board
529 Fifth Avenue
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12 September 2019

Dear Mr Seidenstein,

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

RSM International Limited, a worldwide network of independent audit, tax and consulting firms, appreciates the opportunity to comment on the IAASB's Discussion Paper: Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs.

Less complex entities, which also include smaller entities, are a significant part of most economies throughout the world and form a major part of the client base for many of our member firms. We therefore welcome the IAASB's project to review the application of ISAs to audits of these entities. We are pleased the IAASB is seeking to thoughtfully reflect on the growing frustration and belief that existing auditing standards have been primarily written and directed at larger audit clients.

The challenges noted on pages 12 and 13 of the discussion paper as within in the scope of IAASB's work on audits of LCEs are a very good summary of the problems that practitioners face on a daily basis when seeking to apply ISAs to smaller audit clients who have simpler business models and engage in less complex business transactions. Given the extent of these challenges we believe consideration of a fundamental revision of ISAs is appropriate to enable application to both smaller/less complex and larger/more complex entities. We encourage the adoption of a building blocks approach where ISAs start with the requirements for all audits and then add on additional requirements for larger and listed entities.

We recognise however that a fundamental revision of all standards will not be a quick exercise. As such, in order to deliver much needed change on a more timely basis, we recommend starting with the revision of those ISAs which are highlighted in the Discussion Paper as most problematic for LCEs.

Development of a specific standard for audits of LCEs, as an interim measure, is an alternative. However, we are concerned that this could lead to confusion in the marketplace if it resulted in a two-tier system with differing levels of assurance and if it were only adopted in certain territories. We are also concerned that a separate standard for audit of LCEs would, in the medium to longer term, create a two-tier profession where some auditors would only conduct audits under the LCE audit standard and would not develop the breadth of experience and expertise that has historically attracted talent into the profession.

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Responses to the specific questions posed in the Discussion Paper are attached. We would be pleased to discuss our views further with you. If you have any questions regarding our comments, please contact Steve Whitcher (steve.whitcher@rsm.global) or me at (marion.hannon@rsm.global).

Yours sincerely,

A handwritten signature in black ink, appearing to read "Marion Hannon", followed by a horizontal line extending to the right.

Marion Hannon
Global Leader, Quality & Risk

Comments

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 ?

The definition on page 4 is appropriate but could be expanded to specifically exclude Public Interest Entities as defined by the IESBA Code as these tend to carry higher overall risk. It could also be made more clear that "small entities" are scoped in to LCEs.

In addition some clarity could be added regarding groups. In our view, groups which involve component audits are not suitable for an LCE approach because the involvement of component auditors inherently makes the group more complex. However, where the group auditor also audits all components then an LCE approach might be suitable, taking account of the other factors listed on page 4.

We are aware that benchmarks are sometimes used or referred to as a means of identifying smaller or less complex entities. However, we do not consider that it is practical to set such benchmarks at a global level, eg based on revenue, expenses or employee numbers, because it would not be appropriate for use in all countries, given the differing business environments.

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

See response below under 2b

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 broad challenges that have not been identified that should be considered as we progress our work on LCEs ?

The challenges set out in Section II are a fair summary of those that we see in practice. The length, complexity of language and verbosity of the current ISAs are challenging and there is a perception that they have moved away from being principles based and lack scalability.

Particular ISAs which tend to be challenging on audits of LCEs are:

- ISA 230: Due to the complexity of the ISAs, the extent of the documentation required can be burdensome for auditors of LCEs. In the current regulatory environment, reducing documentation can be difficult but auditors of LCEs sometimes use a memo approach for documentation, rather than giving specific answers to questions on a checklist which can be time

consuming. This brings a further challenge in that the auditor still has to ensure that the memo addresses all of the ISA requirements.

- ISA 240: The close involvement of owners in the financial aspects of an LCE mean that some of the inquiries suggested and required by ISA 240 (for example those in paragraph 17 and 18) appear burdensome in entities with few employees.

Other than indicative guidance within our audit software, we have not substantially addressed this challenge.

- ISA 315: LCEs often have a lack of a documented and robust control environment because, by their nature, these businesses are run on a more informal basis than larger enterprises. Auditors can easily default to a substantive approach and sometimes do not see the relevance of assessing an informal internal control system as a risk assessment procedure.

We have addressed this by providing simplified documentation for auditors of LCEs in this area, but this is not seen as a full response to the challenge that the work required provides little comfort.

- ISA 540: Some auditors take the view that this adds complexity to the audit because it seems to have been developed to address the issues with the audit of complex forward-looking estimates (such as impairment tests or loan loss provisions) without taking into consideration that many estimates are simple and unlikely to have a complex or rigorous process behind them (such as inventory obsolescence in an LCE, or provision for a legal claim). However, we do recognise that this is more driven by accounting standards and that entities with more complex accounting estimates, such as valuation of intangibles, might not qualify as LCEs anyway.

Question 3

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

In our view, the IAASB could use its influence to provide thought leadership, lead debates and encourage others to act on the following:

- Value of an audit; owners of LCEs often see the audit as merely a compliance exercise which must be completed due to a legislative requirement. They fail to see the other benefits, such as access to funding, that an audit can bring. Greater awareness of the wider value of an audit would be useful in mitigating this issue and might help to alleviate the fee pressure issue mentioned in this section.
- Public expectations; as noted on page 12, it is important to close the “expectation gap” and improving the application of ISAs to LCEs may help to do this. However, this would only partly solve the problem. More needs to be done, in conjunction with others, to determine the changes necessary to the audit process to meet public expectations. This would be an opportunity for the profession itself to change and move the emphasis and scope of the audit to provide additional insight and assurance over broader risks and perhaps more forward looking information.

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.**
- Revising the ISAs: This would, in our view, be the ideal long-term solution so that the IAASB could retain just one common set of standards. If the ISAs were to be re-written it would need to be on a 'building blocks' basis, starting with the LCEs and adding on extra requirements for larger and listed entities.

However, we recognise that there are significant challenges in this approach, including the length of time that is required under the current standard setting process to ensure that appropriate research and consultation takes place before a standard is issued. If this approach is adopted, thought is needed to determine how the change process could be streamlined. This would need a thorough re-examination of the standard setting process and timeline.

As a quicker alternative, we recommend that the ISAs noted in the Discussion Paper as most problematic for LCEs should be revised as a standalone exercise.

- Developing a Separate Auditing Standard for Audits of LCEs: As a short term alternative to revising the ISAs in their entirety, this could be a potential solution, although there are significant disadvantages to this approach. Such a standard would need to be stand alone, clear and precise in its requirements and clearly signposted as an interim measure while the ISAs were being revised. It would, however, still need to contain sufficient guidance to enable auditors of LCEs to perform audits in accordance with that standard.

We also caution against an LCE Auditing Standard resulting in a two tier level of assurance. There is already a perception that auditors do not do enough work and a separate LCE standard could lead to the conclusion that auditors will do even less work. The fundamentals of the ISAs are sound but it is the application of the requirements that causes issues for auditors of LCEs.

We would not want to see a permanent LCE Auditing Standard as this could result in more confusion in the marketplace, particularly if it were only adopted in certain territories. This would be particularly problematic for group audits where parent and subsidiary entities could be audited under different standards.

- Developing guidance for Auditors of LCEs or Other Related Actions: There is already a large volume of guidance available, much of which is not sufficiently focussed on the core issues faced by auditors of LCEs. In our view, the profession does not need more guidance but rather a body of standards that meet the needs of LCE audits.

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

We have not identified any other possible actions.

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 re-examination of the standard setting process and timeline should be a key priority to enable a new suite of ISAs, developed using a building blocks approach, to be issued in the relative near term. Both a revised process and a building blocks approach would enable the IAASB to react more nimbly in the future. In the meantime, development of a specific standard for LCEs should be a priority for the reasons already explained in this response.

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 ?

The IAASB could consider the following:

- Working with the IASB to develop accounting standards appropriate to LCEs, ie a “micro-gaap” as an alternative to the existing IFRS for SMEs. This could simplify the audit process for LCEs by removing some of the more judgmental accounting decisions and hence reduce the level of work required by the auditor.
- Without diluting the underlying purpose of an audit, further clarifying the definition of an audit so that it is clearer for the general public.