

August 23, 2019

International Auditing and Assurance Standards Board
529 Fifth Avenue
New York, NY 10017

Re: Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the ISAs

Thank you for the opportunity to comment on this Discussion Paper (“DP”).

MNP LLP (“MNP”) is one of Canada’s largest chartered professional accountancy and business advisory firms. Our client base includes small to mid-size owner-managed businesses in agriculture, agribusiness, retail and manufacturing as well as credit unions, co-operatives, Indigenous communities and businesses, medical and legal professionals, not-for-profit organizations, municipalities, government entities, and publicly traded companies. We believe that we are positioned well to provide feedback on this discussion paper of LCEs (Less Complex Entities).

We have reviewed the DP and have provided our responses to the specific questions below. We support the International Auditing and Assurance Standards Board’s (the “IAASB”) project to review the ISAs in context of audits of LCEs and the unique challenges they face in applying those standards.

Questions

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?

In our view, an LCE will typically possess some of the qualitative characteristics as described on Page 4 of the DP. We agree that the list is not exhaustive, the characteristics are not individually exclusive to an LCE, and an LCE will not necessarily display all of the characteristics. Additionally, some of the characteristics are more persuasive in their indication that an entity may be an LCE. Therefore, we believe that professional judgment will need to be applied in determining whether an entity is considered an LCE. Accordingly, we recommend that clarity in the wording of the description be included to indicate that determining whether an entity is an LCE is judgment based and requires a weighing of all criteria. We also encourage clarity and guidance to be included to indicate that determining whether an entity is an LCE is a continual assessment that could change over time and not necessarily a one-time assessment.

Further we believe that the classification of an entity in terms of complexity runs on more of a spectrum rather than a distinct cut-off between two classes of entities. Certain entities which are for the most part non-complex may have some complex elements or enter into complex transactions on an infrequent basis. Similarly, an entity which is for the most part complex, may have certain areas of its operations which are not complex.

We note that ISA 315 has updated the description ‘few internal controls’ to ‘simpler system of internal controls’ and agree with this change, as a lack of internal controls does not necessarily indicate an LCE, while a simpler system of controls may be indicative of an LCE.

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.

In our view, the following ISAs are difficult to apply:

Estimates

ISA 540 presents difficulties for audits of LCEs in two ways. The first way is that management of LCEs are often inexperienced in accounting and as such, may lack the ability to prepare and document a sophisticated estimate. The second way is that an LCE may be an LCE because it is an operation with very limited transactions, it is relatively newly established, or in an industry with little comparative market information. These scenarios all increase the difficulty in management being able to create and auditors being able to audit an estimate as a lack of information exists to be able to create and verify assumptions.

Journal Entries

ISA 240 requires the testing of the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. Due to the nature of an LCE, practitioners struggle with applying the requirement to a relatively simplistic scenario. This may result in the testing of a significant portion of journal entries with a negligible reduction in overall audit risk. Further guidance on the extent of work required for journal entry testing for LCEs would be beneficial in creating consistencies in the amount of work performed on audits of similar types of entities.

Unpredictability

ISA 240 requires the auditor to incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures. This can be difficult to do with entities that have simple or limited transactions and are not complex in nature. Further guidance is needed on what constitutes “unpredictable” audit procedures in a non-complex situation.

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?

In our view the main underlying cause of these issues is that practitioners do not view the ISAs to be scalable for LCEs, which results in performing work in an inefficient or unnecessary manner. In our opinion scalability in the ISAs and guidance on how to apply that scalability would be beneficial to practitioners who perform audits of LCEs.

- 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?**

In our view it would be beneficial to focus on the value of an audit and public expectations.

The lack of trust in the audit process and persisting expectations gap puts added pressure on auditors already struggling to apply certain aspects of the ISAs to LCEs. Given these outside pressures, and absent any specific scalability guidance, auditors struggle to apply professional judgment to scale the level of procedures to perform on audits of LCEs.

- 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.**

Revising the ISAs

In our opinion, revising the ISAs will most appropriately address the identified challenges.

Introducing scalability into the standards and providing guidance in the appendices of the ISAs on how to implement that scalability will increase audit efficiency and consistency among audit practitioners. The ISAs and their appendices are the main source of guidance referred to by practitioners, therefore, we believe the additional guidance on how to apply the scalability should be included in the ISAs themselves. Providing practitioners with a single, authoritative, source of guidance will be the most efficient way to implement the changes.

Developing a Separate Auditing Standard for Audits of LCEs

In our opinion, this does not appropriately address the challenges identified.

We believe it is very difficult to differentiate entities into two categories (non-complex vs. complex). As noted previously in our response, we believe that the status of an entity as an LCE may change over time, non-complex entities may have certain complex elements and vice-versa. Developing separate auditing standards could result in the adoption of new standards at every reporting period where a change in LCE status was determined, and/or make it difficult to apply the respective set of auditing standards to the elements of financial reporting with varying degrees of complexity. Creating separate standards also increases the technical knowledge in which a practitioner must be fluent. This has the potential to create division in the abilities of auditors to perform engagements for LCEs and more complex entities. Therefore, it is our view that developing separate standards would create additional problems that currently do not exist, while not satisfactorily solving the challenges that currently exist.

Developing Guidance for Auditors of LCEs or Other Related Actions

We believe that the focus should be including new requirements and guidance directly within the ISAs or their appendices, as this is the main authoritative source of guidance practitioners reference. If additional implementation guidance is developed over and above what can practically be included in the ISAs and their appendices, this would be a welcomed complement. However, guidance spread out over multiple sources can be difficult for application in practice.

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?

We are not aware of any other possible actions that have not been identified that should be considered at this time.

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 our view, for the reasons in our response to question 4a, revising the ISAs should be pursued as a priority.

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?

In our view, it would be beneficial to apply the work on audits of LCEs to include the scope of less complex situations for a complex entity audit. As mentioned above, we do not believe adopting a separate standard is appropriate for LCEs, and there are instances where complex audits have simplistic sections and could benefit from applying the same guidance for those sections only. Including scalability in the ISAs for both LCEs and less complex situations will result in increased efficiency and effective application of the ISAs.

We would be pleased to offer assistance to the IAASB in further exploring issues raised in our response or in finding alternative solutions.

Yours truly,

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