November 30, 2020

Audit and Attest Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

To Whom it May Concern:

On behalf of the Tennessee Department of Audit, Division of State Audit, we thank the Auditing Standards Board (ASB) for the opportunity to comment on the Exposure Draft (ED), *Understanding the Entity and its Environment and Assessing the Risk of Material Misstatement*. We generally agree with the board’s proposals and have identified below some suggestions for improvement. In regard to the specific request for comments, our responses follow:

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 believe the requirements and application material of the proposed SAS are capable of being applied to the audits of entities with a wide range of sizes, complexities, and circumstances. Examples included in the narrative provide useful suggestions on how to scale procedures for smaller entities.

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 relating to the auditor’s understanding of each component of the entity’s system of internal control have been appropriately enhanced and clarified. Furthermore, the proposed SAS provides additional details to help clarify what auditors should be gaining an understanding of with respect to each component of the entity’s system of internal control, as well as why the auditors need that understanding, and how that understanding should be used in identifying and assessing the risks of material misstatements.
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 appropriately enhanced. The information included in the application material provides sufficient guidance to help auditors understand how to identify controls that address the identified risks of material misstatement in both large and small entities of various complexities.**

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 believe the terminology and related application material is clear.** However, the Board has historically included considerations for governmental entities, and it is important to acknowledge that while governmental entities are subject to the AICPA’s generally accepted auditing standards, they may use either the U.S. Government Accountability Office’s Standards for Internal Control in the Federal Government, also known as the “Green Book,” or the internal control framework of COSO. The Green Book is based on, and uses the same five elements as, COSO. Therefore, we believe it would be helpful if the application material referenced both COSO and the Green Book, especially considering more governmental entities are beginning to utilize the Green Book.

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? **We believe 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 appear 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. In addition, we agree with the Board’s view that it is unnecessary for the auditor to identify risks arising from use of IT or general IT controls, unless they relate to IT applications determined to be relevant.**

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 new concepts and related definitions of significant classes of transactions, account balances, and disclosures, and their relevant assertions in the proposed SAS. We believe the new**
definitions will result in a better understanding and a more consistent application of the requirements contained in the proposed SAS. We also believe sufficient guidance was included in both the requirements and the application material to allow the auditor to properly apply these new concepts during the risk assessment process.

5. Do you support the introduction of the spectrum of inherent risk into the proposed SAS? **We support the introduction of the spectrum of inherent risk into the proposed SAS.** We believe the guidance around inherent risk factors will assist auditors in more effectively assessing risk and alleviates the need for a separate identification and assessment of significant risks, as high levels of inherent risk are indicative of significant risks. We suggest the Board include additional examples of where certain risks might be categorized along the spectrum to help auditors make more consistent inherent risk assessments.

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 support the separate assessments of inherent and control risk.**

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? **We believe it is clear that if the auditor does not contemplate testing the operating effectiveness of controls, or is not required to test controls, control risk should be assessed at the maximum (i.e., the assessment of the risk of material misstatement is the same as the assessment of inherent risk).**

8. What are your views regarding the clarity of the requirement in paragraph 26d 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 the requirement in ¶26d (to evaluate design and determine implementation of certain control activities) is clear.** We see this as necessary as such evaluation informs the nature, timing, and extent of audit procedures. This is especially true for journal entries because the manner in which an entity incorporates information from transaction processing into the general ledger, and eventually the financial statements, ordinarily involves the use of journal entries, whether standard or nonstandard, automated or manual.

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, and related material, on the determination of significant risks, and it appears appropriate to use the spectrum of inherent risk to assist in the determination of significant risks.**

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 changes to ¶18 of AU-C 330 are clear and appropriately**
resolve the confusion with extant language. However, guidance might be more useful explaining that the auditor is already required to “stand back” and evaluate the sufficiency and appropriateness of work efforts at multiple points in the audit.

11. What are your views with respect to the clarity and appropriateness of the documentation requirements? We agree the documentation requirements are clear and appropriate. However, for consistency, we suggest the Board refer to ¶17 and ¶8 in ¶38(a).

Should you have questions or need clarification on any of our comments, please contact Gerry Boaz (615) 747-5262 (Gerry.Boaz@cot.tn.gov) or me at (615) 747-5251.

Sincerely,

[Signature]

Kathy Stickel, CPA, CGFM
Director, Division of State Audit