

**Comments of the Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India (ICAI) on the IAASB's Discussion Paper on "Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs"**

**Part A: General Comments / Approach being adopted by India for audits of smaller and less complex entities**

**I. Stringent Audit Requirements in India**

In India, **all companies, all banks and all insurers** require **mandatory** audit of their annual financial statements irrespective of their size, nature, ownership structure, capital, turnover, profit/loss. Besides opinion on financial statements, auditors of these entities are also required to report on various additional matters e.g. reporting on internal financial controls, reporting on fraud, compliance of financial statements with accounting standards and other aspects prescribed under respective Acts/Rules/Regulations.

All limited liability partnerships (LLPs) except LLPs having small turnover/contribution are required to get their accounts audited. There is mandatory requirement of tax audit in case of all entities if their turnover from business exceeds 1 crore Indian Rupees or their gross receipts from profession exceed 50 lakh Indian Rupees. As per Income Tax Act, 1961, even non-corporate entities such as individuals, partnerships are covered under mandatory requirement of tax audit. The timeframe available for completion of audits is also stern. Under the provisions of the Companies Act 2013, it is mandatory for auditors of companies to comply with auditing standards. The Companies Act 2013 has also given powers to the Central Government of India to prescribe auditing standards for audit of companies. Compliance with all relevant Standards on Auditing is mandatory for auditors for every audit irrespective of its type or available timeframe. Also, the bankers in India require audited financials for granting of loans exceeding a specified limit (currently Rs. 10 lakh Indian Rupees).

**II. Difficulties faced in complying with standards based on ISAs**

ICAI has converged all its Standards on Auditing (SAs) with ISAs except ISA 600. Presently, these SAs apply to audits of all entities in India irrespective of nature, size, structure of the entity. In case of non-compliance with SAs, auditors are liable to strict disciplinary action under the Chartered Accountants Act 1949. At present, auditors conducting audits of smaller entities are facing many difficulties in implementing SAs in their audits due to following reasons:

- Large number of requirements in ISAs particularly with respect to documentation, internal control & risk assessment and disclosures.
- Increasing complexities in ISAs
  - Voluminous text of ISAs particularly of those ISAs issued in last few years e.g. ISA 720(Revised), ISA 540(Revised)
  - Frequent revisions to ISAs in last few years (ISAs 610, 315, 700, 705, 706, 720, 260, 570, 250, 800, 805, 810).
- Limited scalability of ISAs in audits of smaller entities
  - Many ISAs do not contain paragraphs dealing with “Considerations Specific to Smaller entities”
  - Some ISAs contain paragraphs dealing with “Considerations Specific to Smaller entities”. However, this para does not sufficiently cover this aspect.
- Numerous documentation requirements in ISAs
  - Besides ISA 230, various ISAs contain specific documentation requirements.
  - These numerous documentation requirements are suitable/justified in audit of large entities.
  - However, these requirements are cumbersome and impractical in audit of smaller entities.

### **III. Decision taken to develop separate auditing standard for audits of smaller and less complex entities**

Considering the aforesaid difficulties in implementing SAs (which are based on ISAs) in audits of smaller entities, the Auditing and Assurance Standard Board (the Board) of ICAI has decided to develop separate auditing standard for audits of smaller and less complex entities. This decision was taken by the Board after considering the pros and cons of this option vis-à-vis the other option of revising the existing SAs. This separate auditing standard for audits of smaller and less complex entities will have following broad features:

- It will be written in form of a single comprehensive standard which will be divided in different chapters to cover different topics.
- It will be written in simple language.
- It will not be based on Framework used in ISAs. Instead of separate sections i.e. Introduction, Definitions, Requirements, Application in ISAs, it will have continuous running text. Further, it will have small paragraphs and short sentences.

Considering the fact that development of this Standard will take some time, the Board has also decided to develop non-authoritative guidance regarding practical application of SAs in audit of smaller entities. In the year 2008, the Board had published a publication “Practitioner Guide to Audit of Small Entities”. The Board has started the process of revising this publication. This publication provides a practical approach for implementation of SAs in audits of smaller entities.

## **Part B: Specific Comments on Question 1 of the Discussion Paper**

*Question 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?*

### **Our Comments:**

The Discussion Paper has given following qualitative characteristics to describe a less complex entity (LCE).

*“An entity which typically possesses qualitative characteristics such as:*

- (a) Concentration of ownership and management in a small number of individuals (often a single individual – either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and*
- (b) One or more of the following:*
  - (i) Straightforward or uncomplicated transactions;*
  - (ii) Simple record-keeping;*
  - (iii) Few lines of business and few products within business lines;*
  - (iv) Few internal controls;*
  - (v) Few levels of management with responsibility for a broad range of controls; or*
  - (vi) Few personnel, many having a wide range of duties.*

*These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all of these characteristics.”*

In our view, these qualitative characteristics are subjective in nature and there will be practical difficulties in describing a LCE based on these characteristics. Further, these qualitative characteristics cannot be part of jurisdictional level Acts/Rules/Regulations for classification of entity as small or LCE.

We are of the view that different jurisdictions may apply their own criteria for describing a LCE (or other classification of entities e.g. 'small entities' or 'small and medium entities (SME)' whichever is most suitable in that jurisdiction). The criteria may be based on local laws and regulations and practices prevalent in that jurisdiction.

In India, various Acts/Rules have prescribed quantitative criteria for classification of entities. Some of these criteria are as under:

- Under the Companies Act, 2013 as amended: Small companies have been defined as those companies whose capital and turnover does not exceed a specified monetary limit. The specified monetary limit has been prescribed by the relevant Rules. The limit is reviewed and revised after a period of time.
- Under the Companies (Accounting Standards) Rules, 2006 as amended: Small and medium-sized companies (SMC) have been defined as those companies whose turnover and borrowings (including public deposits) does not exceed a specified monetary limit.
- Under the Micro, Small and Medium Enterprises Development Act, 2006 as amended: Entities have been classified into 3 categories of (1) micro (2) small and (3) medium. Classification is based on monetary amount of their investment in plant and machinery. The limit is reviewed and revised after a period of time.