

### Audit Evidence & Risk Response (AE&RR) – Significant Risks

This Agenda Item considers matters relevant to enhancing the requirement in paragraph 15 of extant ISA 330,<sup>1</sup> that addresses testing controls for significant risks.

#### Significant Risks

1. A significant risk is defined in ISA 315 (Revised 2019)<sup>2</sup> as a risk of material misstatement (ROMM):
  - (a) For which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur; or
  - (b) That is to be treated as a significant risk in accordance with the requirements of other ISAs.<sup>3</sup>

Application material also provides examples of matters that may indicate that a ROMM is a significant risk.<sup>4</sup>

#### Relevant Requirements of the ISAs

##### ISA 315 (Revised 2019)

2. Paragraph 26(a)(i) of ISA 315 (Revised 2019) requires that the auditor identify controls that address ROMM at the assertion level that are determined to be significant risks and evaluate whether these controls are designed in a way to effectively address the ROMM at the assertion level and determine whether they have been implemented according to their design.
3. Paragraph 32 of ISA 315 (Revised 2019) requires the auditor to determine whether any of the assessed risks of material misstatement are significant risks.
4. Accordingly, the requirements in ISA 315 (Revised 2019) to identify, evaluate design and determine implementation of controls determined to be significant risks are intended to achieve two primary outcomes in the context of an audit of financial statements:
  - (a) To inform the design of further audit procedures that are able to provide sufficient appropriate audit evidence related to the ROMM, by requiring that the auditor obtain information about how management have addressed inherent risks that are close to the higher end of the spectrum

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

<sup>2</sup> See ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*, paragraph 12(l)

<sup>3</sup> These include ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* and ISA 550, *Related Parties*.

<sup>4</sup> Paragraph A221 of ISA 315 (Revised 2019) provides the following examples of matters that may indicate a significant risk: (i) transactions for which there are multiple acceptable accounting treatments such that subjectivity is involved; (ii) accounting estimates that have high estimation uncertainty or complex models; (iii) complexity in data collection and processing to support account balances; (iv) account balances or quantitative disclosures that involve complex calculations; (v) accounting principles that may be subject to differing interpretation; (vi) changes in the entity's business that involve changes in accounting, for example, mergers and acquisitions.

of inherent risk. Because significant risks often relate to non-routine or judgmental matters and may therefore be less likely subject to routine controls, irrespective of whether tests of controls are planned, understanding how the entity has addressed the factors that influenced the auditor's determination of a risk as being significant, provides the auditor with information to develop an effective audit approach.

- (b) Support the auditor's identification of any significant control deficiencies (including, for example, the absence of controls over significant risks) that may require communication with those charged with governance (TCWG).<sup>5</sup> If management has not responded to the circumstances that give rise to the significant risk by implementing appropriate controls (whether because they decided to accept the risk, or because they failed to design an effective control, or because they did not implement controls that they had designed and may have been effective had they been implemented), the auditor may determine that there is a significant control deficiency that needs communicating to TCWG.

#### ISA 330

- 5. When the auditor determined that an assessed ROMM at the assertion level is a significant risk, paragraph 21 of ISA 330 requires the auditor to perform substantive procedures that are specifically responsive to that risk. If the auditor chooses to perform tests of controls to obtain sufficient appropriate audit evidence at the assertion level for a ROMM that is significant, then paragraph 15 of ISA 330 requires that the audit evidence to be obtained from such tests of controls performed is obtained in the current period.

#### Significant Risks in Accordance with Other ISAs

- 6. ISA 240 (Revised) and ISA 550 set out specific requirements to treat an assessed ROMM as a significant risk and to undertake subject-matter specific procedures. Neither standard requires that tests of controls be a mandated response in those cases, as follows:
  - (a) Paragraph 39(b) of ISA 240 (Revised) requires the auditor to treat assessed ROMM due to fraud as significant risks. The auditor is required by this standard to identify controls that address such significant risks, evaluate whether they have been designed effectively to address the ROMM, or designed effectively to support the operation of other controls, and determine whether they have been implemented.
  - (b) Paragraph 18 of ISA 550 requires the auditor to identify whether there are any significant risks associated with related party transactions, and to treat significant related party transactions outside the entity's normal course of business as giving rise to significant risks. The auditor is required by the standard to design and perform further audit procedures to address such risks in accordance with ISA 330, including procedures that focus on the entity's process for identifying, and recording related party relationships, and for authorizing related party transactions.

---

<sup>5</sup> See ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*.

## Staff Views and Recommendations

<i>Relevant Paragraphs in Agenda Item 5–M:</i>	<b>Para. 11A, 15</b>
------------------------------------------------	----------------------

### *Criteria to Perform Test of Controls*

7. The criteria in paragraph 8 of ISA 330 to perform tests of controls are the same, irrespective of whether a ROMM is determined to be a significant risk or not. Tests of control may be designed and performed because the auditor:
  - (a) Made a choice to do so by including an expectation that controls operated effectively in their assessment of ROMM; or
  - (b) Had no choice but to do so because the auditor has determined that sufficient appropriate audit evidence at the assertion level cannot be obtained from substantive procedures alone.

### *Enhancements to Paragraph 15 of ISA 330*

8. Staff are of the view that the criteria discussed in paragraph 7 above remain appropriate and sound in relation to the audit risk model embedded in the ISAs. However, Staff are also of the view there is an opportunity to improve the connection between the requirement in paragraph 8(a) of ISA 330 and the requirement in paragraph 15 of extant ISA 330, and in doing so, further encourage auditors toward considering performing test of controls for significant risks as part of the further audit procedures more commonly. This is because of the benefits to audit quality arising from obtaining more persuasive audit evidence in response to significant risks by combining tests of controls and substantive procedures.
9. As illustrated in the box below, Staff are proposing to:
  - (a) Relocate, paragraph 15 of extant ISA 330 in a new subsection of the standard titled ‘Controls Addressing Significant Risks’ following paragraph 11 of extant ISA 330.
  - (b) Clarify the wording of the requirement, to support understanding that it applies in all circumstances in which the auditor intends to use audit evidence about the operating effectiveness of controls that address significant risks.

Controls ~~over-addressing~~ significant risks

11A. If the auditor ~~plans~~~~intends~~ to ~~rely on controls over~~~~obtain~~ audit evidence about the operating effectiveness of controls that address a risk the auditor has determined to be a significant risk, the auditor shall test those controls in the current period.

## Application Material for Significant Risks

10. Post December 2025, and subject to the Board's feedback, Staff intend to consider further enhancements to the application material addressing testing controls in response to significant risks, that will be presented to the Board in due course. Such guidance will aim to enhance the linkages between the auditor's evaluation of the design and determination of implementation of controls in ISA 315 (Revised 2019) with the auditor's decisions in ISA 330 about designing and performing tests of

controls, in the context of significant risks.

**Matters for IAASB Consideration:**

1. The Board is asked for their views on Staff's views and recommendations discussed in paragraphs 7–9 above, including the related drafting presented in paragraph 11A of **Agenda Item 5–M**.
2. The Board is asked whether there are any other matters that should be considered for significant risks, including suggestions for encouraging auditors to more commonly choose to test the operating effectiveness of controls when addressing a significant risk.