

# Thinking small first

Towards better  
auditing standards  
for the audits of less-  
complex entities

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## About this report

This report responds to concerns that International Standards on Auditing (ISAs) can be burdensome when applied to the audits of some smaller and less complex entities. The report proposes that ISAs could be drafted using simpler language and a simpler structure that starts with the most basic requirements and builds up. The report identifies that this approach would benefit regulators and the general public as well as auditors.



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## Executive summary

**For some time, it has been recognised that there are challenges in applying auditing standards to the audits of smaller and non-complex entities.**

In response, there is growing pressure to address these challenges. The solutions proposed so far include exempting smaller companies from audit or creating a separate set of auditing standards for those audits.

This report suggests an alternative way of addressing these challenges. Instead of exemption or separate auditing standards, this report proposes that auditing standards should be written using simpler language and a simpler structure – for all audits. To make this proposal more manageable, it could be applied prospectively rather than retrospectively.

Simpler language and a simpler structure would benefit all auditors, as they would be able to understand auditing standards more easily, and could identify more quickly the requirements that apply to their specific situation. There would also be benefits for audit regulators and for the public understanding of audit.





# History of the problem

**There is a growing perception and concern that auditing standards are designed primarily for the audits of public-interest entities.**

Some practitioners are worried that auditing standards can be difficult to apply when auditing certain smaller or less-complex companies and that the standards require procedures that, in these practitioners' professional judgement, are unnecessary. And practitioners worry that in these circumstances regulators will expect the requirements of auditing standards to be followed regardless of their appropriateness.

## **CREATING SOMETHING SPECIAL FOR SMALLER ENTITIES**

While the benefits of audit are obvious for the largest companies, policymakers have debated how to respond to the cost-benefit question for smaller companies. Many countries have experimented with audit exemption for smaller companies while others have experimented with different types of assurance engagement for certain types of entity, such as the review engagement in the US. Some countries, for example France, have even developed their own standards for simpler entities. And in 2015, the Nordic Federation issued a consultation on its proposal for an auditing standard for smaller entities<sup>1</sup>.

These pressures are continuing to grow and it is time to address them.

## **THE CLARITY PROJECT**

In 2004, the International Auditing and Assurance Standards Board (IAASB) commenced the significant project of revising and reformatting all its auditing standards to simplify their wording and structure. Responding to concerns that standards were too complex, the IAASB reworked every standard to separate its requirements from the application material that helps explain how to implement it properly. Every requirement has been expressed using the verb 'shall' so users have certainty over what each standard requires. Similarly, the application material content has been reviewed to ensure that it only explains the requirements of the standard concerned and does not create new ones.

This process, known colloquially as the 'Clarity Project'<sup>2</sup>, took up a lot of staff and volunteer time and resources. It has produced standards that are easier to read and make it easier for users to identify the requirements. This can also reduce disagreements between audit regulators and auditors as to what a financial statement audit requires.

## **ACCOUNTANCY EUROPE'S 'COGITO' PUBLICATION ON SME AUDIT**

In 2018, Accountancy Europe published a report, as part of its 'Cogito' series, entitled *Simplifying Auditing Standards for Small or Non-complex Entities: Exploring Possible Solutions*<sup>3</sup>. This looks at some of the difficulties of applying the International Standards on Auditing (ISAs) that users have reported. It also considers the practicality of developing a standalone standard that is specifically tailored to the needs of small or less-complex entities.

## **THE IAASB IS THINKING AGAIN ABOUT THE NEEDS OF SME AUDITORS**


The IAASB has a project team that has been collecting views from practitioners in order to understand the areas that concern auditors of small and medium-sized entities (SMEs). This feedback will be used to guide the IAASB's possible future responses.

An initial discussion was held in a private session in March 2018, at which the IAASB agreed to formalise the project. An update was provided to the Board in September 2018.

<sup>1</sup> [https://www.revisorforeningen.no/fag/nyheter/Nordic\\_standard](https://www.revisorforeningen.no/fag/nyheter/Nordic_standard)

<sup>2</sup> <https://www.iaasb.org/clarity-center>

<sup>3</sup> <https://www.accountancyeurope.eu/publications/simplifying-auditing-standards-small-non-complex-entities/>



# Why is finding a solution so difficult?

**Concerns about the appropriateness of ISAs for SME audits have existed for some time, and there are a number of proposals for addressing those concerns. Nonetheless, each of these proposals suffers from one or more limitations. As a result, there has yet to be significant progress on this issue.**

## **MAINTAINING A UNITARY APPROACH TO AUDIT**

Historically, standard-setters have attempted to maintain a unitary approach to audit. This concept has sometimes been summarised by the phrase ‘an audit is an audit’. Standards have attempted to protect audit as a single product that can be applied in a scalable and proportionate manner to all types of entity, recognising that a larger and more complex entity will result in a larger and more difficult audit.

An advantage of viewing audit as a single offering that can be applied to any size of entity is that the size of the audited entity is not a factor in determining audit quality. And one firm’s opinion and another firm’s opinion can be considered to be equivalent because both are an audit and both firms followed the same standards.

On the other hand, some proposed solutions do not maintain a unitary approach to audit. For example, it is difficult to maintain the view that ‘an audit

is an audit’ where there are multiple, incompatible standards. In the hypothetical situation where one firm has followed ISAs to arrive at an (audit) opinion for an entity and another firm has followed a very different set of standards for the same entity, it is hard to argue that these opinions are equivalent. We define the former as an ‘audit’, so can the latter also be called an audit?

## **SUSTAINING PUBLIC CONFIDENCE IN THE RIGOUR OF AUDIT**

An important factor in audit quality is that the public need to have confidence that standards are being maintained. The main approach involves establishing an inspection regime for audits that reviews the audit files of some completed audits, and talking to key staff involved in the engagement to understand whether auditing standards were followed. To the extent that auditing standards have not been followed, the inspection regime will expect the firm to make improvements to its processes so that the deficiency is not repeated.

This process requires a certain specificity of the basic requirements of auditing standards. Where standards for some audits – for example, the audits of less-complex entities – provide less detail, it may be more difficult for the inspection regime to identify deficiencies and seek improvements.

ACCA’s position is that it is preferable to maintain a unitary approach to audit and to ensure that public confidence in the rigour of audit is sustained.



# Simplifying the language of auditing standards is a better approach

**ACCA believes a better solution is for the IAASB to establish a process for writing new standards in a simpler language and with a new structure that accommodates the needs of auditors of smaller and less-complex entities.**

In addition to this, over the medium term, the IAASB should commit to rewriting all existing standards in this format.

## **WHAT ARE THE ADVANTAGES OF THIS APPROACH?**

A common complaint about auditing standards is that they tend to scale down rather than scale up. In other words, the standards reflect the expectation that the user is an auditor of a larger entity and that SME auditors will merely do less. A better approach would be to explain what every auditor must do and then elaborate the requirements as the size and complexity of the audited entity increases. It is important that standards have a simple basis from which they can build up, rather than starting with complex issues and expecting auditors of smaller entities to work out what to remove.

Writing the standards in a scalable way would be proof that the IAASB's standards are scalable. It is also efficient for the IAASB themselves to demonstrate the scalability of their standards, rather than putting the onus on firms.

## **HOW MIGHT THIS APPROACH BE IMPLEMENTED?**

The IAASB has good programmes for supporting high-quality implementation of its newly issued standards, including formal post-implementation reviews for its most important projects. These also consider of how best to support users of new standards, with resources including additional materials, scalability explanations, frequently asked questions and Staff Practice Alerts.

ACCA proposes that some of this support process can be folded into the standard-setting process itself. For example, some of the thinking about workflow and scalability could be brought forward and communicated within standards.

In addition, more of the actual drafting of each standard could be undertaken by specialist drafting teams, with less done in full board meetings. This would be in line with the proposal, as set out in the Monitoring Group's consultation on the future of audit-related standard setting<sup>4</sup>, for a more strategic board.

## **LESSONS FROM ISA 315**

The Key Concepts section of the proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*<sup>5</sup>, is written in simpler English which is much more accessible to users than the rest of the proposed standard. This allows users to understand the overall flow of the rest of the standard more quickly. ACCA believes that, with the right support, the IAASB could move towards drafting all its standards in similar language.

<sup>4</sup> <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD586.pdf>

<sup>5</sup> <https://www.ifac.org/publications-resources/exposure-draft-isa-315-revised-identifying-and-assessing-risks-material>





# The benefits of simpler auditing standards

**Writing auditing standards using simpler language and a simpler structure would benefit auditors of less-complex entities directly, as they could more readily understand the intention of standards.**

In addition, it would make it easier for the auditor of a less-complex entity to find the specific requirements that apply to their situation, instead of having to distil complicated standards into more basic procedures.

In addition to the direct benefits for auditors of less-complex entities, there would also be benefits for other stakeholders in auditing standards.

## **SIMPLER AUDITING STANDARDS BENEFIT ALL AUDITORS**

Simpler language and a simpler structure would also benefit the auditors of larger or more complex entities. It would achieve this by separating the overall flow of the standard from its more detailed requirements and by structuring the requirements in a way that allows users to identify more easily those applicable to their specific situation.

## **SIMPLER AUDITING STANDARDS WOULD BENEFIT AUDIT REGULATORS AND OTHER STAKEHOLDERS**

Simpler auditing standards would also benefit audit regulators and other stakeholders with an interest in auditing. This is because simpler standards would make it easier to understand a standard's expectations of an auditor and to find the requirements of that standard applicable to a specific situation.

Given that some of the concerns of auditors of less-complex entities relate to differences of opinion between the auditor and audit regulator, it would be helpful to reduce opportunities for misinterpretation or disagreement over what auditing standards intend.

## **SIMPLER AUDITING STANDARDS BENEFIT THE PUBLIC**

Publicly, there is a lot of suspicion about whether auditors are fulfilling their responsibilities under auditing standards. The structure and complex language of the standards can make them difficult for lay users to understand. Research by ACCA<sup>6</sup> shows that only one quarter of respondents to a survey of members of the public were able to accurately identify what an auditor does. Writing auditing standards that have simpler language and a simpler structure should allow a wider range of users to understand them, helping to inform public understanding of audit.

# Challenges in implementing this approach



While the advantages of simpler standards are clear, it should be recognised that there are some challenges to producing auditing standards that have simpler language and a simpler structure.

## **REWRITING ALL THE AUDITING STANDARDS WILL TAKE A LONG TIME**

Revising auditing standards is a time-consuming process. The IAASB faces significant time and resource constraints in its standard-setting and remains under pressure to respond to public interest concerns. The IAASB's previous project of revising and restructuring all auditing standards, known as the Clarity Project, took several years and considerable staff and volunteer time.

This may make a project of rewriting all existing standards seem impractical, given the IAASB's current constraints.

In practice, however, it is still possible to apply this approach on a prospective basis to new standards and to revisions of existing standards. Over time, this will deliver the benefits of simpler standards without imposing a large one-off cost.

## **THIS APPROACH MAY ADD TIME TO STANDARDS DEVELOPMENT**

The current standard-setting approach relies upon drafting and redrafting actual standards for review in working group and board meetings. Hence it may take time for the board to become accustomed to a methodology that is,

initially, more conceptual and may depend less upon detailed drafting.

In the long run, the approach may make standard-setting more efficient if it serves to reduce the amount of board time spent redrafting standards. It is also closer to the Monitoring Group's vision of a more strategic board, set out in its consultation on the future of audit-related standard setting<sup>7</sup>.



# Conclusion

**This report proposes that the IAASB sets a goal of rewriting all its standards in a new format that prioritises the needs of auditors of smaller and simpler entities.**

In the short term, it should consider writing any new standards using language and a structure that are sensitive to the needs of the auditors of smaller and less-complex entities.

This will better serve the needs of auditors of less-complex entities and demonstrate scalability. But, vitally, it will also better serve the needs of all auditors, support the activities of regulators and serve the public interest.

While there may be some temporary issues while transitioning towards this new way of working, the benefits for users and for the public interest make this a price worth paying.

