NORDIC STANDARD FOR AUDITS OF SMALL ENTITIES
CONSULTATION PAPER

12 OCTOBER 2015
Background

ICAS welcomes the opportunity to comment on the NRF’s Consultation Paper on a Nordic Standard for Audits of Small Entities

Our CA qualification is internationally recognised and respected. We are a professional body for over 20,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public sector. Almost two thirds of our working membership work in business, many leading some of the UK’s and the world’s great companies.

Our Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members’ views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

1 General comments

We are pleased to respond to the Nordic Federation’s consultation.

Firstly, we welcome the publication of this proposed standard which has been the subject of much discussion in recent years. We are always pleased to see innovation in the field of audit and congratulate the NRF on this initiative. We also welcome that the standard adopts a principles-based approach to the setting of an audit standard. We believe that such an approach better allows for professional judgement to be applied.

We note that the scope of the standard encompasses entities that would not be subject to a mandatory audit under the requirements of the EU Accounting Directive. Please refer to our comments at Appendix A as to the potential use for this standard for the targeted entities in the UK. Whilst we appreciate that there may be regulatory barriers, we believe that there is merit in considering the suitability of such a standard, on a cost benefit basis, for the audit of slightly larger private companies and potentially even smaller quoted companies and charities.

We believe that there would be merit in undertaking an audit of an entity using the Nordic standard and comparing this to an audit of the same entity undertaken using ISAs. This would better illustrate the advantages of such a standard. We would envisage that the required documentation would be substantially less than that associated with an ISA compliant audit but this comparison would allow a better assessment as to the merits of such an approach. It would also be interesting to illustrate the potential different composition of the engagement team.

We also believe that there would be merit in NRF directly feeding the results of its consultation to the IAASB. This is a very important area and one in which many audit practitioners believe there is scope for a more principles-based approach to be adopted.

2 Technical Observations on Proposed Audit Standard

Preface

The final paragraph of the preface on page 1 makes reference to ‘small entities’. We believe that there would be merit in defining more precisely the term ‘small entities’ to avoid any misunderstanding or confusion in the application and interpretation of the standard. That said, in line with our comments above, we would like envisage that the scope of this particular standard could be wider than just entities which are not subject to a mandatory audit under the requirements of the EU Accounting Directive.

Section 1.4 Audit evidence

Within this section, reference is made to the use of information prepared by management’s experts, external experts or other auditors, but there are no details as to how the external
confirmation request might be undertaken. We acknowledge that greater emphasis is placed on the use of the auditor’s professional judgement when applying with this standard. However, we believe that, in order to exercise such judgement, sufficient knowledge, understanding, and familiarity with audit principles and methodology is required. Therefore, the composition of the audit team will require careful consideration to ensure that it includes appropriately experienced individuals, capable of exercising judgement over the extent of sufficient audit evidence required to meet their objectives.

Section 1.51 Documentation requirements
We would suggest that this section should include a statement that the documentation of the planned and performed audit procedures should refer to, and concur with, the approach adopted towards identified risks.

Section 1.52 Assembly of the final audit file
This section should refer to the possibility that the final audit file might be an electronic one.

Section 2.2 Preconditions for an audit
This section is silent on the need for auditor independence although we note the content of the preface in this respect and also the reference to the need to document “conclusions with independence requirements that apply to the audit engagement” at section 2.3. We believe that it would be better to also specifically refer to the need for the auditor to consider independence related issues at section 2.2.

Section 2.3 Additional documentation requirements
We believe that the additional documentation requirements need to be considered early in the audit process, ie at the planning stage of the audit, to ensure that consideration is given to what is likely to be required before the documentation process gets underway.

Section 3.3 Determining materiality
The materiality determination process only refers to financial statement materiality and places significant reliance on auditor judgement when determining materiality levels. We would urge caution in these areas as, in order to be in a position to reach an appropriate decision with regard to materiality, the auditor would require sufficient expertise, experience, knowledge and understanding of the nature and definition of materiality, both quantitative and qualitative, in order to arrive at such judgements. A junior or inexperienced auditor, unfamiliar with an ISA audit, may not be in possession of such skills and therefore the staffing of such engagements needs careful consideration.

Furthermore, there are no references to performance materiality or different levels of materiality for different categories of transactions, including related parties. We appreciate that this is considered to be a matter for the auditor’s professional judgement but once again, we would like to draw attention to our cautionary comments in the paragraph above when relying on auditor’s judgement.

Section 4 Risk assessment
We would suggest that the risk assessment process and guidance should be linked to the documentation process, as mentioned in our earlier comments on Section 1.5.1, to ensure that this informs the audit procedures and documentation process.

Section 4.4.2 Risks that require special consideration
This section includes, within its list of risks requiring special considerations, a bullet point on ‘the complexity of transactions. We suggest that some examples of what might be classed ‘complex transactions’ should be included here. Still within this list, we suggest that greater linkage should be introduced between bullets 4 [whether the risk involves significant transactions with related parties. The auditor shall treat identified significant related party transactions outside the entity’s normal course of business as giving rise to significant risks]; and 6 [whether the risk involves significant transactions that are outside the normal course of business for the entity, or that
otherwise appear to be unusual] as both refer to transactions that are outside the normal course of business.

Section 5.2.2 Substantive procedures
It is not clear from the guidance on 'Considerations when designing substantive procedures to address risks identified at section 4.4', whether the risks identified here are only significant risks or all risks. We believe that greater clarification regarding this matter would be helpful.

Section 5.3.1 Evaluation of misstatements identified during the audit
When the auditor is communicating the effects of material uncorrected misstatements with management and those charged with governance, we would suggest that a comment on the impact of these misstatements on internal controls, along with suggested improvements, should also be communicated.

Section 5.4, Additional documentation requirements
Reference is made here to the documentation of the auditor’s responses to the assessed risks of material misstatement, but there does not appear to be any reference within the standard to the documentation of the identified risks, nor is there any suggestion that this documentation should be linked to both the audit plan and the documentation of the audit process and procedures. Once again, we believe that emphasising the need to link the risk assessment to the audit performance and documentation processes would be helpful.

Section 6 Concluding and reporting
For the purposes of consistency, we suggest that the standard should either refer to 'true and fair' or 'fairly presented' throughout. Currently Sections 6.1: Objectives, and 6.6: Form of opinion, make reference to the financial statements being 'fairly presented'; but Section 6.7: Auditor’s report, and Appendix 1, make reference to a 'true and fair view'.

Section 6.2 Subsequent events
This section requires the auditor, where subsequent events of facts become known, to evaluate the impact of these facts or events on the auditor’s report. Yet there is no further guidance as to the implications for the audit report, or the next steps for the auditor, following this evaluation process. Clarification of the auditor’s responsibilities in such circumstances would be useful.

Auditor’s report Section 6.7
There is nothing in this section to indicate to whom the audit report should be addressed (unlike the example report at appendix 1 which is addressed to the shareholders.

There is a reference in this section to the provision of a statement on any material uncertainty but we suggest that this should also include a reference to an emphasis of matter.

Within bullet point 7, we would suggest including a statement in Section 6.7 that the financial statements and the annual report should be signed on the same day.

Section 6.7.1 Content of the auditor’s report when the opinion is modified
Within this section it states that: 'when disclaiming an opinion of the financial statements [an auditor should] not include in the auditor’s report descriptions of the auditor’s responsibility and state whether sufficient and appropriate evidence is obtained'. We are not clear as to the reasons for excluding these statements but would suggest that they are incorporated when issuing a modified opinion for the purposes of clarity and transparency.

Regarding the bullet point in Section 6.7.1 on the issue of an adverse opinion, the first bullet point refers to the financial statements presenting fairly (or giving a true and fair view) in accordance with the applicable financial reporting framework. We would suggest that this first bullet point only refers to the fair presentation, or true and fair view requirement, as is currently the case in the auditor’s report as required by the ISAs, as the true and fair view opinion is not restricted to compliance with the applicable financial reporting framework.
Appendix 1 Sample audit report
There is nothing within the sample audit report that explicitly expresses the individual responsibilities of auditors and those of management/those charged with governance. Although the inclusion of these details would increase the length of the report, we believe that this information is still valid and relevant for audit engagements applying the SASE. We believe the best way to address this would be to include reference to an appropriate web site where the details of such responsibilities could be stated.

The heading of the opinion paragraph states that it is an ‘Opinion on the Audit of the Financial Statements and the Management Report’. However, the opinion on the management report is only included as a footnote at present. We would suggest that this opinion paragraph is included within the main body of the report. However, clarification is required as to whether or not an audit opinion is provided on the management report.
Appendix A Scope in the UK

We note that the scope of the standard encompasses entities that would not be subject to a mandatory audit under the requirements of the EU Accounting Directive. In the UK this proposed standard would therefore apply to private companies with a turnover of not more than £6.5 million (likely to be increased to £10.2 million for accounting periods commencing on or after 1 January 2016); a balance sheet total of not more than £3.26 million (likely to be increased to £5.1 million for accounting periods commencing on or after 1 January 2016) and not more than 50 employees.

Audit exemption was first introduced in the UK in 1994 with a turnover threshold of £350,000. Since that time the exemption thresholds have been increased ad hoc to arrive at the current proposed thresholds which are expected to apply for accounting periods commencing on or after 1 January 2016. Over this twenty year time period, professional accountancy firms have adapted their business model and a considerable number no longer offer audit as a service to their respective clients. In the UK the vast majority of companies (circa 90%) do not require a statutory audit. The proposed increase in the thresholds will remove another circa 8,000 companies from this requirement. Given the current UK Government’s position we would not envisage that there would be any plans to lower the audit exemption thresholds at any future stage. Therefore, it is questionable, even with the publication of a tailored small entity audit standard whether smaller clients which currently do not have an audit, would demand such a service from their professional accountant. We are therefore unsure as to the value of such a standard in the UK context for the target entity which the standard is aimed at. That said we do believe that there is merit in considering the suitability of such a standard, on a cost-benefit basis, for the audit of slightly larger private companies and potentially even smaller quoted companies and charities. Our comments to this consultation paper have therefore been provided on that basis. We also believe that there would be a need for a real education/marketing campaign to explain why adherence to such a standard would allow an auditor to issue a reasonable assurance opinion when it is not ISA compliant. In this regard ICAS believes that there is a need to revisit the IAASB Assurance Framework and is currently developing its proposals in this area.