



## Agenda Item 2

### *AU-C 315 (Revised), Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment*

#### **Objective of Agenda Item**

To approve proposed Statement on Auditing Standards (SAS), *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment* as an Exposure Draft.

#### **Task Force**

The Task Force members are as follows:

- Tracy Harding–BerryDunn, Chair
- Diane Hardesty–EY
- Kathy Healy–PwC
- Susan Jones–KPMG
- April King–RSM
- Maria Manasses–GT
- Tania Sergott–Deloitte
- Dan Wernke–Clark Schaefer Hackett

Jon Heath, ASB member, has been involved as an IT subject matter expert.

The following areas represent the most significant edits made by the Task Force to the proposed SAS since the draft was presented at the May 2020 ASB meeting.

In leading the ASB discussion, Mr. Harding will refer to item 2A, proposed SAS (marked from May ASB meeting) and item 2B, proposed conforming amendments.

#### *Gaining an Understanding of Internal Control*

At its May meeting, the ASB discussed the Task Force suggested changes to the application material to clarify the difference between the work effort related to evaluating the design of certain controls and determining whether they have been implemented in the control activities component and the work effort related to gaining an understanding of and evaluating certain matters for the other components of internal control.. While supportive of the changes made to the application material by the Task Force, some level of concern was expressed about:

1. The differences in wording between the proposed standard and the PCAOB standard, in particular with respect to gaining an understanding of the internal control components,
2. The clarity of the distinction between the work efforts described above and
3. The differentiation between indirect and direct components of internal control. It was pointed out that this differentiation is consistent with COSO.

The ASB directed the Task Force to consider the guidance in the PCAOB standard, AS 2110, in particular the guidance on evaluating controls that are relevant to the audit.

The Task Force considered the ASB's comments and believes that the requirements (paragraphs 21 – 26) with respect to gaining an understanding of the components as articulated in the proposed SAS are clear. This is because each of the requirements explicitly identify the matters that the auditor is required to understand in making the required evaluations for each of the components of internal control. This understanding and evaluation in other components is differentiated from the requirement to perform procedures to evaluate the design and determine whether they are implemented (D&I) for certain controls in the control activities component (paragraph 26d).

As requested, the task force looked at the relevant guidance in PCAOB's AS 2110 and has added application material to the proposed SAS taken from paragraph 20 of AS 2110 (see paragraphs A194, A195, and A198). This guidance primarily addresses the use of walkthroughs in gaining an understanding of controls.

The Task Force also edited paragraph A105 (formerly A95) to address ASB comments.

#### *Use of Examples*

The Task Force removed boxes highlighting the examples in the application material and edited the sentence structure to enhance readability.

#### *Risks Arising from IT*

The Task Force had added an application material paragraph to further explain the definition of risks arising from the use of IT. Specifically, the AM paragraph explains that the concept of "validity" in the definition corresponds to the existence and occurrence assertions. At the May meeting, an ASB member expressed concern about linking the concept of *validity* to the financial statement assertions existence and occurrence. In response, the Task Force suggests relocating completeness, accuracy, and validity (which are shown as examples illustrating the concept of integrity of information in the definition) to the application material (see paragraph A11).

#### *Gaining an Understanding of the Process of Reconciling Detailed Records to the General Ledger for Material Account Balances*

In response to a comment from certain ASB members, the Task Force relocated the requirement (carried over from extant AU-C 315) from a requirement in the control activities component to

application material related to the information and communication component (see paragraph A146).

### *Conforming Amendments*

The conforming amendments to various AU-Cs are included in appendix G to the proposed SAS. The conforming amendments include amendments to the 900 series of the AU-Cs, including AU-C 940, which were not previously presented. The conforming amendments to AU-C 940 were minimal in order to maintain its alignment with the PCAOB standard.

### **Items Presented**

1. Agenda Item 2 – Cover Memo
2. Agenda Item 2A – Proposed SAS, marked from ISA 315 (changes since the May 2020 ASB meeting are highlighted in yellow)
3. Agenda Item 2B – Proposed conforming amendments
4. Agenda Item 2C – Draft Explanatory Memorandum
5. Agenda Item 2D – Proposed SAS (Clean)