

ANALYSIS OF THE PROVISIONS OF THE INTERNATIONAL STANDARD ON AUDITING FOR AUDITS OF FINANCIAL STATEMENTS OF LESS COMPLEX ENTITIES (ISA FOR LCE) AS APPLIED TO THE CONDITIONS OF THE REPUBLIC OF MOLDOVA

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Abstract: The necessity to elaborate the International Standard on Auditing the Financial Statements of Less Complex Entities (ISA for LCE) arose long ago, primarily due to the fact that when auditing the financial statements of such entities it is not always appropriate to comply with all the provisions of International Standards on Auditing for various reasons, including the fact that the entities are less complex. This standard does not define less complex entities; this prerogative is left to the competent authorities of various jurisdictions. Considering the provisions of this standard, the author analyzes various economic indicators that could be taken into account to classify as less complex enterprises for the Republic of Moldova. Assessing the business risks of the audited entity, the author considers a new category of intentional misstatements of financial statements. The article also analyzes the provisions of the International Standard on Auditing of Financial Statements of Less Complex Entities (ISA for LCE) in relation to the conditions of the Republic of Moldova.

Keywords: less complex entities, ISA, financial statements.

JEL Classification: M41

1 Introduction

In the context of increased business risks, auditing financial statements of enterprises and confirming their financial statements is of particular importance for the stable economic situation of various jurisdictions. In this regard, high-quality audit is of paramount importance for expressing a correct opinion on the reliability of financial statements. To this end, the International Auditing and Assurance Standards Board (IAASB) develops and promotes the use of International Standards on Auditing. At the same time, the large volume of documentation presented in these standards, which is mandatory for execution during the audit, is not always necessary when auditing less complex entities, taking into account achieving high audit quality. In this regard, the International Auditing and Assurance Standards Board (IAASB) published the International Standard on an Audit of Financial Statements of Less Complex Entities (ISA for LCE) in December 2023.

Analyzing the provisions of this standard and the International Standards on Auditing, it can be stated that: when conducting an audit of financial statements using the:

- ✓ *International Standards on Auditing, the auditor must use 37 standards, while,*
- ✓ *International Standard on Auditing for Audits of Financial Statements of Less Complex Entities, the auditor must comply with the provisions of 10 sections of this standard.*

The standard notes that it applies to the audit of financial statements prepared both on the basis of historical information and using the concept of market value. The prerogative of establishing the rules for the preparation of financial statements belongs to the competent authorities of each jurisdiction.

2 Analysis of the provisions of the International Standard on Auditing for Audits of Financial Statements of Less Complex Entities

The International Standard on Auditing for Audits of Financial Statements of Less Complex Entities does not define less complex entities, but it does set limitations on the use of the provisions of this international standard. At the same time, the limitations on the use of ISAs for less complex entities were divided into three categories:

- *specific types of entities for which it is prohibited to use the provisions of ISAs for less complex entities when conducting an audit,*
- *qualitative characteristics related to less complex entities that do not allow the application of the audit standard,*
- *quantitative values (certain limits) that are established by legislative or regulatory authorities of each jurisdiction independently.*

The specific types of entities for which the prohibition is established are reflected in the standard and include (IAASB n.d.):

- *entities for which the relevant jurisdiction has established regulations that require the use of auditing standards other than ISAs for less complex entities in conducting an audit,*
- *entities whose securities are listed on a stock exchange,*
- *financial institutions whose primary function is to accept deposits from the public,*
- *insurance companies,*
- *types of entities for which the use of the standard is prohibited by regulations in a number of jurisdictions.*

The standard notes that the above prohibitions on categories of enterprises cannot be changed by the authorized bodies of the relevant jurisdictions, however, they can make additions or expand the list of enterprises. For example: as a prohibition on the use of IAS's for less complex entities, the relevant jurisdiction can expand the list and include public interest enterprises.

The qualitative characteristics of enterprises that can influence the establishment of a prohibition on the application of this standard include:

- ✓ *business model or specifics of the enterprise's activities that can lead to significant risks,*
- ✓ *organizational structure of the enterprise (complexity, levels of subordination, etc.),*
- ✓ *owners and real beneficiaries,*
- ✓ *compilation of financial statements, for example: 5 or less employees are involved in the preparation of the enterprise's financial statements,*
- ✓ *information technology (software, information flows, etc.),*
- ✓ *the concept of preparing financial statements and the complexity of accounting estimates.*

The International Auditing and Assurance Standards Board (IAASB) notes that each jurisdiction may establish its own prohibitions on the application of ISAs for less complex entities, while establishing the criteria for classification as such enterprises. At the same time, the criteria for classification as less complex enterprises may be different: for example, the complexity of the business, types of activities, but at the same time, the most significant quantitative indicators that indicate the dynamics

of the enterprise are: sales revenue, total assets and number of employees. According to these indicators, micro, small and medium enterprises are classified worldwide.

It should be noted that the European Commission in its recommendations of 6 May 2003 "Concerning the definition of micro, small and medium-sized enterprises" (definition 2003), as well as in the SME Definition - user guide of 07/09/2020 (Definition n.d.) sets the following criteria for classification as small enterprises:

- *number of employees less than 50,*
- *sales revenue less than or equal to EUR 10,000,000,*
- *balance sheet total less than or equal to EUR 10,000,000.*

Thus, the Ministry of Finance of the Republic of Moldova, as the body that develops normative and legislative acts in this area, will have to establish criteria for classification as less complex enterprises. Based on quantitative criteria, there are various indicators for classification as small enterprises in the normative and legislative acts of the Republic of Moldova.

Table 1. Criteria for classification into the relevant categories of enterprises according to the regulatory acts of the Republic of Moldova.

Entities	Law 287/2017 on Accounting and Financial Reporting	Law 179/2016 on Small and Medium-Sized Enterprises
micro	on the reporting date, the limits of two of the following criteria do not exceed: 1. total assets – 5600000 lei; 2. sales revenue – 11200000 lei; 3. average number of employees in the reporting period – 10	the number of employees is not more than 9 people, the annual turnover is up to 18 million lei or the total amount of assets owned by them is up to 18 million lei
small	on the reporting date, the limits of two of the following criteria do not exceed: 1. total assets – 63600000 lei; 2. sales revenue – 127200000 lei; 3. average number of employees in the reporting period – 50	the number of employees does not exceed 49 people, with an annual turnover of up to 50 million lei or the total volume of assets owned by them up to 50 million lei
medium-sized	on the reporting date, the limits of two of the following criteria do not exceed: 1. total assets – 318000000 lei; 2. sales revenue – 636000000 lei; 3. average number of employees in the reporting period – 250	the number of employees does not exceed 249 people, with an annual turnover of up to 100 million lei or the total volume of assets owned by them up to 100 million lei

Source: compiled by the author based on the materials of the Laws of the Republic of Moldova (179/2016 n.d.) (287/2017 n.d.)

If we apply the Euro exchange rate on the last day of July 2024 to the criteria for classification as a small enterprise, as established in the recommendations of the European Commission, then it turns out that in order to be classified as a small enterprise, the following indicators must be met:

- ✓ *sales revenue must be less than or equal to MDL 192,066,000.00,*
- ✓ *balance sheet total less than or equal to MDL 192,066,000.00.*

The closest indicators to the above are those of Law 287/2017 "On Accounting and Financial Reporting", but they also require revision. Let's consider which criteria for classification as a less complex enterprise are most acceptable for the Republic of Moldova, for this we will analyze various economic indicators of the enterprises of the Republic of Moldova.

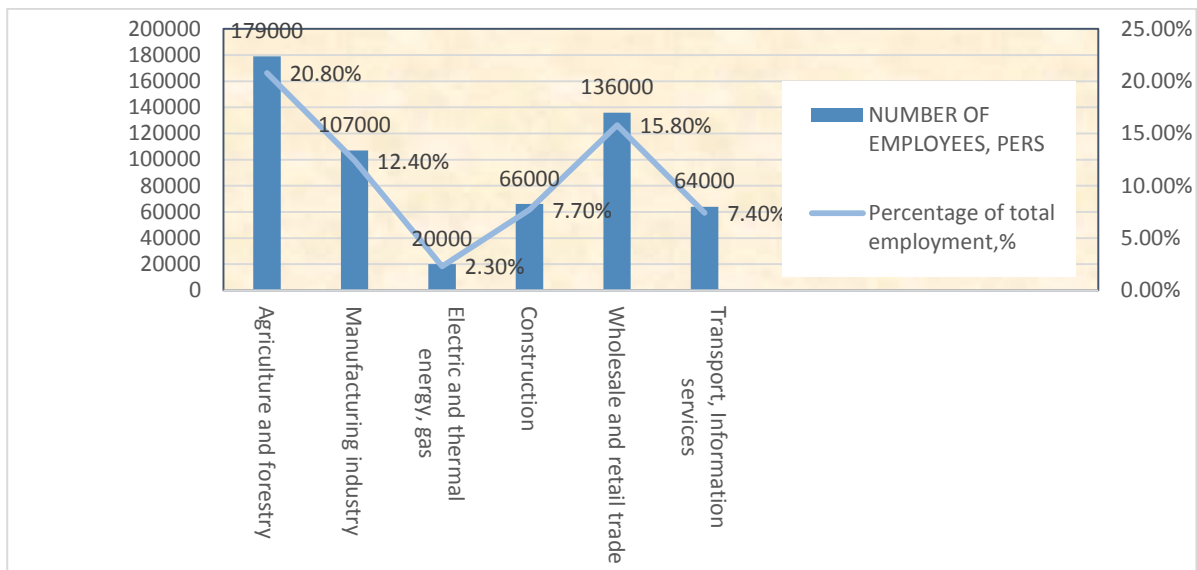


Figure 1. Employment of population by sectors of economy of the Republic of Moldova in 2022

Source: authors own study or based on statistical report (Statistical yearbook n.d.)

Analyzing the data in Figure 1, it can be stated that the largest employment of the population of the Republic of Moldova in 2022 is observed in agriculture, which accounts for 20.8% of the total employment of the population of the Republic of Moldova, in the manufacturing industry -12.4%, wholesale and retail trade -15.8%. By studying the economic indicators of enterprises in the Republic of Moldova, it is possible to analyze the most significant of them: sales income and profit before taxation, the information is presented in Figure 2.

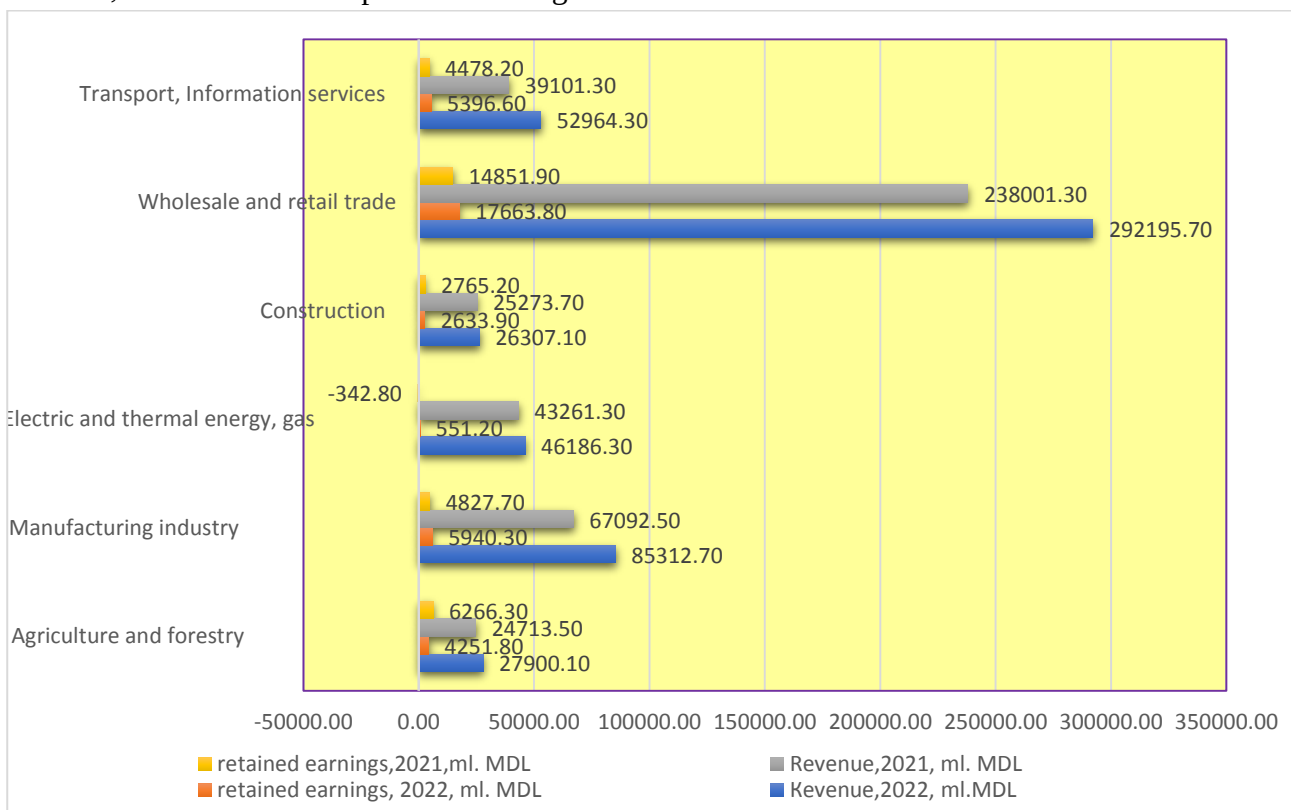


Figure 2 Dynamics of revenue and retained earnings by economic sectors of the Republic of Moldova

Source: authors own study or based on statistical report (Statistical yearbook n.d.)

Analyzing the main performance indicators of enterprises by sectors of the economy, it can be noted that wholesale and retail trade occupy the largest share in terms of both revenue and retained earnings, which is a positive thing, but for the effective development of the economy of any country, dynamic development of industries, services and agriculture is necessary. The transport industry, as well as information services and communications, demonstrate good performance.

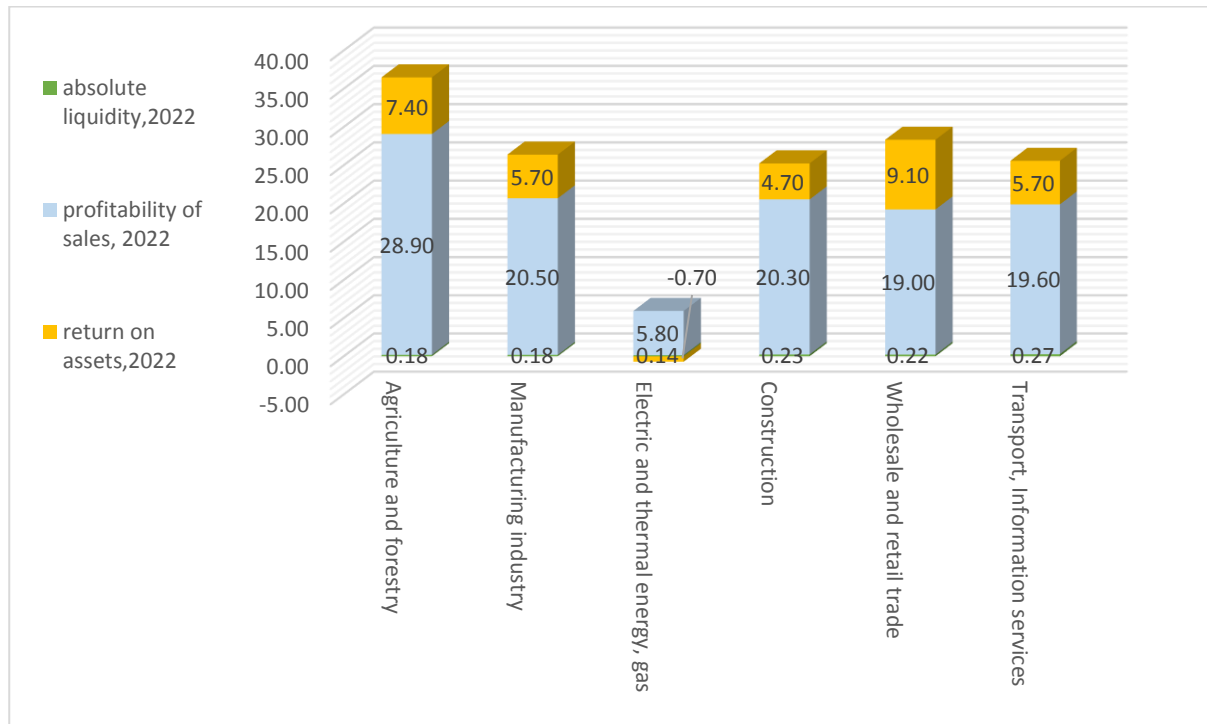


Figure 3 The main relative economic indicators of the activities of the sectors of the economy of the Republic of Moldova for 2022

Source: authors own study or based on statistical report (Statistical yearbook n.d.)

Analyzing the data, we can state the following despite the seasonality of work and high cost, agriculture shows high rates of return on sales and absolute liquidity. The highest economic indicators are inherent in information services, so in 2022 the absolute liquidity was 0.64, with a norm of 0.2-0.25. Thus, it can be stated that the relative values of the economic indicators of the selected industries are at a good level, which indicates the efficiency of enterprises. From the point of view of business risks by sectors of the economy that should be taken into account when conducting an audit, the general ones should include: not reflecting the entire amount of income, undeclared labor, etc. The International Standard on Auditing for Less Complex Entities (ISA for LCEs) has the following content:

Part A The ISA's authority for auditing the financial statements of less complex entities:

- 1. Fundamental Concepts, General Principles and Overarching Requirements,*
- 2. Audit evidence and documentation,*
- 3. Engagement quality management,*
- 4. Acceptance or Continuance of an Audit Engagement and Initial Audit Engagements,*
- 5. Planning,*
- 6. Risk Identification and Assessment,*
- 7. Responding to assessed risks of material misstatement,*

8. Concluding,

9. Forming an Opinion and Reporting,

10. Audits of Group Financial Statements,

Appendices 1-7

The first section, "Fundamental Concepts, General Principles and Overarching Requirements" of ISAs for less complex enterprises, addresses: ethical requirements and quality management at the firm level, establishes the auditor's objectives and general principles for conducting an audit, and addresses fraud detection situations. This section also focuses on regulatory and statutory provisions, related party transactions and communications with management of the audited entity and those with governance authority.

The second section of the standard addresses obtaining sufficient and appropriate audit evidence and the information to be used as audit evidence.

The third section, Engagement quality management, focuses on the responsibilities of the audit mission partner. The fourth section, Acceptance or Continuance of an Audit Engagement and Initial Audit Engagements addresses the objectives of the audit mission and the prerequisites for conducting an audit of financial statements, the grounds for accepting or continuing the engagement, and the terms of the audit engagement. An important point is that attention is also paid to initial audit engagements. This section sets special requirements for communication with the management of the audited entity and documentation. The fifth section, Planning, includes activities for planning and determining materiality.

The sixth section, Risk Identification and Assessment, is devoted to the procedures for identifying and assessing risks and related actions, and, above all, understanding the activities of the enterprise. An important point is the identification and assessment of the risks of material misstatements. The seventh section, Responding to Assessed Risks of Material Misstatements, sets forth audit procedures that respond to the assessed risks of material misstatements at the financial statement level, as well as audit procedures that respond to the assessed risks of material misstatements at the management assertion level. An important point is the process of accumulation of detected errors and distortions. The eighth section, Forming an Opinion and Reporting, deals with the provisions, procedures to be performed at the final stage of the audit of the financial statements, namely, assessment of misstatements identified during the audit, analytical procedures to help form the auditor's opinion, subsequent events, auditor's estimates and other actions to support the auditor's opinion, written representations, assumption of overall responsibility for management and achievement of quality. Section nine relates to the formation of the auditor's opinion and the presentation of the auditor's report. It presents the auditor's objectives in the course of forming an opinion on the reliability of the audited financial statements, the form of the auditor's report itself, cases of modification of the auditor's opinion, other paragraphs of the auditor's report, comparative information - relevant indicators and comparative financial statements.

The tenth section deals with the audit of the financial statements of a group of companies, addressing issues relating to:

- ✓ *planning the audit of the financial statements of a group of entities,*
- ✓ *determining materiality,*
- ✓ *understanding the structure of the enterprise group and its activities, the environment in which it is active,*
- ✓ *the concept of financial reporting,*

- ✓ *organization of the group's internal control system,*
- ✓ *identifying and assessing the risks of material misstatement of financial statements,*
- ✓ *responding to assessed risks of material misstatement of financial statements.*

All sections of the International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE) contain subsections on specific requirements for communication with the management of the audited entity and special documentation requirements. When studying the provisions of the first section " Fundamental Concepts, General Principles and Overarching Requirements " of the standard, special attention should be paid to the provisions related to the detection of fraud in an audit of financial statements. It is obvious that the responsibility for the prevention and detection of fraud lies with the management of the audited entity. Fraud can take various forms and may have different legal definitions from the point of view of regulations of different jurisdictions, but the auditor considers fraud that leads to material misstatements in the financial statements. The standard notes that fraud is distinguished from error by whether the actions that lead to misstatement of the financial statements are intentional or unintentional. In this case, the auditor pays special attention to two types of intentional misstatements - misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. The author considers it appropriate to add another type of deliberate distortion, such as the reflection in accounting of false or inflated obligations to various counterparties, with the subsequent enrichment of the relevant employees.

The auditor must obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. The risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting error, even if the audit is properly planned and performed. This is because fraud may involve complex schemes and may be carefully orchestrated by the management of the audited entity. If fraud is detected, or the auditor is faced with exceptional circumstances that cast doubt on his ability to continue audit, the auditor must first evaluate his legal and professional responsibilities that apply to the circumstances or consider whether to terminate the audit.

In performing an audit of financial statements, the auditor examines whether the audited entity has complied with laws and regulations, and management is responsible for ensuring compliance, with particular attention to those laws that affect the determination of amounts and disclosures in the financial statements.

The auditor is not responsible for preventing non-compliance and cannot expect to detect non-compliance with all laws and regulations during the audit. During an audit of financial statements, the auditor primarily focuses on situations where non-compliance with regulations results in a material misstatement of the financial statements. In this regard, non-compliance with laws and regulations can be classified as follows:

- *those cases where non-compliance directly affects the calculation and determination of material amounts and the presentation and disclosure of information in the financial statements (primarily these are calculations of tax and social obligations); and*
- *regulations that do not directly affect the determination of amounts and disclosure of information in the financial statements, but non-compliance with which may be of fundamental importance for the activities of the audited entity (for example, a violation of the terms of a license to carry out activities, compliance with regulatory requirements for solvency or compliance with environmental standards), i.e. non-compliance with such laws and regulations may have a material impact on the ability of the entity to operate.*

If the auditor has identified non-compliance with regulatory and legislative acts in the activities of the audited entity, he should first determine whether the law of the relevant jurisdiction requires that this information be communicated to the relevant regulatory or supervisory authorities. An important issue that is discussed in the first section is the audit of related party transactions, taking into account: circumstances in which a related party has a dominant influence over the audited entity, information that may indicate related party transactions or transactions that management has not previously identified and disclosed to the auditor; and significant transactions outside the normal course of the entity's activities.

Many jurisdictions have specific requirements when preparing financial statements regarding the accounting and disclosure of transactions and balances with related parties so that users of financial information can understand their nature and the actual or potential effect on the financial statements. Where such requirements are established, the auditor is responsible for performing audit procedures to identify, assess, and respond to the risks of material misstatement arising from an entity's failure to properly reflect or disclose related party transactions or balances. Even though the relevant jurisdiction does not impose specific rules on related party disclosure, the auditor still needs to obtain an understanding of such transactions of the entity to be able to conclude whether the information presented in the financial statements is reliable. It should be noted that the provisions of this standard should be applied to audits of financial statements of less complex entities for periods beginning on or after December 15, 2025.

3 Conclusion

Small enterprises are known to be the basis of any economy, and they account for the largest share of all audit services worldwide. The challenges in applying International standards on auditing for such enterprises are of great relevance to the IAASB. However, a key point needs to be emphasized: the simplicity of an enterprise's structure and operations does not mean that it is small. An enterprise can be large but still remain simple in its management and operations. In addition, there is a balance to be struck between simplification in terms of auditing and avoiding a reduction in audit quality as a result of applying ISAs to less complex enterprises. Since the standard does not define a less complex enterprise and this should be done by the relevant public authorities of each jurisdiction, the author analyzed various indicators of enterprises from different sectors of the Republic of Moldova, such as: number of employees, type of industry, sales revenues, value of assets, return on sales and assets. It should be noted that each branch of the economy has its own business risks, which may lead to distortions in the information presented in the financial statements. At the same time, the author concluded that quantitative indicators of income from sales, number of employees and amount of assets of the balance sheet are the most acceptable for the criteria of attribution to less complex enterprises.

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