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Dear Tom,

Response to the IAASB's Discussion Paper, Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs

EFAA appreciates the opportunity to provide our comments to the IAASB Discussion Paper, [Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs](#). Our response has been prepared with input from our Assurance Expert Group.

We wish to stress that our members are not unanimous in their views as to the preferred solution – revise the ISAs or developing a separate auditing standard for audits of LCEs - but are unanimous in the need for urgent action and for the IAASB to signal as soon as possible its intended way forward.

The European Federation of Accountants and Auditors for SMEs (“EFAA”) represents accountants and auditors providing professional services primarily to SMEs both within the European Union and Europe as a whole. Constituents are mainly small practitioners (“SMPs”), including a significant number of sole practitioners. EFAA’s members, therefore, are SMEs themselves, and provide a range of professional services (e.g. audit, accounting, bookkeeping, tax and business advice) to SMEs. EFAA represents 13 national accounting, auditing and tax advisor organisations with more than 370 000 individual members.

GENERAL COMMENTS

Timely and Robust Action

This project is the most important project of the IAASB since the Clarity project. It is critical to the future of the SME audit and raises fundamental questions about the form and nature of international standards. We therefore strongly support the IAASB’s efforts and applaud it both for its intent as well as the highly consultative process.

SMPs continue to struggle to apply ISAs despite extensive efforts by the IAASB, IFAC, PAOs, software producers, commercial publishers of guidance and others. There is now an urgent need for leadership and robust action by the IAASB. The time for further research to help determine the way forward has passed. There is already more than enough evidence to prove that the status quo is not an option and to justify timely and robust action.

Benefit and Cost of SME Audit

The ultimate objective of this project must be to improve the cost-benefit of the LCE audits. This demands that the project focuses *both* on reducing the cost of performing LCE audits *and* on enhancing the benefits. Presently the project concentrates on the former, paying only lip service to the latter. We urge the Board to not lose sight of the latter and not shy away from changing the standards to increase the benefits and value of audit to SMEs. Moreover, as noted below, these benefits need to be better communicated since public perception is as important as fact.

Less Complex Entities

We have reservations around the use of LCEs and the proposed definition. LCE is a new and unproven concept. LCE is not a sector. LCE is highly subjective. We suspect there is a strong correlation between size and complexity. *Ceteris paribus* smaller entities are less complex than larger. Hence, we encourage the IAASB to assume that all SMEs, and non-PIEs, are LCE unless there is strong evidence to the contrary. In this letter we use the terms interchangeably, as if the same.

Nature of ISAs

While the ISAs are intended for broad application, by all size of practice in the audit of all size and type of company, they are nevertheless voluminous, complex and prescriptive. While the ISAs are technically robust, expertly written and presented, we have serious reservations as to their scalability and usability by SMPs due to their highly prescriptive and detailed composition. We inevitably conclude that they are more suited to the audit of larger more complex PIE by larger practices. Repeatedly saying that the standards are scalable does not make them scalable. SMPs auditing simple SMEs face the enormous burden of having to read and understand the entire body of ISAs and then determine what is relevant to their clients. This burden could be largely if not wholly eliminated by either a fundamental restructuring of the ISAs or the introduction of a new separate auditing standard for LCEs.

We therefore urge the IAASB to *either* reengineer the ISAs in a fundamental Clarity II style endeavour to simplify them and make them scalable from the bottom-up *or* develop a separate auditing standard for audits of LCEs based on the same principles as the ISAs. While we welcome either course of action, we prefer the development of a separate standard for the reasons given below.

Separate Audit Standard for Audit of LCEs

While re-engineering the ISAs on a think simple / small first basis is conceptually and intuitively the best approach we believe this the less feasible, timely and pragmatic solution. A fundamental reworking of the ISAs will prove time consuming and highly disruptive, impacting the audits of all entities, and likely to meet resistance from regulators, such that the end result risks amounting to limited revision, in effect 'a rearranging of the deckchairs on the Titanic'. The revision of ISA 315 demonstrates how immense and difficult a task the infusion of scalability can be. And while the latest working draft ED-ISA 315 marks an improvement on the extant for large entity audits it fails to meet our vision of a truly scalable standard. We therefore urge the Board to consider, as a matter of urgency, developing a separate stand-alone SME auditing standard for less-complex entities, based on the same

principles as the ISAs, could be developed in a much shorter timeframe rather than trying to reengineer the ISAs.

If the IAASB decides to pursue this course of action, then it is vital that the communications around the new separate standard stress that this standard supports an audit of equivalent quality to an audit performed using the ISAs. Every effort needs to be taken to avoid giving the impression that the standard is less rigorous than the ISAs, rather it is a standard tailored to fit different types of entity.

Purpose, Value and Benefits of SME Audit

Irrespective of the outcome of this project we encourage a concerted effort by the IAASB, IFAC, PAOs and others to communicate the value and benefits of SME audit. EFAA has recently published a report '[Evidence on the Value of Audit for SMEs in Europe: Perspectives of Owner-Managers, Company Accountants and Directors](#)' that presents new and previous evidence on the perceived value of audit for SMEs in Europe. The key findings, summarized in the [news release](#), indicate that we seem to be failing to convincingly communicate the purpose, value and benefits of the audit.

A survey of SMEs revealed that the top three most commonly cited benefits from having an audit were 'audit provides a check on accounting systems and records', 'auditor provides useful advice to management' and 'improves internal control', significantly ahead of 'gives assurance to external providers of finance'. The evidence has potentially significant implications. Regulators may have gone too far in exempting small companies from having to have an audit as part of a perceived relief from regulatory burdens on SMEs. Furthermore, if SMEs have a strong desire to receive advice from the auditor as part of the audit then this may ultimately demand that the current auditing and ethical standards be modified to allow for auditors of SMEs to render certain types of advice during the ordinary course of the audit engagement, while at the same time maintaining a high level of auditing and ethical standards. A separate standard, based on the ISAs, make this possible.

IAASB Strategy and Work Plan

In our response to the IAASB's strategy consultation we questioned whether it would make sense for the IAASB to defer completion of ISA315, given how central it is and may need revising again, until clear as to direction of travel of LCE project. We urge the Board to postpone completion of ISA 315, using the project simply as a test bed for what reengineered standards might look like, until it is decided which course of action to pursue.

QUESTIONS IN DP

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?

We have some reservations regarding the focus on LCEs and their definition. We suggest that the Board reconsiders the use of the LCE concept and the definition of the set of enterprises eligible for simplified treatment.

While LCE is conceptually appealing and in keeping with the notion that ISAs underpin a risk-based audit LCE has many drawbacks. LCE is a new and unproven concept. LCE is not a sector. LCE is highly subjective and hard to define. We suspect there is a strong correlation between size and complexity. Ceteris paribus smaller entities are less complex than larger: all banks are perhaps complex relative to other types of business entity, but then a small local bank is less complex than a large international one. Furthermore, SMEs typically share the same characteristics used to define LCEs in the DP.

We see merit in using recognisable and tried and tested concepts such as SME or non-public interest entities (PIE) in place of LCE. If the Board is reluctant to drop LCE then we encourage the IAASB to assume and explicitly state that all SMEs, perhaps defined by size criteria, are LCE unless there is strong evidence to the contrary such as a certain characteristic that suggests they are complex.

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?

While some ISAs and some requirements pose greater problems than others there are more pervasive problems. Many of these problems are well articulated in the DP in the section 'Challenges within the Scope of the IAASB's Work on Audits of LCEs'. These big picture problems deserve the IAASB's attention rather than the detail that is best addressed once a course of action is agreed.

The ISAs require that the auditor read and understand the entire body of the ISAs and then determine what is relevant in the circumstances. For SMPs auditing simple SMEs this represents an enormous burden. It is hard to deconstruct this problem and solve it simply by fixing some difficult ISAs.

The ISAs are voluminous including many long, complex sentences and sophisticated language. Whatever the outcome of this project we urge the IAASB to use simpler language and sentence construction and make effort needs to scale-back the length of the standards, leaving only the essential and the likes of explanatory material in separate non-authoritative guidance.

The ISAs have over the years steadily accumulated requirements, many in isolation seemingly of low burden but collectively a substantial burden. The Clarity project provided much needed clarity to the ISAs but resulted in a significant increase in requirements as much present tense was elevated. On reflection perhaps this could have been avoided by tightening the criteria used to determine when to m raising the criteria this. Since the Clarified ISAs were launched, we have witnessed a steady increase in the number and specificity of the requirements rendering the ISAs increasingly prescriptive and in so doing leaving little room for professional judgment in their application.

Hence, this DP question could be interpreted as 'which piece(s) of straw broke the camel's back?' There is no easy answer. We accept that certain ISAs and requirements pose greater burden than others –

risk identification and assessment (ISA 315), auditing accounting estimates (ISA 540) and documentation (ISA 230) are commonly, and rightly, cited – but the real problem is the cumulative weight, number and specificity of requirements.

Finally, we recognize the IAASB's best intentions in introducing 'Considerations Specific to Smaller Entities'. However, the existence of these considerations, which are unfortunately of limited use, just like text explaining scalability, paradoxically demonstrate that the ISAs are written with more complex / larger entities first in mind. After all, if the ISAs were truly scalable one would more likely see 'Considerations Specific to Larger / More Complex Entities' and scalability would be self-evident.

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 have some concerns regarding the factors driving challenges that the IAASB believes fall outside its control or have been scoped out of its exploratory information gathering activities.

As we state above under 'General Remarks' the ultimate objective of this project must be to improve the cost-benefit of the LCE audit, and this demands the project also focus on enhancing the benefits not just the cost of performing LCE audits as present. We therefore urge the Board keep an open mind as to the need to change the standards to increase the benefits and value of audit to SMEs. Moreover, these benefits need to be better communicated since public perception is as important as fact. This is one area where others can be encouraged to act.

Irrespective of the outcome of this project we encourage a concerted effort by the IAASB, IFAC, PAOs and others to communicate the value and benefits of SME audit. As we explain above EFAA's recently published a report ['Evidence on the Value of Audit for SMEs in Europe: Perspectives of Owner-Managers, Company Accountants and Directors'](#), indicate that we seem to be failing to convincingly communicate the purpose, value and benefits of the audit. This presents other or exacerbates other challenges, for example, intensifying downward pressure on fees and causing regulators to see audit more as a burden than a benefit, prompting them to introduce or raise thresholds.

We otherwise generally concur with the challenges that the IAASB believes fall outside its control or have been scoped out of its exploratory information gathering activities. That said, we think it more accurate and appropriate to say that the challenges viewed as beyond its control are in fact challenges that fall outside its *direct* control as most if not all are indirectly affected by the IAASB. For example, the burdensome nature of the ISAs pushes up the cost of conducting an audit in turn reinforces fee pressure and undermines the commercial viability of SME audits.

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.

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?

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.

We do not see the status quo as an option. While our members are not unanimous in their views as to the preferred solution – revise the ISAs or developing a separate auditing standard for audits of LCEs – they are unanimous in the need for urgent action and for the IAASB to signal as soon as possible its intended way forward.

SMPs continue to struggle to apply ISAs despite extensive efforts by the IAASB, IFAC, PAOs, software producers, commercial publishers of guidance and others. There is now an urgent need for leadership and robust action by the IAASB. The time for further research to help determine the way forward has passed. There is already more than enough evidence to prove that the status quo is not an option and to justify timely and robust action.

Revising the ISAs

Re-engineering the ISAs is conceptually and intuitively the best approach not least since we would retain one set of standards. Such a revision would best be done as one large project in a similar fashion to the Clarity project to avoid years of incremental change: a past IFAC SMP Global Survey cited constant change as the single biggest source challenge of keeping up with standards.

How might one revise the ISAs to achieve truly scalable standards? One would need to think small / simple first. We suggest the adoption of a modular building blocks format comprising a core set of general requirements, either in one place or for each ISA, applicable to every audit no matter how small or simple and additional requirements for entities that are larger, more complex, have a fiduciary role, and are public interest. In this way the standards would be written, as Accountancy Europe coined the phrase in the context of corporate reporting, on a ‘core and more’ basis. In aggregate the ‘core’ requirements would constitute a small minority of the total requirements. SMPs auditing SMEs would normally not need to look beyond the core, it in effect being an SME standard integrated into the ISAs. In effect most requirements would be conditional: on size, complexity, fiduciary status, public interest etc. Considerations specific to smaller entities would drop out. The revised standards might be reordered to align with the chronological sequence of a typical audit. One might move application material and guidance to a separate non-authoritative document(s).

Despite its merits a reworking of the ISAs will prove time consuming and highly disruptive, impacting the audits of all entities, and likely to meet resistance and intransigence from regulators, such that the end result risks amounting to limited revision, in effect ‘a rearranging of the deckchairs on the Titanic’. The revision of ISA 315 demonstrates how immense and difficult a task the infusion of scalability can be. And the current draft marks an improvement on the extant for large entity audits it fails to meet our vision of a truly scalable standard.

Developing a Separate Auditing Standard for Audits of LCEs

We see this as the preferred course of action.

While less intuitively appealing than revising the ISAs, we see the development of a separate auditing standard for audits of LCEs, based on the same principles as the ISAs, a more feasible, timely and pragmatic solution. Some jurisdictions, perhaps most notably Belgium with its audit standard for contractual (voluntary) SME audits developed by EFAA member Institut des Experts-comptables et des Conseils Fiscaux – Instituut Van de Accountants en de Belastingconsulenten (IEC-IAB) and Instituut van de Bedrijfsrevisoren - Institut des Réviseurs d'Entreprises (IBR-IRE), already developed SME audit standards.

How might one revise the ISAs to achieve truly scalable standards? First, we would prefer such a standard be based on the existing ISAs. This would leverage the existing knowledge of auditors conversant with the ISAs and risk-based audits, and as such ease the burden of knowing two sets of standards. There are parallels with IFRS for SMEs. However, while the IFRS for SMEs was developed by simplifying the IFRS we recommend that as far as possible the new standard be developed from first principles, looking only to the conceptual underpinnings of the ISAs, and that the ultimate objective be a considerably shorter and simpler standard than full ISAs. Cross-referencing from the new standard to the ISAs, as is the case with IFRS for SMEs, is best avoided or at least minimized, to ensure the standard is truly standalone.

A separate standard has other valuable advantages over revising the ISAs. First, it provides the opportunity for the LCE audit to be different in some ways from that of larger more complex entities. As our research revealed on the value of SME audit there may be merit in allowing for certain types of advice to be rendered as part of the audit. Second, a separate standard would be less disruptive to the audits of larger more complex entities as they would continue to use the ISAs. If the IAASB's resources allow one might wish to develop a separate standard first and then revise the ISAs to make them simpler and easier to apply for all audits.

Finally, the IAASB's communications around the new separate standard will need to stress that this standard supports an audit of equivalent quality to an audit performed using the ISAs. Every effort needs to be taken to avoid giving the impression that the standard is less rigorous than the ISAs, rather it is a standard tailored to fit different types of entity. Indeed, the IAASB might wish to reinforce this point, and simultaneously ease the burden of those that are fully conversant with using and have methodologies supporting the ISAs for audits of LCEs, by recommending that auditors have the option to use the new standard or the ISAs for audits of LCEs.

Developing Guidance for Auditors of LCEs or Other Related Actions

While guidance may have a role to play, we do not see them as the primary solution. At best they are a supplementary action.

Guidance, and other tools to facilitate implementation including software and other technological tools, cannot fix shortcomings in the underlying standards. Furthermore, many have tried, with mixed success, to develop guidance and tools to help apply ISAs on SME audits.

Perhaps the most notable and comprehensive guidance is the IFAC SMP Guide cited in the DP. The guide has been criticized for being voluminous and complex. But this is inevitable given the requirement of auditors using ISAs is to read and understand all ISAs and, consequently, the need to include all the ISAs and their requirements. Moreover, guidance that seeks to be comprehensive,

providing all the necessary guidance in one document with practical examples, templates etc., will always be long. The IFRS for SMEs training material is many times the volume of the 250-page standard.

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?

As explained above under ‘General Remarks’ and Q3 irrespective of the outcome of this project we encourage a concerted effort by the IAASB, IFAC, PAOs and others to communicate the value and benefits of SME audit. EFAA’s recently published a report ‘[Evidence on the Value of Audit for SMEs in Europe: Perspectives of Owner-Managers, Company Accountants and Directors](#)’, summarized in the [news release](#), indicates that we seem to be failing to convincingly communicate the purpose, value and benefits of the audit.

CONCLUDING COMMENTS

We trust that the above is clear, but should you have any questions on our comments, please do not hesitate to contact us.

Yours faithfully,

Salvador Marin
President

Paul Thompson
Director