



Our Ref.: C/AASC

12 September 2019

International Auditing and Assurance Standards Board
529 Fifth Avenue, 6th Floor,
New York
NY 10017
USA

Dear Sirs,

**IAASB DISCUSSION PAPER, *AUDITS OF LESS COMPLEX ENTITIES:
EXPLORING POSSIBLE OPTIONS TO ADDRESS THE CHALLENGES IN
APPLYING THE INTERNATIONAL STANDARDS ON AUDITING (ISAs)***

The Hong Kong Institute of Certified Public Accountants is the only body authorised by law to set and promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We are grateful for the opportunity to provide you with our comments on this Discussion Paper (DP).

Overall, we support the IAASB's initiative to explore possible actions to address the challenges in audits of less complex entities ("LCEs").

We note that the practitioners generally consider the existing requirements in ISAs, which have been developed mainly from a public interest perspective, are onerous and extensive for auditors of LCEs which are privately owned with straight forward information systems and internal controls. While professional judgment plays an important role to interpret the standards and determine the audit approach for specific circumstance, local Small and Medium Practices ("SMPs") are of the view that the existing ISAs require auditors to perform procedures and documentation which may be unnecessary in the audits of LCEs.

We generally agree with the description for LCEs in the DP and consider that it is fit for the purpose for discussion. However, a clearer definition of LCEs in the actual guidance or standard will be important for auditors to determine whether an entity is a LCE and which auditing standard should be applied for the audit of such entity.

We believe that there are advantages and disadvantages for each of the possible actions. We are concerned regarding the time frame for revising the ISAs. We also consider that it would be challenging to develop a separate auditing standard for LCEs which would have the same fundamental principles as ISAs. We consider that developing separate guidance to address the practical challenges of applying ISAs in LCEs audits may be a possible action as a quick fix to address practitioners' concerns.



Our responses to the specific questions are included in the attachment. We trust that our comments are of assistance to you. If you require any clarifications on our comments, please contact Selene Ho, Deputy Director of the Standard Setting Department (selene@hkiipa.org.hk).

Yours faithfully,

Chris Joy
Executive Director

CJ/SH

**HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS'
COMMENTS ON THE IAASB'S DISCUSSION PAPER
AUDITS OF LESS COMPLEX ENTITIES: EXPLORING POSSIBLE OPTIONS TO
ADDRESS THE CHALLENGES IN APPLYING THE INTERNATIONAL STANDARDS
ON AUDITING (ISAs)**

- 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?**

In general, we consider that the description is appropriate for the types of entities that would be the focus of the IAASB's work in relation to audits of LCEs.

We consider that the description is fit for the purpose as a starting point for discussion. However, the IAASB should tailor the characteristics when developing the guidance or standards and provide more parameters on how to determine LCEs. A clear definition of LCEs will be important to enable the auditor to determine whether an entity is a LCE and which auditing standard should be applied for the audit of such entity.

Other than the characteristics set out in the DP, we consider that LCEs should explicitly exclude listed entities or public interest entities ("PIEs). Listed entities or PIEs normally have a large number and wide range of stakeholders, additional regulatory or legal requirements are applied to these entities to address the perception concerns. Therefore, these entities usually have more complex internal controls and more levels of management with responsibility for a broad range of controls.

- 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?**

The following reflect the comments solicited from local SMPs:

| ISAs | Problematic requirements and underlying cause(s) | How the challenges were managed or addressed |
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| <p>ISA 240, <i>The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements</i></p> | <p>Under ISA 240, when identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.</p> <p>The standard gives an example that the presumption of fraud risk in revenue recognition may be rebutted where the client undertakes a single type of simple revenue transactions (e.g. property rental). Where the revenue transactions are more complex, auditors should always treat revenue recognition as a significant risk and design appropriate audit work. As a result of this presumption, the auditors of LCEs are required to perform extensive testing and documentation even when the assessed risks of fraud are considered to be low.</p> | <p>Extensive documentation is a key challenge for auditors of LCEs. In order to address the challenges, more time were spent on planning stage and documentation of the risk assessment and audit procedures.</p> |
| <p>ISA 300, <i>Planning an Audit of Financial Statements</i></p> <p>ISA 315 (Revised), <i>Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment</i></p> | <p>Under ISA 300, the auditor shall develop an audit plan that shall include a description of the nature, timing and extent of planned risk assessment procedures, as determined under HKSA 315 (Revised). Under ISA 315 (Revised), the auditor shall perform</p> | <p>Some auditors developed two sets of planning templates, one for general audits and one for small audits. The small audit templates basically adopted the same audit methodology as the general templates but with simplified</p> |

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| | <p>and document risk assessment procedures and understanding of the entity's internal control for designing and implementing responses to the assessed risks of material misstatement.</p> <p>For LCEs, they typically have uncomplicated transactions and few internal controls, the requirements on risk assessment procedures and documentation of internal controls would be too onerous and ineffective. Extensive documentation is made even when some requirements are not applicable for audits of LCEs in order to justify what has not been done.</p> | <p>questions and less documentation.</p> |
| <p>ISA 320, <i>Materiality in Planning and Performing an Audit</i></p> <p>ISA 530, <i>Audit Sampling</i></p> | <p>Under ISA 320, the auditor shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures. Performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.</p> | <p>Given LCEs generally have less transactions or account balances, some of the auditors of LCEs simply perform 100% audit testing and identify all the audit adjustments rather than documenting and applying the basis for determining the relevant materiality.</p> |

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| | <p>Under ISA 530, the auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.</p> <p>The determination of materiality and sample size for audit testing both involve the use of professional judgment. For audits of LCEs, the extent of audit testing tends to be more judgmental. As LCEs generally have less transactions or account balances, auditors found it more efficient to perform audit testing judgmentally based on past experience or their understanding of the LCEs rather than reference to a pre-set materiality or sample size.</p> | |
| <p><i>ISA 520, Analytical Procedures</i></p> | <p>Under ISA 520, when designing and performing substantive analytical procedures, the auditor shall develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.</p> <p>It is difficult for auditors of LCEs to develop and evaluate the expectation of recorded amounts or ratios, as the market indexes or information are usually not relevant to the LCEs.</p> | <p>Sometimes this challenge cannot be fully addressed and the auditors need to place some reliance on the LCEs' internal projections which are estimates based on past experience and expectations about future which can never be fully verifiable at the time they are made.</p> |

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| <p>ISA 540 (Revised), <i>Auditing Accounting Estimates and Related Disclosures</i></p> | <p>Under ISA 540 (Revised), the objective of the auditor is to obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures in the financial statements are reasonable in the context of the applicable financial reporting framework.</p> <p>In order to meet the objective, the auditor is required to perform and document the risk assessment procedures and audit procedures as stated in the standard.</p> <p>Based on our practice reviews, many deficiencies identified in auditing accounting estimates. The key challenge for the auditors of LCEs is the increasing complexity of the accounting standards and the difficulty in understanding them. This resulted in insufficient or inappropriate audit work on management assumptions and appropriateness of accounting estimates.</p> | <p>A considerable amount of time is consumed by the auditors to understand the accounting standards and design the audit procedures.</p> |
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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?

We agree with the IAASB on the areas which have been identified as not within IAASB's control or scoped out and we do not have comment on encouraging others to act.

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.**

A. Revising the ISAs

We noted that the IAASB had increased the focus on scalability in the recent projects on ISA 540 (Revised) and ISA 315 (Revised). However, we believe that the challenges would not be addressed appropriately and in a timely manner by revising the ISAs.

One of the identified challenges is the increasing length of the standards, revising the ISAs by adopting the "building –blocks approach" will probably add to complexity and volume of the standards. In addition, the time taken to revise all the ISAs will be too long and it is not able to address the challenges currently faced by the auditors of LCEs in a reasonable timeframe.

B. Developing a Separate Auditing Standard for Audits of LCEs

From our outreach activities, most of the local stakeholders were in favour of this option and considered that it is desirable to have a small auditing standard for entities which apply small accounting standard. The separate auditing standard should be based on the existing ISAs and scale down for LCEs.

On the other hand, the local stakeholders are concerned about the timing factor of this option. Considerable time may be required for the IAASB to develop a separate standard. An alternative option to speed up the process is to adopt or build on those standards already developed by other jurisdictions.

As a standard setter, we have concerns on the development of a separate standard for auditing LCEs. With two sets of auditing standards, i.e. ISAs and a separate auditing standard for LCEs, which aim to achieve the same level of assurance for the audit opinion, it would be difficult for users of audit reports to understand how two different sets of auditing standards could achieve the same level of assurance and the separate standard is of similar robustness as the ISAs.

Another concern is the length of the separate standard and how comprehensive should the content be. Although some of the ISAs are complex and lengthy but the requirements are relevant for all entities. It may not be easy to decide on the scope of the separate auditing standard.

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

Developing guidance for auditors of LCEs would address the identified challenges appropriately and should be achievable in a reasonable time. Guidance could be provided for those problematic requirements of specific ISAs which are identified in 2(a) above. For example, guidance can be provided on how to apply the ISAs and what kind of documentation is expected in audits of LCEs. Suggested documentation templates included as part of the guidance would be helpful.

(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.

We have not identified other possible actions.

(c) In your view, what possible actions should be pursued by us as a priority, and why? This may include one or more of the possible actions, or aspects of those actions, set out in Section III, or noted in response to 4b above.

From our feedback to Question 2 above, we consider that the IAASB should firstly focus on the specific ISAs with problematic requirements and develop separate guidance for the application of specific areas within these ISAs.

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?

In preparing the feedback to Question 2 above, we have also discussed with our Quality Assurance Department which is responsible for practice reviews. We therefore suggest the IAASB should work with the relevant regulators who perform practice reviews and inspect the audit documentation of the practitioners as the IAASB deliberates on the way forward. These regulators should have certain expectations on audit documentation and can provide some insights to the IAASB in relation to audits of LCEs.

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