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Subject: IAASB Discussion Paper Audits of Less Complex Entities

Referent: Mag. Gerhard Prachner


Dear Sir or Madam,

KSW¹ is pleased to provide you with its comments on the possible actions in relation to audits of LCEs.

For further information on this KSW letter, please contact.

Yours sincerely,

Mag. Gerhard Marterbauer e.h.
(Vorsitzender des Fachsenats für
Unternehmensrecht und Revision)


Dr. Gerald Klement
(Kammerdirektor)

¹ Kammer der Steuerberater und Wirtschaftsprüfer – Austrian Chamber of Tax Advisors and Public Accountants

Appendix

- 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?**

Answer: We support the description of an LCE, which is based on qualitative characteristics rather than size. Although the IAASB should consider more risk-based factors.

We suggest the classification of the entity as an LCE should be performed in the course of the client/engagements acceptance procedures because a basic, but sufficient understanding of the entity would be attained at this early stage.

On the other hand, the IAASB should think about a different approach in general, where a description of a LCE would not be needed. Having in mind the audit procedures to be performed in order to achieve the required assurance level, the consideration of complexity should be performed on an audit area or cycles level of an entity, for example revenue cycle or purchasing cycle. Entities could have simple transactions in one cycle and therefore to be considered as less complex, but complex transactions in another cycle.

- 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?*

Answer: We share all of the concerns and challenges within the scope of the IAASB's work and want to comment on some of them without prioritization:

- **Language and Length of the Standards**

The ISAs are currently written in complex language and are too lengthy. Difficult language leads to ambiguity and misunderstanding and makes translations burdensome. As an example take characteristic (b)(i) of a LCE: "straightforward" and "uncomplicated" have nearly the same meaning. The minor differences are potentially

unknown to non-native speakers and even hard to be translated by experts into local language.

The IAASB has not set any guidelines or rules for drafting or revising standards in plain English and precise language. Therefore, we recommend formulating such guidelines and/or rules.

The ISAs should be drafted considering these basic principles:

1. Avoid redundancies with other standards
2. Implementing the Building-Block-Approach by drafting basic requirements applicable especially for LCE audits and any additional procedures required for other than LCE audits if applicable and relevant
3. Minimal requirements and additional requirements should be clearly separated from each other

- **Documentation, Lack of Clarity as to What Needs to be Done or Why**

Auditors see it as a burden to document why they have not performed certain audit procedures linked to requirements of ISAs. The practice of documenting reasons why a required procedure does not apply or was not performed has lead that audits of LCEs are compliance exercises.

In addition, the lack of clarity on what needs to be done drive regulators' expectations and demands when it comes to audit procedures and documentation. To avoid such unnecessary documentation, it would be very helpful to clearly state in the ISAs (ISA 200 and 230) that if the auditor has evaluated a requirement not to be applicable in an audit, the auditor does not to have to document this assessment. The auditor should apply professional judgment and document what he considers necessary in the circumstances.

- **Documentation Related to Internal Controls in LCE Audits**

LCEs may not have strong internal controls in place. Therefore, the auditor may choose a full substantive approach, without relying on any internal controls. For this reason, it seems disproportionate to require the auditor to identify and assess the risk of material misstatement in the financial statements through understanding the entity's internal control and documenting it as required by ISA 315.

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?

Answer: In general, we encourage the IAASB to focus on ISAs for all audits, notwithstanding a possible discussion about the future of the IAASB based on any findings

of the Monitoring Group. We do not need two sets of ISAs, one for the audit of listed entities at the responsibility of the IAASB and one for the audit of LCEs at the responsibility of National Standard Setters. There must be a global solution.

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.

Answer: Pros and Cons of the proposed Approaches:

- **Revising the ISAs**

Revising the ISAs would be the preferred approach ensuring scalability and proportionality. However, it would take a long time and therefore may not be a feasible solution in the short term.

- **Developing a Separate Auditing Standard for Audits of LCEs**

While this seems to be the appropriate solution for a quick fix in the near future, we want to draw your attention to a couple of impediments of this approach. Firstly, this option could lead to two sets of standards, which would create a two-tier auditing profession and raise questions with regard to the assurance level based on the LCE standard. Two set of standards would also create difficulties with respect to audit methodology, training and audit software for audit firms.

- **Developing Guidance for Auditors of LCEs or Other related Actions**

At this point, newly developed or revised guidance would not be answer to respond to the current challenges faced by auditors in the audit of LCEs. More guidance would be considered even more burdensome.

Although new and revised guidance on its own is not the answer to the problem, it should be part of any solution for LCE audits.

Actions to be Pursued by the IAASB

Considering all pros and cons of the recommended solutions, we prefer the Revising the ISAs approach most. As mentioned in the discussion paper a rolling or phased basis using the so-called “building-blocks approach” is our preferred solution.

The IAASB should start revising the most fundamental ISAs first, i.e. ISA 315, 330, 240 and 540. To ease the application of ISAs, in relation to LCE audits and also to the benefit of all audits, ISAs cannot be developed as they are today and should be fundamentally revised using the building-block approach. This means that the core of the ISAs would consist of the basic requirements applicable in all audits. In doing so, IAASB should rigorously question any proposed requirement and check its usefulness and applicability for all LCE audits, as well as disclose its respective reasoning why the requirement should be a requirement.

Further requirements should be added systematically addressing further complexity and risks of the audited entity and circumstances. In this process the IAASB should also make sure that the ISAs become technology – based, for example by integrating a software to help the auditor navigate and apply the ISAs.

If the IAASB decides to develop a separate standard at first, this should be the way forward. The separate standard should contain the basic requirements of all ISAs. The separate standard could be the first building block of the revised and rewritten ISAs.

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?

Answer: The IAASB could play an important role in promoting the role and value of audits, including LCE audit, in our society. In particular, the IAASB could do this by focusing on positive contributions of audit such as providing trust to the users of financial statements, including those of LCEs. The IAASB could also stress the value of an audit, which could change the view of many entities, even very large ones, that an audit is only a costly and time-consuming burden.