

Maintenance of the ISA for LCE¹ – Drafting Rationale

This agenda item sets out the revisions made in the International Standards on Auditing (ISAs) that are in-scope for the ISA for LCE maintenance project and the Project Team's views and recommendations to align, in a proportionate way, the ISA for LCE with the ISAs. This agenda item must be read together with **Agenda Items 12-A** and **12-C**.

Background

1. After identifying the public interest issues (PIIs) that are relevant to the ISA for LCE (see **Agenda Item 12-A**), the Project Team reviewed the revisions made to the ISAs that addressed the PIIs.
2. When reviewing these revisions, the Project Team determined whether the new or revised requirements:
 - (a) Are proportionate to an audit of an LCE; and
 - (b) Need to be revised given the ISA for LCE design principles.
3. The Project Team also consulted the Basis for Conclusions of the in-scope ISA projects² to obtain details of key changes to the standards and how these changes were responsive to stakeholders' feedback.
4. This paper sets out the Project Team's views and recommendations for the proposed revisions to the ISA for LCE as follows:
 - Section I – Part A, *Authority of the ISA for Audits of Financial Statements of Less Complex Entities*;
 - Section II – Part 1, *Fundamental Concepts, General Principles and Overarching Requirements*; and
 - Section III – Part 3, *Engagement Quality Management*.

¹ International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (the ISA for LCE)

² Please refer to the following Basis for Conclusions:

- [ISA 240 \(Revised\), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*](#);
- [ISA 570 \(Revised 2024\), *Going Concern*](#); and
- [Narrow Scope Amendments to the International Standards on Quality Management \(ISQMs\), ISAs and International Standard on Review Engagement \(ISRE\) 2400 \(Revised\), *Engagements to Review Historical Financial Statements Related to the Definitions of Listed Entity and Public Interest Entity \(PIE\)*](#).

Section I – Part A, Authority of the ISA for Audits of Financial Statements of Less Complex Entities

Revisions to the ISAs	Project Team's Views and Recommendations for the ISA for LCE
Narrow Scope Amendments Related to the Definitions of Listed Entity and PIE	
<p><i>Public Interest Issue³</i></p> <p>39. Increased complexity and inconsistent application and understanding when concepts across the IAASB and IESBA standards differ, including when there is misalignment in the types of entities to which differential requirements apply.</p>	
<p><i>Paras. 9A–9B and A13A–A13E of ISA 200⁴</i></p> <ul style="list-style-type: none"> Incorporating in the Introduction and related application material of ISA 200 the approach for establishing differential requirements in the ISAs, aligned with the IESBA Code. This includes providing a framework for when it may be appropriate to apply a differential requirement set out in the ISAs for audits of financial statements of publicly traded entities to the audits of other entities. 	<p><i>Not Addressed in the ISA for LCE</i></p> <ul style="list-style-type: none"> The Project Team is of the view that the revisions made to the introduction section of ISA 200 are not applicable to the ISA for LCE given that these paragraphs explain the purpose of the differential requirements in the ISAs. The ISA for LCE does not have differential requirements for publicly traded entities (or any other entities). Therefore, no revisions have been made to the ISA for LCE.
<p><i>Para. 13(l)B of ISA 200</i></p> <ul style="list-style-type: none"> Adopting the definition of “publicly traded entity” in the Definitions section of the ISAs as a replacement for the term listed entity. The definition of “publicly traded entity” is aligned with the definition included in the IESBA code. 	<p><i>Paragraph A.1(b) and Essential Explanatory Material (EEM) under A.2</i></p> <ul style="list-style-type: none"> The Project Team notes that the ISA for LCE uses the term listed entity twice (both times in the Authority – paragraph A.1 and the EEM to paragraph A.2) and that listed entities is a class of entities for which the use of the ISA for LCE is prohibited. The Project Team proposes to replace the term “listed entity” with the term “publicly traded entities” in the ISA for LCE to align with the recent revisions to the ISAs. In addition, the Project Team notes that the term “publicly traded entities” has been adopted in ISQM 1.⁵ Given that ISQM 1 also

³ In the tables in this agenda item, the number of each PII corresponds with the list of PIIs presented in **Agenda Item 12-A**.

⁴ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

⁵ ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

Revisions to the ISAs	Project Team's Views and Recommendations for the ISA for LCE
	<p>applies to engagements performed using the ISA for LCE, it is important that terms are aligned.</p> <ul style="list-style-type: none"> • The Project Team proposes to include essential explanatory material under paragraph A.2. to clarify how legislative or regulatory authorities or relevant local bodies with standard-setting authority may define the definition of publicly traded entity more explicitly. The EEM already included guidance on how legislative or regulatory authorities or relevant local bodies with standard-setting authority may modify the classes of entities included in A.1.(c) and therefore, this is well placed here. • The Project Team also proposes to include the definition of publicly traded entity in the glossary of terms in Appendix 1 of the ISA for LCE. • The Project Team recognizes that the definition of PIE has not been adopted in the ISAs, and therefore the ISAs do not include the classes of entities that constitutes a PIE. However, the Project Team is of the view that the use of the classes in paragraph A.1(c) remains appropriate for the purpose of the ISA for LCE and therefore does not propose any revisions to this paragraph. The Project Team also notes that these classes are included in the ISA for LCE even though the ISAs did not refer to them and therefore this is a pre-existing difference between the two standards given the function of Part A in the ISA for LCE.

Section II – Part 1, Fundamental Concepts, General Principles and Overarching Requirements

Revisions to the ISAs	Project Team's Views and Recommendations for the ISA for LCE
ISA 240 (Revised)	
1. The introductory paragraphs in ISA 240 ⁶ explaining the inherent limitations of an audit can be misleading and result in misunderstanding of the auditor's obligations.	
<p><i>Paras. 9–11 and A12</i></p> <ul style="list-style-type: none"> Moved the inherent limitations (including related application material) of an audit out of the "Responsibilities of the Auditor" into the new "Key Concepts of this ISA" section in ISA 240 (Revised). The intent was to decouple descriptions about inherent limitations of the audit and the auditor's responsibilities because the inherent limitations do not diminish the auditor's responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud. 	<p><i>EEM under Section 1.5.</i></p> <ul style="list-style-type: none"> The Project Team is of the view that the emphasis of the auditor's responsibilities is also relevant for the typical nature and circumstances of an audit of an LCE and therefore proposes to align the wording with the revised wording in ISA 240 (Revised), including adding a sentence to the EEM under paragraph 1.5. reinforcing the message that the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence. The Project Team has not added paragraph 11 of ISA 240 (Revised) as ISA 240 included a similar paragraph and that paragraph was not included in ISA for LCE to keep the EEM concise, as per the design principles.
2. A need has been expressed to clarify and emphasize the auditor's responsibilities regarding fraud in an audit of financial statements.	
<p><i>Paras. 2, 3 and A1</i></p> <ul style="list-style-type: none"> Reordered the introductory paragraphs (including related application material) to refer to the responsibilities of the auditor before the responsibilities of management and TCWG to describe first the role of the auditor related to fraud in an audit of financial statements, recognizing that this is an auditing standard. 	<p><i>EEM under Section 1.5.</i></p> <ul style="list-style-type: none"> The Project Team introduced subheadings to clearly distinguish the different concepts explained in section 1.5. As in ISA 240 (Revised), the Project Team moved the responsibilities of the auditor in the ISA for LCE before management's and those charged with governance's as this will emphasize the auditor's responsibilities regarding fraud.

⁶ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

Revisions to the ISAs	Project Team's Views and Recommendations for the ISA for LCE
	<ul style="list-style-type: none"> The Project Team proposes to revise the auditor's responsibilities to be more aligned with paragraph 2 of ISA 240 (Revised). However, the Project Team is of the view that the second sentence of paragraph 2 (this paragraph includes a more detailed list of responsibilities) was not necessary given that they are included in paragraph 1.5.1. of the ISA for LCE
<p><i>Paras. 4–8 and A2–A11</i></p> <ul style="list-style-type: none"> Introduction of two new paragraphs on fraud or suspected fraud to emphasize that the auditor may identify fraud or suspected fraud when applying the standard and that it is a matter of professional judgment to determine whether a fraud or suspected fraud is material to the financial statements. 	<p><i>EEM under Section 1.5.</i></p> <ul style="list-style-type: none"> The Project Team is of the view that these paragraphs may be useful for the ISA for LCE but not in section 1.5. Similarly to ISA 240 (Revised), the Project team envisions introducing a fraud or suspected fraud section in Part 7⁷ that would include key messages based on these paragraphs. Part 7 will be considered for the March 2026 IAASB meeting.
<p>3. There are terms and concepts associated with fraud, such as bribery, corruption, and money laundering, that are not directly addressed in the definition of fraud, and it has been noted that it is therefore unclear whether the auditor's procedures extend to include work related to such terms and concepts.</p>	
<p><i>Paras. A19–A23</i></p> <ul style="list-style-type: none"> Clarified in the application material how concepts such as bribery and corruption, and money laundering, relate to the definition of fraud for purpose of an audit of financial statements. 	<p><i>EEM under Section 1.5.</i></p> <ul style="list-style-type: none"> The Project Team is of the view that this clarification is equally relevant for an audit of an LCE and added a new paragraph in EEM under 1.5.
<p>11. The relationship between ISA 240 and ISA 250 (Revised)⁸ is unclear, i.e., more clarity is needed if a fraud is identified or suspected, whether the auditor is performing procedures to comply with ISA 240 or ISA 250 (Revised).</p>	
<p><i>Paras. 14 and A15–A17</i></p> <ul style="list-style-type: none"> Added an introductory paragraph explaining 	<p><i>EEM under Section 1.5.</i></p> <ul style="list-style-type: none"> The Project Team is of the view that this

⁷ Part 7, *Responding to Assessed Risks of Material Misstatement*

⁸ ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

Revisions to the ISAs	Project Team's Views and Recommendations for the ISA for LCE
<p>the relationship of ISA 240 (Revised) with the other ISAs, including ISA 250 (Revised). This paragraph also explains that ISA 240 (Revised) is intended to be applied in conjunction with other relevant ISAs.</p> <ul style="list-style-type: none"> Clarified that fraud ordinarily constitutes an instance of NOCLAR, and as such, the identification of fraud or suspected fraud gives rise to additional responsibilities for the auditor in accordance with ISA 250 (Revised). Added application material to further clarify how ISA 240 (Revised) interacts with ISA 250 (Revised). 	<p>clarification is also relevant for an audit of an LCE and added a new sentence in EEM under 1.5. that links to the auditor's responsibilities relating to laws and regulations in section 1.6.</p>
<p>23. The appropriate exercise of professional skepticism needs to be reinforced, including reminding the auditor of the importance of remaining alert to conditions that may indicate possible fraud and maintaining professional skepticism throughout the audit.</p>	
<p><i>Paras. 12–13, 19–22, 42 and A13–A14, A27–A37</i></p> <ul style="list-style-type: none"> Added an introductory paragraph, which draws on the approach adopted in ISA 220 (Revised),⁹ ISA 315 (Revised 2019),¹⁰ and ISA 600 (Revised).¹¹ The paragraph clarifies that professional skepticism supports the quality of judgments made by the engagement team when exercising their professional judgment in making informed decisions about the courses of action that are appropriate in the circumstances, including when the auditor identifies fraud or suspected fraud. Removed the reference to “notwithstanding the auditor’s past experience of the honesty and integrity of the entity’s management and those charged with governance” to emphasize that the exercise of professional 	<p><i>Paras. 1.4.4. and 1.4.5.</i></p> <ul style="list-style-type: none"> The Project Team noted that the section on professional skepticism in the ISA for LCE is based on the concepts in ISA 200. Recognizing the significant emphasis on professional skepticism in ISA 240 (Revised), the Project Team reviewed the professional skepticism requirements in ISA 240 (Revised) and noted the following: <ul style="list-style-type: none"> Paragraph 19: This paragraph is sufficiently covered by paragraph 1.4.4. of the ISA for LCE. Paragraph 20: The Project Team added additional examples about the auditor remaining alert during the course of the audit to emphasize the need to exercise professional

⁹ ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

¹⁰ ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

¹¹ ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Revisions to the ISAs	Project Team's Views and Recommendations for the ISA for LCE
<p>skepticism requires the auditor to, among other things, approach each audit with a “fresh pair of eyes.”</p> <ul style="list-style-type: none"> • Removed the reference to “Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine” from the conditional requirement which deals with the authenticity of records and documents to apply a fraud lens to the principle in ISA 200.¹² • Added a requirement for the auditor to remain alert throughout the audit for information that is indicative of fraud or suspected fraud. • Added a requirement for the auditor to design and perform audit procedures in response to the assessed ROMMs due to fraud in a manner that is not biased towards obtaining audit evidence that may corroborate management’s assertions or towards excluding audit evidence that may be contradict such assertions. • Added application material to: <ul style="list-style-type: none"> ○ Explain the relationship with relevant guidance on professional judgment in ISQM 1 and ISA 220 (Revised). ○ Regarding the attribute of authenticity of records and documents, included examples of conditions that may lead the auditor to believe that a record or document is not authentic or that the terms in the document have been modified but not disclosed to the auditor. ○ Explain how fraud, suspected fraud or alleged fraud may be identified or otherwise come to the auditor’s 	<p>skepticism in the EEM under paragraph 1.4.5. These examples are aligned with the examples included in paragraph 20 of ISA 240 (Revised).</p> <ul style="list-style-type: none"> ○ Paragraph 21 is covered by paragraph 1.8.6 of the ISA for LCE. The Project team aligned the wording of paragraph 1.8.6 with paragraph 21 but did not include the specific reference to “individuals within the internal audit function”, because internal audit would ordinarily not be applicable for LCEs. ○ Paragraph 22 is covered by paragraph 2.3.3 of the ISA for LCE. • The Project Team noted that ISA 240 (Revised) no longer includes reference to the auditor’s past experience and that unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. Given that these concepts are still included in ISA 200 and that the section on professional skepticism (paragraph 1.4.4–1.4.5) is based on the concepts in ISA 200, the Project Team is of the view that no changes are needed.

¹² ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

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<p>attention.</p> <ul style="list-style-type: none"> ○ Address circumstances or threats to relevant ethical requirements that may be encountered at, or near the end of the audit. 	
<p>24. The required communications with those charged with governance on fraud considerations may not be sufficiently robust in the current environment, including that such communications relating to fraud matters are not presently explicitly required throughout the audit.</p>	
<p><i>Paras. 21, 25, 64–66 and A195–A200</i></p> <ul style="list-style-type: none"> • Added an overarching requirement to communicate with management and TCWG matters related to fraud at appropriate times throughout the audit engagement. Related application material explains that the appropriate timing of the communications may vary depending on the significance and nature of the fraud-related matters and the expected action(s) to be taken by management or TCWG. • Enhanced the requirement addressing inconsistent responses to inquiries of management or TCWG. 	<p><i>Paras. 1.8.7, 1.8.8(c) and 1.8.9.</i></p> <ul style="list-style-type: none"> • ISA 240 (Revised) includes a new requirement (paragraph 25) to have ongoing communication with management and those charged with governance for matters related to fraud. Given the typical nature and circumstances of an audit of an LCE, the Project Team believes that the engagement partner and engagement team often work closely with management and TCWG throughout the audit. Also, paragraph 1.8.3 highlights the importance of timely communications with management and, where appropriate, those charged with governance. Therefore, the Project Team decided not to include this specific requirement in the ISA for LCE. • The Project Team also noted the revisions to the specific communication requirements in ISA 240 (Revised), paragraphs 64–66. The Project Team is of the view that the ISA and the ISA for LCE should be aligned in terms of the specific communication requirements and, therefore, proposes a revision to paragraphs 1.8.7 and 1.8.8.(c) and 1.8.9.
<p><i>Paras. 59 and A173–A176</i></p> <ul style="list-style-type: none"> • Clarified the work effort for the auditor when withdrawing from the engagement is not permitted by law or regulation. 	<p><i>Para. 1.5.2.</i></p> <ul style="list-style-type: none"> • Considering this is often the case for public sector entities, as indicated in the EEM under paragraph 1.5.2., the Project Team is of the view that the clarification should be

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	incorporated into the ISA for LCE. In addition, the Project Team streamlined the drafting by bringing "consider whether" into the lead-in of the paragraph.
ISA 570 (Revised 2024)	
<p>34. The exercise of professional skepticism needs to be reinforced as it relates to the auditor's considerations about the appropriateness of management's use of the going concern basis of accounting, management's assessment of going concern, and maintaining professional skepticism when gathering audit evidence, questioning judgments made and assumptions used, and developing conclusions.</p>	
<p><i>Paras. 18, A11 and A37</i></p> <ul style="list-style-type: none"> New requirement to emphasize the importance of professional skepticism when evaluating management's assessment in a manner that is not biased towards obtaining audit evidence that may be corroborative or excluding audit evidence that may be contradictory. New application material to enhance the link to the requirement in ISA 315 (Revised 2019) for the auditor to design and perform risk assessment procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory. 	<p><i>Already addressed in the ISA for LCE</i></p> <ul style="list-style-type: none"> The Project Team reviewed the new requirement and is of the view that this paragraph is sufficiently covered by paragraph 1.4.5. of the ISA for LCE. In addition, the EEM under paragraph 1.4.5. includes examples of matters to consider when applying the requirement. Therefore, no changes are proposed to the ISA for LCE.

Section III – Part 3, *Engagement Quality Management*

Revisions to the ISAs	Project Team's Views and Recommendations for the ISA for LCE
ISA 240 (Revised)	
<p>4. Calls for the auditor undertaking more forensic type procedures, or the need for forensic specialists on all, or some, audits have been made due to the increasing use of forensic procedures on audits, including by forensic specialists.</p>	

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<p><i>Paras. 23 and A38–A42</i></p> <ul style="list-style-type: none"> Added a requirement that expand on relevant requirements in ISA 220 (Revised), for the engagement partner to determine that members of engagement team collectively have the appropriate competence and capabilities, including <i>appropriate specialized skills or knowledge</i> to perform risk assessment procedures, identify and assess the ROMMs due to fraud, design and perform further audit procedures to respond to those risks, or evaluate the audit evidence obtained. Added application material that: <ul style="list-style-type: none"> Leverages relevant guidance provided in ISA 220 (Revised) explaining that the engagement partner's determination of whether additional engagement level resources are required is a matter of professional judgment and is influenced by the nature and circumstances of the audit engagement, taking into account any changes that may have arisen during the engagement. Illustrates the scalability of the requirement through examples and by explaining that the nature, timing, and extent of the involvement of individuals with specialized skills or knowledge, such as forensic and other experts, may vary based on the nature and circumstances of the audit engagement. Describes forensic skills and explains how forensic skills in the context of an audit of financial statements may be used, including examples of forensic skills. 	<p><i>Not Addressed in the ISA for LCE</i></p> <ul style="list-style-type: none"> ISA 240 (Revised) paragraph 23 is based on ISA 220 (Revised) paragraph 26. Paragraph 3.2.7. of the ISA for LCE is the equivalent of paragraphs 26–27 of ISA 220 (Revised) and requires the engagement partner to determine that members of the engagement team, and any auditor's external experts, have the appropriate competence and capabilities to perform the audit engagement. The Project Team is of the view that paragraph 3.2.7 is appropriate for the typical nature and circumstances of an audit of an LCE and that it is expected to deliver a similar outcome as with the ISA requirements when applied to an audit of an LCE. Therefore, the Project Team is not proposing any revisions to the ISA for LCE. The application material included in ISA 240 (Revised) related to engagement resources provides a description of what forensic skills are and examples of when such skills may be needed. The Project Team is of the view that in an audit of a LCE the use a specialist is most likely when fraud or suspected fraud is identified. Therefore, the Project Team proposes that the matters included in the application material in ISA 240 (Revised) should be included in Part 7 of the ISA for LCE. Part 7 will be considered for the March 2026 IAASB meeting.

Revisions to the ISAs	Project Team's Views and Recommendations for the ISA for LCE
<p><i>Paras. 24 and A43</i></p> <ul style="list-style-type: none"> Added a requirement that expand on relevant requirements in ISA 220 (Revised), for the engagement partner to determine that the nature, timing and extent of direction, supervision and review by considering fraud-related matters identified during the course of the audit engagement. 	<p><i>EEM under 3.2.2.</i></p> <ul style="list-style-type: none"> ISA 240 (Revised) paragraph 24 is based on ISA 220 (Revised) paragraph 30(b). Paragraph 3.2.2. of the ISA for LCE is the equivalent of paragraph 30(b) of ISA 220 (Revised) and requires the engagement partner to determine that the nature, timing and extent of direction, supervision and review is responsive to the nature and circumstances of the engagement and the resources assigned. The EEM to paragraph 3.2.2. provides examples of circumstances for the engagement partner to consider when tailoring the approach to direction, supervision and review. The Project Team believes that the fraud-related matters included in the requirement in ISA 240 (Revised) are best located in the EEM under paragraph 3.2.2., consistent with the original design of this section in the ISA for LCE.