

Agenda Item

6-B.4

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

| Revisions to the ISAs | Project Team's Views and Recommendations for the Proposed ISA for LCE (Revised) |
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| ISA 240 (Revised)² | |
| <p>7. The auditor's responses to the assessed risks of material misstatement due to fraud should be more robust.</p> <p><i>Note that Public Interest Issue (PII) 7 is addressed by paragraphs 42 to 52. Some paragraphs are also addressing other PIIs (e.g., para. 43) and therefore are explained under a different PII.</i></p> | |
| <p>Paragraphs 42–52 and A126–A153</p> <ul style="list-style-type: none"> 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. | <p>Paragraphs 7.2.2(a), 7.4.6(b)–(c) Essential Explanatory Material (EEM) under paragraphs 7.2.2 and 7.4.6</p> <ul style="list-style-type: none"> The Project Team noted paragraph 45 of ISA 240 (Revised) is based on paragraph 30 of ISA 240⁵ which was addressed by paragraph 7.2.2(a). Therefore, the Project Team proposes changing paragraph 7.2.2.(a) to align with paragraph 45 of ISA 240 (Revised), except for the reference to complex transactions as |

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*

⁵ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

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| <p>The requirement is consistent with similar requirements in ISA 315 (Revised 2019)³ and ISA 540 (Revised).⁴</p> <ul style="list-style-type: none"> Enhanced the requirement for the auditor to review accounting estimates for “indicators of possible management bias,” by adding a requirement for the auditor to consider the audit evidence obtained from the retrospective review performed. Added application material addressing indicators of possible management bias, including relevant linkages to ISA 540 (Revised) and examples of indicators of possible management bias in how management makes the accounting estimates that may represent a ROMM due to fraud. | <p>those would not be expected for entities in scope of the proposed ISA for LCE (Revised).</p> <ul style="list-style-type: none"> Paragraphs 50–51 of ISA 240 (Revised) are based on paragraph 33 (b) of ISA 240 which were addressed in paragraph 7.4.6 (b). Therefore, the Project Team proposes changing paragraph 7.4.6 (b) to align with paragraphs 50–51 of ISA 240 (Revised). The Project Team noted paragraph 52 of ISA 240 (Revised) is based on paragraph 33(c) of ISA 240 which was addressed by paragraph 7.4.6(c). Therefore, the Project Team proposes changing paragraph 7.4.6(c) to align with paragraph 52 of ISA 240 (Revised). The Project Team is of the view that EEM under paragraph 7.2.2 needs to be updated. The project team noted that the EEM is based on paragraph A37 of ISA 240, which is paragraph A126 in ISA 240 (Revised), and made changes to align the EEM with paragraph A126. In addition, the project team added the first sentence of paragraph A127 to highlight that the extent to which the auditor chooses to incorporate an element of unpredictability is a matter of professional judgment. The Project Team noted that paragraph A136 of ISA 240 (Revised) is based on paragraph A42 of ISA 240 which was addressed in EEM under paragraph 7.4.6. (second paragraph). Therefore, the Project Team proposes changing the EEM to align with paragraph A136 of ISA 240 (Revised). |

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

⁴ 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) |
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| | <ul style="list-style-type: none"> The project team is of the view that EEM is needed to explain the importance of obtaining audit evidence about the completeness of the population and about selecting journal entries and other adjustments. The EEM under paragraph 7.4.6 (third and fourth paragraphs)_is based on paragraphs A140 and A141 in ISA 240 (Revised). The Project Team is of the view that the following paragraphs in ISA 240 (Revised) are sufficiently addressed in the proposed ISA for LCE (Revised): <ul style="list-style-type: none"> Paragraph 42 of ISA 240 (Revised) is addressed by paragraphs 1.4.5. and 2.3. Paragraph 44 of ISA 240 (Revised) is addressed by paragraph 7.2.1. Paragraph 46 of ISA 240 (Revised) is addressed by paragraph 7.3.1. Paragraph 47 of ISA 240 (Revised) is addressed by paragraph 7.4.6(d). See PII 18 below for paragraph 43, and PII 13 for paragraphs 48 and 49 of ISA 240 (Revised). |
| 13. Journal entries – uncertainty about how to select which journal entries to test that has resulted in inconsistent application. | |
| <p><i>Paragraphs 48–49 and A136–A147</i></p> <ul style="list-style-type: none"> Added a requirement and related application material, for the auditor to obtain audit evidence about the completeness of the population of journal entries and other adjustments made in the preparation of the financial statements throughout the period. | <p><i>Paragraph 7.4.6(a)</i></p> <ul style="list-style-type: none"> The Project Team noted paragraphs 48–49 of ISA 240 (Revised) are based on paragraph 33(a) of ISA 240 which was addressed by paragraph 7.4.6(a). Therefore, the Project Team proposes |

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| <ul style="list-style-type: none"> Strengthened the work effort related to the requirement to test journal entries and other adjustments throughout the period by changing the work effort verb from “consider” to “determine.” Added application material that: <ul style="list-style-type: none"> Clarifies why the testing of journal entries and other adjustments is performed. Explains that the auditor’s design and performance of audit procedures over journal entries and other adjustments may be informed by: <ul style="list-style-type: none"> The auditor’s understanding of the entity and its environment, the applicable financial reporting framework and the entity’s system of internal control. Drawing on the experience and insight of the engagement partner or other key members of the engagement team. Explains how the use of automated tools and techniques may be used by the auditor to test journal entries and other adjustments. | <p>changing paragraph 7.4.6(a) to align with paragraphs 48–49 of ISA 240 (Revised).</p> |
| 17. Fraud is identified or suspected – lack of clarity around the auditor’s response in such circumstances. | |
| <p><i>Paragraphs 55–57, A7–A11, A28, A156–A172</i></p> <ul style="list-style-type: none"> Added a separate section in ISA 240 (Revised) for audit procedures when fraud is identified or suspected. Added requirements, and related application material, that: | <p><i>EEM under paragraph 7.5.5</i></p> <ul style="list-style-type: none"> See Agenda Item 6, Section II Part 7 for details on how fraud or suspected fraud are addressed in the proposed ISA for LCE (Revised). |

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| <ul style="list-style-type: none"> ○ Clarifies that the auditor is required to obtain an understanding on all instances of fraud or suspected fraud in order to determine the effect on the audit engagement. ○ Clarifies the engagement partner's responsibilities relating to fraud or suspected fraud that is not clearly inconsequential, including requiring the engagement partner to determine whether: <ul style="list-style-type: none"> ▪ Additional risk assessment procedures are needed; ▪ Further audit procedures are needed; and ▪ There are additional responsibilities under law, regulation or relevant ethical requirements. ○ Clarifies the auditor's responsibilities when the auditor identifies a misstatement due to fraud, including: <ul style="list-style-type: none"> ▪ Determining whether the identified misstatement is material; ▪ Determining whether control deficiencies exist; ▪ Determining the implications of the misstatement in relation to other aspects of the audit; and ▪ Reconsider the reliability of management's representations and audit evidence previously obtained. • Introduced a threshold in the fraud or suspected fraud requirements for the auditor to exclude from further consideration fraud or suspected fraud that is determined to be clearly inconsequential | <ul style="list-style-type: none"> • The Project Team noted that paragraph A168 of ISA 240 (Revised) is based on paragraph A53 of ISA 240 which was addressed in EEM under paragraph 7.5.5 (third paragraph). Therefore, the Project Team proposes changes to align EEM under paragraph 7.5.5. (third paragraph) with paragraph A168 of ISA 240 (Revised). • The Project Team noted that EEM under paragraph 7.5.4 is still useful as it addresses paragraph A169 of ISA 240 (Revised) and proposes moving EEM from under paragraph 7.5.4 to under paragraph 7.5.5 (fourth paragraph) since paragraph 7.5.4 is removed and replaced with paragraph 7.5.5 (see Agenda Item 6, paragraph 40 for details). |

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| 18. Unpredictability of audit procedures – unclear as to the required actions or types of fraud-related procedures to be undertaken by the auditor. | |
| <p><i>Paragraphs 43 and A126–A128</i></p> <ul style="list-style-type: none"> Relocated the requirement relating to unpredictability in the selection of audit procedures outside of the overall response section to ensure that an element of unpredictability is incorporated so that it applies to assessed ROMMs due to fraud at the assertion level and financial statement level. Enhanced the application material by adding examples of unpredictable audit procedures, including incorporating unpredictability through the use of automated tools and techniques, such as anomaly detection or statistical methods, on an entire population to identify items for further investigation. | <p><i>Paragraphs 7.2.2(b) and 7.3.2(e)</i></p> <ul style="list-style-type: none"> The Project Team noted that the equivalent of paragraph 43 in ISA 240 (Revised) (paragraph 30(c) of ISA 240) only applied to financial statement level risks. In ISA 240 (Revised), paragraph 43 applies to risks of material misstatement at the assertion level and financial statement level. The project team is of the view that the proposed ISA for LCE (Revised) should be aligned and notes the following: <ul style="list-style-type: none"> The financial statement level risk is already addressed by paragraph 7.2.2(b). Therefore, the Project Team proposes no changes to this paragraph. The assertion level risk was not addressed, and changes were made to paragraph 7.3.2(e) to incorporate it. |
| 19. Non-material fraud – clarity is needed with respect to the auditor's responsibilities and whether more should be done when a possible non-material fraud is identified or suspected. | |
| <p><i>Paragraphs A11</i></p> <ul style="list-style-type: none"> Enhanced the application material by clarifying that identified misstatements due to fraud that are not quantitatively material may be qualitatively material depending on who instigated or perpetrated the fraud and why the fraud was perpetrated. Clarified that the auditor is required to obtain an understanding on all instances of fraud or suspected fraud in order to determine the effect on the audit engagement. | <ul style="list-style-type: none"> See Agenda Item 6, paragraph 44(b) for detail. |

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| <p>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> | |
| <p><i>Paragraph 68(e)–(g)</i></p> <ul style="list-style-type: none"> Added a requirement for the auditor to document fraud or suspected fraud identified, the results of audit procedures performed, the significant professional judgments made, and the conclusions reached. | <p><i>Paragraphs 7.7.1(d) and (g), 7.7.2</i></p> <ul style="list-style-type: none"> The project team noted that paragraph 68(e)–(g) in ISA 240 (Revised) relate to Part 7 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(e) is addressed in paragraph 7.7.1(d). Paragraph 68(f) is included in paragraph 7.7.1(g) Paragraph 68(g): See Agenda Item 6, paragraph 42(b) As the documentation requirements in the proposed ISA for LCE (Revised) are aligned with the documentation requirements in the ISAs, the Project Team is of view that paragraph 7.7.2 is not necessary. Therefore, the Project Team proposes to remove paragraph 7.7.2. |
| <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>Note that PII 24 is addressed by paragraphs paras. 49(a), 55 and A158–A162. Some paragraphs are also addressing other PIIs (e.g., para. 49(a)) and therefore are explained under a different PII.</i></p> | |
| <p><i>Paragraphs 49(a), 55 and A158–A162</i></p> <ul style="list-style-type: none"> Added requirements and related application material, dealing with circumstances when the auditor identifies fraud or suspected fraud, for the auditor to make inquiries about the | <ul style="list-style-type: none"> See above PII 13 for details on paragraph 49(a) of ISA 240 (Revised). |

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| <p>matter(s) with an appropriate level of management and, when appropriate in the circumstances, TCWG.</p> | <ul style="list-style-type: none"> See Agenda Item 6, paragraphs 37–39, for details on addressing paragraph 55 of ISA 240 (Revised). |
| ISA 570 (Revised 2024)⁶ | |
| <p>27. There was a call to consider requiring the auditor to assess the reasonableness of the period utilized by management in their going concern assessment.</p> <p>28. There are inconsistencies across financial reporting frameworks in the commencement of the twelve-month period for the going concern assessment. This has resulted in reconsideration of whether the twelve-month period over which the going concern assessment is made should commence on the date of approval of the financial statements (or the date of the auditor's report) instead of the date of the financial statements. Stakeholders also noted that in considering the period of assessment, the requirements of the applicable financial reporting framework need to be taken into account.</p> | |
| <p><i>Paragraphs 21–23 and A50–A57</i></p> <ul style="list-style-type: none"> Change in the commencement date of the twelve-month period of management's assessment, which is used as the basis for the auditor's evaluation, from the date of the financial statements to the date of approval of the financial statements. Strengthened requirements when management is unwilling to make or extend its assessment to at least twelve months from the date of approval of the financial statements. New application material to: <ul style="list-style-type: none"> Explain that management and TCWG may provide the auditor additional information to support the appropriateness of the period used by management in its assessment or about events or conditions that may cast | <p><i>Paragraphs 7.4.1C–7.4.1D and EEM under paragraph 7.4.1D</i></p> <ul style="list-style-type: none"> The Project Team proposes to add paragraphs 7.4.1C–7.4.1D to mirror paragraphs 21–23 of ISA 570 (Revised 2024). In doing so, the Project Team has merged paragraph 22 and 23 into one paragraph and added a footnote to paragraph 7.4.1D to refer to Part 9 for the effect on auditor's report. Given the addition of paragraph 7.4.1C–7.4.1D, the project team deleted paragraph 7.4.2(a) as that paragraph is replaced by the newly added paragraphs. The Project Team is of view that paragraphs A55 and A56 of ISA 570 (Revised 2024) are essential to understand the scalability of the requirement when the period used in the management's assessment is less than twelve months from the date of approval |

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

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| <p>significant doubt on the entity's ability to continue as a going concern.</p> <ul style="list-style-type: none"> ○ Emphasize that the level of detail and formality of management's update to extend its assessment may vary from entity to entity and that a less formal update or lack of detailed analysis to support the update may not necessarily prevent the auditor from concluding on the appropriateness of management's use of the going concern basis of accounting. ○ Support practical application of the auditor's request to management to extend its commencement period of assessment such as making management aware, at a sufficiently early stage of the audit engagement, of the request to management to provide a going concern assessment that covers a period of at least twelve months from the date of approval of the financial statements. | <p>of the financial statements. Therefore, the Project Team proposes adding EEM under paragraph 7.4.1D (first and second paragraphs).</p> |
| <p>29. There was a call to consider when auditors may leverage information from sources external to the entity to assist them when evaluating whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern.</p> <p>30. It is unclear when it is appropriate to use information from a third-party when obtaining evidence of financial support.</p> | |
| <p><i>Paragraphs 26–28, A17, A28 and A59–A65</i></p> <ul style="list-style-type: none"> • New requirement for the auditor to obtain audit evidence about the intent and ability of a third or related party, including the entity's owner-manager, when financial support by such parties | <p><i>Paragraphs 7.4.4, 7.4.4A, 7.4.5, EEM under paragraph 7.4.4A</i></p> <ul style="list-style-type: none"> • The Project Team noted that paragraph 26 of ISA 570 (Revised 2024) is based on paragraph 16 of ISA 570 (Revised)⁷ which was addressed by paragraph 7.4.4. Therefore, the Project Team proposes aligning paragraph 7.4.4. with paragraph 26 of ISA 570 |

⁷ ISA 570 (Revised), *Going Concern*

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| <p>is necessary to support management's assessment of going concern.</p> <ul style="list-style-type: none"> New application material to: <ul style="list-style-type: none"> Provide guidance for the auditor's consideration of requesting a written confirmation from third or related parties, including the entity's owner-manager, and for the terms and conditions of borrowing facilities, including scalability considerations. Provide guidance when finance providers are reluctant to confirm to an entity or the auditor that borrowing facilities will be renewed. Emphasize how information from sources external to the entity can be leveraged in the auditor's work related to going concern. | <p>(Revised 2024) on evaluating management's plans for future actions.</p> <ul style="list-style-type: none"> See Agenda Item 6, paragraphs 45–49 for details addressing paragraph 27 of ISA 570 (Revised 2024). The Project Team proposes adding paragraph 7.4.4A to address paragraph 28 of ISA 570 (Revised 2024). The Project Team noted paragraph 26 in ISA 570 (Revised) is not included anymore in ISA 570 (Revised 2024). Therefore, the Project Team proposes to remove paragraph 7.4.5. which was based on paragraph 26 in ISA 570 (Revised). The Project Team noted that EEM under paragraph 7.4.1. (fourth paragraph) which explains the circumstances when the entity is dependent on support from the owner-manager is best placed under paragraph 7.4.4A as this specifically addresses the requirement. Therefore, the project team proposes to move the EEM. |
| <p>33. ISA 570 (Revised) does not reflect the more robust concepts in ISA 540 (Revised) when designing and performing audit procedures related to management's assessment of going concern. Embedding some of those concepts in ISA 570 (Revised) will assist the auditor by strengthening the audit procedures related to the evaluation of management's assessment of going concern, for example, in relation to the significant assumptions and data used in management's assessment of going concern.</p> | |
| <p><i>Paragraphs 16–17, 19, 24–25, 44 and A33–A36, A38–A46, A58</i></p> <ul style="list-style-type: none"> New and enhanced requirements to: <ul style="list-style-type: none"> Perform audit procedures to evaluate management's assessment of going concern, irrespective of whether events or conditions have been identified that may cast | <p><i>Paragraphs 7.4.0A, 7.4.1, 7.4.2(b), 7.4.2A, 7.7.5 and EEM under paragraph 7.4.1</i></p> <ul style="list-style-type: none"> The Project Team is of view that paragraph 16 of ISA 570 (Revised 2024) should be included in the proposed ISA for LCE (Revised) and added the requirement as the first requirement under the Going Concern section in Part 7 (see paragraph 7.4.0A). |

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| <p>significant doubt on the entity's ability to continue as a going concern.</p> <ul style="list-style-type: none"> ○ Perform audit procedures to evaluate the method, significant assumptions and data used by management to make its assessment of going concern by leveraging concepts in ISA 540 (Revised). In doing so, emphasized scalability by taking into account the results of the risk assessment procedures performed. ○ Explicitly request management to update its assessment and for the auditor to perform audit procedures, when necessary, on such revised assessment, when the auditor identifies events or conditions that may cast doubt on the entity's ability to continue as a going concern that management has not previously identified or disclosed to the auditor. ○ Promote consistent practice and behavior regarding documentation when applying ISA 230.⁸ • New application material to: <ul style="list-style-type: none"> ○ Explain what is to be understood by the term 'method' in the context of the standard, including that a method for assessing going concern may be based on using qualitative or quantitative information that involve applying assumptions and data. ○ Address scalability. In particular, to provide examples that demonstrate how the auditor's procedures may vary | <ul style="list-style-type: none"> • The Project Team noted paragraph 17 of ISA 570 (Revised 2024) is based on paragraph 12 in ISA 570 (Revised) which was addressed by paragraph 7.4.1. Therefore, the Project Team proposes changes to align paragraph 7.4.1 with paragraph 17 of ISA 570 (Revised 2024). • For paragraph 19 of ISA 570 (Revised 2024) see Agenda Item 6 paragraphs 45–49 for details. • The Project Team noted paragraph 24 of ISA 570 (Revised 2024) is based on paragraph 14 in ISA 570 (Revised) which was addressed by paragraph 7.4.2.(b). Therefore, the Project Team proposes changes to align paragraph 7.4.2(b) with paragraph 24 of ISA 570 (Revised 2024). • The Project Team proposes adding paragraph 7.4.2A which is based on paragraph 25 of ISA 570 (Revised 2024). The project team is of the view that paragraph 25 of ISA 570 (Revised 2024) applies to the typical nature and circumstances of an audit of an LCE. • The Project Team proposes adding paragraph 7.7.5 to address paragraph 44(a) of ISA 570 (Revised 2024). For Paragraph 44(b) of ISA 570 (Revised 2024) see Agenda Item 6-B.5. • The Project Team is of view that paragraph A39 of ISA 570 (Revised 2024) is essential to understand what is meant with the method related to going concern as the meaning is different than the meaning related to accounting estimates. Therefore, the Project Team proposes adding EEM under paragraph 7.4.1 |

⁸ ISA 230, *Audit Documentation*

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| <p>depending on the method, significant assumptions and data used by management to assess the entity's ability to continue as a going concern.</p> <ul style="list-style-type: none"> More robustly challenge the method, significant assumptions and data used by management to make its assessment of going concern, including considering the risk of management bias. | <p>(second paragraph).</p> <ul style="list-style-type: none"> The Project Team is of view that paragraph A35 of ISA 570 (Revised 2024) is essential to understand the requirement to evaluate management's assessment and propose to add EEM under 7.4.1 (third paragraph). |

| Changes Not Directly Linked to PII |
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| <p><i>EEM under Part 7.4</i></p> <ul style="list-style-type: none"> The Project Team is of the view that the auditor's responsibilities related to going concern are better located in Part 1 and therefore proposes moving the EEM under Part 7.4 to Part 1. See Agenda Item 6-B.1 for further details. |
| <p><i>EEM under paragraph 7.4.1</i></p> <ul style="list-style-type: none"> The Project Team noted the EEM under paragraph 7.4.1 (third paragraph) was based on paragraph A12 of ISA 570 (Revised) and the equivalent application and other explanatory material is not included in ISA 570 (Revised 2024). However, the Project Team is of the view that the guidance which explains how the auditor's evaluation may be satisfied when management has not prepared a detailed assessment is still relevant and appropriately describes the situation for many LCEs. Therefore, the Project Team proposes retaining the EEM. |
| <p><i>Paragraph 7.4.1B</i></p> <ul style="list-style-type: none"> The Project Team noted paragraph 20 of ISA 570 (Revised 2024) is based on paragraph 15 in ISA 570 (Revised) which was addressed by paragraph 7.4.3. in the ISA for LCE. Therefore, the Project Team proposes changes to align paragraph 7.4.3 with paragraph 20 of ISA 570 (Revised 2024). In addition, the Project Team proposes to move paragraph 7.4.3. to paragraph 7.4.1B to align the flow of requirements with ISA 570 (Revised 2024). |

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| Changes Not Directly Linked to PII |
| <i>EEM under paragraph 7.4.1B</i> <ul style="list-style-type: none">The Project Team proposes to make changes to the EEM under paragraph 7.4.2 so that the EEM is aligned with paragraph A47 of ISA 570 (Revised 2024). In addition, the project team proposes to move the EEM to under paragraph 7.4.1B. to place the EEM after the requirement to which the EEM relates. |
| <i>Paragraph 7.4.6(b)(ii)</i> <ul style="list-style-type: none">The Project Team proposes to move paragraph 7.4.6(b)(ii) to Part 6. See Agenda Item 6-B.3 for further details. |