

## Proposed Discussion Paper on Audits of Less Complex Entities–Discussion

### Objective of the IAASB Discussion

The objective of this agenda item is to approve, for public consultation, the proposed Discussion Paper (DP), *Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs*, as set out in **Agenda Item 1-A**.

#### Less Complex Entities (LCE) Working Group

1. The LCE Working Group exploring possible actions to address perceived issues when undertaking audits of LCEs for further IAASB consideration includes:
  - Roger Simnett, IAASB member and Chair of the LCE Working Group
  - Chun Wee Chiew, IAASB member and SMP Committee Liaison
  - Kai Morten Hagen, IAASB member
  - Rich Sharko, IAASB member
  - Isabelle Tracq-Sengeissen, IAASB member and SMP Committee Liaison
  - Christopher Arnold, representing IFAC's SMP Committee
  - Gordon Cummings, former member of the Canadian Auditing Standards Board
  - Brendan Murtagh, former IAASB member

Subsequent to the March 2019 IAASB meeting, the LCE Working Group has convened for a short face to face meeting as well as a teleconference in the development of these agenda items.

#### Background

2. The LCE Working Group has further developed the proposed DP taking into account the comments made by the Board during the March 2019 IAASB meeting.
3. An extract of the draft March 2019 IAASB meeting minutes on the proposed DP is included in the Appendix to this agenda item.

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

4. In response to the comments received from the IAASB on the proposed DP, the LCE Working Group made changes within the 'what is a less complex entity' section of the DP, the challenges related to applying of the ISAs in audits of LCEs (i.e., Section II of the DP), the possible actions to be explored (i.e., Section III of the DP) and the questions posed to respondents in order to obtain relevant and useful feedback. While most of these were editorial to improve the readability of the document, the more substantive of these changes is outlined below.

*Changes Describing ‘What is a Less Complex Entity’*

5. To respond to Board comments about the types of entities that may be considered to be an LCE, additional context was added to the proposed description of an LCE. The LCE Working Group has also clarified that the application of the definition would depend on the nature of any outputs from the Board’s possible future actions, as well as clarifying that the IAASB would leave how the definition is applied up to individual jurisdictions.

*Changes within Section II – Challenges Related to Applying the ISAs in Audits of LCEs*

6. The LCE Working Group rearticulated the “issues and challenges” previously used to just “challenges,” because it agreed with Board comments that one broader term was more appropriate to describe what the Board had been hearing, and that they were not necessarily issues but rather challenges. The LCE Working Group has also emphasized that it is important to hear from stakeholders about the underlying reasons, or root causes, of the challenges to be able to appropriately address the challenges, which is one of the objectives of the consultation.
7. In the draft DP presented to the Board in March 2019, the challenges that are not within the scope of possible IAASB future action were presented first, followed by those that are within the scope of the IAASB. Some Board members expressed the view that this would be better reversed as they felt the IAASB will be perceived as being more positive and proactive if the challenges the IAASB is capable of tackling are presented upfront. Members of the LCE Working Group debated the sequence again, and while there were mixed views on this, on balance, it was agreed that presenting the challenges within scope later will provide a stronger link to the possible actions section that immediately follows.
8. Although there were not strong views expressed by other Board members, and the LCE Working Group continuing to have mixed views on this matter (generally not strong views either way), the LCE Working Group continues to believe, on balance, that it is better presented second to help with the flow of the DP, directly linking into the actions of the IAASB as outlined in Section III. However, in order to alleviate the concern by some Board members that the IAASB might be seen as being less proactive by scoping out various matters first, the drafting has been enhanced to be clear that it is the boundaries of the IAASB’s work that is being clarified in that Section.

*Changes within Section III – Possible Actions to be Explored*

9. Section III has been revised so that each of the various possible actions appears more consistent in presentation (adhering to the principal of achieving balance across the options), and making it clear that the IAASB remains open minded as to what are the most appropriate future possible actions. As a consequence, the description of ‘developing a separate standard’ has been revised and presented in a way that describes what may be further explored if the IAASB decides to further consider this possible action, without suggesting that significant deliberation of this by the IAASB has taken place. In addition, the draft has been further revised with regard to the benefits and consequences, to make these consistent for each possible action presented.
10. Further, clearer description of the section on ‘developing a separate standard that is not the ISAs’ has been provided, making clear that this may necessitate the development of a new framework that still provides a level of assurance that is the same as an audit using the ISAs (i.e., is not related to other types of engagements such as direct engagements).

*Changes within Questions for Respondents*

11. All of the questions for respondents have been moved to the end. Changes have also been made to the questions to enhance the ability of responses to inform the IAASB in its future deliberations, whilst maintaining the neutrality and the appropriateness of the questions for the stakeholder group to which they are aimed.

*Other Changes*

12. A number of changes were also made to the proposed DP in response to more detailed clarifications and suggestions by various Board members, including consistency in the way that terms are used throughout the DP (for example, the term ‘applying’ the ISAs or ‘implementing’ the ISAs is now consistently presented as the application of the ISAs / applying the ISAs (including in the title of the DP)).
13. The way that technology has been presented in the DP was reconsidered, and the challenges of technology as well as the effect it may have on any future work has been more strongly recognized. In addition, the distinction between how technology impacts the IAASB’s work, (such as converting the handbook to an electronic format), and what others may do with technology (e.g., develop a technology solution for audits of LCEs) has been made clearer.
14. Section I has also been revised to enhance the flow of the section and various changes made to the Appendix to shorten it as appropriate.

**Consultation Period**

15. Once the DP has been approved by the IAASB, it is proposed that it will be published for a 120-day consultation period.

**Matters for IAASB Consideration**

1. The IAASB is asked whether it agrees with the content of the proposed DP, as set out in **Agenda Item 1-A**, and the consultation period, and to approve the DP for public consultation.

## Extracts from Draft March 2019 Minutes<sup>1</sup>

### Audits of Less Complex Entities

The Board discussed a proposed Discussion Paper (DP), *Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Implementing the ISAs*, which highlighted the shift in focus on the complexity of an entity rather than its size in driving the ongoing discussions and activities to address challenges related to the use of the ISAs in audits of less complex entities (LCEs). The Board was supportive of the DP's overall direction, highlighting the importance of the project and the need for action by the IAASB and others.

The Board acknowledged the simple, clear and balanced way the DP had been presented and noted it was appropriate for its key target audience (i.e., auditors of LCEs). It was highlighted that it was important to finalize the document for consultation, keeping in mind the balance between providing sufficient information for respondents and maintaining the succinctness of how it was presented for the March Board discussion.

The Board encouraged the LCE Working Group to consider how the following key messages could be better emphasized earlier in the DP:

- The IAASB is in the 'next phase' of its research and information gathering activities to support an evidence-based response to the identified challenges related to the use and application of the ISAs in audits of LCEs, because much of the content of the DP was developed based on anecdotal evidence.
- The IAASB continues to remain mindful that when considering any future possible actions, the needs of all of its stakeholders would be considered so that there are not any unintended consequences. Accordingly, it was highlighted that it was important that the DP makes clear that the IAASB is looking for input from all of its stakeholders.
- The IAASB is neutral and open-minded to explore possible actions to address the challenges related to the use of ISAs in audits of LCEs, and has not yet decided on a course of action.

In addition to editorials, the Board also noted the following more significant matters related to the content of the DP for the LCE Working Group's consideration.

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

The Board noted that it was important to highlight that the IAASB is aware of many of the challenges facing auditors of LCEs, but would like to further understand the underlying reasons for, or root causes of, the identified challenges, which will assist with identifying appropriate future possible actions.

Board members emphasized the importance of outreach with audit inspection bodies and those writing audit methodologies as it was difficult to really understand the underlying issues, and these stakeholder groups may be able to provide greater insight. The Board further noted that it may be useful to understand whether there is anything else, other than what has currently been identified, that should be considered as it progresses its thinking in relation to audits of LCEs. The Board also noted, with regard to challenges within the scope of the IAASB's work on audits of LCEs, in relation to documentation that it is not clear for

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<sup>1</sup> The draft minutes are still subject to IAASB and other review and therefore may still change.

audits of LCEs as to what needs to be documented, as well as the extent thereof, and that both of these needed to be highlighted within the DP.

The LCE Working Group were also asked to consider the flow of this section.

#### POSSIBLE ACTIONS TO BE EXPLORED

The Board suggested explaining that there may not only be one exclusive solution, including emphasizing that the most appropriate way forward may be a combination of the possible actions, or only some aspects of the possible actions, and may also include any other actions identified by respondents. The Board also asked for further consideration by the LCE Working Group about how various aspects of the possible actions had been presented within the DP, including:

- The balance of the information presented about each of the possible actions, as it appeared that more consideration had been given to some of the actions over others, which may indicate that the IAASB had already decided on a course of action. In particular, it was noted that the presentation of benefits and consequences in some sections may suggest that more thought had been given to these possible actions that had actually been done.
- How the current work of the IAASB in further considering scalability and proportionality was presented within the DP. It was noted that this work effort should be more clearly recognized, and was likely part of the ‘revising the ISAs’ possible action rather than undertaking no further action, as something was being, and would continue to be, done.
- How technology was presented within the DP, including how it may impact each of the various possible actions presented. It was noted that although it was not necessarily within the IAASB’s remit to produce a ‘technology solution,’ technology would still impact the possible actions. It was also highlighted that the aspects of technology for the IAASB and for others should be better distinguished.
- With regard to revising the ISAs, the Board suggested clarifying the so-called “building-blocks approach” to possible actions that are feasible.
- With regard to developing a separate auditing standard for audits of LCEs, the Board noted that the way that this section had been articulated may suggest that it appeared that the IAASB has deliberated the contents of such a standard when it had not.
- With regard to a separate auditing standard based on the existing ISAs, the Board asked that it be made clearer that such a separate auditing standard may be based on the existing ISAs with the aim of achieving the same objective and encompassing all the requirements, including compliance with the relevant quality management standards and relevant ethical requirements.
- With regard to a separate auditing standard developed based on a different framework, the Board asked that this possible action be clarified to distinguish it from a separate standard developed using the ISAs as a framework. (i.e., developing a different framework with necessary criteria to obtain reasonable assurance). It was also noted that it was not clear whether this would involve a different level of assurance or whether it alluded to other types of assurance engagements that are not audits and could be considered instead of an audit of an LCE, for example such as a direct engagement.

Although broadly supporting the revisions that were made during the week, noting that good progress had been made in revising the DP, Board members noted that certain areas still needed further consideration, in particular, in relation to technology and the development of a separate auditing standard. There were

also Board members that still expressed a preference for more on the benefits and consequences of the potential actions to help respondents better understand how the actions may impact them.

#### QUESTIONS FOR RESPONDENTS

In order for the IAASB to make an informed decision on the best way forward, the Board noted that it was important to clarify the questions to be more focused and direct in order to obtain relevant and useful feedback from respondents with respect to the:

- Appropriateness of the shift in focus on complexity of the entity rather than its size in driving the ongoing discussions and activities to address the challenges in audits of LCEs;
- Appropriateness and completeness of the qualitative characteristics currently included in the DP to describe LCEs;
- Challenges that have been identified, in particular in relation to those that the IAASB is looking for more information on to better understand the underlying reasons for the challenges;
- What respondents' may have done to address the challenges related to the use of the ISAs in audits of LCEs; and
- Whether there are any other matters that have not been identified that should be considered.

The Board broadly supported the revised questions that had been presented during the week, but noted that some questions were now asking for too much detail in relation to the stakeholder group that was being targeted. The Board also expressed a view, on balance, to not include questions with 'allocations' to indicate the respondents' preferences.

#### IAASB CAG CHAIR'S REMARKS

Mr. Dalkin highlighted the CAG's support for this work, and noted the importance of emphasizing that this was an information gathering exercise, and that no decisions had yet been taken about the possible actions. He also encouraged the Board to remain open minded about the possible actions when considering the feedback, as the solution may encompass something that had not yet been considered. Mr. Dalkin also expressed his support for exploring an alternative possible action taking a different approach from that in the current ISAs (i.e., developing a different framework with necessary criteria to obtain reasonable assurance).

#### PIOB REMARKS

Ms. Stothers expressed concern about how public interest entities may interpret the definition of an LCE, noting that it was important to maintain the robustness of the audit for these entities. She suggested that the Board further consider a question focusing on the appropriateness and completeness of the qualitative characteristics of LCEs currently included in the DP to describe LCEs. She also suggested further consideration of how the IAASB intends to use the definition of an LCE. In response, it was noted that LCEs may, in some jurisdictions, encompass a broad range of entities including such entities as those in the public and not-for-profit sectors, as well as entities that may be considered to be public interest entities, if those entities are deemed as LCEs within those jurisdictions.

#### WAY FORWARD

Proposed changes to the DP to address Board comments will be presented in a Board call on April 10<sup>th</sup>, 2019, with the final DP targeted to be published for public consultation before the end of April 2019.