

Audit Evidence and Risk Response (AE&RR) – Clarifying the Use of Tests of Controls

This Agenda Item sets out the key messages from the stakeholder feedback received from the outreach for whether tests of controls as defined can also separately fulfill other purposes, and the related Staff views and recommendations.

Background

AE&RR Project Proposal – Proposed Action(s)

1. The AE&RR project proposal includes an action to determine whether tests of controls as defined in ISA 330,¹ can also separately fulfil other purposes, including evaluating the relevance and reliability of information intended to be used as audit evidence.²

Relevant Paragraphs of the ISAs

2. A test of controls is defined in ISA 330 as follows: *an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.*³
3. Proposed ISA 500 (Revised) explains that:⁴
 - (a) The evaluation of relevance and reliability may be performed concurrently with the audit procedures applied to the information (e.g., a test of controls may be used to evaluate accuracy and completeness of information generated internally from the entity's information system).
 - (b) Audit evidence obtained from audit procedures performed in accordance with other ISAs may also assist the auditor in evaluating the relevance and reliability of information (e.g., tests of controls over the preparation and maintenance of the information performed in accordance with ISA 330).
 - (c) The reliability of information, in particular the attributes of accuracy, completeness and authenticity, may also be affected by whether the integrity of the information has been maintained through all stages of information processing (e.g., effective general information technology controls (GITCs) to safeguard and maintain the integrity of the financial information).

¹ International Standard on Auditing (ISA) 330, *The Auditor's Responses to Assessed Risks*

² See Action B.1 of **Agenda Item 9–I**.

³ See ISA 330, paragraph 4(b)

⁴ See '[Proposed ISA 500 \(Revised\) Pre-finalization Holding Package](#)' in Agenda Item 5 discussed by the IAASB at the March 2024 quarterly meeting, paragraphs A37–A38 and A56F.

Input from Outreach Activities⁵

4. Outreach with individual firms has indicated the following perspectives relevant to the topic:
- (a) Firms encourage, through training or guidance materials, testing controls for the express purpose of evaluating the operating effectiveness of controls that address risks to the integrity of information in an entity's information system, and use those as a basis for evaluating the reliability of information intended to be used as audit evidence.
 - (b) However, those controls are likely to have only been identified when they also either directly address a risk of material misstatement (ROMM) at the assertion level that arises *because* of a risk to the integrity of information, or when they support the operation of other controls that directly address ROMM at the assertion level.⁶
 - (c) Testing the operating effectiveness of GITCs is performed in the context of evaluating the integrity of information extracted from an entity's information systems (e.g., 'system-generated reports') that is used in the performance of audit procedures, irrespective of whether those audit procedures are risk assessment procedures, or further audit procedures.
 - (d) Certain tests of controls do not fit neatly into the extant definition of tests of controls because the controls are not precise enough to prevent or detect and correct material misstatements at the assertion level. For example, when testing group-level controls, which affect decisions about nature, timing and extent of further audit procedures to be performed for different components, such controls may not be precise enough to prevent or detect and correct material misstatements at the assertion level for the component information.
 - (e) Some auditors may not recognize (or it may not be clear) that performing tests of controls in responding to a ROMM at the assertion level may simultaneously also provide a basis for evaluating the reliability of a wider range of information intended to be used as audit evidence.

Other Standard-Setting Initiatives

5. While the PCAOB's standards do not define tests of controls, their analogous ISA 330 auditing standard requires tests of controls to be performed for each relevant assertion for which substantive procedures alone cannot provide sufficient appropriate audit evidence *and when necessary to support the auditor's reliance on the accuracy and completeness of financial information used in performing other audit procedures*.⁷ This approach explicitly recognizes that tests of controls may be used to obtain audit evidence about the operating effectiveness of controls that support aspects of the reliability of information in the entity's information system and when the auditor uses that information in performing audit procedures.

⁵ Refer to **Agenda Item 9** for a comprehensive overview of the feedback received from the project outreach undertaken to date with a broad range of stakeholders.

⁶ ISA 315 (Revised 2019), paragraph 26.

⁷ See the Public Company Accounting Oversight Board (PCAOB): AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, paragraph .17.

Staff Views and Recommendations

6. As currently defined, it is not explicit that tests of controls may be used for a purpose other than designing and performing further audit procedures to respond to an assessed ROMM at the assertion level. While this is not systematically resulting in auditors *not* performing tests of controls when evaluating reliability of information, Staff believe that there is value in being clearer in the ISAs that a test of controls can be used in this manner, irrespective of whether the controls will also be tested to address assessed ROMM at the assertion level.
7. As illustrated in the box below, Staff propose revising the definition of tests of controls in ISA 330 by broadening its scope to facilitate testing the operating effectiveness of controls that operate more widely than at the assertion level. Staff also propose application material to the definition to further clarify the linkages with Proposed ISA 500 (Revised) aiming to facilitate consistent practice and behaviors when designing and performing audit procedures to obtain and evaluate audit evidence.

Definitions

4. For purposes of the ISAs, the following terms have the meanings attributed below:

...

- (b) Test of Controls - An audit procedure designed to ~~evaluate~~ obtain audit evidence about the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level. (Ref: Para. A0A)

...

Application and Other Explanatory Material

Definitions (Ref: Para. 4)

A0A. Test of controls may be performed to:

- Obtain audit evidence about the operating effectiveness of controls that address risks of material misstatement thereby confirming the auditor's assessment of control risk;⁸ or
- Provide a basis for the auditor's evaluation of the reliability of information in accordance with Proposed ISA 500 (Revised).⁹

Example:

An entity may have designed and implemented an application control to prevent unauthorized access to an IT application, supported by general IT controls. These controls may have been designed by the entity to address risks to the integrity of information. The auditor may test the operating effectiveness of these controls as part of:

- The further audit procedures performed to address a risk of material misstatement; or

⁸ ISA 315 (Revised 2019), paragraph 34.

⁹ Proposed ISA 500 (Revised), *Audit Evidence*, paragraph 9.

- As part of evaluating the reliability of information in accordance with Proposed ISA 500 (Revised).

Matter for the IAASB Consideration:

1. The Board is asked for their views on Staff's views and recommendations discussed in paragraphs 6–7 above, including the proposed drafting to the definition of Test of Controls and related application material presented in paragraph 7.