

Perspective

This is one of a series of articles where experts in assurance, reporting and regulatory matters discuss recent technical and policy developments in these areas



Future Options for Auditing Standards applicable to Audits of Less Complex Entities (LCEs)

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The International Auditing and Assurance Standards Board (IAASB) has issued a Discussion Paper (DP) exploring possible options to address the challenges in applying the International Standards on Auditing (ISAs) for audits of less complex entities. The AUASB seeks feedback on the DP from Australian Stakeholders – particularly those audit and assurance practitioners in the ‘Small/Medium Practice’ (SMP) segment.

Background

In recent years there has been an increase in audit practitioners raising concerns relating to the complexity and difficulties in applying the auditing standards on audits of small entities and expressing a need for urgent global action. It is a significant issue in Australia and New Zealand, where we have a large and important cohort of small audit practitioners, particularly in regional areas. In response to this issue some territories have already been investigating or implementing initiatives specifically targeted at audits of smaller entities. But while some of these show promise, the AUASB supports initiatives implemented by the IAASB to identify a global solution that responds to the issue which is practical and doesn't conflict with the core concepts that underpin what an audit is designed to achieve.



In late April 2019 the IAASB issued its Discussion Paper on *Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs* (available via the AUASB's website [here](#)). The purpose of the DP is to obtain input on the challenges and further understand the underlying reasons and root causes of the identified challenges to be able to consider how these can be best addressed and guide the IAASB's future actions.

The AUASB has been actively monitoring initiatives in this area as part of a strategic project on small/medium audits in its work plan over the last 2 years. What is very clear is that globally there is a broad range of potential options to address this issue and not necessarily a 'one-size-fits-all' solution. This was underpinned at a conference organised by the IAASB and French professional body for SMP auditors in Paris in May 2019 (the Paris Conference) where representatives from standard setters, regulators and practitioners around the world agreed that immediate action is required on this issue.

What is a Less Complex Entity?

The discussion about the challenges of applying the ISAs has historically been around the difficulties experienced in audits of smaller entities. However, in the current environment, the IAASB are of the view that when dealing with issues of scalability and proportionality in the ISAs it is appropriate to focus on the complexity and risk of material misstatement associated with the entity, rather than its size.

Further consideration will be given to how the IAASB describes Less Complex Entities (LCEs) for the purpose of its work and ultimately how this description is applied will be determined at a territory level. As a starting point however, the IAASB has adopted the current definition in the ISAs of a "smaller entity", as it sets out many of the qualitative characteristics attributable to an LCE, such as concentration of ownership and management in a small number of individuals, straightforward or uncomplicated transactions, simple record-keeping, few internal controls, and few personnel having a wide range of duties. The definition recognises that these qualitative characteristics are not exhaustive however and the DP includes a specific question about whether the description is appropriate for these types of entities.

Challenges within the Scope of the IAASB's Work on Audits of LCEs

The IAASB has to be mindful of the need for the ISAs to be applicable to all entities, ranging from those whose nature and circumstances are simpler and more straightforward (i.e. LCEs), to those entities where the nature and circumstances are more complex.

When it revises an ISA the IAASB makes a concerted effort to keep the new or updated standard proportional and scalable. While there has been increased focus on scalability and proportionality when revising ISA 315 and ISA 540 in the last 12 months, feedback from a range of stakeholders has made it clear this is not enough and further action to make the standards more applicable to LCEs is required.

Recurring comments practitioners have made about the unsuitability of the ISAs for LCEs include that the language in the standards has become more complex and prescriptive, which impacts the ability to apply professional judgement. Many believe the most recent ISAs are difficult to understand and interpret, don't contain suitable application guidance for LCE Audits and have documentation requirements that are onerous without a corresponding contribution to audit quality.

The AUASB is interested to hear about what particular auditing standards and the specific requirements that are difficult to apply in an LCE audit, as well as understanding the underlying cause(s), how these have been managed or addressed and if there are any other broad challenges that have not been identified in the DP that should be considered.

Challenges Not within the Control or Scope of the IAASB Work on Audits of LCEs

There a range of factors driving the challenges that impact the audit environment for LCEs which are not associated with the auditing standards, such as:

- The legal and other requirements for an audit prescribed in each jurisdiction (e.g. reporting thresholds).
- Commercial considerations relating to an audit, like audit fee pressures and the real or perceived value of an audit.
- A lack of understanding of the standards or inadequate staff training can negatively impact the way auditing standards are applied.
- The audit expectation gap between what the auditor is required to do and what different stakeholders expect the auditor does.

Whilst the IAASB's consultation recognises that these issues are outside the remit of the current project as it is specifically related to the ISAs, there is still an acknowledgement that more work is needed to address these issues, and to also consider how they impact the audit environment for LCEs. Also, other types of assurance in the IAASB framework (i.e. review engagements) may be appropriate alternatives in cases where an audit is not required or needed.

Possible Actions to be explored

The DP has been designed in an easily digestible format and to ensure that, before committing to further actions, the IAASB has a thorough understanding about the nature and causes of challenges faced by auditors of LCEs. There is not necessarily a one-size-fits-all solution and the IAASB remains open minded about future actions, recognising that the best way forward may involve a combination of different approaches. The potential possible actions outlined in the DP for the IAASB in relation to the ISAs are:

Revising the ISAs

The auditing standards could be revised to make the auditor's work effort clearer. This option would apply for the benefit of all audits, not just audits of LCEs. Broadly, this may involve a greater focus within each of the ISAs on one or more of the following:

- More clearly setting out what the auditor needs to do (i.e. focusing on the way the requirements have been articulated using clearer and understandable language).
- Revising the application material to feature more scalability and proportionality considerations (e.g. providing examples of both simple and complex circumstances in order to contrast the differences).
- And/or adopting an approach of revising the standards by setting out the basic requirements for all audits, then expanding as needed to address more complex circumstances (the so-called "building-blocks" approach).

There are various ways that such a revision could be undertaken over the suite of ISAs, including revising all of the standards as part of one substantial project, revising them on a rolling or phased basis, or making targeted changes when a standard is being revised.

Developing a Separate Auditing Standard for Audits of LCEs

Another action, which could be pursued at the same time as the other options, is to develop a separate auditing standard for audits of LCEs. The IAASB have not specifically discussed the content of such a standard and more would need to be done to determine whether this is a feasible option. Any separate standard developed needs to retain a similar robustness as the ISAs (i.e. reasonable assurance) as we do not want to create a scenario where the term 'audit' has different meanings.

Whilst further research and analysis would be necessary if this option is supported, a separate standard may:

- Include a description of the types of entities for which it would be appropriate to use or not (for example, it may not be appropriate to use such a standard for audits of publicly listed entities). As with the current standards, local laws and regulations would then prescribe when such a standard could be used in a particular jurisdiction.
- Be based on the existing ISAs with the aim of achieving the same objective (i.e. retaining existing principle and risk-based requirements, but reduced documentation requirements and be more substantive in nature).

Developing Guidance for Auditors of LCEs or Other Related Actions

A further action, again not mutually exclusive from the other options, could be the development of guidance and other support material specifically for audits of LCEs outside of the auditing standards (i.e. not application or other explanatory material within the ISAs), so the nature of such material would be non-authoritative. This may be in the form of a comprehensive guide about how to apply the ISAs in situations where the nature and circumstances of the entity being audited are less complex like the existing IFAC [Guide to Using ISAs in Audits of SMEs](#), or guidance on the application of specific areas within the ISAs, that are considered challenging for audits of LCEs (for example, a guide specifically targeted at risk identification and assessment).

At the Paris Conference in May 2019 there was no consensus on which option in the DP should be prioritised, with participants evenly split between revising the ISAs and developing a new standalone auditing standard for LCEs. There was also a strong view expressed that additional Guidance is not going to fix this issue, but there is a role for guidance to support the potential reforms to the standards which may be selected.

Further details and analysis of each of these potential options is covered in greater detail in the DP.

We Need to Hear from You!

The AUASB would like to understand stakeholders' views about each of the possible actions, including which should be pursued as a priority and the implications or consequences if the possible actions(s) were undertaken. We are keen to hear from as many practitioners as possible, especially current auditors of LCE's who may not normally provide input into the standards setting process.

Some of the possible actions will be quicker to progress, while others will take longer, and there may be other actions not discussed in the DP which should be considered. Whatever actions are selected, they must maintain a balance between competing needs and being mindful that any changes do not reduce the robustness of the existing auditing standards and thereby have a negative impact on audit quality (i.e. have unintended consequences on audits other than those that are audits of LCEs).

Your input will help the AUASB and IAASB develop a clear direction for the future work relating to LCE Audits and to appropriately scope any future projects related to these matters.

The AUASB will be arranging a number of outreach activities over the next 3 months to gather feedback on the options in the DP. A short survey based on the DP is also available to capture feedback from practitioners and other interested stakeholders on this issue. The details of these can all be found via links on the AUASB website at www.auasb.gov.au.

Comments are requested to be sent to the AUASB on the DP by 31 August 2019 and, based on feedback received from around the globe, the IAASB have committed to assess all options and identify the best solution to move forward later this year.

For further information contact the AUASB at enquiries@auasb.gov.au.