

Agenda Item

6-B.3

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 proposed ISA for LCE (Revised) maintenance project in **Part 6** and the Project Team's views and recommendations to align, in a proportionate way, the proposed drafting for revisions to the ISA for LCE (herein referred to as proposed ISA for LCE (Revised)) with the ISAs. This agenda item must be read together with **Agenda Items 6, 6-A and 6-C**.

Part 6, Risk Identification and Assessment

Revisions to the ISAs	Project Team's Views and Recommendations for the Proposed ISA for LCE (Revised)
ISA 240 (Revised)²	
<p>5. The auditor's risk identification and assessment process as it relates to fraud should be more robust (including that many aspects of the enhanced risk identification and assessment procedures in ISA 315 (Revised 2019)³ have not been reflected in ISA 240).⁴</p> <p><i>Note that Public Interest Issue (PII) #5 is addressed by paragraphs 26 to 41. Some paragraphs are also addressing other PIIs (e.g., para. 30) and therefore are explained under a different PII.</i></p>	
<p><i>Paragraphs 26–41 and A24–A26, A49–A125, Appendix 1</i></p> <ul style="list-style-type: none"> Restructured ISA 240 (Revised) to follow a similar structure as ISA 315 (Revised 2019), which helps demonstrate the integrated relationship between the two standards. 	<p><i>General</i></p> <ul style="list-style-type: none"> See Agenda Item 6 (Section II, Part 6) for an explanation of how the Project Team built in the concept of fraud risk factors in Part 6.

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

² ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

³ ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

⁴ 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 Proposed ISA for LCE (Revised)
<ul style="list-style-type: none"> Enhanced requirements and application material by emphasizing that the procedures performed by the auditor to obtain audit evidence for the identification and assessment of ROMMs due to fraud at the financial statement and assertion levels take into account fraud risk factors. To align with ISA 540 (Revised)⁵ and to reflect the actual nature of the procedure, relocated the requirement and application material relating to the retrospective reviews from the “Responses to the Assessed Risk of Material Misstatement Due to Fraud” section to the “Risk Assessment Procedures and Related Activities” section of ISA 240 (Revised). Enhanced or added requirements and application material to incorporate recent changes in ISA 315 (Revised 2019) to make fraud risk identification and assessment more robust, including requirements describing the auditor’s explicit or specific fraud considerations when obtaining an understanding of the: <ul style="list-style-type: none"> Entity and its environment, and the applicable financial reporting framework; and The components of the entity’s system of internal control, including the control environment, the entity’s risk assessment process, the entity’s process to monitor the system of internal control, the information system and communication, and control activities. 	<p><i>Paragraph 26 of ISA 240 (Revised)</i></p> <ul style="list-style-type: none"> See Agenda Item 6, paragraph 27 (a) for details. <p><i>Paragraph 27 of ISA 240 (Revised)</i></p> <ul style="list-style-type: none"> Paragraph 27 of ISA 240 (Revised) is based on paragraph 24 of ISA 240, which was not included in the ISA for LCE because it was deemed to be covered by paragraph 1.5.1. (a) and the Essential Explanatory Material (EEM) under section 2.3 (third and fourth paragraphs). Therefore, the Project Team proposes no changes <p><i>Paragraph 28 of ISA 240 (Revised)</i></p> <ul style="list-style-type: none"> As part of the revision of ISA 240, the retrospective review was moved from the section on responding to assessed risk of material misstatement to the risk assessment and related activities section. To align the proposed ISA for LCE (Revised) with the changes to ISA 240 (Revised), the Project Team proposes to move paragraph 7.4.6(b)(ii) to Part 6 (see paragraph 6.2.4A). In addition, we aligned the wording in paragraph 6.2.4A with paragraph 28 of ISA 240 (Revised). <p><i>Paragraph 29–30 of ISA 240 (Revised)</i></p> <ul style="list-style-type: none"> Paragraph 29 is addressed in Part 5 (See Agenda Item 6-B.2). Paragraph 30 is addressed in PII 16 below.

⁵ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

Revisions to the ISAs	Project Team's Views and Recommendations for the Proposed ISA for LCE (Revised)
<ul style="list-style-type: none"> ○ Entity's whistleblower program, or other program to report fraud, when such program exists at the entity. • Enhanced requirements by expanding on the relevant requirements in ISA 315 (Revised 2019) for the auditor to consider whether information from other sources obtained by the auditor indicates that one or more fraud risk factors are present. • Added requirements and application material to clarify that the risks of management override of control reside at the financial statement level and that the auditor must determine whether such risks affect the assessment of risks at the assertion level. • Enhanced or added application material that: <ul style="list-style-type: none"> ○ Explains more precisely what the expanded requirements relating to risk identification and assessment in ISA 240 (Revised) are intended to cover, as well as in some cases "why" a procedure or action is needed. ○ Provides examples demonstrating how the requirements can be applied for smaller or less complex entities. ○ Further explains the relationship between fraud risk factors, inherent risks and control risks. • Updated the fraud risk factors in Appendix 1 to ISA 240 (Revised). 	<p><i>Paragraph 31 of ISA 240 (Revised)</i></p> <ul style="list-style-type: none"> • Paragraph 31 of ISA 240 (Revised) adds a fraud lens to ISA 315 (Revised 2019) by requiring the auditor to obtain an understanding of matters that may lead to an increased susceptibility to misstatement due to management bias or other fraud risk factors. As the proposed ISA for LCE (Revised) is designed to follow the flow of an audit and incorporates all relevant stages or elements of an audit within this flow, the Project Team is of the view that such a requirement is not needed. Also, see Agenda Item 6 (Section II, Part 6) for an explanation of how the Project Team built in the concept of fraud risk factors in Part 6. • The Project Team added EEM under 6.3 explaining that the auditor's understanding of relevant aspects of the entity assists the auditor in identifying fraud risk factors. <p><i>Paragraph 32(a) of ISA 240 (Revised)</i></p> <ul style="list-style-type: none"> • The Project Team is of the view that paragraph 32(a)(i) of ISA 240 (Revised) is deemed to be sufficiently covered by the EEM under paragraph 6.3.7 (first paragraph). Therefore, the Project Team does not propose changes to the proposed ISA for LCE (Revised). • The Project Team is of the view that paragraph 32(a)(ii) of ISA 240 (Revised) is not relevant given the typical nature and circumstances of an audit of an LCE – an LCE will ordinarily not have a formal whistleblower program. Therefore, the Project Team does not propose changes to the proposed ISA for LCE (Revised). • The Project Team is of the view that paragraph 32(a)(iii) of ISA 240 (Revised) is not relevant given the typical nature and

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	<p>circumstances of an audit of an LCE. Therefore, the Project Team does not propose changes to the proposed ISA for LCE (Revised).</p> <ul style="list-style-type: none"> Paragraph 32(b) and (c) are addressed in PII 24 below. <p><i>Paragraph 33(a) of ISA 240 (Revised)</i></p> <ul style="list-style-type: none"> General: In the development of the ISA for LCE it was decided that inquiry would be sufficient to obtain an understanding of the entity's risk assessment process. The Project Team is of the view that paragraph 33(a)(i), (ii) and (iii) of ISA 240 (Revised) are sufficiently addressed by paragraph 6.3.1(b) and the related EEM (third paragraph). Paragraph 33(b) of ISA 240 (Revised) is addressed in PII 24 below. <p><i>Paragraph 34(a) of ISA 240 (Revised)</i></p> <ul style="list-style-type: none"> General: In the development of the ISA for LCE it was decided that inquiry would be sufficient to obtain an understanding of the entity's process to monitor the system of internal control. The Project Team is of the view that paragraph 34(a)(i) of ISA 240 (Revised) is useful in an LCE environment and therefore changed the inquiry in paragraph 6.3.1.(c). The Project Team is of the view that paragraph 34(a)(ii) of ISA 240 (Revised) is not relevant given the typical nature and circumstances of an audit of an LCE – an LCE will ordinarily not have an internal audit function. Also, the ISA for LCE does not have requirements or EEM on internal audit. Therefore, the Project

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	<p>Team does not propose changes to the proposed ISA for LCE (Revised).</p> <ul style="list-style-type: none"> Paragraph 34(b) is addressed in PII 24 below. <p><i>Paragraph 35–36 of ISA 240 (Revised)</i></p> <ul style="list-style-type: none"> Paragraphs 35 and 36 are addressed in PII 13 below. <p><i>Paragraph 37 of ISA 240 (Revised)</i></p> <ul style="list-style-type: none"> The Project Team proposes no changes to the proposed ISA for LCE (Revised) as it is of the view that paragraph 6.3.14 addresses paragraph 37 of ISA 240 (Revised) sufficiently. In ISA 240 (Revised) this paragraph was added to establish a link with ISA 315 (Revised 2019) but given the design of the proposed ISA for LCE (Revised) such a link is not needed. However, to clarify that paragraph 6.3.14 applies to fraud and error, the Project Team proposes to clarify in the EEM under paragraph 6.3.14 (first paragraph) that “the auditor may consider the effect of those deficiencies on the identification and assessment of risks of material misstatement whether due to fraud or error”. Also, the Project Team added EEM under paragraph 6.3.14 (second paragraph) that in understanding the entity’s system of internal control, the auditor may have identified deficiencies in respect of the prevention or detection of fraud. <p><i>Paragraph 38 of ISA 240 (Revised)</i></p> <ul style="list-style-type: none"> See Agenda Item 6, paragraph 27 (c) for details.

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	<p><i>Paragraph 39–40 of ISA 240 (Revised)</i></p> <ul style="list-style-type: none"> Paragraph 39(a): See Agenda Item 6, paragraph 27 (e) for details. Paragraph 39(b): The Project Team notes that paragraph 39 (b), the first sentence is covered by paragraph 6.4.6 and the second sentence is covered by paragraph 6.3.12. Therefore, the Project Team does not propose changes to the proposed ISA for LCE (Revised). Paragraph 40(a): The Project Team notes that paragraph 40(a) is covered by paragraph 6.4.6 in the proposed ISA for LCE (Revised) and paragraph 40(b) is covered by paragraph 6.4.1.(a). Therefore, the Project Team does not propose changes to the proposed ISA for LCE (Revised).
<p>13. Journal entries – uncertainty about how to select which journal entries to test that has resulted in inconsistent application.</p>	
<p><i>Paragraphs 35 and 36, A99–A107 and Appendix 4</i></p> <ul style="list-style-type: none"> Added requirements and related application material, for the auditor to obtain an understanding of: <ul style="list-style-type: none"> How journal entries and other adjustments are initiated, processed, recorded, and corrected, as necessary. Controls over journal entries and other adjustments, designed to prevent or detect fraud. <p>These requirements build on the relevant requirements in ISA 315 (Revised 2019).</p>	<ul style="list-style-type: none"> The Project Team notes that paragraphs 35 and 36 were introduced into ISA 240 (Revised) to make a clear linkage between ISA 315 (Revised 2019). Both paragraphs are also used as a hook for the related application material. Given the design of the proposed ISA for LCE (Revised), the Project Team is of the view that such a linkage is not needed. In addition, the Project Team is of the view that paragraph 35 of ISA 240 (Revised) is sufficiently covered by paragraph 6.3.8 in the proposed ISA for LCE (Revised) and paragraph 36 of ISA 240 (Revised) is sufficiently covered by paragraph 6.3.12(b). Therefore, the Project Team does not propose changes to the proposed ISA for LCE (Revised).

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<ul style="list-style-type: none"> Added an appendix with additional considerations that may be used by the auditor when selecting journal entries and other adjustments for testing. 	
<p>14. Presumption of fraud risk in revenue recognition – it is not clear when it may, or may not, be appropriate to rebut the presumption of fraud risk in revenue recognition, which has resulted in inconsistent application.</p> <p>15. Presumption of fraud risk in other account balances – stakeholders have questioned whether the presumption of fraud risk should be extended to include other account balances, such as goodwill.</p>	
<p><i>Paragraphs 41, A114, A116, A119– A125</i></p> <ul style="list-style-type: none"> Enhanced the requirement by changing the work effort verb from “evaluate” to “determine” which types of revenue, revenue transactions or relevant assertions give rise to ROMMs due to fraud. Also, the reference to the documentation requirement, where the auditor concludes that the presumption is not applicable in the circumstances of the engagement, was removed to shift the focus from the auditor developing a rebuttal to emphasizing the importance of performing robust risk identification and assessment. <p>Enhanced or added application material that:</p> <ul style="list-style-type: none"> Highlights relevant assertions and other related classes of transactions, account balances and disclosures that may be susceptible to ROMMs due to fraud. Provides examples of circumstances where there may be greater ROMMs due to fraud in revenue recognition. Clarifies that the significance of fraud risk factors related to revenue recognition, individually or in combination, ordinarily 	<ul style="list-style-type: none"> See Agenda Item 6, paragraphs 28–30, for an explanation of how the Project Team addressed the presumption of fraud risk in revenue recognition.

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<p>makes it inappropriate for the auditor to rebut the presumption that there are ROMMs due to fraud in revenue recognition.</p> <ul style="list-style-type: none"> Clarifies the limited circumstances when it may be appropriate to rebut the presumption that there are ROMMs due to fraud in revenue recognition. Clarifying that in the public sector entities there may be fraud risks related to expenditures instead of revenue recognition. 	
<p>16. Analytical procedures – analytical procedures at the planning and completion stages of the audit are not robust enough to support the auditor's consideration of the risk of fraud and the planned audit response (nature, timing, extent of audit procedures)</p>	
<p><i>Paragraphs 30 and A60</i></p> <ul style="list-style-type: none"> Enhanced requirements relating to analytical procedures at the planning and completion stages of the audit by changing the work effort verb from “evaluate” to “determine.” Enhanced or added application material that: <ul style="list-style-type: none"> Explains that the auditor may identify fluctuations or relationships at the planning stage when performing analytical procedures in accordance with ISA 315 (Revised 2019) that are inconsistent with other relevant information or that differ from expected values significantly. 	<ul style="list-style-type: none"> The Project Team noted that the equivalent of paragraph 30 in ISA 240 (Revised) was paragraph 23 in extant ISA 240. In the development of the ISA for LCE it was noted that paragraph 23 of ISA 240 was sufficiently addressed by the EEM under paragraphs 6.2.3 (second paragraph) and 6.4.2 (first paragraph). Therefore, the Project Team does not propose changes to the proposed ISA for LCE (Revised).

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20. Third party fraud – clarity is needed around the auditor's actions with respect to third party fraud.	
<p><i>Paragraph A84</i></p> <ul style="list-style-type: none"> Added application material that: <ul style="list-style-type: none"> Explains that the entity's risk assessment process may include an assessment of how the entity may be susceptible to third-party fraud. 	<ul style="list-style-type: none"> EEM related to third-party fraud is included in the EEM under section 1.5. (last paragraph) and paragraph A84 of ISA 240 (Revised) is not deemed essential.
21. Audit documentation – clarity is needed on what needs to be documented for fraud when identifying and assessing the risk of material misstatement, performing audit procedures and concluding.	
<p><i>Paragraphs 68(b)–(d)</i></p> <ul style="list-style-type: none"> Added a requirement for the auditor to document: <ul style="list-style-type: none"> Key elements of the auditor's understanding, the sources of information from which the auditor's understanding was obtained and the risk assessment procedures performed. 	<ul style="list-style-type: none"> The Project Team noted that paragraph 68(b), (c) and (d) in ISA 240 (Revised) relate to Part 6 of the proposed ISA for LCE (Revised). The Project Team included these documentation requirements in the proposed ISA for LCE (Revised) and the wording is, where applicable, aligned with the wording in ISA 240 (Revised): <ul style="list-style-type: none"> Paragraph 68(b) is included in paragraph 6.7.1(a); Paragraph 68(c) is included in paragraph 6.7.1(c); and Paragraph 68(d) is included in paragraph 6.7.1(d).
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><i>Paragraphs 32(c), 33(b), 34(b), A80–A82, A92–A95, A97–A98,</i></p> <ul style="list-style-type: none"> Enhanced requirements and application material related to making inquiries of TCWG about certain fraud related matters, 	<p><i>General</i></p> <ul style="list-style-type: none"> The Project Team compared the inquiries in the risk assessment of ISA 240 (Revised) (paragraphs 32(b), 32(c), 33(b) and 34(b)) with the inquiries included in the proposed ISA for LCE (Revised). If

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<p>when obtaining an understanding of the entity's system of internal control.</p>	<p>deemed appropriate given the typical nature and circumstances of an LCE, the Project Team aligned the inquiries.</p> <p><i>Paragraphs 32(b), 32(c), 33(b) and 34(b) of ISA 240 (Revised)</i></p> <ul style="list-style-type: none"> • The Project Team noted that paragraph 32(b) of ISA 240 (Revised) is based on paragraph 18(c) in ISA 240 which was addressed by EEM under paragraph 6.3.1 (third paragraph) in the ISA for LCE. Given that there is no change from extant 240, the Project Team is also not proposing a change. • The Project Team notes that paragraphs 32(c)(i) and 33(b)(i) of ISA 240 (Revised) are covered by paragraph 6.3.3. The Project Team made changes to paragraph 6.3.3 to align the wording with ISA 240 (Revised). • The Project Team reflected paragraphs 32(c)(ii) and 33 (b)(ii) in paragraph 6.3.3 to emphasize the importance of these inquiries. Extant ISA 240 also required the inquiry of management's views about whether and how the financial statements may be materially misstated due to fraud. This requirement was reflected in the EEM under paragraph 6.3.1 (third paragraph, first bullet). Given that it is now reflected in a requirement the EEM was deleted. • With respect to paragraph 32(c)(iii), the Project Team is of the view that it is relevant for an audit of an LCE and therefore added a new requirement (paragraph 6.3.3A). • The Project Team is of the view that paragraph 34(b) of ISA 240 (Revised) is not relevant given the typical nature and circumstances of an audit of an LCE – an LCE will ordinarily not have an internal audit function. Also, the ISA for LCE does not have requirements or EEM on internal audit. Therefore, the Project

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	<p>Team does not propose changes to the proposed ISA for LCE (Revised).</p> <ul style="list-style-type: none"> The Project Team added EEM under paragraph 6.3.1 (fourth paragraph) that is based on paragraph A94 of ISA 240 (Revised) and that highlights that an attitude of professional skepticism is particularly important when evaluating management's responses to inquiries (given that management is often in the best position to perpetrate fraud)
ISA 570 (Revised 2024)⁶	
<p>26. ISA 570 (Revised)⁷ does not reflect the more robust risk identification and assessment process in ISA 315 (Revised 2019). A stronger link to ISA 315 (Revised 2019) would support timely identification of matters relating to management's assessment of going concern about events and conditions that may cast significant doubt on the entity's ability to continue as a going concern.</p> <p>35. The communication with those charged with governance on going concern may not be sufficiently robust, including that such communication may not always occur on a timely basis throughout the audit.</p>	
<p><i>Paragraphs 11–15, A7–A10; A12–A32</i></p> <ul style="list-style-type: none"> New and enhanced requirements to: <ul style="list-style-type: none"> Enable a more robust approach for performing risk assessment procedures that will enable the auditor to determine in a timely manner, based on audit evidence obtained, whether events or conditions are identified that may cast significant doubt on the entity's ability to continue as a going concern. 	<p><i>General</i></p> <ul style="list-style-type: none"> See Agenda Item 6 (Section II, Part 6) for an explanation of how the Project Team built in the concept of “events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern” in Part 6. <p><i>Paragraph 11 of ISA 570 (Revised 2024)</i></p> <ul style="list-style-type: none"> See Agenda Item 6, paragraph 27 (a) for details.

⁶ ISA 570 (Revised 2024), *Going Concern*

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<ul style="list-style-type: none"> ○ Perform risk assessment procedures related to going concern matters to obtain an understanding about the entity and its environment, the applicable financial reporting framework and the entity's system of internal control by building on the foundational requirements in ISA 315 (Revised 2019). ○ New requirement to obtain an understanding, as part of the risk assessment procedures and related activities, how TCWG exercise oversight over management's assessment of the entity's ability to continue as a going concern. ● New application material to: <ul style="list-style-type: none"> ○ Address scalability. In particular, to provide examples that demonstrate where the nature and extent of the auditor's risk assessment procedures may vary based on the nature and circumstances of the entity. ○ Provide more current examples of identified events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. ○ Strengthen the link to ISA 240 where the identified events or conditions that may cast significant doubt on the entity's ability to continue as a going concern may also be indicative of fraud risk factors. ○ Provide guidance and examples in respect of the auditor's application of ISA 315 (Revised 2019) through a 'going concern lens.' 	<ul style="list-style-type: none"> ● The Project Team included the last sentence of paragraph 11 of ISA 570 (Revised 2024) as EEM under paragraph 6.2.4 (second paragraph in Going Concern section). The Project Team was of the view that adding the sentence in paragraph 6.2.4.(c) would cause an imbalance in the requirement as it would become too granular compared to the other bullets. The Project Team was also of the view that the sentence lends itself to being EEM. <p><i>Paragraph 12 of ISA 570 (Revised 2024)</i></p> <ul style="list-style-type: none"> ● Paragraph 12 (a)-(c): See Agenda Item 6, paragraph 27 (b) for details. ● Paragraph 12 (d): The Project Team clarified in paragraph 6.3.5(a)(ii) that the auditor's understanding of the applicable financial reporting framework includes obtaining an understanding of the applicable financial reporting framework relating to going concern, and the related disclosures that are required to be included in the entity's financial statements ● Paragraph 12(e): The Project Team is of the view that this paragraph is sufficiently covered by paragraph 6.3.1(f). ● Paragraph 12(f): The Project Team added EEM under paragraph 6.3.1 (last paragraph) to address this requirement. The Project Team notes that this is similar to how paragraph 32(b) of ISA 240 (Revised) has been dealt with. ● Paragraph 12(g): In the development of the ISA for LCE it was decided that inquiry would be sufficient to obtain an understanding of the entity's risk assessment process. The Project Team is of the view that paragraph 12(g) of ISA 570 (Revised 2024) is sufficiently addressed by paragraph 6.3.1(f).

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	<ul style="list-style-type: none"> Paragraph 12(h): The Project Team is of the view that this paragraph is sufficiently covered by paragraphs addressing accounting estimates in Part 6. Paragraph 12(i): The Project Team added a bullet under 6.3.8 that addresses this paragraph. <p><i>Paragraph 13 of ISA 570 (Revised 2024)</i></p> <ul style="list-style-type: none"> The Project Team noted that paragraph 13 of ISA 570 (Revised 2024) is based on paragraph 11 of ISA 570 (Revised) which was addressed by paragraph 6.4.10. The Project Team aligned paragraph 6.4.10 with paragraph 13 of IA 570 (Revised). <p><i>Paragraph 14 of ISA 570 (Revised 2024)</i></p> <ul style="list-style-type: none"> See Agenda Item 6, paragraph 27 (d) for details. In addition, the Project Team was of the view that it is important to highlight in the EEM under paragraph 6.4.8 that when management has intentionally failed to identify or disclose events or conditions to the auditor, this may raise doubts about their integrity and honesty. The EEM is based on A31 of ISA 570 (Revised 2024). <p><i>Paragraph 15 of ISA 570 (Revised 2024)</i></p> <ul style="list-style-type: none"> The Project Team notes that paragraph 15 was introduced into ISA 570 (Revised 2024) to make a clear linkage with ISA 315 (Revised 2019). Given the design of the proposed ISA for LCE (Revised), the Project Team is of the view that such a linkage is not needed but has added EEM under 6.3.14 (second paragraph) that, in understanding the entity's system of internal control, the auditor

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	may have identified deficiencies in respect of management's assessment of going concern.