In Brief

A plain and simple overview of the barriers to effective and efficient audits of less complex entities – results of November 2018 outreach session

This is an overview of the joint efforts of the AASB and CPA Canada to identify and address the challenges that practitioners face when auditing less complex entities.

**Background:**

On November 30, 2018, the Auditing and Assurance Standards Board (AASB) and Chartered Professional Accountants Canada (CPA Canada) staff jointly hosted an outreach session that brought together some 30 practitioners to discuss the barriers to effective and efficient audits of less complex entities (LCEs).

**Current status:**

The AASB and CPA Canada are considering the feedback received in working together to understand how the challenges that practitioners face when auditing LCEs can be overcome through standards activities, development of implementation guidance, and/or technology initiatives.
Introduction

Canada has many small and micro-entities\(^1\) and an audit is an important service that instills confidence in this part of the economy.

A critical objective of the AASB and CPA Canada is to encourage and support the delivery of high-quality audits. The AASB is an independent standard-setting board that establishes standards on auditing, review, other assurance, quality control, and related services. CPA Canada is the national organization established to support a unified Canadian accounting profession.

We heard from previous outreach with stakeholders that some small and medium-sized practices (SMPs) experience challenges in auditing LCEs. This is a Canadian and an international issue. National standard-setting bodies and practitioners around the world have been debating how to make the auditing standards more suitable for LCEs.

The AASB and CPA Canada are committed to identifying and addressing the challenges practitioners experience when auditing LCEs.

\(^1\) According to Innovation, Science and Economic Development Canada’s report, Key Small Business Statistics (June 2016), of the 1.17 million businesses in Canada, 98 per cent are small businesses (fewer than 100 employees) and 54 per cent are micro-businesses (one to four employees).
What we heard about the characteristics of less complex entities

Although the size of an entity contributes to its complexity, size is not the only determinant of complexity. Some smaller entities can be more complex, and some larger entities can be less complex.

The Canadian Auditing Standards (CASs) include application material titled “Considerations Specific to Smaller Entities.” Some national standard setters around the world felt that the phrase “smaller entities” does not appropriately capture the type of entities for which practitioners experience scalability challenges in performing audits. Rather, a more fulsome phrase could be “less complex entities.”

Participants of the outreach agreed that complexity of the entity provides an appropriate lens for identifying practitioners’ challenges in performing financial statement audits. However, there is not yet a single, clear-cut description of LCEs.

We asked participants whether characteristics of an LCE would include the presence of few formal internal controls and limited financial expertise of the management team. We heard that LCEs may have a financially adept, but small management team (one or two individuals), or may be governed by boards of directors who have financial expertise.

We also asked participants whether having only a few stakeholders would be a characteristic of an LCE. We heard that LCEs could have many stakeholders, for example real estate investment companies and not-for-profit organizations.
What we heard about challenges in applying the Canadian Auditing Standards

Areas identified as being hard to scale for LCEs include:

• The extent and nature of work relating to fraud in accordance with CAS 240², such as:
  ○ rebutting the presumption that there is always a risk of material misstatement due to fraud related to revenue recognition;
  ○ incorporating an element of unpredictability in the design and selection of audit responses for recurring engagements; and
  ○ developing relevant testing of journal entries to meet the prescribed requirements when the risk of management override of controls is assessed as being low.

• The extent and nature of work relating to risk assessment in accordance with CAS 315³. Where internal controls will not be relied upon, some expressed that the audit evidence obtained from understanding the client’s internal controls does not contribute to the auditor’s overall conclusion or opinion.

• The extent and nature of work relating to controls of a service organization in accordance with CAS 402⁴. Entities are increasingly relying on third party service providers for support in their operations. These service providers may be smaller organizations that do not have reports on their controls, or the auditor may be unable to gain direct access to the service provider’s records and internal processes. In such cases, the auditor’s responsibility for collecting evidence to support the audit opinion is not clear.

• The extent and nature of work relating to group audits in accordance with CAS 600⁵. Participants have expressed difficulty in determining whether a multi-location audit meets the criteria of a group audit.

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² CAS 240, The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements
³ CAS 315, Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment
⁴ CAS 402, Audit Considerations Relating to an Entity Using a Service Organization
⁵ CAS 600, Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)
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General concerns expressed about audits of LCEs include:

- Significant time can be spent documenting and supporting which standards and requirements are not relevant to an audit engagement.
- The CASs scalability guidance needs to fit a broader range of entities. An example of this is that existing application guidance does not sufficiently consider not-for-profit organizations, including charities, and their specific structures and circumstances.
- Figuring out how to remain relevant and technologically current in the age of big data when performing audits.

Participants felt that clarity on the above listed items could be addressed through non-authoritative guidance.
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What we heard about the audit methodologies used

We heard that SMPs that lack internal resources to develop a customized audit methodology often use off-the-shelf implementation packages, such as the Professional Engagement Guide (PEG).

We heard that participants either use the PEG as their audit methodology or refer to PEG in developing their own proprietary methodology. The practitioners who use the PEG felt that the user-friendliness of the forms could be improved as some have struggled to apply the PEG effectively to audits of LCEs.

What we heard about enhancing the implementation and guidance material

We heard that guidance materials produced by CPA Canada are helpful, but they are not easily located.

Participants noted that they are happy with the quality of the implementation guides available and are supportive of CPA Canada continuing to produce alert and implementation guidance for CASs. However, participants expressed concern that guidance material is not easily accessible through the CPA Canada website. Consequently, it is more challenging to share knowledge among practitioners and team members to keep pace with changes in standards. Participants suggested that an LCE specific auditing guide would be helpful.

What we heard about challenges in practice management

We heard that a reduction in the perceived value of an LCE audit to intended users contributes to fee pressures with clients.

Participants noted that there should be more done by the profession to promote the value of an audit.

Participants also noted that a lack of in-house resources makes it difficult to keep up with changes in standards and technology, attract and retain talent and compete with other firms for business.
What we heard about having a separate auditing standard for LCEs

Globally, conversations are taking place to debate whether there should be a separate standard for audits of LCEs.

Participants who supported having a separate auditing standard for LCEs felt that such an approach would be complementary to the multiple accounting frameworks which form Canadian GAAP for different types of entities.

Participants who did not support having a separate standard for audits of LCEs cited the following reasons:

- It could be difficult for practitioners to keep abreast of changes to two sets of auditing standards.
- It may be a challenge to differentiate when to apply the auditing standard for LCEs and when to apply the CASs.
- A separate auditing standard for LCEs could be perceived by users to result in a lower audit quality than a CAS audit.
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Next Steps

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<td>In April 2019, the International Auditing and Assurance Standards Board (IAASB) is expected to publish a Discussion Paper expected to publish a Discussion Paper (DP) on the topic of less complex entities.</td>
<td>In January 2019, the CPA Canada Small and Medium-sized Practices Advisory Committee (SMPAC) had its inaugural meeting to discuss the challenges of providing auditing services for LCEs. In June 2019, the SMPAC will prioritize the identified challenges and discuss potential ways in which CPA Canada could assist SMPs in addressing these matters.</td>
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<td>In May 2019, the IAASB will hold a conference in Paris, France to deliberate this DP. The conference will be attended by AASB staff and the AASB Chair.</td>
<td>CPA Canada will continue to produce non-authoritative resources, such as alert communications and implementation guidance as new and revised CASs are issued.</td>
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<td>Canadian practitioners will be asked to provide input on the IAASB’s DP shortly after it is published.</td>
<td>CPA Canada will look for opportunities to market availability of resources through the Knotia platform to help practitioners access materials developed by CPA Canada more readily.</td>
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<td>The IAASB will continue to make necessary enhancements to its ISAs6, while considering the need for the standards to be operational and scalable. The AASB is committed to adopting the ISAs as CASs.</td>
<td>The PEG task force is being formed to bring greater relevance and utility to the resource already used by many practitioners to perform assurance engagements. Their first meeting will take place in the second quarter of 2019.</td>
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<td>The AASB is participating in discussions with the global community about the evolving business environment, increased variation and application of technology, and the related impacts on audit evidence. These discussions are part of the activities undertaken to investigate and understand how to enhance the relevance of audit in the evolving environment.</td>
<td>CPA Canada is in discussions with various software providers to deliver resources, including guidance and practice management tools, to assist practitioners. These discussions are being held with a goal of assisting practitioners in keeping up with the pace of change in technology and understanding how various technologies can be used to maximize the quality and efficiency of the assurance engagements. Resource availability is anticipated in the 3rd and 4th quarters of 2019.</td>
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6 International Standard on Auditing (ISA)
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Get more information

Have questions? Contact us!

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