



International Auditing and Assurance Standards Board
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IAASB's Discussion Paper on Audits of Less Complex Entities

The Nordic Federation of Public Accountants (NRF) is pleased to provide you with some comments on the Discussion Paper *Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs*.

General comments

Smaller entities make a critical contribution to the world economy, and quantitatively the majority of audits globally relate to audits of smaller entities. It is therefore crucial that audits of these entities are not only of high quality, but also that they provide value to the clients and all stakeholders. These factors might be even more prominent in the Nordic region, where the thresholds for statutory audits are very low¹ and audits of less complex entities (LCEs) are provided by both the big audit firms and SMPs.

We appreciate that the IAASB has listened to the widespread concern about audit of LCEs and acknowledged that there are issues with applying the ISAs on these audits. We therefore welcome this discussion paper and note that there are high expectations on the IAASB to take action. Moving forward, status quo is no longer an option.

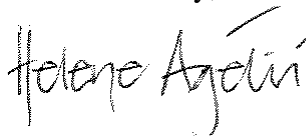
¹ For example, in Sweden statutory audit is required for limited companies where the company fulfills more than one of the following conditions during each of the two most recent financial years: 1. The average number of employees has exceeded three; 2. The company's reported balance sheet has exceeded 150,000 euro; 3. The company's reported net turnover has exceeded 300,000 euro.

NRF

Taking into account current global developments with national initiatives on standards for LCEs, we cannot stress enough the importance for the IAASB to act urgently. A global solution is the preferred option. We are concerned that if the IAASB does not act fast enough, there will be a fragmented audit market based on different national standards. Such an unwanted development will most likely dilute the role of IAASB as the global standard setter, but it might also have a negative impact on the relevance of audit engagements for LCEs.

As explained in our response to the specific questions below, NRF has come to the conclusion that the option of developing a separate standard should be further explored.

Yours sincerely,



Helene Agélii
Secretary General and CEO
Nordic Federation of Public Accountants

About NRF

NRF is a separate legal institution, founded in 1932, acting on behalf of and under the direction of the recognized audit and accounting institutes in the Nordic region (DnR in Norway, FAR in Sweden, FLE in Iceland, FSR – danske revisorer in Denmark and Finnish Association of Authorized Public Accountants in Finland).

APPENDIX 1 – NRF comments to IAASB’s specific questions:

- 1) **We are looking for views about how LCEs could be described. 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 support the use of the term “less complex entities”, since we agree that it is probably complexity rather than size that should be the defining factor, especially on a global level.

Overall, we also support using the characteristics for “smaller entities” when defining LCEs. However, we would like to emphasize that the most important matter when deciding the characteristics of this term, is that the term is easy to understand and apply. In this regard, we also encourage the IAASB to work closer with the national standard setters.

Also, we suggest that the definition should state that listed entities, and other public interest entities, are not covered by this definition, since those entities are covered by stricter laws and regulations.

- 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 causes(s) of these challenges and how have you managed to address 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?**

In our opinion, there are some major challenges with applying the ISAs to audits of LCEs. We agree with the challenges already mentioned in the discussion paper.

We believe that the overall challenges relate to the structure, drafting style and the volume of the ISAs. Length and complexity are key issues that run through the entire ISAs. The language used in the standards is complex and the sentences are long, which, among other things, causes translation difficulties.

Also, the standards themselves are getting longer and more complex. This is a consequence of the top-down approach, but also because of an increase in numerous and detailed requirements.

We believe that the extensive number of requirements at the cost of having a truly principles-based approach causes confusion and has led to several negative consequences. Because of the length of the standards and all the requirements, it has become a challenge to understand and follow “the big picture” and it encourages a check-list behavior/audit. This way of drafting also reduces the possibility to use professional judgment.

Visible and clear scalability options are fundamental when trying to maintain one set of global standards that fits all audits and using a top down structure approach. We do not think that the ISAs have accomplished these objectives. It is quite obvious that the standards are not written with audits of LCEs in mind. A lot of time needs to be spent on understanding the scalability options. In addition to issues with visibility and clarity, we also believe that the scalability options are too limited. For example, there are situations when scalability does not seem to be applicable, so the auditor has to comply with requirements regardless of whether this might lead to effective or efficient audits.

The standards also include extensive documentation requirements, which are often related to complying with the standards rather than to the audit itself. The top-down approach with the scalability options has caused a “comply or explain” approach to documentation, which have resulted in over documentation.

In our view, ISA 200 paragraphs 22 and 23 are good examples of the overall challenges of applying the standards on audits of LCEs, as these paragraphs capture the essence of the above-mentioned challenges of length, complexity and scalability. They also indirectly affect how the documentation requirements are being perceived and applied.²

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?

We believe that audits of LCEs that are characterized as being of high quality and performed in an efficient and effective manner, will ensure the relevance and value of

² ISA 200.22 states that if an individual ISA has been deemed applicable to an audit assignment, the auditor must fulfill all the requirements in that ISA, regardless of whether the auditor considers certain sections of the ISA as not being relevant to the audit. Paragraph 23 does provide some exceptions to paragraph 22. However, these exceptions do not include any possibility for the auditor to disregard certain requirements, they only deal with the possibility to carry out alternative audit procedures. Regardless of the IAASB's intention, these paragraphs are perceived by auditors as obstacles to the scalability of the audit.

audit to these entities. Providing auditing standards that enable the audit to meet these objectives is fundamental and might even have an impact on the thresholds for statutory audits, in that if legislators and audit clients appreciate the benefits of audit the incentives for raising the audit thresholds further will decrease.

Parallel to working towards these objectives, we suggest that the IAASB should more actively participate in the public debate and promote the value and relevance of audit and other services provided to LCEs/SMEs.

- 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 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, 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.**

Revising the ISAs

Revising the ISAs would have the benefit of maintaining one set of global standards that would be fit for purpose for all audits, regardless of complexity or size.

Taking into account the challenges noted above with the current ISAs, we believe that the ISAs would need to be drafted and structured differently, most likely by having a bottom-up/building block structure in order to achieve the desired effect, i.e. starting by setting out the basic requirements that should be applicable on all audits and then adding necessary regulations to address more complex circumstances.

Making such necessary changes could be a very time and resource consuming exercise, considering, among other things, the time spent on the Clarity-project. There are also uncertainties related to the outcome of the Monitoring Group's ongoing review.

Separate standard

Considering the challenges with the current ISAs as listed above (length, complexity, top down approach, onerous documentation requirements and the amount of detailed requirements), we believe that a separate standard focusing on audits of LCEs, would address these issues. A separate standard for audits of LCEs would have the

advantage of being shorter and more direct. The auditors would not have to start the audit by scaling down the requirements and documenting why certain requirements are not required for this audit. We believe that it would have positive implications on documentation requirements and provide room for auditors to apply professional judgment.

In our view, a separate standard must be based on the ISA framework and accomplish the same high-level objectives in order to avoid creating a two-tier profession. We believe this is fundamental in order not to create different, or the perception of different, audits, but also for the auditors not having to learn two different approaches/frameworks in order to audit both LCEs and larger entities. Also, if developed within the ISA framework it would better fit with the methodologies developed by the firms or software providers, and would therefore not be forcing two completely different sets of methodologies.

The standard would have to be robust, since applying it should result in a statement with the same level of assurance as in an ISA audit. It should have a principles-based approach combined with an encouragement to use professional judgment.

Developing Guidance for Auditors of LCEs

We do not believe that developing guidance for auditors of LCEs is a standalone option. It will not solve the issues with the current ISAs and would rather add length and work to the IAASB. The work has to be focused on the standards themselves and not on providing additional guidance material. Also, trying to deal with the challenges with applying the ISAs on audits of LCEs by developing additional guidance has already been explored by many countries and also by IFAC's SMP Committee without solving the problem.

In our opinion, this option should rather be used as a supplement to the preferred option.

Conclusion

In this discussion paper, the IAASB is asking stakeholders for directions on what option to explore further. With regard to the urgency to take actions to find a global solution and, by that, trying to inhibit further national solutions, it is our view that the IAASB should explore the development of a separate standard.

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?

With regard to global developments and the associated risks of a fragmented audit market and IAASB losing relevance, we would like to stress the importance of prioritizing this project, i.e. when this outreach phase is completed, the IAASB should immediately transfer this into a regular project.