

Proposed Auditing Standard for Less Complex Entities

by Emer Kelly

In late August 2021, the International Auditing and Assurance Standards Board (IAASB) opened a six-month public consultation on its landmark new proposed standard for audits of financial statements of less complex entities (LCEs).

This stand-alone standard is a significant milestone for the IAASB and the entire accountancy profession.

CPA Ireland has long advocated for proportionality and scalability in the standards used by the profession and has endeavoured to consider the impact of new standards and requirements on SMEs in particular. All with a view to ensuring that the value of the audit service is not lost in an overly burdensome tick box approach to the process.

Background

The IAASB is responsible for the development and publication of the International Standards on Auditing (ISAs). At present, approximately 130 jurisdictions, including Ireland, have adopted, or partially adopted the ISAs. The ISAs are designed to be applied to a wide variety of entities with differing circumstances and sizes, ranging from those whose nature and circumstances are simpler and more straightforward (i.e. LCEs), to those entities whose nature and circumstances are more complex (for example, entities with more complex structures, more complex information systems or controls, or more complex transactions).

It is estimated that more than 90% of entities across the world are small and medium-sized entities (SMEs), and many of these entities are audited by small and medium-sized practices (SMPs).

Indeed, in Ireland, the Irish Auditing and Accounting Supervisory Authority's publication Profile of the Profession for 2020, reflects an audit profession dominated by SMPs. The report shows that at 31st December 2020, 98% of audit firms in Ireland had five partners or

less (59% being sole practitioners), and 99% of audit firms had no Public Interest Entity audit engagements. Typically, such SMP firms have LCE audit clients.

In recent years, the audits of such LCEs have become more complex and challenging. In response to a fast-changing financial world, where the evolving business environment has resulted in more complex transactions and structures and the rapid advance of technology, affecting how transactions are undertaken and records are kept, the ISAs have been keeping pace and in doing so have become more complex and voluminous.

2019 Discussion Paper

A 2019 IAASB discussion paper on the topic of the audit of LCEs, specifically highlighted the potential impact for such increases in the length and detail of the ISAs to:

- 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.

It noted that these factors could potentially lead to a reduction in audit quality as they could affect how the auditor applies the standards.

From an Irish perspective, in 2019, as part of its consideration of this initial discussion paper, CPA Ireland, surveyed its members to gather their views on

the current challenges facing Irish LCE auditors.

Some of the challenges identified by the CPA Ireland survey in this regard were as follows:

- 91% of respondents cited audit fee pressure
- 63% of respondents cited availability of audit staff
- 64% of respondents cited the availability of audit technology solutions for LCEs

More specifically, the planning stages of the audit were identified by CPA practitioners as a particularly challenging stage of the audit of an LCE. The extensive planning requirements of ISA 300, 315 and 330 were cited as being overly burdensome for such client types.

CPA practitioners considered that the sheer length of some of the ISAs and the increasingly complex language and terminology throughout many of the standards made it difficult to apply to an LCE, for example the consideration of an LCE's "control environment" can often be difficult to consider in terms of the systems of an LCE, which are often very basic in nature but perhaps sufficiently appropriate to record the activities of a less complex entity.

The 2019 discussion paper proposed various actions that the IAASB could undertake as follows:

- a. Revise the ISAs to address scalability more explicitly and make the auditors work effort clearer.
- b. Develop a separate auditing standard for audits of LCEs that provides the same level of assurance as the ISAs (i.e., reasonable assurance).



c. Develop guidance for auditors of LCEs or other related actions on how the ISA requirements apply in the circumstances of LCEs.

CPA members preferred the second option i.e., that of a separate standalone standard.

That is what the IAASB is now proposing with this new draft standard. In developing this current proposal to develop a separate standard, the intention is to serve the public interest by:

- a. Maintaining confidence in financial reporting of LCEs
- b. Helping auditors of LCEs undertake consistent, effective, and high-quality audits
- c. Being responsive to stakeholder needs
- d. Promoting a more consistent application of the auditing standards to audits of LCEs

It was also considered that the development a global solution would be in the public interest to ensure consistency of application of the

standards in an audit of an LCE, as well as supporting a common understanding of the procedures undertaken in an audit of an LCE.

Who is the proposed standard aimed at?

There is no global definition for a 'small- or medium-sized entity,' and the use and meaning of the term may differ in different jurisdictions. The proposed standard considers that it is appropriate to focus on the complexity of the entity rather than its size, and therefore uses the term "less complex entities".

The definitive eligibility criteria for use of the proposed standard will be decided at national level.

However, the following specific prohibitions for the use of the new standard are outlined in the proposal:

- a. Law or regulation prohibits use of the standard in a particular jurisdiction:
 - i. Explicitly prohibits the use of the proposed ISA for LCE (i.e., the standard is not authorised for use in a particular jurisdiction); or
 - ii. Specifies the use of auditing

standards, other than the proposed ISA for LCE, for an audit of financial statements in that jurisdiction.

b. The entity is a listed entity

c. An entity meets one of the following criteria:

- i. An entity one of whose main functions is to take deposits from the public;
- ii. An entity one of whose main functions is to provide insurance to the public;
- iii. An entity whose function is to provide post-employment benefits;
- iv. An entity whose function is to act as a collective investment vehicle and which issues redeemable financial instruments to the public; or
- v. A class of entities where use of the proposed ISA for LCE is prohibited for that specific class of entity by a legislative or regulatory authority or relevant local body with standard setting authority in the jurisdiction

d. The audit is an audit of group financial statements

What does the proposed standard look like?

The proposed standard is a stand-alone, self-contained standard, unlike the current suite of ISAs in use. It would not be considered necessary for an auditor conducting the audit of an LCE to refer back to specific ISAs. The auditor of an LCE, it is proposed, should only need to refer to one standard to perform an LCE audit. Indeed, if it is necessary for an auditor to seek guidance on an aspect of an audit, which is not provided for within the proposed standard, then it would be necessary to apply the full suite of ISAs to the circumstances.

The proposed standard has been grouped into nine "Parts" that follow the flow of an audit engagement (rather than by subject matter or topic like the ISAs) as follows;

Part 1 –

Fundamental Concepts: General Principles and Overarching Requirements

Part 2 –

Audit Evidence and Documentation

Part 3 –

Engagement quality management

Part 4 –

Acceptance or continuance of an Audit Engagement and Initial Audit Engagements

Part 5 –

Planning

Part 6 –

Risk Identification and Assessment

Part 7 –

Responding to Assessed Risks of Material Misstatement

Part 8 –

Concluding

Part 9 –

Forming an Opinion and Reporting

These 9 parts are preceded by a Preface to the standard, and the Authority.

The same structure has been used within each Parts 1–9, to help with consistency of application.

In addition, the IAASB has focused on:

- Simpler numbering.
- Limiting the number of "sub-bullets"

where appropriate.

- One thought per paragraph.
- Combining requirements from the ISAs where appropriate and avoiding repetition.
- Articulating the requirements in a clearer and simpler way where feasible.

All these elements enhance the ease of navigation and useability of the proposed standard.

Many of the basic concepts used in the ISAs to support a risk-based approach have also been incorporated into the proposed standard.

There are many differences between the ISAs and the proposed standard, with the detail of these differences set out in detailed mapping documents. However, there are three more significant areas where the requirements are broadly different as outlined below:

- Accounting estimates
- Where the entity uses a service organization for processing transactions
- Management amendments to the financial statements after the date of the auditor's report

What is the level of assurance proposed?

When developing the proposed standard for auditing LCE's, the IAASB consulted on and discussed the appropriate level of assurance that would be appropriate for the intended users of the financial statements of an LCE, including whether another kind of engagement, or a different level of assurance, should be considered.

The resulting proposal has been to develop a separate auditing standard that will provide a reasonable assurance opinion, using the concepts and principles already used in an ISA audit (as the ISAs are already designed for the auditor to obtain a reasonable level of assurance).

It should also be clear in the auditor's report which standard(s) have been used so that users of the financial statements have transparency as to which standards have been applied in conducting the audit.

Next Steps

Since the publication of the proposed standard in August, CPA Ireland has held an information webinar for members and CPA Ireland's Audit Practices Committee have engaged with stakeholders both internationally and nationally on the proposal. The Committee will formulate CPA Ireland's response to this important proposal. Audit quality will be a key consideration for the committee, ensuring that the resulting standard provides a robust audit process which is fit for purpose and provides a solution to the challenges outlined during the consultation process by CPA members.

The IAASB consultation closes on 31 January 2022.

Recognising that the proposed standard is new and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning at least 18 months after the approval of a final standard. Earlier application would be permitted and encouraged.

What is clear from the consultation process to date, is that in an increasingly complex world with evolving reporting needs, there is a need for a set of high-quality requirements tailored for the audits of less complex entities. With this proposed standard, the IAASB is moving to provide a globally consistent approach.

CPA Ireland will be working to support the eventual adoption of an auditing standard for LCEs for use in the Irish market.



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