

Draft International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE)

(February 2021)

CONTENTS

	Page
PREFACE	4
A. Applicability of the ISA for LCE	6
1.Fundamental Concepts and General Principles	9
1.1. Effective Date	9
1.2. Overall Objectives of the Auditor.....	10
1.3. Fundamental Concepts and General Principles for Performing the Audit	10
2.Engagement Quality Management	14
2.1. Objectives	14
2.2. The Engagement Partner’s Responsibilities	14
3.Audit Evidence	18
3.1. Objectives	18
3.2. Audit Evidence	18
3.3. Procedures for Obtaining Audit Evidence	19
3.4. Fraud.....	21
3.5. Laws and Regulations	22
3.6. Remaining Alert for Related Party Information.....	22
3.7. Overarching Communications with Management and Those Charged with Governance.....	22
4.Acceptance or Continuance of an Audit Engagement and Initial Engagements	26
4.1. Objectives	26
4.2. Preconditions for an Audit.....	26
4.3. Terms of the Audit Engagement.....	27
4.4. Initial Engagements.....	28
4.5. Specific Communication Requirements	29
4.6. Specific Documentation Requirements	29

5.Planning	30
5.1. Objectives	30
5.2. Planning Activities	30
5.3. Materiality.....	33
5.4. Specific Communication Requirements	34
5.5. Specific Documentation Requirements	34
6.Risk Identification and Assessment	35
6.1. Objectives	35
6.2. Procedures for Identifying and Assessing Risks and Related Activities	35
6.3. Understanding Relevant Aspects of the Entity	37
6.4. Identifying Risks of Material Misstatement.....	42
6.5. Risk Assessment.....	43
6.6. Specific Inquiries of Management and Those Charged with Governance	45
6.7. Specific Documentation Requirements	45
7.Responding to Assessed Risks of Material Misstatement	47
7.1. Objectives	47
7.2. Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Financial Statement Level	47
7.3. Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level.....	48
7.4. Specific Focus Areas.....	50
7.5. Specific Communication Requirements	54
7.6. Specific Documentation Requirements	55
8.Concluding	56
8.1. Objectives	56
8.2. The Auditor’s Evaluations and Other Activities to Support the Auditor’s Conclusion	56
8.3. Evaluation of Misstatements Identified During the Audit	58
8.4. Analytical Procedures that Assist When Forming an Overall Conclusion	59
8.5. Subsequent Events	59
8.6. Written Representations	60
8.7. Taking Overall Responsibility for Managing and Achieving Quality	62
8.8. Specific Communication Requirements	62
8.9. Specific Documentation Requirements	63
9.Forming an Opinion and Reporting	65
9.1. Objectives	65

9.2. Forming an Opinion on the Financial Statements	65
9.3. Form of Opinion.....	66
9.4. Auditor’s Report	66
9.5. Modified Opinions.....	68
9.6. Other Paragraphs in the Auditor’s Report	70
9.7. Comparative Information	71
9.8. Other Information	71

International Standards on Auditing for Less Complex Entities (ISA for LCE), should be read in the context of the *Preface to the International Quality Control, Auditing, Review, Other Assurance and Related Services Pronouncements*.

PREFACE

International Standard on Auditing Financial Statements of Less Complex Entities (ISA for LCE)

- P1. The IAASB develops and [issues] a separate ISA for LCE designed to apply to audits of financial statements of less complex entities (LCEs). This standard is the ISA for LCE. The ISA for LCE is based on the International Standards on Auditing (ISAs) with modifications to reflect the nature of an audit of an LCE.
- P2. The applicability of the ISA for LCE is explained in Part A. Many jurisdictions around the world have developed their own descriptions for entities of different sizes or complexities, which may be used to prescribe financial reporting or auditing obligations. Regardless, the intended scope of this standard corresponds to the description of an audit of the financial statements of an LCE as set out in Part A.

Authority for the ISA for LCE

- P3. Decisions relating to the use of the ISA for LCE, that is when it is required or permitted to be used, rests with legislative and regulatory authorities and standard-setters in individual jurisdictions ('relevant local authorities'). However, a clear description of the type of audit for which the standard is intended - as set out in Part A – is essential so that:
- The IAASB can decide on and design objectives and requirements that are appropriate for an audit of an LCE and therefore should be included within the ISA for LCE; and
 - The relevant local authorities, auditors, and others will be informed of the intended applicability of the ISA for LCE.
- P4. This standard does not override local laws or regulations that govern audits of financial statements in a particular jurisdiction.
- P5. The ISA for LCE has been designed to apply to audits of LCEs as set out in Part A. If it is used for audit engagements other than those contemplated in Part A, the auditor is not permitted to represent compliance with the ISA for LCE in the auditor's report.

Format of the ISA for LCE

- P6. The ISA for LCE has been presented in Parts::
- Part 1 sets out the fundamental concepts and overarching principles.
 - Part 2 sets out the auditor's and engagement partner's obligations and responsibilities for quality management in an audit of an LCE.
 - Part 3 sets out the general requirements relating to audit evidence, communication and documentation, as well as the overall objective of the audit. The concepts and principles within this part are to be applied throughout the audit.
 - Parts 4 to 9, which follows the flow of an audit engagement, set out the detailed requirements for the audit. Each of these Parts includes specific communication and documentation requirements as necessary.
- P7. Each Part includes:
- Non-authoritative introductory material in a box that sets out the content and scope of that Part (but does not create any additional obligations for the auditor).

- Objective(s), which link the requirements and the overall objective of the audit.
- Requirements to be met, except where the requirement is conditional and the condition does not exist. All requirements are numbered relating to the relevant Part, for example A.1., A.2., or 1.1.1., 1.1.2., etc. Requirements are expressed using “shall.”
- Essential explanatory material (EEM), designed to provide further explanation relevant to a sub-section or a specific requirement.

P8. All essential explanatory material is presented in italics and does not impose additional obligations on the auditor. All essential explanatory material is presented in separate blue boxes. There are two types of essential explanatory material: general introductory EEM that explains the context of the section that follows and EEM specific to the requirement directly above it.



P9. Throughout this standard, requirements related to the auditor’s exercise of professional skepticism are indicated with the symbol to the left.



P10. Documentation requirements within this standard have been indicated by the symbol to the left.

Non-Authoritative Material

P11. The IAASB may issue Staff publications or other non-authoritative material to support the implementation of the ISA for LCE.

Maintenance of the ISA for LCE

P12. The IAASB expects to propose amendments to the ISA for LCE periodically, but not more frequently than once every three years. In developing the exposure draft of the changes, the IAASB will consider new and revised ISAs as well as specific issues that have been brought to the attention of the IAASB regarding application of the ISA for LCE. The IAASB expects that there will be a period of at least eighteen months between when amendments to the ISA for LCE are issued and the effective date of those amendments.

P13. Until the ISA for LCE is amended, changes made or proposed to the ISAs do not apply to the ISA for LCE. The ISA for LCE is a standalone document. Users of the ISA for LCE should not anticipate or apply changes made in the ISAs before the changes are incorporated in the ISA for LCE.

1. A. Applicability of the ISA for LCE

- A.1. The ISA for LCE has been developed for use in an audit of the financial statements of an LCE.
- A.2. The auditor's procedures in the ISA for LCE are written in the context of an audit of the financial statements of an LCE and do not address complex matters or circumstances. The auditor's procedures are designed for auditors in the private and public sector.
- A.3. The ISA for LCE shall not be used if:
- Laws or regulations restrict or prohibit the use of the ISA for LCE.
 - The entity that is a listed entity.
 - The audit is an audit of group financial statements.
 - The audit is judged not to be an audit of a less complex entity. This Applicability Part describes the characteristics of an audit of an LCE.

Description of an Audit of Financial Statements of a Less Complex Entity

- A.4. The auditor's determination about whether the audit is an audit of a less complex entity for the purpose of using the ISA for LCE is a professional judgment. This professional judgment, in the context of the entity being audited, will help the auditor determine whether the ISA for LCE is appropriate for the nature and circumstances of the entity being audited, which will enable the auditor to obtain sufficient appropriate audit evidence to support a reasonable assurance opinion. If the audit is performed using the ISA for LCE when it is not appropriate, this will likely result in the inability of the auditor to obtain sufficient or appropriate evidence to be able to issue a reasonable assurance opinion.

Characteristics of an Audit of an LCE

- A5. Characteristics of an entity that would fall within the applicability of the ISA for LCE may include:
- Business activities and governance structure that is not complex.

Business Activities

The entity's objectives, strategy and business model may result in risks that are pervasive to the entity, which in some form may have financial consequences and therefore an effect on the financial statements. Examples of risks that may result in pervasive risks that may increase the complexity of an audit include:

- High risk products and services, that may result in legal liability and reputational risk.*
- Entity's that operate in highly regulated industries (for example, prudential requirements)*

Governance Structures

The structures in place for appropriate oversight will vary depending on the nature and circumstances of the entity. Oversight includes those charged with governance, who may, or may not be, the same as those managing the entity. However, where the governance structures are multifaceted, for example there are executive and non-executive directors' groups, audit committees, and similar groups, this would not be considered governance structures of a less complex entity.

- An information system that is less complex.

The entity's information system includes the entity's IT system, people involved in the capture of information and the processes designed to capture and process the information relating to the entity's financial position and financial performance. Indicators that the entity's information system may be less complex include:

IT System and Processing of Information

- *The IT environment is less complex—for example, an entity uses commercial software and does not have access to source code to make any program changes; there will also unlikely be a dedicated IT department that develops and implements program changes.*
- *The entity does not have multiple, or multi-faceted, IT applications.*
- *There are basic controls over the flow of transactions without the necessity for significant testing of those controls by IT specialists.*
- *IT applications automatically process information or maintain data and the volume of data is significant, such that the IT applications perform automated information processing controls.*
- *If a service organization is used, the entity has access to the relevant records and information.*

People Involved in the Capture of Information

- *Oversight responsibilities that rest with one or very few individual(s).*
- *There are few individuals involved in roles related to financial reporting, including those involved in the initiation and processing of transactions.*

- The financial statements only include basic accounting estimates.

Accounting estimates vary widely in nature and are subject to varying degrees of estimation uncertainty, which is the susceptibility to a lack of precision in measurement. An accounting estimate is likely to be considered a 'basic accounting estimate' when it, individually or in combination:

- *Is relevant to accounting estimates that may be uncomplicated because the business activities are simple or the required estimates may have a lesser degree of estimation uncertainty.*
- *Is derived from an active market that generally provides readily available, reliable information, such as published interest rates or exchange traded prices of securities (such data may be referred to as observable).*
- *Does not have a high degree of estimation uncertainty. For example, a high degree of estimation uncertainty exists when uncertain future inflows or outflows that result from the underlying asset or liability are estimated using assumptions that inherently have a high level of estimation uncertainty (such as assumptions with a long forecast period, assumptions that are based on data that is unobservable and are therefore difficult for management to develop, or the use of various assumptions that are interrelated).*
- *It does not require a complex model to calculate its value.*
- *The model used to measure the accounting estimate is well-known or widely used.*
- *Does not involve a sophisticated information system with extensive controls over the processing of the accounting estimates.*

Appendix 3 provides a list of the types of basic accounting estimates that could be encountered in the audit of a less complex entity.

- A6. As the audit progresses, the auditor shall remain alert to changes in the matters set out above which may change the auditor's determination about whether the ISA for LCE is appropriate and relevant to the audit.

Specific Documentation Requirements

- A.7. The auditor shall document the professional judgments made in determining that the ISA for LCE is appropriate for the nature and circumstances of the entity being audited.

1. Fundamental Concepts and General Principles

Content of this Part

Part 1 sets out the:

- Effective date of the standard.
- Overall objectives of the auditor. Each Part within this standard contains an objective, which provides a link between the requirements within that Part and the overall objectives of the auditor.
- Fundamental concepts and general principles applicable to the engagement, including for professional skepticism and professional judgment. Quality management and ethical requirements on which this standard is premised.

Scope of this Part

The concepts and principles in this part apply throughout the audit engagement using this standard.

1.1. Effective Date

1.1.1. This standard is effective for audits of financial statements for periods beginning on or after [XXX].

1.2. Definitions

1.2.1. For purposes on the ISA for LCE, the definitions contained in the ISAs, as compiled in the *Glossary of Terms* (the Glossary) included in the [2020] *IAASB Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*, apply. The Glossary also includes descriptions of other terms used in the ISA for LCE standard to assist in consistent application and interpretation.

1.2.2. Within this standard, if a word or term is defined or described in the glossary, it is underlined on its first use in a Part. (*Note for Board – this has only been done so far for ISA 200, ISA 220 (revised) and ISA 315 (Revised 2019 – this is for discussion at the Board meeting)*)

1.3. Relevant Ethical Requirements and Firm-Level Quality Management on Which this Standard is Premised

Relevant Ethical Requirements Relating to an Audit of Financial Statements

1.3.1. The auditor is subject to relevant ethical requirements, including those related to independence, relating to financial statement audit engagements. Relevant ethical requirements ordinarily comprise the *International Code of Ethics for Professional Accountants, Including International Independence Standards* (Code of Ethics) related to an audit of financial statements together with national requirements that are more restrictive. The ISA for LCE is premised on the basis that the auditor is complying with the Code of Ethics or to national requirements that are at least as demanding, and that the engagement partner and engagement team have a sufficient understanding of the requirements.

Firm Quality Management

1.3.2. Systems of quality management, including the policies or procedures are the responsibility of the firm. International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that*

Perform Audits or Reviews for Financial Statements, or Other Assurance or Related Services Engagements applies to all firms that perform audits. The ISA for LCE is premised on the basis that the firm is subject to ISQM 1 or to national requirements that are at least as demanding.

- 1.3.3. If an engagement quality review is required by the policies or procedures that are in accordance with ISQM 1, ISQM 2, *Engagement Quality Reviews*, deals with the appointment and eligibility of the engagement quality reviewer, and the performance and documentation of the engagement quality review.

1.4. Overall Objectives of the Auditor

- 1.4.1. To achieve the overall objectives, the auditor shall achieve the objectives in each Part of the ISA for LCE. The overall objectives of the auditor when conducting an audit of financial statements using the ISA for LCE are to:

- (a) Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, to enable the auditor to express an opinion on whether the financial statements are prepared, in all material respects in accordance with an applicable financial reporting framework; and
- (b) Report on the financial statements, and communicate as required by the ISA for LCE, in accordance with the auditor's findings.

- 1.4.2. Because the circumstances of audit engagements vary widely and all such circumstances cannot be anticipated, the auditor shall determine whether procedures in addition to those required by the ISA for LCE are required to achieve the objectives in each Part.

- 1.4.3. If the objective(s) of a particular part cannot be achieved, the auditor shall consider the effect on achieving the overall objective, for example the auditor is required to:

- (a) Modify the auditor's opinion; or
- (b) Withdraw from the engagement.

1.5. Fundamental Concepts and General Principles for Performing the Audit

Preparation of the Financial Statements

Law or regulation may establish the responsibilities of management, and where appropriate, those charged with governance, in relation to financial reporting. An audit in accordance with the ISA for LCE is conducted on the premise that management (or where appropriate, those charged with governance) have acknowledged and understood that they have responsibility:

- *For the preparation of the financial statements in accordance with the applicable financial reporting framework.*
- *To provide the auditor with access to all information of which they are aware that is relevant to the preparation of the financial statements, and persons within the entity from whom the auditor determines it necessary to obtain audit evidence.*

Reasonable Assurance

As the basis for the auditor's opinion, this standard requires the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement,

whether due to fraud or error. Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

Inherent Limitations of an Audit

There are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive in nature. The inherent limitations of an audit arise from:

- *The nature of financial reporting frameworks;*
- *The nature of audit procedures; and*
- *The need for audits to be conducted within a reasonable time and at a reasonable cost.*

There are also practical and legal limitations on the auditor's ability to obtain audit evidence. For example:

- *Not all relevant information may be provided to the auditor, either intentionally or unintentionally.*
- *Fraud may be occurring via schemes designed to conceal it, and audit procedures may therefore be ineffective.*
- *An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal authority, such as the powers of search, which may be necessary for such an investigation.*

- 1.5.1. When an audit is performed in accordance with the ISA for LCE, the auditor shall comply with all relevant requirements. A requirement is relevant when the circumstances addressed by the requirement exist.
- 1.5.2. The auditor shall not represent in the auditor's report that an audit was performed in accordance with the ISA for LCE unless all applicable requirements have been met.
- 1.5.3. The auditor shall have an understanding of the entire text of this standard to understand its objectives and apply its requirements properly.
- 1.5.4. In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement. In such circumstances, the auditor shall perform alternative procedures to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the aim of the requirement.

Sufficient Appropriate Audit Evidence

- 1.5.5. To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level thereby enabling the auditor to draw reasonable conclusions on which to base the auditor's opinion.

Sufficiency is the measure of the quantity of audit evidence, and is affected by the auditor's risks of material misstatement (the higher the assessed risks, the more evidence is likely to be required) and also the quality of the evidence (the higher the quality, the less may be required). Obtaining more evidence, however, may not compensate if it is of poor quality.

Appropriateness is the measure of the quality of the audit evidence, that is its relevance and reliability in providing support for the conclusions on which the auditor's opinion is based. The reliability of evidence is influenced by its source and by its nature, and dependent on the individual circumstances under which it is obtained.

Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment.



Professional Skepticism

- 1.5.6. The auditor shall plan and perform the audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.
- 1.5.7. Professional skepticism involves performing procedures in a way that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that is contradictory.

Professional skepticism is necessary to the critical assessment of audit evidence, and the auditor remains alert to, for example:

- *Audit evidence that contradicts other audit evidence obtained.*
- *Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.*
- *Conditions that may indicate possible fraud.*
- *Circumstances that suggest the need for audit procedures in addition to those required by this standard.*

- 1.5.8. Throughout the audit the auditor shall recognize the possibility that a material misstatement because of fraud may exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance.

Professional Judgment

- 1.5.9. The auditor shall exercise professional judgment in planning and performing the audit.

The exercise of professional judgment in any particular case is based on the facts and circumstances that are known to the auditor up to the date of the auditor's report, and decisions made by auditors whose training, knowledge and experience are appropriate to achieve reasonable professional

judgments (i.e., the professional judgment reached reflects a competent application of auditing and accounting principles and is appropriate in the circumstances).

Professional judgment needs to be appropriately documented in accordance with the requirements of the ISA for LCE.

2. Engagement Quality Management

Content of this Part

Part 2 sets out the broad responsibilities for managing and achieving quality in the audit engagement.

Scope of this Part

The firm is responsible for designing, implementing and operating a system of quality management for audits of financial statements, that provides the firm reasonable assurance that the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements, and that engagement reports issued are appropriate in the circumstances. The engagement team, led by the engagement partner, is responsible within the context of the firm's system of quality management for:

- Implementing the firm's responses to quality risks;
- Determining whether additional responses are needed; and
- Communicating as required.

The requirements in this Part apply throughout the audit engagement using this standard.

2.1. Objectives

2.1.1. The objectives of the auditor are to manage quality at the engagement level to obtain reasonable assurance that quality has been achieved such that:

- (a) The auditor has conducted the audit in accordance with the ISA for LCE, relevant ethical standards and the applicable legal and regulatory requirements; and
- (b) The auditor's report is appropriate in the circumstances.

2.2. The Engagement Partner's Responsibilities

Leadership Responsibilities for Managing and Achieving Quality

The requirements relating to direction, supervision and review of the work of other members of the engagement team are only relevant if there are members of the engagement team other than the engagement partner.

2.2.1. The engagement partner shall take overall responsibility for managing and achieving quality on the audit engagement. In doing so, the engagement partner shall be sufficiently and appropriately involved throughout the audit engagement to determine that the significant judgments made and conclusions reached are appropriate in the circumstances.

Being sufficiently and appropriately involved throughout the audit engagement when procedures, tasks or actions have been assigned to other members of the engagement team may be demonstrated by the engagement partner in different ways, including:

- *Informing assignees about the nature of their responsibilities and authority, the scope of the work being assigned and the objectives thereof; and to provide any other necessary instructions and relevant information.*
- *Direction and supervision of the assignees.*

- *Review of the assignees' work to evaluate the conclusions reached.*

- 2.2.2. The engagement partner shall take responsibility for clear, consistent and effective actions being taken that reflect the firm's commitment to quality, and establish and communicate the expected behavior of the engagement team members.

The engagement partner's responsibility for managing and achieving quality is supported by a firm culture that demonstrates a commitment to quality. In addressing the requirements in paragraphs 2.2.1. and 2.2.2. above, the engagement partner may communicate directly to other members of the engagement team and reinforce this communication through conduct and actions (e.g., leading by example). The nature and extent of the actions of the engagement partner to demonstrate the firm's commitment to quality may depend on a variety of factors including the size, structure, geographical dispersion and complexity of the firm and the engagement team, and the nature and circumstances of the audit engagement. With a smaller engagement team with few engagement team members, influencing the desired culture through direct interaction and conduct may be sufficient.

- 2.2.3. If the engagement partner assigns the design or performance of procedures, tasks or actions to other members of the engagement team, the engagement partner shall continue to take overall responsibility for managing and achieving quality through direction and supervision of those members of the engagement team, and review of their work. In taking overall responsibility for managing and achieving quality through direction and supervision, the engagement partner shall determine that the nature, timing and extent of direction, supervision and review is responsive to the nature and circumstances of the engagement and in compliance with the firm's related policies or procedures, this ISA for LCE, relevant ethical standards and regulatory requirements.

Relevant Ethical Requirements

- 2.2.4. Throughout the audit engagement, the engagement partner shall:

- (a) Take responsibility for identifying, evaluating and addressing threats to compliance with relevant ethical requirements, including those related to independence that are applicable given the nature and circumstances of the engagement and the firm's related policies or procedures; and
- (b) Remain alert, through observation, inspection of audit documentation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team.

- 2.2.5. If matters come to the engagement partner's attention that indicate that:

- (a) A threat to compliance with relevant ethical requirements exists; or
- (b) Relevant ethical requirements have not been fulfilled;

the engagement partner shall take appropriate action, including evaluating the matter, complying with the firm's related policies or procedures and consulting with others in the firm, as appropriate.

Other Engagement Partner Responsibilities

2.2.6. Taking into account the nature and circumstances of the audit and the firm's related policies or procedures, the engagement partner shall determine that:

- (a) Sufficient and appropriate resources are assigned or made available to the engagement team in a timely manner; and
- (b) Members of the engagement team, and any experts, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement.

If the above conditions are not met, the engagement partner shall take appropriate action, including communicating with appropriate individuals about the need to assign or make available additional or alternative resources to the engagement.

2.2.7. The engagement partner shall take responsibility for using the resources assigned or made available to the engagement team appropriately.

2.2.9. The engagement partner shall review audit documentation at appropriate points in time during the audit, including documentation relating to significant matters, significant judgments (including those relating to difficult or contentious matters) and other matters that, in the engagement partner's professional judgment, are relevant to the engagement partner's responsibilities.

The engagement partner need not review all documentation.

2.2.10. On or before the date of the auditor's report, the auditor shall determine that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.

2.2.11. The engagement partner shall:

- (a) Determine whether the results of the firm's monitoring and remediation process and, if applicable, other network firms, and deficiencies noted in that information, may affect the audit engagement; and
- (b) Take appropriate action, including remaining alert to matters that are relevant to be communicated to the firm.

2.2.12. The engagement partner shall:

- (a) Take responsibility for differences of opinion being addressed and resolved in accordance with the firm's policies or procedures;
- (b) Take responsibility for consultations being made in accordance with the firm's related policies or procedures, or where deemed necessary, on difficult or contentious matters;
- (c) Determine that conclusions reached with respect to differences of opinion and difficult or contentious matters are documented and implemented; and
- (d) Not date the auditor's report until any differences of opinion are resolved.

Forming an objective view on the appropriateness of the judgments made in the course of the audit can present practical problems when the same individual also performs the entire audit. If particularly complex or unusual issues are involved, it may be desirable to consult with other suitably-experienced auditors or the auditor's professional body.

Consultation may be appropriate when there are issues that are complex or unfamiliar, significant risks, significant transactions that are outside the normal course of business, or that otherwise appear to be unusual, limitations imposed by management or non-compliance with laws and regulations.

- 2.2.13. If applicable, the engagement partner shall determine that an engagement quality review has been performed in accordance with the firm's related policies or procedures, and:
- (a) Determine that the engagement quality review has been performed;
 - (b) Discuss significant matters and significant judgments arising during the audit with the engagement quality reviewer; and
 - (c) Not date of the auditor's report before the engagement quality review is complete.

Review of Communications

- 2.2.14. The engagement partner shall review, prior to their issuance, formal written communications to management, those charged with governance or regulatory authorities.

3. Audit Evidence

Content of this Part

Part 3 sets out the broad requirements to be applied throughout the audit for:

- Audit evidence.
- Procedures for obtaining audit evidence, including sampling and substantive analytical procedures.
- Overarching documentation requirements. Communication with management and those charged with governance.

The ISA for LCE includes the auditor's objectives in planning and performing the audit. These objectives are intended to assist the auditor to understand the procedures to be performed and audit evidence to be obtained.

This Part also sets out the overarching documentation and communication requirements for all Parts. Within individual Parts there may be additional specific documentation and communication requirements.

Scope of this Part

The requirements in this Part apply throughout the audit engagement using this standard.

3.1. Objectives

3.1.1. The objectives of the auditor are to:

- (a) Obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion;
-  (b) Prepare documentation that provides a sufficient and appropriate record of the basis for the auditor's opinion and provides evidence that the audit was planned and performed in accordance with the ISA for LCE and applicable laws and regulations; and
- (c) Communicate clearly about matters related to the audit, obtain information relevant to the audit, and provide timely observations that are relevant to management and those charged with governance (where relevant) and, promote effective two-way communication between the auditor and those charged with governance.

3.2. Audit Evidence

Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the audit.

3.2.1. The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.

Audit procedures to obtain audit evidence throughout the audit can include inspection, observation, confirmation, recalculation, reperformance and analytical procedures, often in some combination, in addition to inquiry. Inquiry alone does not ordinarily provide sufficient audit evidence.

Information to be Used as Audit Evidence

- 3.2.2. When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence.

Relevance deals with the logical connection with, or bearing upon, the purpose of the audit procedure and, where appropriate, the assertion under consideration. The relevance of the information may be affected by the direction of testing.

The reliability of information to be used as audit evidence is influenced by its source and nature, as well as the circumstances under which it was obtained. Generally, the reliability of information is increased when it is obtained from a source outside of the entity, original is more reliable than a copy and written is more reliable than oral information. However, circumstances may exist that could affect these generalizations.

- 3.2.3. When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes and determine:
- (a) The accuracy and completeness of the information as necessary in the circumstances; and
 - (b) Whether the information is sufficiently precise and detailed for the auditor's purposes.
- 3.2.4. The auditor may accept records and documents as genuine unless there is reason to believe otherwise, in which case the auditor shall investigate any inconsistencies. If conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further and determine the effect on the rest of the audit evidence obtained.
- 3.2.5. The auditor shall determine what modifications or additions to audit procedures are necessary if:
- (a) Audit evidence obtained from one source is inconsistent with that obtained from another; or
 - (b) The auditor has doubts about the reliability of information to be used as audit evidence.

Using Audit Evidence Obtained During an Interim Period

- 3.2.6. If the auditor obtains audit evidence about the operating effectiveness of controls in an interim period, the auditor shall obtain evidence about significant changes to those controls subsequent to the interim period and determine additional evidence to be obtained for the remaining period.
- 3.2.7. If substantive procedures are performed at an interim date, the auditor shall cover the remaining period by performing:
- (a) Substantive procedures, combined with tests of controls for the intervening period; or
 - (b) If the auditor determines that it is sufficient, further substantive procedures only, that provide a reasonable basis for extending the audit conclusions from the interim date to the period end.

3.3. Procedures for Obtaining Audit Evidence

Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing procedures to identify and assess risks of material misstatement (see Part 6) and

further audit procedures (comprising test of controls and substantive procedures) (see Part 7). Tests of controls are only required in specific circumstances (see paragraph 7.3.4.)) or the auditor may choose to perform tests of controls. Substantive procedures include tests of detail and substantive analytical procedures.

- 3.3.1. When designing tests of controls and tests of details, the auditor shall determine the means of selecting items to test that are effective in meeting the purpose of the audit procedure.

Analytical Procedures

- 3.3.2. When the auditor uses analytical procedures for to obtain audit evidence (either in risk identification or in responding to assessed risks), the auditor shall:
- (a) Determine the suitability of the analytical procedures for the purpose of the test or for the given assertion;
 - (b) Evaluate the reliability of data used in the analyses;
 - (c) Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify misstatements;
 - (d) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation being required. For identified differences exceeding acceptable levels, use professional judgment when investigating such differences and perform additional audit procedures as necessary in the circumstances; and
 - (e) Evaluate whether unusual or unexpected relationships that have been identified, including those related to revenue accounts, may indicate risks of material misstatement due to fraud.

Audit Sampling

- 3.3.3. If the auditor uses audit sampling when responding to assessed risks of material misstatement as a means for selecting items for testing, the auditor shall:
- (a) Consider the purpose of the audit procedures and the characteristics of the population from which the sample will be drawn.
 - (b) Determine a sample size sufficient to reduce sampling risk to an acceptably low level.
 - (c) Select items in a way that each sampling unit in the population has a chance of selection.
 - (d) Perform audit procedures, appropriate to the purpose, on each item selected, unless it is not applicable to the selected item in which case the auditor shall select a replacement item or perform an alternative procedure. If the auditor is unable to apply the procedure to the selected item, unless it is not applicable, that item will be treated as a deviation.
 - (e) Investigate deviations or misstatements identified in the sample as to their nature and cause, and consider their effect on the purpose of the audit procedure and other areas of the audit.
 - (f) For tests of detail, excluding misstatements that do not affect the remaining population, project misstatements found in the sample to the population.

External Confirmations

- 3.3.4. The auditor shall consider whether external confirmation procedures are to be performed as substantive procedures.

External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties. External confirmation procedures also may be performed to obtain audit evidence about the absence of certain conditions.

3.4. Fraud



The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. Although fraud is a broad legal concept, for the purposes of the ISA for LCE, the auditor is concerned with fraud that causes a material misstatement in the financial statements.

An auditor conducting an audit in accordance with the ISA for LCE is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor.

When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in the ISA for LCE are designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.

- 3.4.1. The auditor shall include specific considerations with regard to fraud when:

- (a) Identifying and assessing risks of material misstatement. In doing so, the auditor shall evaluate whether information obtained from the procedures to identify and assess risks and related activities indicates that one or more fraud risk factors are present;¹
- (b) Obtaining sufficient appropriate audit evidence through designing and implementing appropriate responses to assessed risks of material misstatement; and
- (c) Responding appropriately to fraud or suspected fraud identified during the audit.

Auditor Unable to Continue the Engagement

- 3.4.2. If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall determine the legal and professional responsibilities applicable in the circumstances or whether it is appropriate to withdraw from the engagement.

¹ Appendix 1 sets out fraud risk factors relevant to less complex entities.

3.5. Laws and Regulations

It is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.

The requirements in this standard are designed to assist the auditor in identifying material misstatement of the financial statements due to non-compliance with laws and regulations. The auditor's responsibilities in relation to compliance with two different categories of laws and regulations are distinguished as follows:

- (a) The provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements (e.g., tax and pension laws and regulations); and*
- (b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (e.g., compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations), i.e., non-compliance with such laws and regulations may therefore have a material effect on the financial statements*

3.5.1. During the audit, the auditor shall remain alert to the possibility that other audit procedures applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor's attention.

3.5.2. In the absence of identified or suspected non-compliance with laws and regulations, the auditor is not required to perform audit procedures regarding the entity's compliance with laws and regulations, other than what is required by the ISA for LCE.

3.6. Remaining Alert for Related Party Information

3.6.1. During the audit, the auditor shall remain alert, when inspecting records or documents, for:

- (a) The entity's related parties, including circumstances relating to the existence of a related party with dominant influence; and
- (b) Arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor, and significant transactions outside the entity's normal course of business.

3.7. Overarching Communications with Management and Those Charged with Governance

Governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. Governance is the collective responsibility of a governing body, such as a board of directors, a supervisory board, partners, proprietors, a committee of management, a council of governors, trustees or equivalent. However, in many less complex entities, one person may be charged with governance, for example the owner-manager. In such cases the auditor may need to establish with whom communications are needed.

If those charged with governance are separate from management, the communication requirements to those charged with governance also apply to management, and therefore the auditor is required to communicate with both.

There may be other cases where it is not clear with whom to communicate, for example in some family owned businesses, some not-for-profit organizations and some government entities. In such cases the auditor may need to discuss and agree with whom communications should be made.

- 3.7.1. The auditor shall communicate with management, and those charged with governance as relevant, on a timely basis.

The appropriate timing for communications will vary with the circumstances of the audit, and may be affected by the significance and nature of the matter, and the actions expected to be taken by those charged with governance.

- 3.7.2. Specific matters to be communicated are required throughout the ISA for LCE. The auditor shall use professional judgment in determining the appropriate form, timing and general content of the communications with management and those charged with governance (if separate). When determining the form of communication, the auditor shall consider:

- (a) Legal requirements for communication; and
- (b) The significance of the matters to be communicated.

- 3.7.3. Where responses to inquiries of management and those charged with governance are inconsistent, the auditor shall investigate the inconsistencies.

- 3.7.4. If the auditor has identified fraud or has obtained information that indicates that fraud may exist, the auditor shall communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities.

Specific Communications to Those Charged with Governance in Relation to Fraud

- 3.7.5. If the auditor has identified or suspects fraud involving:

- (a) Management;
- (b) Employees who have significant roles in internal control; or
- (c) Others where the fraud results in a material misstatement in the financial statements,

the auditor shall communicate these matters to those charged with governance on a timely basis, unless prohibited by law or regulation. If the auditor suspects fraud involving management, the auditor shall communicate these suspicions to those charged with governance and discuss with them the nature, timing and extent of audit procedures necessary to complete the audit.

 *Documentation of the Communications*

- 3.7.6. The auditor shall document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.

- 3.7.7. Where matters required by the ISA for LCE to be communicated are communicated orally, the auditor shall include them in the audit documentation, and when and to whom they were communicated.

Written communications need not include all matters that arose during the audit.

- 3.7.8. Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of the audit documentation. Written communications need not include all matters that arose during the audit.

3.8. Overarching Documentation Requirements

- 3.8.1. Specific matters to be documented are set out throughout the ISA for LCE. The auditor shall prepare audit documentation on a timely basis that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

- (a) The nature, timing and extent of the audit procedures performed in accordance with this Part and applicable legal and regulatory requirements, including recording:
 - (i) The identifying characteristics of the specific items or matters tested;
 - (ii) Who performed the work and the date such work was completed;
 - (iii) Who reviewed the audit work performed and the date and extent of such review, including what was reviewed;
- (b) The results of the audit procedures performed, and the audit evidence obtained; and
- (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

The significance of a matter requires professional judgment and the analysis of the facts and circumstances, and may include matters giving rise to significant risks, areas where the financial statements could be materially misstated, circumstances where the auditor has had difficulty in applying the necessary audit procedures, or any findings that could result in a modified audit opinion.

The form, content and extent of audit documentation depends on many factors related to the nature and circumstances of the entity and the procedures being performed. Audit documentation may be in paper or electronic format. It is not necessary to include superseded drafts of working papers or financial statements in the audit documentation. Oral explanations, by the auditor on their own, do not adequately support the work performed by the auditor or the conclusions reached.

- 3.8.2. If the auditor identified information that is inconsistent with the auditor's conclusion regarding a significant matter, the auditor shall document how the inconsistency was addressed.
- 3.8.3. If, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement of this standard, the auditor shall document how the alternative audit procedures performed achieve the aim of that requirement, and the reasons for the departure.
- 3.8.4. The auditor shall include in the audit documentation any:
- (a) Communications about fraud made to management, those charged with governance, regulators and others; and

- (b) Discussions of significant matters related to non-compliance with laws and regulations with management, those charged with governance and others, including how the matter has been responded to.

4. Acceptance or Continuance of an Audit Engagement and Initial Engagements

Content of this Part

Part 4 sets out the auditor's responsibilities for agreeing the terms of the audit engagement with management and, where appropriate, those charged with governance. This includes establishing that certain preconditions for an audit are present.

Part 4 also addresses activities related to initial engagements.

Scope of this Part

Paragraph 1.3.2. sets out that the ISA for LCE is premised on the basis that the firm is subject to ISQM 1 or to national requirements that are at least as demanding. ISQM 1 requires the firm to establish quality objectives that address the acceptance and continuance of client relationships and specific engagements. In addition, compliance with ISQM 1 may require firms to have policies and procedures to address other matters of relevance to this Part.

Audit engagements may only be accepted when the auditor considers that relevant ethical requirements such as independence and professional competence and due care will be satisfied. In addition, the auditor considers the performance of non-assurance services for the audit client and whether this is permissible.

4.1. Objectives

4.1.1. The objectives of the auditor are:

- (a) To accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:
 - (i) Establishing whether the preconditions for an audit are present; and
 - (ii) Confirming that there is a common understanding between the auditor and management and, where appropriate those charged with governance, of the terms of the audit engagement.
- (b) For initial engagements, to obtain sufficient appropriate audit evidence about whether:
 - (i) Opening balances contain misstatements that materially affect the current period's financial statements, and
 - (ii) The entity's accounting policies are appropriately reflected in the opening balances.

4.2. Preconditions for an Audit

4.2.1. In order to establish whether the preconditions for an audit are present, the auditor shall:

- (a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable;
- (b) Obtain the agreement of management that it acknowledges and understands its responsibility:

- (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
 - (ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
 - (iii) To provide the auditor with:
 - a. Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - b. Additional information that the auditor may request from management for the purpose of the audit; and
 - c. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.
- 4.2.2. If management or those charged with governance impose a limitation on the scope of the auditor's work such that the auditor believes that the limitation will result in the auditor disclaiming the opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.
- 4.2.3. If the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement:
- (a) If there are any threats to compliance with relevant ethical requirements (that have not been addressed by appropriate safeguards), including independence;
 - (b) If the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable; or
 - (c) If the agreement of management that it acknowledges and understands its responsibility has not been obtained.

4.3. Terms of the Audit Engagement

Performing acceptance or continuance procedures before planning commences assists the auditor in identifying and evaluating events or circumstances that may adversely affect the auditor's ability to plan and perform the current engagement. Paragraph 2.2.6. sets out the engagement partner's responsibilities with regard to the acceptance and continuance of the audit engagement.

- 4.3.1. The auditor shall agree the terms of the audit engagement, in writing, with management or those charged with governance, as appropriate.
- 4.3.2. On recurring engagements, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the engaging party of the existing terms of engagements.
- 4.3.3. The auditor shall not agree to a change in the terms of the audit engagement where there is no reasonable justification for doing so.

- 4.3.4. If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.
- 4.3.5. If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.
- 4.3.6. If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:
- (a) Withdraw from the audit engagement where possible under applicable law or regulation; and
 - (b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.
- 4.3.7. The engagement partner shall determine that the firm's policies or procedures regarding acceptance and continuance of the audit engagement have been followed and that conclusions reached in this regard are appropriate.

4.4. Initial Engagements

The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements.

- 4.4.1. If the engagement is an initial audit and there has been a change in auditors, the auditor shall communicate with the predecessor auditor.
- 4.4.2. The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that may materially affect the current period's financial statements by:
- (a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated;
 - (b) Determining whether the opening balances reflect the application of appropriate accounting policies; and
 - (c) Performing one or more of the following:
 - (i) Where the prior year financial statements were audited, reviewing the predecessor auditor's working papers to obtain evidence regarding the opening balances;
 - (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
 - (iii) Performing specific audit procedures to obtain evidence regarding the opening balances.
- 4.4.3. If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional

audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements.

- 4.4.4. The auditor shall obtain sufficient appropriate audit evidence about whether the accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, and that any changes in accounting policies have been appropriately accounted for and adequately disclosed.

4.5. Specific Communication Requirements

Communications with Those Charged with Governance

- 4.5.1. The auditor shall communicate the auditor's responsibilities for forming and expressing an opinion on the financial statements prepared by management, and that the auditor's responsibilities do not relieve management or those charged with governance from their responsibilities for oversight of the preparation of the financial statements.



4.6. Specific Documentation Requirements

- 4.6.1. In addition to the general documentation requirements (paragraphs 3.8.1.–3.8.4.) for an audit engagement, the auditor shall include in the audit documentation matters identified, relevant discussions with personnel, and conclusions reached with respect to:

- (a) Fulfillment of responsibilities relating to relevant ethical requirements, including applicable independence requirements.
- (b) The acceptance and continuance of the client relationships and audit engagement.

- 4.6.2. The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and include:

- (a) The objective and scope of the audit of the financial statements;
- (b) The responsibilities of the auditor;
- (c) The responsibilities of management;
- (d) Identification of the applicable financial reporting framework for the preparation of the financial statements;
- (e) Reference to the expected form and content of any reports to be issued by the auditor; and
- (f) A statement that there may be circumstances in which a report may differ from its expected form and content.

- 4.6.3. If law or regulation prescribes in sufficient detail the terms of the audit engagement referred to in this standard, the auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities.

5. Planning

Content of this Part

Part 5 sets out the auditor's responsibility to plan the audit (including holding an engagement team discussion), and the concept of materiality when planning and performing the audit.

Scope of this Part

Planning is not a discrete phase of the audit but is iterative, as necessary, throughout the audit. Some requirements within this Part are linked to procedures in other Parts and may require the auditor to execute on those procedures in order to meet the requirements in this Part.

5.1. Objectives

5.1.1. The objectives of the auditor are to:

- (a) Plan the audit so that it will be performed in an effective manner; and
- (b) Determine materiality so that the concept of materiality can be used appropriately in planning and performing the audit.

5.2. Planning Activities

The nature and extent of planning activities will vary according to the complexity of the entity, the size and nature of the engagement team, the engagement team members' previous experience with the entity and any changes in circumstances that occur during the audit engagement. When an engagement is carried out by a single individual some of the requirements may not be relevant (e.g., the engagement team discussion), however consideration may still be given to the matters within the relevant paragraphs as they may still assist the auditor.

5.2.1. The engagement partner and other key members of the engagement team shall be involved in planning the audit.

5.2.2. The auditor shall set the scope, timing and direction of the audit. In establishing the scope, timing and direction of the audit, the auditor shall:

- (a) Identify the characteristics of the engagement that define its scope;
- (b) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
- (c) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
- (d) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for this entity is relevant;
- (e) Ascertain the nature, timing and extent of resources necessary to perform the audit, including determining whether experts are needed; and
- (f) Plan the nature, timing and extent of direction and supervision of engagement members and review of their work.

In the audit of an LCE, establishing the scope, timing and direction of the audit need not be a complex or time-consuming exercise. For example, a brief memorandum prepared at the completion of the previous audit, based on a review of the working papers and highlighting issues identified in the audit just completed, updated in the current period based on discussions with the owner-manager, can serve as the documented scope, timing and direction for the current audit engagement if it covers the matters noted in paragraph 5.2.2.

- 5.2.3. The engagement partner shall take into account information obtained in the acceptance and continuance process in planning and performing the audit.
- 5.2.4. When information has been obtained from the previous experience with the client, or prior audits, the auditor shall evaluate whether such information remains relevant and reliable.
- 5.2.5. The auditor shall update and change the scope, timing and direction as necessary during the audit.

Engagement Team Discussion

- 5.2.6. The engagement partner and other key engagement team members shall:
 - (a) Discuss the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement.
 - (b) Discuss fraud to identify possible areas where risks of material misstatement could arise. In doing so, the engagement team discussion shall place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur, and how fraud or error could arise from related party relationships or transactions.

Any discussions among the engagement team shall occur setting aside beliefs the engagement team may have that management and those charged with governance are honest and have integrity.

The engagement team discussion may also include other matters related to the audit such as the logistics, operational and other matters (such as where risks of material misstatement may have changed from prior years or matters related to relevant ethical requirement including independence) and the timing of the audit and communications that are required.

- 5.2.7. When there are engagement team members not involved in the discussion, the engagement partner shall determine which matters are to be communicated to those members.

Using the Work of Management's Expert

- 5.2.8. If information to be used as audit evidence has been prepared using the work of management's expert, the auditor shall, to the extent necessary, have regard to the significance of the expert's work and evaluate the competence capabilities and objectivity of that expert, and evaluate the appropriateness of the expert's work as audit evidence for the relevant assertion.

Determining Whether to Use the Work of an Auditor's Expert

This section deals with whether there is a need for the work of an individual or organization in a field of expertise other than accounting or auditing, which can then be used to assist the auditor in obtaining sufficient appropriate audit evidence. The auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an

auditor's expert. Nonetheless, if the auditor using the work of an auditor's expert concludes that the work of that expert is adequate for the auditor's purposes, the auditor may accept that expert's findings or conclusions in the expert's field as appropriate audit evidence.

- 5.2.9. If expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the auditor shall determine whether to use the work of an auditor's expert.

If the preparation of the financial statements involves the use of expertise in a field other than accounting, the auditor, who is skilled in accounting and auditing, may not possess the necessary expertise to audit those financial statements. The engagement partner is required to be satisfied that the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the audit engagement. Further, the auditor is required to ascertain the nature, timing and extent of resources necessary to perform the engagement. The auditor's determination of whether to use the work of an auditor's expert, and if so when and to what extent, assists the auditor in meeting these requirements. As the audit progresses, or as circumstances change, the auditor may need to revise earlier decisions about using the work of an auditor's expert.

- 5.2.10. The auditor shall consider the following when determining the nature, timing and extent of procedures related to the auditor's expert:

- (a) The nature of the matter to which that expert's work relates;
- (b) The risks of material misstatement in the matter to which that expert's work relates;
- (c) The significance of that expert's work in the context of the audit;
- (d) The auditor's knowledge of and experience with previous work performed by that expert; and
- (e) Whether that expert is subject to the auditor's firm's quality management policies or procedures.

- 5.2.11. If the auditor is using the work of an auditor's expert, the auditor shall:

- (a) Evaluate whether the auditor's expert has the necessary competence, capabilities and objectivity for the auditor's purpose;
- (b) Obtain sufficient understanding of the field of expertise to enable the auditor to determine the nature, scope and objectives of the auditor's expert work; and
- (c) Agree in writing with the auditor's expert the nature, scope and objectives of the expert's work, the role of the expert and the auditor's responsibilities in relation to that work, the nature, timing and extent of communications and whether there is a need for confidentiality.

Going Concern

- 5.2.12. The auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern, and:

- (a) If such an assessment has been performed, discuss the assessment with management and determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern and, if so, management's plans to address them; or

- (b) If such an assessment has not yet been performed, discuss with management the basis for the intended use of the going concern basis of accounting, and inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

- 5.2.13. The auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

5.3. Materiality

The concept of materiality is applied by the auditor in both planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements if any, on the financial statements and in forming an opinion in the auditor's report.

- 5.3.1. The auditor shall determine materiality for the financial statements as a whole.

The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial needs of users of the financial statements. The auditor's professional judgment about misstatements that will be considered material provides a basis for:

- *Determining the nature, timing and extent of procedures to identify and assess risks of material misstatement;*
- *Identifying and assessing the risks of material misstatement; and*
- *Determining the nature, timing and extent of further audit procedures.*

- 5.3.2. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

- 5.3.3. The auditor shall determine performance materiality for the purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures.

Planning the audit solely to detect individually material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated, and leaves no margin for possible undetected misstatements. Performance materiality (which, as defined, is one or more amounts) is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole.

- 5.3.4. If the auditor becomes aware of information during the audit that would have caused the auditor to determine a different materiality level or levels for particular classes of transactions, account balances or disclosures, the materiality level shall be revised. If this level is lower than what was initially determined, the auditor shall determine whether it is necessary to revise performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.

5.4. Specific Communication Requirements

Communications with Those Charged with Governance

- 5.4.1. The auditor shall communicate to those charged with governance an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor.



5.5. Specific Documentation Requirements

- 5.5.1. In addition to the general documentation requirements (paragraphs 3.8.1–3.8.4) for an audit engagement, the auditor shall include the scope, timing and direction of the audit, and significant changes made during the audit, together with the reasons for such changes, in the audit documentation.
- 5.5.2. The auditor shall document the discussion among the engagement team and significant decisions reached, including significant decisions regarding the susceptibility of the entity's financial statements to material misstatement due to fraud or error.
- 5.5.3. With regard to materiality, the auditor shall include the following amounts and the factors considered in their determination in the audit documentation (including any revisions as applicable):
- (a) Materiality for the financial statements as a whole;
 - (b) If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures; and
 - (c) Performance materiality.
- 5.5.4. The auditor shall document changes, if any, to the determination of the use of the ISA for LCE (i.e., the applicability of the use of the ISA for LCE in the circumstances) if further information comes to the auditor's attention during the audit that may change the professional judgment made in this regard.

6. Risk Identification and Assessment

Content of this Part

Part 6 contains the requirements relevant to the auditor's responsibility to perform procedures and related activities to:

- Understand the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control;
- Identify risks of material misstatement at the financial statement and assertion levels, whether due to fraud or error; and
- Assess inherent risk and control risk.

Scope of this Part

This Part deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements, which provides the basis for the audit procedures undertaken to respond to assessed risks in Part 7.

6.1. Objectives

- 6.1.1. The objectives of the auditor are to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.

Understanding the entity and its environment, the applicable financial reporting framework and the entity's system of internal control (the entity's internal control system) enables the auditor to identify and assess the risks of material misstatement. The auditor's risk identification and assessment process is iterative and dynamic. The auditor's understanding of the entity and its environment, the applicable financial reporting framework, and the entity's internal control system are interdependent with concepts within the requirements to identify and assess the risks of material misstatement.

6.2. Procedures for Identifying and Assessing Risks and Related Activities

The auditor uses professional judgment to determine the nature and extent of the procedures to be performed to meet the requirements of this Part, which will vary with the formality of the entity's policies or procedures. Some less complex entities, and particularly owner-managed entities, may not have established structured processes and systems (e.g., a risk assessment process or a process to monitor the entity's internal control system) or may have established processes or systems with limited documentation or a lack of consistency in how they are undertaken. When such systems and processes lack formality, the auditor may still be able to perform the required procedures through observation and inquiry. However, the procedures within this Part are still required to be done.

- 6.2.1. The auditor shall design and perform procedures to obtain audit evidence that provides an appropriate basis for:
- (a) The identification and assessment of risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels; and

- (b) The design of further audit procedures.

Designing and performing procedures to obtain audit evidence in a manner that is not biased may involve obtaining evidence from multiple sources within and outside the entity. However, the auditor is not required to perform an exhaustive search to identify all possible sources of evidence.

- 6.2.2. The procedures to identify and assess risks shall include:

- (a) Inquiries with management, and other appropriate individuals within the entity;
- (b) Analytical procedures, including those to identify unusual or unexpected trends and relationships that may indicate risks of material misstatement. If unusual or unexpected trends and relationships are identified they shall be considered for fraud or error; and
- (c) Observation and inspection.

The auditor is not required to perform all of these procedures for each aspect of the auditor's understanding required.

- 6.2.3. In performing procedures to identify and assess the risks of material misstatement, the auditor shall also focus on possible risks of material misstatement arising from:

- (a) Potential incentives or pressure to commit fraud, perceived opportunities to do so and rationalization of the act.
- (b) Matters that may result in unrecognized liabilities, future commitments, or changes to current asset valuations.
- (c) Whether transactions, events or conditions exist that may give rise to the need for accounting estimates to be recognized or disclosed in the financial statements.
- (d) Events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.
- (e) Non-compliance with laws and regulations that may have a material effect on the financial statements.

Events or conditions that may cast significant doubt on the entity's ability to continue as a going concern of particular relevance to an LCE include the risk that banks and other lenders may cease to support the entity, as well as the possible loss of a principal supplier, major customer, key employee, or the right to operate under a license, franchise or other legal agreement.

- 6.2.4. The auditor shall consider information, including related to the auditor's consideration of fraud, from the acceptance and continuance procedures, and other engagements performed by the engagement partner for the entity, in identifying risks of material misstatement (including arising from fraud).

- 6.2.5. Unless all of those charged with governance are involved in managing the entity, the auditor shall understand how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the controls that management has established to mitigate these risks.

- 6.2.6. The auditor shall consider whether other information obtained by the auditor indicates risks of material misstatement due to fraud.

6.3. Understanding Relevant Aspects of the Entity

The auditor's understanding of the entity and its environment, and the applicable financial reporting framework, establishes a frame of reference in which the auditor identifies and assesses the risks of material misstatement, and also informs how the auditor plans and performs further audit procedures. The auditor's understanding of the entity's internal control system influences the auditor's identification and assessment of the risks of material misstatement, and also assists the auditor in planning and designing further audit procedures. The entity's internal control system consists of the five components of internal control, for which an understanding is required for each:

- *The control environment.*
- *The entity's risk assessment process.*
- *The entity's process to monitor the internal control system.*
- *The information system and communications.*
- *Control activities.*

6.3.1. In obtaining an understanding of the entity and its environment and the applicable financial reporting framework, the auditor shall understand how inherent risk factors affect the susceptibility of assertions to misstatement, and the degree to which they do so.

6.3.2. For the entity's accounting estimates, the auditor shall take into account the degree to which the accounting estimate is subject to estimation uncertainty, and the degree to which the method, assumptions and data are affected by complexity and subjectivity.

Inherent risk factors may be qualitative or quantitative and affect the susceptibility of assertions to misstatement. Qualitative inherent risk factors relating to the preparation of information required by the applicable financial reporting framework include:

- *Complexity;*
- *Subjectivity;*
- *Change;*
- *Uncertainty (for accounting estimates this is estimation uncertainty); or*
- *Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk.*

Understanding the Entity and Its Environment

6.3.3. The auditor shall understand:

- (a) The entity's organizational structure, ownership and governance, business model (including how the entity uses IT in its business model).
- (b) The industry and other external factors.
- (c) How the entity's financial performance is measured.
- (d) The legal and regulatory framework applicable to the entity, and how the entity is complying with that framework.

- (e) The entity's transactions and other events and conditions that may give rise to accounting estimates. When an estimate is assessed to be significant for an item in the financial statements, the auditor shall understand of the assumptions and methods used in determining the estimate.
- (f) Agreements or relationships that may result in unrecognized liabilities, future commitments or changes to current asset valuations through reviewing minutes of meetings and correspondence with legal counsel and reviewing legal expense accounts.

Understanding the entity's objectives, strategy and business model helps the auditor to understand the entity at a strategic level, and to understand the business risks the entity takes and faces. An understanding of the business risks that have an effect on the financial statements assists the auditor in identifying risks of material misstatement, since most business risks will eventually have financial consequences and, therefore, an effect on the financial statements.

Understanding the Applicable Financial Reporting Framework

6.3.4. The auditor shall understand of:

- (a) The applicable financial reporting framework. In relation to accounting estimates, the understanding includes the recognition criteria, measurement bases, and the related presentation and disclosure requirements and how these apply in the context of the nature and circumstances of the entity and its environment.
- (b) The entity's accounting policies and reasons for any changes thereto.

6.3.5. The auditor shall evaluate whether the entity's accounting policies are appropriate and consistent with the applicable financial reporting framework.

Understanding the Entity's Internal Control System

In less complex entities, and in particular owner-manager entities, the way in which the entity's internal control system is designed, implemented and maintained will vary with the entity's size and complexity. When there are no formal processes or documented policies or procedures, the auditor is still required to understand how management or those charged with governance prevent and detect fraud and error, and use professional judgment to determine the nature and extent of the work to obtain the required understanding.

6.3.6. The auditor shall consider whether management (with the oversight of those charged with governance, if applicable) has created and maintained a control environment that provides an appropriate foundation for the other components of the entity's internal control system, including determining whether there are any deficiencies in this regard. For this purpose, the auditor shall understand:

- (a) How management, and where applicable those charged with governance, oversee the entity, and demonstrate integrity and ethical values;
- (b) The culture of the entity; and
- (c) How owner-managers have an active involvement and influence the risks arising from management override of controls due to lack of segregation of duties

The control environment provides an overall foundation for the operation of the other components of the entity's internal control system and deficiencies may undermine the rest of the entity's internal control system. Although it does not directly prevent or detect and correct misstatements, it may influence the effectiveness of other controls in the internal control system. The control environment includes the governance and management functions and the attitudes, awareness and actions of those charged with governance and management concerning the entity's internal control system and its importance in the entity.

- 6.3.7. The auditor shall consider whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature and complexity of the entity. For this purpose, the auditor shall understand the entity's risk assessment process relevant to the preparation of the financial statements (i.e., how risks are identified, assessed and addressed), including how this process identifies and addresses risks related to accounting estimates.

Understanding how the entity assesses its business risks and other risks may assist the auditor in understanding where there are identified risks, and whether the entity has responded to those risks. This may inform the auditor in understanding whether the risks faced by the entity have been identified, assessed and addressed as appropriate to the nature and circumstances of the entity.

- 6.3.8. The auditor shall consider whether the entity's process for monitoring the internal control system is appropriate to the entity's circumstances considering the nature and complexity of the entity. For this purpose, the auditor shall understand the entity's process to monitor the entity's internal control system, including how deficiencies are remediated.

Understanding the entity's monitoring of the internal control system assists the auditor to understand whether the entity's internal control system is present and functioning. In less complex entities, and in particular owner-manager entities, the auditor's understanding of the entity's process to monitor the entity's internal control system is often focused on how management or the owner-manager is directly involved in operations, as there may not be any other formal monitoring activities.

- 6.3.9. The auditor shall understand the information system relevant to the preparation of the financial statements, including:

- (a) For classes of transactions, account balances and disclosures, how those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements, as well as:
 - (i) How the information system captures, processes and discloses events and conditions, other than transactions;
 - (ii) The accounting and other supporting records relating to the flows of information;
 - (iii) The entity's resources used in the financial reporting process;
 - (iv) The IT environment; and
- (b) The financial reporting process used to prepare the entity's financial statements, including disclosures.

In doing so, the auditor shall consider whether the entity's information system appropriately supports the preparation of the entity's financial statements in accordance with the applicable financial reporting framework.

The auditor's understanding of the information system may be obtained in various ways and may include:

- *Inquiries of relevant personnel about the procedures used to initiate, record, process and report transactions or about the entity's financial reporting process;*
- *Inspection of policy or process manuals or other documentation of the entity's information system;*
- *Observation of the performance of the policies or procedures by entity's personnel; or*
- *Selecting transactions and tracing them through the applicable process in the information system (i.e., performing a walk-through).*

6.3.10. For accounting estimates, the auditor's understanding of the information system relevant to the preparation of the financial statements shall include:

- (a) How the accounting estimates are made, the models used, the source of data, and the selection of assumptions;
- (b) How management reviews the outcomes of previous estimates and responds to the results of that review; and
- (c) A review of the outcome of previous accounting estimates, or, if applicable, their subsequent re-estimation.

6.3.11. The auditor shall understand how the entity communicates significant matters related to the preparation of the financial statements, and related reporting responsibilities, between people within the entity, between management and those charged with governance (if applicable) and with external parties (such as regulatory authorities or others as required).

6.3.12. Based on the auditor's consideration whether the control environment, the entity's risk assessment process, the monitoring of the entity's internal control system and the information system are appropriate in context of the nature and circumstances of the entity, the auditor shall determine whether one or more control deficiencies have been identified.

6.3.13. The auditor shall understand controls that address risks of material misstatement at the assertion level as follows:

- (a) Controls that address risks determined to be significant risks;
- (b) Controls over journal entries including to record non-recurring unusual transactions or adjustments;
- (c) Controls for which the auditor plans to test the operating effectiveness of controls, including those controls where substantive procedures alone are not enough to obtain sufficient appropriate audit evidence;
- (d) Other controls, based on the auditor's professional judgment, where the auditor considers it appropriate to meet the objectives of identifying risks of material misstatement at the assertion level;
- (e) If applicable, controls that relate to information processed by a service organization; and
- (f) Controls, if any, established in relation to related party relationships to identify, account for, and disclose in accordance with the applicable financial reporting framework, authorize

and approve significant transactions and relationships, and authorize and approve significant transactions and arrangements outside the normal course of business.

For each control identified in (a)–(f) above, the auditor shall evaluate whether the control is designed effectively, and determine whether the control has been implemented, by performing procedures more than inquiry.

The auditor is required to identify specific controls, evaluate the design and determine whether these controls have been implemented. This assists the auditor's understanding of management's approach to addressing certain risks, and therefore provides a basis for the design and performance of further audit procedures responsive to these risks even when the auditor does not plan to test the operating effectiveness of identified controls.

The auditor's identification and evaluation of controls is focused on information processing controls, which are controls applied during the processing of information in the entity's information system that directly address risks to the integrity of information (i.e., the completeness, accuracy and validity of transactions and other information). However, the auditor is not required to identify and evaluate all information processing controls - controls are required to be identified when such controls meet one or more of the criteria included in paragraph 6.3.13. In addition, when multiple controls each achieve the same objective, it is unnecessary to identify each of the controls related to such objective.

6.3.14. For the controls identified in paragraph 6.3.13, the auditor shall identify:

- (a) The IT applications and other aspects of the IT environment that are subject to risks arising from the use of IT; and
- (b) The related risks arising from the use of IT.

6.3.15. For those risks arising from the use of IT identified, the auditor shall identify the entity's general IT controls, and evaluate whether the general IT control is designed effectively and determine whether the control has been implemented by performing procedures more than inquiry.

The auditor's understanding of the information system (which may be done by performing a walkthrough test) includes the IT environment relevant to the flows of transactions and processing of information in the entity's information system. This is because the entity's use of IT applications or other aspects of the IT environment may give rise to risks arising from IT (i.e., the susceptibility of information processing controls to ineffective design or operation, or risks to the integrity of information).

Identifying the IT applications that are subject to risks arising from the use of IT involves taking into account controls identified by the auditor because such controls may involve the use of IT or rely on IT. The auditor may focus on whether an IT application includes automated controls that management is relying on and that the auditor has identified, including controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence. The auditor may also consider how information is stored and processed in the information system relating to significant classes of transactions, account balances and disclosures and whether management is relying on general IT controls to maintain the integrity of that information. The extent of the auditor's understanding of the IT processes, including the extent to which the entity has general IT controls in place, will vary with the nature and the circumstances of the entity and its IT environment, as well as based on the nature and extent of controls identified by the auditor. The

number of IT applications that are subject to risks arising from the use of IT also will vary based on these factors.

- 6.3.16. If the entity uses the services of a service organization, the auditor's understanding of the information system shall include:
- (a) The nature of the services provided by the service organization and the significance of those services to the entity;
 - (b) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organization;
 - (c) The relevant contractual terms for the activities undertaken by the service organization;
 - (d) Controls at the service organization relevant to the entity's transactions; and
 - (e) The controls applied to transactions with the service organization.

Deficiencies in the Entity's Internal Control System

- 6.3.17. The auditor shall determine whether any deficiencies identified in the entity's internal control system, individually or in combination, constitute significant deficiencies.

6.4. Identifying Risks of Material Misstatement

Risks of material misstatement are identified and assessed by the auditor to determine the nature, timing and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

- 6.4.1. The auditor shall identify the risks of material misstatement, due to fraud or error, at:

- (a) The financial statement level; and
- (b) The assertion level for classes of transactions, account balances, and disclosures.

Risks of material misstatement at the financial statement level refer to risks that relate pervasively to the financial statements as a whole, and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance or disclosure level (e.g., risk of management override of controls).

In identifying and assessing the risks of material misstatement, the auditor uses assertions to consider the different types of potential misstatements that may occur. Appendix 2 sets out assertions that may be used by the auditor in considering different types of misstatements at the assertion level.

The identification of risks of material misstatement is performed before consideration of any related controls (i.e., the inherent risk), and is based on the auditor's consideration of misstatements that have a reasonable possibility of both occurring, and being material if they were to occur.

- 6.4.2. In identifying the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

- 6.4.3. The auditor shall determine the relevant assertions and the related significant classes of transactions, account balances and disclosures.

Assertions for which the auditor has identified related risks of material misstatement are relevant assertions.

Determining relevant assertions and the significant classes of transactions, account balances and disclosures provides the basis for the scope of the auditor's understanding of the entity's information system required to be obtained, and the identification and assessment of risks of material misstatement.

6.5. Risk Assessment

Assessing Inherent Risk

6.5.1. For identified risks of material misstatement, the auditor shall assess:

- (a) The risks of material misstatement at the financial statement level. In doing so, the auditor shall determine whether such risks affect risks at the assertion level, and evaluate the nature and extent of their pervasive effect on the financial statements; and
- (b) Inherent risk for identified risks of material misstatement at the assertion level by assessing the likelihood and magnitude of misstatement, and taking into account the inherent risk factors, including estimation uncertainty for the entity's accounting estimates.

The assessed inherent risk relating to a particular risk of material misstatement at the assertion level represents a judgment within a range, from lower to higher, on the spectrum of inherent risk.

In assessing inherent risk, the auditor uses professional judgment in determining the significance of the combination of the likelihood and magnitude of a misstatement on the spectrum of inherent risk. The judgment about where in the range inherent risk is assessed may vary based on the nature, size and complexity of the entity, and takes into account the assessed likelihood and magnitude of the misstatement and inherent risk factors.

In considering the likelihood of a misstatement, the auditor considers the possibility that a misstatement may occur, based on consideration of the inherent risk factors. In considering the magnitude of a misstatement, the auditor considers the qualitative and quantitative aspects of the possible misstatement (i.e., misstatements in assertions about classes of transactions, account balances or disclosures may be judged to be material due to size, nature or circumstances.

6.5.2. The auditor shall determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the risks of material misstatement at the assertion level.

Due to the nature of a risk of material misstatement, and the controls that address that risk, in some circumstances the only way to obtain sufficient appropriate audit evidence is to test the operating effectiveness of controls. Accordingly, there is a requirement for the auditor to identify any such risks because of the implications for the design and performance of further audit procedures.

Significant Risks

6.5.3. The auditor shall determine whether any of the assessed risks of material misstatement are, in the auditor's professional judgment, a significant risk.

The determination of which of the assessed risks of material misstatement are close to the upper end of the spectrum of inherent risk, and are therefore significant risks, is a matter of professional judgment, unless the risk is of a type specified to be treated as a significant risk as set out below.

Being close to the upper end of the spectrum of inherent risk will differ from entity to entity, and will not necessarily be the same for an entity period on period. It may depend on the nature and circumstances of the entity for which the risk is being assessed.

- 6.5.4. In exercising professional judgment as to which assessed risks are significant risks, the auditor shall consider at least the following:
- (a) Whether the risk is a risk of fraud (for example, because of management override of controls or a presumed risk of fraud such as in revenue recognition).
 - (b) Whether the risk involves significant transactions with related parties.
 - (c) How, in the case of accounting estimates, the inherent risk factors, such as the complexity of transactions and the degree of subjectivity in the measurement of financial information related to the risk, including those measurements involving a wide range of measurement uncertainty, have influenced the auditor's assessment on the spectrum of risk.
 - (d) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.
- 6.5.5. The auditor shall treat:
- (a) Identified fraud risks as significant risks; and
 - (b) Identified significant related party transactions outside the entity's normal course of business as giving rise to significant risks.

Assessing Control Risk

- 6.5.6. If the auditor plans to test the operating effectiveness of controls the auditor shall assess control risk, otherwise the risk of material misstatement is the same as the assessment of inherent risk.

Evaluation of the Procedures to Identify and Assess Risks of Material Misstatement and Revision of Risk Assessment

- 6.5.7. The auditor shall evaluate whether the audit evidence obtained from procedures to identify and assess the risks of material misstatement provides an appropriate basis for the identification and assessment of the risks of material misstatement. If not, the auditor shall perform additional procedures.
- 6.5.8. The auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained. In circumstances where the auditor obtains audit evidence from performing further audit procedures, or if new information is obtained, either of which is inconsistent with the audit evidence on which the auditor originally based the assessment, the auditor shall revise the assessment and modify the further planned audit procedures accordingly.

Evaluation of the Applicability of the ISA for LCE

- 6.5.9. The auditor's determination to use the ISA for LCE may change as additional audit evidence is obtained. The auditor shall determine whether the ISA for LCE continues to be appropriate for the nature and circumstances of the entity being audited in circumstances where audit evidence, or

new information, is obtained during risk identification and assessment procedures which is inconsistent with the auditor's original determination for using the ISA for LCE.

6.6. Specific Inquiries of Management and Those Charged with Governance

6.6.1. In performing procedures to identify and assess the risks of material misstatement due to fraud or error, the auditor shall make inquiries of management regarding:

- (a) Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments;
- (b) Management's process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist;
- (c) Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity;
- (d) Management's communication, if any, to employees regarding its views on business practices and ethical behavior;
- (e) The identity of the entity's related parties, including changes from the prior period; the nature of the relationships between the entity and these related parties; and whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions; and
- (f) Non-compliance with laws and regulations that may have a material effect on the financial statements, and inspecting correspondence, if any, with the relevant licensing or regulatory authorities.
- (g) Events or conditions that exist that individually, or collectively, may affect the ability of the entity to continue as a going concern.

6.6.2. The auditor shall make inquiries of management, those charged with governance (if different to management), and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity.



6.7. Specific Documentation Requirements

The form and extent of documentation may be simple and relatively brief, and is influenced by:

- *The nature, size and complexity of the entity and its internal control system.*
- *Availability of information from the entity.*
- *The audit methodology and technology used in the course of the audit.*

It is not necessary to document the entirety of the auditor's understanding of the entity and matters related to it, but rather apply the principles in paragraph 3.8.1 and the matters noted below.

6.7.1. In addition to the general documentation requirements (paragraphs 3.8.1–3.8.4.) for an audit of an LCE, the auditor shall include the following in the audit documentation:

- (a) Key elements of the understanding obtained regarding each of the aspects of the entity and its environment, the applicable financial reporting framework and the entity's internal control system;

Key elements of understanding documented by the auditor may include those on which the auditor based the assessment of risks of material misstatement.

- (b) The names of the identified related parties (including changes from prior period), the nature of the related party relationships, and whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions;
- (c) The identified and assessed risks of material misstatement, including risks due to fraud, at the financial statement level and at the assertion level, including significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made;

The auditor is required to take into account the inherent risk factors when identifying and assessing the risks of material misstatement. However, the auditor is not required to document how every inherent risk factor was taken into account in relation to each class of transaction, account balance or disclosure.

- (d) If applicable, the reasons for the conclusion that there is not a risk of material misstatement due to fraud related to revenue recognition.
- (e) The controls set out in paragraph 6.3.13. and the evaluation whether the control is designed effectively and determination whether the control has been implemented;
- (f) For accounting estimates, key elements of the auditor's understanding of the accounting estimates, including controls as appropriate, the linkage of the assessed risks of material misstatements to the auditor's further procedures, and any indicators of management bias and how those were addressed; and
- (g) Identified or suspected non-compliance with laws and regulations and the results of discussion with management and, where applicable, those charged with governance and parties outside the entity.



7. Responding to Assessed Risks of Material Misstatement

Content of this Part

Part 7 contains content related to the:

- Design and implementation of an overall responses that are appropriate to assessed risks of material misstatement at the financial statement level;
- Design and implementation of responses that are appropriate to the assessed risks of material misstatement at the assertion level (i.e., design and performance of further audit procedures). These further procedures include substantive procedures (tests of detail and substantive analytical procedures) and tests of control (as appropriate), and each is expanded on in this Part; and
- Procedures for specific topics when responding to assessed risks of material misstatement.

Scope of this Part

This Part sets out the specific requirements for obtaining audit evidence through responding to assessed risks of material misstatement. Part 2 sets out the broad requirements for audit evidence, as well as the types of procedures that may be used in the audit. In complying with the requirements in this Part, the auditor may find it useful to refer to the following paragraphs that set out relevant matters:

- Analytical procedures – see paragraph 3.3.2.
- Audit sampling – see paragraph 3.3.3.
- External confirmations – see paragraph 3.3.4.
- Considerations with regard to laws and regulations – see paragraphs 3.5.1. to 3.5.2.

7.1. Objectives

7.1.1. The objectives of the auditor are to:

- (a) Obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement (the assessed risks), through designing and implementing appropriate responses to those risks;
- (b) Respond, as appropriate, to risks of material misstatement arising from fraud;
- (c) Obtain sufficient appropriate audit evidence regarding management's use of the going concern assumption and related disclosures; and
- (d) To respond to instances of non-compliance with laws and regulations that may have a material effect on the financial statements.

7.2. Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Financial Statement Level

7.2.1. The auditor shall design and implement overall responses to address the assessed risks of material misstatement (i.e., assessed risks) at the financial statement level, whether due to fraud or error.

The auditor's overall responses at the financial statement level, for example, making general changes to the nature, timing or extent of audit procedures, or adjustments to resources assigned

or using experts, are based on those risks that relate pervasively to the financial statements as a whole. These may include, for example, risks arising from industry, regulatory and other external factors, or matters related broadly to the entity's basis of accounting or accounting policies.

In particular, the auditor's overall responses also are influenced by the auditor's understanding of the control environment. The control environment provides a foundation for the operation of the other components of the entity's internal control system. The control environment does not directly prevent, or detect and correct, misstatements. It may, however, influence the effectiveness of controls in the other components of the entity's internal control system. Therefore, an effective control environment may allow the auditor to have more confidence in internal control and the reliability of audit evidence generated internally within the entity. Deficiencies that have been identified in the control environment when obtaining an understanding of the entity's internal control system, however, have the opposite effect and may result in the need for more extensive audit evidence from substantive procedures. A weak control environment also impacts the work that may be undertaken at an interim period.

7.2.2. In determining overall responses to address assessed risks of material misstatement, due to fraud or error, at the financial statement level, the auditor shall:

- (a) Assign and supervise personnel taking account of the knowledge, skill and ability of the individuals to be given significant engagement responsibilities and the auditor's assessment of the risks of material misstatement due to fraud or error for the engagement;
- (b) Evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements, may be indicative of errors or fraudulent financial reporting resulting from management's effort to manage earnings; and
- (c) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures.

7.3. Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level

7.3.1. The auditor shall design and perform further audit procedures whose nature, timing and extent are based on, and responsive to, assessed risks, whether due to fraud or error, at the assertion level.



Further audit procedures are responsive to the assessed risk of material misstatement at the assertion level, and provide a clear linkage between the auditor's further procedures and the risk assessment. If the assessed risks of material misstatement are due to fraud risks at the assertion level, the nature timing and extent of audit procedures may need to be changed to obtain audit evidence that is more reliable and relevant or to obtain additional corroborative information.

7.3.2. In designing the further audit procedures, the auditor shall:

- (a) Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each significant class of transactions, account balance, or disclosure, including:
 - (i) The likelihood and magnitude of misstatement due to the characteristics of the significant class of transactions, account balance, or disclosure (that is, the inherent risk); and

- (ii) Whether the risk assessment takes account of controls that address the risk of material misstatements (that is, the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (where the auditor plans to test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures);
- (b) Obtain more persuasive audit evidence the higher the auditor's assessment of risk;
- (c) In designing and performing tests of control, obtain more persuasive audit evidence the greater the reliance the auditor places on the operating effectiveness of controls; and
- (d) Design and perform tests of controls if the auditor intends to rely on the operating effectiveness of controls or substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

In an audit of an LCE, there may not be many controls that could be identified by the auditor, or the extent to which their existence or operation have been documented by the entity may be limited. In such cases, it may be more efficient for the auditor to perform further audit procedures that are primarily substantive procedures.

When obtaining more persuasive audit evidence because of a higher assessment of risk, the auditor may increase the quantity of the evidence, or obtain evidence that is more relevant or reliable, for example, by placing more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources.

- 7.3.3. The auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements.

Tests of Controls

- 7.3.4. If the auditor is planning to place reliance on the effectiveness of controls, the auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of such controls. If the control is a control over a significant risk, the auditor shall test the control in the current period.
- 7.3.5. When performing test of controls, the auditor shall perform audit procedures in combination with inquiry to obtain audit evidence about controls, including:
- (a) How the controls were applied at relevant times during the period;
 - (b) The consistency with which they were applied; and
 - (c) By whom and what means they were applied.
- 7.3.6. The auditor shall determine whether the controls to be tested depend on other controls, and if so, consider whether it is necessary to obtain evidence about the effective operation of the other controls.
- 7.3.7. If deviations from controls, upon which the auditor intends to rely, are detected, the auditor shall make specific inquiries to understand deviations and the potential consequences, including whether the tests of controls provide an appropriate basis for reliance on the controls.

Substantive Procedures

- 7.3.8. Irrespective of the assessed risks, substantive procedures shall be performed for each material class of transactions, account balance, and disclosure.
- 7.3.9. The auditor's substantive procedures shall include audit procedures related to the financial statement closing process, including:
- (a) Agreeing or reconciling information in the financial statements with the underlying accounting records, including agreeing or reconciling information in disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers; and
 - (b) Examining material journal entries and other adjustments made during the course of preparing the financial statements.
- 7.3.10. The auditor's substantive procedures shall include substantive procedures specifically responsive to significant risks. When the response to a significant risk consists only of substantive procedures, those procedures shall include tests of detail.

7.4. Specific Focus Areas

Going Concern

In many cases, the management of less complex entities may not have prepared a detailed assessment of the entity's ability to continue as a going concern, but instead may rely on in-depth knowledge of the business and anticipated future prospects. Nevertheless, in accordance with the requirements of this Part, the auditor evaluates management's assessment of the entity's ability to continue as a going concern. For less complex entities, it may be appropriate to discuss the medium and long-term financing of the entity with management, provided that management's contentions can be corroborated by sufficient documentary evidence and are not inconsistent with the auditor's understanding of the entity.

- 7.4.1. The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern. In doing so, the auditor shall cover the same period as used by management. If that period is less than twelve months from the date of the financial statements, the auditor shall ask management to extend the period. If management does not make or extend its assessment, the auditor shall consider the implications for the auditor's report (for example, a qualified opinion or disclaimer of opinion may be appropriate because the auditor is unable to obtain sufficient appropriate audit evidence).

The auditor also remains alert to the possibility that there are known events, scheduled or otherwise, or conditions that will occur beyond the period of assessment used by management that may bring into question management's use of the going concern basis of accounting in preparing the financial statements. The further into the future the events or conditions are, the more significant the going concern issues need to be before the auditor takes further action. If events or conditions that may cast significant doubt on the entity's ability to continue as a going concern are identified after the auditor's risk assessments are made, the auditor's assessment of the risks of material misstatement may need to be revised.

- 7.4.2. In evaluating management's assessment, the auditor shall consider whether management's assessment includes all relevant information of which the auditor is aware.

- 7.4.3. The auditor shall inquire of management as to its knowledge of events or conditions beyond the period of management's assessment that may cast significant doubt on the entity's ability to continue as a going concern.
- 7.4.4. If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional procedures, including consideration of mitigating factors (a "material uncertainty" relates to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern).

A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary for the fair presentation of the financial statements.

Management Override of Controls

- 7.4.5. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and therefore a significant risk.
- 7.4.6. Irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to:
- (a) Test the appropriateness of manual and automated journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.
 -  (b) Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud.
 - (c) For significant unusual transactions, evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.

Material misstatement of financial statements due to fraud often involves the manipulation of the financial reporting process by recording inappropriate or unauthorized journal entries. This may occur throughout the year or at period end, or both, or by management making adjustments to amounts reported in the financial statements that are not reflected in journal entries, such as through reclassifications.

Related Parties

- 7.4.7. The auditor shall design and perform further audit procedures to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions.
- 7.4.8. For identified arrangements or information that suggests the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor, the auditor shall:
- (a) Determine whether the underlying circumstances confirm the existence of those relationships or transactions;

- (b) Promptly communicate the relevant information to the other members of the engagement team;
 - (c) Where the applicable financial reporting framework establishes related party requirements:
 - (i) Request management to identify all transactions with the newly identified related parties for the auditor's further evaluation;
 - (ii) Inquire as to why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions;
 - (d) Perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions;
 - (e) Reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclosed to the auditor, and perform additional audit procedures as necessary; and
 - (f) If the non-disclosure by management appears intentional (and therefore indicative of a risk of material misstatement due to fraud), evaluate the implications for the audit.
- 7.4.9. For significant related party transactions outside of the entity's normal course of business the auditor shall inspect the underlying contracts or agreements, if any, and evaluate whether:
- (a) The business rationale (or lack thereof) for significant of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets;
 - (b) The terms of transactions are consistent with management's explanations; and
 - (c) The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.
- 7.4.10. If management has made an assertion in the financial statements to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, the auditor shall obtain sufficient appropriate audit evidence about the assertion.

Accounting Estimates

- 7.4.11. The auditor's further audit procedures on an accounting estimate shall include one or more of the following approaches:
- (a) Obtaining audit evidence from events occurring up to the date of the auditor's report. In doing so, the auditor shall consider any changes in circumstances and other relevant conditions between the event and the measurement date that may affect the relevance of such evidence;
 - (b) Testing how management made the accounting estimate. In doing so, the auditor shall consider:
 - (i) Whether the method selected is appropriate;
 - (ii) Significant assumptions and the data used by management, and whether judgments give rise to indicators of management bias;



(iii) Whether calculations are mathematically accurate and whether judgements have been applied consistently; or

(c) Developing an auditor's point estimate or range. In doing so, the auditor shall determine that the range includes only amounts that are supported by sufficient appropriate audit evidence and have been evaluated by the auditor to be reasonable in the context of the circumstances of the entity and the applicable financial reporting framework.

7.4.12. The auditor shall design and perform further audit procedures to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement at the assertion level for disclosures related to an accounting estimate.

Inventory

7.4.13. If inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

(a) Attendance at physical inventory counting, unless impracticable, to:

- (i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
- (ii) Observe the performance of management's count procedures;
- (iii) Inspect the inventory; and
- (iv) Perform test counts; and

(b) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

7.4.14. If the auditor has not attended the inventory count, the auditor shall make or observe some physical counts on an alternative date, and perform audit procedures on intervening transactions. If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory, or determine the effect on the auditor's report.

In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. In some cases where attendance is impracticable, alternative audit procedures, for example, inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory. In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, the auditor is required to modify the opinion in the auditor's report as a result of the scope limitation.

Litigation and Claims

7.4.15. The auditor shall design and perform further audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:

(a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;

- (b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
- (c) Reviewing legal expense accounts.

Audit Procedures When Non-Compliance with Laws and Regulations is Identified or Suspected

- 7.4.16. If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall:
- (a) Understand the nature and circumstances, and any further information necessary to evaluate the possible effect on the financial statements;
 - (b) Discuss the non-compliance with management, and where appropriate, those charged with governance, unless prohibited to do so by law and regulation;
 - (c) If sufficient information is not provided with regard to the non-compliance or suspected non-compliance:
 - (i) Using professional judgment, consider the need for legal advice;
 - (ii) Evaluate the effect of the lack of appropriate audit evidence on the auditor's opinion; and
 - (d) Evaluate the implications on other aspects of the audit, including the auditor's risk assessment and the reliability of written representations.

Using the Services of a Service Organization

- 7.4.17. If the entity is using the services of a service organization, the auditor shall:
- (a) Determine whether sufficient appropriate audit evidence concerning the relevant financial statement assertions is available at the entity; and, if not,
 - (b) Perform further audit procedures to obtain sufficient appropriate audit evidence or use another auditor to perform those procedures at the service organization on the auditor's behalf.

7.5. Specific Communication Requirements

7.5.1. The auditor shall communicate:

-  (a) In writing, significant deficiencies in the entity's internal control system identified during the audit to those charged with governance on a timely basis.
- (b) With management, on a timely basis, matters that have been communicated to those charged with governance and other deficiencies that have not been communicated but are of sufficient importance to merit management's attention.

The communication of other deficiencies in internal control that merit management's attention need not be in writing but may be oral.

- 7.5.2.  Where the communications are in writing, the auditor shall include a description and explanation of the potential impact of the deficiencies, and sufficient information to describe the auditor's work and responsibilities in relation to those deficiencies.

- 7.5.3. In communicating with management and those charged with governance, the auditor shall consider the matters, if any, to communicate regarding accounting estimates, taking into account the reasons given to the risks of material misstatement relate to estimation uncertainty, or the effects of complexity, subjectivity or other inherent risk factors in making accounting estimates and related disclosures.



7.6. Specific Documentation Requirements

- 7.6.1. In addition to the general documentation requirements (paragraphs 3.8.1.–3.8.4.) for an audit engagement, the auditor shall include the following in the audit documentation:
- (a) The overall responses to the assessed risks of material misstatement at the financial statement level;
 - (b) The nature, timing and extent of further audit procedures performed in response to risks of material misstatement at the assertion level;
 - (c) The linkage between the procedures performed and the assessed risks at the assertion level;
 - (d) The results of the audit procedures, including the conclusions where these are not otherwise clear, and
 - (e) The results of audit procedures designed to address the risk of management override of controls.
- 7.6.2. Where the assessed risk of material misstatement is due to fraud, the auditor's documentation shall include the specific fraud response.
- 7.6.3. Where the auditor has identified or suspected non-compliance with laws and regulations, the auditor shall document the audit procedures performed, the significant professional judgments made and the conclusions reached thereon.
- 7.6.4. For accounting estimates, the auditor shall include key elements of the auditor's understanding of the accounting estimates, including controls as appropriate, the linkage of the assessed risks of material misstatements to the auditor's further procedures, and any indicators of management bias and how those were addressed.



8. Concluding

Content of this Part

Part 8 sets out the requirements for the:

- Auditor's evaluations as to whether sufficient appropriate audit evidence has been obtained, including for relevant assertions, and other activities, to be able to conclude.
- Auditor's conclusion about management's use of the going concern assumption and related disclosures.
- Corrected and uncorrected misstatements identified during the audit.
- The auditor's consideration of the effect of subsequent events.
- Other concluding activities, including obtaining written representations and performing concluding analytical procedures.

Scope of this Part

The conclusions reached and evaluations performed will form the basis for the auditor's opinion in Part 9.

8.1. Objectives

8.1.1. The objectives of the auditor are to:

- (a) Evaluate the effect of identified misstatements on the audit and the effect of any uncorrected misstatements on the financial statements;
- (b) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and
- (c) Conclude on whether sufficient appropriate audit evidence has been obtained on which to base the auditor's opinion.

8.2. The Auditor's Evaluations and Other Activities to Support the Auditor's Conclusion

8.2.1. Based on the audit procedures performed and the audit evidence obtained, the auditor shall evaluate whether the assessments of the risks of material misstatement at the financial statement and assertion levels remain appropriate.

8.2.2. The auditor shall evaluate, based on the audit procedures performed and audit evidence obtained, whether:

(a) In respect of accounting estimates:



- (i) The assessments of the risks of material misstatement at the assertion level remain appropriate, including when indicators of possible management bias have been identified;
- (ii) Management's decisions relating to the recognition, measurement, presentation and disclosure of accounting estimates in the financial statements are reasonable

in the context of the applicable financial reporting framework (including for a fair presentation framework, whether disclosures beyond those that are required but are necessary to achieve fair presentation of the financial statements as a whole have been provided); and

- (iii) Sufficient appropriate audit evidence has been obtained.
 - (b) In respect of using the work of an auditor's expert, if applicable, the work is adequate for the purpose of the audit, including relevance and reasonableness of the expert's findings or conclusions, and consistency with other audit evidence. If the auditor determines that the work of the auditor's expert is not adequate for the purpose of the audit, the auditor shall perform additional audit procedures or agree with the auditor's expert on further procedures.
 - (c) With respect to the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, sufficient appropriate audit evidence has been obtained.
 - (d) Adequate two-way communication between the auditor and those charged with governance occurred. If it has not, the auditor shall evaluate the effect, if any, and take action as appropriate (for example, revising the original risk assessments, modifying the auditor's opinion on the basis of a scope limitation or other actions as appropriate).
 - (e) The results of the external confirmation procedures provide relevant and reliable audit evidence, or whether further audit evidence is necessary.
- 8.2.3. If the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud, the auditor shall evaluate the implications on the audit including on the assessed risks of material misstatement and the auditor's report.
- 8.2.4. If an objective of a particular Part within the ISA for LCE cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby require the auditor to modify the audit opinion.

Concluding

- 8.2.5. The auditor shall conclude whether sufficient appropriate audit evidence has been obtained. In forming an opinion, the auditor shall consider all relevant audit evidence, regardless of whether it appears to be corroborative or contradictory to other information obtained.
- 8.2.6. If the auditor has not obtained sufficient appropriate audit evidence as to a relevant assertion, the auditor shall attempt to obtain additional audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements.
- 8.2.7. Based on the audit evidence obtained, the auditor shall conclude whether, in the auditor's professional judgment, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.
- 8.2.8. The auditor shall conclude on management's use of the going concern basis of accounting.

- 8.2.9. The auditor shall perform audit procedures to evaluate whether the overall presentation of the financial statements is in accordance with the applicable financial reporting framework. In making this evaluation, the auditor shall consider whether the financial statements are presented in a manner that reflects the appropriate:
- (a) Classification and description of financial information and the underlying transactions, events and conditions; and
 - (b) Presentation, structure and content of the financial statements

8.3. Evaluation of Misstatements Identified During the Audit

- 8.3.1. The auditor shall accumulate misstatements identified, other than those that are clearly trivial, throughout the audit.

Misstatements that are clearly trivial will be of a wholly different (smaller) order of magnitude, or of a wholly different nature than those that would be determined to be material, and will be misstatements that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any criteria of size, nature or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the misstatement is considered not to be clearly trivial.

- 8.3.2. If the auditor identifies a misstatement during the audit, the auditor shall evaluate whether the misstatement is indicative of fraud. If there is such an indication, the auditor shall determine the implications on other aspects of the audit, including on the identified and assessed risks of material misstatement and the reliability of management representations.
- 8.3.3. If the auditor identifies a misstatement that may be the result of fraud, and suspects that management is involved, the auditor shall:
- (a) Reevaluate the risks of material misstatement due to fraud and the auditor's responses thereto; and
 - (b) Consider whether circumstances or conditions indicate possible collusion involving employees, management or third parties when reconsidering the reliability of evidence previously obtained.

The implications of identified fraud depend on the circumstances. For example, an otherwise insignificant fraud may be significant if it involves senior management. In such circumstances, the reliability of evidence previously obtained may be called into question, since there may be doubts about the completeness and truthfulness of representations made and about the genuineness of accounting records and documentation. There may also be a possibility of collusion involving employees, management or third parties.

- 8.3.4. The auditor shall determine the impact of identified misstatements on the identification and assessment of risks of material misstatement, and whether changes need to be made if the nature and circumstances of their occurrence indicate that other misstatements may exist, or the identified misstatements accumulated during the audit approach materiality.
- 8.3.5. The auditor shall request management to correct all misstatements accumulated during the audit. If management has examined a class of transactions, account balance or disclosure and corrected identified misstatements, the auditor shall perform additional procedures to determine whether misstatements remain.

- 8.3.6. The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate by
- (a) Reassessing materiality to confirm whether it remains appropriate in the context of the entity's actual financial results;
 - (b) Considering the:
 - (i) Size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence; and
 - (ii) Effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

8.4. Analytical Procedures that Assist When Forming an Overall Conclusion

- 8.4.1. The auditor shall design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity, including any indications of a previously unrecognized risk of material misstatement arising from fraud.

8.5. Subsequent Events

Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Such financial reporting frameworks ordinarily identify two types of events:

- (a) *Those that provide evidence of conditions that existed at the date of the financial statements; and*
 - (b) *Those that provide evidence of conditions that arose after the date of the financial statements.*
- 8.5.1. The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.
- 8.5.2. The auditor shall perform procedures to cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto, including:
- (a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
 - (b) Inquire of management, and where appropriate, those charged with governance, as to whether any subsequent events have occurred that may affect the financial statements.
 - (c) Reading minutes of meetings held after the balance sheet date.
- 8.5.3. If the auditor has identified events that require or adjustment in terms of the entity's applicable financial reporting framework, the auditor shall determine whether each such event is appropriately reflected in the financial statements.

8.5.4. The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report or after the financial statements have been issued. However, if the auditor becomes aware of facts or events that may have an effect on the auditor's report:

- (a) After the date of the auditor's report but before the financial statements are issued, or
- (b) After the financial statements have been issued,

the auditor shall discuss the matter with management and those charged with governance where applicable, determine whether the financial statements need amendment and inquire how management intends to address the amendment needed.

8.6. Written Representations

Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. However, although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.

8.6.1. The auditor shall request written representations from management, having appropriate knowledge of the matters concerned and responsibility for the financial statements, and where applicable those charged with governance:

- (a) That it has fulfilled its responsibility for the preparation of the financial statement in accordance with the applicable financial reporting framework;
- (b) That it has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement;²
- (c) That all transactions are recorded and are reflected in the financial statements;
- (d) That it acknowledges its responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud;
- (e) That it has disclosed to the auditor the result of its assessment of the risk that the financial statements may be materially misstated because of fraud;
- (f) That it has disclosed to the auditor their knowledge if fraud, or suspected fraud, or allegations of fraud or suspected fraud;
- (g) It has disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which it is aware;
- (h) It has appropriately accounted for and disclosed related party relationships and transactions in accordance with the requirements of the financial reporting framework;
- (i) That all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to the auditor.

² The management representation shall be described in the same way as described in the terms of engagement.

- (j) That all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.
 - (k) With regard to accounting estimates, whether the methods, significant assumptions and data used in making the accounting estimates and disclosures are appropriate to achieve recognition, measurement or disclosure is in accordance with the applicable financial reporting framework;
 - (l) That all events occurring subsequent to date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed;
 - (m) With regard to going concern, if a material uncertainty exists, information about their plans for future actions and the feasibility of these plans; and
 - (n) Other representations the auditor determines necessary to support other audit evidence in the financial statements, including where necessary to support oral representations.
- 8.6.2. The written representation shall be in the form of a representation letter addressed to the auditor. Appendix 5 sets out an example management representation letter.
- 8.6.3. If managements' responsibilities are clearly defined in law and regulation, the auditor may determine not to obtain written representation about those matters already addressed.
- 8.6.4. The auditor shall request a written representation from management, and where appropriate those charged with governance, whether they believe the effects of uncorrected misstatements are immaterial, individually or in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation.
- 8.6.5. If the auditor has concerns about the reliability of management's representations, or representations are inconsistent with other audit evidence, the auditor shall determine the effect on audit evidence more generally and take appropriate actions, including the possible effect on the opinion in the auditor's report.
- 8.6.6. If management does not provide one or more of the requested written representations, the auditor shall:
- (a) Discuss the matter with management.
 - (b) Reevaluate the integrity of management and evaluate the effect this may have on the reliability of oral and written representations and audit evidence in general; and
 - (c) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report.
- 8.6.7. The date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements.

8.7. Taking Overall Responsibility for Managing and Achieving Quality

8.7.1. Prior to dating the auditor's report, the engagement partner shall determine that:

- (a) There has been sufficient and appropriate involvement by the engagement partner such that significant judgments made and conclusions reached are appropriate given the nature and circumstances of the engagement.
- (b) Overall responsibility for managing and achieving quality on the audit engagement has been taken.

8.7.2. Prior to dating the auditor's report, the engagement partner shall review the financial statements and the auditor's report to determine that the auditor's report being issued is appropriate in the circumstances. If key audit matters are voluntarily presented, the engagement partner's review shall include reviewing the description of the key audit matters and related audit documentation.

8.8. Specific Communication Requirements

8.8.1. The auditor shall communicate all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation and request management to correct the misstatements.

8.8.2. The auditor shall communicate to those charged with governance:

- (a) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.
- (b) Significant difficulties, if any, encountered during the audit.
- (c) Significant matters arising during the audit that were discussed, or subject to correspondence, with management.
-  (d) Significant findings from the audit. If, in the auditor's professional judgment, oral communications would not be adequate this communication shall be in writing.
- (e) Any other matters, not already reported, related to fraud that may be relevant to the responsibilities of those charged with governance, unless prohibited by law or regulation.
- (f) Identified or suspect non-compliance with laws or regulations with relevance for the audit, unless prohibited by law or regulation. If the matter is intentional; and material, this shall be communicated as soon as practicable.
- (g) Circumstances, if any, that affect the form and content of the auditor's report.
- (i) Written representations the auditor is requesting.
- (j) Any other significant matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

8.8.3. The auditor shall communicate significant matters arising during the audit in connection with the entity's related parties and any other related matters discussed with management (as relevant).

8.8.4. In regard to uncorrected misstatements, the auditor shall communicate:

- (a) Uncorrected misstatements (identified individually) and the effect that they, individually or in aggregate, may have on the auditor's opinion, unless prohibited by law or regulation.

- (b) The effect of uncorrected misstatements from prior periods on the current year financial statements.

8.8.5. The auditor shall communicate events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:

- (a) Whether the events or conditions constitute a material uncertainty;
- (b) Whether management's use of the going concern basis of accounting is appropriate in the preparation of the financial statements;
- (c) The adequacy of related disclosures in the financial statements; and
- (d) Where applicable, the implications for the auditor's report.



8.9. Specific Documentation Requirements

8.9.1. In addition to the audit documentation requirements (paragraphs 3.8.1.–3.8.4.) for an audit engagement, the auditor shall include the following in the audit documentation:

- (a) Demonstration that information in the financial statements agrees or reconciles with the underlying accounting records, including disclosures.
- (b) The amount below which misstatements would be regarded as clearly trivial, all misstatements accumulated during the audit and the auditor's conclusion on the uncorrected misstatements.
- (c) The nature and scope of, and conclusions from, consultations undertaken during the audit, including how such conclusions were implemented.
- (d) If, in exceptional circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the auditor shall document:
 - (i) The circumstances encountered;
 - (ii) The new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor's report; and
 - (iii) When and by whom the resulting changes to audit documentation were made and reviewed.

8.9.2. The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.

An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report. The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions. Changes may, however, be made to the audit documentation during the final assembly process if they are administrative in nature.

8.9.3. After assembly of the final audit file is complete, the auditor shall not remove audit documentation of any nature before the end of its retention period (for example, a period of 5 years).

- 8.9.4. If applicable, the auditor shall document the failure to meet an objective of any Part of the ISA for LCE, and the resulting action (such as the effect on the auditor’s opinion or withdrawal from the engagement if the overall objective of the auditor cannot be met).
- 8.9.5. If the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the assembly of the final audit file has been completed, the auditor shall, regardless of the nature of the modifications or additions, document:
- (a) The specific reasons for making them; and
 - (b) When and by whom they were made and reviewed.

9. Forming an Opinion and Reporting

Content of this Part

Part 9 sets out the requirements for:

- Forming an opinion;
- The types of audit opinions; and
- The content of the auditor's report.

Scope of this Part

Appendix 6 sets out an example auditor's report. Examples of modified opinions and other matter paragraphs can be found in [the supporting guide]. Further detailed examples of auditor's reports can be found in the 700-series in the International Standards on Auditing.

9.1. Objectives

9.1.1. The objectives of the auditor are to:

- (a) Form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained and to express clearly that opinion through a written report; and
- (b) Consider whether there is a material inconsistency between the other information, if any, and the financial statements as well as the auditor's knowledge obtained in the audit and respond appropriately.

9.2. Forming an Opinion on the Financial Statements

9.2.1. The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

9.2.2. In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion takes into account:

- (a) Whether sufficient appropriate audit evidence has been obtained;
- (b) Whether uncorrected misstatements, individually or in aggregate are material; and
- (c) The evaluations required by paragraphs 9.2.3. to 9.2.6.

9.2.3. In order to conclude, the auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

9.2.4. In performing the evaluation in paragraph 9.2.3., the auditor shall evaluate, in view of the applicable financial reporting framework:

- (a) Whether the financial statements disclose the entity's significant accounting policies, and whether they have been presented in an understandable way;

- (b) Whether the entity's accounting policies are applied consistently and are appropriate;
- (c) The accounting estimates made by management are reasonable;
- (d) Whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework;
- (e) The information presented in the financial statements is relevant reliable, comparable and understandable;
- (f) Whether the financial statements provide adequate disclosures to enable intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and
- (g) The terminology used in the financial statements is appropriate.

9.2.5. If the financial statements are prepared in accordance with a fair presentation framework, the auditor shall also evaluate whether the financial statements achieve fair presentation.

Some financial reporting frameworks acknowledge explicitly or implicitly the concept of fair presentation. A fair presentation financial reporting framework not only requires compliance with the requirements of the framework, but also acknowledges explicitly or implicitly that it may be necessary for management to provide disclosures beyond those specifically required by the framework. The auditor's evaluation about whether the financial statements achieve fair presentation, both in respect of presentation and disclosure, is a matter of professional judgment.

9.2.6. The auditor shall evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework.

9.3. Form of Opinion

9.3.1. The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

9.3.2. If the auditor concludes that the financial statements are not free from material misstatement, or is unable to obtain sufficient appropriate audit evidence, the auditor shall modify the auditor's opinion.

9.3.3. If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, determine whether it is necessary to modify the auditor's opinion.

9.4. Auditor's Report

9.4.1. The auditor's report shall be in writing and³:



- (a) Have a title that clearly indicates that it is the report of an independent auditor.

³ Depending on regulatory requirements there might be additional reporting requirements, such as;

- express an opinion on:
 - whether the management report is consistent with the financial statements, and
 - whether the management report has been prepared in accordance with the applicable legal requirements;

- (b) Identify the entity whose financial statements have been audited; identify each financial statement, notes and significant accounting policies and the date and period covered; and identify the financial reporting framework that has been applied in the preparation;
- (c) Include a description of the scope of the audit which identifies the audit was conducted in accordance with the ISA for LCE.
- (d) Include a statement that the auditor is independent of the entity in accordance with relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
- (e) Include a section describing managements responsibilities for preparing the financial statements in accordance with the applicable financial reporting framework, and assessing the entity's ability to continue as a going concern and use of the going concern basis of accounting;
- (f) Include a section describing the auditor's responsibilities for the audit of the financial statements;
- (g) State whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.
- (h) Express an opinion, which shall be either unqualified, qualified or an adverse opinion and state clearly the opinion as to:
 - (i) Whether the financial statements give a true and fair view in accordance with the relevant financial reporting framework, or
 - (ii) Whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework; and,
 - (iii) Where appropriate, whether the financial statements comply with statutory requirements.
- (i) Be signed and dated, and identify the place of establishment of the statutory auditor(s) or the audit firm(s). The auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.

Paragraphs (e) – (g) above may be presented in the Appendix to the auditor's report. Appendix 6 sets out an example auditor's report.

9.4.2. The auditor's report shall include:

- (a) The auditor's opinion and the basis for the auditor's opinion; and
- (b) If there is other information in the entity's annual report, and the auditor has obtained some or all of the information, a separate section with a heading "other information."

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- if applicable, state whether, in the light of the knowledge and understanding of the undertaking and its environment obtained in the course of the audit, he, she or it has identified material misstatements in the management report, and shall give an indication of the nature of any such misstatements.

- 9.4.3. When the financial statements are prepared in accordance with a fair presentation framework, the description of responsibilities for the financial statements in the auditor’s report shall refer to “the preparation and fair presentation of these financial statements” or “the preparation of financial statements that give a true and fair view,” as appropriate in the circumstances.
- 9.4.4. If key audit matters are voluntarily described in the auditor’s report, the auditor shall apply the requirements of ISA 701.⁴

9.5. Modified Opinions

<i>Nature of Matter Giving Rise to the Modification</i>	<i>Auditor’s Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements</i>	
	<i>Material but Not Pervasive</i>	<i>Material and Pervasive</i>
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

- 9.5.1. When modifying the opinion, the auditor shall provide:
- (a) A qualified opinion when the auditor:
 - (i) Having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements;
 - (ii) Is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive. or
 - (iii) In the auditor’s professional judgment management’s use of the going concern basis of accounting in the preparation of the financial statements is appropriate in the circumstances but a material uncertainty exists that is not adequately disclosed in the financial statements.
 - (b) An adverse opinion when the auditor concludes that:
 - (i) Misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
 - (ii) In the auditor’s professional judgment managements use of the going concern basis of accounting in the preparation of the financial statement is inappropriate.
 - (c) A disclaimer of opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to form an audit opinion, and the auditor concludes that the possible

⁴ ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

Other Circumstances Where a Modification is Required

- 9.5.2. If the auditor identifies or suspects non-compliance with laws and regulations that have a material effect on the financial statements:
- (a) If the auditor concludes that the non-compliance with laws and regulations has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion;
 - (b) If the auditor is precluded from obtaining sufficient appropriate audit evidence about whether the non-compliance has, or is likely to have occurred, the auditor shall express a qualified opinion or disclaim an opinion on the basis of a limitation on the scope of the audit; or
 - (c) If the auditor is unable to determine whether non-compliance has occurred because of limitations imposed by the circumstances rather than by management or those charged with governance, the auditor shall evaluate the effect on the auditor's opinion.

Content of the Auditor's Report When the Opinion Is Modified

- 9.5.3. When the auditor modifies the audit opinion, or expresses a qualified, adverse, or disclaimer of opinion, the auditor shall:
- (a) Amend the heading "Basis for Opinion" as appropriate.
 - (b) Within the basis of opinion section, include a description of the matter giving rise to the modification.
 - (c) Use a heading as appropriate for the modification (e.g., "qualified opinion").

Qualified Opinion

- 9.5.4. When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion section:
- (a) When reporting in accordance with a fair presentation framework, the accompanying financial statements present fairly, in all material respects (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or
 - (b) When reporting in accordance with a compliance framework, the accompanying financial statements have been prepared, in all material respects, in accordance with [the applicable financial reporting framework]. When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase "except for the possible effects of the matter(s) ..." for the modified opinion.

Adverse Opinion

- 9.5.5. When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion section:

- (a) When reporting in accordance with a fair presentation framework, the accompanying financial statements do not present fairly (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or
- (b) When reporting in accordance with a compliance framework, the accompanying financial statements have not been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

Disclaimer of Opinion

9.5.6. When the auditor disclaims an opinion, the auditor's report shall:

- (a) State that the auditor does not express an opinion on the accompanying financial statements;
- (b) Refer to any other matters or emphasis of matter paragraphs to which the auditor draw attention without qualifying the audit opinion;
- (c) Provide a statement on any material uncertainty relating to events or conditions that may cast significant doubt about the entity's ability to continue as a going concern;
- (d) State that, because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements;
- (e) Amend the statement which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements;

9.6. Other Paragraphs in the Auditor's Report

Emphasis of Matter Paragraphs

9.6.1. If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's professional judgment, is of such importance that it is fundamental to the users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report indicating that the auditor's report is not modified in respect of the matter emphasized.

Other Matter Paragraphs

9.6.2. If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's professional judgment, is relevant to the users' understanding of the audit, the auditor's responsibilities or the auditor's report the auditor shall include an Other Matter paragraph in the auditor's report provided this is not prohibited by law or regulation.

Material Uncertainty Related to Going Concern

9.6.3. If the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether adequate disclosure about a material uncertainty related to going concern is made, including management's plans to deal with the events and conditions, in the financial statements.

In such cases, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Relating to Going Concern, to:

- (a) Draw attention to the note in the financial statements that discloses the matters related to the material uncertainty; and
 - (b) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.
- 9.6.4. If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.
- 9.6.5. If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion.
- 9.6.6. If adequate disclosures are not made about the material uncertainty, the auditor shall qualify the audit opinion or issue an adverse opinion.

9.7. Comparative Information

- 9.7.1. The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework. In doing so, the auditor shall evaluate whether the amounts and disclosures in the prior period have been restated, and the accounting policies reflected in the comparative information are consistent with those applied in the current period.
- 9.7.2. If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists.

9.8. Other Information

"Other information" is financial or non-financial information (other than the financial statements and the auditor's report thereon) included in an entity's annual report.

- 9.8.1. The auditor shall determine, through discussion with management, which document(s) comprises the annual report, and the entity's planned manner and timing of the issuance of such document(s).
- 9.8.2. The auditor shall read the other information to consider whether there is a material inconsistency between the other information and the financial statements, or with the auditor's knowledge obtained in the audit. As the basis for this consideration, the auditor shall, to evaluate their consistency, compare selected amounts or other items in the other information (that are intended to be the same as, to summarize, or to provide greater detail about, the amounts or other items in the financial statements) with such amounts or other items in the financial statements.

In evaluating the consistency of selected amounts or other items, the auditor is not required to compare all amounts or other items in the other information that are intended to be the same as, or summarize, or to provide greater details about, the amounts or other items within the financial statements, with such amounts or other items in the financial statements.

9.8.3. If the auditor identifies that a material inconsistency appears to exist (or becomes aware that the other information appears to be materially misstated), the auditor shall discuss the matter with management and, if necessary, perform other procedures to conclude whether:

- (a) A material misstatement of the other information exists;
- (b) A material misstatement of the financial statements exists; or
- (c) The auditor's understanding of the entity and its environment needs to be updated.

 9.8.4. The auditor shall document the procedures performed in relation to other information.

FRAUD RISK FACTORS

The fraud risk factors set out below are examples of factors that may be faced by auditors during an audit of less complex entities in a broad range of situations. Separately presented are examples relating to the two types of fraud relevant to the auditor's consideration – that is, fraudulent financial reporting and misappropriation of assets. For each of these types of fraud, the risk factors are further classified based on the three conditions generally present when material misstatements due to fraud occur: (a) incentives/pressures, (b) opportunities, and (c) attitudes/rationalizations. Although the risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different risk factors. Not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in less complex entities of different sizes or with different ownership characteristics or circumstances. Also, the order of the examples of risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting

The following are examples of risk factors relating to misstatements arising from fraudulent financial reporting.

Incentives/Pressures

Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by):

- Significant declines in customer demand and increasing business failures in either the industry or overall economy.
- Operating losses making the threat of bankruptcy or foreclosure.
- Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth.
- Rapid growth or unusual profitability especially compared to that of other companies in the same industry.

Information available indicates that the personal financial situation of management or those charged with governance is threatened by the entity's financial performance arising from the following:

- Significant financial interests in the entity.
- Personal guarantees of debts of the entity.

Opportunities

The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

- Related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm.

The monitoring of management is not effective as a result of the following:

- Domination of management by a single person or small group (in a non owner-managed business) without compensating controls.

- Oversight by those charged with governance over the financial reporting process and internal control is not effective.

Internal control components are deficient as a result of the following:

- Inadequate monitoring of controls.
- High turnover rates or employment of staff in accounting.
- Accounting and information systems that are not effective, including situations involving significant deficiencies in internal control.

Attitudes/Rationalizations

- Communication, implementation, support, or enforcement of the entity's values or ethical standards by management, or the communication of inappropriate values or ethical standards, that are not effective.
- The owner-manager makes no distinction between personal and business transactions.
- Dispute between shareholders in a closely held entity.
- Recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality.
- The relationship between management and the current or predecessor auditor is strained, as exhibited by the following:
 - Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters.
 - Unreasonable demands on the auditor, such as unrealistic time constraints regarding the completion of the audit or the issuance of the auditor's report.
 - Restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with those charged with governance.
 - Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor's work or the selection or continuance of personnel assigned to or consulted on the audit engagement.

Risk Factors Arising from Misstatements Arising from Misappropriation of Assets

Risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists: incentives/pressures, opportunities, and attitudes/rationalization. Some of the risk factors related to misstatements arising from fraudulent financial reporting also may be present when misstatements arising from misappropriation of assets occur. For example, ineffective monitoring of management and other deficiencies in internal control may be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist. The following are examples of risk factors related to misstatements arising from misappropriation of assets.

Incentives/Pressures

Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.

Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:

- Known or anticipated future employee layoffs.
- Recent or anticipated changes to employee compensation or benefit plans.
- Promotions, compensation, or other rewards inconsistent with expectations.

Opportunities

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

- Large amounts of cash on hand or processed.
- Inventory items that are small in size, of high value, or in high demand.
- Fixed assets which are small in size, marketable, or lacking observable identification of ownership.

Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:

- Inadequate segregation of duties or independent checks.
- Inadequate oversight of senior management expenditures, such as travel and other re-imbursements.
- Inadequate record keeping with respect to assets.
- Inadequate system of authorization and approval of transactions (for example, in purchasing).
- Inadequate physical safeguards over cash, inventory, or fixed assets.
- Lack of mandatory vacations for employees performing key control functions.
- Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.

Attitudes/Rationalizations

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
- Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.
- Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
- Tolerance of petty theft.

ASSERTIONS

Assertions are representations, explicit or otherwise, with respect to the recognition, measurement, presentation and disclosure of information in the financial statements which are inherent in management representing that the financial statements are prepared in accordance with the applicable financial reporting framework. Assertions are used by the auditor to consider the different types of potential misstatements that may occur when identifying, assessing and responding to the risks of material misstatement.

In identifying and assessing the risks of material misstatement, the auditor of less complex entities (LCEs) may use the categories of assertions as described below or may express them differently provided all aspects described below have been covered. The auditor of LCEs may choose to combine the assertions about classes of transactions and events, and related disclosures, with the assertions about account balances, and related disclosures.

Auditors of LCEs may use the following assertions in considering the different types of potential misstatements that may occur. The assertions may fall into the following categories:

Assertions about classes of transactions and events, and related disclosures, for the period under audit:

- Occurrence—transactions and events that have been recorded or disclosed have occurred, and such transactions and events pertain to the entity.
- Completeness—all transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
- Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.
- Cutoff—transactions and events have been recorded in the correct accounting period.
- Classification—transactions and events have been recorded in the proper accounts.
- Presentation—transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

Assertions about account balances, and related disclosures, at the period end:

- Existence—assets, liabilities and equity interests exist.
- Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
- Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
- Accuracy, valuation and allocation—assets, liabilities and equity interests have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described.

- Classification—assets, liabilities and equity interests have been recorded in the proper accounts.
- Presentation—assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

The assertions described above, adapted as appropriate, may also be used by the auditor of LCEs in considering the different types of misstatements that may occur in disclosures not directly related to recorded classes of transactions, events or account balances.

BASIC ACCOUNTING ESTIMATES

The following sets out characteristics and typical examples of basic accounting estimates that may be found in an audit of an LCE:

Characteristics	Typical Examples in an LCE⁵
Processes relevant to accounting estimates may be uncomplicated because the business activities are simple or the required estimates may have a lesser degree of estimation uncertainty.	Depreciation
Accounting estimate relates to frequently made accounting estimates	Allowance for doubtful debts or warranty provisions
An accounting estimate that is derived from an active market that generally provides available, reliable information	Impairment calculations where value in use is linked to an observable interest or currency rate Property, plant and equipment held at fair value (including investment property) where the fair value is determined in relation to observable information Valuation of marketable securities. Financial instruments such as interest rate swap, forward currency exchange contract, or a frequently traded equity security, share based payments
An accounting estimate that does not have a high degree of estimation uncertainty	Allowance for doubtful debts, inventory obsolescence, warranty provision, asset useful life, provisions (e.g., for leave pay), lease assets / liabilities, accounts payable or other liabilities measured using an amortized cost model
The model used to measure the accounting estimate is well-known or generally accepted	Measuring a call or put option (e.g., an interest rate swap) using, for example, Black-Scholes binomial option pricing, and Monte-Carlo simulation.

⁵ The typical examples provided in this table refer to transactions and balances where the measurement of these items is considered straightforward. For some of these examples there may also be characteristics described in the applicability section that would result in a measurement process that is considered complex – such accounting estimates would not be described as basic accounting estimates.

ILLUSTRATIVE ENGAGEMENT LETTER

The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with [applicable financial reporting framework]. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in the ISA for LCE. It will need to be varied according to individual requirements and circumstances. It is drafted to refer to the audit of financial statements for a single reporting period and would require adaptation if intended or expected to apply to recurring audits (see paragraph 4.3.2).

To the appropriate representative of management or those charged with governance of ABC Company:⁶

[The objective and scope of the audit]

You⁷ have requested that we audit the financial statements of ABC Company, which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the International Standard on Auditing Less Complex Entities (the ISA for LCE) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

[The responsibilities of the auditor]

We will conduct our audit in accordance with the ISA for LCE. The ISA for LCE requires that we comply with ethical requirements. As part of an audit in accordance with the ISA for LCE, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing

⁶ The addressees and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction

⁷ Throughout this letter, references to "you," "we," "us," "management," "those charged with governance" and "auditor" would be used or amended as appropriate in the circumstances

concerning any significant deficiencies in internal control relevant to the audit of the financial statements that we have identified during the audit.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with ISAs.

Our audit will be conducted on the basis that [management and, where appropriate, those charged with governance]⁸ acknowledge and understand that they have responsibility:

- (a) For the preparation and fair presentation of the financial statements in accordance with [applicable financial reporting framework];⁹
- (b) For such internal control as [management] determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
- (c) To provide us with:
 - (i) Access to all information of which [management] is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - (ii) Additional information that we may request from [management] for the purpose of the audit; and
 - (iii) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from [management and, where appropriate, those charged with governance], written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation from your staff during our audit.

[Other relevant information]

⁸ Use terminology as appropriate in the circumstances

⁹ Or, if appropriate, "For the preparation of financial statements that give a true and fair view in accordance with [applicable financial reporting framework]"

[Insert other information, such as fee arrangements, billings and other specific terms, as appropriate.]

[Reporting]

[Insert appropriate reference to the expected form and content of the auditor's report including, if applicable, the reporting on other information in accordance with ISA 720 (Revised).]

The form and content of our report may need to be amended in the light of our audit findings.

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.

XYZ & Co.

Acknowledged and agreed on behalf of ABC Company by

(signed)

.....

Name and Title

Date

ILLUSTRATIVE REPRESENTATION LETTER

The following illustrative letter includes written representations that are required by Part 8.6 of the [International Standard for Auditing Less Complex Entities (ISA for SME)]. It is assumed in this illustration that the applicable financial reporting framework is the [applicable financial reporting framework]; the requirement relating to going concern to obtain a written representation are not relevant; and that there are no exceptions to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions.

(Entity Letterhead)

(To Auditor)

(Date)

This representation letter is provided in connection with your audit of the financial statements of ABC Company for the year ended December 31, 20XX for the purpose of expressing an opinion as to whether the financial statements are presented fairly, in all material respects, (or *give a true and fair view*) in accordance with [applicable financial reporting framework].

We confirm that:

Financial Statements

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated [insert date], for the preparation of the financial statements in accordance with [applicable financial reporting framework]; in particular the financial statements are fairly presented (or give a true and fair view) in accordance therewith.
- Significant assumptions used by us in making accounting estimates are reasonable.
- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of [applicable financial reporting framework].
- All events subsequent to the date of the financial statements and for which [applicable financial reporting framework] require adjustment or disclosure have been adjusted or disclosed.
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to the representation letter.
- [Any other matters that the auditor may consider appropriate.]

Information Provided

- We have provided you with:
 - Access to all information of which we are aware that is relevant to the preparation of the financial statements, such as records, documentation and other matters;
 - Additional information that you have requested from us for the purpose of the audit; and
 - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.

- All transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves:
 - Management;
 - Employees who have significant roles in internal control; or
 - Others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.
- We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.
- [Any other matters that the auditor may consider necessary.]

Management

Management

ILLUSTRATIVE AUDITOR'S REPORT

1.1 Unmodified Opinion

Unmodified Opinion

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- **Audit of a complete set of financial statements of an entity (not a listed entity) using a fair presentation framework.**
- **The financial statements are prepared by management of the entity in accordance with the [applicable financial reporting framework] (a general purpose framework).**
- **The terms of the audit engagement reflect the description of management's responsibility for the financial statements in **part 4.3** of the ISA for LCE.**
- **The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.**
- **The relevant ethical requirements that apply to the audit are those of the jurisdiction.**
- **The auditor decided not to communicate key audit matters.**
- **There is no other information reported in an annual report.**
- **Those responsible for oversight of the financial statements are the same as those responsible for the preparation of the financial statements.**
- **The auditor has no other reporting responsibilities required under local law. The auditor elects to include the description of the auditor's responsibilities for the audit of the financial statements in an appendix to the auditor's report.**

2. INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Opinion

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with [applicable financial reporting framework].

Basis for Opinion

We conducted our audit in accordance with the [International Standard for Auditing Financial Statements of Less Complex Entities (the ISA for SME)]. Our responsibilities under the ISA for SME are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in [jurisdiction], and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

A description of our responsibilities for the audit of the financial statements is included in the appendix of this auditor's report. This description, which is located at [indicate page number or other specific reference to the location of the description], and forms part of our auditor's report.

[Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate for the particular jurisdiction]

[Auditor Address]

[Date]

Appendix to Auditor's Report

Responsibilities of Management for the Financial Statements¹⁰

Management is responsible for the preparation and fair presentation of the financial statements in accordance with [applicable financial reporting framework],¹¹ and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Financial Statements of an LCE

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISA for LCE will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with the ISA for LCE, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or

¹⁰ Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

¹¹ Where management's responsibility is to prepare financial statements that give a true and fair view, this may read: "Management is responsible for the preparation of financial statements that give a true and fair view in accordance with [applicable financial reporting framework], and for such ..."

conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

DRAFT