



**MALAYSIAN INSTITUTE  
OF ACCOUNTANTS**

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Mr Matt Waldron

Technical Director, International Auditing and Assurance Standards Board

International Federation of Accountants

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New York, 10017 USA

Dear Matt,

**INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD ("IAASB")  
DISCUSSION PAPER, AUDITS OF LESS COMPLEX ENTITIES: EXPLORING POSSIBLE  
OPTIONS TO ADDRESS THE CHALLENGES IN APPLYING THE ISAs**

The Auditing and Assurance Standards Board ("AASB") of the Malaysian Institute of Accountants ("MIA or the Institute") welcomes the opportunity to provide its comments on the International Auditing and Assurance Standards Board ("IAASB") Discussion Paper (DP), *Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs*.

The AASB supports the IAASB's initiatives in examining the challenges faced by the practitioners in applying the existing ISAs in the audit of LCEs and possible actions that could be undertaken to address the identified challenges, including the review of the scalability of the standards. The AASB formed a working group and conducted a roundtable discussion to gather views on the DP. The Institute had also encouraged its members to submit their comments on the DP and participate in the online survey by the IAASB.

We attach in Appendix 1, our response to the questions found in the Discussion Paper. The response is compiled based on wider views of the members of the Institute and other stakeholders through our outreach activities. Therefore, it contains both arguments for and against the proposal rather than a single consensus on certain matters.

We hope our comments would contribute to further deliberation of the IAASB on the matter. If you have any queries or require clarification of this submission, please contact Simon Tay Pit Eu at +603 2722 9271 or email at [simontaypiteu@mia.org.my](mailto:simontaypiteu@mia.org.my).

Yours sincerely,

**MALAYSIAN INSTITUTE OF ACCOUNTANTS**

**DR. NURMAZILAH DATO' MAHZAN**

Chief Executive Officer



## **APPENDIX 1**

Our comments on Discussion Paper are as follows:

**Q1. 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 believe that the term “less complex entity” (LCE) is appropriate. However, we are of the view that the term “few” in the qualitative characteristics set out in the DP has ambiguity in its meaning as different assessments of what would be considered as few internal controls, few lines of business, few levels of management or few personnel in an entity may occur.

We believe the following characteristics could be added for consideration in describing LCEs:

- The audit does not involve the use of experts and specialists.
- The entity does not operate in a complex or highly regulated industry.
- The entity operates in a simple IT environment.
- The entity’s owners and management are the same individuals.
- The entity does not actively seek third party finance.
- The entity is not a component of a public interest entity (PIE).
- There are no significant minority interests.
- The organizational structure is not complicated or unusual.
- The entity has no or few significant judgements and estimates in accounting.

We also wish to highlight possible consequences in applying the definition of LCE which are as follows:

- Given the description of LCE on page 4 of the DP, stakeholders may assume an entity as LCE by fulfilling the concentration of ownership or management criteria with only one of the criteria listed in part (b) of the definition. For example, a technology company may have few levels of management with responsibility for a broad range of controls but transactions could be complex or complicated. In this case, the IT company will meet the LCE definition which may not be appropriate.
- Stakeholders may be confused by what constitutes an LCE and a non-LCE.
- It may be difficult to achieve consensus on the definition of LCE similar to the definition of public interest entities (PIE) where there is no global consensus reached to date on what ought to be classified as PIE.
- There is a possibility for stakeholders to force the definition of a LCE to a non-LCE and vice versa which may further create confusion.

**Q2. 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.**

We found the following ISAs and its aspects are challenging:

ISAs	Challenges
<p>ISA 315 (Revised)</p> <p><i>Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment</i></p>	<p>This ISA requires the auditors to document the risk assessment procedures performed and the information obtained regarding the entity, its environment and its internal controls components.</p> <p>The internal controls in an LCE are mostly unstructured and there may be limited/no audit trail available for the auditors to evaluate its design and implementation appropriately. In addition, with limited personnel in LCEs, there is often insufficient segregation and allocation of duties for a control reliance audit approach. This is a challenge to the auditors of LCEs, as the required information is usually not readily available for LCE.</p> <p>Furthermore, it may not be cost effective for the auditors of LCEs to perform detailed risk assessment as the financial statements are straightforward and not complicated.</p>
<p>ISA 540 (Revised)</p> <p><i>Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures</i></p>	<p>Generally, LCEs have no or few estimates. For the latter, the estimates may be not complex but the requirement of the standard is onerous in particular the application of paragraphs 22 to 36. This has often led to significant time being spent in the area, especially in challenging management assumptions, for example, the reasonableness of the discount rate.</p> <p>Management of LCEs generally lacks skills in making such estimates. Significant time is also spent to educate the LCEs on the need to do so. In most cases, LCEs fail to appreciate such a process and view it as non-beneficial.</p> <p>Certain LCEs would require forward-looking information in making the estimates, for example impairment assessment. The requirements of this standard would necessitate the auditors to develop auditor's range which is very challenging to the auditors of LCEs, mainly due to the non-available of ready information or the excessive time and cost that it takes to acquire such information.</p>
<p>ISA 240 <i>The Auditor's</i></p>	<p>The set-up of the LCEs themselves (which are typically family owned, owner-managed or have concentration of</p>



<p><i>Responsibilities Relating to Fraud in an Audit of Financial Statements</i></p>	<p>control of few individuals) coupled with the lack of appropriate governance structure have resulted in the impracticability in the application of ISA 240. Management of an LCE may not have structured assessment of risks related to fraud in the entity or even processes for identifying and responding to fraud risk. This imposes a challenge on the auditors to respond to the assessed risk of material misstatement due to fraud. In addition, effective communication of identified fraud may be challenging for auditors of LCEs due to the cost-benefit assessment of obtaining legal advice as suggested in paragraph A65 of ISA 240.</p>
<p><i>ISA 580 Written Representations and ISA 500 Audit Evidence</i></p>	<p>ISA 580 states that the written representations on its own does not provide sufficient appropriate audit evidence. However, due to the nature of LCEs, there may be lack of documentary evidence put in place by the management and therefore the auditors of LCE may find it challenging to corroborate the management representation to other source of information, for example in determining the fair value of a simple investment in non-quoted entities whereby information may be limited and if information is available, the exercise may not be cost-beneficial. This poses challenges to the practitioner to obtain sufficient appropriate audit evidence as required by ISA 500.</p> <p>Paragraph 4 of ISA 580 states that written representations do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Notwithstanding the guidance available, an exemption to paragraph 4 in limited circumstances, for example, when an entity can prove that cost of preparing such documentary evidence would outweigh the benefits, would be helpful.</p>

The challenges highlighted above in each ISA would then relate to the challenges in applying ISA 230 *Audit Documentation* which requires the auditor to prepare documentation that provides sufficient and appropriate record of the basis for the auditor's report as well as evidence that the audit was planned and performed in accordance with ISAs and applicable legal and regulatory requirements.

- 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?**



We believe that the main underlying cause of these challenges is due to the cost-benefit of the audit procedures performed on LCEs as perceived by the management of the entity. The owners of LCEs may believe that periodic financial reporting and audit are compliance in nature and does not directly provide value to the management of the entity. This perception imposes hurdles to practitioners' work in performing the audit. In addition, the management of LCEs usually hire non-qualified accountants to prepare the accounts of the LCEs. Additional requirements such as cash flow forecast to support fair value may not be prepared as it is deemed as incurring additional cost with no clear benefits.

In many occasions, written representations as required by ISA 580 appear to be used as an alternative on non-cost beneficial item that may not be of importance to the LCEs. Besides, the management of LCEs are also often reminded and informed on the relevance and importance of the audit procedures performed.

Complex requirements of accounting standards such as fair value measurement also cause challenges to the audit of LCEs as many smaller businesses do not necessarily benefit from complying with complex accounting requirements.

**Q3. 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 believe that the IAASB should focus on commercial considerations relating to an audit because owners of the LCEs often hesitate to spend on audit fees and matters arising from the audit such as engaging a valuation expert. Despite the fact that they acknowledge the requirements of the ISAs as onerous, they hesitate to pay the audit fee that is commensurate with the audit work.

Another area on which the IAASB can place more efforts would be the promotion and advocacy of the value of audit of LCEs and how it is fit for purpose for their users, namely the LCE business owners.

As audit procedures are driven by accounting requirements, the complexity of accounting standards will determine the required auditing procedures. Accordingly, we believe that communication between the IAASB and the International Accounting Standards Board (IASB) on challenges faced in applying complex accounting requirements is important.

**Q4. 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.**

#### Revising ISAs

- i. Revising ISAs was supported by the majority of the participants of our outreach activities as this is the most appropriate long-term action to address the challenges identified. The building-blocks approach would eliminate ambiguity on what is required in ALL audits including LCEs and also cater for entities with more complex circumstances.
- ii. This action may be the most time consuming and costly approach to be adopted by the IAASB as it would involve detailed work in relation to the requirements in each ISA. This approach may also cause the auditing standards to be lengthier and affect the readability of the standards.

#### Developing a separate auditing standard for audits of LCEs

- i. The benefits of this approach is that it may provide clarity in terms of what is specifically required from audits of LCEs.
- ii. However, a separate auditing standard may bring confusion not only to practitioners but also to users of financial statements. This approach may also cause dual perception on value of audit where standards applicable for non-LCEs may be perceived as superior in comparison to standards applicable for LCEs. This will lead to worsening of fee pressure for audits of LCEs as LCEs may not be willing to pay for audits that are considered as less complex.

Furthermore, in the event that the audit opinion/report issued under separate auditing standards differs, it may create more confusion among the users of the audit report.

#### Developing guidance for auditors of LCEs or other related actions

- i. Developing clear and helpful guidance may address the challenges identified for a short-term period. As such, this approach may be used as a stopgap measure.
- ii. However, the drawback of this approach is that the guidance materials issued are usually in a non-authoritative form. As such, it may not address the challenges identified in LCE audits as practitioners may choose to apply the guidance materials selectively. There is also the possibility of those practitioners only focusing on the guidance provided rather than the ISAs which have a detrimental effect on audit quality.

- 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?**

Other than those that have been mentioned elsewhere in our response, we have not identified any other possible actions that should be considered by IAASB.

- 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.**

Please refer to our response in 4(a) above.

- Q5. Are there any other matters that should be considered by us as we deliberate on the way forward in relation to audits of LCEs?**

We would like to highlight that currently, the accounting standards: only provide a definition of Small and Medium Size Entities (SMEs) rather than LCEs. IFRS for SMEs defines SMEs as entities that do not have public accountability and publish general purpose financial statements for external users. It would be beneficial for the IAASB to consider harmonising the definition of LCEs with the IASB to avoid confusion in terminology and allow effective implementation of audit of LCEs.

