

Proposed Revisions to the International Standard on Auditing for Audits of Financial Statements of Less Complex Entities

This agenda item includes selected paragraphs from the proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (the ISA for LCE), marked from the currently effective version of ISA for LCE. Changes agreed in the December 2025 meeting are hardcoded. This agenda item must be read together with **Agenda Items 6, 6-A and 6-B.1–B.7.**

A. Authority of the ISA for Audits of Financial Statements of Less Complex Entities

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Limitations for Using the ISA for LCE

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Specific Prohibitions

Paragraph A.1. sets out the classes of entities for which the use of this standard is specifically prohibited.

A.1. The ISA for LCE shall not be used if:

- (a) Law or regulation prohibits the use of the ISA for LCE or specifies the use of auditing standards other than the ISA for LCE for the audit of the financial statements in that jurisdiction.
- (b) The entity is a ~~listed entity~~ publicly traded entity.
- (c) The entity falls into one of the following classes:
 - (i) An entity one of whose main functions is to take deposits from the public;
 - (ii) An entity one of whose main functions is to provide insurance to the public; or
 - (iii) A class of entities where use of the ISA for LCE is prohibited for that specific class of entity by a legislative or regulatory authority or relevant local body with standard-setting authority in the jurisdiction.
- (d) The audit is an audit of group financial statements (group audit) and:
 - (i) Any of the group's individual entities or business units meet the criteria as described in paragraph A.1.(b) or A.1.(c); or
 - (ii) Component auditors are involved, except when the component auditor's involvement is limited to circumstances in which a physical presence is needed for a specific audit procedure for the group audit (e.g., attending a physical inventory count or physically inspecting assets or documents).

A single legal entity may be organized with more than one business unit, for example, a company with operations in multiple locations, such as a store with multiple branches. When those business

units have characteristics such as separate locations, separate management, separate general ledger and the financial information is aggregated in preparing the single legal entity's financial statements, such financial statements meet the definition of group financial statements because they include the financial information of more than one entity or business unit through a consolidation process.

In some cases, a single legal entity may configure its information system to capture financial information for more than one product or service line for legal or regulatory reporting or other management purposes. In these circumstances, the entity's financial statements are not group financial statements because there is no aggregation of the financial information of more than one entity or business unit through a consolidation process. Further, capturing separate information (e.g., in a sub-ledger) for legal or regulatory reporting or other management purposes does not create separate entities or business units (e.g., divisions) for purposes of this ISA for LCE.

Component Auditors

A component auditor is an auditor who performs audit work related to a component¹ for purposes of the group audit. A component auditor is a part of the engagement team for a group audit. Component auditors may be from a network firm, a firm that is not a network firm, or the group auditor's firm (e.g., another office within the group auditor's firm).

In some circumstances, the group auditor may perform centralized testing on classes of transactions, account balances or disclosures, or may perform audit procedures related to a component. In these circumstances, the group auditor is not considered a component auditor.

Part 3 contains requirements in relation to engagement quality, including relevant ethical requirements, and the direction and supervision of the members of the engagement team, and the review of their work.

- A.2. The classes in paragraph A.1.(a) ~~(b)~~ and (d) are outright prohibitions and cannot be modified. Legislative or regulatory authorities or relevant local bodies with standard-setting authority can define more explicitly a publicly traded entity (see paragraph A.1.(b)) or modify each class described in paragraph A.1.(c) but a class cannot be removed.

Publicly Traded Entity

If legislative or regulatory authorities or relevant local bodies with standard-setting authority define more explicitly a publicly traded entity in a specific jurisdiction, that more explicit definition applies for purposes of the ISA for LCE. Legislative or regulatory authorities or relevant local bodies with standard-setting authority may use terms other than publicly traded entity for entities where there is significant public interest in their financial condition due to the potential impact of their financial well-being on stakeholders. These terms are regarded as equivalent to "publicly traded entity".

Classes of Entities in Paragraph A.1(c)

A.1.(c) sets out some classes of entities that may exhibit public interest characteristics. Entities that have public interest characteristics could embody a level of complexity in fact or appearance and are specifically prohibited from using the ISA for LCE. Modifications can be made by adding a class of

¹ A component is an entity, business unit, function or business activity, or some combination thereof, determined by the group auditor for the purposes of planning and performing audit procedures in a group audit.

entities to the list of prohibited entities, permitting specific sub-sets within a class to be able to use this standard or using quantitative thresholds to prohibit use of this standard. Legislative or regulatory authorities or relevant local bodies with standard-setting authority may subsequently remove or amend modifications that they have made.

Qualitative Characteristics

The requirements in this ISA for LCE have been designed to be proportionate to the typical nature and circumstances of an audit of an LCE.

The ISA for LCE has not been designed to address:

- *Complex matters or circumstances relating to the nature and extent of the entity's business activities, operations and related transactions and events relevant to the preparation of the financial statements.*
- *Topics, themes and matters that increase, or indicate the presence of, complexity, such as those relating to ownership of the entity, corporate governance arrangements of the entity, or policies, procedures or processes established by the entity.*

Also, the ISA for LCE does not include any requirements addressing:

- *Procedures or matters typically relevant to ~~listed~~ publicly traded entities, including reporting on segment information or key audit matters.*
- *When the auditor intends to use the work of internal auditors, as this would ordinarily not be applicable to an audit of an LCE.*
- *When the auditor intends to use a report provided by a service auditor of a service organization either as audit evidence about the design and implementation of controls at the service organization (i.e., a type 1 or type 2 report), or as audit evidence that controls at the service organization are operating effectively (i.e., a type 2 report), as this would ordinarily not be applicable to an audit of an LCE.*

- A.3. The following list describes characteristics of an LCE for the purpose of determining the appropriate use of the ISA for LCE. The list is not exhaustive nor intended to be absolute (including numerical indicators), and other relevant matters may also need to be considered. Each of the qualitative characteristics may not, on its own, be sufficient to determine whether the ISA for LCE is appropriate or not in the circumstances. Therefore, the matters described in the list are intended to be considered both individually and in combination. For the purpose of group audits, these considerations shall apply to both the group and each of its individual entities and business units.

Business Activities, Business Model & Industry	<p>The entity's business activities, business model, or the industry in which the entity operates, do not give rise to significant pervasive business risks.</p> <p>There are no specific laws or regulations that govern the business activities that add complexity (e.g., prudential requirements).</p> <p>The entity's transactions result from few lines of business or revenue streams.</p>
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Organizational Structure and Size	The organizational structure is relatively straightforward, with few reporting lines or levels and a small key management team (e.g., 5 individuals or less).
Ownership Structure	The entity's ownership structure is straightforward and there is clear transparency of ownership and control, such that all individual owners and beneficial owners are known.
Nature of Finance Function	<p>The entity has a centralized finance function, including centralized activities related to financial reporting.</p> <p>There are few employees involved in financial reporting roles (e.g., 5 individuals or less).</p>
Information Technology (IT)	<p>The IT environment of the entity, including its IT applications and IT processes, is straightforward.</p> <p>The entity uses commercial software and does not have the ability to make any program changes other than to configure the software (e.g., the chart of accounts, reporting parameters or thresholds).</p> <p>Access to the software is generally limited to one or two designated individuals for the purpose of making the configurations.</p> <p>Few formalized general IT controls are needed in the entity's circumstances.</p>
Application of the Financial Reporting Framework and Accounting Estimates	<p>Few accounts or disclosures in the financial statements of the entity necessitate the use of significant management judgment in applying the requirements of the financial reporting framework.</p> <p>The entity's financial statements ordinarily do not include accounting estimates that involve the use of methods, models, assumptions, or data, that are complex.</p>
<p>Additional Characteristics Relevant for Group Audits</p> <p>For group audits, the following qualitative characteristics are to be considered in addition to those above:</p>	
Group Structure and Activities	<p>The group has few entities or business units (e.g., 5 or less).</p> <p>Entities or business units within the group operate in jurisdictions with similar characteristics, for example laws or regulations and business practices.</p>
Access to Information or People	Group management will be able to provide the engagement team with access to information and unrestricted access to persons within the group as determined necessary by the group auditor.

Consolidation Process	<p>The group has a simple consolidation process. For example:</p> <ul style="list-style-type: none"> • Intercompany or other consolidation adjustments are not complex; • Financial information of all entities or business units has been prepared in accordance with similar accounting policies applied to the group financial statements; and • All entities or business units have the same financial reporting period-end as that used for group financial reporting.
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Notwithstanding that professional judgment is applied in determining whether this standard is appropriate to use, if there is uncertainty about whether an audit meets the criteria as set out in this Authority, the use of the ISA for LCE is not appropriate.

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1. Fundamental Concepts, General Principles and Overarching Requirements

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1.4. Fundamental Concepts and General Principles for Performing the Audit

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Professional Skepticism

1.4.4. 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.

1.4.5. The auditor shall design and perform procedures in a way that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory.

Professional skepticism includes being 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.*
- *Information that indicates that one or more fraud risk factors are present.²*
- *Circumstances that may be indicative of fraud or suspected fraud. ~~Conditions that may indicate possible fraud.~~*
- *Circumstances that suggest the need for audit procedures in addition to those required by this standard.*

Professional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management, and where appropriate, those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances.

The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management, and where appropriate, those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less than persuasive audit evidence when obtaining reasonable assurance.

Conditions of the engagement can create pressures on the engagement team that may impede the appropriate exercise of professional skepticism when designing and performing audit procedures and when evaluating audit evidence.

1.4A. 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

² Appendix 4 sets out fraud risk factors relevant to less complex entities.

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. [Moved from EEM under paragraph 6.3.1]

Responsibility of the Auditor and Management

Where the going concern basis of accounting is a fundamental principle in the preparation of financial statements, the preparation of the financial statements requires management to assess the entity's ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so.

The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude:

- On the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements; and
- Based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on ~~about~~ the entity's ability to continue as a going concern.

These responsibilities exist even if the financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern. [Moved from EEM under Part 7.4.]

1.4A.1. The auditor shall:

- (a) Obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements;
- (b) 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) Report in accordance with this standard.

1.5. Fraud

Responsibility of the Auditor, Management and Those Charged with Governance

An auditor conducting an audit in accordance with this standard is responsible for:

- Planning and performing the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud.
- Communicating and reporting about matters related to fraud.

The primary responsibility for the prevention and detection of fraud rests with both management, and where appropriate, those charged with governance of the entity.

Characteristics of Fraud

~~Although fraud is a broad legal concept, for the purposes of this standard, the auditor is concerned with fraud that causes a material misstatement in the financial statements.~~

Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional. Two types of intentional misstatements are relevant to the auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

Although fraud is a broad legal concept, for the purposes of this standard, the auditor is concerned with a material misstatement in the financial statements due to fraud. Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred.

Inherent Limitations

~~An auditor conducting an audit in accordance with this standard 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~~While the risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error that does 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. Because of the significance of the inherent limitations of an audit as it relates to fraud, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with this standard. 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. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence.

Professional Skepticism and Professional Judgment

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.

Non-Compliance with Laws and Regulations

Fraud ordinarily constitutes an instance of non-compliance with laws and regulations. As such, if the auditor identifies fraud or suspected fraud, the auditor also has responsibilities in accordance with section 1.6. of this standard.

Relationship of Fraud with Corruption, Bribery and Money Laundering

Corruption, bribery and money laundering are forms of illegal or unethical acts and may be fraudulent acts, or may be carried out to facilitate or conceal fraud. Depending on the nature and circumstances

of the entity, certain laws, regulations or aspect of relevant ethical requirements dealing with corruption, bribery or money laundering may be relevant to the auditor's responsibilities to consider laws and regulations in an audit of financial statements.

Third-Party Fraud

Fraud or suspected fraud committed against the entity by parties external to the entity is generally described as third-party fraud. As such, if the auditor identifies or suspects an intentional act by a third party resulting in misappropriation of the entity's assets or fraudulent financial reporting by the entity, the auditor performs audit procedures in accordance with "Responding to Identified Fraud or Suspected Fraud" section in Part 7.4 of this standard. Parties external to the entity that may commit third-party fraud may include related parties, customers, suppliers, service providers or other external parties known to the entity.

1.5.1. The auditor shall address the risks of material misstatement due to fraud when:

- (a) Identifying and assessing risks of material misstatement, whether due to fraud or error. [Moved to paragraph 6.3.15]
- (b) Obtaining sufficient appropriate audit evidence through designing and implementing appropriate responses to assessed risks of material misstatement, including risks of material misstatement due to fraud; and
- (c) Responding appropriately to fraud or suspected fraud identified during the audit.

Considerations Specific to Public Sector Entities

The public sector auditor's responsibilities relating to fraud may be a result of law, regulation or other authority applicable to public sector entities or separately covered by the auditor's mandate. Consequently, the public sector auditor's responsibilities may not be limited to consideration of risks of material misstatement of the financial statements, but may also include a broader responsibility to consider risks of material misstatement due to fraud.

Auditor Unable to Continue the Engagement

1.5.2. 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, and consider whether:

- ~~(a) or consider whether it~~ It is appropriate to withdraw from the engagement, where withdrawal is possible under law or regulation; or
- ~~(b) Where withdrawal is prohibited by law or regulation, to include a disclaimer of opinion in the auditor's report.~~

Considerations Specific to Public Sector Entities

In many cases in the public sector, the option of withdrawing from the engagement may not be available to the auditor due to the nature of the mandate or public interest considerations.

1.6. Laws and Regulations

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1.6A. Reporting to an Appropriate Authority Outside the Entity

~~Reporting to an Appropriate Authority Outside the Entity~~

1.6.2. If the auditor has identified or suspects non-compliance with laws and regulations, or has identified fraud or suspected fraud, including fraud, or when the auditor considers including a separate section under the heading “Material Uncertainty Related to Going Concern” in the auditor’s report, or issuing a modified opinion in respect of matters related to going concern, the auditor shall determine whether law, regulation or relevant ethical requirements:

- (a) Require the auditor to report to an appropriate authority outside the entity.
- (b) Establish responsibilities or rights under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances.

~~Reporting identified or suspected non-compliance with laws and regulations, including fraud, to an appropriate authority outside the entity may be required or appropriate in the circumstances because:~~

- ~~• The auditor has determined reporting is an appropriate action to respond to identified or suspected non-compliance in accordance with relevant ethical requirements; or~~

~~Law, regulation or relevant ethical requirements provide the auditor with the right to do so. The reporting may be to an applicable regulatory, enforcement, supervisory or other appropriate authority outside of the entity.~~

~~Reporting matters to an appropriate authority outside the entity may involve professional judgments. Accordingly, the auditor may consider consulting internally or on a confidential basis with a regulator or professional body (unless doing so is prohibited by law or regulation or would breach the duty of confidentiality). The auditor may also consider obtaining legal advice to understand the auditor’s options and the professional or legal implications of taking any particular course of action.~~

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1.8. General Communications with Management and Those Charged with Governance

1.8.1. The auditor shall determine the appropriate person(s) within the entity’s governance structure with whom to communicate.

1.8.2. The auditor shall communicate with those charged with governance the relevant ethical requirements, including those related to independence, that the auditor applies for the audit engagement.

1.8.3. The auditor shall communicate, on a timely basis, with management and, where appropriate, 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.

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 (e.g., the governance structure may not be defined). In such cases the auditor may need to discuss and agree with management or the engaging party with whom communications should be made.

- 1.8.4. Specific matters to be communicated are required throughout this standard. The auditor shall use professional judgment in determining the appropriate form, timing, and general content of the communications with management, and where appropriate, those charged with governance. When determining the form and timing of communication, the auditor shall consider:

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

The appropriate form and timing of 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 management, and where appropriate, those charged with governance.

Communication with management and, where appropriate, those charged with governance, often may occur in a less structured manner and matters may be communicated orally. This standard requires that the auditor exercises professional judgement to determine when oral communication of a matter would not be adequate and communication in writing is appropriate. In addition, certain matters are required to be communicated in writing, as set out in this standard.

- 1.8.5. In some cases, all of those charged with governance are involved in managing the entity, for example, an LCE where a single owner manages the entity and no one else has a governance role. In these cases, if matters required by this standard are communicated with person(s) with management responsibilities, and those person(s) also have governance responsibilities, the matters need not be communicated again with those same person(s) in their governance role. The auditor shall nonetheless be satisfied that communication with person(s) with management responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity.
- 1.8.6. Where the responses to inquiries of management, and where appropriate, those charged with governance or others within the entity ~~about a particular matter~~ are inconsistent, the auditor shall investigate the inconsistencies.

~~Specific Communications in Relation to Fraud~~

- 1.8.7. [Moved to paragraph 7.6.3A]

[Moved to EEM under paragraph 7.6.3A]

- 1.8.8. [Moved to paragraph 7.6.3B]

- 1.8.9. [Moved to paragraph 7.6.3C]

~~1.9. Specific Documentation Requirements~~

~~In addition to the general documentation requirements in Part 2.4 which apply throughout the audit engagement, specific matters to be documented relevant to this Part are described below.~~

- 1.9.1. [Moved to paragraph 7.7.1(h)]

2. Audit Evidence and Documentation

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2.3. Information to be Used as Audit Evidence

Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by designing and performing procedures to identify and assess risks of material misstatement (see Part 6) and responding to assessed risks of material misstatement (see Part 7), as well as procedures in other Parts to comply with the requirements of the ISA for LCE.

Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, reperformance and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.

Audit evidence is cumulative in nature and is primarily obtained from audit procedures performed during the audit, but may also include information from other sources, such as:

- Previous audits (provided that the auditor has confirmed there are no changes);*
- Other engagements performed for the client; and*
- The firm's quality management procedures for acceptance and continuance.*

Audit evidence may come from inside or outside the entity (the entity's accounting records are an important source of audit evidence), the work of management's expert, and includes information that both supports and corroborates management's assertions, as well as contradicts such assertions.

Automated Tools and Techniques (ATT)

ATT, for the purpose of this standard, are IT-enabled processes that involve the automation of methods and procedures, for example the analysis of data using modelling and visualization, or drone technology to observe or inspect assets.

In applying this standard, an auditor may design and perform audit procedures manually or through the use of ATT, and either technique can be effective. Regardless of the tools and techniques used, the auditor is required to comply with the requirements in this standard.

Using ATT can supplement or replace manual or repetitive tasks. In certain circumstances, when obtaining audit evidence, an auditor may determine that the use of ATT to perform certain audit procedures may result in more persuasive audit evidence relative to the assertion being tested. In other circumstances, performing audit procedures may be effective without the use of ATT.

The use of ATT may potentially create biases or a general risk of overreliance on the information or output of the audit procedure performed. As powerful as these tools may be, they are not a substitute for the auditor's knowledge and professional judgment. Further, although the auditor may have access to a wide array of data, including from varying sources (i.e., increased quantity), the exercise of professional skepticism remains necessary to critically assess audit evidence arising from the use of data and from the outputs from using ATT.

- 2.3.1. When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence, including information from external information sources.

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, including the controls over its preparation and maintenance where relevant. Generally, the reliability of information is increased when it is obtained from independent sources outside of the entity, by the auditor directly, is an original document rather than a copy and is written rather than oral information. However, circumstances may exist that could affect these generalizations.

- 2.3.2. When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes including, as necessary in the circumstances:

- (a) Obtaining evidence about the accuracy and completeness of the information; and
- (b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes.

Obtaining audit evidence about the accuracy and completeness of such information may be performed concurrently with the actual audit procedure applied to the information when obtaining such audit evidence is an integral part of the audit procedure itself. In other situations, the auditor may have obtained audit evidence of the accuracy and completeness of such information by testing controls over the preparation and maintenance of the information. In some situations, however, the auditor may determine that additional audit procedures are needed.

- 2.3.3. Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. 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.

- 2.3.4. 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.

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3. Engagement Quality Management

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3.2. The Engagement Partner's Responsibilities

Leadership Responsibilities for Managing and Achieving Quality

3.2.1. The engagement partner shall take:

- (a) Overall responsibility for managing and achieving quality on the audit engagement, including being sufficiently and appropriately involved throughout the audit engagement such that the engagement partner has the basis for determining whether the significant judgments made, and conclusions reached are appropriate in the circumstances; and
- (b) Responsibility for clear, consistent and effective actions being taken that reflect the firm's commitment to quality.

The engagement partner's responsibility for managing and achieving quality is supported by a firm culture that demonstrates a commitment to quality.

Considerations When There Are Members of the Engagement Team Other Than the Engagement Partner

3.2.2. In taking overall responsibility for managing and achieving quality on the audit engagement, the engagement partner shall determine that the nature, timing and extent of direction, supervision and review is:

- (a) Responsive to the nature and circumstances of the engagement and the resources assigned; and
- (b) Planned and performed in accordance with the firm's policies or procedures, this standard, relevant ethical requirements and regulatory requirements.

Sufficient and Appropriate Involvement

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.*

Direction, Supervision and Review

The approach to direction, supervision and review may be tailored depending on, for example:

- *The engagement team member's previous experience with the entity and the area to be audited.*

- *The assessed risks of material misstatement. A higher assessed risk of material misstatement may require a corresponding increase in the extent and frequency of the direction and supervision of engagement team members and a more detailed review of their work.*
- *Fraud risk factors, fraud or suspected fraud, or control deficiencies related to the prevention or detection of fraud identified during the course of the audit engagement.*
- *The competence and capabilities of the individual engagement team members performing the audit work.*

3.2.3. The engagement partner shall take responsibility for establishing and communicating to the members of the engagement team the expected behavior of the engagement team members, including emphasizing:

- (a) That all engagement team members are responsible for contributing to the management and achievement of quality at the engagement level;
- (b) The importance of professional ethics, values and attitudes;
- (c) The importance of open and robust communication within the engagement team, and supporting the ability of engagement team members to raise concerns without fear of reprisal; and
- (d) The importance of exercising professional skepticism throughout the audit engagement.

In addressing the requirements in paragraphs 3.2.2. and 3.2.3., 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).

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5. Planning

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5.2. Planning Activities

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Engagement Team Discussion

Considerations When There Are Members of the Engagement Team Other Than the Engagement Partner

5.2.7. The engagement partner and other key engagement team members shall discuss the susceptibility of the entity's financial statements to material misstatement, including:

- (a) The application of the applicable financial reporting framework to the entity's facts and circumstances.
- (b) 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.

Discussions among the engagement team shall occur setting aside beliefs the engagement team may have that management, and where appropriate, those charged with governance are honest and have integrity.

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

In discussing how and where the entity's financial statements may be susceptible to material misstatement due to fraud, the engagement team may exchange ideas about the entity's culture, management's commitment to integrity and ethical values and fraud risk factors, including:

- *Incentives or pressures on management, those charged with governance, where appropriate, or employees to commit fraud;*
- *How one or more individuals among management, those charged with governance, where appropriate, or employees could perpetrate and conceal fraudulent financial reporting; and*
- *How assets of the entity could be misappropriated by management, those charged with governance, where appropriate, employees or third parties.*

In addition to the use of journal entries and other adjustments, significant estimates or transactions outside the normal course of business, the engagement team may consider other ways in which management may override controls, for example, creating fictitious employee or vendor records or manipulating the timing of transactions.

5.2.8. 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.

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

5.2.10. 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 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 the requirements in paragraphs 3.2.7. and 5.2.1.(e). 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.

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, based on the audit procedures performed and the evidence obtained, 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.

5.2.11. 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; ~~and~~
- (f) Whether relevant ethical requirements include provisions related to using the work of an expert.

5.2.12. 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 purposes. In the case of an auditor's external expert, the evaluation of objectivity shall include inquiry regarding interests and relationships that may create a threat to that expert's objectivity;
- (b) Obtain sufficient understanding of the field of expertise of the expert to enable the auditor to determine the nature, scope and objectives of the expert's work for the auditor's purpose, and evaluate the adequacy of that work for the auditor's purpose; and
- (c) Agree, in writing when appropriate, the nature, scope and objectives of the expert's work, the respective roles and responsibilities of the auditor and that expert, the nature, timing and extent of communications and the need for the expert to observe confidentiality requirements.

5.2.12A If, based on the evaluation in accordance with paragraph 5.2.12(a), the auditor concludes that the auditor's expert does not have the necessary competence or capabilities, or that threats to the

expert's objectivity cannot be eliminated or reduced to an acceptable level, the auditor shall not use the work of that expert.

...

5.5. Specific Documentation Requirements

In addition to the general documentation requirements in Part 2.4 which apply throughout the audit engagement, specific matters to be documented relevant to this Part are described below.

- 5.5.1. The auditor shall include in the audit documentation a description of the scope, timing and direction of the audit, including the nature, timing and extent of procedures to be performed, and significant changes made during the audit, together with the reasons for such changes.

Considerations When There Are Members of the Engagement Team Other Than the Engagement Partner

- 5.5.2. The auditor shall include in the audit documentation the matters discussed among the engagement team and significant decisions reached, including the significant decisions regarding the susceptibility of the entity's financial statements to material misstatement due to fraud.

- 5.5.3. The auditor shall include in the audit documentation the:

- (a) Following amounts and the factors considered in their determination (including any revisions as applicable):
 - (i) Materiality for the financial statements as a whole;
 - (ii) If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures; and
 - (iii) Performance materiality.
- (b) Amount below which misstatements would be considered clearly trivial.

6. Risk Identification and Assessment

...

6.2. Procedures for Identifying and Assessing Risks and Related Activities

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.

The auditor uses professional judgment to determine the nature and extent of the procedures to be performed, which may 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 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 procedures described in paragraph 6.2.3. are still required.

Designing and performing procedures to obtain audit evidence in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory 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. When obtaining audit evidence to identify and assess risks of material misstatement and design further audit procedures, the auditor shall consider information from:

- (a) The acceptance or continuance procedures; and
- (b) When applicable, other engagements performed by the engagement partner for the entity.

6.2.3. The procedures to identify and assess risks of material misstatement shall include:

- (a) Inquiries of management, and other appropriate individuals within the entity;
- (b) Analytical procedures; 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 by this Part.

Analytical procedures performed as a procedure to identify and assess risks of material misstatements help to identify inconsistencies, unusual transactions or events, and amounts, ratios, and trends that indicate matters that may have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud, including those relating to revenue accounts.

Analytical procedures performed as part of the risk identification and assessment may include both financial (e.g., sales price) and non-financial information (e.g., volume of goods sold) and the use of data aggregated at a high level. The auditor may perform a simple comparison of information, such

as the change in account balances from balances in prior periods, to identify potential higher risk areas.

Observation and inspection may support, corroborate or contradict inquiries of management and others, and may also provide information about the entity and its environment. Where policies or procedures are not documented, or the entity's controls lack formality, the auditor may still be able to obtain some audit evidence to support the identification and assessment of the risks of material misstatement through observation or inspection of the performance of the control.

Considerations Specific to Public Sector Entities

When making inquiries of those who may have information that is likely to assist in identifying risks of material misstatement, auditors of public sector entities may obtain information from additional sources such as from the auditors that are involved in performance or other audits related to the entity. Procedures performed by auditors of public sector entities to identify and assess risks of material misstatement may also include observation and inspection of documents prepared by management for the legislature, for example documents related to mandatory performance reporting.

Automated Tools and Techniques

If the auditor uses ATT, the auditor may design and perform audit procedures to identify and assess risks of material misstatement on relatively large volumes of data (from the general ledger, sub-ledgers or other operational data) including for analysis, observation or inspection.

6.2.4. In designing and performing procedures to identify and assess risks of material misstatement, whether due to fraud or error, the auditor shall: ~~consider possible risks of material misstatement arising from:~~

- (a) Consider the presence of fFraud risk factor~~or error~~;
- (b) Consider rRelated party relationships and transactions; and
- (c) Determine whether eEvents or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern.

Fraud

Fraudulent financial reporting involves intentional misstatements, including omissions of amounts or disclosures in financial statements to deceive financial statement users. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively, such as recording fictitious journal entries close to the end of the financial reporting period.

Misappropriation of assets involves the theft of the entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect.

Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

Fraud risk factors

Fraud risk factors are events or conditions that indicate an incentive or pressure to commit fraud, or provide an opportunity to commit fraud, or an attitude or rationalization that justifies the fraudulent

action. While fraud risk factors may not necessarily indicate the existence of fraud, they have often been present in circumstances where frauds have occurred and therefore may indicate risks of material misstatement due to fraud.

In an LCE there may be different fraud risk factors than in more complex entities. On one hand, management or the owner-manager may be able to exercise more effective oversight than in a more complex entity which may compensate for more limited opportunities for segregation of duties. On the other hand, less segregation of duties and more direct involvement of management or the owner-manager may provide management or the owner-manager with a greater opportunity to override controls and commit fraud. LCEs, including owner-managers may also have different pressures or incentives to commit fraud than management in more complex entities.

Appendix 4 sets out fraud risk factors relevant to less complex entities.

Related Parties

In some LCEs, related party transactions between owner-managers and close family members may be common, in particular in closely held entities. These transactions may not be conducted under normal market terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration, or for consideration significantly different from fair value.

Going Concern

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, close family members or owner-managers 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. Because of its size, an LCE may be able to respond quickly to exploit opportunities but may lack reserves to sustain operations.

The identification of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, is before consideration of any related mitigating factors included in management's plans for future actions.

Some events or conditions may not cast significant doubt when considered individually, however when considered collectively with other events or conditions they may cast significant doubt on the entity's ability to continue as a going concern.

Appendix 4A sets out events or conditions that may cast significant doubt on the entity's ability to continue as a going concern relevant to less complex entities.

6.2.4A. The auditor shall design and Pperform a retrospective review of management judgments and assumptions related to ~~significant-the outcome of previous~~ accounting estimates, ~~reflected in the financial statements of the prior year~~ or where applicable, their subsequent re-estimation to assist in identifying and assessing the risks of material misstatement, whether due to fraud or error, in the current period. [Moved from paragraph 7.4.6(b)(ii)]

6.2.5. If the audit opinion on the prior period's financial statements was modified, the auditor shall evaluate the effect on the current year's financial statements when identifying and assessing risks of material misstatement.

6.3. Understanding Relevant Aspects of the Entity

The auditor's understanding of relevant aspects of the entity, including the entity and its environment, the applicable financial reporting framework and the entity's system of internal control 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. Also, understanding relevant aspects of the entity assists the auditor in identifying fraud risk factors and events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

Inquiries of Management and Others Within the Entity

6.3.1. The auditor shall inquire of management and, where appropriate, those charged with governance, regarding:

- (a) How the entity identifies business risks relevant to the preparation of the financial statements and how they are addressed~~;~~
- (b) The risks of fraud in the entity and the controls that management has established to mitigate these risks~~;~~
- (c) The nature and extent of management's direct involvement in operations or other activities that may help management to prevent or detect misstatements in accounting information or identify controls, including controls to prevent or detect fraud, that are not operating as intended.
- (d) The identity of the entity's related parties, including:
 - (i) Changes from the prior period;
 - (ii) The nature of the relationships between the entity and these related parties; and
 - (iii) 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
- (e) Whether the entity is in compliance with laws or regulations that may have an effect on the financial statements, and if there has been any correspondence with relevant licensing or regulatory authorities that may be relevant to the financial statements.
- (f) The basis for the intended use of the going concern basis of accounting, whether events or conditions exist 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.

Inquiries of management and, when applicable, those charged with governance, assist the auditor to identify and assess risks of material misstatement and respond to those risks.

Inquiries about how the entity identifies and assesses its business risks relevant to the preparation of the financial statements may assist the auditor in understanding:

- *Where there are identified business risks;*
- *Whether, and how the entity has responded to those risks;*
- *Whether the risks faced by the entity have been identified, assessed and addressed as appropriate to the nature and circumstances of the entity.*

Inquiries about the ~~material misstatement due to risks of~~ fraud in the entity may assist the auditor in understanding:

- ~~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;~~
- 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;
- 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.

Management is often in the best position to perpetrate fraud. Accordingly, when evaluating management's responses to inquiries with an attitude of professional skepticism, the auditor may judge it necessary to corroborate responses to inquiries with information from other sources.

Inquiring about how management performs activities to prevent or detect misstatements in accounting information and identifies controls that are not operating as intended may include inquiring about what information management uses and the basis upon which management considers the information to be sufficiently reliable, as well as inquiring about how deficiencies are remediated. These inquiries assist the auditor to understand whether the other aspects of the entity's system of internal control are present and functioning as appropriate to the entity's circumstances considering the nature and complexity of the entity.

Inquiries about the basis for the intended use of the going concern basis of accounting may assist the auditor in understanding how those charged with governance exercise oversight over management's assessment of the entity's ability to continue as a going concern.

[Moved to EEM under paragraph 1.4A.1]

Considerations When There Are Members of the Engagement Team Other Than the Engagement Partner

6.3.2. The auditor shall share relevant information obtained about the entity's related parties with other members of the engagement team.

6.3.3. The auditor shall make inquiries of management, those charged with governance, and as appropriate others within the entity about:

- (a) ~~, to determine whether they have knowledge of any actual, fraud or suspected fraud, including or allegations of ed fraud affecting the entity.~~
- (b) Their views about whether and how the financial statements may be materially misstated due to fraud.

6.3.3A Unless all those charged with governance are involved in managing the entity, the auditor shall make inquiries of those charged with governance about whether they are aware of deficiencies in the system of internal control related to the prevention and detection of fraud, and the remediation efforts to address such deficiencies.

Understanding the Entity and Its Environment

6.3.4. The auditor shall obtain an understanding of:

- (a) The entity's organizational structure, ownership and governance, and business model.
- (b) The industry and other external factors affecting the entity.
- (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 the need for, or changes in, accounting estimates to be recognized or disclosed.
- (f) Agreements or relationships that may result in unrecognized liabilities or future commitments.

Understanding the entity's business model helps the auditor to understand the entity's objectives and strategy, and to understand the business risks the entity takes and faces. Understanding the entity's business risks 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. When obtaining an understanding of the entity's business model, the auditor may consider how the entity uses IT.

Relevant industry factors include industry conditions such as the competitive environment, supplier and customer relationships, and technological developments. Other external factors affecting the entity that the auditor may consider include climate-related risks, the general economic conditions, interest rates and availability of financing, and inflation or currency revaluation.

When understanding agreements or relationships that may result in unrecognized liabilities or future commitments the auditor may consider inspecting minutes of meetings and correspondence with legal counsel and inspecting legal expense accounts.

Considerations Specific to Public Sector Entities

Entities operating in the public sector may create and deliver value in different ways to those creating wealth for owners but will still have a 'business model' with a specific objective. Matters public sector auditors may obtain an understanding of that are relevant to the business model of the entity, include:

- *Knowledge of relevant government activities, including related programs.*
- *Program objectives and strategies, including public policy elements.*

Understanding the Applicable Financial Reporting Framework

6.3.5. The auditor shall obtain an understanding of:

- (a) The applicable financial reporting framework including,
 - (i) ~~F~~for accounting estimates, 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.

(ii) For going concern, the requirements 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.

(b) The entity's accounting policies and reasons for any changes thereto.

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

Understanding the Entity's System of Internal Control

In LCEs, and in particular owner-managed entities, the way in which the entity's system of internal control is designed, implemented and maintained ~~may~~^{will} vary with the entity's size and complexity. When there are no formalized processes or documented policies or procedures, the auditor is still required to obtain an understanding of how management, or where appropriate, those charged with governance prevent and detect fraud and error, and use professional judgment to determine the nature and extent of the procedures to obtain the required understanding.

Considerations Specific to Public Sector Entities

Auditors of public sector entities often have additional responsibilities with respect to internal control, for example, to report on compliance with an established code of practice or reporting on spending against budget. Auditors of public sector entities may also have responsibilities to report on compliance with law, regulation or other authority. As a result, their considerations about the system of internal control may be broader and more detailed.

Understanding the Entity's Control Environment

6.3.7. The auditor shall:

- (a) Obtain an understanding of the control environment relevant to the preparation of the financial statements; and
- (b) Evaluate whether the control environment provides an appropriate foundation for the entity's system of internal control considering the nature and complexity of the entity.

The auditor's understanding may include:

- *How management, and where appropriate, those charged with governance, oversee the entity, demonstrate integrity and ethical values, for example, through communication to employees regarding expectations for business practices and ethical behavior;*
- *The culture of the entity, including whether management supports honesty and ethical behavior;*
- *The entity's assignment of authority and responsibility;*
- *How the entity attracts, develops, and retains competent individuals; and*
- *When applicable, how owner-managers are actively involved in the business and how this may impact 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 aspects of the entity's system of internal control, and deficiencies may undermine the rest of the entity's system of internal control. Although it does not directly prevent or detect and correct misstatements, it may influence the effectiveness of other controls in the system of internal control. 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 system of internal control and its importance in the entity.

Because the control environment is foundational to the entity's system of internal control, any deficiencies could have pervasive effects on the preparation of the financial statements. Therefore, the auditor's understanding and evaluation of the control environment affects the auditor's identification and assessment of risks of material misstatement at the financial statement level, and may also affect the identification and assessment of risks of material misstatement at the assertion level, as well as the auditor's responses to the assessed risks.

Some or all aspects of the control environment may not be applicable for an LCE or may be less formalized. For example, an LCE may not have a written code of conduct but, instead, may have developed a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example.

Some entities may be dominated by a single individual who may exercise a great deal of discretion. The actions and attitudes of that individual may have a pervasive effect on the culture of the entity, which in turn may have a pervasive effect on the control environment. Domination of management by a single individual in an LCE does not generally, in and of itself, indicate a failure by management to display and communicate an appropriate attitude regarding internal control and the financial reporting process. In some entities, the need for management authorization can compensate for otherwise deficient controls and reduce the risk of employee fraud. However, domination of management by a single individual creates a conducive environment ~~can be a potential control deficiency since there is an opportunity~~ for management override of controls.

Understanding the Entity's Process to Prepare its Financial Statements

6.3.8. For significant classes of transactions, account balances and disclosures, the auditor shall obtain an understanding of the entity's process to prepare its financial statements including:

- (a) The accounting records and other records that support the classes of transactions, account balances and disclosures in the financial statements;
- (b) How transactions are initiated, and how information about them is recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
- (c) How information about events and conditions, other than transactions are identified, processed and disclosed; and
- (d) The entity's resources, including the IT environment, relevant to (a) to (c) above.
- (e) For going concern, how disclosures related to the entity's ability to continue as a going concern are addressed.

Matters the auditor may consider when obtaining an understanding of the entity's process to prepare its financial statements relating to significant classes of transactions, account balances and disclosures include how:

- *The data or information relating to transactions, other events and conditions is processed;*
- *The integrity of that data or information is maintained; and*
- *The information processes, personnel and other resources are used.*

The auditor's understanding 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 process to prepare the financial statements;*
- *Observation of the performance of the policies or procedures by entity's personnel; or*
- *Selecting transactions and tracing them through the applicable process to prepare the financial statements (i.e., performing a walk-through).*

LCEs with direct management involvement may not need extensive descriptions of accounting procedures, sophisticated accounting records, or written policies.

Automated Tools and Techniques

The auditor may also use ATT to obtain direct access to, or a digital download from, the databases in the entity's information system that store accounting records of transactions. By applying ATT to this information, the auditor may confirm the understanding obtained about how transactions flow through the information system by tracing journal entries, or other digital records related to a particular transaction, or an entire population of transactions, from initiation in the accounting records through to recording in the general ledger. Analysis of complete or large sets of transactions may also result in the identification of variations from the normal, or expected processing procedures for these transactions, which may result in the identification of risks of material misstatement.

6.3.9. For accounting estimates and related disclosures for significant classes of transactions, account balances or disclosures, the auditor shall obtain an understanding of how management:

- (a) Identifies, selects and applies relevant methods, assumptions and data that are appropriate in the context of the applicable financial reporting framework, including identification of significant assumptions;
- (b) Understands the degree of estimation uncertainty and addresses such uncertainty, including selecting a point estimate and related disclosures for inclusion in the financial statements; and
- (c) Reviews the outcome(s) of previous accounting estimates and responds to the results of that review.

6.3.10. The auditor shall evaluate whether the entity's process to prepare its financial statements, including for accounting estimates, appropriately supports the preparation of its financial statements in accordance with the applicable financial reporting framework.

...

Understanding the Entity's Control Activities

6.3.12. The auditor shall obtain an understanding of the entity's control activities by identifying controls that address risks of material misstatement at the assertion level as set out below. For each control identified in (a)–(e) below, the auditor shall perform procedures, beyond inquiry, to evaluate whether the control is designed effectively and has been implemented:

- (a) Controls that address risks determined to be significant risks;
- (b) Controls over journal entries, including journal entries to record non-recurring, unusual transactions or adjustments;
- (c) Controls, if any, for which the auditor plans to test the operating effectiveness of controls in determining the nature, timing and extent of substantive testing, including those controls that address risks for which substantive procedures alone are not enough to obtain sufficient appropriate audit evidence; and
- (d) Controls, if any, related to significant transactions and arrangements with related parties, and significant transactions and arrangements outside the normal course of business.
- (e) Controls, if any, in (a) to (d) at the user entity related to the services provided by the service organization, including those that are applied to the transactions processed by the service organization.

The auditor's required understanding of the entity's control activities involves identifying specific controls, as appropriate in the entity's circumstances, and evaluating their design and determining whether the controls have been implemented. Evaluating the design and implementation of controls includes the evaluation of whether the control is designed effectively to address the risk of material misstatement at the assertion level, or effectively designed to support the operation of other controls, and the determination whether the control has 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.

Journal Entries

Controls over journal entries are expected to be identified for all audits because the manner in which an entity incorporates information from transaction processing into the general ledger ordinarily involves the use of journal entries, whether standard or non-standard, or automated or manual. The extent to which other controls are identified may vary based on the nature of the entity and the auditor's planned approach to further audit procedures. For example, the entity's information system may not be complex and the auditor may not intend to test the operating effectiveness of controls. Further, the auditor may not have identified any significant risks or any other risks of material misstatement for which it is necessary for the auditor to evaluate the design of controls and determine that they have been implemented. In such an audit, the auditor may determine that there are no identified controls other than the entity's controls over journal entries.

Related Parties

Controls in LCEs are likely to be less formal and such entities may have no documented processes for dealing with related party relationships and transactions. An owner-manager may mitigate some of the risks arising from related party transactions, or potentially increase those risks, through active involvement in all the main aspects of the transactions. For such entities, the auditor may obtain an understanding of the related party relationships and transactions, and any controls that may exist over these, through inquiry of management combined with other procedures, such as observation of management's oversight and review activities, and inspection of available relevant documentation.

6.3.13. For the controls identified in paragraph 6.3.12. the auditor shall:

- (a) Identify the IT applications and other aspects of the IT environment that are subject to risks arising from the use of IT and what those related risks are;
- (b) Identify the entity's general IT controls that respond to those identified risks; and
- (c) By performing procedures in addition to inquiries, evaluate whether the identified general IT controls are designed effectively and have been implemented.

The auditor's understanding of the entity's process to prepare the financial statements (which may be done by performing walk-through procedures) includes the IT environment relevant to the flows of transactions and processing of information. This is because the entity's use of IT applications or other aspects of the IT environment may give rise to risks arising from the use of IT (i.e., the susceptibility of information processing controls to ineffective design or operation, or risks to the integrity of 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. General IT controls support the continued proper operation of the IT environment, including the continued effective functioning of information processing controls and the integrity of information.

Deficiencies Within the Entity's System of Internal Control

6.3.14. The auditor shall determine whether one or more deficiencies have been identified in the entity's system of internal control and, if so, whether, individually or in combination, they constitute significant deficiencies.

In understanding the entity's system of internal control, the auditor may determine that certain of the entity's policies or procedures are not appropriate to the nature and circumstances of the entity. Such a determination may be an indicator that assists the auditor in identifying deficiencies in internal control. If the auditor has identified one or more deficiencies, 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, and on the design of further audit procedures.

In understanding the entity's system of internal control, the auditor may have identified deficiencies in respect of management's assessment of going concern or the prevention or detection of fraud.

The auditor uses professional judgment in determining whether a deficiency represents a significant deficiency in internal control.

Evaluation of Fraud Risk Factors

~~6.3.15. In doing so, the~~ auditor shall evaluate whether ~~information-audit evidence~~ obtained from the procedures to identify and assess risks, and related activities, indicates that one or more fraud risk factors are present.³ **[Moved from paragraph 1.5.1(a)]**

The significance of fraud risk factors varies widely. Some fraud risk factors will be present in entities where the specific conditions do not present risks of material misstatement. Accordingly, the determination as to whether fraud risk factors, individually or in combination, indicate that there are risks of material misstatement due to fraud is a matter of professional judgment.

6.4. Identifying and Assessing the 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 and assess the risks of material misstatement, due to fraud or error, taking into account fraud risk factors, at:

- (a) The financial statement level. In doing so, the auditor shall determine whether they affect risks at the assertion level and consider the nature and extent of the pervasive effect of identified risks on the financial statements; and
- (b) The assertion level for classes of transactions, account balances, and disclosures. In doing so, the auditor shall:
 - (i) Determine the relevant assertions and related significant classes of transactions, account balances and disclosures; and
 - (ii) Assess inherent risk for identified risks of material misstatement at the assertion level by assessing the likelihood and magnitude of misstatement.

Financial Statement Level Risks

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 related to specific assertions at the class of transactions, account balance or disclosure level (e.g., risk of management override of controls).

Assertion Level Risks

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 5 sets out assertions that may be used by the auditor in considering different types of misstatements at the assertion level.

An assertion about a class of transactions, account balance or disclosure is a relevant assertion when it has an identified risk of material misstatement. The determination of whether an assertion is a relevant assertion is made 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

³ ~~Appendix 4 sets out fraud risk factors relevant to less complex entities.~~

occurring (i.e., likelihood), and being material if they were to occur (i.e., magnitude). Significant classes of transactions, account balances and disclosures are those for which there is one or more relevant assertions. Determining relevant assertions and the significant classes of transactions, account balances and disclosures provides a basis for the identification and assessment of risks of material misstatement.

Assessing Inherent Risk

The assessed inherent risk for 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 or circumstances of the entity, and takes into account the assessed likelihood and magnitude of the misstatement.

In considering the likelihood of a misstatement, the auditor considers the possibility that a misstatement may occur. 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 nature, size or circumstances).

When assessing inherent risk, factors relating to the preparation of information required by the applicable financial reporting framework that affect the susceptibility of assertions to misstatement may 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.

The presence of these factors may give rise to higher inherent risk and may be an indication that the ISA for LCE is not appropriate for the audit.

When risks of material misstatement relate more pervasively to the financial statements as a whole, and potentially affect many assertions, the risks of material misstatement are assessed at the financial statement level. When assessing risk at the assertion level, the auditor considers the degree to which the risks of material misstatement at the financial statement level affects the assessment of inherent risks for risks of material misstatement at the assertion level.

In identifying and assessing risks of material misstatement, the results of the engagement team discussion and any inquiries relating to fraud and going concern are relevant.

Fraud Risk Factors

In determining whether fraud risk factors, individually or in combination, indicate that there are risks of material misstatement due to fraud, the auditor may consider:

- The likelihood and magnitude of fraud resulting from fraud risk factors.
- The number of fraud risk factors that relate to the same class of transactions, account balance or disclosure.

Considerations Specific to Public Sector Entities

In exercising professional judgment as to the assessment of the risk of material misstatement, public sector auditors may consider the complexity of the regulations and directives, and the risks of non-compliance with authorities.

- 6.4.2. ~~When~~ identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of material misstatement due to fraud in revenue recognition, ~~determine~~evaluate which types of revenue, revenue transactions, or relevant assertions give rise to such risks, taking into account related fraud risk factors.

When identifying and assessing risks of material misstatement due to fraud, the auditor may consider whether unusual or unexpected relationships have been identified in performing analytical procedures, including those related to revenue accounts.

There may be limited circumstances where it may be appropriate to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition. The auditor may conclude that there are no risks of material misstatement due to fraud relating to revenue recognition in the case where fraud risk factors are not significant. ~~The presumption that there are risks of fraud in revenue recognition may be rebutted.~~ For example, the auditor may conclude, based on the audit evidence obtained, that there is no risk of material misstatement due to fraud relating to revenue recognition in the case where there is a single type of simple revenue transaction, for example, leasehold revenue from a single rental property.

- 6.4.3. In identifying and assessing risks of material misstatement relating to an accounting estimate and related disclosure at the assertion level, the auditor shall consider the degree to which the accounting estimate is subject to estimation uncertainty, and the degree to which the following are affected by complexity, subjectivity, change or management bias:
- The selection and application of the method, the assumptions and data used; and
 - The selection of management's point estimate and related disclosures.

Significant Risks

- 6.4.4. 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 in paragraph 6.4.6. 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.

- 6.4.5. The auditor shall determine whether the assessed risks associated with related party relationships and transactions, and assessed risks relating to accounting estimates are significant risks.

6.4.6. The auditor shall treat the following as significant risks:

- (a) Risk of material misstatement from management override of controls;
- (b) Any other risks of material misstatement due to fraud, including risks that the auditor identified in accordance with paragraph 6.4.2; or
- (c) Identified significant related party transactions outside the entity's normal course of business.

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.

...

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

6.4.8. 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, whether due to fraud or error. If not, the auditor shall perform additional procedures until audit evidence has been obtained to provide such a basis. In identifying and assessing the risks of material misstatement, the auditor shall consider all audit evidence obtained from the procedures to identify and assess the risks of material misstatement, whether corroborative or contradictory to assertions made by management.

The auditor's evaluation may indicate the existence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern that management has not previously identified or disclosed to the auditor. When management has intentionally failed to identify or disclose to the auditor events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, this may raise doubts about their integrity and honesty, such as when the auditor suspects an intention to mislead.

6.4.9. 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.

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

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.

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6.7. Specific Documentation Requirements

In addition to the general documentation requirements in Part 2.4 which apply throughout the audit engagement, specific matters to be documented relevant to this Part are described below.

The form and extent of documentation for the identification and assessment of the risks of material misstatement may be simple and relatively brief, and is influenced by:

- *The nature, size and complexity of the entity and its system of internal control.*
- *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 Part 2.4 and the matters noted below.

6.7.1. The auditor shall include the following in the audit documentation:

- (a) Key elements of the auditor's understanding obtained regarding each of the aspects of the entity and its environment, the applicable financial reporting framework, the entity's system of internal control, and the procedures performed to identify and assess risks of material misstatement;
- (b) The names of the identified related parties (including changes from prior period) and the nature of the related party relationships;
- (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;
- (d) If the auditor has concluded that the presumption that a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, applicable, the reasons for that the conclusion ~~that there is not a risk of material misstatement due to fraud related to revenue recognition;~~
- (e) The controls set out in paragraphs 6.3.12. and 6.3.13 and the evaluation whether the control is designed effectively and determination whether the control has been implemented; and
- (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.

6.7.2. The auditor shall document the basis for the evaluation about whether the ISA for LCE continues to be appropriate for the nature and circumstances of the entity being audited.

7. Responding to Assessed Risks of Material Misstatement

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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, through designing and implementing responses to those risks;
- (b) Respond appropriately to risks of material misstatement arising from fraud or suspected fraud;
- (c) Obtain sufficient appropriate audit evidence regarding management's use of the going concern assumption and related disclosures; and
- (d) Respond appropriately to identified or suspected non-compliance with law or regulation that have been identified during the audit.

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 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 an overall foundation for the operation of the other aspects of the entity's system of internal control. Although the control environment does not directly prevent, or detect and correct misstatements, it may influence the effectiveness of other controls in the system of internal control. 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 system of internal control, 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 the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall:

- (a) Evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements, may be indicative of fraudulent financial reporting ~~resulting from management's effort to manage earnings~~; and
- (b) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures.

The extent to which the auditor chooses to incorporate an element of unpredictability in the selection of the nature, timing, and extent of audit procedures is a matter of professional judgment.

Incorporating an element of unpredictability may be achieved by, for example:

- Performing ~~substantive-further audit~~ procedures on selected classes of transactions, account balances ~~or disclosures and assertions not otherwise tested due to their materiality or risk that were not determined to be material~~.
- Performing tests of detail where the auditor performed substantive analytical procedures in previous audits.
- Adjusting the timing of audit procedures from that otherwise expected.
- Using different sampling methods or using different approaches to stratify the population.
- Performing audit procedures at different locations or at locations on an unannounced basis.
- Performing substantive analytical procedures at a more detailed level or lowering thresholds when performing substantive analytical procedures for further investigation of unusual or unexpected relationships.
- Using automated tools and techniques, such as anomaly detection or statistical methods, on an entire population to identify items for further investigation.

Considerations When There Are Members of the Engagement Team Other Than the Engagement Partner

7.2.3. In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall 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 for the engagement.

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 comprise tests of controls and substantive procedures. The auditor may choose to perform tests of controls or they may be required in specific circumstances (see paragraph 7.3.2.(d)). Substantive procedures include tests of details and substantive analytical procedures.

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 relevant and reliable or to obtain additional corroborative information.

The auditor need not design and perform further audit procedures where the assessment of the risk of material misstatement is below the acceptably low level. However, as required by paragraph 7.3.14 irrespective of the assessed risk, the auditor shall perform substantive procedures for each material class of transactions, account balance, and disclosure.

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 controls, obtain more persuasive audit evidence the greater the reliance the auditor places on the operating effectiveness of controls; ~~and~~
- (d) If the auditor intends to test the operating effectiveness of controls or when substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level, design and perform tests of controls, to obtain sufficient appropriate audit evidence as to the operating effectiveness of such controls; ~~and~~
- (e) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures to address assessed risks of material misstatement due to fraud.

In some audits, the auditor may not be able to identify many controls, or the extent of documentation prepared by the entity to which they exist or operate 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.

Considerations Specific to Public Sector Entities

For the audits of public sector entities, the audit mandate and any other special auditing requirements may affect the auditor's consideration of the nature, timing and extent of further audit procedures.

7.3.3. When designing tests of controls and tests of details, the auditor shall determine the means of selecting items for testing that are effective in meeting the purpose of the audit procedure.

In selecting items for testing, the auditor is required by paragraph 2.3.1 to determine the relevance and reliability of information to be used as audit evidence; the other aspect of effectiveness (sufficiency) is an important consideration in selecting items to test. The means available to the auditor for selecting items for testing are selecting all items (100% examination), selecting specific items and audit sampling.

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External Confirmations

7.3.21. 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.

7.3.22. When using external confirmation procedures, the auditor shall maintain control over:

- (a) Determining the information to be confirmed or requested and selecting the appropriate confirming party;
- (b) Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and
- (c) Sending the requests, including follow-up requests when applicable, to the confirming party.

7.3.23. If management refuses to allow the auditor to send a confirmation request, the auditor shall:

- (a) Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness;
- (b) Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risks of material misstatement due to fraud, and on the nature, timing and extent of other audit procedures; and
- (c) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

7.3.24. If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance. The auditor also shall determine the implications for the audit and the auditor's opinion.⁴

7.3.25. If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts. If the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risks of material misstatement due to fraud, and on the related nature, timing, and extent of other audit procedures.

7.3.26. In the case of each non-response, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence.

7.3.27. The auditor shall investigate exceptions to determine whether they are indicative of misstatements.

7.3.28. The auditor shall evaluate whether the results of the external confirmation procedures, if any, provide relevant and reliable audit evidence, or whether further audit evidence is necessary.

⁴ For the effect on the auditor's report see Part 9, paragraph 9.5.14.

7.4. Specific Focus Areas

Going Concern

[EEM Moved to under paragraph 1.4A.1]

Evaluating Management's Assessment

7.4.0A. Where management has not yet performed an assessment of the entity's ability to continue as a going concern, the auditor shall request management to make its assessment. If management is unwilling to make its assessment, the auditor shall consider the implications for the audit.

7.4.1. The auditor shall design and perform audit procedures to evaluate management's assessment of the entity's ability to continue as a going concern, including the significant judgments on which management's assessment is based.⁵

When evaluating the method, significant assumptions and data used by management in assessing the entity's ability to continue as a going concern, the auditor may consider the procedures in paragraph 7.4.17.

For purposes of the evaluation of management's assessment, "method" refers to the approach taken by management to assess the entity's ability to continue as a going concern, and it is not limited to a measurement technique used by management to make an accounting estimate. A method may be based on using qualitative or quantitative information and involves applying assumptions and data, and taking into account a set of relationships between them.

~~In accordance with the requirements of this Part, the auditor needs to evaluate management's assessment of the entity's ability to continue as a 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. In such cases, it may be appropriate to discuss the medium- and long-term financing of the entity with management, provided that management's plans can be corroborated by sufficient documentary evidence and are consistent with the auditor's understanding of the entity. Therefore, the auditor's evaluation of going concern, for example, may be satisfied by discussion, inquiry and inspection of supporting documentation. It is not the auditor's responsibility to rectify a lack of analysis by management. In some circumstances, however, a less extensive analysis by management to support its assessment may not prevent the auditor from concluding whether management's use of the going concern basis of accounting is appropriate in the circumstances.

[EEM moved to under paragraph 7.4.4A]

7.4.1B 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. If management or the auditor identifies such events or conditions, the auditor shall request management to evaluate the potential significance of the events or conditions on its assessment of the entity's ability to continue as a going concern. [Moved from paragraph 7.4.3]

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 degree of uncertainty

⁵ For the effect on the auditor's report see Part 9, paragraph 9.5.17.

~~associated with the outcome of an event or condition increases more significant the going concern issues need to be before the auditor takes further action.~~ [EEM moved from under paragraph 7.4.2]

7.4.1C If management's assessment of the entity's ability to continue as a going concern covers less than twelve months from the date of approval of the financial statements, the auditor shall request management to extend its assessment period to at least twelve months from that date.

7.4.1D If management is unwilling to extend its assessment when requested to do so by the auditor, the auditor shall:

- (a) Discuss the matter with management and, where appropriate, those charged with governance; and
- (b) If, following the discussion, in the auditor's professional judgment it is necessary for management to extend its assessment and management remains unwilling to do so, determine the implications for the audit.⁶

Where management has chosen not to extend the period of assessment, management and those charged with governance may be able to provide additional information to support the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements. For example, this may be the case when the entity has profitable operations and has no liquidity concerns, and management or those charged with governance have not identified any events or conditions that may cast significant doubt beyond the period of assessment they have chosen.

The level of detail and the formality of management's process to extend its assessment of the entity's ability to continue as a going concern to at least twelve months from the date of approval of the financial statements may vary from entity to entity. For LCEs, it may often be that management can update their assessment through less formal means.

7.4.2. In evaluating management's assessment of the entity's ability to continue as a going concern, the auditor shall:

- ~~(a) Cover the same period as used by management, as required by the applicable financial reporting framework. 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.⁷~~
- ~~(b) Consider whether management's assessment includes all relevant information of which the auditor is aware of as a result of the audit.~~

[EEM Moved to under 7.4.1B]

7.4.2A If the auditor identifies events or conditions that may cast significant doubt on the entity's ability to continue as a going concern that management has not previously identified or disclosed to the auditor, the auditor shall:

⁶ For the effect on the auditor's report see Part 9, paragraphs 9.5.20 and 9.5.20A

⁷ For the effect on the auditor's report see Part 9, paragraph 9.5.20.

- (a) Discuss the matter with management to understand the effects of those events or conditions on management's assessment of the entity's ability to continue as a going concern and request management to evaluate their potential significance;
- (b) Determine whether it is necessary to request management to revise its going concern assessment to address the effect of those events or conditions; and
- (c) If applicable, design and perform additional audit procedures to evaluate management's assessment of the entity's ability to continue as a going concern.

7.4.3. [Moved to paragraph 7.4.1B]

Evaluating Management's Plans for Future Actions

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 evaluate management's plans for future actions in relation to its going concern assessment, including whether obtain sufficient appropriate audit evidence to determine whether a material uncertainty exists through performing additional procedures, including consideration of mitigating factors. These procedures shall include:

- ~~(a) Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.~~
- ~~(ab) Evaluating management's plans for future actions in relation to its going concern assessment, whether t~~The outcome of these plans is likely to be sufficient to mitigate the effects of the identified events or conditions improve the situation, and
- ~~(b) whether m~~Management's plans are feasible in the circumstances; and
- ~~(c) Management has both the intent and ability to carry out specific courses of action.~~
- ~~(c) Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:~~
 - ~~(i) Evaluating the reliability of the underlying data generated to prepare the forecast; and~~
 - ~~(ii) Determining whether there is adequate support for the assumptions underlying the forecast.~~
- ~~(d) Considering whether any additional facts or information have become available since the date on which management made its assessment.~~

[EEM moved to under paragraph 8.5.9]

If management's plans for future actions include the use of significant assumptions or data, the auditor may consider the procedures in paragraph 7.4.17.

7.4.4A. If management's plans for future actions include financial support by third parties or related parties, including the entity's owner-manager, the auditor shall obtain audit evidence about the intent and ability of those parties to maintain or provide the necessary financial support.

Continued support by owner-managers is often important to a less complex entity's ability to continue as a going concern. Where an LCE is largely financed by a loan from the owner-manager, it may be important that these funds are not withdrawn. Where an entity is dependent on additional support from the owner-manager, the auditor may evaluate the owner-manager's ability to meet the obligation

under the support arrangement. In addition, the auditor may request written confirmation of the terms and conditions attaching to such support and the owner-manager's intention or understanding.
 [Moved from EEM under paragraph 7.4.1]

~~7.4.5. If there is significant delay in the approval of the financial statements by management or those charged with governance after the date of the financial statements, the auditor shall inquire as to the reasons for the delay. If the auditor believes that the delay could be related to events or conditions relating to the going concern assessment, the auditor shall perform additional audit procedures as necessary, as well as consider the effect on the auditor's conclusion regarding the existence of a material uncertainty.~~

Management Override of Controls

7.4.6. 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, including:
 - (i) Making inquiries of individuals involved in the financial reporting process about their knowledge of inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
 - ~~(ii) Obtaining audit evidence about the completeness of the population of journal entries and other adjustments made throughout the period;~~
 - (iii) Selecting journal entries and other adjustments made at the end of a reporting period; and
 - ~~(iiiv) Considering~~Determining the need to test journal entries and other adjustments throughout the period.
- (b) Review accounting estimates for indicators of possible management biases~~es~~ and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing the review, the auditor shall:
 - ~~(i) Consider the audit evidence obtained from the retrospective review performed in accordance with paragraph 6.2.4A; and~~
 - ~~(iA) Evaluate whether the judgments and decisions made by management indicate a possible bias on the part of the entity's management, even if they are individually reasonable, that may represent a risk of material misstatement due to fraud. If so, the auditor shall~~If indicators of possible bias are identified, reevaluate the accounting estimates taken as a whole; and
 - ~~(ii) —~~ [Moved to paragraph 6.2.4A]
- (c) For significant unusual transactions outside the normal course of business for the entity or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment and information from other sources obtained during the audit, 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.

- (d) Respond to the identified risks of management override of controls to the extent not already addressed by (a) to (c).

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.

Material misstatements of financial statements due to fraud often involve the manipulation of the financial reporting process by recording inappropriate or unauthorized journal entries in the general ledger and other adjustments. 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.

Failing to obtain audit evidence about the completeness of the population may limit the effectiveness of the audit procedures in responding to the risks of management override of controls associated with fraudulent journal entries and other adjustments.

Prior to selecting items to test, the auditor may need to consider whether the integrity of the population of journal entries and other adjustments has been maintained in preparation of the financial statements.

Automated Tools and Techniques

In manual general ledger systems, non-standard journal entries may be identified through inspection of ledgers, journals, and supporting documentation. When automated procedures are used to maintain the general ledger and prepare financial statements, such entries may exist only in electronic form and may therefore be more easily identified through the use of ATT.

...

Accounting Estimates

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Testing How Management Made the Accounting Estimate

7.4.17. When testing how management made the accounting estimate, the auditor's further audit procedures shall address whether:

- (a) The method selected is appropriate;
- (b) The significant assumptions and data are consistent and appropriate, and their integrity maintained in applying the method;
- (c) Changes from prior periods in the method, significant assumptions and data are appropriate;
- (d) Management has the intent to carry out specific courses of actions;
- (e) The judgments made in selecting the method, significant assumptions and data, give rise to indicators of possible management bias. When indicators of possible management bias are identified, the auditor shall evaluate the implications for the audit. Where there is intention to mislead, management bias is fraudulent in nature;
- (f) The data is relevant and reliable in the circumstances; and

- (g) Calculations are mathematically accurate and whether judgements have been applied consistently.

Method, Significant Assumptions and Data

Relevant considerations for the auditor regarding the appropriateness of the method, significant assumptions and data in the context of the applicable financial reporting framework, and, if applicable, the appropriateness of changes from the prior period may include:

- *Management's rationale for the selection of the method, assumption and data;*
- *Whether the method, assumption and data are appropriate in the circumstances given the nature of the accounting estimate, the requirements of the applicable financial reporting framework, and the business, industry and environment in which the entity operates;*
- *Whether a change from prior periods in selecting a method, assumption or data is based on new circumstances or new information. When it is not, the change may not be reasonable nor in compliance with the applicable financial reporting framework. Arbitrary changes in an accounting estimate may give rise to material misstatements of the financial statements or may be an indicator of possible management bias.*
- *When management has determined that different methods result in a range of significantly different estimates, how management has investigated the reasons for these differences.*
- *Whether the significant assumptions are inconsistent with each other and with those used in other accounting estimates.*

Automated Tools and Techniques (ATT)

ATT may be used when testing significant assumptions or data used. For example, ATT may be used when evaluating the reliability of data or evaluating management's significant assumptions by performing sensitivity analysis to understand how outcomes are affected by changes in input variables, such as discount or growth rates.

7.4.18. The auditor's further audit procedures shall address whether, in the context of the applicable financial reporting framework, management has taken appropriate steps to understand estimation uncertainty and address estimation uncertainty by selecting appropriate point estimates and developing related disclosures. When management has not undertaken appropriate steps, the auditor shall:

- (a) Request management to perform additional procedures to understand estimation uncertainty or to address it by reconsidering the selection of management's point estimate or considering providing additional disclosures related to the estimation uncertainty; and
- (b) If the auditor determines that management's response to the auditor's request does not sufficiently address estimation uncertainty, to the extent practicable, develop an auditor's point estimate or range.

When the applicable financial reporting framework does not specify how to select a point estimate from among reasonably possible outcomes or does not require specific disclosures, the exercise of judgment by management is an important consideration for the auditor regarding the appropriateness of the point estimate selected and the related disclosures.

Matters that may be relevant for the auditor regarding management's disclosures about estimation uncertainty include the requirements of the applicable financial reporting framework, which may require disclosures:

- *That describe the amount as an accounting estimate and explain the nature and limitations of the process for making it; and*
- *About material accounting policy information related to accounting estimates, which may include significant or critical management judgments as well as significant forward-looking assumptions or other sources of estimation uncertainty.*

...

Litigation and Claims

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

7.4.24. If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by this standard, seek direct communication with the entity's external legal counsel. The auditor shall do so through a letter of inquiry, prepared by management and sent by the auditor, requesting the entity's external legal counsel to communicate directly with the auditor.⁸

7.4.25. The auditor shall modify the opinion in the auditor's report,⁹ if:

- (a) Management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding; and
- (b) The auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures.

Audit Procedures When Non-Compliance with Law or Regulation is Identified or Suspected

7.4.26. 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.¹⁰

⁸ — For the effect on the auditor's report see Part 9, paragraph 9.5.14.

⁹ For the effect on the auditor's report see Part 9, paragraph 9.5.16.

¹⁰ For the effect on the auditor's report see Part 9, paragraph 9.5.10.

7.4.27. If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws or regulations, the auditor shall:

- (a) Understand the nature and circumstances, and obtain 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 or regulation;
- (c) If sufficient information about suspected non-compliance cannot be obtained, evaluate the effect of the lack of sufficient 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 and take appropriate action.¹¹

Responding to Identified Fraud or Suspected Fraud

7.4.27A. If the auditor identifies fraud or suspected fraud, the auditor shall obtain an understanding of the matter(s) in order to determine the effect on the audit engagement. In doing so, the auditor shall:

- (a) Make inquiries about the matter(s) with the appropriate level of management and, when appropriate, with those charged with governance; and
- (b) If the entity has a process to investigate the matter(s) or has implemented remedial actions to respond to the matter(s), evaluate whether they are appropriate in the circumstances.

7.4.27B. Except for fraud or suspected fraud determined by the auditor to be clearly inconsequential, the engagement partner shall:

- (a) Determine whether:
 - (i) To perform additional procedures to identify and assess risks to provide an appropriate basis for the identification and assessment of the risks of material misstatement due to fraud;
 - (ii) To design and perform further audit procedures to appropriately respond to the risks of material misstatement due to fraud; and
 - (iii) There are additional responsibilities for the auditor under law, regulation or relevant ethical requirements about the entity's non-compliance with laws or regulations.
- (b) If applicable, consider the impact on prior period audits.

When fraud or suspected fraud is identified, the auditor may involve individuals with specialized skills or knowledge, such as an individual with forensic skills. Forensic skills may combine accounting, auditing and investigative skills.

The understanding obtained about the fraud or suspected fraud impacts the engagement partner's determination of whether and how to adjust the overall audit strategy, especially in circumstances when information comes to the engagement partner's attention that differs significantly from the information available when the overall audit strategy was originally established.

¹¹ For the effect on the auditor's report see Part 9, paragraphs 9.5.11., 9.5.12. and 9.5.13.

...

7.5. Accumulation of Misstatements

7.5.1. The auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial.

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 nature, size 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.

7.5.2. The auditor shall request management to correct all misstatements accumulated during the audit.

7.5.3. If, at the auditor's request, management has examined a class of transactions, account balance or disclosure and corrected misstatements that were detected, the auditor shall perform additional audit procedures to determine whether misstatements remain.

Such a request may be made, for example, based on the auditor's projection of misstatements identified in an audit sample to the entire population from which it was drawn.

~~7.5.4. 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.~~

[Moved to EEM under paragraph 7.5.5]

7.5.5. If the auditor identifies a misstatement ~~due to 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~~ Determine whether the identified misstatement is material by considering the nature of the qualitative or quantitative circumstances giving rise to the misstatement; ~~or~~

(aA) Determine whether control deficiencies exist;

(aB) Determine the implications of the misstatement in relation to other aspects of the audit; and

(b) ~~Consider whether circumstances or conditions indicate possible collusion involving employees, management or third parties when reconsidering~~ Reconsider the reliability of management's representations and audit evidence previously obtained.

Even when an identified misstatement due to fraud is not quantitatively material, it may be qualitatively material depending on:

- Who instigated or perpetrated the fraud – a fraud perpetrated by senior management, or a public official is ordinarily considered qualitatively material irrespective of the amount involved.
- Why the fraud was perpetrated – misstatements may have been made intentionally by management to manage earnings.

Considerations Specific to Public Sector Entities

In the public sector, misstatements may have been made intentionally by management to achieve a surplus when a deficit is prohibited by legislation or to misreport expenses incurred to avoid breaching statutory limits.

The implications of *an identified misstatement due to suspected fraud on the reliability of information intended to be used as audit evidence* depends on the circumstances. For example, an otherwise insignificant fraud may be significant if it involves senior management. In such circumstances, the reliability of *information previously obtained and intended to be used as audit evidence previously obtained* may be called into question *as, since* there may be doubts about the completeness and truthfulness of representations made and about the *authenticity/genuineness* of accounting records and documentation. *There may also be a possibility of collusion involving employees, management or third parties.*

Since fraud involves incentive or pressure to commit fraud, a perceived opportunity to do so or some rationalization of the act, an instance of fraud is unlikely to be an isolated occurrence. Accordingly, misstatements, such as numerous misstatements even though the cumulative effect is not material, may be indicative of a risk of material misstatement due to fraud. [Moved from EEM under paragraph 7.5.4]

7.5.6. The auditor shall determine whether the scope, timing and direction of the audit needs to be revised if:

- (a) The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material; and
- (b) The aggregate of misstatements accumulated during the audit approaches materiality.

7.6. Specific Communication Requirements

...

Specific Communications in Relation to Fraud

7.6.3A. If the auditor ~~has identified~~ identifies fraud or suspected fraud ~~or has obtained information that indicates that fraud may exist,~~ the auditor shall communicate these matters, unless prohibited by law or regulation, 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. [Moved from paragraph 1.8.7]

If the auditor identifies fraud or suspected fraud, it is important that the matter be brought to the attention of management as soon as practicable, even if the matter may be considered clearly inconsequential.

Considerations Specific to Public Sector Entities

In the public sector, requirements for reporting fraud, whether or not discovered through the audit process, may be subject to specific provisions of the audit mandate or related law, regulation or other authority. [EEM moved from under paragraph 1.8.7]

7.6.3B. Unless prohibited by law or regulation, the auditor shall communicate with those charged with governance, on a timely basis, if the auditor has identified or suspects fraud involving:

- (a) Management, unless those charged with governance are involved in managing the entity;

- (b) Employees who have significant roles in the entity's system of internal control; or
- (c) Others, ~~except for matters that are clearly inconsequential where the fraud results in a material misstatement in the financial statements.~~ [Moved from paragraph 1.8.8]

7.6.3C. If the auditor identifies suspected fraud involving management, the auditor shall communicate ~~discuss~~ with those charged with governance the nature, timing and extent of audit procedures necessary to complete the audit. [Moved from paragraph 1.8.9]

7.7. Specific Documentation Requirements

In addition to the general documentation requirements in Part 2.4 which apply throughout the audit engagement, specific matters to be documented relevant to this Part are described below.

7.7.1. 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 linkage between the procedures performed and the assessed risks at the assertion level;
- (c) The results of the audit procedures, including the conclusions where these are not otherwise clear;
- (d) The results of audit procedures ~~designed~~ performed to address the risk of management override of controls, ~~the significant professional judgments made, and the conclusions reached;~~
- (e) All misstatements accumulated during the audit and whether they have been corrected; and
- (f) If the auditor plans to use audit evidence about the operating effectiveness of controls obtained in previous audits, the conclusions reached about relying on such controls that were tested in a previous audit.
- (g) Fraud or suspected fraud identified, the results of audit procedures performed, the significant professional judgments made, and the conclusions reached.
- (h) ~~The auditor shall include in the audit documentation c~~ommunications about matters related to fraud or suspected fraud made to management, those charged with governance, regulators, regulatory and enforcement authorities, and others, including how management, and where applicable, those charged with governance have responded to the matters. [Moved from paragraph 1.9.1.]

~~7.7.2. Where the assessed risk of material misstatement is due to fraud, the auditor's documentation shall include the specific fraud response.~~

7.7.3. Where the auditor has identified or suspected non-compliance with laws and regulations, the auditor shall document:

- (a) The results of discussion with management, and where appropriate, those charged with governance and others; including how the matter has been responded to; and
- (b) The audit procedures performed, the significant professional judgments made, and the conclusions reached thereon.

7.7.4. In respect of accounting estimates, the auditor shall document significant judgments relating to the auditor's determination of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated.

7.7.5. In respect of going concern, the auditor shall include in the audit documentation significant professional judgments made relating to the auditor's conclusions on:

(a) The appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements; and

(b) Whether or not a material uncertainty exists.

8. Concluding

...

8.3. Analytical Procedures that Assist When Forming an Overall Conclusion

- 8.3.1. 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, and to identify any indications of a previously un~~recognized~~~~identified~~ risk of material misstatement due to fraud.

Automated Tools and Techniques

The auditor may use ATT to identify unusual or inconsistent transaction posting patterns in order to determine if there is a previously unrecognized risk of material misstatement due to fraud.

- 8.3.2. The auditor shall investigate fluctuations or relationships that are inconsistent with other relevant information obtained during the course of the audit, by inquiring of management and performing other audit procedures as necessary in the circumstances.

8.4. Subsequent Events

...

Facts Which Become Known to the Auditor After the Date of the Auditor's Report but Before the Date the Financial Statements Are Issued

- 8.4.4. The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, if the auditor becomes aware of facts or events that, had it been known to the auditor at the date of the auditor's report but before the financial statements are issued, may have caused the auditor to amend the auditor's report, the auditor shall discuss with management, and where appropriate, those charged with governance, and determine whether the financial statements need amendment and, if so, inquire how management intends to address the matter.
- 8.4.5. If management amends the financial statements, the auditor shall carry out the audit procedures necessary in the circumstances on the amendment, including extending the audit procedures performed to the date of the new auditor's report and providing a new auditor's report on the amended financial statements.
- 8.4.6. In jurisdictions where management is not required by law, regulation or the financial reporting framework to issue amended financial statements, the auditor need not provide an amended or new auditor's report. However, if management does not amend the financial statements in circumstances where the auditor believes they need to be amended, then the auditor shall:
- (a) If the auditor's report has not yet been provided to the entity modify the opinion and then provide the auditor's report;¹² or
 - (b) If the auditor's report has already been provided to the entity, notify management and those charged with governance not to issue the financial statements to third parties before the

¹² For the effect on the auditor's report see Part 9, paragraph 9.5.21.

necessary amendments have been made. If the financial statements are nevertheless subsequently issued without the necessary amendments, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report.

...

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

Evaluations Required

- 8.5.1. Based on the audit procedures performed and the audit evidence obtained, the auditor shall evaluate whether the assessments of the risks of material misstatement due to fraud or error at the financial statement and assertion levels remain appropriate.

An audit of financial statements is a cumulative and iterative process. As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing or extent of planned audit procedures. Information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based. In such circumstances, the auditor may need to reevaluate the planned audit procedures, based on the revised consideration of assessed risks for all or some of the classes of transactions, account balances, or disclosures and related assertions.

The auditor may also consider whether such information changes the auditor's determination about the appropriateness of use of the ISA for LCE for the audit, which may necessitate a modification to the terms of engagement.

- 8.5.2. For accounting estimates, the auditor shall evaluate, based on the audit procedures performed and audit evidence obtained, whether:
- (a) The assessments of the risks of material misstatement at the assertion level remain appropriate, including when indicators of possible management bias have been identified; and
 - (b) Management's decisions about the recognition, measurement, presentation, and disclosure of accounting estimates in the financial statements are reasonable in the context of the applicable financial reporting framework.
- 8.5.3. The auditor shall evaluate whether two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, the auditor shall evaluate the effect, if any, on the audit and take action as appropriate.

For example, the original risk assessments may need to be revised, the auditor's opinion may need to be modified on the basis of a scope limitation or other actions may need to be taken as appropriate.

- 8.5.4. 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.

Concluding

8.5.5. 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.

8.5.6. 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.¹³

8.5.7. The auditor shall evaluate whether sufficient appropriate audit evidence has been obtained regarding, and shall conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.¹⁴ In doing so, the auditor shall evaluate whether the judgments and decisions made by management in making its assessment of the entity's ability to continue as a going concern are indicators of possible management bias. When indicators of possible management bias are identified, the auditor shall evaluate the implications for the audit.

8.5.8. The auditor shall conclude, based on the audit evidence obtained, 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.⁴⁵

When events or conditions are identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor's conclusion is dependent on the auditor's evaluation of management's plans for future actions.

Plans for future actions may include, for example, that management realizes assets sooner than originally intended or obtains alternative or additional sources of liquidity to support the entity's ability to continue as a going concern. In such circumstances, the timing of the events or conditions giving rise to the uncertainty may also be relevant.

8.5.8A. 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, including, as applicable, when significant judgments are made by management in concluding that there is no material uncertainty. [Moved from paragraph 8.5.10]

When significant judgments are made by management in concluding that there is no material uncertainty, the auditor may determine, depending on the facts and circumstances, that additional disclosures are necessary for the financial statements to achieve fair presentation (for fair presentation frameworks) or for the financial statements not to be misleading (for compliance frameworks), as appropriate

¹³ For the effect on the auditor's report see Part 9, paragraph 9.5.27.

¹⁴ For the effect on the auditor's report see Part 9, paragraph 9.5.17.

⁴⁵ ~~For the effect on the auditor's report see Part 9, paragraph 9.5.18.~~

8.5.9. 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 the financial statements:¹⁶

- (a) Adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans for future actions to address to deal with these events or conditions; and
- (b) Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business and continue its operations for the foreseeable future.

~~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".~~

~~When Aa material uncertainty exists, when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's professional judgment, appropriate adequate disclosure of the nature and implications of the uncertainty is, for a fair presentation framework, necessary for the fair presentation of the financial statements or, for a compliance framework, necessary for the financial statements not to be misleading. [EEM moved from under paragraph 7.4.4]~~

~~8.5.10. [Moved to paragraph 8.5.8A]~~

8.5.11. If the auditor ~~confirms~~ determines that, ~~or is unable to conclude whether,~~ the financial statements are materially misstated ~~as a result of due to~~ fraud ~~or the auditor is unable to obtain sufficient appropriate audit evidence to enable the auditor to conclude whether the financial statements are materially misstated due to fraud,~~ the auditor shall:

- ~~-(a) evaluate Determine~~ the implications ~~on for~~ the audit and the auditor's opinion on the financial statements in accordance with Part 9; and
- ~~(b) If appropriate, obtain advice from legal counsel. including on the assessed risks of material misstatement and the auditor's report.~~

8.6. Written Representations

Written representations are necessary information that the auditor requests 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 obtain written representations from management who have appropriate knowledge of the matters concerned and responsibility for the financial statements, and where appropriate those charged with governance, about the following matters:

¹⁶ If adequately disclosed in accordance with paragraph 8.5.9, for the effect on the auditor's report see Part 9, paragraph 9.6.6. In such case, "Material Uncertainty Related to Going Concern" section is used instead of "Going Concern" section. If adequate disclosures are not made, for the effect on the auditor's report see Part 9, paragraphs 9.5.18. and 9.5.19.

- (a) That they have fulfilled their responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation. The responsibilities shall be described in the same way in the representation as described in the terms of engagement;
- (b) That they have provided the auditor with all relevant information and access as agreed in the terms of the audit engagement;
- (c) That all transactions are recorded and are reflected in the financial statements;
- (d) With respect to fraud:
 - (i) That they acknowledge their responsibility for the design, implementation and maintenance of controls to prevent and detect fraud and have appropriately fulfilled those responsibilities;
 - ~~(e)~~ (ii) That they have disclosed to the auditor the result of its assessment of the risk that the financial statements may be materially misstated because of fraud;
 - ~~(f)~~ (iii) That their knowledge of fraud, or suspected fraud, ~~or including~~ allegations of fraud ~~or suspected fraud~~ has been disclosed to the auditor;
- (g) With respect to related parties:
 - (i) That they have disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which they are aware;
 - ~~(h)~~ (ii) That they have 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;
- (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 respect 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 the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed;
- (m) With respect to going concern, ~~if a material uncertainty exists, information about their plans for future actions and the feasibility of these plans;~~
 - (i) Whether the use of the going concern basis of accounting in the preparation of the financial statements is appropriate;

- (ii) Whether the methods, significant assumptions and data used in making the assessment of going concern and any related disclosures are appropriate in accordance with the applicable financial reporting framework;
 - (iii) That the assessment of going concern reflects all events or conditions that may cast significant doubt on the entity's ability to continue as a going concern that they are aware of, and all such events or conditions, if any, have been disclosed to the auditor;
 - (iv) That matters relevant to going concern have been adequately disclosed in the financial statements, including, when applicable, significant judgements made by management in concluding that there is no material uncertainty;
- (n) Regarding any restatement made to correct a material misstatement in prior period financial statements that affect the comparative information; and
- (o) Other representations the auditor determines necessary to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements, including where necessary to support oral representations.

8.6.2. The auditor shall consider the need to obtain representations about specific accounting estimates.

8.6.2A. If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the written representations shall also address management's plans for future actions and whether such plans mitigate the effects of the identified events or conditions, the feasibility of these plans and whether management has the intent to carry out specific courses of action and has the ability to do so.

8.6.3. The written representation shall be in the form of a representation letter addressed to the auditor.

Appendix 7 sets out an illustrative representation letter.

If law or regulation requires management to make written public statements about its responsibilities, and the auditor determines that such statements provide some or all of the representations required by this standard, the relevant matters covered by such statements need not be included in the representation letter.

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 competence, integrity, ethical values, or diligence of management, or about its commitment to or enforcement of these, or representations received are inconsistent with other audit evidence, the auditor shall determine the effect on audit evidence more generally and take appropriate actions, including considering the possible effect on the opinion in the auditor's report¹⁷ having regard to the requirement in paragraph 8.6.7.

In the case of identified inconsistencies between one or more written representations and audit evidence obtained from another source, the auditor may consider whether the risk assessment remains appropriate and, if not, revise the risk assessment and determine the nature, timing and extent of further audit procedures to respond to the assessed risks.

¹⁷ For the effect on the auditor's report see Part 9, paragraph 9.5.22.

Concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, may cause the auditor to conclude that the risk of management misrepresentation in the financial statements is such that an audit cannot be conducted. In such a case, the auditor may consider withdrawing from the engagement, where withdrawal is possible under applicable law or regulation, unless those charged with governance put in place appropriate corrective measures. Such measures, however, may not be sufficient to enable the auditor to issue an unmodified audit opinion.

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 report¹⁸ having regard to the requirement in paragraph 8.6.7.

8.6.7. If the auditor concludes that there is sufficient doubt about the integrity of management such that the written representations required by paragraphs 8.6.1.(a)–(c) are not reliable¹⁹ or management does not provide the written representations required by paragraphs 8.6.1.(a)–(c),²⁰ the auditor shall disclaim an opinion on the financial statements.

8.6.8. 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. The written representations shall be for all financial statements and period(s) referred to in the auditor's report.

...

8.8. Specific Communication Requirements

8.8.1. The auditor shall communicate, on a timely basis, all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation.

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

- (a) Uncorrected misstatements and the effect that they, individually or in aggregate, may have on the auditor's opinion, unless prohibited by law or regulation. The auditor's communication shall identify the material uncorrected misstatements individually.
- (b) The effect of uncorrected misstatements from prior periods on the current year's financial statements.
- (c) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates, and financial statement disclosures.
- (d) Significant difficulties, if any, encountered during the audit.

¹⁸ For the effect on the auditor's report see Part 9, paragraph 9.5.23.

¹⁹ For the effect on the auditor's report see Part 9, paragraph 9.5.24.

²⁰ For the effect on the auditor's report see Part 9, paragraph 9.5.25.

- (e) Significant matters arising during the audit, including in connection to the entity's related parties, that were discussed, or subject to correspondence, with management.
- (f) Significant findings from the audit. If, in the auditor's professional judgment, oral communications would not be adequate this communication shall be in writing.
- (g) 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.
- (h) Circumstances, if any, that affect the form and content of the auditor's report.
- (i) Written representations the auditor is requesting.
- (j) Other significant matters, if any, arising from the audit that, in the auditor's professional judgment, are relevant to the oversight of the financial reporting process.
- (k) The expectation thereof and the wording if the auditor expects to include an Emphasis of Matter or Other Matter Paragraph in the auditor's report.

8.8.3. Unless all those charged with governance are involved in managing the entity, the auditor shall communicate on a timely basis with those charged with governance 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;
- (bA) An overview of the audit procedures performed and the basis for the auditor's conclusions, including the auditor's evaluation of management's plans for future actions;
- (c) The adequacy of related disclosures in the financial statements, including disclosures that describe the significant judgments made by management;
- (cA) When applicable, management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested; and
- (d) ~~Where applicable, t~~he implications for the auditor's report.

8.9. Specific Documentation Requirements

In addition to the general documentation requirements in Part 2.4 which apply throughout the audit engagement, specific matters to be documented relevant to this Part are described below.

8.9.1. The auditor shall include the following in the audit documentation:

- (a) All misstatements accumulated during the audit and whether they have been corrected, and the auditor's conclusion as to whether the uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion; ~~and~~
- (b) The nature and scope of, and conclusions from, consultations undertaken during the audit, including how such conclusions were implemented; ~~and~~
- (c) Significant professional judgments made relating to the auditor's determination of the adequacy of management's disclosures in the financial statement related to going concern.

8.9.2. The auditor's documentation shall demonstrate that information in the financial statements agrees or reconciles with the underlying accounting records, including agreeing or reconciling disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers.

8.9.3. 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.

ISQM 1 (or national requirements that are at least as demanding) requires firms' systems of quality management to establish a quality objective that addresses the assembly of engagement documentation on a timely basis after the date of the engagement reports.²¹ 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.²²

8.9.4. After assembly of the final audit file is complete, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.

ISQM 1 (or national requirements that are at least as demanding) requires firms' systems of quality management to establish a quality objective that addresses the appropriate maintenance and retention of engagement documentation to meet the needs of the firm and to comply with law, regulation, relevant ethical requirements, or professional standards.²³ The retention period for audit engagements ordinarily is no shorter than five years from the date of the auditor's report, or, if later, the date of the auditor's report on the group financial statements, when applicable.²⁴

8.9.5. 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).

8.9.6. 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.

²¹ ISQM 1, paragraph 31(f)

²² ISQM 1, paragraph A83

²³ ISQM 1, paragraph 31(f)

²⁴ ISQM 1, paragraph A85

9. Forming an Opinion and Reporting

...

9.4. Auditor's Report

9.4.1. The auditor shall report in accordance with the specified format and content below unless:

- (a) Amendment to the auditor's report is required for compliance with a specific layout or wording of the auditor's report required by law or regulation of a jurisdiction. When the layout or wording of the auditor's report is prescribed by law or regulation, the auditor's report shall refer to this ISA for LCE only if the elements of the specified format and content illustrated below are included;
- (b) The auditor is required to conduct the audit in accordance with the auditing standard of a specific jurisdiction for less complex entities (the "national LCE auditing standard") that prescribes a layout or wording of the auditor's report different from that required by the ISA for LCE and has additionally complied with the ISA for LCE in the conduct of the audit. If this is the case, the auditor's report may refer to the ISA for LCE in addition to the national LCE auditing standard only if the auditor's report includes the elements of the specified format and content illustrated below; or
- (c) The auditor's report includes a modified opinion, emphasis of matter paragraph, other matter paragraph, material uncertainty related to going concern, other reporting responsibilities, or a separate section dealing with Other Information, in which case the auditor shall modify the auditor's opinion (according to Part 9.5.) or amend the auditor's report (according to ~~Parts 9.6–9.8.~~).

INDEPENDENT AUDITOR'S REPORT

To the [Shareholders of ABC Company or Other Appropriate Addressee]²⁵

Opinion

We have audited²⁶ the financial statements of [ABC Company (the Entity)], 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 (replace these report names with the appropriate titles)].²⁷

In our opinion, the accompanying financial statements ["present fairly, in all material respects" or "give a true and fair view of"]²⁸ the financial position of the [Entity] 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].²⁹

Basis for Opinion

We conducted our audit in accordance with the International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (the ISA for LCE). Our responsibilities under the ISA for LCE are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.³⁰ We are independent of the [Entity] 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.³¹

Going Concern

No Material Uncertainty Related to Going Concern^{32 33}

In the context of our audit of the financial statements as a whole, and in forming our opinion thereon, we have concluded that management's use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Based on the audit evidence obtained, we have not identified a material uncertainty related to events or conditions that may cast significant doubt on the [Entity's] ability to continue as a going concern.

Our conclusions are based on the audit evidence obtained up to the date of our auditor's report and are not a guarantee as to the [Entity's] ability to continue as a going concern.

Responsibilities of [Management] for the Financial Statements³⁴

[Management] is responsible for the preparation [and fair presentation] of the financial statements in accordance with [applicable financial reporting framework],³⁵ 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 [Entity'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 [Entity] or to cease operations, or has no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Financial Statements^{36 37}

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 aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these

- ²⁵ Matters reflected in the specified format and content of the auditor's report in square brackets (e.g. []) are to be tailored accordingly.
- ²⁶ When disclaiming an opinion, the statement which indicates that the financial statements have been audited is amended to state that the auditor was engaged to audit the financial statements.
- ²⁷ Identify the entity whose financial statements have been audited; identify each financial statement and its date and period, and refer to the notes and significant accounting policies or use another appropriate description in accordance with the applicable financial reporting framework.
- ²⁸ See also 9.4.2 below. When the financial statements are prepared in accordance with a compliance framework, the opinion and description of the auditor's responsibilities refer instead to whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.
- ²⁹ Identify the jurisdiction of origin of the financial reporting framework if it is not International Financial Reporting Standards or International Public Sector Accounting Standards as issued by the International Public Sector Accounting Standards Board.
- ³⁰ When the auditor disclaims an opinion on the financial statements, this statement is not included in the auditor's report.
- ³¹ When the auditor expresses a qualified or adverse opinion, the statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion is amended to include the word "qualified" or "adverse", as appropriate. When the auditor disclaims an opinion on the financial statements, this statement is not included in the auditor's report.
- ³² This additional sub-title may be useful to enhance intended users' understanding about the nature of the matters addressed in the Going Concern section of the auditor's report.
- ³³ If the auditor concludes that the going concern basis of accounting is appropriate and no material uncertainty exists, and when significant judgments are made by management in concluding that there is no material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, the auditor may decide to include:
(i) A reference to the related disclosure(s) in the financial statements, if any; and
(ii) Describe how the auditor evaluated management's assessment of the entity's ability to continue as a going concern.
- ³⁴ Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction.
- ³⁵ 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 ..."
- ³⁶ The description of the auditor's responsibilities may also be included within an appendix, or where law, regulation or national auditing standards expressly permit, as a description on a website of an appropriate authority when the description addresses, and is not inconsistent with, this ISA for LCE. In such cases, a reference to the location of appendix or description shall be included within the auditor's report. When the auditor disclaims an opinion on the financial statements, the description of the auditor's responsibilities only includes the matters required by paragraph 9.5.33.
- ³⁷ When Part 10 applies, further describe the auditor's responsibilities in a group audit engagement by stating that;
- (i) The auditor's responsibilities are to plan and perform the group audit to obtain sufficient appropriate audit evidence regarding the financial information of the entities or business units within the group as a basis for forming an opinion on the group financial statements;
 - (ii) The auditor is responsible for the direction, supervision and review of the audit work performed for purposes of the group audit; and
 - (iii) The auditor remains solely responsible for the auditor's opinion.

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 [Entity'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 conditions that may cast significant doubt on the [Entity'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 [Entity] 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.]³⁸

We communicate with [management, and where appropriate, those charged with governance] regarding, among other matters, the planned scope and timing of the audit and significant audit findings that we identify during our audit, including any:

- Significant deficiencies in internal control;
- Identified fraud or suspected fraud; and
- Other matters related to fraud that are, in our judgment, relevant to the responsibilities of [management, and where appropriate, those charged with governance] that we identify during our audit.

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

[Auditor Address: name the location in the jurisdiction where the auditor practices]

[Date: 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, including evidence that (i) All the statements and disclosures that comprise the financial statements have been prepared; and (ii) Those with the recognized authority have asserted that they have taken responsibility for those financial statements.]

- 9.4.2. When the financial statements are prepared in accordance with a fair presentation framework, the auditor 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, in the description of responsibilities for the financial statements in the auditor’s report.
- 9.4.3. The auditor shall not refer to the work of an auditor’s expert in an auditor’s report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the auditor shall indicate in the auditor’s report that the reference does not reduce the auditor’s responsibility for the auditor’s opinion.

9.5. Modifications to the Opinion

Tables A to C below set out the requirements for which a modified opinion is to be used in different situations, and the form and content of a modified opinion.

- 9.5.1. The auditor shall modify the opinion in the auditor’s report according to Tables A–C below when:
- (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
 - (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.
- 9.5.2. When the auditor modifies the audit opinion, the auditor shall:
- (a) Amend the heading “Basis for Opinion” to “Basis for Qualified Opinion,” “Basis for Adverse Opinion,” or “Basis for Disclaimer of Opinion” as set out in Tables A–C; and
 - (b) Within the basis for opinion section, include a description of the matter giving rise to the modification.

Table A below specifies how the auditor’s professional judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

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

Table B below specifies the modification to be made to the opinion for each type of opinion in Table A.

³⁸ Relevant when the financial statements are prepared in accordance with a fair presentation framework.

TABLE B Form of opinion	Fair Presentation Framework	Compliance Framework
9.5.3. Qualified opinion Auditor's Report – Heading for opinion: "Qualified Opinion" Auditor's Report – Heading for Basis for Opinion: "Basis for Qualified Opinion"	"In our opinion, except for the [effects or possible effects] ³⁹ of the matter(s) described in the Basis for Qualified Opinion section, the accompanying financial statements [present fairly, in all material respects / [give a true and fair view of] [...] in accordance with [the applicable financial reporting framework]"	"...except for the [effects or possible effects] of the matter(s) described in the Basis for Qualified Opinion section, the accompanying financial statements have been prepared, in all material respects, in accordance with [the applicable financial reporting framework]"
9.5.4. Adverse opinion Auditor's Report – Heading for opinion: "Adverse Opinion" Auditor's Report – Heading for Basis for Opinion: "Basis for Adverse Opinion"	"...the accompanying financial statements do not [present fairly /give a true and fair view of] [...] in accordance with [the applicable financial reporting framework]"	"...the accompanying financial statements have not been prepared, in all material respects, in accordance with [the applicable financial reporting framework]"
9.5.5. Disclaimer of opinion Auditor's Report – Heading for opinion: "Disclaimer of Opinion" Auditor's Report – Heading for Basis for Opinion: "Basis for Disclaimer of Opinion"	"We were engaged to audit the financial statements of..." "We do not express an opinion on the accompanying financial statements. Because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements." <u>"We are unable to conclude on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements and 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."</u>	

Table C below sets out specific circumstances when the auditor's opinion is to be modified, and the types of opinions expressed in those circumstances based on the nature of the matter giving rise to the modification (see Table A). Table C is not an exhaustive list of all circumstances when the auditor's opinion is to be modified.

³⁹ Matters reflected in square brackets (e.g., []) are to be tailored accordingly

TABLE C				
Specific Circumstances When the Auditor's Opinion is to be Modified	Para Ref	Qualified	Adverse	Disclaimer
<i>Opening Balances</i>				
9.5.6. The auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances.	4.5.4.	✓		✓
9.5.7. The auditor concludes, based on the audit evidence obtained, that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not appropriately accounted for or not adequately presented or disclosed.	4.5.5.	✓	✓	
9.5.8. The auditor concludes, based on the audit evidence obtained, that the current period's accounting policies are not consistently applied in relation to opening balances in accordance with the applicable financial reporting framework or a change in accounting policies is not appropriately accounted for or adequately presented or disclosed, in accordance with the financial reporting framework.	4.5.6.	✓	✓	
9.5.9. The predecessor auditor's opinion regarding the prior period's financial statements included a modification that remains relevant and material to the current period's financial statements.	4.5.3.	✓	✓	✓
<i>Non-Compliance with Laws and Regulations</i>				
9.5.10. Sufficient information about suspected non-compliance cannot be obtained.	7.4.26.	✓		✓

TABLE C				
Specific Circumstances When the Auditor's Opinion is to be Modified	Para Ref	Qualified	Adverse	Disclaimer
9.5.11. The auditor concludes that the identified or suspected non-compliance has a material effect on the financial statements and has not been adequately reflected in the financial statements.	7.4.27	✓	✓	
9.5.12. The auditor is precluded by management or those charged with governance from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be material to the financial statements has, or is likely to have, occurred.	7.4.27.	✓		✓
9.5.13. 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.	7.4.27.	✓		✓
<i>External Confirmations</i>				
9.5.14. The auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures.	7.3.24.	✓		✓
<i>Inventory</i>				
9.5.15. The auditor cannot perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory.	7.4.21.	✓		✓

TABLE C Specific Circumstances When the Auditor's Opinion is to be Modified	Para Ref	Qualified	Adverse	Disclaimer
<i>Litigation and Claims</i>				
9.5.16. Management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding; and the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures.	7.4.25	✓		✓
<i>Going Concern</i>				
9.5.17. The financial statements have been prepared using the going concern basis of accounting but, in the auditor's professional judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate. <u>9.5.17A. In this circumstance, unless required by law or regulation, the auditor shall not include separate sections on Going Concern or Material Uncertainty Related to Going Concern in the auditor's report.</u>	7.4.1. 8.5.7.		✓	
9.5.18. Adequate disclosures are not made about a material uncertainty in the financial statements. 9.5.19. In this circumstance: <u>(a) The</u> the basis for qualified (or adverse) opinion section shall state that "a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do	7.4.4 8.5.98	✓	✓	

TABLE C Specific Circumstances When the Auditor's Opinion is to be Modified	Para Ref	Qualified	Adverse	Disclaimer
<p>not adequately disclose this matter.”</p> <p><u>(b) The auditor's report shall include a separate section under the heading “Material Uncertainty Related to Going Concern”. The separate section draws attention to the Basis for Qualified (Adverse) Opinion section of the auditor's report that states that a material uncertainty exists that has not been adequately disclosed in the financial statements.</u></p> <p><u>The sections shall state that in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, the auditor concluded that management's use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Also, that the auditor's conclusions are based on the audit evidence obtained up to the date of the auditor's report and are not a guarantee as to the entity's ability to continue as a going concern.</u></p>				
<p>9.5.20. When evaluating management's assessment of the entity's ability to continue as a going concern, the period is less than twelve months from the date of <u>approval of</u> the financial statements, and management does not make or extend its assessment, leading to the</p>	<p>7.4. <u>1D2.</u></p>	<p>✓</p>		<p>✓</p>

TABLE C				
Specific Circumstances When the Auditor's Opinion is to be Modified	Para Ref	Qualified	Adverse	Disclaimer
<p>auditor being unable to obtain sufficient appropriate audit evidence.</p> <p><u>9.5.20A. When the auditor disclaims an opinion on the financial statements, unless required by law or regulation, the auditor shall not include separate sections on Going Concern or Material Uncertainty Related to Going Concern in the auditor's report.</u></p>				
<i>Subsequent Events</i>				
9.5.21. Facts become known to the auditor after the date of the auditor's report but before the date the financial statements are issued, and management does not amend the financial statements in circumstances where the auditor believes they need to be amended.	8.4.6.	✓	✓	✓
<i>Written Representations</i>				
9.5.22. The auditor concludes that the written representations required by this standard are not reliable.	8.6.5.	✓		✓
9.5.23. Management does not provide one or more of the requested written representations.	8.6.6.	✓		✓
9.5.24. The auditor concludes that there is sufficient doubt about the integrity of management such that the written representations required by 8.6.1.(a)–(c) are not reliable.	8.6.7.			✓
9.5.25. When management does not provide the written representations required by paragraphs 8.6.1.(a)–(c).	8.6.7.			✓

TABLE C Specific Circumstances When the Auditor's Opinion is to be Modified	Para Ref	Qualified	Adverse	Disclaimer
<i>Corresponding Figures</i>				
<p>9.5.26. Corresponding figures are presented, the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is unresolved.</p> <p>The Basis for Modification paragraph shall either: (a) refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material,; or (b) in other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.</p>	9.7.6	✓	✓	✓
<i>Other Items</i>				
9.5.27. The auditor is unable to obtain sufficient appropriate audit evidence.	8.5.6.	✓		✓
9.5.28. The financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation.	9.3.2.		✓	
9.5.29. The financial statements are prepared in accordance with a compliance framework and, in extremely rare circumstances, the auditor concludes, based on the audit evidence	9.3.3	✓	✓	✓

TABLE C Specific Circumstances When the Auditor's Opinion is to be Modified	Para Ref	Qualified	Adverse	Disclaimer
obtained, that such financial statements are misleading.				

...

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, and the auditor would not be required to modify the opinion as a result of that matter, 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.

Examples of where Emphasis of Matter paragraphs may be needed include:

- *When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation.*
- *When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report (i.e., subsequent events).*

The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. An Emphasis of Matter paragraph is not a substitute for:

- *A modified opinion when required by the circumstances of a specific audit engagement;*
- *Disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation; or*
- *Reporting when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern or in the circumstances contemplated in footnote 47 (see paragraph 9.4.1).*

...

Content of Other Paragraphs in the Audit Report

- 9.6.3. When the auditor includes an Emphasis of Matter, Other Matter paragraph or a material uncertainty related to going concern in the auditor's report, the auditor shall include the paragraph or section according to Table D below:

TABLE D			
Paragraph or Section	Location	Heading shall include	Content shall include
9.6.4. Emphasis of Matter paragraph	A separate section of the auditor's report	Appropriate heading that includes "Emphasis of Matter"	<p>A clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements.</p> <p>A reference only to information presented or disclosed in the financial statements.</p> <p>An indication that the auditor's opinion is not modified in respect of the matter emphasized.</p>
9.6.5. Other Matter paragraph	A separate section of the auditor's report	Appropriate heading that includes "Other Matter"	As appropriate in the circumstances.
9.6.6. Material Uncertainty Related to Going Concern section paragraph – For unmodified opinion	A separate section of the auditor's report	"Material Uncertainty Related to Going Concern"	<p>Draw attention to the note in the financial statements that discloses the matters related to the material uncertainty.</p> <p><u>Include a reference to the related disclosure(s) in the financial statements.</u></p> <p>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</p> <p><u>State that:</u></p> <p><u>(a) The auditor's opinion is not modified in respect of the matter;</u></p> <p><u>(b) In the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, the auditor concluded that management's use of the going concern basis of accounting in the preparation of the financial statements is appropriate; and</u></p> <p><u>(c) The auditor's conclusions are based on the audit evidence obtained up to the date of the auditor's report and are not a guarantee as to the entity's ability to continue as a going concern.</u></p>

- 9.6.7. When facts become known to the auditor after the financial statements have been issued and if management amends the financial statements, the auditor shall include in the new or amended auditor's report an Emphasis of Matter paragraph or Other Matter paragraph drawing users' attention to the reason for the amendment and referring to the earlier report provided by the auditor.

...

10. Audits of Group Financial Statements

...

10.5. Identifying and Assessing the Risks of Material Misstatement

10.5.1. In applying Part 6, based on the understanding obtained in paragraph 10.4.1. the auditor shall identify and assess the risks of material misstatement of the group financial statements, including with respect to the consolidation process.

In applying Part 6, the auditor is required to identify and assess the risks of material misstatement of the financial statements due to fraud, and to design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. Information used to identify the risks of material misstatement of the group financial statements due to fraud may include the following:

- *Whether there are particular components that are more susceptible to risks of material misstatement due to fraud.*
- *Whether any fraud risk factors or indicators of management bias exist in the consolidation process.*
- *How those charged with governance of the group monitor group management's processes for identifying and responding to the fraud risks ~~of fraud~~ in the group, and the controls group management has established to mitigate these risks.*
- *Responses of those charged with governance of the group, and group management to the auditor's inquiry about whether they have knowledge of any fraud or actual, suspected fraud, including allegations of ~~or alleged~~ fraud affecting a component or the group.*

...

10.7. Specific Communication Requirements

10.7.1. The auditor shall communicate the following matters with those charged with governance:

- (a) An overview of the work to be performed at the components of the group.
- (b) Fraud or suspected fraud involving:
 - (i) ~~g~~Group management, ~~or~~ component management; _i
 - (ii) ~~e~~Employees who have significant roles in the group's system of internal control; _i or
 - (iii) ~~o~~Others, except for matters that are clearly inconsequential when the fraud resulted in a material misstatement of the group financial statements.

...

APPENDIX 1

Glossary of Terms

This glossary lists the terms that are defined for the purpose of the ISA for LCE. The definitions assist in the consistent application and interpretation of this standard, and are not intended to override definitions that may be established for other purposes, whether in law or regulation or otherwise. Unless otherwise indicated, the definitions carry the same meanings throughout this standard. In addition, this glossary includes descriptions of other terms found in the ISA for LCE to assist in common and consistent interpretation and translation (such other terms are identified by an asterisk “*”).

...

Fraud risk factors—Events or conditions that indicate an incentive or pressure to commit fraud, or provide an opportunity to commit fraud, or an attitude or rationalization that justifies the fraudulent action.

...

Material uncertainty (related to going concern)—An uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. “May cast significant doubt” is used to refer to circumstances where the magnitude of the potential impact and likelihood of occurrence of the identified events or conditions are such that, unless management's plans for future actions mitigate their effects, the entity may be unable to realize its assets and discharge its liabilities in the normal course of business and continue its operations for the foreseeable future.

...

Publicly traded entity—An entity that issues financial instruments that are transferrable and traded through a publicly accessible market mechanism, including through listing on a stock exchange. A listed entity as defined by relevant securities, law or regulation is an example of a publicly traded entity.

...

Illustrative Engagement Letter

The following is an illustrative 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 4.4.2).

To the appropriate representative of management or those charged with governance of ABC Company:⁴⁰

[The objective and scope of the audit]

You⁴¹ 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 for Audits of Financial Statements of Less Complex Entities (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.
- Understand 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

⁴⁰ The addressees and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction.

⁴¹ 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.

effectiveness of the entity's internal control. However, we will communicate to you in writing 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 and report 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 the ISA for LCE.

[The responsibilities of management and identification of the applicable financial reporting framework]⁴²

Our audit will be conducted on the basis that [management, and where appropriate, those charged with governance]⁴³ 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];⁴⁴
- (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, such as a going concern assessment that covers a period of at least twelve months from the date of approval of the financial statements; and
 - (iii) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

⁴² For purposes of this illustrative engagement letter, it is assumed that the auditor has not determined that the law or regulation prescribes those responsibilities in appropriate terms; the descriptions in paragraph 4.2.1(b) of this standard are therefore used)

⁴³ Use terminology as appropriate in the circumstances.

⁴⁴ Or, if appropriate, "For the preparation of financial statements that give a true and fair view in accordance with [applicable financial reporting framework]"

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]

[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.]

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

...

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. Examples are separately presented for the two types of fraud – fraudulent financial reporting and misappropriation of assets.

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 entities of different sizes or with different ownership characteristics or circumstances. Also, the order of the examples 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, geopolitical, or entity operating conditions, such as (or as indicated by):

- Significant declines in customer demand or increasing business failures in the industry or overall economy.
- High degree of competition or market saturation, accompanied by declining margins.
- Operating losses causing the threat of bankruptcy or foreclosure.
- Recurring negative cash flows from operations or an inability to generate cash flows from operations.
- Pandemics or wars triggering major disruptions in the entity's operations, financial distress and severe cashflow shortages.
- Economic sanctions imposed by governments and international organizations against a jurisdiction.

Pressure exists for management to meet the requirements or expectations of third parties due to pressure to:

- Pressure to rRenew, or obtain additional, financing, or to meet debt repayment or debt covenant requirements and therefore to overstate performance or position in order to demonstrate profitability and long-term viability.
- Pressure to understate revenue in order to reduce tax liabilities.
- Qualify for government assistance.

Considerations Specific to Public Sector Entities

- Public sector entities subject to statutory limits on their spending may result in inaccurate reporting of expenditure incurred.

Opportunities

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 domination of management by a single person or small group (in a non owner-managed business) without compensating controls.
- The system of internal control is deficient as a result of the following:
 - Limited segregation of duties or anti-fraud controls (e.g., whistleblower program~~fraud hotlines~~)
 - Inadequate involvement of management in operations or other activities that may help management to prevent or detect misstatements in accounting information, or to identify controls that are not operating as intended.
 - Inadequate controls due to changes in the current environment, for example, increased data security risks.
 - Accounting and information systems that are not effective, including situations involving significant deficiencies in internal control.

Attitudes/Rationalizations

- Management and those charged with governance have not created a culture of honesty and ethical behavior. For example, ~~Peer~~-communication, implementation, support, or enforcement of the entity's values or ethical standards by management are not effective, or the communication of inappropriate values or ethical standards.
- The owner manager or management demonstrates an unusually high tolerance to risk or display an unusually high standard of lifestyle, a pattern of significant personal financial issues, or frequently engage in high-risk activities.
- The owner-manager makes no distinction between personal and business transactions.
- Dispute between shareholders in a closely held entity.
- Recurring attempts by management or owners to justify marginal or inappropriate accounting on the basis of materiality or to help the company survive.
- The relationship between management and the current or predecessor auditor is strained by disputes, unreasonable demands on the auditor, restrictions on access to people or information, or domineering management behavior.

Risk Factors ~~Arising from~~Relating to Misstatements Arising from Misappropriation of Assets

Some of the risk factors related to misstatements arising from fraudulent financial reporting may also be present when misstatements arising from misappropriation of assets occur, which often is a common fraud in less complex entities. For example, 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:
- 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:

- 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 system of authorization and approval of transactions (for example, in purchasing).
- Inadequate record keeping or physical safeguards over cash, inventory, or fixed assets.
- Lack of mandatory vacations for employees performing key control functions.
- Inadequate management understanding of information technology.

Considerations Specific to Public Sector Entities

- The nature of certain revenue transactions (e.g., taxes and grants) may provide a greater opportunity to manipulate the timing or amount of revenue recognized in the current period.

Attitudes/Rationalizations

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
- Disregard for internal control by overriding existing controls or failing to take appropriate remedial action on known misappropriations, including petty theft.
- Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
- Rationalizing misappropriations committed during severe economic downturns by intending to pay back the entity when circumstances return to normal.

APPENDIX 4A

Events or Conditions That May Cast Significant Doubt on the Entity's Ability to Continue as a Going Concern

The following are examples of identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. These examples are not all-inclusive.

Financial

- Net liability or net current liability position.
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
- Indications of withdrawal of financial support by creditors.
- Recurring negative cash flows from operations or inability to generate cash flows from operations indicated by historical or prospective financial statements.
- Adverse key financial ratios.
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
- Inability to pay creditors on due dates.
- Non-compliance or marginal ability to meet debt repayment or other debt covenant requirements or comply with the terms of loan agreements.
- Change from credit to cash-on-delivery transactions with suppliers.
- Inability to obtain additional debt or equity financing.
- Exposure to liquidity risk as a result of the maturity mismatch of financial assets and liabilities.

Operating

- Management intentions to liquidate the entity or to cease operations.
- Loss of key personnel and management without replacement.
- Significant declines in customer demand.
- Loss of a major market, significant customer(s), franchise, license, or principal supplier(s).
- Labor difficulties.
- Shortages of important supplies.
- Emergence of a highly successful competitor.

Other

- Significant or sustained business interruption due to a cyber attack (e.g., denial of access to information or inability to provide service).
- Pending litigation and contingent liabilities arising that may, if successful, result in claims that the entity is unlikely to be able to satisfy.

- Changes in law or regulation or government policy expected to adversely affect the entity.
- Significant exposures to volatile markets, such as exchange rates or interest rates.
- Uninsured or underinsured catastrophes or business interruption losses when they occur (e.g., an earthquake).
- Changes in the environment such as war, civil unrest, outbreaks of disease expected to adversely affect the entity or physical risks related to climate change (e.g., extreme flooding).

...

Illustrative Representation Letter

The following illustrative letter includes written representations that are required by Part 8.6 of the ISA for LCE. It is assumed in this illustration that the requirement to obtain a written representation relating to going concern is 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.
- The methods, the data, and the significant assumptions used in making accounting estimates, and their related disclosures are appropriate to achieve recognition, measurement or disclosure that is reasonable in the context of the applicable financial reporting framework.
- 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 actual or possible litigation and claims whose effects should be considered when preparing the financial statements are accounted for and disclosed in accordance with the applicable financial reporting framework.
- [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 any 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~~an effect on the financial statements.
- We have disclosed to you all information in relation to ~~allegations of fraud, or~~ suspected fraud, including allegations of 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 law or regulation whose effects should be considered when preparing financial statements.
- We have disclosed to you all known actual or possible litigation and claims whose effects should be considered when preparing the 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