

AUDITS OF LESS COMPLEX ENTITIES: THE CHALLENGES IN APPLYING THE ISA'S

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Abstract. *Currently, when performing an audit in accordance with the requirements of International Standards on auditing, a large number of audit procedures must be performed to confirm the financial statements. In some cases, this is not entirely justified, for example, when conducting audits in less complex entities. In this regard, the International Auditing and Assurance Standards Board Committee issued a discussion paper with an analysis of the situation and suggestions for improving the regulatory framework. In this article, the author analyzes the current situation and suggests ways to improve the regulatory framework.*

Keywords: audit, less complex entities.

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Introduction

Issues related to the audit of less complex enterprises were first raised after the 2017 Paris conference on small and medium-sized audit companies. This is primarily due to the fact that small businesses are the backbone of any economy, and they account for the largest share of all audit services in the world. Difficulties in application of International Standards on auditing in respect of them are of great relevance to the IAASB.

In addition many countries are considering the specifics of conducting an audit in less complex entities, such as:

- In June 2015, a consultation on a “Nordic Standard for Audits of Small Entities” was published. The draft standard was developed by the Nordic Federation of Public Accountants for consultation in Sweden, Denmark, Finland, Iceland and Norway.
- In 2018, Sri Lanka issued “The Sri Lanka Auditing Standard for the Audits of Non-Specified Business Enterprises” Which was developed at the Institute of Chartered Accountants of Sri Lanka with the draft Nordic Standard being used in its development.
- In March 2019, Belgium published a statutory standard for auditing SMEs and small not-for-profit entities.

The International Auditing and Assurance Standards Board (IAASB) has published a new discussion paper on how to apply international standards of audit (ISA) to organizations with less complex structures. Comments on it were accepted until September 12, 2019[1].

In this regard, there are a number of issues that arise due to the fact that small audit firms conduct audits and they may have limited opportunities: in terms of resources, for example: financial or labor.

However, small audit firms conduct audits in less complex enterprises, and in this regard, it may not be necessary to perform any complex audit procedures. At the same time, it is necessary to have a clear understanding of all the current difficulties for auditors that they face in jurisdictions where ISA is applied. In addition, there is a need to strike a balance between simplifying and preventing a decrease in the quality of the audit.

When analyzing the discussion paper issued by the IAASB, first of all, you should pay attention to the definition of less complex entities, which is reflected in this document. So, a less complex enterprise is one that:

- 1) Carries out identical and simple transactions (sales, operations),

- 2) Maintains accounting records using the Simple record-keeping system,
- 3) Conducts several types of business or produces several types of products,
- 4) Has several levels of control that are responsible for a wide range of controls; or
- 5) Has a small number of staff, many of whom perform a wide range of duties.

The author suggests adding to this definition certain requirements that state authorities of different jurisdictions set for their entities.

The discussion paper notes that currently 129 jurisdictions apply International auditing standards.

It should be noted that a number of factors that are indicated in the following figure affect the audit in less complex enterprises.

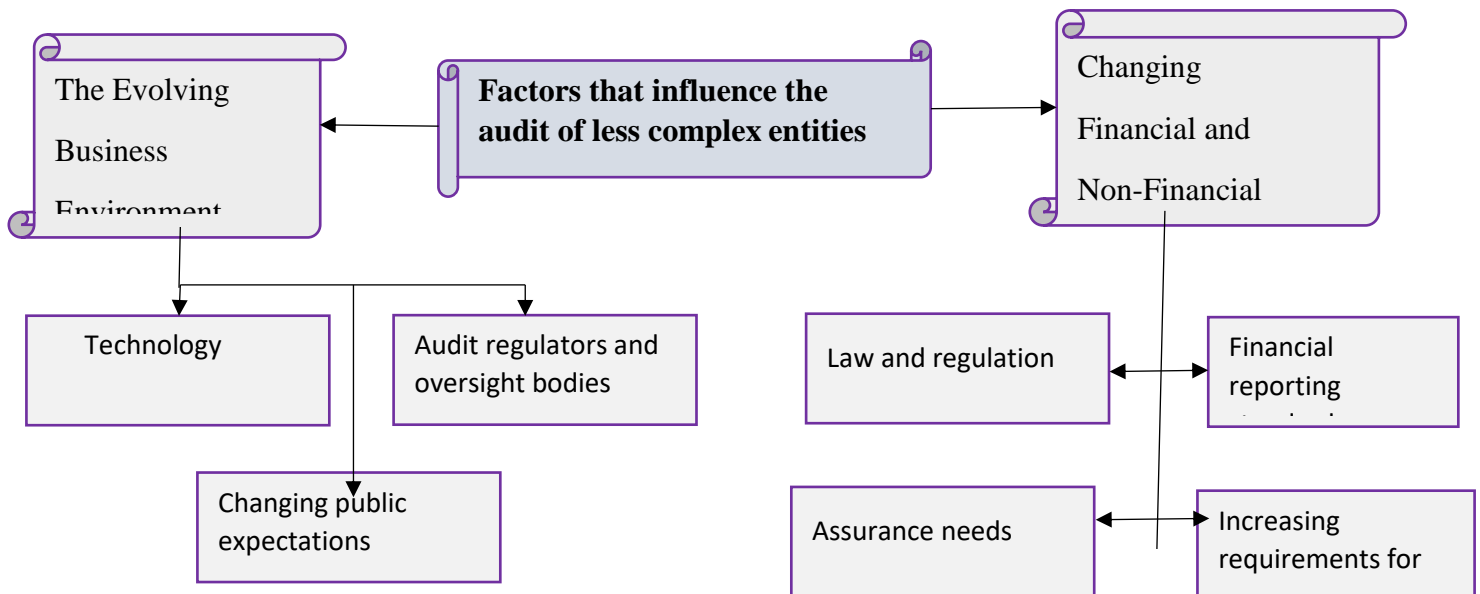


Fig.1 Factors that influence auditing of less complex entities

Source: developed by the author based on materials DISCUSSION PAPER: Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs

The problems of applying ISAS vary depending on a number of factors. For example, additional support may be required when ISAs are first adopted in a particular jurisdiction or may vary depending on the scope of audit practice, the amount of resources, the number of audit tasks performed by the auditor, and the nature and complexity of the business being audited.

When considering issues related to the creation of regulations for conducting audits in less complex entities the International Auditing and Assurance Standards Board committee took into account the following points:

- *Language and Basic Approach to the Standards,*
- *Length of the Standards,*
- *Documentation,*
- *Lack of Clarity as to What Needs to be Done or Why,*
- *Not Enough Guidance Within / Outside of the ISAs,*
- *ISAs Noted as Particularly Problematic.*

Language and Basic Approach to the Standards. The standards can be difficult to navigate as they break up a continuous audit process into discrete elements, and are written in a linear

way, but the audit process is iterative in nature. In addition, they are not electronic, so navigating is done manually.

Length of the Standards. The ISAs become more complex; however, they are needed to support the application of the standards.

Documentation requirements throughout the ISAs are extensive, and becoming more onerous, in many cases they lead to different interpretations.

Lack of Clarity as to What Needs to be Done or Why. This is due to the fact that the standards are not clear about the need for certain audit procedures/

Not Enough Guidance Within / Outside of the ISAs. Informations detailing considerations specific to smaller entities, where they are presented within the ISAs, are not usefull in all cases to understand scalability and proportionality of the requirements.

ISAs Noted as Particularly Problematic. The discussion paper states that some of the requirements of the ISA for conducting audits in less complex entities are too complicated. These include:

- ❖ *risk assessment in a simple environment,*
- ❖ *understanding of the internal control system,*
- ❖ *the auditor's views on fraud, and*
- ❖ *auditing accounting estimates.*

Analyzing the current situation, the International Auditing and Assurance Standards Board committee suggested discussing the following options for improving the regulatory framework of International Standards on Auditing with regard to conducting audits in less complex entities:

- *Revising the ISAs,*
- *Developing a Separate Auditing Standard for Audits of LCEs,*
- *Developing Guidance for Auditors of LCEs or Other Related Actions.*

Consider and analyze each of the proposed options:

Revising the ISAs. It represents a good opportunity for high-quality audit for less complex entities, first of all, this concerns the fact that in each of the standards there will be information or a separate chapter or paragraphs regarding the features of the audit for such enterprises

However, there are also negative aspects in this proposal that are related to the fact that the auditor will need to consult with many standards before forming a complete picture of the features of the audit in for less complex entities.

Developing a Separate Auditing Standard for Audits of LCEs. As The International Auditing and Assurance Standards Board emphasizes, in many jurisdictions standards are developed or have been developed to conduct audits in enterprises of less complexity. This approach is explainable, since it will be easier for the auditor in his work to conduct a high-quality audit based on information from one source: namely, one standard. The negative point is the fact that in the annexes of the standard it is impossible to attach a lot of explanations on its application.

Developing Guidance for Auditors of LCEs or Other Related Actions. It is a reasonable proposal that has various options for implementation:

- *Complete guide about how to apply the ISAs in circumstances of auditing less complex entities. Such guide has already been developed by IFAC (the Guide to Using ISAs in Audits of SMEs) which is provided practical support when applying the ISAs in audits of SMEs. The Guide consists of two volumes, with Volume 1 covering the fundamental concepts of a risk-based approach, and Volume 2 setting out practical examples including illustrative case studies. The Guide has been translated into over 20 languages, and the latest version has been downloaded in more than 140 countries.*
- *An International Auditing Practice Note (IAPN) for Audits of LCEs—IAPNs does not set additional or new requirements on auditors beyond those required by the ISAs, nor do they change the auditor's responsibility to comply with all of the ISAs relevant to the audit being undertaken. An International Auditing Practice Note provides practical assistance to*

auditors. Such an IAPN would likely only cover specific areas where additional guidance is needed.

➤ *Guidance for the application of specific areas within the ISAs, for challenges identified related to audits of LCEs—for example, a guide specifically targeted at risk identification and assessment, or to internal control.*

➤ *Implementation for new and revised ISAs specifically for audits of LCEs—including slide presentations, webinars and focused guidance about how to implement the revised or new ISA, to educate and assist once new or revised standards are published.*

Conclusions

Analyzing the above, it should be noted that the author, as a practicing auditor during the audit, faced a situation when a very large amount of work had to be performed at less complex entities during the audit. This was not always justified. Therefore, the International Auditing and Assurance Standards Board's discussion paper is very timely and necessary.

The necessity to develop a regulatory document regarding the audit in less complex entities is obvious. In our opinion it is necessary to develop an International Standard on auditing for auditing less complex entities and the arguments in this case are as follows:

- 1) we need a compact, comprehensive document that would contain the main goals, subject matter, and definitions for conducting audits in less complex entities. This criterion is ideally suited to the standard,
- 2) the standard is always accompanied by explanations of important practical points.

If you supplement all the standards, then it will be problematic for the auditor to find the necessary answers, looking at all International standards on auditing. If Guidance for the application practices is developed, then they may not include a number of important theoretical aspects.

Bibliography

1. DISCUSSION PAPER COMMENTS DUE: SEPTEMBER 12, 2019 Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs <https://www.ifac.org/system/files/publications/files/IAASB-Discussion-Paper-Audits-of-Less-Complex-Entities.pdf>