

### Audits of Less Complex Entities–Discussion

#### Objectives of Agenda Item

The objectives of this Agenda Item are to discuss and approve the Discussion Paper, *Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges*, set out in **Agenda Item 5-A** for public consultation.

#### Introduction

1. In September 2018, the IAASB broadly supported the proposed work of the Less Complex Entities (LCE) Working Group to develop a Discussion Paper (DP) on Audits of Less Complex Entities.
2. The IAASB's proposal for action, *Proposal for IAASB Action to Develop a Discussion Paper and Recommendations for Future Possible Actions Relating to Audits of Less Complex Entities* (the proposal) (**Agenda Item 5-B**)<sup>1</sup> sets out the LCE Working Group's actions to develop recommendations for the most appropriate way forward relating to audits of LCE's for IAASB consideration. The proposal was finalized with the IAASB's Steering Committee in February 2019, and sets out the Board's activities until the Board's discussions about the appropriate way forward, as it was agreed it was important to set out the IAASB's commitment to exploring what more can be done in relation to audits of LCE's.
3. Paragraph 8 of the proposal sets out the IAASB's activities in 2017 and 2018 leading up to the discussions at the September 2018 IAASB meeting, illustrating the progress being made in this area which has now culminated in the draft DP for consultation.
4. This Agenda Item outlines the LCE Working Group's thinking in developing the DP and related outreach and other activities of the LCE Working Group. The development of the recommendations about possible courses of action will be based on the feedback received from the DP and other outreach activities.

#### Draft Discussion Paper

5. The LCE Working Group has developed the draft DP (**Agenda Item 5-A**) with the intended audience in mind, in particular practitioners who undertake audits of LCEs. The LCE Working Group has also been mindful of including sufficient and balanced information for context in order to elicit informed feedback about the potential courses of action for the IAASB, while keeping the paper short and succinct. The draft DP is also not intended to presuppose any specific courses of action and makes clear that the IAASB has not settled on any specific course of action.

#### Structure of the DP

6. The draft DP includes:
  - (a) *Chairman's Foreword*—emphasizing the IAASB's commitment to this work and highlighting some of the key messages that are built into the DP.
  - (b) *The purpose of the DP*—emphasizing that the focus of the DP is on audits of LCEs.
  - (c) *A description of what an LCE is*, and why we use this term rather than “small- and medium-sized entities” (SMEs).

<sup>1</sup> The proposal in **Agenda Item 5-B** has been presented for reference only and will not be discussed.

- (d) *Section I: Background*—describing the more significant environmental factors influencing audits of LCEs, and the possible impact for the International Standards on Auditing (ISAs). This section also covers the major initiatives undertaken by other parties in relation to the changing environment, and the IAASB's journey in dealing with the issue to date.
- (e) *Section II: Issues and challenges*—this section sets out the issues and challenges that have been identified relating to audits of LCEs. The LCE Working Group is of the view that it is important to clearly outline what is within the scope of this initiative, and so has “scoped out” what is out of its control or is not part of this work.
- (f) *Section III: Possible actions to be explored*—this section sets out the possible actions for which respondents' input will be vital, distinguishing between standards-based actions and those outside of the standards.

#### *Development of the DP – LCE Working Group Views*

7. In its deliberations about scalability/proportionality on proposed ISA 315 (Revised),<sup>2</sup> the IAASB considered how to address these matters within ISA 315 (Revised) in light of discussions that it was not only smaller entities that were impacted. In the ISA 315 project, it was agreed that scalability/proportionality is also about the complexity of the entity being audited, and therefore the proposals included reference to “smaller and less complex entities.” The LCE Working Group had also had similar discussions, agreeing that it is about the complexity of the entity being audited, not necessarily the size, and has therefore framed all of the discussions, including the DP, using the term “less complex entities.”
8. The DP provides a “definition” of an LCE, which is the current definition of “smaller entity” currently within the ISAs, with a discussion about how this applies in the circumstances of the work being undertaken. In considering this definition, the LCE Working Group was of the view that it inherently deals with complexity through the descriptions of a number of qualitative characteristics, and is therefore appropriate to use as an initial description of a “less complex entity.” Views could then be obtained in the consultation as to whether this definition appropriately describes the types of entities to be considered in this initiative, or whether further changes are needed.
9. Although a large majority of SME audits are likely audits of LCEs, it is possible that some stakeholders may perceive this work on LCEs to be addressing something different to the auditing issues and work streams to date related to audits of SMEs (the issues and challenges have for many years been represented as being issues related to audits of SMEs). Accordingly, the LCE Working Group believes the DP should bridge this potential expectation gap by explaining upfront this change in focus from SMEs to LCEs.
10. The LCE Working Group recognizes that the IAASB is likely to be only part of the solution, and believes that it is important to initially set out the identified issues and challenges related to auditing LCEs, in order to be seen as a comprehensive examination of these issues and challenges. However, in developing Section II of the DP about the issues and challenges that have been identified, the LCE Working Group is also mindful that some of the issues and challenges are not for the IAASB to solve, either because the potential solutions are out of the IAASB's control or because they are not within the scope of this initiative on *audits* of LCEs (i.e., they may relate to the IAASB's agenda but are not related to audits of LCEs because they relate to a different level of assurance than reasonable assurance). Therefore the LCE Working Group believes it is important to make clear what is in the scope of this work for the IAASB (i.e., IAASB

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<sup>2</sup> Proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*

activities related to audits of LCEs) and clearly present the actions that are within the scope of the work being undertaken.

11. The LCE Working Group debated whether to include those matters “scoped out” first, then present the issues and challenges that were within the remit of the initiative, or the other way around (i.e., present the issues and challenges that would be dealt with, then those that would not). There were mixed views about this, but on balance the group agreed to present the issues and challenges that are within the IAASB’s remit at the end of the section, as this was a better structure and flow and provides context for the possible actions presented in the next section.
12. In developing Section III of the DP about the possible actions on which respondents’ views were sought, the LCE Working Group had the view that:
  - (a) It should be made clear that the IAASB has not yet committed to any specific action, nor considered in detail the specifics of the proposed solutions listed in Section III of the DP.
  - (b) Once input has been received, further IAASB deliberations could result in one or more of the possible actions presented, or possibly none of the alternatives presented in the DP (for example, the IAASB could continue with the current approach to scalability / proportionality on the IAASB’s ongoing projects).
13. In Section III of the DP, the LCE Working Group has provided a description of what each possible IAASB action could involve, while at the same time recognizing that more work would be needed in respect of any of these options in order to properly scope the work should the IAASB decide to pursue that particular action. In presenting these descriptions, the LCE Working Group aimed to provide sufficient and balanced detail about each possible action so that respondents could have an informed view about the IAASB’s possible actions to be able to respond, while recognizing the need to keep the information in the DP at a length that would be appropriate for the targeted stakeholders of this DP.
14. The objective of developing the DP is to gather further evidence as the basis for IAASB discussion about the most appropriate way forward in relation to audits of LCEs. With this in mind, as well as the targeted audience, the LCE Working Group deliberated about how to present the questions within the DP. With regard to Section I (Background) and Section II (Challenges and Issues), the LCE Working Group has the view that broader questions will solicit the information needed in respect of these sections. However, with respect to Section III, where stakeholders’ views on various possible options will drive the recommendations for further action, various options were considered by the LCE Working Group, including:
  - (a) Very broad high-level questions to solicit views that respondents would like to provide.
  - (b) More detailed, specific questions (either within the paper or possibly through a link to a survey using a survey tool which is easy to answer, but with space for substantiation where respondents may wish to write something).
  - (c) Some form of ranking of preferred options.

The DP has presented the questions at a higher level, but Board views on the questions and how to present them is sought.

#### **Matters for IAASB Consideration**

1. The IAASB is asked for its overall views about the DP presented in **Agenda Item 5-A**, including the outlined structure, whether it is appropriate for the intended audience, and whether there is anything significant missing.
2. The LCE Working Group Chair will ask for views about each section within the document, in particular whether the matters set out in each section sufficiently describe the information on which the IAASB is seeking input, including the completeness of the information, and the order of presenting the matters scoped out of the project as outlined in paragraph 11 above.
3. The IAASB is asked for its views about how to present the questions as described in paragraph 14 above.

#### **Approach to Obtaining Responses and Other LCE Working Group Activities**

15. The LCE Working Group recognizes the importance of obtaining input from a broad range of stakeholders, but in particular from practitioners who audit LCEs. Therefore further consideration will be given to how best to engage with and encourage input from practitioners auditing LCEs (for example a short webinar explaining the DP, articles in the International Federation of Accountants' (IFAC) Gateway, through social media, working with national standard setters (NSS) and IFAC through its committees and professional accountancy organizations, etc.). The LCE Working Group is also considering translating the DP into Spanish and French to reach those who the IAASB would not ordinarily hear from.
16. Plans for a second "Paris conference" in May 2019 are underway (the first Paris conference was a working conference focused on understanding the needs of SMPs when applying audit and non-audit standards to SMEs). The focus of the second Paris conference in May 2019 would be on audits of LCEs, and the DP would serve as the context for the roundtable discussions. IAASB Staff are also considering whether other roundtables (such as at regional conferences or planned outreach) are feasible.
17. Although not specifically addressed in the DP, the LCE Working Group has reached out to academics and obtained a compilation of published research on a range of issues around audits of SMEs. The LCE Working Group has also undertaken a review of related issues papers prepared and regulatory initiatives in this area. A list of the most relevant publications in this area is included as an Appendix to the DP. The LCE Working Group will continue to pursue whether there is anything further that may help inform the IAASB's future deliberations.
18. A number of NSS representatives have continually raised the audit of LCEs as one of the most significant issues facing their jurisdiction. The LCE Working Group will also further consider how best to work with NSS to solicit input to further inform the Board's deliberations about the most appropriate way forward. Further discussions are planned for the annual IAASB-NSS meeting in May 2019, which precedes the second Paris conference.
19. The LCE Working Group also plans to reach out to representatives from the public sector through the International Organization of Supreme Audit Institutions' (INTOSAI) Financial Accounting and Auditing Sub-group to further understand whether there are any unique issues relating to audits of LCEs within public sector audits.

**Matters for IAASB Consideration**

4. The IAASB is asked whether there are:
- (a) Any other activities that should be considered in order to solicit input to the DP.
  - (b) Any other resources that should be listed in the Appendix to the DP.
  - (c) Any other matters that the LCE Working Group should consider as it finalizes the DP for consultation.

**Appendix**

1. The LCE Working Group comprises:

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| Roger Simnett (Chair)     | IAASB Member   |
| Chun Wee Chiew            | IAASB Member, IFAC SMP Committee Liaison                                   |
| Kai Morten Hagen          | IAASB Member   |
| Rich Sharko               | IAASB Member   |
| Isabelle Tracq-Sengeissen | IAASB Member, IFAC SMP Committee Liaison                                   |
| Brendan Murtagh           | Past IAASB Member  |
| Christopher Arnold        | IFAC SMP Committee Representative  |
| Gordon Cummings           | CPA Canada, past member of Canadian Auditing and Assurance Standards Board |

2. The LCE Working Group has met once in person, and twice by teleconference in the development of these agenda items.