

Comments on IAASB Discussion Paper “Audits of Less Complex Entities:
Exploring possible options to address the challenges in applying the ISAs”

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Dear Sir,

I appreciate the opportunity to comment on IAASB Discussion Paper: “Audits of Less Complex Entities: Exploring possible options to address the challenges in applying the ISAs”.

My comments are included in the following pages of this document.

It is worth to mention that my comments are written mainly from a financial statements auditor’s point of view, but also considering the perspectives of users and preparers.

The comments included in this document represent my own opinions and points of view and they do not necessarily represent the official views of any organization I am part of.

If you have any questions regarding this document, please feel free to contact me at cristian_munarriz@yahoo.com.ar.

Yours faithfully,

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1. We are looking for views about how LCEs could be described. 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?

I think the qualitative characteristics in b. are more relevant to a faithful representation of “complexity”. The characteristics in a. are not representative of “complexity” (but may be relevant for some specific issues, like communications to TCWG as I will explain later). Nonetheless, it should be noted that characteristics in b. may be subjective, so, while simply mentioning qualitative characteristics may be appropriate for issuing guidance, it may not be appropriate to determine the scoped entities in case the “separate standard” approach is selected because different parties may have different ideas about if a specific entity is complex or not for the purposes of this standard. In the latter case, a more objective definition will be necessary.

2. 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.

2. 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?

The ISAs and ISAs requirements that are most difficult to apply are:

- Extent of audit documentation (not specifically related to ISA 230, but to many ISAs). For example, many ISAs require documentation of discussion of significant matters to management and TCWG, and documentation of significant judgments and conclusions, creating the feeling that you need to document these issues in different working papers. It might be helpful to include all communications and documentation requirements in a single standard.
- Enquiries: many ISAs require enquiries to management and TCWG. If the result of these enquiries is documented in engagement letter or representation letter, it is not helpful to document the same thing in specific working papers (i.e. fraud and NOCLAR enquiries) unless it is considered necessary to do so.
- Communications to TCWG (not limited to ISA 260): the extent of required communications is generally excessive not only for small audits but also to large audits where there is significant concentration of ownership, and owners also manage the business (i.e. family businesses). Some communications add little value and easily misunderstood because of the technical nature (i.e. planning communications and views about accounting practices). It should be permitted communications to be made be agreed upon the parties when agreeing the terms of the engagement assuming some conditions are met (i.e. no opposition from stakeholders and the entity is not a public interest entity).
- Communications of significant deficiencies in internal control (ISA 265): the requirement to communicate in writing is excessive as significant deficiencies will generally be documented in the working papers and written communications add little value. Oral communication should be permitted.
- Extent of understanding of internal control (ISA 315/ISA 402): it is not clear the effort needed when the auditors assess control risk at the maximum. In my view, the

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understanding of internal control is relevant in those cases only to the extent that potential internal control deficiencies may be considered to affect inherent risk by creating opportunities for fraud (i.e. if there are not adequate controls regarding safeguarding of assets that are easy to be misappropriated, the fraud risk will increase because of the higher opportunities for misappropriation of assets) or affect compliance with laws and regulations with material effect to financial statements. Understanding controls relevant to significant risks not related to the before mentioned cases should not be required if a substantive approach is followed unless the potential control deficiencies may raise or increase fraud risk or affect compliance with laws and regulations with material effect to financial statements. It is also challenging to document some aspects of internal control which are generally informal in less complex entities (not only small entities) so guidance may be helpful (i.e. control environment and monitoring of controls).

For less complex entities, a relevant factor may be risk of management override of controls. Guidance may be helpful to an effective application of requirements in ISA 240, paragraph 32 (i.e. journal entries testing).

- Documentation for understanding of entity and its environment (ISA 315): the extent of documentation is not clear.
- Extent of work required for simple accounting estimates (ISA 540): it is not practicable to perform all the work required in ISA 540 for simple accounting estimates. Focus should be made on estimates susceptible to management bias (i.e. retrospective review should only be required to that estimates).
- Related parties (ISA 550): audit of related parties transactions is generally challenging in less complex entities because they typically have many transactions with related parties.
- It is generally not clear the relevant issues to be considered when the auditor also performs material bookkeeping services.

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, if the IAASB were to focus on encouraging others to act, where should this focus be, and why?

Providing templates and training material. It may be helpful for small audit firms with little internal resources. It would also be helpful to provide guidance (i.e. Q&A) for issues that are not jurisdiction specific.

4. 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.

I think revising ISAs would be the best approach but may not be timely, so it should be considered as a medium- long term initiative.

In the short-term, I think the most appropriate approach would be issuing a practice note, with a structure similar to a separate standard (i.e which can be read on its own by including all the most relevant requirements and specific considerations for these entities), while at the same time removing all unnecessary requirements in the ISAs.

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Issuing a separate standard is not appropriate because:

1) it would create the illusion of lesser quality audits if the standard is significantly shorter than the ISAs (note it is not the case for AICPA and PCAOB standards because, even when both set of standards are different, the content and extent is very similar, in fact AICPA standards are substantially the same as the ISAs);

2) it will complicate training and education for audit firms performing audits under both the separate standard and the ISAs, creating further burden for some small audit firms;

3) it would be difficult to establish the scope of this standard on a consistent basis. In fact, the complexity of the entity may be a subjective issue and it is not generally not possible to have an idea about the complexity of the entity without having an understanding of the entity before (which is part of the audit itself). For example, an auditor may preliminarily assess the company is not complex but later finds out, after obtaining further understanding of the entity, that the entity has one or more “complexities”, and therefore the standard for LCEs is no longer appropriate. Note it is substantially different to the scope of the IFRS for SMEs because the scope can be objectively assessed before adoption of the standard;

4) It will be complicated to apply in a group audit environment when the group auditor applies ISAs and the component auditor applies the standard for LCEs.

4. 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?

No.

4. 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, or noted in response to 4b above.

See response in 4.a

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?

No.