November 24, 2020

Auditing Standards Board
American Institute of Certified Public Accountants
27th Floor
1345 Avenue of the Americas
New York, NY 10105

Re: Proposed Statement on Auditing Standards, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*

RSM US LLP appreciates the opportunity to offer our comments in response to the proposed Statement on Auditing Standards (SAS), *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (the “Exposure Draft”). RSM US LLP is a leading provider of audit, tax and consulting services focused on the middle market. We have nearly 11,000 professionals in more than 90 cities in the United States and Canada.

We support the Auditing Standards Board’s (ASB) comprehensive efforts to enhance the auditing standards relating to the auditor’s risk assessment. We believe the proposed revisions to AU-C section 315 generally are easily understandable and clarify many requirements. We found the following to be especially helpful:

- The explanations as to why certain requirements exist. For example, it is helpful to explain to auditors why the understanding of the entity’s system of internal control is required to be obtained.

- Distinguishing between indirect controls (i.e., controls that generally do not directly address the risks of material misstatement at the assertion level) and direct controls (i.e., controls that are more likely to directly address the risks of material misstatement at the assertion level). This will further help the auditor to recognize how the understanding of the entity’s system of internal control provides the basis for the auditor’s identification and assessment of risks of material misstatement.

- Including, in the application material, considerations for audits of entities that are less complex. These considerations will allow the auditor to more efficiently apply the standard to audits of financial statements for all entities, ranging from noncomplex entities to complex multinational entities.

- The references to COSO’s 2013 *Internal Control—Integrated Framework*, since the COSO framework often is used by entities and their auditors.

- New Appendix E, “Considerations for Understanding Information Technology.”

In this letter, we offer comments in response to the issues for which feedback was specifically requested in the Exposure Draft.
Request for Comment

1. Are the requirements and application material of the proposed SAS sufficiently scalable, that is, is the proposed SAS capable of being applied to the audits of entities with a wide range of sizes, complexities, and circumstances?

   We have observed that auditors sometimes struggle with documentation of certain areas of the control environment, and risk-assessment and monitoring processes in audits of less complex entities. The new and revised application paragraphs and related examples regarding scalability will help auditors apply the guidance more efficiently and effectively to audits of entities with a wide range of sizes, complexities and circumstances, particularly in relation to internal control understanding.

2. Do the proposals made relating to the auditor’s understanding of the entity’s system of internal control assist with understanding the nature and extent of the work effort required and the relationship of the work effort to the identification and assessment of the risks of material misstatement? Specifically:

   a. Have the requirements related to the auditor’s understanding of each component of the entity’s system of internal control been appropriately enhanced and clarified? Is it clear why the understanding is obtained and how this informs the risk identification and assessment process?

      We believe the requirements related to the auditor’s understanding of each component of the entity’s system of internal control have been clarified and enhanced. We also believe the proposed standard clarifies why the understanding is obtained and how this informs the risk identification and assessment process.

   b. Have the requirements related to the auditor’s identification of controls that address the risks of material misstatement been appropriately enhanced and clarified? Is it clear how controls that addressed the risks of material misstatement are identified, particularly for audits of smaller and less complex entities?

      We believe the requirements related to the auditor’s identification of controls that address the risks of material misstatement have been enhanced and clarified appropriately. In particular, we believe the discussion about how controls may be direct or indirect (e.g., in paragraph A5) will be helpful to auditors. Also, paragraph 26.a. added clarity by providing a list of the types of control activities that, if applicable, are always relevant to the risks of material misstatement. This “roadmap” will help guide auditors with a starting point for the use of professional judgment in determining whether there are any other controls for which evaluation is necessary.

   c. Given that COSO’s 2013 Internal Control—Integrated Framework (COSO framework) is often used by entities subject to the AICPA’s generally accepted auditing standards, is the terminology in paragraphs 21–27 and related application material of the proposed SAS clear and capable of consistent interpretation for audits of entities that use the COSO framework?

      We think the tie to the COSO framework is very appropriate. We believe the terminology in paragraphs 21 through 27, and the related application material, is clear and capable of consistent interpretation for audits of entities that use the COSO framework.
3. Are the enhanced requirements and application material related to the auditor’s understanding of the IT environment, the identification of the risks arising from the entity’s use of IT, and the identification of general IT controls clear to support the auditor’s consideration of the effects of the entity’s use of IT on the identification and assessment of the risks of material misstatement?

The auditor’s consideration of the effects of the entity’s use of IT on the identification and assessment of the risks of material misstatements is one of the more difficult aspects of the risk assessment process to implement. However, the related enhanced requirements and application materials will be helpful as they are more clear than the extant versions. Also, it will be helpful for auditors to refer to the Appendix E examples of matters the auditor may consider in obtaining an understanding of the IT environment based on the complexity of IT applications used in the entity’s information system.

4. Do you support the introduction in the proposed SAS of the new concepts and related definitions of significant classes of transactions, account balances, and disclosures, and their relevant assertions? Is there sufficient guidance to explain how they are determined (that is, that an assertion is relevant when there is a reasonable possibility of occurrence of a misstatement that is material with respect to that assertion), and how they assist the auditor in identifying where risks of material misstatement exist?

We support the introduction in the proposed SAS of the new concepts and related definitions of significant classes of transactions, account balances, and disclosures, and their relevant assertions. We believe there is sufficient guidance to explain how they are determined (i.e., that an assertion is relevant when there is a reasonable possibility [rather than some possibility] of occurrence of a misstatement that is material with respect to that assertion) and how they assist the auditor in identifying where risks of material misstatement exist. The clarified guidance will help auditors visualize a framework for how all of the “pieces” interact, further validating the importance of risk assessment being a dynamic, iterative process. Also, we believe the application paragraphs add meaningful context to the identification and assessment of the risks of material misstatement.

5. Do you support the introduction of the spectrum of inherent risk into the proposed SAS?

We like the introduction of the spectrum of inherent risk as we believe it will support more freedom to perform the procedures auditors believe are necessary in relation to the actual risk. Presenting a spectrum of inherent risk also will help auditors think more dynamically about inherent risk.

6. Do you support the separate assessments of inherent and control risk in relation to all risks of material misstatement at the assertion level?

We agree that a separate assessment of inherent risk and control risk should be required in relation to all risks of material misstatement at the assertion level.

We agree that the order in which the requirements related to the identification of the risks of material misstatement are to be applied should not be required. 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 and (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 assessments were based. We believe requiring an order in which the requirements related to the identification of the risks of material misstatement are to be applied during audit planning could inappropriately lead auditors to not continually reassess risk when new information is identified throughout the engagement. In addition, firms may have different approaches
in their methodologies regarding the order in which the risks of material misstatement, and the significant classes of transactions, account balances, and disclosures and the relevant assertions to which they relate, are identified. Therefore, we believe it may be helpful to add in the AICPA Audit Guide, *Assessing and Responding to Audit Risk in a Financial Statement Audit*, a diagram illustrating the identification and assessment of the risks of material misstatement, similar to the flowchart published as a supplement to the 2018 International Auditing and Assurance Standards Board Exposure Draft of proposed International Standard on Auditing 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*.

7. What are your views regarding the clarity of the requirement to assess the control risk, in particular, when the auditor does not plan to test the operating effectiveness of controls?

On page 16 of the Exposure Draft, the ASB states its intention to clarify that “if the auditor does not contemplate testing the operating effectiveness of controls, or is not required to test controls, control risk is assessed at maximum (that is, the assessment of the risk of material misstatement is the same as the assessment of inherent risk). This means that control risk cannot be reduced based on the effective operation of controls unless the auditor intends to test them.”

We do not believe the requirements in paragraph 34 clearly reflect the ASB’s intention. We therefore suggest revising paragraph 34 as follows (proposed additions are shown in bold text and proposed deletions are struck through):

> If the auditor plans to test the operating effectiveness of controls, the auditor should assess control risk. If the auditor does not plan to test the operating effectiveness of controls, the auditor’s assessment of control risk should be such that the assessment of the risk of material misstatement is the same as the assessment of inherent risk and cannot be reduced by the control risk assessment. (Ref: par. A248-A252)

8. What are your views regarding the clarity of the requirement in paragraph 26.d of the proposed SAS to evaluate design and determine implementation of certain control activities (including, specifically, the requirement related to controls over journal entries)?

We believe that the requirement in paragraph 26.d. to evaluate design and determine implementation of certain control activities is clear. We think it is important to specifically require procedures related to controls over journal entries because (a) the manner in which an entity incorporates information from transaction processing into the general ledger ordinarily involves the use of journal entries, and (b) nonstandard journal entries are used to record nonrecurring, unusual transactions or adjustments, which may be applied to accounts that contain significant estimates or are otherwise associated with an identified risk of material misstatement due to fraud.

Paragraph 26.d. directs the auditor to paragraphs A194 through A202 for guidance regarding the evaluation of whether the control is designed effectively and whether the control has been implemented. Paragraph A196 and several other paragraphs throughout the proposed standard (including paragraph 14) indicate that risk assessment procedures to evaluate the design and implementation of a control include inquiry, inspection and observation. However, paragraph A197 includes a sentence that states, “…walk-throughs, as described in paragraph A198, ordinarily are sufficient to evaluate design and determine implementation.” Paragraph A197 also states, “Walk-through procedures usually include a combination of inquiry, observation, inspection of relevant documentation, and reperformance of controls.” The procedure of reperformance of controls in this paragraph is inconsistent with previous paragraphs addressing risk assessment procedures. To avoid
potential confusion as to the necessary procedures, we believe it would be helpful to add clarifying guidance to paragraph A197 as follows (proposed additions are shown in bold text):

The auditor may perform walk-throughs in evaluating the design of controls that address the risks of material misstatement and determining whether those controls have been implemented. Such walk-throughs, as described in paragraph A198, ordinarily are sufficient to evaluate design and determine implementation when the risk assessment procedures described in paragraph A196 are performed. A walk-through involves following a transaction from origination through the entity's processes, including information systems, until it is reflected in the entity's financial records, using the same documents and IT that entity personnel use. Walk-through procedures usually include a combination of inquiry, observation, inspection of relevant documentation, and reperformance of controls.

9. Do you support the revised definition, and related material, on the determination of significant risks? What are your views on the matters previously presented relating to how significant risks are determined based on the spectrum of inherent risk?

We support the revised definition of "significant risk" and believe it appropriately directs the auditor's focus to the nature of the risk rather than the response to the risk.

10. What are your views about the proposed stand-back requirement in paragraph 36 of the proposed SAS and the conforming amendments proposed to paragraph .18 of AU-C section 330?

We believe the proposed "stand-back" requirement is appropriate and will help drive an evaluation by the auditor of the completeness of the identification of significant classes of transactions, account balances and disclosures, which, in turn, will help drive the completeness of the identification of the risks of material misstatement.

11. What are your views with respect to the clarity and appropriateness of the documentation requirements?

We believe the documentation requirements in paragraph 38 generally are clear and appropriate.

We appreciate this opportunity to provide feedback on the Exposure Draft and would be pleased to respond to any questions the ASB or the AICPA staff may have about our comments. Please direct any questions regarding this letter to Sara Lord, Chief Auditor, at 612.376.9572 or April King, Partner—National Professional Standards Group, at 612.376.9509.

Sincerely,

RSM US LLP

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