

**ISA 330 (Redrafted)****THE AUDITOR'S PROCEDURES IN RESPONSE TO ASSESSED RISKS****CONTENTS**


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## **Introduction**

### **Scope of this ISA**

1. This International Standard on Auditing (ISA) deals with the auditor's response to the assessed risks of material misstatement in a financial statement audit.

### **Effective Date**

2. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 200x.

### **Objectives to Be Achieved**

3. In relation to the subject matter of this ISA, the objectives of the auditor are to:
  - (a) Determine and implement overall responses to assessed risks at the financial statement level;
  - (b) Design and perform further audit procedures to respond to assessed risks at the assertion level; and
  - (c) Evaluate whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level.

### **Definitions**

4. The following terms are introduced in this ISA:
  - (a) Substantive procedure – An audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise:
    - (i) Tests of details (of classes of transactions, account balances, and disclosures), and
    - (ii) Substantive analytical procedures.
  - (b) Test of controls – An audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

### **Requirements**

#### **Overall Responses**

5. The auditor shall determine overall responses to address the risks of material misstatement at the financial statement level. (Ref: Para. A1-A3)

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

6. The auditor shall design and perform further audit procedures whose nature, timing, and extent are based on and responsive to the assessed risks of material misstatement at the assertion level. The purpose is to provide a clear linkage between the nature, timing and extent of the auditor's further audit procedures and the risk assessment.
7. In determining the further audit procedures to be performed, the auditor shall:

- (a) Consider the reasons for the assessment of the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure, including:
  - (i) The particular characteristics of the relevant class of transactions, account balance, or disclosure (i.e., the inherent risks); and
  - (ii) Whether the relevant risk assessment takes account of the entity's controls (i.e., the control risk), including the nature of the specific controls used by the entity and whether they are manual or automated, and whether the auditor expects to obtain evidence to determine if the controls are effective; and
- (b) Seek more persuasive audit evidence, whether from tests of controls or substantive procedures, the higher the auditor's assessment of risk. More persuasive audit evidence may be obtained by increasing the quantity of the evidence, or obtaining evidence that is more relevant or reliable. The nature of the audit procedures is, however, of most importance in responding to the assessed risks. (Ref: Para. A4-A16)

#### TESTS OF CONTROLS

- 8. The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when:
  - (a) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively, or
  - (b) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. (Ref: Para. A17-A21)

#### Nature of tests of controls

- 9. In designing and performing tests of controls, the auditor shall:
  - (a) Perform other audit procedures in combination with inquiry to test the operating effectiveness of the controls. (Ref: Para. A22-A24)
  - (b) Obtain audit evidence about the operating effectiveness of the controls at an appropriately detailed level, including:
    - (i) How the controls were applied at relevant times during the period under audit.
    - (ii) The consistency with which they were applied.
    - (iii) By whom or by what means they were applied.
  - (c) If the controls to be tested depend upon other controls (indirect controls), consider whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls. (Ref: Para. A25-26)

#### Timing of tests of controls

- 10. The auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls, subject to paragraphs 11 and 14 below. The purpose of this requirement and those in paragraphs 11 and 14, is to provide an appropriate basis for the auditor's intended reliance at relevant times during the period under audit. (Ref: Para. A27)

*Using audit evidence obtained during an interim period*

11. When the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, the auditor shall:
- (a) Obtain audit evidence about changes to those controls subsequent to the interim period; and
  - (b) Determine what additional audit evidence should be obtained for the remaining period. (Ref: Para. A28-A29)

*Using audit evidence obtained in previous audits*

12. In considering whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, and, if so, the length of the time period that may elapse before retesting a control, the auditor shall consider the following:
- The effectiveness of other elements of internal control, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process.
  - The risks arising from the characteristics of the control, including whether controls are manual or automated.
  - The effectiveness of general IT-controls.
  - The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect the application of the control.
  - Whether the lack of a change in a particular control poses a risk due to changing circumstances.
  - The risk of material misstatement and the extent of reliance on the control. (Ref: Para. A30)
13. If the auditor plans to use audit evidence from a prior audit about the operating effectiveness of specific controls, the auditor shall establish the continuing relevance of that evidence by obtaining audit evidence about whether changes in those controls have occurred subsequent to the previous audit. The auditor shall obtain audit evidence about whether such changes have occurred by performing inquiry combined with observation or inspection, to confirm the understanding of those specific controls, and:
- (a) If there have been changes, the auditor shall test the operating effectiveness of the controls in the current audit. (Ref: Para. A31)
  - (b) If there have not been changes, the auditor shall test the operating effectiveness of the controls at least once in every third audit.

However, when there are a number of controls for which the auditor determines that it is appropriate to use audit evidence obtained in previous audits, the auditor shall test the operating effectiveness of some controls each audit. The purpose of this requirement is to avoid the possibility that the auditor might test controls in a single audit period with no testing of controls in the subsequent two audit periods. (Ref: Para. A32-34)

14. When the auditor plans to rely on controls over a risk the auditor has determined to be a significant risk, the auditor shall test those controls in the current period.

#### Extent of tests of controls

15. The auditor shall increase the extent of tests of controls the more the auditor relies on their operating effectiveness in the assessment of risk. (Ref: Para. A35-A36)

#### Evaluating the operating effectiveness of controls

16. When evaluating the operating effectiveness of relevant controls, the auditor shall consider misstatements that have been detected by substantive procedures. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the assertion being tested are effective. (Ref: Para. A37)
17. When deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether:
  - (a) The tests of controls that have been performed provide an appropriate basis for reliance on the controls;
  - (b) Additional tests of controls are necessary; or
  - (c) The potential risks of misstatement need to be addressed using substantive procedures. (Ref: Para. A38)

#### SUBSTANTIVE PROCEDURES

18. Irrespective of the assessed risk of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure. This requirement reflects the facts that: (i) the auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement; and (ii) there are inherent limitations to internal control, including management override. (Ref: Para. A39-A43)
19. When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedure, those procedures shall include tests of details. (Ref: Para. A44)
20. The auditor's substantive procedures shall include the following audit procedures related to the financial statement closing process:
  - (a) Agreeing the financial statements to the underlying accounting records; and
  - (b) Examining material journal entries and other adjustments made during the course of preparing the financial statements.

The nature and extent of the auditor's examination of journal entries and other adjustments depends on the nature and complexity of the entity's financial reporting process and the associated risks of material misstatement.

#### Timing of substantive procedures

##### *Using audit evidence obtained during an interim period*

21. When substantive procedures are performed at an interim date, the auditor shall perform further substantive procedures, or substantive procedures combined with tests of controls to

- cover the remaining period, that provide a reasonable basis for extending the audit conclusions from the interim date to the period end.
22. If misstatements are detected at an interim date, the auditor shall modify the related assessment of risk and the planned nature, timing, or extent of substantive procedures covering the remaining period. This may include extending or repeating such procedures at the period end.
23. When the auditor plans to perform substantive analytical procedures with respect to the intervening period between the interim date and the period end, the auditor shall consider whether:
- (a) The period end balances of the particular classes of transactions or account balances are reasonably predictable with respect to amount, relative significance, and composition.
  - (b) The entity's procedures for analyzing and adjusting such classes of transactions or account balances at interim dates and for establishing proper accounting cutoffs are appropriate.
  - (c) The information system relevant to financial reporting will provide information concerning the balances at the period end and the transactions in the remaining period that is sufficient to permit investigation of:
    - (i) Significant unusual transactions or entries (including those at or near period end),
    - (ii) Other causes of significant fluctuations, or expected fluctuations that did not occur, and
    - (iii) Changes in the composition of the classes of transactions or account balances.  
(Ref: Para. A45-46)

#### *Using audit evidence obtained in previous audits*

24. The auditor shall only use audit evidence obtained in previous audits as substantive audit evidence in the current period if the audit evidence and the related subject matter have not fundamentally changed. If the auditor plans to use such evidence, the auditor shall perform audit procedures during the current period to establish its continuing relevance. (Ref: Para. A47)

#### **Adequacy of Presentation and Disclosure**

25. The auditor shall perform audit procedures to evaluate whether the overall presentation of the financial statements, including the related disclosures, are in accordance with the applicable financial reporting framework. (Ref: Para. A48)

#### **Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained**

26. Based on the audit procedures performed, the audit evidence obtained and consideration of how the detection of a misstatement may affect the risks of misstatement, the auditor shall evaluate before the conclusion of the audit whether the assessments of the risks of material misstatement at the assertion level remain appropriate. (Ref: Para. A49-50)
27. The auditor shall conclude whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level.

28. If the auditor has not obtained sufficient appropriate audit evidence as to a material financial statement assertion, the auditor shall attempt to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall express a qualified opinion or a disclaimer of opinion.

### **Documentation**

29. The auditor shall document:
- (a) The overall responses to address the assessed risks of material misstatement, identifying separately those due to fraud, at the financial statement level and the nature, timing, and extent of the further audit procedures;
  - (b) The linkage of those procedures with the assessed risks at the assertion level; and
  - (c) The results of the audit procedures.
30. If the auditor plans to use audit evidence about the operating effectiveness of controls obtained in previous audits, the auditor shall document the conclusions reached about relying on such controls that were tested in a previous audit.

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### **Application Material**

#### **Overall Responses** (Ref: Para. 5)

- A1. Overall responses to address the risks of material misstatement at the financial statement level may include:
- Emphasizing to the audit team the need to maintain professional skepticism.
  - Assigning more experienced staff or those with special skills or using experts.<sup>1</sup>
  - Providing more supervision.
  - Incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.
  - Making general changes to the nature, timing, or extent of audit procedures, for example: performing substantive procedures at period end instead of at an interim date; or modifying the nature of audit procedures to obtain more persuasive audit evidence.
- A2. The assessment of the risks of material misstatement at the financial statement level, and thereby the auditor's overall responses, is affected by the auditor's understanding of the control environment. 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 and thus, for example, allow the auditor to conduct some audit procedures at an interim date rather than at period end. Weaknesses in the control environment, however, have the opposite effect; for example, the auditor may respond to an ineffective control environment by conducting more audit procedures as of the period end rather than at an interim date, seeking more extensive audit evidence from

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<sup>1</sup> The assignment of engagement personnel to the particular engagement reflects the auditor's risk assessment, which is based on the auditor's understanding of the entity, including its internal control, and its environment.

substantive procedures, or increasing the number of locations to be included in the audit scope.

- A3. Such considerations, therefore, have a significant bearing on the auditor's general approach, for example, an emphasis on substantive procedures (substantive approach), or an approach that uses tests of controls as well as substantive procedures (combined approach).

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

THE NATURE, TIMING, AND EXTENT OF FURTHER AUDIT PROCEDURES (Ref: Paras. 6-7)

- A4. The auditor's assessment of the identified risks at the assertion level provides a basis for considering the appropriate audit approach for designing and performing further audit procedures. For example, in some cases (as appropriate and notwithstanding the requirements of this ISA<sup>2</sup>), the auditor may determine that:

- Only by performing tests of controls may the auditor achieve an effective response to the assessed risk of material misstatement for a particular assertion.
- Performing only substantive procedures is appropriate for specific assertions and, therefore, the auditor excludes the effect of controls from the relevant risk assessment. This may be because the auditor's risk assessment procedures have not identified any effective controls relevant to the assertion, or because testing controls would be inefficient.
- A combined approach using both tests of controls and substantive procedures is an effective approach.

Considerations specific to smaller entities

- A5. In the case of very small entities, there may not be many control activities that could be identified by the auditor. For this reason, the auditor's further audit procedures are likely to be primarily substantive procedures. In some rare cases, however, the absence of controls may make it impossible to obtain sufficient appropriate audit evidence.

Nature

- A6. The nature of an audit procedure refers to its purpose (i.e., test of controls or substantive procedure) and its type (i.e., inspection, observation, inquiry, confirmation, recalculation, reperformance, or analytical procedure).
- A7. The auditor's assessed risks may affect both the types of audit procedures to be performed and their combination. For example, the auditor may confirm the completeness of the terms of a contract with a third party, in addition to inspecting the document. Further, certain audit procedures may be more appropriate for some assertions than others. For example, in relation to revenue, tests of controls may be most responsive to the assessed risk of misstatement of the completeness assertion, whereas substantive procedures may be most responsive to the assessed risk of misstatement of the occurrence assertion.

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<sup>2</sup> For example, as required by paragraph 18, irrespective of the approach selected, the auditor designs and performs substantive procedures for each material class of transactions, account balance, and disclosure.

- A8. The reasons for the assessment of a risk are relevant in determining the nature of audit procedures. For example, if an assessed risk is low because of the particular characteristics of a class of transactions without consideration of the related controls, then the auditor may determine that substantive analytical procedures alone provide sufficient appropriate audit evidence. On the other hand, if the assessed risk is low because of internal controls, and the auditor intends to base the substantive procedures on that low assessment, then the auditor performs tests of those controls, as required by paragraph 8(a). This may be the case, for example, for a class of transactions of reasonably uniform, non-complex characteristics that are routinely processed and controlled by the entity's information system.

#### Timing

- A9. Timing of an audit procedure refers to when it is performed, or the period or date to which the audit evidence applies.
- A10. The auditor may perform tests of controls or substantive procedures at an interim date or at period end. The higher the risk of material misstatement, the more likely it is that the auditor may decide it is more effective to perform substantive procedures nearer to, or at, the period end rather than at an earlier date, or to perform audit procedures unannounced or at unpredictable times (for example, performing audit procedures at selected locations on an unannounced basis). This is particularly relevant when considering the response to the risks of fraud. For example, the auditor may conclude that, given the risks of intentional misstatement or manipulation, audit procedures to extend audit conclusions from interim date to the period end would not be effective.
- A11. On the other hand, performing audit procedures before the period end may assist the auditor in identifying significant matters at an early stage of the audit, and consequently resolving them with the assistance of management or developing an effective audit approach to address such matters. Similarly, because an intentional misstatement, involving improper revenue recognition for example, may have been initiated in an interim period, the auditor may elect to apply substantive procedures to transactions occurring earlier in, or throughout, the reporting period.
- A12. In addition, certain audit procedures can be performed only at or after period end, for example:
- Agreeing the financial statements to the accounting records,
  - Examining adjustments made during the course of preparing the financial statements, and
  - Procedures to respond to a risk that the entity may have entered into improper sales contracts, or that transactions may not have been finalized at period end.
- A13. Further relevant factors that influence the auditor's consideration of when to perform audit procedures include the following:
- The control environment.
  - When relevant information is available (for example, electronic files may subsequently be overwritten, or procedures to be observed may occur only at certain times).

- The nature of the risk (for example, if there is a risk of inflated revenues to meet earnings expectations by subsequent creation of false sales agreements, the auditor may wish to examine contracts available on the date of the period end).
- The period or date to which the audit evidence relates.

#### Extent

- A14. Extent of an audit procedure refers to the quantity to be performed, for example, a sample size or the number of observations of a control activity.
- A15. The extent of an audit procedure is determined by the judgment of the auditor after considering the materiality, the assessed risk, and the degree of assurance the auditor plans to obtain. When a single objective is met by a combination of procedures, the extent of each procedure is considered separately. In general, the extent of audit procedures increases as the risk of material misstatement increases. For example, in response to the assessed risk of material misstatement due to fraud, increased sample sizes or performing substantive analytical procedures at a more detailed level may be appropriate. However, increasing the extent of an audit procedure is effective only if the audit procedure itself is relevant to the specific risk.
- A16. The use of computer-assisted audit techniques (CAATs) may enable more extensive testing of electronic transactions and account files, which may be useful when the auditor decides to modify the extent of testing, for example, in responding to the risks of material misstatement due to fraud. Such techniques can be used to select sample transactions from key electronic files, to sort transactions with specific characteristics, or to test an entire population instead of a sample.

#### TESTS OF CONTROLS

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

- A17. Tests of controls are performed only on those controls that the auditor has determined are suitably designed to prevent, or detect and correct, a material misstatement in an assertion. If substantially different controls were used at different times during the period under audit, each is considered separately.
- A18. Testing the operating effectiveness of controls is different from obtaining audit evidence that controls have been implemented. However, the same types of audit procedures are used. The auditor may, therefore, decide it is efficient to test the operating effectiveness of controls at the same time as evaluating their design and determining that they have been implemented.
- A19. Further, although some risk assessment procedures may not have been specifically designed as tests of controls, they may nevertheless provide audit evidence about the operating effectiveness of the controls and, consequently, serve as tests of controls. For example, the auditor's risk assessment procedures may have included inquiries about management's use of budgets, observed management's comparison of monthly budgeted and actual expenses, and inspected reports pertaining to the investigation of variances between budgeted and actual amounts. These audit procedures provide knowledge about the design of the entity's budgeting policies and whether they have been implemented, but may also provide audit evidence about the effectiveness of the operation of budgeting policies in preventing or detecting material misstatements in the classification of expenses.

- A20. In addition, the auditor may design a test of controls to be performed concurrently with a test of details on the same transaction. Although the objective of a test of controls is different from the objective of a test of details, both may be accomplished concurrently by performing a test of controls and a test of details on the same transaction, also known as a dual-purpose test. For example, the auditor may design, and evaluate the results of, a test to examine an invoice to determine whether it has been approved and to provide substantive audit evidence of a transaction. A dual-purpose test is designed and evaluated by considering each objective of the test separately.
- A21. In some cases, as discussed in ISA 315 (Redrafted), "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatements," the auditor may find it impossible to design effective substantive procedures that by themselves provide sufficient appropriate audit evidence at the assertion level, for example when an entity conducts its business using IT and no documentation of transactions is produced or maintained, other than through the IT system. In such cases, the auditor is required by paragraph 8(b) of this ISA to perform tests of relevant controls.

#### Nature of Tests of Controls

##### *Other audit procedures in combination with inquiry* (Ref: Para. 9(a))

- A22. A higher level of assurance is ordinarily sought about controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.
- A23. Inquiry alone is not sufficient to test the operating effectiveness of controls. Accordingly, it is necessary to perform other audit procedures in combination with inquiry. In this regard, inquiry combined with inspection or reperformance ordinarily provides more assurance than inquiry and observation, since an observation is pertinent only at the point in time at which it is made.
- A24. The nature of the particular control influences the type of procedure required to obtain audit evidence about whether the control was operating effectively. For example, if operating effectiveness is evidenced by documentation, the auditor may decide to inspect it to obtain audit evidence about operating effectiveness. For other controls, however, documentation may not be available or relevant. For example, documentation of operation may not exist for some factors in the control environment, such as assignment of authority and responsibility, or for some types of control activities, such as control activities performed by a computer. In such circumstances, audit evidence about operating effectiveness may be obtained through inquiry in combination with other audit procedures such as observation or the use of CAATs.

##### *Testing of indirect controls* (Ref: Para. 9(c))

- A25. In some circumstances, it may be necessary to obtain audit evidence supporting the effective operation of indirect controls. For example, when the auditor decides to test the effectiveness of a user review of exception reports detailing sales in excess of authorized credit limits, the auditor may also need to consider the effectiveness of controls related to the accuracy of the information in those reports (for example, the general IT-controls). The user review and related follow up is the control that is directly of relevance to the auditor; the controls over the accuracy of the information in the reports are described as 'indirect' controls.

A26. Because of the inherent consistency of IT processing, audit evidence about the implementation of an automated application control, when considered in combination with audit evidence about the operating effectiveness of the entity's general controls (in particular, change controls), may also provide substantial audit evidence about its operating effectiveness.

#### Timing of Tests of Controls

##### *Intended period of reliance* (Ref: Para. 10)

A27. Audit evidence pertaining only to a point in time may be sufficient for the auditor's purpose, for example, when testing controls over the entity's physical inventory counting at the period end. If, on the other hand, the auditor intends to rely on a control over a period, tests that are capable of providing audit evidence that the control operated effectively at relevant times during that period are appropriate. Such tests may include tests of the entity's monitoring of controls.

##### *Using audit evidence obtained during an interim period* (Ref: Para. 11)

A28. Relevant factors in determining what additional audit evidence should be obtained about controls that were operating during an interim period include:

- The significance of the assessed risks of material misstatement at the assertion level.
- The specific controls that were tested during the interim period.
- The degree to which audit evidence about the operating effectiveness of those controls was obtained.
- The length of the remaining period.
- The extent to which the auditor intends to reduce further substantive procedures based on the reliance of controls.
- The control environment.

A29. Additional audit evidence may be obtained, for example, by extending tests of controls over the remaining period or testing the entity's monitoring of controls.

##### *Using audit evidence obtained in previous audits* (Ref: Para. 12)

A30. In certain circumstances, audit evidence obtained from previous audits may provide audit evidence where the auditor performs audit procedures to establish its continuing relevance. For example, in performing a previous audit, the auditor may have determined that an automated control was functioning as intended. The auditor may obtain audit evidence to determine whether changes to the automated control have been made that affect its continued effective functioning through, for example, inquiries of management and the inspection of logs to indicate what controls have been changed. Consideration of audit evidence about these changes may support either increasing or decreasing the expected audit evidence to be obtained in the current period about the operating effectiveness of the controls.

##### Controls that have changed from previous audits (Ref: Para. 13(a))

A31. Changes may affect the relevance of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance. For example, changes in a

system that enable an entity to receive a new report from the system probably do not affect the relevance of audit evidence from a previous audit; however, a change that causes data to be accumulated or calculated differently does affect it.

Controls that have not changed from previous audits (Ref: Para. 13(b))

- A32. The auditor's decision on whether to rely on audit evidence obtained in previous audits for controls that:
- (a) Have not changed since they were last tested; and
  - (b) Are not controls that mitigate a significant risk,
- is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment, but cannot exceed two years.
- A33. In general, the higher the risk of material misstatement, or the greater the reliance on controls, the shorter the time period elapsed, if any, is likely to be. Factors that may decrease the period for retesting a control, or result in not relying on audit evidence obtained in previous audits at all, include the following:
- A weak control environment.
  - Weak monitoring of controls.
  - A significant manual element to the relevant controls.
  - Personnel changes that significantly affect the application of the control.
  - Changing circumstances that indicate the need for changes in the control.
  - Weak general IT-controls.
- A34. When there are a number of controls for which the auditor intends to rely on audit evidence obtained in previous audits, testing some of those controls in each audit provides collateral evidence about the continuing effectiveness of the control environment and therefore contributes to the decision about whether it is appropriate to rely on audit evidence obtained in previous audits.

Extent of Tests of Controls (Ref: Para. 15)

- A35. The more the auditor relies on a control, the greater the testing of the control. Other matters the auditor may consider in determining the extent of the auditor's tests of controls include the following:
- The frequency of the performance of the control by the entity during the period.
  - The length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
  - The expected rate of deviation from a control.
  - The relevance and reliability of the audit evidence to be obtained in supporting that the control prevents, or detects and corrects, material misstatements at the assertion level.
  - The extent to which audit evidence is obtained from tests of other controls related to the assertion.

ISA 530, "Audit Sampling and Other Means of Testing" contains further guidance on the extent of testing.

A36. Because of the inherent consistency of IT processing, the auditor may not need to increase the extent of testing of an automated control. An automated control should function consistently unless the program (including the tables, files, or other permanent data used by the program) is changed. Once the auditor determines that an automated control is functioning as intended (which could be done at the time the control is initially implemented or at some other date), the auditor may consider performing tests to determine that the control continues to function effectively. Such tests might include determining that:

- Changes to the program are not made without being subject to the appropriate program change controls,
- The authorized version of the program is used for processing transactions, and
- Other relevant general controls are effective.

Such tests also might include determining that changes to the programs have not been made, as may be the case when the entity uses packaged software applications without modifying or maintaining them. For example, the auditor may inspect the record of the administration of IT security to obtain audit evidence that unauthorized access has not occurred during the period.

Evaluating Operating Effectiveness (Ref: Para. 16-17)

A37. A material misstatement detected by the auditor's procedures ordinarily indicates the existence of a material weakness in internal control.

A38. The concept of effectiveness of the operation of controls recognizes that some deviations in the way controls are applied by the entity may occur. Deviations from prescribed controls may be caused by such factors as changes in key personnel, significant seasonal fluctuations in volume of transactions and human error. The detected rate of deviation, in particular in comparison with the expected rate, may indicate that the control cannot be relied on to reduce audit risk at the assertion level to that assessed by the auditor.

#### SUBSTANTIVE PROCEDURES

Nature and extent of substantive procedures (Ref: Para. 18)

A39. The greater the risk of material misstatement, the greater the extent of substantive procedures. Because the risk of material misstatement takes account of internal control, the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory. However, increasing the extent of an audit procedure is appropriate only if the audit procedure itself is relevant to the specific risk.

A40. Depending on the circumstances, the auditor may determine that:

- Performing only substantive analytical procedures may be sufficient to reduce audit risk to an acceptably low level. For example, where the auditor's assessment of risk is supported by audit evidence from tests of controls.
- Only tests of details are appropriate.
- A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.

A41. Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. ISA 520, "Analytical Procedures"

contains standards and guidance on the application of analytical procedures during an audit.

- A42. The nature of the risk and assertion is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion involve selecting from items contained in a financial statement amount and obtaining the relevant audit evidence. On the other hand, tests of details related to the completeness assertion involve selecting from items that likely should be included in the relevant financial statement amount and investigating whether they are included.
- A43. In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. However, other matters are also relevant, including whether it is more effective to use other selective means of testing. See ISA 530 for additional guidance.

Substantive procedures responsive to significant risks (Ref: Para. 19)

- A44. The auditor is required by paragraph 19 of this ISA to perform substantive procedures that are specifically responsive to risks the auditor has determined to be significant risks. For example, if the auditor identifies that management is under pressure to meet earnings expectations, there may be a risk that management is inflating sales by improperly recognizing revenue related to sales agreements with terms that preclude revenue recognition or by invoicing sales before shipment. In these circumstances, the auditor may, for example, design external confirmations not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return and delivery terms. In addition, the auditor may find it effective to supplement such external confirmations with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms.

Timing of Substantive Procedures

*Using audit evidence obtained during an interim period* (Ref: Para. 21-23)

- A45. In some circumstances, the auditor may determine that it is effective to perform substantive procedures at an interim date, and to compare and reconcile information concerning the balance at the period end with the comparable information at the interim date to:
- (a) Identify amounts that appear unusual,
  - (b) Investigate any such amounts, and
  - (c) Perform substantive analytical procedures or tests of details to test the intervening period.
- A46. Performing substantive procedures at an interim date increases the risk that misstatements that may exist at the period end are not detected by the auditor. This risk increases as the remaining period is lengthened. Factors such as the following influence whether to perform substantive procedures at an interim date include:
- The control environment and other relevant controls.
  - The availability of information at a later date that is necessary for the auditor's procedures.
  - The objective of the substantive procedure.
  - The assessed risk of material misstatement.

- The nature of the class of transactions or account balance and related assertions.
- The ability of the auditor to perform appropriate substantive procedures or substantive procedures combined with tests of controls to cover the remaining period in order to reduce the risk that misstatements that exist at period end are not detected.

Using audit evidence obtained in previous audits (Ref: Para. 24)

A47. The use of audit evidence from substantive procedures performed in previous audits is not sufficient to address a risk of material misstatement in the current period. In most cases, audit evidence from a previous audit's substantive procedures provides little or no audit evidence for the current period. There are, however, exceptions in some cases; for example, audit evidence obtained from the performance of substantive procedures in a previous audit that may be relevant in the current year is a legal opinion related to the structure of a securitization to which no changes have occurred during the current period.

**Adequacy of Presentation and Disclosure** (Ref: Para. 25)

A48. Evaluating presentation and disclosure relates to the assessed risk of material misstatement at the assertion level regarding the form, arrangement, and content of the financial statements and their appended notes. This includes, for example, the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth. See ISA 500 (Redrafted), "Audit Evidence," for a description of the assertions related to presentation and disclosure.

**Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained** (Ref: Para.26)

A49. 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 other planned audit procedures. Information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based. For example,

- The extent of misstatements that the auditor detects by performing substantive procedures may alter the auditor's judgment about the risk assessments and may indicate a material weakness in internal control.
- The auditor may become aware of discrepancies in accounting records, or conflicting or missing evidence.
- Analytical procedures performed at the overall review stage of the audit may indicate a previously unrecognized risk of material misstatement.

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. ISA 315 (Redrafted) contains further guidance on revising the auditor's risk assessment.

A50. The auditor cannot assume that an instance of fraud or error is an isolated occurrence. Therefore, the consideration of how the detection of a misstatement affects the assessed risks of material misstatement is important in determining whether the assessment remains appropriate.