



**The Institute of
Chartered Accountants
of Pakistan**

**CA
PAKISTAN**

HEAD OFFICE

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(submitted electronically)

Director
The International Auditing and Assurance Standards Board (IAASB)
529, Fifth Avenue, NY 10017
New York, USA

Comments on the Discussion Paper of Audits of Less Complex Entities - Exploring Possible Options to Address the Challenges in Applying the ISAs

The Institute of Chartered Accountants of Pakistan (ICAP) is pleased to comment on the Discussion Paper of Audits of Less Complex Entities - Exploring Possible Options to Address the Challenges in Applying the ISAs published by the International Auditing and Assurance Standards Board (IAASB) in April 2019.

We fully support IAASB's focus and efforts to address the challenges in applying the ISAs in the audit of Less Complex Entities.

Our responses detailed by the questions contained in the Discussion Paper, are presented in the 'Appendix' to this letter.

We hope our comments are helpful to the IAASB's deliberation on the Discussion Paper.

Should you require further clarification on our comments, please contact the undersigned at sohail.malik@icap.org.pk

Yours truly

Sohail Malik
Director Technical Services



“Appendix”

ICAP comments on the questions contained in Discussion Paper of Audits of Less Complex Entities - Exploring Possible Options to Address the Challenges in Applying the ISAs

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 note that the definition of LCE is same as that of ‘smaller entity’ provided in ISAs. The focus of LCE definition seems to be on the complexity and risk of material misstatement associated with the entity rather than its size and nature.

As a starting point, the LCE definition appropriately outlines the characteristics of less complex entities. However, we believe that the interaction of the LCE related qualitative characteristics (as provided in the definition) with other qualitative factors such as group structure, listing status of the entity, public-interest nature etc would require consideration for the development of an all-encompassing and generally applicable definition.

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.

Similar to global concerns, practitioners in Pakistan face a challenge of carrying out effective efficient and cost effective audit under ISAs, especially with regard to LCEs. There are concerns that ISAs in present form and structure are difficult to scale and apply on the LCE audits.

We believe that the following aspects of ISAs have some challenges in their application on the audits of LCEs, for instance:

- Audit documentation requirements are detailed and time consuming for audit procedures on certain areas not directly attributable to any significant account balance or the classes of transactions of audit clients that are less complex in nature. For instance, assessing the internal control environment, fraud risk assessments, going concern assessments, related party transactions testing, use of experts, audit on the risk of management’s override of controls, use of management estimates and judgements, etc.). These are those procedures performed under various ISAs such as ISA 240, 300, 315, 540, 550, 570, etc. Accordingly, we believe there should be lesser need for extensive documentation in LCE audits and therefore explicit guidance on those areas as mentioned above.
- Identifying and assessing the risks of material misstatements needs more guidance/application material for situations where the LCE lacks internal control system and resultant impact on the nature, timing and extent of substantive procedures (detailed and analytical both) and other general audit procedures not



attributable therefore the auditor is unable to perform enquiries and other analytical procedures.

- Audit sampling methods need further guidance due to less technology available with the auditors (i.e. SMPs) generally auditing LCEs.

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?

With regard to above, the main challenges are but not limited to the:

- Application of extensive and complex audit procedures and standards requirements (in terms of documentation) on less complex entities.
- Lack of or weakness in the internal control environment in LCEs requires more guidance application material for applying the ISAs.
- Other factors/matters as discussed in our response to 2a above.

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?

- Sometime there is a tendency to rigidly follow a “tick-box” approach on the audit. This undermines the exercise of professional judgment and professional skepticism.
- Other area which we noted is that the extensive advancement in technologies (robust use of Robot Process Automation, Data Analytics and Artificial Intelligence) have already shown significant positive impact on the quality of audits and it will continue to do as time progresses. However, there is a possibility that certain auditors /auditing firms (that are involved in the audit of LCEs generally) may have limited access to such latest technologies given lack of resources. These are emerging trends and in coming years would be relevant to LCEs, therefore guidance/application material might be needed on these areas.

We believe that IAASB should also work towards technological tools/ solution/s which the practitioners around the globe (especially SMEs) can afford and benefit from. This will help the small firms to become more competitive, and will improve the audit quality around the globe by applying auditing standards based on the standardised and consistent working methodologies.

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?

The auditing profession is committed to safeguard the public interest. Fundamentally, any action on the development of an auditing framework for LCEs should be centered on this principle. The audit of all entities should be based on similar principles, approach and standards, therefore ensuring same vigor, audit quality and safeguard of public interest.

We believe that the prospect of development of a separate standalone auditing standard for LCEs appears to be more practicable, scalable and understandable approach, in comparison to other possible actions. We would like to highlight that it would be of foremost importance that the principle of safeguarding public interest while following this approach should be considered, and in this context any actual or perceived risk of public perception about auditing under LCEs should be considered and resolved at the onset of the project.

We have evaluated each possible action in terms of potential benefits and risks, and our comments are set out below:

Possible Action 1: Revising auditing standards

While this approach offers the obvious and important benefit of having single set of auditing standards, however, in consideration of existing structure and drafting of ISAs we note following challenges:

- The revision of existing ISAs to bring in LCE related scalability while maintaining the clarity and understandability would be a challenge.
- This action would also require extensive time for completion.
- This action will involve extensive resources. The current standard-setting approach relies upon drafting and redrafting actual standards for review in working groups and board meetings.
- Incorporating provisions for LCE's could add to the volume of the existing standards and hence make it even more voluminous for the SMP's or other LCE auditors to read. Further, the risk of achieving a balance between putting in all the requirements and meeting stakeholder's expectations would be a challenge. If not carefully drafted, the revised standards could make it even more difficult to differentiate the provisions between LCEs and non-LCEs.

Possible Action 2: Developing Separate Auditing Standard for Audit of LCEs

We believe that the option of developing a separate auditing standard for audit of LCEs could be considered. The auditors of LCE's would not be required to go through the voluminous complete set of ISAs, instead there would be a shorter standalone standard designed just for the needs of the audits of LCEs.

The new standalone standard could take into account the digitalization aspect also, which is currently missing in the ISAs. However, the 'fundamental principles' of an audit will remain the same that is: following a risk-based approach, assessment of the environment, evidence gathering with the application of professional judgement and exercise of professional



skepticism at all times. A standalone standard could bring these fundamental principles together and help practitioners focus on the relevant aspects of the audit of small or non-complex entities while emphasizing the need for professional judgement.

However, if the option of developing a separate standard for LCE is explored, it could expose auditing profession to differential assurance levels. Quality of Audits conducted as per ISAs may be considered as better compared to audits performed under a specific standalone LCE auditing standard. Therefore, stakeholder/ users notion could be similar to the perception of financial statements prepared under the full IFRS and IFRS for SMEs.

Possible Action 3: Developing Guidance for Auditors of LCEs or other related actions

The supplemental guidance is generally considered as non-authoritative; therefore, auditors might not consistently apply them. Whereby, the perceived benefit would be lost. Further, for auditors lacking a general understanding of the ISAs, it would mean referring to two sets of documents the guide as well as the ISAs, hence diminishing its value as well as the objective would not be achieved of creating ease.

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.

As mentioned above, the option of developing a separate auditing standard for audit of LCE could be explored. However, it could expose auditing profession to a differential assurance levels.

Nevertheless, we believe that the stipulated advantages of this particular option are far more than that of the other two options.

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?

None.

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.

In view of the pros and cons of each possible approach as highlighted in our response to 4a(i) above, we would suggest developing a separate standard on LCEs. This would be easier to read and understand and thus would result in effective implementation of the same. We already have examples in the form of separate IFRS for SMEs and separate set of auditing standards available in Sri Lanka and France. There would of course be challenges which are detailed in 5 below for the IAASB's consideration.



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?

The approach suggested above could result in challenges like:

- Ensuring completeness of all necessary requirements of ISAs in the separate standalone standard;
- Dealing with the possible issue of stakeholders' perception on the level of assurance provided by an auditor's report based on separate (condensed) standards;

Consideration of the possible level of costs and resources needed to develop / draft a separate standard that is all inclusive, comprehensive and robust.