

Plenary Session – SME Audit

Thursday 7th September 2006

15:35 to 18:15

Facilitators:

André-Paul Bahuon, President of the OEC de Paris Ile-de-France

Gérard Varona, Deputy Chairman FEE SME/SMP Working Party

FEE Annual European SME/SMP Congress, Palais des Congrès, Versailles, France, 7th & 8th September 2006

Plenary Session – SME Audit

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Speakers:

Vincent Baillot, President of the Compagnie Nationale des Commissaires aux Comptes (CNCC)

David Damant, Chairman of the International Auditing and Assurance Standards Board Consultative Advisory Group (IAASB CAG)

Pierre Delsaux, Acting Director, DG Internal Market, European Commission

Lino De Vecchi, Deputy Chairman, International Federation of Accountants SMP Committee (IFAC)

Klaus-Günter Klein, FEE Vice-President

Per Hanstad, CEO, Den norske Revisorforening

Jon Grant, Technical Director APB, UK Auditing Standard Setter, Technical Adviser to UK IAASB Member

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SME Audit – The point of view of the European Commission

[AMA/FEE Congress, Versailles, 7 September 2006](#)

Philippe Pellé
DG Internal Market and Services
European Commission

FRAMEWORK FOR THE DEBATE

- In the EU, 9 out of 10 companies are SMEs
- SMEs drivers of growth and employment
- Audit exemption: alleviate the burden, cut red tape
- But need not to lose investors' confidence

The New Statutory Audit Directive

- Context
- Principle: an audit is an audit
- Add-ons for public interest entities
- Duties of statutory auditors, professional behaviour
- Public oversight for all auditors
- Audit committee for listed companies

Adoption of ISAs, relation EC-IAASB

- Proper governance of the standard setting mechanism (PIOB/IAASB) essential for ISA to become law
- IAASB improving – Clarity project end 2008
- Commission equipped with all proactive instruments, but ...
- ISAs for SMEs?

Policy on small practitioners

- 1st priority: to implement the 8th Directive
- Alternatives to audit: too early for us



SME AUDIT – VIEWS OF IFAC SMALL AND MEDIUM PRACTICES COMMITTEE

FEE/AMA SME/SMP Versailles Congress
"Growing Businesses in a Changing Global Environment"
7 September, 2006

Lino De Vecchi
IFAC SMP Committee Deputy Chair

Content

- SME audits – the problems
- IFAC SMP Committee strategy
- Increasing relevance of ISAs:
 - Applicability to SME audits
 - Clarity
 - Documentation
 - Input to standard-setting
- Increasing capacity of SMPs:
 - Explanatory guidance
 - Derivatives
 - IFAC *KnowledgeNet*

SME audits – the problems

- **Relevance problem** – low relevance of ISAs to SME audits:
 - More suited to public interest entity audits
 - Complexity making more difficult/costly to apply
- **Capacity problem** – low capacity of SMPs to comply with ISAs:
 - Lack of in-house technical resources
 - Many member bodies unable to provide support

IFAC SMP Committee Strategy

- Two-pronged approach to solving the problems of SME audits
- **Relevance problem** - help shape form & content of ISAs via input to standard-setting
- **Capacity problem** - help SMPs perform high quality audits via provision of practical support

Increasing Relevance of ISAs Applicability to SME Audits

- An audit is an audit
- Conceptual framework and think small first
- Single set of auditing standards
- Auditor flexibility to exercise professional judgment

Increasing Relevance of ISAs Clarity

- Key project for SME/SMP
- Potential to greatly improve understandability and usability of ISAs
- Highly satisfied with current direction
- Not the complete solution

Increasing Relevance of ISAs Documentation

- Particular area of concern
- Is the bar set unnecessarily high?
- Disproportionate burden may undermine viability of SME audit
- Focus on documentation that drives audit quality
- “Think small first”

Increasing Relevance of ISAs Input to Standard Setting

- SMPC provides input on most ISA projects from SMP/SME perspective
- Constructive criticism
- Various ways of inputting:
 - Comments letters
 - Membership on IAASB project task forces
 - Representation at IAASB CAG meetings
 - SMP members on IAASB
- Input is proving increasingly effective

Increasing Capacity of SMPs Explanatory Guidance

- In June 2006 IFAC Board approved funding for ISA Guide
- IFAC will have full copyright; member bodies free to use content to develop domestic variants & derivative products
- Will be non-authoritative implementation guidance
- Will *not* constitute a standard
- Will be a 'platform' product
- Will be an IFAC SMPC publication
- Will *not* be approved or endorsed by IAASB

Increasing Capacity of SMPs Explanatory Guidance

- Attributes:
 - Process driven, rather than standards-driven
 - Written with an international audience in mind
 - Accommodate developing nations' issues
 - Suitable for both common and civil law jurisdictions
- Rigorous multi-lateral quality review process
- Timing (*see overleaf*):
 - Initial guide to be launched in Q2 2007
 - Updates in 2009 (Clarity ISAs effective) and 2010
- Not the complete solution

Increasing Capacity of SMPs Explanatory Guidance

Edition	Expected Timing	ISAs effective as at	Per ISAs in
First	Q2 2007	End 2006	2007 Handbook
Second	Q2 2009	End 2008	2009 Handbook
Third (final per this contract)	Q2 2010	End 2009	2010 Handbook

Increasing Capacity of SMPs Explanatory Guidance

- Possible other explanatory guides:
 - Quality Control Guide (early 2008?)
 - Practice Management Guide (late 2008?)

Increasing Capacity of SMPs Derivatives

- Audit software, checklists, questionnaires, forms, practice aids, training materials etc
- IFAC involvement with derivatives to be determined:
 - **Direct** – commission development; *or*
 - **Indirect** – facilitate market's development/distribution.

Increasing Capacity of SMPs IFAC KnowledgeNet

- Customized web search engine providing access to the resources of IFAC and its member bodies
- Due to launch in October 2006
- Initially aimed at accountants in business
- Expansion to SMP in 2007
- Significant benefits for IFAC member bodies, participating and otherwise, as well as end users

Increasing Capacity of SMPs *IFAC KnowledgeNet*



A KnowledgeNet for Accountants in Business

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This electronic resource has been developed by the International Federation of Accountants and its Member Bodies.



Alternatives to Audit

- Alternatives to SMEs doing nothing
- Trend is towards new or increased audit thresholds
- Increasing numbers of SMEs exempt from audit
- Need to update relevant IAASB standards
- SMPC may conduct global fact finding survey

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SME Audit

Presented by
Prof. Dr. Klaus-Günter Klein

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An audit is an audit

- FEE welcomes Art 26 of the Statutory Audit Directive, This provides for statutory audits of all companies to be carried out in accordance with international standards
- FEE launched an initiative for MEPs to explain the implementation process

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An audit is an audit

- Users expect a consistent level of assurance and consistent audit quality from an unqualified audit opinion.
- The audit opinion is expressed in the same overall terms whatever the nature, complexity and risks attaching to the audited entity and the work performed by the auditor.

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An audit is an audit

- The Statutory Audit Directive requires “statutory auditors and audit firms to carry out statutory audits in accordance with international auditing standards” to ensure consistent high quality statutory audits in Europe.
- This requirement supports the belief that there should be one benchmark audit and this concept is referring to as „an audit is an audit“

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An audit is an audit

- Some might still conclude that two sets of auditing standards, one for publicly traded companies and one for SMEs would be an appropriate parallel response to the developments in the area of IFRS.
- This alternative model however would create in our view first- and second-class audits.

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An audit is an audit

- The objectives of each audit are the same, the requirements to achieve the objectives are the same.
- The specific audit procedures to be undertaken to comply with the requirements may vary considerably in the audit of a small and simple company compared to that of a large or complex one.

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An audit is an audit

- Different levels of audit assurance, arising from different sets of auditing standards is not the solution as it could not easily be explained in a transparent way.
- All users of financial statements already have difficulty in understanding the concept of „reasonable assurance“ envisaged in ISAs.

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An audit is an audit

- FEE recognises that increasingly prescriptive auditing standards introduce an additional burden for auditors of SMEs.
- FEE believes that IAASB should give more weight to the „think small first“ principle.

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An audit is an audit

- This approach leaves it to the professional auditor to determine the best way to achieve the objectives.
- It ensures that auditing continues to be a thoughtful activity exercising professional judgement.

An audit is an audit

- FEE welcomes the work that is under way within the standard setting community to address the special considerations in the audits of small entities.
- Those projects are designed to maintain the benchmark of an audit but recognise that there are certain characteristics commonly found in SMEs that will impact the application of the ISAs.

An audit is an audit

- FEE calls upon the IAASB to ensure that its standards continue to emphasise objectives, with limited prescription, leaving professional auditors with responsibility to design the necessary procedures that are appropriate to the size, risk and complexity of the audited entity.

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Activities of the European profession in relation to the Implementation of the New Statutory Audit Directive

Implementation of the New Statutory Audit Directive

- **Tasks**
 - Understanding and observing the implementation process within individual member states
 - Observation of the carrying out of the comitology procedure by the EC
 - Working on specific areas of interest in the FEE working parties

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Implementation of the New Statutory Audit Directive

- **Organisation and measures**
 - 8th Directive Implementation Task Force
 - Directly reporting to the Executive
 - Organising the liaison with member bodies
 - Information and communication
 - Report to Council
 - Information of member bodies

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Implementation of the New Statutory Audit Directive

- Activities of the European Profession
 - Studies on specific areas
 - EU-liability study of London Economics according to Art. 31
 - EU-Study on ownership
 - FEE Study on quality assurance and oversight
 - Seminar on Audit Regulation in Brussels October 12,2006

FEE/AMA European Congress for SMEs

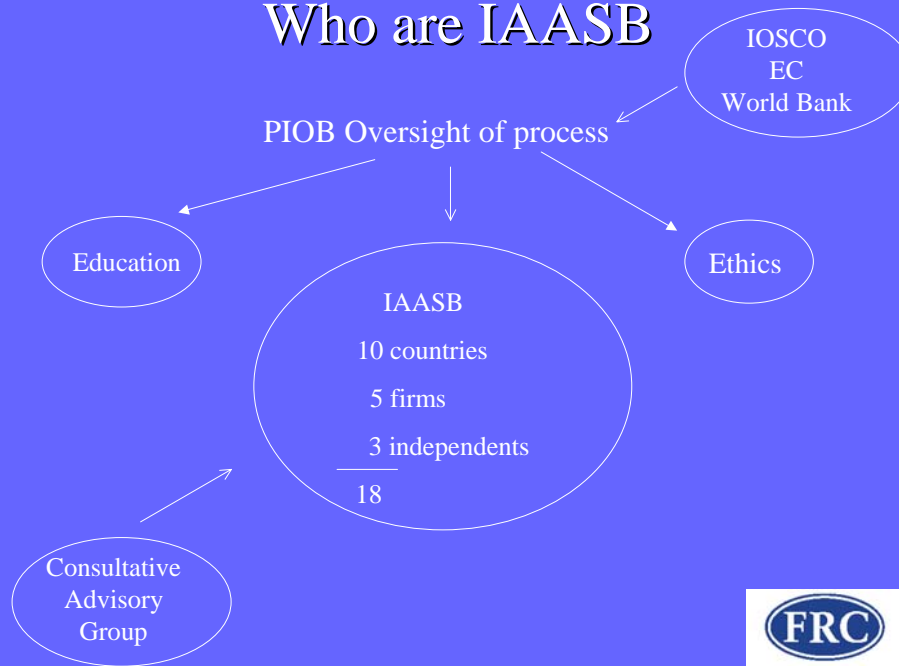
Presentation on:

- IAASB Clarity Project
- UK experience with implementation of ISAs

Jon Grant – UK Auditing Practice Board



Who are IAASB



IAASB Clarity Project Origins

- Status of 'present tense' guidance
- Disquiet about length and complexity of latest ISAs
- Questions as to the usability of new ISAs (especially small practitioners)
- Difficulties of linking ISAs to law



IAASB Plans Re Clarity

Announcement on 31 October 2005:

- Set an objective in each standard
- Clarify Professional Requirements
 - Use 'shall' to identify requirements
 - Eliminate the use of the present tense to describe actions
- Improve the structure and readability



Clarifying Professional Requirements

Criteria for 'shall':

- Necessary to achieve the objective
- Applicable in virtually all engagements to which the standard is relevant
- Not duplicative – objective unlikely to be met by requirements in other standards



Structural Improvements

Four principal sections:

- Introduction
- Objective
- Requirements
- Application material



Current Consultation

Announcement accompanied by four exposure drafts:

- ISA 240 – Fraud
- ISA 300 – Planning
- ISA 315 – Understanding the entity and assessing risk
- ISA 330 – Response to assessed risks
- Revised Preface



Three phases

- | | |
|---------------------|--|
| 1. <u>Clarify</u> | 2. <u>Revise and Clarify</u> |
| – Audit risk | – Groups |
| – Fraud | – Qualified opinions |
| – Quality Control | – Related parties |
| – Planning | – Communication with those charged with governance |
| – Auditor's Reports | – Materiality |
| – Documentation | – Accounting estimates/fair values |



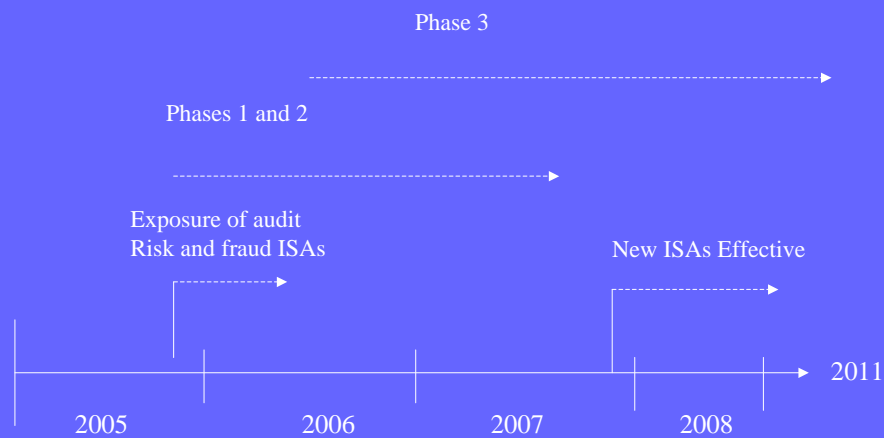
Three phases

3. Unrevised ISAs

- Terms of engagement
- Laws and regulations
- **Service organisations**
- **External confirmations**
- Analytical procedures
- Sampling
- Subsequent events
- Going concern
- **Management representations**
- **Experts**
- Comparatives



IAASB Proposed Timetable



New IAASB Timetable

EC Process

Review of ISAs
- issued after due process
- contribute high level of
credibility to accounts
- are conducive to the
European public good

Endorsement? →

IAASB

Exposure of audit
Risk and fraud →

Finalisation of
clarity project →

2005

2006

2007

2008



Main issues being debated

- Wording of objectives
- Status of objectives
- Documentation requirements
- ISA 200 concepts e.g. reasonable assurance
- Detailed wording on ISAs 300, 315, 330 and 240



End Game

Clarity

- Clearer standards
- More likely to be acceptable in EU
- Opportunity for added guidance for SME audits
- But more prescription

Revisions

- Significant change from current ISAs
- Major training challenge
- Unclear what impact they will have on costs



UK Implementation of ISAs



The arguments for and against Harmonisation of Auditing Standards

FOR

- Strong support from international regulators especially the EC
- Aids consistency of group audits and international monitoring of quality
- National standard setting a costly process

AGAINST

- Over complicates standards for small audits
- Legal requirements differ between countries
- Competition in standards is a 'good thing'



ISAs (UK and Ireland)

- Issued ISAs (UK and Ireland) in December 2004 for audits of accounting periods commencing on or after 15 December 2004
- Based on ISAs
- Includes '+s' from existing UK auditing standards



Impact on smaller audits

- Added costs from audit risk ISAs (20% Year 1)
(10% Year 2)
- Caused by more work on controls and more documentation
- Some client benefits from work on controls
- Major training challenge
- Variations in training and software/documentation systems



Actions

- New guidance within 'Clarity' version of ISA 315
- APB project on documentation
- IFAC project on application of ISAs to smaller audits



FEE/AMA SME/SMP VERSAILLES CONGRESS

“GROWING BUSINESSES IN A CHANGING GLOBAL ENVIRONMENT”

PLENARY SESSION ON SME AUDIT, 7 September, 15.35 Hrs – 18.15 Hrs

Summary of Remarks by David Damant

I. Audit

As a result of the changes to the structure of the International Federation of Accountants (IFAC) agreed in 2003, the Consultative Advisory Group of the International Auditing and Assurance Standards Board was considerably expanded, and I was appointed as the first independent Chair, my own background being investment management. The membership of the IAASB CAG is by organisation in the large majority of cases, and a list of the current members is attached.

On several occasions the CAG has discussed the question of an audit in the context of SMEs. It will be noted that a number of the members of the CAG are concerned in the small company area, and in addition the two relevant IFAC committees, on Developing Nations and SMEs, were represented in the discussions.

The principal conclusion of these discussions was that an audit is an audit. That is, the overwhelming view of the CAG was that there should be no derogation in audit quality whether the enterprise being audited is large or small. The degree of assurance provided by the audit remains the same in all cases.

One of the concerns during these discussions, and in other arenas, has been the extended documentation which an audit would require in the case of a small enterprise, even when many audit procedures were unnecessary in view of the limited extent of the enterprise's activities. This matter is a matter of continuing discussion in the CAG (and is also taken up by the IAASB in the context of the Clarity Project). Discussions in the CAG on the application of ISQC1 to SMEs will also be held.

The relevant point, as regards SMEs in the context of the Clarity Project, is that in the third section of the clarified ISAs (the Application Guidance) appropriate space will be given to explicit comments on considerations relevant to SMEs. This explicit delineation of SME concerns is an important dimension in the ongoing work of clarification.

II. Alternatives to Audits for SMEs

It may be that in some jurisdictions the regulatory authorities may decide that for all enterprises, including SMEs, an audit should be required. In other cases a jurisdiction may decide that for small (or very small) enterprises, no public assurance is necessary. But this “all or nothing” approach may not be satisfactory in the minds of many observers, since on the one hand some degree of assurance may be desirable, whereas on the other hand a full audit may be regarded as onerous.

It is interesting in this context, therefore, to discuss the various mechanisms which might be developed to provide a limited degree of assurance, not the “reasonable assurance” provided by an audit. The following possibilities may be considered amongst others:

- a) The first and existing possibility is that of a “Review”. The International Standard on Review Engagements 2400 may be considered. A Review as currently delineated may be appropriate when given as a degree of assurance on interim results for a company where the annual results will be audited to the full extent, and in other contexts, but it may not be suitable in all contexts, such as SMEs. Furthermore, a Review as currently conceived may entail the degree of independence of the auditor which is also applicable in the case of the audit; and although this may be appropriate for some purposes it could be inappropriate, it may be argued, for other purposes.
- b) The question of the degree of independence arises for example if there is direct involvement by the “auditor” in the preparation of a company’s accounts, which is sometimes referred to as a “Compilation”. The approach to independence in this context, and the delineation of the roles of the management and of the auditor, has to be different than in the case of a full audit. Nevertheless this approach recognises reality, as it exists in many countries, and that is that the auditor is in fact the financial advisor to the enterprise, to a greater or lesser degree.

In the light of these considerations, the IAASB through the IFAC staff is discussing the possibility of holding a Forum on this topic, to be arranged in each of three centres - in New Delhi, Brussels and Sydney (Australia). There will be a meeting of the IAASB CAG the day after the Forum held in Brussels, in order to develop the ideas in more detail and from the viewpoint of the different interest groups represented on the CAG.

This topic - that is, the question of an interim tool to give a degree of assurance without being a full audit - is of importance in the development of standards on assurance throughout the world, in diverse economies and in diverse legal and regulatory environments. This FEE/AMA Congress to consider the possible lines of the approach to these questions is therefore very well timed.

Consultative Advisory Group Members

The Consultative Advisory Group (CAG) is an integral and important part of the IAASB's formal process of consultation. As of December 31, 2005, the membership of the CAG comprised:

- Asian Financial Executives' Institutes
- Basel Committee on Banking Supervision
- CFA Institute
- Chairman of the Standards Advisory Council of the International Accounting Standards Board
- Eastern, Central and Southern African Federation of Accountants
- European Commission
- European Federation of Accountants and Auditors for SMEs
- European Financial Executives' Institutes
- Fédération des Experts Comptables Européens
- Information Systems Audit and Control Association
- Institute of Internal Auditors
- Institute of International Finance
- Instituto Brasileiro de Governanca Corporativa
- International Accounting Standards Board
- International Actuarial Association
- International Bar Association
- International Corporate Governance Network
- International Organization of Securities Commissions
- International Organization of Supreme Audit Institutions
- Islamic Financial Services Board
- Japan Securities Dealers Association
- National Organization for Financial Accounting and Reporting Standards in Russia
- North American Financial Executives' Institutes
- United Nations Conference on Trade & Development
- World Bank
- World Federation of Exchanges

Observers to the IAASB are also observers to the CAG.



Descartes 3

Methodology and tool for SME-audits

Per Hanstad
CEO
Den norske Revisorforening

FEE Annual European SME/SMP Congress, Palais des Congrès, Versailles, France, 7th & 8th September 2006

Background

- Statutory audit required for all limited companies in Norway (± 200.000)
- More than 50 % of statutory audits performed by SMPs
- Implemented ISAs already in 1998
- Only Big Firms had advanced audit methodologies and tools
- Institute goal to give all members access to a high quality methodology supported by an IT-application for planning, performing and documenting the audit
- Financial and resource synergies when developing “together”
- Descartes 2 launched in 2000

Descartes 3

- New audit risk standards implemented in Norway from January 1, 2006
- A high quality audit methodology operationalizing the new standards and supported by a modern IT application is the only way to an effective quality audit fully in compliance with the ISAs
- Launched Descartes 3 June 1, 2006
 - new methodology
 - new technology

Demo Descartes 3

Descartes 3 – continued

- Technology
 - .net framework
 - functionality (Outlook)
 - several users
 - distribution/updates
- Technical development
- 2000 users in Norway

More information?

- www.descartes3.com
- contact us at our stand during the conference