

### Audit Evidence and Risk Response (AE&RR) – Substantive Procedures Alone Unable to Provide Sufficient Appropriate Audit Evidence

This Agenda Item sets out Staff's views and recommendations related to enhancing ISA 330<sup>1</sup> to address circumstances when substantive procedures alone cannot provide sufficient appropriate audit evidence.

#### Background

##### *AE&RR Project Proposal – Proposed Action(s)*

1. The AE&RR project proposal includes an action to explore enhancements to ISA 330 related to modernizing application material to clarify the attributes of circumstances that indicate that substantive procedures alone may be unable to provide sufficient appropriate audit evidence.<sup>2</sup>

##### *Relevant Paragraphs of the ISAs*

2. Paragraph 8(b) of ISA 330 requires the auditor to design and perform test of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of controls if substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. This requirement operates together with paragraph 33 of ISA 315 (Revised 2019)<sup>3</sup> given that in some circumstances an auditor may identify a risk of material misstatement (ROMM) for which the only way to obtain sufficient appropriate audit evidence when responding to the ROMM is to test the operating effectiveness of controls.<sup>4</sup>
3. Application material in several ISAs sets out the following examples of circumstances when risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level exist:<sup>5</sup>
  - The entity conducts its business using IT and no documentation of transactions is produced or maintained other than through the IT system.
  - Routine business transactions are subject to highly automated processing with little or no manual intervention.
  - Controls are necessary to mitigate risks relating to the initiation, recording, processing, or reporting of information obtained from outside of the general and subsidiary ledgers.
  - Information supporting one or more assertions is electronically initiated, recorded, processed, or reported.

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

<sup>2</sup> See Action B.2 of **Agenda Item 9–I**.

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

<sup>4</sup> Paragraph 33 of ISA 315 (Revised 2019) requires the auditor to determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the ROMMs at the assertion level.

<sup>5</sup> See ISA 330, paragraph A24, ISA 315 (Revised 2019), paragraphs A222–A225 and ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*, paragraphs A87–A89.

*Input from Outreach Activities<sup>6</sup>*

4. Outreach with individual firms indicated that there are challenges with consistently identifying circumstances in practice in which the requirement in paragraph 8(b) of ISA 330 applies. Additionally, a range of stakeholders raised questions about the interaction of the requirement with the auditor's evaluation of the entity's control environment as a whole, including their IT environment and, in particular, general IT controls.

**Staff Views and Recommendations**

5. The version of the equivalent requirement in paragraph 8(b) of ISA 330,<sup>7</sup> previous to the redraft of the standard during the [IAASB Clarity Project](#), referred to circumstances when the auditor had determined that it is *not possible* or *practicable* to obtain sufficient appropriate audit evidence at the assertion level from substantive procedures alone. On this basis, the phrase *cannot provide* is meant to encompass both circumstances.
6. Staff appreciate that there is a subtle difference between impossibility and impracticability, and that the practicability of an action may be dependent on the context in which it is considered. Staff believes that enhancing application material with examples and factors of these circumstances would:
  - (a) Illustrate a broader range of considerations to aid auditors in consistently identifying that the requirement of paragraph 8(b) of ISA 330 applies.
  - (b) Enhance the clarity, consistency of implementation, and the enforceability of the requirement.
7. The box below illustrates the proposed drafting for the proposed application material:

*Tests of Controls*

Designing and Performing Tests of Controls (Ref: Para. 8)

...

- A24. In some cases, the auditor may find it impossible or impracticable to design effective substantive procedures that by themselves provide sufficient appropriate audit evidence at the assertion level.<sup>8</sup> In such cases, paragraph 8(b) requires the auditor to perform tests of controls that address the risk for which substantive procedures alone cannot provide sufficient appropriate audit evidence. [Example moved to Para. Ref. A24A]

A24A. In determining whether substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level (i.e., that it may not be possible or practicable to do so), the auditor may consider factors such as:

- The relevant assertion addressed by the further audit procedures.

<sup>6</sup> 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.

<sup>7</sup> See [Agenda Item 4](#) discussed by the IAASB at its September 2005 meeting.

<sup>8</sup> See ISA 315 (Revised 2019), paragraph 33

- The extent to which information intended to be used as audit evidence about a class of transactions, account balance or disclosure is:
  - Available to the auditor from sources outside of the entity's information system.
  - Initiated, processed, recorded and reported, within the entity's information system, entirely electronically.
  - Dependent on the operating effectiveness of the entity's controls over the integrity of information.
- The significance or consequence to management or those charged with governance of the effective operation of the controls for a relevant assertion of a class of transactions, account balance or disclosure.
- The characteristics of the class of transaction, account balance or disclosure (e.g., when individual transactions are small, then the larger the volume of transactions, the greater the likelihood that sufficient appropriate audit evidence cannot be obtained without obtaining audit evidence about the operating effectiveness of controls).
- The basis for the auditor's assessment of inherent risk for the relevant assertion (e.g., when inherent complexity in the entity's reporting processes is addressed by controls).
- The assessment of the risk of material misstatement (e.g., when the auditor's assessment of inherent risk is higher, the auditor may determine that more persuasive audit evidence will be obtained from an audit approach that includes both tests of controls and substantive procedures).
- The nature and complexity of the entity's operations.

**Examples:**

This may occur when an entity:

- eConducts its business using IT and ~~no documentation of~~ transactions are initiated, processed, recorded, and reported electronically, and the information about those transactions is produced or maintained only in digital form, other than through the IT system. [Example moved from Para. Ref. A24]
- Reports accounting estimates based on models that incorporate information from a wide range of sources both within and outside of the entity, such that the accuracy of the estimate depends on the operating effectiveness of controls over the models.
- Uses probabilistic technologies (e.g., large language models), to produce, record, and report account balances or disclosures, and has implemented controls to address specific risks arising from their use.
- Operates across multiple locations that process cash sales (e.g., food and beverage outlets or retail stores), where control activities at certain points in the information processing system are necessary for achieving the entity's financial reporting objectives.

- Performs cycle inventory counts across multiple locations throughout the period, such that the accuracy, completeness, and valuation of inventory and amounts recorded as costs of goods sold are dependent on the operating effectiveness of those controls.
- Holds inventory whose nature, location or operations may be such that it is not practicable to for the auditor to physically inspect the inventory and directly obtain substantive audit evidence about its existence (e.g., inventory held in an automated warehouse or a hazardous location or inventory of a hazardous nature).

A24B.ISA 315 (Revised 2019)<sup>9</sup> and ISA 540 (Revised)<sup>10</sup> also include examples of situations in which substantive procedures alone are unlikely to provide sufficient appropriate audit evidence.

**Matters for IAASB Consideration:**

1. The Board is asked for their views on Staff's views and recommendations discussed in paragraph 5–7 above, including the proposed drafting presented in paragraph 7.
2. The Board is asked whether there are any other matters that should be considered in relation to attributes of circumstances when substantive procedures alone cannot provide sufficient appropriate audit evidence.

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<sup>9</sup> ISA 315 (Revised 2019), A224

<sup>10</sup> ISA 540 (Revised), A87