

Small Entity Update

Introduction

1. The current version of IAPS 1005, “The Special Considerations in the Audit of Small Entities” was issued in March 1999 and replaced a previous version issued in March 1989 that had only 22 paragraphs. The practice statement is not intended to be a “how to” guide for audits of small entities, nor is it intended to be a guide for small practitioners on how to carry out audits. Rather, it is intended to be used by practitioners who already know how to conduct an audit in accordance with ISAs, but who need guidance on how audits of the financial statements of small entities differ from audits of the financial statements of other entities. Accordingly, explanatory information and guidance that might be helpful but does not relate only to small entities is not included.

Main Audit Guidance

ISA 100, “Assurance Engagements”

2. ISA 1005 is directed to audits of the financial statements of small entities. Other types of assurance engagements are not within its scope. ISA 100 deals with the general principles of assurance engagements and their general application to high level assurance engagements. These principles do not change when the subject matter of the engagement originates with a small entity. For these reasons, no change is proposed to IAPS 1005 in respect of this standard.

ISA 200, “Objective and General Principles Governing an Audit of Financial Statements”

3. A change was made to the paragraph that requires the auditor to exercise professional skepticism. IAPS 1005 does not discuss ISA 200 directly, but it does refer to professional skepticism. However, the discussion in IAPS 1005 is closer to the thoughts expressed in the revised version of ISA 200 than it is to the original version, and no change is proposed.

ISA 240, “The Auditor’s Responsibility to Consider Fraud and Error in an Audit of Financial Statements”

4. IAPS 1005 contained two paragraphs dealing with the application of the old version of ISA 240. The first paragraph (paragraph 32) was necessary to explain that when ISA 240 indicated management being dominated by one person was an example of a condition or event that increased the risk of fraud or error, that was not intended to imply that all small entities were to be regarded as necessarily involving a higher risk of fraud or error than larger entities. In the new ISA 240, this point is discussed in the standard itself and so there is no need for it to be included in the practice statement. It is proposed that this paragraph be deleted.

5. Paragraph 33 gave some useful guidance on how to assess the effect of the presence of a dominant owner manager. The discussion is in terms entirely consistent with the new version of ISA 240 and no changes to it need to be made.
6. The other changes made to ISA 240 dealt mainly with what the auditor does once fraud or error has been discovered. None of these raise any points that are peculiar to small entities or raise difficulties that arise only in small entities.

ISA 260, “Communications of Audit Matters With Those Charged With Governance”

7. The following paragraph should be added to the IAPS.

As paragraph 8 of ISA 260 indicates, governance structures in small entities are often not well defined. In such entities, management and those charged with governance are the same people. Where audit matters of governance interest have been communicated to persons in their capacity as management of the entity, auditors are not required to recommunicate those matters to the same people in their capacity as persons charged with governance. However, where management does not include all persons charged with governance, the auditor communicates audit matters of governance interest to all those charged with governance, notwithstanding that some of those persons may already have received the relevant information from the auditor.

ISA 505, “External Confirmations”

8. This ISA replaced and expanded part B of ISA 501. IAPS 1005 has no paragraphs dealing with ISA 501. No points raised in ISA 505 cause any problems with small entities, and there do not seem to be any particular difficulties in the use of confirmations that arise in audits of small entities.

ISA 545, “Auditing Fair Value Measurements and Disclosures”

9. The standard deals with a similar subject matter to ISA 540, “Audit of Accounting Estimates”. IAPS has no paragraph dealing with ISA 540, as there are no issues unique to audits of financial statements of small entities in that standard. No such issues arise in ISA 545 either.

ISA 570, “Going Concern”

10. This existing ISA is dealt with by paragraphs 83–86 of the practice statement. Paragraphs 83 and 86 give useful advice on specific risks and the evidence the auditor might require. These paragraphs remain valid and could remain unchanged. However, the other paragraphs use terminology that is closely linked with the old standard and need to be revised. The revisions, however, are fairly minor. The changes to the standard were not such as to require additional material. Set out below are the revised versions of the two affected paragraphs, showing the changes made.

84. ISA 570 requires that auditors consider whether there are any events or conditions which may cast significant doubt on the entity’s ability to continue as a going concern, the risk that the going concern assumption may not be appropriate. Risk factors Conditions of particular relevance to small entities include the risk prospect that banks and other lenders may might cease to support the entity, the risk possibility of the loss of a major customer or key employee, and the risk of the possible loss of the right to operate under a license, franchise or other legal agreement.

85. ISA 570 gives guidance on the ~~evidence to be obtained~~ additional audit procedures that may be relevant when a question arises as to the appropriateness of the going concern basis events or conditions have been identified which may cast significant doubt on the entity's ability to continue as a going concern. Such ~~evidence procedures~~ may include a review of documentation such as ~~budgets~~, cash flow and profit forecasts. In the audit of a small entity, the auditor does not ordinarily expect to find detailed ~~budgets and~~ forecasts relevant to the consideration of going concern. Nevertheless, the auditor discusses with the owner-manager the going concern status of the entity and in particular, the financing of the entity in the medium and long-term. The auditor considers these discussions in the light of corroborative documentation and the auditor's knowledge of the business. The auditor considers the need to obtain written management representations.

ISA 700, "The Auditor's Report on Financial Statements"

11. The only change made to ISA 700 was to require the auditor's report to refer to the country of origin of the financial reporting framework. For financial statements of small entities this will usually be an easy matter to determine, and no change is proposed to the existing paragraphs in IAPS 1005 that deal with ISA 700.

Guidance When the Auditor Also Provides Accounting Services

ISA 100, "Assurance Engagements"

12. For the reasons given above, no additional wording is required here.

ISA 200, "Objective and General Principles Governing an Audit of Financial Statements"

13. For the reasons given above, no additional wording is required here.

ISA 240, "The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements"

14. The IAPS contains one paragraph, paragraph 106, on this aspect. The paragraph and its terminology are entirely appropriate for the new standard, and no changes are proposed.

ISA 260, "Communications of Audit Matters With Those Charged With Governance"

15. There do not seem to be any additional points that need to be brought out other than those mentioned above.

ISA 505, "External Confirmations"

16. The paragraph dealing with ISA 500, "Audit Evidence", paragraph 110, makes clear that, accounting services will seldom provide all the audit evidence the auditor needs. There does not seem to be a need to repeat the point. Accordingly it is proposed that no paragraph be added dealing with ISA 505

ISA 545, “Auditing Fair Value Measurements and Disclosures”

17. Much the same considerations apply to ISA 545 as apply to ISA 540. Accordingly it is proposed that a single paragraph be added to that effect.

ISA 570, “Going Concern”

18. The paragraph that deals with the ISA is completely appropriate to the new version of the ISA and no changes are proposed.

ISA 700, “The Auditor’s Report on Financial Statements”

19. No need for any guidance on this subject, and none is currently included.