Auditing Standards Board  
American Institute of Certified Public Accountants  
220 Leigh Farm Road  
Durham, NC  27707-8110

Members of the Board:

We have reviewed the AICPA Auditing Standards Board's exposure draft of a proposed statement on auditing standards entitled *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement* and generally agree with the proposed standards and with the proposed implementation date. Our responses to the issues for consideration are as follows:

**Request for Comment: Scalability**

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?*

Response: Yes, we consider the requirements and application material sufficiently scalable. There is a wide variety of non-issuer entities that use these standards, and we consider them applicable to entities of varying sizes.

**Request for Comment: Understanding the Entity’s System of Internal Control**

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?*

Response: While we consider the requirements as appropriately enhanced and clarified, we recommend the ASB retain the existing term of “internal
control” rather than amending it to “system of internal control.” We do not consider the addition of “system of” to add value or substance to the definition. With COSO’s publication of “Internal Control: An Integrated Framework”, the audit community has grown accustomed to “internal control” and its underlying meaning.

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?

Response: Yes, we consider the details provided in paragraphs .24, .25, and .26 as sufficiently detailed to identify controls addressing the risk of material misstatement.

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?

Response: We recommend adhering to the terminology established in the Internal Control Integrated Framework. The audit community has grown accustomed to this terminology and continues to effectively use it among staff and with their auditees. We also recognize the federal government will use the U.S. Government Accountability Office’s Standards for Internal Control in the Federal Government, also known as the “Green Book”, so it would be helpful to also reference that document in addition to 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?

Response: Yes, we consider the definitions and usage in the standard as appropriate and have no suggested changes. We also agree that it is not necessary to identify risks arising from the use of IT or general IT controls unless they relate to IT applications that are relevant to the engagement.
Request for Comment: Identifying and Assessing the Risks of Material Misstatement

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?

Response: While we have no objections to the new terminology, the new concepts and definitions will require outreach on the part of the AICPA to educate the audit community on the proper usage and meaning of the terms.

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

Response: Yes, we agree inherent risk varies by assertion and that this can be referred to as a spectrum of 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?

Response: Yes, we consider it appropriate to separately assess inherent and control risk at the assertion level.

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?

Response: We view this as very helpful as we often plan to not test the operating effectiveness of controls.

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)?

Response: We consider the application material paragraph A201 as vital in informing auditors that evaluating the design and determining the implementation of identified controls is not the same as, and “...is not sufficient”, to test the operating effectiveness of the control. It is an important concept that even though an auditor may decide to assess
control risk at maximum and not test the operating effectiveness of controls, that an evaluation of the design and determining the implementation of identified controls is still necessary.

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?

Response: We consider the definition of significant risk as understandable and should be easily understood by auditors.

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

Response: In general, we consider this requirement as unnecessary. This paragraph addresses the situation when material classes of transactions, account balances, or disclosures that are not significant but are material. We view this as a very likely scenario and is simply part of the process in determining significant classes of transactions, account balances, or disclosures since we would start with those that are material. Therefore, the standard codifies what should logically occur. We appreciate that there is no specific documentation requirement to differentiate between material and significant since the documentation of significant items presumes all other are not significant.

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

Response: We consider the documentation requirements as appropriate and offer no suggested changes.

We appreciate the opportunity to comment on this exposure draft. Should you have any questions or desire further details on our comments, please contact me or Craig M. Murray, CPA, CGFM, CIA, Director of Professional Practice.

Sincerely,

Doug Ringler
Auditor General

Via email