

DISCUSSION PAPER  
COMMENTS DUE: SEPTEMBER 12, 2019



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

**IAASB**

International Auditing  
and Assurance  
Standards Board



The International Auditing and Assurance Standards Board is a global independent standard-setting body that serves the public interest by setting high-quality international standards which are generally accepted worldwide.

The IAASB follows a rigorous process in developing its standards, involving multi-stakeholder input, including from the IAASB's Consultative Advisory Group, the International Federation of Accountants' (IFAC) relevant committees and professional accountancy organizations, regulatory and oversight bodies, firms, national standard setters (NSS), governmental agencies, investors, preparers and the general public.

For copyright, trademark, and permissions information, please see page 21.

## Request for Input

This Discussion Paper was developed by the International Auditing and Assurance Standards Board® (IAASB®).

Comments are requested by **September 12, 2019**.

Respondents are asked to submit their comments electronically through the IAASB website, using the "Submit a Comment" link. Please submit comments in both a PDF and Word file. First-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website.

This publication may be downloaded from the IAASB website: <http://www.iaasb.org>.

---

# CONTENTS

Chairman’s Foreword .....	2
The Purpose of this Discussion Paper .....	3
What is a Less Complex Entity? .....	4
SECTION I - Background.....	5
SECTION II - Challenges Related to Applying the ISAs in Audits of LCEs .....	10
SECTION III - Possible Actions to be Explored.....	14
Questions for Respondents.....	18
Appendix - Standards, Guidance and Tools (Recent Literature) and Articles and Thought Leadership (Recent Publications) .....	19

---

## CHAIRMAN'S FOREWORD



Smaller entities make a critical contribution to the world economy, and quantitatively the majority of audits globally are audits of smaller entities. The ongoing challenges relating to the complexity and difficulties in applying the International Standards on Auditing (ISAs) faced by those auditing smaller entities is an area that is of particular importance to the Board, and to me personally. The strides that we have made since our Small- and Medium-Sized Practices (SMP) Working Conference held in Paris in 2017 in moving forward and building on what we already know about these challenges have culminated in this Discussion Paper (DP).

We hear the urgency for action, and recognize that we need to think more, and with an open mind, about actions that will result in solutions that will help not only those auditing smaller entities, but also those auditing entities where their nature and circumstances is less complex (hereafter referred to as less complex entities (LCEs)). We acknowledge the efforts of others in their activities to support auditors of LCEs and have heeded the call for global action.

However, before committing to further actions, we need to make sure that we have a thorough understanding about the challenges faced by auditors of LCEs, including the underlying causes of those challenges, in the many jurisdictions impacted by our activities. We need to work out what actions are for us, and what actions may be for others, and we will encourage others, as needed, to take action, recognizing that the best way forward may involve a combination of approaches. Therefore, we need to hear from all our stakeholders about the different possible actions we outline in this paper, including whether there are other actions that we have not identified, to enable us to determine what is most appropriate and what will be most effective.

We must also maintain the fine balance between competing needs and being mindful that any changes do not reduce the robustness of the existing auditing standards thereby affecting audit quality (i.e., have unintended consequences on audits other than those that are audits of LCEs). There is no easy 'fix,' and it will take time to progress global actions, but we are very aware that more must be done to keep the ISAs relevant to those auditing LCEs.

We remain committed to actively further exploring and progressing our thinking in relation to audits of LCEs. I wish to emphasize the importance of hearing from those most affected by these challenges to be able to progress this topic and look forward to hearing from all of our stakeholders about the matters set out in this DP. A feedback statement will be published to share what we have heard from the input received, and we will then deliberate about how to best move forward.

**Prof. Arnold Schilder**  
*IAASB Chairman*

## THE PURPOSE OF THIS DISCUSSION PAPER

In order to achieve its objective of enhancing the quality and consistency of audit practice throughout the world, and strengthening public confidence in the global auditing and assurance profession, the IAASB develops and maintains one set of auditing standards. These are applied to a wide variety of entities with differing circumstances.

Recognizing the challenges faced by practitioners in applying the ISAs, in particular for engagements where the entity being audited is less complex, this DP focuses on audits of LCEs using the ISAs, and sets out:

- Challenges that have been identified to date.
- A number of possible actions that could be undertaken to address the identified challenges.

The purpose of this consultation is to obtain input on the challenges and to help us determine our actions in relation to audits of LCEs. Accordingly, we are looking for input from all stakeholders, but in particular practitioners auditing LCEs on the matters set out in this DP, as well as any other challenges or possible actions we have not yet thought about.

# WHAT IS A LESS COMPLEX ENTITY?

## *What do we mean by a “less complex entity” (LCE) and why do we use this term rather than “small- and medium-sized entity” (SME)?*

Although the discussion about the challenges of applying the ISAs has historically been around the difficulties experienced in audits of smaller entities as outlined in the Chairman’s Foreword, we are of the view that it is appropriate to focus on the complexity of the entity rather than its size. This is because in today’s environment it is not only about size—there may be entities that are smaller but may be considered complex, and there may be other entities that would not be considered smaller, but would be considered less complex.

As we move forward, further consideration will be given to how we describe LCEs for the purpose of our work. How this description may be applied in individual jurisdictions will depend on the nature of the outputs arising from this consultation process and how each jurisdiction adopts any possible future pronouncements, and the legal or regulatory requirements and other relevant circumstances of the jurisdiction (it is possible that this may encompass a broad range of entities including such entities as those in the public sector and not-for-profit sectors). However, as a starting point, we have looked to our current definition of a “smaller entity,” which sets out many of the qualitative characteristics that could be attributable to an LCE:

*“An entity which typically possesses qualitative characteristics such as:*

- a. Concentration of ownership and management in a small number of individuals (often a single individual – either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and*
- b. One or more of the following:*
  - i. Straightforward or uncomplicated transactions;*
  - ii. Simple record-keeping;*
  - iii. Few lines of business and few products within business lines;*
  - iv. Few internal controls;*
  - v. Few levels of management with responsibility for a broad range of controls; or*
  - vi. Few personnel, many having a wide range of duties.*

*These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all of these characteristics.”<sup>1</sup>*

We are seeking views of respondents about how best to describe LCEs (refer to Question 1).

---

<sup>1</sup> IAASB’s Glossary of Terms

# I. BACKGROUND



At present, 129 jurisdictions use, or are committed to using, the ISAs (up from some 90 countries in the mid-2000's) demonstrating the increasing importance the global community attaches to the ISAs. This widespread and continually growing international use of the ISAs, in both well-developed as well as developing economies, underscores the importance of the IAASB continuing to focus its efforts on maintaining the quality and scalability<sup>2</sup> of these standards for entities of all sizes, and to meeting the expectations that stakeholders have regarding their application.

## The Evolving World and the Effect on the ISAs

There are a number of influences driving changes to the environment in which auditors operate. These influences are described in the section that follows, and although these influences may impact audits of all entities, the intention is to consider these influences in the context of LCEs as background to the identified challenges and future possible actions:

<b>The Evolving Business Environment</b>	<ul style="list-style-type: none"><li>• The <i>evolving business environment</i>—which is driving increasingly complex structures and transactions.</li><li>• <i>Technology</i>—is advancing at a rapid pace, affecting how transactions are undertaken and how records are kept.</li><li>• <i>Audit regulators and oversight bodies have become more coordinated and are committed to driving audit quality</i>—primarily through their audit inspection processes, including focusing on remedial action plans to address the root causes of deficiencies identified. This increased robustness in inspections has resulted, for example, in calls for more specificity in the requirements in the ISAs against which the audits can be inspected.</li><li>• <i>Changing public expectations</i>—audits are under increasing scrutiny, with continued discussion of the need to better address the gap between what the auditor is required to do and what some stakeholders expect the auditor to do.</li></ul>
<b>Changing Financial and Non-Financial Reporting</b>	<ul style="list-style-type: none"><li>• <i>Law and regulation</i>—is changing, with enhanced and evolving reporting requirements, including in relation to non-financial reporting, which are driving different business and reporting decisions.</li><li>• <i>Financial reporting standards</i> are continually evolving to address changes in the business environment, public expectations, and other influences, and are also becoming more complex, lengthy and require more interpretation and judgment.</li><li>• <i>Assurance needs related to non-financial reporting</i> continue to evolve.</li><li>• <i>Increasing requirements for estimates</i> using forward-looking information, which requires practitioners to apply heightened professional judgment and professional skepticism.</li></ul>

<sup>2</sup> The ability to apply the ISAs to a wide range of entities with varying complexity is referred to as 'scalability.'

The evolving influences outlined above are taken into account when updating the ISAs. However, these may also be creating new challenges which in turn are perceived to be impacting the way that audits of LCEs are undertaken. Specifically, increases in the length and detail of the ISAs can:

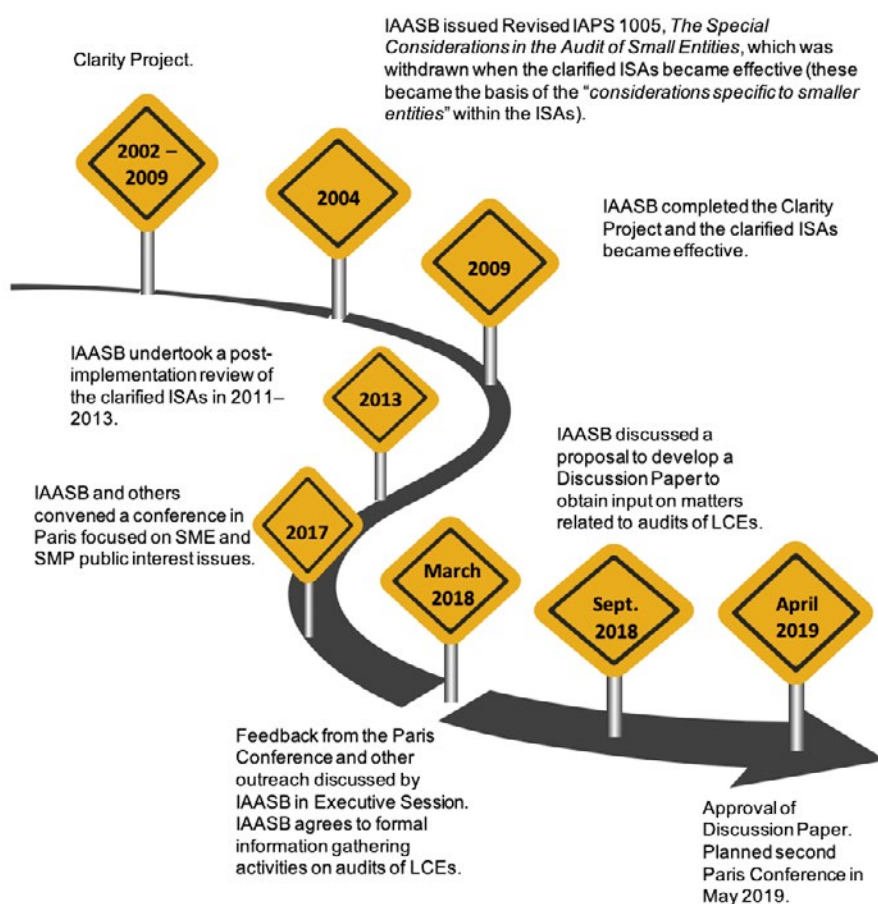
- Act as a barrier to auditors reading and understanding the ISAs, particularly for those auditors in situations where there is a gap in available guidance for applying the ISAs.
- Result in a perceived ‘checklist-approach,’ with a greater focus on compliance rather than using professional judgment.
- Lead to increased documentation in audit files, with no perceived commensurate benefit.

All of these can potentially lead to a reduction in audit quality as they could affect how the auditor applies the standards.

## The IAASB’s Journey...

The IAASB has always been mindful of the need for the ISAs to be applicable to all entities,<sup>3</sup> 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 (for example, more complex structures or more complex transactions). Furthermore, the environment is continually evolving, which is driving changes to the ISAs, and may be making them more challenging to apply to audits of LCEs.

Since 2002 when our Clarity Project commenced, we have been making concerted efforts to keep the revised or developed standards operational and scalable, but there continues to be concern about the increasing complexity and usability of the ISAs, in particular for LCEs. There have also been questions raised as to whether the ISAs remain fit-for-purpose for audits of LCEs. In 2017, as explained further below, we convened a working conference in Paris that included consideration of the issues related to audits of SMEs, thereby providing the impetus for further IAASB action. The diagram above sets out our ‘journey’.



<sup>3</sup> IFAC has a [policy position \(no. 2\)](#) that notes that the ISAs are designed for audits of entities of all sizes, and that their design enables them to be applied in a manner that is proportionate to the size and complexity of an entity, and therefore that it is in the public interest to have audits of SMEs performed using the same standards (i.e., as some would say “an audit is an audit”).



---

## Others Have Reacted to the Evolving Environment and Growing Complexity of the ISAs

Others too have recognized that there are challenges with applying the ISAs for audits of LCEs:

- At a global level, IFAC has developed a Guide to Using ISAs in the Audits of SMEs,<sup>4</sup> to assist with the application of the ISAs, and the Guide to Using ISAs in the Audits of SMEs is now in its Fourth Edition.
- National Standard Setters (NSS) and others have also sought to develop solutions to help practitioners when undertaking audits in circumstances where the entity is less complex, including national guidance for audits of SMEs, information technology (IT) tools (such as electronic methodologies) and ISA manuals.
- Jurisdictions have been changing their statutory thresholds for when an audit is required.
- Regional bodies, such as Accountancy Europe, have engaged stakeholders on matters relating to simplifying auditing standards for small or non-complex entities through publications and events.

The **Appendix** sets out examples of tools and resources developed by various jurisdictions.

More recently, there have also been various jurisdictional or regional initiatives specifically targeted at audits of less complex (or smaller) entities, including:

- In June 2015, a consultation on a “[Nordic Standard for Audits of Small Entities](#)” was published. The draft standard was developed by the Nordic Federation of Public Accountants for consultation in Sweden, Denmark, Finland, Iceland and Norway. Responses were received from all around the world, not only from the intended targeted countries. Respondents echoed the call for something to be done, but had mixed views about what this should be. One of the major messages from the responses was that, in order for this initiative to be successful, an international rather than a regional response was required. In light of this, the Nordic Federation of Public Accountants has continued to encourage the IAASB to focus efforts in this area.
- In 2018, Sri Lanka issued “[The Sri Lanka Auditing Standard for the Audits of Non-Specified Business Enterprises](#)” (SLAuS). The SLAuS was developed at the Institute of Chartered Accountants of Sri Lanka with the draft Nordic Standard being used in its development.
- In considering the introduction of a minimum threshold for mandatory audits in France, consideration is being given to a new ‘pronouncement’ for audits that would fall below the statutory threshold but where the entity may voluntarily seek an audit (this pronouncement may possibly be a simplified audit standard).
- In March 2019, Belgium published a statutory standard for auditing SMEs and small not-for-profit entities. This standard on contractual audits of SMEs, can be performed by both the registered auditors and the external accountants. It does not apply to statutory audits (for which only the ISAs apply) and includes the possibility to apply the ISAs if agreed between the relevant parties. The definition of an SME is linked to the threshold for mandatory audits. However, when the SME is considered to be complex, the registered auditors will have to apply the ISAs.

---

4 IFAC’s [Guide to Using International Standards on Auditing in the Audits of Small- and Medium-Sized Entities](#) (hereafter referred to as The Guide to Using ISAs in Audits of SMEs).

---

The concerns being expressed and the initiatives being undertaken in different jurisdictions around the world signal that additional support is likely needed in the application of the ISAs for LCEs, as well as further consideration about the standards themselves. Notwithstanding that guidance and other support is being developed at a jurisdictional or regional level, pressure is increasing for a global solution, with similar challenges being identified in many jurisdictions regardless of the size or complexity of the local business environment. In light of these jurisdictional and regional developments, we remain mindful of the relevance of our standards in relation to audits of LCEs.

## The Paris SMP / SME Conference

Shaping the way forward...

In early 2017, we (together with the Compagnie Nationale des Commissaires aux Comptes (CNCC) / the Conseil Supérieur de l'Ordre des Experts-Comptables (CSOEC)) convened a conference in Paris, France, to further discuss the needs of SMPs and SMEs and help shape a way forward. The two-day conference was attended by over 100 stakeholders from all over the world, including many practitioners representing SMPs, with a focus on both audits of SMEs and also other services performed by practitioners for SMEs. Broadly, the discussions related to audit can be summarized as follows:



- A strong need was expressed for better support for audits of smaller entities and LCEs.
- After a presentation on the draft Nordic Standard, mixed views were expressed about the need for a new separate standard.
- More needs to be done to understand the root causes of the issues that have been identified relating to audits of smaller entities, for example, further considering whether there is a deficiency in the standards or whether it is more an issue in the execution when applying the standards.
- Some stakeholders encouraged the IAASB to “think simpler first” in the revisions that were underway at the time.
- There is a growing perception in some jurisdictions that the increasing length and complexity of standards may lead to overly costly audits in the LCE sector of their economy.
- It was emphasized that more thought was needed about how to utilize the advances in technology (by the IAASB and others).
- Further consideration was needed:
  - To bridge the ‘expectations gap’ between different stakeholders.
  - About how to better promote the value of an audit.

Attendees recognized that it was not only the IAASB that needed to action some of these matters.

After this conference, we started to more intently explore what actions may be required to address the concerns and issues that had been discussed at the conference. The timeline on page 6 illustrates our related activities in this area before and since this conference.

## Our Ongoing Efforts Regarding Scalability and Proportionality in our Current Projects

We have also increased our focus on scalability and proportionality to explore what more can be done, for example, in our recent projects on ISA 540 (Revised)<sup>5</sup> and ISA 315 (Revised).<sup>6</sup>

With regard to ISA 540 (Revised), the standard now recognizes explicitly that scalability of the risk assessment and further procedures inherently varies with the complexity of the estimate, which may be particularly relevant for LCEs, i.e., where the processes relevant to accounting estimates may be uncomplicated because the business activities are simple or the required estimates may have a lesser degree of estimation uncertainty.

The exposure draft of ISA 315 (Revised) (ED-315)<sup>7</sup> has also taken a similar approach, with further support provided in new introductory paragraphs explaining the various aspects of the standard in 'simpler' language, as well as enhanced examples in the application material to illustrate how the requirements can be applied in varying circumstances. Many of these changes have been supported by respondents to the exposure draft. However, significant concerns were still expressed with regard to the length and scalability of the proposed revised standard. We will continue our efforts to address the concerns of our stakeholders as we finalize the revised standard, while remaining mindful of retaining the robustness of our standards.

## Next Steps

We are seeking feedback about whether the challenges relating to audits of LCEs have been correctly identified (refer to Section II), to be able to consider how the underlying reasons for these challenges can be best addressed. The information collected through the responses to this DP will help us make an informed decision on possible further actions in relation to audits of LCEs. The possible actions that could be explored by the IAASB (and on which we are seeking views of respondents) are set out in Section III.

---

<sup>5</sup> ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

<sup>6</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

<sup>7</sup> ED-315, *Identifying and Assessing the Risks of Material Misstatement*

---

## II. CHALLENGES RELATED TO APPLYING THE ISAs IN AUDITS OF LCEs

As set out in Section I, there is a broad range of influences on the audit environment, and therefore, there is not necessarily a one-size-fits-all solution. Furthermore, solutions may not lie with the IAASB alone, there will likely be action required by others too.

Not all of the influences leading to challenges when using the ISAs for audits of LCEs are under the control of the IAASB, or may form part of our considerations related to this initiative. We are, however, of the view that it is important to set out all the relevant considerations as we explore and gain feedback on the challenges related to auditing LCEs.

We are aware of various challenges that have been identified facing auditors of LCEs, and would like to further understand the underlying reasons for, or root causes of, the identified challenges. In addition, we would like to know whether there is anything else that should be considered as we progress our thinking in relation to audits of LCEs.

This section first sets out those identified challenges that are not within the boundaries of our work relating to audits of LCEs, and then, as context for the possible actions that follow in Section III, describes those identified challenges that are within the boundaries of our work related to audits of LCEs. We recognize the important role we play in relation to setting the standards and the influence we have, and are therefore committed to exploring what further can be done while being mindful of our stakeholders' expectations about what can be done.

Challenges in applying the ISAs differ, depending on a variety of factors. For example, additional support may be needed when the ISAs are first adopted within a particular jurisdiction, or may vary based on the size of the audit practice,<sup>8</sup> the level of resources, the number of audit engagements undertaken by an auditor, and the nature and complexity of the firm's audit clients.

The support available for applying the ISAs also varies between:

- Jurisdictions—for example, some jurisdictions have very active professional accountancy organizations providing substantial support, guidance and other related resources; and
- Firms—for example, some SMPs have less access to ongoing technical resources and other appropriate support compared to those belonging to large international networks.



---

<sup>8</sup> For example, a report from the UK's Financial Reporting Council, *Key Facts and Trends in the Accountancy Profession*, notes that 5,351 out of 5,660 (95%) registered audit firms have 6 or less principals per firm, indicating that a large majority of firms in the UK are smaller.

## Setting Boundaries for Our Work

### Challenges Not within Our Control or Within the Scope of the IAASB's Work on Audits of LCEs

The following sets out the factors driving the challenges noted by our stakeholders, and other relevant matters, that may impact the audit environment for LCEs, but that do not fall within our remit as an international standard-setter, or which we do not intend to consider as part of this project because it is related to other assurance engagements that are not audits and is therefore 'not in scope' when considering audits of LCEs. Notwithstanding that we do not intend to directly address these as part of our work in relation to audits of LCEs, we may be in a position to further consider how we may best influence and encourage actions by others.

Factors Driving Challenges that are Not Within the Control of the IAASB	
<b>Legal and Other Requirements for an Audit</b>	<p>The IAASB does not set the requirements for which entities require an audit as this is prescribed by each jurisdiction's laws and regulations (some jurisdictions have audit exemption thresholds above which an audit is mandatory) or influence in any way where an entity voluntarily elects to have an audit undertaken. We do not, and cannot be expected to be, involved in such jurisdictional or entity level determinations.</p> <p><i>To illustrate the variation in practice of different jurisdictions using audit exemption thresholds, countries within the European Union continue to change their thresholds, with some member states (Cyprus, Estonia, Italy and Romania) having lowered their thresholds in the last two years, while two member states (Denmark and Ireland) have increased their thresholds in the last two years.<sup>9</sup> Italy has recently introduced mandatory audits for very small companies, which is effective at the end of 2019. Other jurisdictions in Europe, such as France, have recently introduced audit thresholds as a way of reducing the burden on smaller entities. To further illustrate the point of jurisdictional mandate, an independent body of the Swedish parliament evaluated the impact of Sweden's 2010 reform that raised audit thresholds, and concluded that the costs to society outweighed the benefits, in particular that small companies' competitiveness and growth were not enhanced by abolishing audits. Accordingly, in 2018 Sweden did not further raise its audit threshold. It is not only in Europe that audit thresholds are changing, for example, Malaysia introduced audit thresholds, which were effective in 2018, and Australia has current proposals to double the current audit threshold (see Appendix).</i></p>
<b>Commercial Considerations Relating to an Audit</b>	<ul style="list-style-type: none"> <li>• Audit fee pressure,<sup>10</sup> often driven by market forces and other environmental influences, may lead to questions about the cost-benefit of performing the required audit procedures.</li> <li>• The auditing standards do not address fees, rather the Ethics Code sets out considerations relating to fees (including independence and objectivity).<sup>11</sup></li> </ul>
<b>Technology / Methodology</b>	<ul style="list-style-type: none"> <li>• Access to technology tools / methodologies that may help with the application of the ISAs in an audit of an LCE may be limited.</li> <li>• Although a helpful global solution, developing or promoting such technology tools or methodologies is not part of the remit of the IAASB as a standard-setter.</li> </ul>
<b>Education and People</b>	<ul style="list-style-type: none"> <li>• The ISAs set out the principles to be complied with in an audit, but do not prescribe how auditors are trained. The auditor's knowledge of the ISAs contributes to the effective execution of an audit. Therefore, a lack of understanding of existing, new or revised ISAs may negatively impact the way that the ISAs are applied.</li> <li>• Attracting and retaining talented people has been identified as a challenge, but is outside of the scope of the IAASB.</li> </ul>

9 Source: Accountancy Europe's "Audit Exemption Thresholds in Europe – 2019 Update."

10 *IFAC's 2018 Global SMP Survey* found that pressure to lower fees is the top challenge facing SMPs.

11 The International Ethics Standards Board for Accountants (IESBA) issued a publication, *Ethical Considerations Relating to Audit Fee Setting in the Context of Downward Fee Pressure*, to highlight auditor's ethical obligations under the *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the Code).

## Scoped Out of Exploratory Activities Related to Audits of LCEs

<b>Engagements Other than Audit</b>	<ul style="list-style-type: none"><li>• Although our other standards (i.e., review, assurance and related services standards) may be appropriate alternatives in cases where an audit is not required or needed, the scope of the IAASB's work on audits of LCEs addressed in this DP excludes further consideration of engagements that are not audits.</li><li>• Other engagements not specifically addressed by our International Standards, such as direct engagements.</li></ul>
<b>Enhanced Accessibility of the ISAs</b>	<ul style="list-style-type: none"><li>• Although we recognize the importance of converting the IAASB's Handbook to an electronic format to make it easier to use through better navigation and improved signposting, these efforts are outside of the project on audits of LCEs.<sup>12</sup></li></ul>
<b>Value of an Audit</b>	<ul style="list-style-type: none"><li>• Questions have been raised about the value of having an audit, including:<ul style="list-style-type: none"><li>– Trust in the audit process;</li><li>– Appropriate communication of information to support investment or funding decisions;</li><li>– Relevance of the information being reported on (e.g., backward-looking versus forward-looking); and</li><li>– Using technology to execute better audits.</li></ul></li></ul> <p>Although the changes to the standards may impact the matters influencing the value of an audit, and may influence the value of the audit for LCEs, the objective of the work on audits of LCEs addressed in this DP is not about directly exploring the value of an audit.</p>
<b>Public Expectations</b>	<ul style="list-style-type: none"><li>• Notwithstanding our recent efforts requiring the auditor to provide more transparency in relation to their work,<sup>13</sup> the gap in expectations between what the auditor does and what the auditor is expected to do still exists.</li><li>• The scope of this work is not intended to directly address this gap, but improving the application of ISAs to LCEs may close aspects of this gap and indirectly help users of financial statements better understand the procedures undertaken in an audit.</li></ul>

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

The objectives of our Clarity Project<sup>14</sup> was to write the standards in a clear and concise way, with the requirements set out as principles, and application material that sets out further explanation about the requirements and guidance about how to carry them out. In our view, a principles-based approach to the standards enables the application of the ISAs to entities with a wide variety of nature and circumstances.

The influences set out in Section I, and our journey in thinking more about what can be done to improve the application of the ISAs for LCEs, have already driven changes in our current work practices. For example, we have revised, or are in the process of revising, some of our core ISAs, including considering focusing on scalability as part of the revisions. However, ongoing concern and challenges with applying the ISAs (or proposals) is continually being highlighted by our stakeholders, in particular in relation to our recent exposure drafts (for example, in the responses to ED-315 as well as the responses that were received to the proposals to revise ISA 540 (Revised)).

The more significant, recurring comments regarding the ISAs set out below are presented in the context of what we have heard in relation to challenges when auditing LCEs, for the purpose of determining where the focus of our work should be. In addition, although some of these may be conflicting (for example, there have been criticisms regarding the increasing length of the standards, while there have also been calls for more guidance within the standards) we need to understand all of the challenges and their root causes to be able to determine an appropriate way forward.

<sup>12</sup> In 2019, working with IFAC, work effort will commence relating to converting the IAASB's Handbook to an electronic format.

<sup>13</sup> For example, through reporting on Key Audit Matters in the auditor's report and proposed new requirements for communication with external parties under the proposed International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*.

<sup>14</sup> In March 2009, we completed our Clarity Project, which had involved a comprehensive review of all ISAs to improve their clarity and thereby facilitate their consistent application. Approximately half of the clarified ISAs included substantive changes aimed at improving practice in a variety of respects.

<b>Language and Basic Approach to the Standards</b>	<ul style="list-style-type: none"> <li>• Some of the ‘clarity’ principles have diminished, with the language becoming more complex and therefore more difficult to comprehend. This may also impact the translation of the standards.</li> <li>• The standards are now being drafted to include the “how” in requirements i.e., the process to undertake the procedure, which is resulting in more detailed requirements, which is sometimes seen as a move away from principle-based requirements.</li> <li>• The detail in the standards is driving auditors towards more of a ‘compliance with the standards’ approach rather than an approach that encourages the use of professional judgment in determining the most appropriate audit procedures for the specific circumstances.</li> <li>• The standards can be difficult to navigate as they break up a continuous audit process into discrete elements, and are written in a linear way, but the audit process is iterative in nature. In addition, they are not electronic, so navigating is done manually.</li> </ul>
<b>Length of the Standards</b>	<ul style="list-style-type: none"> <li>• ISAs are voluminous, which can make them difficult to read and determine what needs to be done, and which has the potential to discourage some auditors from reading all of the relevant and necessary material.</li> <li>• Significant material is being added through recent revision processes of the core ISAs, in particular, to add application material as the ISAs become more complex; however, this material is needed to support the application of the standards. Paradoxically, some of this additional length is to aid scalability of the ISAs.</li> </ul>
<b>Documentation</b>	<ul style="list-style-type: none"> <li>• Documentation requirements throughout the ISAs are extensive, and becoming more onerous.</li> <li>• In many cases, there is a lack of clarity as to what needs to be documented, and the extent thereof, in particular, when auditing LCEs. This lack of clarity has sometimes resulted in: <ul style="list-style-type: none"> <li>– Different interpretations about how certain matters need to be documented.</li> <li>– Over documentation (for example, auditors of LCEs may include extensive documentation to justify what has not been done, which is seen as additional work that does not provide additional assurance or a measurable increase in audit quality).</li> </ul> </li> </ul>
<b>Lack of Clarity as to What Needs to be Done or Why</b>	<ul style="list-style-type: none"> <li>• In some cases, unnecessary procedures are being performed because when an auditor is faced with a specific set of circumstances, the standards are not clear about the nature and extent of the work required. In other circumstances, necessary procedures are not being performed because the application of the requirements to the circumstances are not clear.</li> </ul>
<b>Not Enough Guidance Within / Outside of the ISAs</b>	<ul style="list-style-type: none"> <li>• Paragraphs detailing <i>considerations specific to smaller entities</i>, where they are presented within the ISAs, are not helpful in all cases to understand scalability and proportionality of the requirements.</li> <li>• There is insufficient supporting material to aid effective application of the ISAs.<sup>15</sup></li> </ul>
<b>ISAs Noted as Particularly Problematic</b>	<ul style="list-style-type: none"> <li>• Risk identification and assessment—some stakeholders have noted that the proposals in ED-315 may lead to an over-engineered risk assessment for entities in a non-complex environment. The changes proposed in ED-315 have also been seen by some to add unnecessary complexity, in particular, in relation to obtaining an understanding of the system of internal control (which is also a noted issue in extant ISA 315 (Revised)).</li> <li>• The auditor’s considerations in relation to fraud—the focus of the work to comply with the requirements of ISA 240<sup>16</sup> when auditing an LCE is considered by some to be more onerous than what would be appropriate in the circumstances.</li> <li>• Auditing accounting estimates—some audit procedures required under ISA 540 (Revised) have been noted by some as unnecessary, especially where the estimates do not involve complex fair values or significant forward-looking information.</li> <li>• In addition to the ISAs noted above, there may be other aspects of the ISAs where the standards are not seen to be robust with regard to scalability and proportionality – the IAASB is looking for further feedback on these (refer to Question 2).</li> </ul>

15 However, the IAASB’s proposed [Strategy for 2020–2023](#) has indicated a future focus on implementation activities, and we have been increasing our activities relating to the initial implementation of new and revised standards through webinars, supporting guidance, etc.

16 ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*

---

### III. POSSIBLE ACTIONS TO BE EXPLORED

The IAASB and others have recognized the need for global solutions to address the challenges in relation to audits of LCEs.

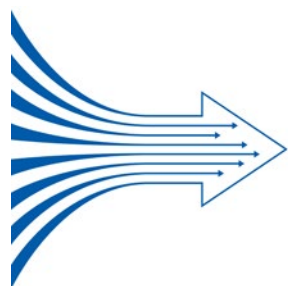
In light of the challenges within the scope of our work on audits of LCEs as set out in Section II, we have reflected on potential possible actions that could be undertaken.

The most appropriate way forward may be one, or a combination of the possible actions, or only some aspects of the possible actions, set out hereafter, and may also include other actions identified by respondents. Some of the possible actions will be quicker to progress (for example, developing non-authoritative guidance), while others will take longer (for example, standard-setting activities). In addition, consideration will be given to the impact on **all** stakeholders using the ISAs (positively or negatively), not only those interested in audits of LCEs.

In our efforts to date, we have recognized that there is no simple solution—the ISAs are intended for audits of a wide variety of entities, ranging from large, complex public interest entities to entities that are considerably less complex; therefore, there are competing interests. We have not yet decided on a future course of action and remain open minded as to what are the most appropriate future possible actions. Accordingly, responses to the challenges outlined in this DP are needed to better understand whether:

- Such possible actions may be appropriate for all stakeholders;
- There is anything else that we need to know in our considerations of these actions; or
- Further research and information gathering is needed.

The input will help us develop a clear direction for our future work in this area and to appropriately scope any future projects related to these matters. There will likely be mixed views on some of these possible actions,<sup>17</sup> and it is therefore essential that we are informed as to the views of **all** our stakeholders, including understanding the rationale underpinning those views. The potential possible actions that we have identified that are described further in this document include:



- A. Revising the ISAs.
- B. Developing a Separate Auditing Standard for Audits of LCEs.
- C. Developing Guidance for Auditors of LCEs or Other Related Actions.

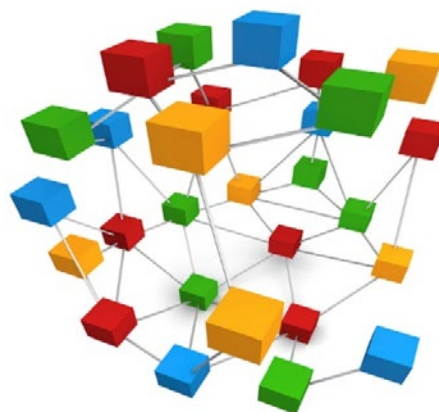
---

<sup>17</sup> The Accountancy Europe publication, [Simplifying Auditing Standards for Small or Non-Complex Entities](#), sets out Pros and Cons of various possible actions that have been explored in its publication.



## A. Revising the ISAs

The ISAs could be revised to make the auditor’s work effort clearer, in particular to benefit audits where the circumstances of the entity are less complex. We continue to place great emphasis on addressing complexity and scalability of the ISAs in our projects, as have been described in Sections I and II. In order to address the identified challenges in applying ISAs in audits of LCEs, we are keen to get views on what further can be done, while always remaining mindful of the need to retain the robustness and quality of our standards.



Broadly, this may involve one or more of the following:

- Greater focus on 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), with appropriate application material to support applying the requirements effectively and efficiently.
- 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”).
- Considering how the application material could feature more scalability and proportionality considerations, e.g., providing examples of both simple and complex circumstances in order to contrast the differences.
- Better signposting within the application material about how to apply the requirements that are relevant to audits of LCEs. This could be done, for example, by enhancing the considerations specific to audits of LCEs (previously included in the standards as considerations specific to smaller entities) in a separate section within each ISA.

There are various ways that such a revision of the ISAs could be undertaken:

- Revising all of the ISAs as part of one substantial project.
- Revising the ISAs on a rolling or phased basis (for example, selecting a group of ISAs for updating, and once completed select other ISAs, or selecting certain standards to be revised first, possibly those where the most challenges for audits of LCEs have been identified).
- Making targeted changes when an ISA is being revised—we are currently exploring this approach on projects currently underway. For example, we are focusing on the complexity, and scalability and proportionality, of our proposals relating to the revision of ISA 315 (Revised).<sup>18</sup>

The exact approach how best to revise the standards would still need to be determined, and further exploratory work may be needed to determine our specific activities.

---

<sup>18</sup> Our Consultation Paper on our [proposed Strategy for 2020–2023 and Work Plan for 2020–2021](#) has highlighted the importance of developing ways to address complexity, while maintaining scalability and proportionality, as a strategic focus in our future strategy period.

---

## B. Developing a Separate Auditing Standard for Audits of LCEs

The development of a separate standard specifically for audits of smaller entities has been the subject of discussion internationally, with a number of jurisdictions having developed, or in the process of developing, drafts or pronouncements. However, from previous outreach (including the 2017 Paris Conference), we have heard concerns from some stakeholders about the development of a separate standard for auditing LCEs. Nevertheless, in light of developments in the environment where others are actively pursuing an alternative for audits of LCEs, and our commitment to exploring a global approach, we have the view that this is included as a possible option to gather input from our stakeholders.

From outreach undertaken to date, it is clear that the level of assurance for the audit opinion issued in accordance with any standard should be the same as the ISAs (i.e., reasonable assurance). However, what reasonable assurance means in the circumstances may vary by context, which may need to be explored further. It has also been highlighted that any separate standard developed should retain a similar robustness as the ISAs.

We have not specifically discussed the content of such a standard but recognize the importance of outlining the key features of such a standard to provide a basis for respondents to form their views. The following has been developed based on work done by others in this area. More would need to be done to determine whether this is a feasible option.

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 ISAs, local laws and regulations would then prescribe when such a standard could be used in a particular jurisdiction.

### *Separate Auditing Standard Based on the Existing ISAs*

A separate auditing standard could be based on the existing ISAs with the aim of achieving the same objective and encompassing all the relevant requirements for an audit of an LCE, including compliance with ISQC 1 (or the IAASB's new proposed quality management standards) and relevant ethical requirements.

Other possible features include:

- Mirroring the risk-based approach of the ISAs but be presented in a way that follows the work flow of an audit.
- Quality management principles at the engagement level, setting out, for example, a focus on the broad quality management principles such as the engagement partner's responsibilities.
- Retaining principle-based requirements appropriate for audits of LCEs that allow the auditor to use their professional judgment to focus on the objectives to be achieved by the auditor (i.e., more appropriately focused on being outcomes-based in the circumstances of LCEs and refraining from including specific procedures and processes); developed based on the existing ISAs where relevant for LCEs.
- Aligning any documentation requirements with the principles of ISA 230,<sup>19</sup> with consideration given to whether more specific documentation requirements may be needed in areas that would be applicable to LCEs.

As the standard would be based on the ISAs, it may not have a complete set of specific application material developed; rather the development of supporting guidance and application material could be left to others (such as NSS) to develop, or if based on the same principles and structure as the ISAs, may reference the applicable parts of the ISAs (in a similar way that International Financial Reporting Standards (IFRSs) are referenced in the *IFRS for SMEs Standard*).

---

<sup>19</sup> ISA 230, *Audit Documentation*

---

### **Separate Auditing Standard Developed Based on a Different Framework**

The approach for the development of a separate standard described above focuses on the ISAs as a starting point. An alternative is to explore the option of developing a standalone standard taking a different approach from the risk-based approach in the current ISAs. Such an approach would likely require the development of a supporting framework including relevant criteria, with the objective that the engagement would result in the same assurance as an audit opinion. Such an approach could, for example, be more substantive in nature.

The development of a separate standard of this nature would require substantial research and information gathering activities to be undertaken in order to determine viability and, therefore, would likely have a substantially longer timeframe than some of the other options that have been identified.

### **C. Developing Guidance for Auditors of LCEs or Other Related Actions**

There have been ongoing calls for more guidance for applying the ISAs in audits of LCEs, notwithstanding our current, and future proposed, efforts in relation to the development of guidance and support materials. In particular, there are calls for a practical “how to” guide when approaching an audit of an LCE, as well as for specific areas within the ISAs specific to auditing LCEs.

This section addresses guidance and other support material developed specifically for audits of LCEs that is outside of the ISAs (i.e., not application or other explanatory material within the ISAs), so the nature of such material would be non-authoritative. Options for guidance, in addition to current and planned future efforts relating to implementation guidance, may include:

- a. *A comprehensive guide about how to apply the ISAs in circumstances where the nature and circumstances of the entity being audited are less complex.* A guide along these lines has already been developed by IFAC (the Guide to Using ISAs in Audits of SMEs, see footnote 4, hereafter referred to as “The Guide”), which is intended to provide practical support when applying the ISAs in audits of SMEs. The Guide is currently set out in two volumes, with Volume 1 covering the fundamental concepts of a risk-based approach, and Volume 2 setting out practical examples including illustrative case studies. The Guide has been translated into over 20 languages, and the latest version has been downloaded in more than 140 countries. However, notwithstanding the broad demand for The Guide, it is voluminous and there are many stakeholders still calling for more. Instead of developing our own guide, we could also consider how we could collaborate with IFAC in enhancing The Guide, as appropriate.
- b. *An International Auditing Practice Note (IAPN) for Audits of LCEs*—IAPNs do not impose additional requirements on auditors beyond those required by the ISAs, nor do they change the auditor’s responsibility to comply with all of the ISAs relevant to the audit being undertaken. They are intended to provide practical assistance to auditors. Such an IAPN would likely only cover specific areas where additional guidance is needed.
- c. *Guidance for the application of specific areas within the ISAs, or particular ISAs<sup>15</sup> specifically for challenges identified related to audits of LCEs*—for example, a guide specifically targeted at risk identification and assessment.
- d. *Focused “implementation packs” for new and revised ISAs specifically for audits of LCEs*—including slide presentations, webinars and focused guidance about how to implement the revised or new ISA, to educate and assist once new or revised standards are published.

# QUESTIONS FOR RESPONDENTS

Your feedback will be helpful to us in determining an appropriate way forward in relation to audits of LCEs. In answering the following questions, providing detail and reasons for your answers will assist us in understanding the views of our stakeholders.

*Stakeholders may choose to answer all, or only some, of the questions below—all input is helpful to our future considerations.*

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?
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.
  - 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?
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?
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.
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?

---

# APPENDIX

## Standards, Guidance and Tools (Recent Literature)

1. [\*Belgian Standard on Contractual Audits of Small and Medium Entities.\*](#)
2. [\*Chartered Professional Accountants Canada, 2011. Anatomy of a 12-hour audit for micro-entities.\*](#)
3. [\*Conseil Supérieur de l'Ordre des Experts-Comptables, 2017. Professional Standard for the Audit Mission of Financial Statements in a Small Entity \(NP 2910\).\*](#)
4. [\*CPA Australia, 2017. Small Entities Audit Manual \(SEAM\).\*](#)
5. [\*Hong Kong Institute of Certified Public Accountants, 2016. Audit and Practice Manual.\*](#)
6. [\*IFAC, 2018. Guide to Using International Standards on Auditing in the Audits of Small- and Medium-Sized Entities \(4th Edition\).\*](#)
7. [\*Institut Österreichischer Wirtschaftsprüfer, 2017. Quality Assurance Handbook – Guidance No 27.\*](#)
8. [\*Instituut van de Bedrijfsrevisoren - Institut des Réviseurs d'Entreprises, 2018. Pack Petites Entités - Small Entities \(PE-KE\) version 4.0 and Case Study.<sup>21</sup>\*](#)
9. [\*Instituut van de Bedrijfsrevisoren - Institut des Réviseurs d'Entreprises, 2017. Technical note: Summary of the audit approach in non-complex entities.\*](#)
10. [\*Nordic Federation of Public Accountants, 2015. Consultation - Nordic Standard for Audits of Small Entities.\*](#)
11. [\*The Institute of Chartered Accountants of Sri Lanka, 2018. Sri Lanka Auditing Standard \(SLAuS\) for the Audits of Non-Specified Business Enterprises \(Non-SBEs\).\*](#)

## Articles and Thought Leadership (Recent Publications)<sup>22</sup>

1. [\*Accountancy Europe, 2018. Rediscovering the Value of SME Audit.\*](#)
2. [\*Accountancy Europe, 2018. Simplifying Auditing Standards for Small or Non-Complex Entities.\*](#)
3. [\*Accountancy Europe, 2019. Audit exemption thresholds in Europe.\*](#)
4. [\*Association of Chartered Certified Accountants, 2018. Thinking Small First. Towards better auditing standards for the audits of less complex entities.\*](#)
5. [\*Centre for Financial Reporting Reform – World Bank Group, 2017. Small and Medium Practices: The Trusted Advisors of SMEs.\*](#)
6. [\*Centre for Financial Reporting Reform – World Bank Group, 2016. Smaller audits: Challenges and Insights.\*](#)

---

21 This tool was originally developed by CNCC and is used in France and many other countries.

22 IFAC Knowledge Gateway Audit & Assurance Section, which includes just under 100 articles and videos. Available at: <http://www.ifac.org/global-knowledge-gateway/audit-assurance>.

- 
7. [Chartered Accountants Australia and New Zealand, 2016. Perspective: How audits can work for small entities.](#)
  8. [Chartered Accountants Australia and New Zealand, 2017. Perspective: Are International Auditing Standards suitable for small audits?](#)
  9. [Edinburgh Group, 2019. The SMP of the future in a changing world.](#)
  10. [European Federation of Accountants and Auditors for SMEs, 2018. To audit or not to audit: Debunking the myths about audit for SMEs.](#)
  11. [Evidence on the Value of an Audit for SMEs in Europe, 2019](#)
  12. [IFAC, 2016. Choosing the Right Service: Comparing Audit, Review, Compilation, and Agreed-Upon Procedure Services.](#)
  13. [IFAC, 2016. The Role of SMPs in Providing Business Support to SMEs: New Evidence – Key Findings.](#)
  14. [IFAC, 2017. 2016 IFAC Global SMP Survey Report & Summary.](#)
  15. [IAASB, 2017. SMP / SME Audits Presentation](#)
  16. [IFAC 2018. IFAC Global SMP Survey: 2018 Summary.](#)
  17. [Swedish National Audit Office, 2017. Abolition of audit obligation for small limited companies.](#)
  18. [Treasury Australia, 2018. Reducing the financial reporting burden by increasing the thresholds for large proprietary companies.](#)

The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants® or IFAC®.

The IAASB and IFAC do not accept responsibility for loss caused to any person who acts or refrains from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

International Standards on Auditing, International Standards on Assurance Engagements, International Standards on Review Engagements, International Standards on Related Services, International Standards on Quality Control, International Auditing Practice Notes, Exposure Drafts, Consultation Papers, and other IAASB publications are published by, and copyright of, IFAC.

Copyright © 2019 by IFAC. All rights reserved. Permission is granted to make copies of this work to achieve maximum exposure and feedback provided that each copy bears the following credit line: "Copyright © 2019] by the International Federation of Accountants® or IFAC®. All rights reserved. Used with permission of IFAC. Permission is granted to make copies of this work to achieve maximum exposure and feedback."

The 'International Auditing and Assurance Standards Board', 'International Standards on Auditing', 'International Standards on Assurance Engagements', 'International Standards on Review Engagements', 'International Standards on Related Services', 'International Standards on Quality Control', 'International Auditing Practice Notes', 'IAASB', 'ISA', 'ISAE', 'ISRE', 'ISRS', 'ISQC', 'IAPN', and IAASB logo are trademarks of IFAC, or registered trademarks and service marks of IFAC in the US and other countries.

For copyright, trademark, and permissions information, please go to [permissions](#) or contact [permissions@ifac.org](mailto:permissions@ifac.org).

ISBN: 978-1-60815-405-0



529 Fifth Avenue, New York, NY 10017  
T +1 (212) 286-9344 F +1 (212) 286-9570  
[www.iaasb.org](http://www.iaasb.org)