

### Audit Evidence & Risk Response (AE&RR) – Tests of Controls Alone to Respond to an Assessed Risk of Material Misstatement (ROMM)

This Agenda Item sets out the key messages from the stakeholder feedback received from the outreach for using tests of controls alone to respond to an assertion level ROMM, and the related Staff's views and recommendations.

#### Background

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

1. The AE&RR project proposal includes an action to explore enhancements to the in-scope standards relating to the design of further audit procedures to encourage the auditor to consider the use of tests of controls to respond to assessed ROMMs.<sup>1</sup>

##### *Previous IAAAB Deliberations*

2. In March 2025, Staff presented to the Board examples of circumstances that are relevant to whether or not a test of controls alone approach could be appropriate to provide sufficient appropriate audit evidence at the assertion level, noting that under certain circumstances and on a conditional basis, such an approach could be appropriate under the extant ISAs.<sup>2</sup> The Board supported further exploration of this topic, including consideration about the circumstances and conditions where performing only tests of controls may be appropriate to respond to ROMMs at the assertion level (e.g., circumstances involving highly automated information processing).<sup>3</sup>

#### Overview of the Feedback from Outreach Activities

##### *Stakeholder Engagement*

3. Staff have engaged on this topic with Monitoring Group members (MG), regulators, Professional Accountancy Bodies (PAOs), audit firms, Forum of Firms (FoF) representatives, and members of the Small and Medium Practices Advisory Group (SMPAG).

##### *Highlights from the Feedback<sup>4</sup>*

##### Audit Approach

- The following are views, including stakeholder expectations, around the appropriates of the audit approach to obtain sufficient appropriate audit evidence:
  - Audit approaches usually rely on a combination of tests of controls and substantive

<sup>1</sup> See Action B.3 of **Agenda Item 9–I**.

<sup>2</sup> See Section V, paragraphs 124–130 of [Agenda Item 7](#) discussed by the IAASB at the March 2025 quarterly meeting.

<sup>3</sup> See the March 2025 approved [meeting minutes](#).

<sup>4</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.

procedures, but there is a shift towards substantive-only approaches in some jurisdictions.

- Firm methodologies do not explicitly allow the possibility that an assertion-level ROMM may be addressed only with tests of controls.
- In audits of smaller and less complex entities, where controls are not ordinarily well documented, audit approaches are often wholly substantive.
- Permitting a ‘test of controls only’ approach would likely encourage auditors to consider testing the operating effectiveness of controls more frequently.
- With technological advancements, the difference between test of controls and substantive procedures is becoming less clear (or important), in view of the level of granularity that controls may operate.

#### Specific Concerns About a Tests of Controls-Only Approach

- Caution from stakeholders, including strong views from MG members and regulators, about the appropriateness of an approach that would allow tests of controls alone to address an assertion level ROMM:
  - Concerns about the impact on audit quality in view of recurring inspection findings that indicate deficiencies in tests of controls (e.g., overreliance on ineffective controls or testing controls that are not appropriate or precise enough to address relevant risks).
  - Internal control, no matter how well designed and operated, can only reduce, but not eliminate, ROMM in the financial statements as there are inherent limitations of controls, including risk of management override.
  - Because the objective of a test of control differs from that of a substantive procedure, misstatements are most often detected through substantive testing.
  - While it is probable that some assertion-level ROMMs can be addressed effectively through test of controls alone, it is questionable whether test of controls alone would provide sufficient appropriate audit evidence related to a COTABD as a whole.
  - Deficiencies in internal control are often identified from substantive procedures. Performing fewer substantive procedures may result in control deficiencies not being identified.

#### Circumstances and Conditions

- The following views were shared on specific circumstances and conditions that are necessary for a test of controls only approach to address an assertion level ROMM:
  - A sole reliance on controls approach to address a ROMM at the assertion level could be acceptable under very specific conditions (e.g., highly automated environments with limited human intervention or judgment).
  - The appropriateness of such an approach would depend on both the nature of the control and the nature of the risk involved.

- To support consistent implementation of this approach, clarification is needed for the criteria by which to make professional judgments (it would be a significant judgment), including the characteristics of risks and of the related controls that would support such an approach.
- There is a need to ensure that the ROMM that arises from the possibility that management may override controls is also explicitly addressed for the assertion.

#### A Need for Clarity

- Varying interpretations were noted for extant requirements and application material of the ISAs.
- All stakeholders supported clarity about whether the ISAs permit a controls alone approach to respond to ROMMs.

### Staff Views and Recommendations

#### Views on the Feedback

4. On the basis of the feedback obtained from all stakeholder groups, Staff notes the caution expressed by stakeholders about *allowing* tests of controls alone to respond to an assessed ROMM at the assertion level. However, Staff believes that such an approach is not *prohibited* by extant ISAs and remains conceptually sound and consistent with the audit risk model in a narrow range of circumstances.
5. Staff is of the view that it is in the public interest to provide appropriate guardrails in the standards that mitigate against applying a 'test of controls only' approach to address an assertion level ROMM when it is not appropriate to do so. Providing clarity about the circumstances when it may apply, and the necessary conditions to apply such an approach, remain important in this regard. Staff also believe it is necessary for the ISAs to remain future proof to be able to support quality audits in a rapidly evolving technology-driven environment.

#### A Conceptually Sound Approach

6. Paragraph A43 of ISA 200<sup>5</sup> sets out that in an audit under the ISAs some control risk will always exist.<sup>6</sup> Notwithstanding that inherent limitations in internal controls will always exist, the audit risk model is not premised on the possibility that controls in an entity are able to eliminate ROMMs; but only to reduce to an acceptably low level the risk that a material misstatement that exists is not detected.
7. At the assertion level, this means that a test of controls-only approach is theoretically possible when the auditor's assessment of ROMM at the assertion level is *at or below* the acceptably low level, *even if detection risk is not directly addressed through substantive procedures*.

<sup>5</sup> International Standard on Auditing (ISA) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

<sup>6</sup> Paragraph A43 of ISA 200 explains that internal control, no matter how well designed and operated, can only reduce, but not eliminate ROMM in the financial statements, because of the inherent limitations of controls. These include, for example, the possibility of human errors or mistakes, or of controls being circumvented by collusion or inappropriate management override.

8. Paragraph A4 of ISA 330<sup>7</sup> supports this, by clarifying that the auditor need not design and perform further audit procedures where the assessment of the ROMM is below the acceptably low level. This can arise in one of two circumstances:
- (a) The auditor's assessment of inherent risk is such that, the 'net or combined assessment'<sup>8</sup> of ROMM at the assertion level is *below the acceptably low level*; or
  - (b) The auditor's assessment of inherent risk is *higher than the acceptably low level*, but the auditor's assessment of control risk in accordance with ISA 315 (Revised 2019)<sup>9</sup> is that there are controls that are designed effectively and implemented, that address the assessed inherent risk to an extent that the 'net or combined assessment' of ROMM at the assertion level is below the acceptably low level. In such circumstances, ISA 330, paragraph 8(a) requires that the auditor design and perform tests of controls to obtain sufficient appropriate audit evidence about the operating effectiveness of those controls. If the results of the tests of controls confirm the auditor's initial expectation about the operating effectiveness of those controls, thereby confirming their assessment of control risk, the auditor need not perform substantive procedures.<sup>10</sup>

#### *An Alternative Approach to the ISAs*

9. The PCAOB's analogous ISA 330 auditing standard requires the auditor to perform substantive procedures *for each relevant assertion of each significant account and disclosure, regardless of the assessed level of control risk*.<sup>11</sup> This requirement reflects that according to PCAOB auditing standards in order reduce audit risk to an acceptably low level, detection risk for a financial statement assertion must be reduced through substantive procedures.<sup>12</sup> Operationally, this means that under PCAOB standards, it is not permissible to design and perform tests of controls alone to respond to a ROMM at the assertion level.

#### *Interactions with Extant Paragraph 18 of ISA 330 and the Proposals in Agenda Item 9-A*

10. Extant paragraph 18 of ISA 330 requires that, irrespective of the assessed ROMM, substantive procedures are performed for all material classes of transactions, account balances, or disclosures (COTABD).
11. Application material explains the rationale for the requirement in extant paragraph 18 of ISA 330,

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<sup>7</sup> ISA 330, *The Auditor's Responses to Assessed Risks*

<sup>8</sup> The 'net or combined assessment' of ROMM at the assertion level is the implied ROMM at the assertion level that results from the auditor's separate assessments of inherent risk and control risk. It is the auditor's assessment of the ROMM at the assertion level after considering the effect of controls. See also the definition of risk of material misstatement in paragraph 13(n) of ISA 200.

<sup>9</sup> See ISA 315 (Revised 2019, *Identifying and Assessing the Risks of Material Misstatement*, paragraph 34.

<sup>10</sup> See ISA 330, paragraph 17.

<sup>11</sup> See the Public Company Accounting Oversight Board (PCAOB): AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, paragraph .36.

<sup>12</sup> See AS 1101, *Audit Risk*, paragraphs .9 –.11.

which among other, is to reflect the fact that there are inherent limitations of controls, including management override.<sup>13</sup> However, because the requirement applies at the COTABD level, rather than the assertion level, when it applies to significant COTABDs (which are all material COTABD),<sup>14</sup> it does not require substantive procedures to be performed to address *each relevant assertion of each significant COTABD*.<sup>15</sup>

12. Operationally, the requirement in paragraph 18 of ISA 330:
  - (a) Allows the auditor to make a professional judgment that the ROMM for one or more relevant assertions of a COTABD may be addressed through tests of controls alone. It implicitly permits the auditor to obtain audit evidence from tests of controls alone for one or more assertion(s), as long as substantive procedures are performed in respect of at least one assertion of a significant COTABD. In doing so, the assertion(s) need not be the same as the assertion(s) for which only tests of controls have been planned and are selected as contemplated by paragraph A44 of ISA 330.
  - (b) Mitigates against an auditor concluding that audit risk has been reduced to an acceptably low level for a significant COTABD when all relevant assertions of the COTABD have only been addressed through tests of controls.
13. For significant COTABDs, extant paragraph 18 of ISA 330 operates as a guardrail that prevents the auditor concluding that performing only tests of controls is an appropriate response for every relevant assertion. The recommended proposals discussed in **Agenda Item 9–A**, if agreed, would modify this guardrail because it would no longer apply to significant COTABDs.

#### *Other Guardrails in the IAASB's Standards*

14. In addition to paragraph 18 of ISA 330, the standard establishes other requirements that serve as guardrails against inappropriate use of controls only approach to address a significant COTABD. For example, ISA 330 requires:
  - (a) Substantive procedures to address a significant ROMM, that are specifically responsive to that risk (i.e., tests of control alone are explicitly not permitted to address a significant ROMM).<sup>16</sup>
  - (b) The auditor to attempt to obtain further audit evidence if sufficient appropriate audit evidence has not been obtained related to a relevant assertion about a COTABD.<sup>17</sup> This extends to circumstances where tests of controls alone have not resulted in a ROMM being assessed as being at the acceptably low level. If this is the case, then the auditor would be required to perform additional work to obtain audit evidence.

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<sup>13</sup> See ISA 330, paragraph A43.

<sup>14</sup> A significant COTABD is one for which there is one or more relevant assertions. A relevant assertion is an assertion about a COTABD which has an identified ROMM. Thus, while a significant COTABD is always material, a material COTABD is not always a significant COTABD. See also paragraphs A233–A235 of ISA 315 (Revised 2019).

<sup>15</sup> See ISA 330, paragraph A44.

<sup>16</sup> See ISA 330, paragraph 21.

<sup>17</sup> See ISA 330, paragraph 27.

15. In addition, in June 2025, Staff proposed, and the Board supported, including a new ‘stand-back’ evaluation in paragraph 25A of ISA 330 for the auditor to evaluate whether the audit evidence obtained from the further audit procedures is sufficient and appropriate in responding to the assessed ROMM.<sup>18</sup>
16. There are also other requirements in the ISAs (more broadly) which establish guardrails against inappropriate use of a test of controls only approach to address a significant COTABD. For example, ISA 220 (Revised) establishes responsibility for the engagement partner to achieve engagement quality and determine that sufficient appropriate audit evidence has been obtained to support the conclusions reached.<sup>19</sup> The auditor is also required to conclude on the overall sufficiency and appropriateness of the audit evidence obtained.<sup>20</sup>

#### *Proposed Way Forward*

17. Staff recommend retaining the current approach of the ISAs that permit, under a narrow range of circumstances and on a conditional basis, for tests of control alone to respond to an assessed ROMM at the assertion level. This is because such an approach remains reflective of the technological environments in which entities operate and is supporting more future-proof standards.
18. Staff also believe that certain clarifications and enhancements are necessary to the extant application material of ISA 330 to enable:
  - (a) Offering an explicit approach, that could encourage auditors to more frequently consider the use of tests of controls to respond to assessed ROMMs at the assertion level when appropriate to do so.
  - (b) Retaining a robust approach, safeguarding, together with the other guardrails of the ISAs, against inappropriate use of a test of controls-only approach. In view of the proposals discussed in **Agenda Item 9–A**, which, if agreed, would modify the guardrail established by paragraph 18 of ISA 330, Staff is of the view that it is important to clarify the expectations for the circumstances when a controls-only approach could apply, thereby setting out considerations against which auditors may evaluate their judgments and regulators may enforce the standards.
19. Accordingly, Staff propose new application material in ISA 330, as illustrated in the box below, explicitly recognizing that in certain narrow circumstances the auditor may design further audit procedures to obtain sufficient appropriate audit evidence related to a relevant assertion by performing only tests of controls. The application material sets out attributes of the circumstances in which this may be deemed appropriate, including the specific attributes of the controls for which this could apply.

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<sup>18</sup> See *Part B*, Section I, paragraphs 115–116 of [Agenda Item 4](#) discussed by the IAASB at the June 2025 quarterly meeting.

<sup>19</sup> See ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*, paragraph 32.

<sup>20</sup> In March 2025, the IAASB decided to reposition paragraph 26 of ISA 330 into paragraph 11A of ISA 700, *Forming an Opinion and Reporting on Financial Statements*.

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level

*The Nature, Timing and Extent of Further Audit Procedures (Ref: Para. 6)*

A4. The auditor's assessment of ~~the identified risks~~ of material misstatement at the assertion level in accordance with ISA 315 (Revised 2019) provides a basis ~~for considering the appropriate audit approach~~ for designing and performing further audit procedures. For example, the auditor may determine that:

- (a) Only by performing tests of controls may the auditor obtain sufficient appropriate audit evidence to address ~~achieve an effective response to~~ the assessed risk of material misstatement for a ~~particular relevant~~ assertion. This may be the case when the auditor has identified a risk for which substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level, and is therefore required to test the operating effectiveness of controls that address that risk;<sup>21</sup>
- (b) Performing only substantive procedures can provide sufficient appropriate audit evidence to address the assessed risk of material misstatement for ~~particular a relevant~~ assertions. In these circumstances, and, therefore, the auditor excludes the expected effect of controls from the assessment of the risk of material misstatement at the assertion level. This may be because the auditor has not identified a risk for which substantive procedures alone cannot provide sufficient appropriate audit evidence, or in assessing control risk, the auditor does ~~and therefore the auditor may~~ not plan to test the operating effectiveness of controls; ~~in determining the nature, timing and extent of substantive procedures;~~<sup>22</sup> or
- (c) A combined approach, using both tests of controls and substantive procedures is an effective approach.

The auditor need not design and perform further audit procedures for relevant assertions where for which the assessment of ~~inherent the risk is~~ such that the risk of material misstatement is below the acceptably low level. However, as required by paragraph 18, ~~irrespective of the approach selected and the assessed risk of material misstatement,~~ the auditor determines the need to designs and performs substantive procedures for each material class of transactions, account balance, and disclosure that is not determined to be a significant class of transactions, account balance or disclosure.

A4A. In certain specific circumstances it may be appropriate for the auditor to design further audit procedures to obtain sufficient appropriate audit evidence related to a relevant assertion by performing only tests of controls. That is, the auditor may assess that a risk of material misstatement at the assertion level is at an acceptably low level because of the auditor's expectation that the controls that the auditor considered when assessing the control risk related to the relevant assertion are operating effectively. The auditor's professional judgment as to whether it may be appropriate to design and perform only test of controls for a relevant assertion is

<sup>21</sup> ISA 315 (Revised 2019), paragraph 33

<sup>22</sup> ISA 315 (Revised 2019), paragraph 34

influenced by factors such as:

- The risk of management override of controls does not affect the assessment of risk at the assertion level in accordance with ISA 240 (Revised).<sup>23</sup>
- The assessment of inherent risk for the relevant assertion is at the lower end of the spectrum of inherent risk.
- The controls that formed part of the auditor's assessment of control risk and are planned to be tested in the circumstance:
  - Are sufficiently precise to respond to the events or conditions that gave rise to the identification and assessment of the inherent risk;
  - Are automated controls requiring little or no manual intervention;
  - Include the indirect controls that support the operation of the direct controls that address the relevant assertion; and
  - Operate in the entity's information system that the auditor has evaluated as appropriately supporting the preparation of financial statements in accordance with the applicable financial reporting framework.<sup>24</sup>
- The further audit procedures designed and performed in relation to the particular class of transactions, account balance or disclosure do not involve performing only tests of controls for all the relevant assertions of the class of transactions, account balance or disclosure.

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**Matter for IAASB Consideration:**

1. The Board is asked for their views on Staff's views and recommendations discussed this Agenda Item. In particular:
  - (a) The recommendation to retain the current approach of the ISAs that permits, under a narrow range of circumstances and on a conditional basis, for tests of controls alone to respond to an assessed ROMM at the assertion, as discussed in paragraph 17 above.
  - (b) The proposed clarifications and enhancements to the application material of ISA 330 discussed in paragraphs 18–19 above, including the proposed drafting presented in paragraph 19.
2. The Board is asked whether there are any other matters that should be considered in relation to performing tests of tests of controls alone to respond to an assessed ROMM at the assertion level.

<sup>23</sup> ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph 40

<sup>24</sup> ISA 315 (Revised 2019), paragraph 25