

# Joint submission by Chartered Accountants Australia and New Zealand and The Association of Chartered Certified Accountants

12 September 2019

To: Mr Thomas R. Seidenstein  
The Chairman  
International Auditing and Assurance Standards Board  
529 5th Avenue 6th Floor  
New York 10017  
United States of America

Submission via IAASB website

## Submission on IAASB's Audits of Less Complex Entities Discussion Paper

This submission is made jointly by Chartered Accountants Australia and New Zealand (CA ANZ) and the Association of Chartered Certified Accountants (ACCA) under our strategic alliance.

ACCA and CA ANZ created a strategic alliance in June 2016, forming one of the largest accounting alliances in the world. It represents 800,000 current and next generation accounting professionals across 180 countries and provides a full range of accounting qualifications to students and business. Together, ACCA and CA ANZ represent the voice of members and students, sharing a commitment to uphold the highest ethical, professional and technical standards. More information about ACCA and CA ANZ is contained in Appendix B.

### General comments

We appreciate the opportunity to comment on the IAASB's Audits of Less Complex Entities (LCEs) Discussion Paper (DP). The difficulties that audit practitioners encounter in auditing LCEs are significant to the profession because of the large number of LCEs subject to audit requirements globally. The IAASB's standards need to be suitable for such audits or there is a risk that the wider adoption of the standards will fall if jurisdictions are forced to introduce local solutions to this issue. We therefore commend the IAASB for prioritising this issue. We are particularly supportive of the approach taken by the IAASB in defining audits of LCEs by focusing on the qualitative characteristics of the entities rather than simply their size.

We are also very pleased to note that the language used in drafting this DP was simple and straightforward to follow. We therefore suggest that the same style of drafting is adopted in the



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standards and other IAASB publications going forward, irrespective of the direction the IAASB decides to take in relation to LCEs.

## Challenges

The main challenges for LCE audits according to the feedback received are as follows:

- Complexity in the language used in the existing standards.
- The value added in performing certain requirements of existing ISAs is not clearly articulated.
- Current ISAs are written for complex entities and then scale down to less-complex. As a result, auditors of LCEs have to do additional work to determine how the standards apply to their engagements. This seems counterintuitive.

## Action

According to the feedback received from our members and the wider stakeholder discussions regarding the best action as the way forward, out of the three options provided in DP, the result was mixed with a number of arguments in favour of and against each of the possible approaches available.

Our responses to the specific matters for comment raised in the DP follow in Appendix A. Should you have any queries about the matters in this submission, or wish to discuss them in further detail, please contact Melanie Scott, Senior Policy Advocate at CA ANZ via email; [melanie.scott@charteredaccountantsanz.com](mailto:melanie.scott@charteredaccountantsanz.com) and Antonis Diolas, Manager Audit and Business Law at ACCA via email; [antonis.diolas@accaglobal.com](mailto:antonis.diolas@accaglobal.com)

Yours sincerely

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## Appendix A

**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?**

As noted in our general comments we are supportive of the IAASB's approach to define LCEs by referring to qualitative characteristics that may indicate complexity rather than simply focusing on size. We are broadly supportive of the description provided on page 4 regarding the types of entities that will form part of LCEs.

In addition to the characteristics mentioned on page 4, we suggest that the following should also be taken into consideration:

- As noted in our general comments, we are supportive of the approach taken by the IAASB focusing on the qualitative characteristics of entities rather than their size in defining LCEs. We believe that quantitative characteristics should not be included due to the differences in entity size and the different audit exemption thresholds that exist in individual countries. National standard setters can then impose any quantitative characteristics that are appropriate for their jurisdiction.
- It is likely that there will be some LCEs identified that are also PIEs (such as simple 'letterbox' listed entities). The Board needs to consider if guidance is required in situations where a PIE is also an LCE or whether such guidance should be provided by local standard setters or regulators.
- With a separate single standard for LCEs there is a risk that practitioners may be tempted to try and apply that standard to entities that only meet a few of the characteristics within the definition. Consideration needs to be given to how this can be managed to ensure a separate standard is only used where it is appropriate to do so. The Board might therefore need to reconsider the definition based on the action decided.

**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.**

### ***Specific ISAs and requirements***

#### *ED-ISQM1*

Although we recognise the task force's efforts to incorporate scalability considerations, most of the guidance for small practices is included at the end of the Application Material. This means that smaller firms will have to navigate through what they will perceive as complex requirements and guidance, with the hope of 'seeing the light' only right at the end (e.g. requirements to establish

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structure and reporting lines; the need to conduct periodic evaluation; etc.). We believe that in order to overcome this issue, the standards should start small and scale up as complexity increases, allowing smaller practices to quickly navigate through what is applicable to them and what is not. As discussed in our response to part (b), we believe the Board's approach to standards should be to write the base requirements for simple audits and then add additional requirements to address complexity.

If the decision is made to develop a single standard for the audits of LCEs, consideration will also need to be given to how that standard interacts with the quality management standards and whether a more streamlined approach to quality management may be appropriate for assurance practices that only perform LCE audits.

### *ISA 240*

Paragraph 240.32(a) requires that, irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. However, audits of LCEs often take a substantive approach due to lack of controls and would include journal entry testing as part of their substantive procedures. For this reason, practitioners find that the requirement to perform and document additional mandatory journal entry testing adds very little, if any, value. The IAASB should ensure that the 'why' of performing certain audit procedures is better articulated, allowing practitioners to recognise the value added and to conduct their work in the right spirit rather than by performing 'tick-box' procedures with a compliance mindset. This will also ensure that the principles-based nature of the IAASB standards is followed. Consideration needs to be given as to whether the same mandatory procedures are appropriate for less complex engagements.

### *ISA 315*

ISA 315 also presents a challenge for auditors of LCEs. The risk assessment process is not well designed for audits of LCEs with the 'why' not being sufficiently clear, resulting in a 'tick-box' exercise with no clear understanding of its value added. In the case of LCEs, they are often lacking in controls or the required information on systems and controls may not be available, so auditors are likely to need to use a substantive approach. There is a need for the standard to be clearer on how, for example, the lack of controls may impact the risks and the substantive approach taken so that practitioners can easily understand what they are required to do for risk assessment in these audits, rather than just moving to a substantive approach with limited documentation.

### *Documentation*

Under the existing standards, auditors experience challenges in determining how much to document in their audits, particularly when the value of audit procedures performed such as the examples mentioned above regarding ISA 240 and ISA 315 are not clear. This risks regulators expecting extensive and non-value adding documentation, and auditors, in response, "over-documenting" to avoid the risk of regulatory criticism or penalty. This is an unfortunate outcome

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given that the objectives of regulators and the audit profession in relation to achieving high audit quality should be aligned.

**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?**

### ***Length and language of standards***

As noted in a number of our submissions to recent IAASB consultations (such as the exposure drafts on proposed ISA 315, proposed ISA 540, and the quality management suite of standards), the length of the standards and their application material is becoming daunting to read and absorb particularly for SMPs. This is, indeed, noted in the DP itself.

We believe that the Board needs to revisit its drafting approach and come up with an approach that addresses:

- The language used in the standards, which our members find to be overly complicated, making the standards hard to follow. The complexity of the language also impacts the length of the standards. Standards that are too long deter the practitioners from reading and understanding the material. Standards should be drafted so far as possible in plain English. Care should be taken with areas such as definitions, where recently we have noted examples of terms being described as equivalent when in plain English they would not necessarily be. An example is paragraph 16(h) of ED-315 which states that 'reasonable possibility' means the same as 'more than remote' likelihood. Overly complex language also creates challenges in translation, with a higher risk of varying interpretation, and a higher likelihood of divergence in practice in those jurisdictions that rely on translations.
- The need to refocus on the clarity approach (or adopt a similar new approach) which focuses on principles-based standards that establish the base requirements for auditors of LCEs and then move to additional requirements to address layers of complexity.

ACCA's thought leadership report '*Thinking Small First: Towards better auditing standards for the audits of less-complex entities*' argues that simplifying the language of auditing standards is a better approach. More specifically, the report suggests an approach to developing and drafting standards that:

- Explains clearly what every auditor must do and scales up as complexity increases
- Uses specialist drafting teams which allows less drafting to be done at Board meetings. This will allow the Board to focus on its strategic role.

The main benefits identified by using this approach are as follows:

- Simpler language and structure will be beneficial for all auditors, including those who deal with larger and more complex audits as the requirements will be straight forward. This will allow auditors to focus on the riskier and more judgemental areas of the audit and improve audit quality.

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- Simpler auditing standards would benefit audit regulators and other stakeholders as it would make it easier to understand a standard's expectations of an auditor and find that applicable requirements of that standard applicable to a specific situation.
- Simpler auditing standards would benefit the public as it would allow a wider range of users to understand them, and therefore help to narrow the expectation gap.

### **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?**

It is clear that corporate reporting, in particular, the International Financial Reporting Standards (IFRS), have grown more complex and the fair value accounting that has been adopted requires more judgement on the part of both preparers and auditors. Like the auditing standards, the IASB's standards have become more difficult for users to understand and apply and financial reports have grown longer with additional levels of disclosure being added. Accounting standard complexity, drafting and disclosures add to the difficulty in delivering audits of LCEs and other entities. We therefore encourage the Board to prompt the IASB to consider whether the current IFRS are meeting the needs of users and whether a move to quality of information over quantity needs to be considered.

We recognise and support the IAASB initiative to work with IFAC to embrace the use of an electronic format by converting the IAASB's Handbook as mentioned in footnote 12 of the discussion paper. We believe that it is also highly important to embrace the use of technology beyond the change in format. For example, having the base requirements with links that give practitioners 'pop up' or other format access to definitions, application paragraphs or other guidance material that the IAASB has produced (flowcharts etc). This would make the standards more user friendly and easier to understand. This may present challenges in how to also present the standards in hard copy but the value gained would be considerable.

The DP notes that exploring the value of an audit is relevant to LCE audits, but places this outside the scope of the discussion paper. We believe that broader considerations of the value of an audit are fundamental to the consideration of the LCE audits issue. A cornerstone of the discussion about the value of audit to the market is the need for the product (whether that is an 'audit' or an 'LCE audit') to be fit for purpose and meet the needs of users. The approach taken in addressing LCE audits will play a role in how the profession adds value to the market in this space and therefore needs to be fit for purpose.

### **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?**

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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?**

As the IAASB is well aware, there are arguments in favour of and against each of the possible approaches available. We set these out below, along with a view from the ACCA and CA ANZ representative member views on each approach.

**(a) and (b)**

### Revising the ISAs

#### *Arguments in favour*

- Revising the ISAs to be scalable by thinking small first (i.e. start simple and scale up based on complexity) and by using simpler language will help all auditors (not just those auditing LCEs), improve audit quality as well as help regulators.
- As noted in our response to 2b) above, if the IAASB engages with drafting specialists to assist in redrafting the standards that will give the Board extra capacity to be more strategic and focus on getting the principles right rather than spending time on detailed drafting.
- Revising ISAs using simpler language will also allow the wider public to better understand what auditors are required to do and how audits work, helping to narrow the expectation gap.

#### *Arguments against*

- The main concern raised in relation to taking this approach is that it will take too long to revise the full set of ISAs at a time where the audit profession has a more pressing need for a solution on how to deal with audits of LCEs.
- It is also questionable whether this approach would move sufficiently away from the current ISAs to really make a difference, given the professed desire already of the IAASB to be mindful of drafting to meet scalability needs.

#### *Action*

Whilst revision of the suite of ISAs was the most desirable amongst the options for our members, most of them are concerned with the time frame this would take place over, particularly when considering the experience with the development and implementation of the Clarity suite of standards. Furthermore, looking at the amendments made to the ISAs post-Clarity, it is questionable if that was successful and hard to argue that by repeating the exercise it will make a sufficient difference. However, as ACCA's thought leadership report *Thinking small first: Towards better auditing standards for audits of less-complex entities*<sup>1</sup> argues, in practice it is still possible to apply this approach on a prospective basis to new standards and to revisions of existing

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<sup>1</sup> [https://www.accaglobal.com/content/dam/ACCA\\_Global/professional-insights/Supporting-SME-audit/pi-SME-auditing-standards.pdf](https://www.accaglobal.com/content/dam/ACCA_Global/professional-insights/Supporting-SME-audit/pi-SME-auditing-standards.pdf)

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standards. Over time, this could deliver the benefits of simpler standards without imposing a large one-off cost. As discussed above, we encourage the Board to review and refine the drafting approach to the ISAs with a view to simple, clear standards that set out basic requirements before addressing additional layers of complexity, even if a separate LCE standard is developed.

Furthermore, ACCA's above mentioned report also refers to the lessons that should be learned from ISA 315. More specifically, referring to the Key Concepts section of the proposed ISA 315 (Revised), written using simpler English which is much more accessible to users than the rest of the proposed standard. This allows users to understand the overall flow of the rest of the standard more quickly. We therefore suggest using this as an example if the way forward is the revision of the ISAs.

### Developing a separate Auditing Standard for Audits of LCEs

#### *Arguments in favour*

- The perception is that this would be a less time-consuming option than the revision of ISAs, though the complexity of coming up with an appropriate standard should not be underestimated.
- Firms are already using their own versions of LCE standards by developing internal templates for audits of LCEs building on their audit methodologies. Therefore the development of such a standard would promote greater consistency in LCE audits. This can also apply in the case of development of guidance.
- In the absence of a global separate standard there is a risk that national standards setters may develop single LCE standards to meet the needs of their local jurisdictions. This may lead to there being multiple versions of LCE standards which reduces the comparability of audits.

#### *Arguments against*

- Many jurisdictions operate with both ISAs and PCAOB standards so developing a third standard will only make it even more complex for anyone to be accredited or maintain their professional skills across multiple sets of standards.
- There is a risk that national standard setters may further 'customize' a single LCE standard to meet the needs of their jurisdictions. This may lead to there being multiple version of the global separate LCE standard which would again have a negative impact on the comparability of audits.
- If the standard is not developed based on the existing ISAs then it will be hard to argue that the same assurance level is provided. Similarly, if the single standard becomes overly simplified, will the engagement still provide reasonable assurance?
- It will be difficult to find the right degree of detail and to determine how the single standard may interact with the full suite of ISAs. For example, will practitioners be expected to refer to the ISAs for additional procedures etc. if they encounter an issue in an LCE not addressed in the single standard and how will transitional requirements for audits that may move from being LCEs to more complex over time be addressed? How will the single standard evolve over time (i.e. if ISAs are revised, will it be revised at the same time or will it be reviewed on a set schedule e.g. every three years)?

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- The development of a new standard would require investment in training resources (at IAASB, local standard setters, professional body, and firm levels), investment in new methodology development and in additional technology solutions or new modules of technology solutions as well as ongoing investment in maintaining professional skill sets. Furthermore, it will require revisiting the existing suite of ISAs with some of those requiring revision before developing a separate standard, and how would that interact with the full set of ISAs. It is therefore questionable if this action will be indeed less time-consuming than the option of revising the existing ISAs.

### *Action*

The feedback received from our members is that although this option has a number of arguments against it, it is perceived in practice to be the most realistic one. That is mainly because revising the ISAs is perceived to be too time-consuming and there is a more pressing need for a solution on how to deal with the audits of LCEs.

### **Developing Guidance for Auditors of LCEs**

#### *Arguments in favour*

- Although additional guidance was not considered one of the favourable options for our members in isolation, it could be helpful to be provided in combination with the other options particularly if a separate standard for audits of LCEs is decided to be developed. This will assist in overcoming some of the points raised in our answer to question 1.
- This option could be worth exploring as it is likely to be the action with the quickest turnaround out for the three options, provided that different approaches than the ones explored in the past are considered. For example, the Board may consider referring to the the IFRIC model used by the IASB.

#### *Arguments against*

- Some members have commented that there is already additional guidance for LCEs (such as the IFAC SMP's committee guidance material and the application material in the ISAs themselves) and that this does not seem to have addressed the problem to date. Therefore there would need to be further outreach to auditors of SMPs to understand why this guidance has not been utilised and what kinds of guidance—including methods of delivery would be useful.
- All ISAs include application materials and many of them have additional appendices, and irrespective if the audit practitioner works for a large or small firm it is unreasonable to expect the audit professional to try and maintain fluency with all standards. Professionals in large firms rely on national offices to maintain an audit methodology to apply the ISAs, and professionals in small firms are already struggling to go through all the material that applies. It is therefore unlikely that additional guidance will be of any more help.

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## *Actions*

Although according to our feedback simply developing further guidance for LCEs in isolation was not considered to be a popular option as an action for the way forward, we believe that there is a place for guidance in the short term to address specific issues identified by our responses to this DP while other options such as revision of standards or development of a separate standard are underway. This will require further outreach to obtain a better understanding of the key problem areas for practitioners. We also believe that guidance will be required to supplement the approach that is ultimately adopted in relation to audits of LCEs but that again, the Board will need to be careful to understand how best to develop and present guidance etc. meet the needs of the practitioners.

Additionally, as mentioned above in the arguments in favour of a developing guidance for auditors of LCEs, if the development of guidance took a different approach than the ones explored in the past, it might be worth developing further. For example, the Board may consider using the IFRIC model used by the IASB and set up an equivalent for the ISAs. Although we do recognise that in some respects the IFRIC model does not translate directly across to audit standard-setting, the mode of operation could allow the interpretation of the existing ISA requirements to be developed while leaving the ISAs intact, offering a potentially quicker way for the Board to respond to the challenges faced by practitioners in implementing ISAs. This would help dealing with LCE as well as non-LCE audit challenges.

**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.**

As discussed above, we are of the opinion that additional short term guidance on how to apply the existing standards in the case of LCEs would be very helpful given that the timeframe involved in implementing either the revision of the ISAs or the development of a single standard is likely to be long. However, this guidance needs to be carefully considered to avoid the issues that existing guidance has encountered.

We highly support exploring the use of technology enabled standards. A technology solution could be implemented on existing standards ahead of any revisions or separate standard development.

**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 also recognise that the discussion paper scoped out 'engagements other than audit' of the explanatory activity. However, we think that that the Board should reconsider if those should be scoped out. Feedback received from our members mentioned that the solution may be a hybrid level of assurance such as a combination of assurance and agreed-upon procedures that might better meet the needs of users.

The IAASB should take into consideration that certain jurisdictions have very low audit exemption thresholds with some of them having no exemption at all. As a result, a very large number of audits taking place in these jurisdictions relates to dormant or other micro-entities. It is therefore

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important for the Board to understand whether the action chosen as the way forward in such jurisdictions, is driven because of their experience with such audits or whether they would have chosen a different action if their audit exemption thresholds were higher.



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## Appendix B

### About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand is a professional body comprised of over 121,000 diverse, talented and financially astute members who utilise their skills every day to make a difference for businesses the world over.

Members are known for their professional integrity, principled judgment, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations.

We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

### About ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people around the world who seek a rewarding career in accountancy, finance and management.

ACCA supports its 219,000 members and over 527,000 students in 179 countries, helping them to develop successful careers in accounting and business, with the skills required by employers. ACCA works through a network of 110 offices and centres and 7,571 Approved Employers worldwide, who provide high standards of employee learning and development.

Through its public interest remit, ACCA promotes appropriate regulation of accounting and conducts relevant research to ensure accountancy continues to grow in reputation and influence.

ACCA has introduced major innovations to its flagship qualification to ensure its members and future members continue to be the most valued, up to date and sought-after accountancy professionals globally.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability.

The expertise of our senior members and in-house technical experts allows ACCA to provide informed opinion on a range of financial, regulatory, public sector and business areas, including: taxation (business and personal); small business; audit; pensions; education; corporate governance and corporate social responsibility.



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