Agenda Item 3

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

Objective of Agenda Item

To discuss feedback arising from the comment letters received in connection with the Exposure Draft related to the proposed Statement on Auditing Standards (SAS), *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment*, and obtain the Board's feedback with respect to select items prior to proposing revisions to address the feedback received.

Task Force

The Task Force members are as follows:

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

In leading the ASB discussion, Ms. Manasses will refer to this Issues Paper.

Background

On August 27, 2020, the Auditing Standards Board (ASB) issued the Exposure Draft related to the proposed SAS. The Exposure Draft period ended November 25, 2020. The Task Force met on December 4, 2020 and December 18, 2020 to begin analyzing the feedback from the comment letters and discuss the recommendations outlined in this paper.

Thirty-two comment letters were submitted by responders (see Appendix for the full list of responders).[1] The comment letters expressed support of the overall objectives of the Exposure

[1] https://www.aicpa.org/research/exposuredrafts/accountingandauditing/comment-letters-on-proposed-auditing-standards-and-risk-assessments.html

Draft ("ED") and the general direction of the project. However, the comment letters suggested further refinements to the proposed SAS and drafting recommendations that will need to be further evaluated by the Task Force.

This Issues Paper summarizes the feedback received in the comment letters. The Issues Paper has been organized in following sections:

I. Matters that Require ASB's Strategic Direction
II. Matters Raised by Responders that Contain the Task Force's Preliminary Views
III. Matters Raised by Responders to be Addressed by the Task Force after the ASB Meeting

The comments presented in each of the sections represent excerpts from the comment letters that are intended to be representative of the issues raised by responders in the comment letters. While the ASB meeting will be focused on Section I, it is critical for the ASB to provide significant views, if any, related to Sections II and III in order to meet the established timetable for the release of the final SAS with an effective date that aligns with SAS No. 143, *Auditing Accounting Estimates and Related Disclosures*. Responders were generally supportive of the effective date (for audits of financial statements for periods ending on or after December 15, 2023).

I. Matters that Require ASB's Strategic Direction

Length, Complexity, and Understandability of the Proposed Standard

1. Reduce Size of Standard - At more than 200 pages, the exposure draft is far too large for the average practitioner to quickly and easily understand.[2] Suggest the following to help practitioners more easily understand the standard:[3]

   - Move the appendices and most of the application material to the audit guide, *Assessing and Responding to Audit Risk in a Financial Statement Audit*. Practitioners will understand the standard more easily because the audit guide uses a case study approach. The Board should issue the revised audit guide at same time as the revised AU-C 315. The application guidance in AU-C 315 should refer to the guide.

   - Divide the single standard into two separate standards, consisting of the following: 1. Understanding the entity and its environment. 2. Assessing the risks of material misstatement. This will shorten both standards, making them both easier to understand. (Cotton)

2. To achieve the objective of enhancing audit quality, it is important the standard is easy to understand so it can be appropriately and consistently utilized in practice. While TIC believes this standard is well designed, TIC members had varying interpretations of some very key aspects of the risk assessment process. (TIC)

3. TIC understands that effectively addressing all aspects of risk assessment while providing appropriate scalability results in a lengthy standard and application guidance. However, the length and complexity also make it more difficult to understand. TIC believes that adding a summary to the application guidance that helps auditors understand the flow of the risk assessment process to enhance understandability would be helpful. Many of the smaller firms that TIC represents do not have the resources to dedicate to fully evaluating all aspects of this standard and a summary would enhance their understanding and ensure consistent application of appropriate risk assessment procedures. Additional guidance in an audit guide and nonauthoritative practice aid would also be beneficial. (TIC)

4. ASB could improve the proposed standard's clarity by making certain changes to the language to augment the auditors' understanding and ability to comply with the proposed SAS in the U.S. environment. (GAO)

5. We are concerned that adopting the standard, as proposed, could exacerbate the execution challenges that currently exist in practice. For example, a current challenge relates to auditors not obtaining a sufficient understanding of internal control to inform risk assessments. The proposed standard contains extensive requirements related to understanding the entity's system of internal control in an attempt to clarify what, exactly, the auditor should do. However, we do not believe the proposed standard is clear enough to enable the auditor to

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[2] TIC, GAO, and GT expressed similar concerns.

[3] GAO expressed concern about the organization of the proposed standard as well.

comprehend how that understanding impacts the auditor's response to identified risks of material misstatement. This could create a situation where obtaining the understanding will be cursory at best because there ultimately is no impact on the auditor's response to identified risks of material misstatement at the assertion level. On the other hand, we believe there are good reasons why the auditor should understand the system of internal control and IT environment. This understanding should inform the judgments about the nature, timing, and extent of the response to the risks of material misstatement. Expanding the requirements and related work effort in this area, while appearing to provide no clear connection to the auditor's response, will not likely yield enhanced audit quality. (GT)

6. We believe the proposed SAS does clarify the applicable standards, but we also identified opportunities to improve conciseness and eliminate redundancies to strengthen the overall understandability. We also encourage the Board to consider whether the proposed SAS will be effective in improving audit quality or whether the breadth of guidance provided is more comprehensive than necessary. (Virginia Auditor)

7. The volume of application guidance makes the standard difficult to navigate. While we support the Board's efforts to harmonize its standard with the ISAs, this should not be a rote exercise of wholly accepting the ISAs with minimal changes and without due consideration of the U.S. jurisdiction and the AICPA standard-setting structure. We feel strongly that the audit and accounting guides here in the U.S. can be better leveraged to make the proposed standard more understandable without creating significant divergence from the ISAs. There is a significant opportunity to better streamline the proposed standard and make it more manageable by moving the appendices and a lot of the application guidance into the risk assessment guide; the guide provides better context to the proposed content than it if were retained in the standard. We do not view this as a divergence from the ISAs because the auditor is required to consider the guides in planning and performing the audit. (GT)

Task Force Views

As noted above, responders raised the concern that the length and complexity of the proposed standard hinders the understandability of the proposed standard, and thus may hinder its effective implementation. The Task Force acknowledges these concerns. However, the Task Force is mindful that, while some responders called for the reduction of the length of the proposed standard, others called for more guidance and examples.

The Task Force also acknowledged that the IAASB does not have a GAAS hierarchy, which includes the ability to include more detailed guidance and examples in an audit guide. In this respect, the Task Force agreed that it would not be appropriate to release a voluminous standard followed be a voluminous, repetitive audit guide. Accordingly, revisions to the proposed SAS as well as the AICPA's Audit Guide, *Assessing and Responding to Risks of Material Misstatements*, may need to occur (or be planned) currently. However, the final, revised guide would ultimately be available when the proposed SAS becomes effective.

To make the application material more concise and succinct, the Task Force discussed an approach in which certain content from the application material could be relocated to a new appendix. The application material is currently organized in sections that describe the "what", "how," and "why" of the requirement along with certain examples. The Task Force could explore whether there would be a further opportunity to streamline the application material by relocating content considered to be more educational in nature (for example, the related examples) to the proposed new appendix.

The Task Force will also refer to the AICPA's Audit Guide, *Assessing and Responding to Risks of Material Misstatements* to assess whether guidance exists in the audit guide that would assist the Task Force in addressing the issues raised in the comment letters. In addition, in response to the request to include more guidance and examples, the Task Force believes that it may be appropriate to develop a comprehensive case study, which would illustrate key concepts throughout the risk assessment process.

An alternative approach would be to relocate some of the application guidance to the audit guide. However, some concerns were expressed with respect to the criteria that would be applied to relocate the application guidance to the guide. The Task Force also notes that some responders prefer harmonization, even with respect to the application guidance (see Convergence below).

Question for the ASB

1. What are the ASB's views with respect to (a) relocating certain application guidance to an appendix, (b) considering the guidance within the audit guide for inclusion within the final standard, and (c) relocating certain application material to the audit guide?

Scalability

Request for Comment No. 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?

Summary of Results

Support	14	
Support with Comments	11	1. Maryland 2. TIC 3. AGA 4. KPMG 5. Eide Bailly 6. PwC 7. GT 8. Firriolo 9. EY 10. MACPA

		11. Illinois
Does not Support	2	1. Texas 2. Anders
Did not answer	5	

Excerpts from Comment Letters

1. Need more guidance or add more examples to assist implementation. (Maryland, AGA) There are still areas where it will be difficult to scale to smaller entities; encourage development of additional guidance that will help minimize differing interpretations between practitioners and peer reviewers. (MACPA)

2. Several suggestions provided with regard to references to "size and complexity," which could continue to lend more weight to size; size does not equate to complexity. In addition, suggestion to add application material to illustrate that entity with a more robust internal control would have a lower risk of RMM than entity with a less robust internal control. (KPMG)

3. Include more specific guidance about the circumstance in which risk assessment procedures cannot be performed or internal control does not exist. (KPMG)

4. Provide guidance on how an engagement team would evaluate risk and related responses when corroborating documentary evidence does not exist. (Eide Bailly)

5. The standard is sufficiently scalable but has concerns about the unintended consequences due to a lack of clarity in the documentation requirements; see response to Question 11. (PwC)

6. Too long and prescriptive. (GT, EY). The standard is overwhelming, and can inhibit understandability. It is our view that the proposed standard reads more as an audit methodology, and the level of detail and prescription could lead to further confusion and inconsistencies in practice. (GT) Even with the application material to assist the auditors of smaller and less complex entities, we believe that it would be too time-consuming to apply the proposed SAS for audits of smaller and less complex entities. One way to help the auditors of smaller and less complex entities manage this issue may be to create a separate section or appendix specifically to provide guidance for smaller and less complex entities, rather than discussing it throughout the proposed SAS. (EY)

7. Accomplishing this includes leadership, education, and proper resources. I believe auditors may be inclined to take a - Same as Last Year (SALY) approach to address the cost effectiveness of additional procedures described in the proposed SAS. I believe scalability problems are likely – however the proposed SAS provides enough guidance. (Firriolo)

8. The Board could go further in addressing difficulties encountered by small and mid-sized audit firms. Many of the current risk assessment compliance issues are arising within small to mid-sized firms that do not have the same resources as larger firms. The ASB would see fewer compliance issues if it provided more guidance to these firms in areas such as assessing inherent risk, linking risk of material misstatement to audit procedures and designing walk-through procedures for the significant controls identified by the auditor. The revised definitions and concepts proposed in the standard may have the effect of making the risk assessment process more difficult for firms without significant resources to develop internal practice aids. (Illinois)

9. Two responders did not believe that the proposed standard was scalable, specifically for entity with few employees lacking segregation of duties and the current and proposed standard are an unnecessary burden for auditors (Texas). Cost benefit should be considered compared to the required extent of risk assessments performed. If the auditor has knowledge that there is not an effective system of internal control in place, then inherent risk would be assessed as high. In this case, the risk assessment procedures should be minimal, but documented sufficiently, and audit procedures would be performed to mitigate the high inherent risk. (Texas) Need more examples and guidance to assist in the scalability of the proposed standard and need a definition of what constitutes a less complex entity (the requirements are somewhat vague, and it is difficult to understand what would be required for less complex entities). (Anders)

Task Force Views

The Task Force believes that length and complexity differ from scalability; however, the comments raised by responders related to scalability may stem from the length and complexity of the proposed standard, which may be impacting its understandability. Thus, the Task Force believes that the understanding of the scalability of the standard could be potentially enhanced by restructuring the application material and providing additional guidance, such as a case study (as discussed above). In addition, the Task Force plans to seek additional feedback through targeted outreach related to the following:

- presenting the special considerations of audits of less complex entities in one location (rather than being interspersed throughout the application material) with the appropriate references to the relevant application material

- providing implementation guidance that would assist auditors in the initial implementation of the proposed standard

- explaining how auditors could leverage the work performed in prior audits, thereby reducing the work required in subsequent audits, as appropriate.

Questions for the ASB

2. Does the ASB continue to believe that the proposed standard is scalable, considering the comments received?

3. Does the ASB believe that the understanding of the scalability of the proposed standard could be enhanced by restructuring the application material? What are the ASB's views about such restructuring as well as the potential, additional guidance?

Convergence

1. We understand that the requirements and guidance within this proposed SAS reflect the Board's objective to converge with the equivalent ISAs, and believe that additional guidance to clarify the auditing requirements and application guidance would be helpful in the U.S. The requirements themselves are, in some cases, overly general and may lead to inconsistent application. Given that risk assessment is fundamental to the success of a risk-based audit, we believe additional guidance is needed to define or clarify critical concepts. It is important for auditors to have clear and executable guidance that can be the basis for a compliant methodology for risk assessment that allows them to develop the appropriate audit responses to the risks identified and design and perform procedures to support a conclusion at a level of reasonable assurance. (KPMG)

2. We understand the ASB's strategic initiative to converge U.S. auditing standards with those of the International Auditing and Assurance Standards Board, and we are generally supportive of that initiative, to an extent. However, our clients do not typically participate in a high level of international business activities; therefore, the users of our clients' financial statements often have considerably different needs than users of publicly traded entities' financial statements. Furthermore, the litigious nature of our U.S. marketplace, which is also vastly different than that of the global market, truly warrants certain auditor protections. We feel that certain aspects of the proposal do not adequately protect the auditor from these threats. These comments seem to link their most significant and fundamental concern to scalability. (Anders)

3. In determining what revisions are necessary in the context of the US environment, we believe it would also be helpful to consider PCAOB AS 2110. In certain areas of the proposed standard, we are concerned that terminology that differs from PCAOB standards could lead to confusion in practice and potentially inconsistent application. (PwC) We are concerned that the proposed standard could create operational challenges, particularly for auditors in the United States that also follow the standards of the PCAOB. (GT)

4. As someone who very much appreciates the desire of the ASB to converge GAAS with the ISAs, I also believe, and have stated publicly on many occasions, that we never intended to blindly follow the ISA if we believe that we can create greater clarity or if we believe that we can improve the quality of an audit standard. (Landes)

5. We agree with the changes made by the ASB to ISA 315 (Revised) to develop the proposed SAS in those instances where the changes address circumstances and requirements specific to the U.S. and AICPA Professional Standards. However, in an effort to maximize convergence efforts, we have identified matters within the proposed SAS that result in differences with ISA 315 (Revised) that we believe should be eliminated. It is our view that the matters we identified create unnecessary differences between ISA 315 (Revised) and the proposed SAS

and are not needed as they are not related to circumstances unique to the U.S. environment. (Deloitte)

Task Force Views

Consistent with the ASB's convergence strategy, the proposed standard was developed using ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement,* as the base and changes were made to ISA 315 that are suitable for our local jurisdiction. The process included considering the guidance in AS 2110, *Identifying and Assessing the Risks of Material Misstatement.*

At the same time, the Task Force recognizes the overall request by responders for further clarification, acknowledging that further changes to the proposed SAS may be needed. This includes considering whether additional changes are necessary to support alignment with PCAOB's AS 2110, which would be appropriate to assist those auditors that apply both US GAAS and PCAOB standards. Examples of such changes include consideration of additional guidance related to understanding controls (paragraph .34 of AS 2110), consideration of whether to include guidance similar to the PCAOB's notes related to integrated audits to better link to AU-C 940 (see the following issue), and consideration of additional guidance to bridge the definition of significant risks. Currently, the Task Force does not anticipate changes to the requirements as a result of the review of AS 2110.

Question for the ASB

4. Does the ASB agree with the Task Force that additional changes to the proposed SAS may be necessary to address comments received as well as consider PCAOB standards?

Coordination with AU-C section 940

1. AU-C 940 and AU-C 315 both deal with internal control; however, they use different approaches and terminology.[4] Consistent approaches and terminology will help the auditor better understand both standards. We suggest the following:

   - Use the same terminology in both sections. For example, use "internal control over financial reporting" rather than "system of internal control" and use "entity-level controls" rather than "indirect controls."

   - Indicate that, in order to give an opinion on controls, the auditor should perform the same analysis of inherent risk and design of internal control. The only difference should be that an opinion on controls requires the auditor to perform tests of controls, while an opinion on the financial statements does not require the auditor to perform tests of controls.

   - Consider combining much of the material in AU-C 940 into AU-C 315. For example, material such as the standards on top-down approach, understanding how the components of internal control are integrated, understanding the controls over the year-end closing

[4] AGA expressed a similar concern.

process, understanding likely misstatements, and benchmarking of automated controls applies to a financial statement audit and therefore belongs in AU-C 315.

- Include the application guidance in AU-C 940 in AU-C 315 or in the audit guide, as it also applies to financial statement audits. This would include the guidance on the importance of walkthrough procedures, the guidance on the control environment, and the guidance on the other elements of internal control.

- Move the following definitions and concepts from AU-C 940 to AU-C 315:

    1. Control objective

    2. Preventive control

    3. Detective control (Cotton)

2. Consider providing "compare and contrast" guidance on how the risk assessment procedures should be performed for an audit of internal control over financial reporting under AU-C 940 versus a regular financial statement audit discussed in the ED. (AGA)

Task Force Views

As noted above, responders requested further alignment between the proposed standard and AU-C section 940. The Task Force notes that, in the proposed standard, the Task Force included conforming amendments to AU-C section 940 to bridge the two standards. As a reminder, the amendments to AU-C section 940 were minimal to align with the proposed SAS but also retain consistency with PCAOB standards, particularly for FDICIA purposes.

The Task Force further notes that the scopes of AU-C section 315 and AU-C section 940 are different. AU-C section 315 requires the auditor to obtain an understanding of internal control for the purpose of rendering an opinion on the financial statements. In contrast, under AU-C section 940, the auditor is required to test the operating effectiveness of controls and render an opinion on internal control over financial reporting. Therefore, the nature of the application material in these sections are inherently different, and the combination of these sections is not possible. The Task Force also notes that the PCAOB has a separate standard addressing audits of internal control over financial reporting.

The Task Force plans to further review AU-C section 940 after the completion of the proposed SAS in order to assess whether further changes to AU-C section 940 are necessary. The Task Force also discussed whether it may be helpful to include guidance related to AU-C section 940 within the final SAS, similar to PCAOB standards. This may, however, impact the length of the standard.

Questions for the ASB

5. Does the ASB agree that AU-C section 940 should not be combined with AU-C section 315?

6. Does the ASB have any concerns with including guidance related to AU-C section 940 within the final SAS?
7. Further, what additional revisions, if any, does the ASB believe need to be made to AU-C section 940 to align with AU-C section 315?

Stand-Back and Paragraph .18 of AU-C section 330

Request for Comment No. 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?

Summary of Results

Support	12	
Support with Comments	7	1. Texas 2. CliftonLarsen 3. Anders 4. PwC 5. GT 6. Deloitte 7. Tennessee
Does not support	7	1. Virginia Auditor 2. Michigan Auditor 3. Washington Auditor 4. AGA 5. Eide Bailly 6. NSAA 7. Firriolo
Did not answer	6	

Excerpts from Comment Letters

1. Paragraph 36 should be expanded to clarify evaluation of financial statements with regard to material vs. significant audit observations. Auditors should document evaluation of any high-level evaluation performed. (Texas)

2. We believe the revisions to paragraph 36 of the proposed SAS help clarify the identification of significant classes of transactions, account balances, and disclosures, but the application material could be enhanced to be more explicit. Additional application material for paragraph .18 of AU-C section 330 in the form of examples would help clarify when these requirements would apply. We also suggest clarifying that the purpose of the requirement is to include a stand-back procedure. (CliftonLarsen)

3. The proposed stand-back requirement is vague in what is required to be done to meet the standard. Interpretation of this requirement could result in redoing the risk assessment and adding procedures, which we believe is not the intention. Either in the application material or implementation guides, we believe the ASB should provide clear examples for how the stand-back requirement applies when there is a clean audit versus when there were significant adjustments and what the documentation entails. This would make sure the standard is consistently applied in practice. (Anders)

4. The ASB and other standard setters should continue to monitor the use of automated tools and techniques; there will likely be a need to revisit whether this requirement is meaningful if persuasive evidence can be obtained from performing procedures using automated tools and techniques such as audit data analytics, which may not be viewed as meeting the definition of substantive procedures. The ASB should clarify the nature and extent of documentation that would be needed in relation to the stand-back. (PwC)

5. Concerned that auditors might infer that the notion of "materiality" as used in paragraph 36 indicates that any general ledger balances that are quantitatively material should be subjected to audit procedures. Not every general ledger account that is simply above the determined materiality amount needs to be considered significant. Therefore, recommend adding application guidance that (1) further clarifies the notion of materiality at the financial statement level and (2) includes a consideration of the size and composition of the class of transaction, account balance, or disclosure, which is a concept that currently exists in paragraph A50 of AU-C section 940. (GT)

6. While D&T is supportive of the conforming amendments proposed to paragraph .18 of AU-C Section 330, we question the appropriateness of the requirement to perform substantive procedures for each of the relevant assertions of each significant class of transactions, account balance, and disclosure. D&T believes that in today's increasingly automated environments, and considering the new automated tools and techniques (including data analytics) used to perform audit procedures, the discrete classification of audit procedures as either risk assessment procedures, tests of controls, or substantive procedures becomes more challenging. The auditor should be focusing on whether sufficient appropriate audit evidence for a relevant assertion has been obtained; the "classification" of the procedures resulted in such evidence should not be a focus. Also, requiring that substantive procedures be performed for each relevant assertion when evidence of the operating effectiveness of controls provides more persuasive evidence, does not seem to benefit audit quality. (Deloitte)

7. 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. (Tennessee)

8. Seven responders did not support the guidance.

   a. The proposed stand-back requirement is unnecessary and is duplicative of other requirements, such as AU-C 330.A74 as well as general review and supervision requirements. (Virginia Auditor)

   b. 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. The requirement is also confusing because the definition of "material" requires essentially the same determination as for "significant" (the definition of "material" yields results that are too similar to "significant"). A determination cannot be made that a required financial statement element is not "material" without consideration of the likelihood and magnitude of potential misstatements for a specific entity in its environment. And the only basis to determine such a potential for misstatement is the auditor's risk assessment procedures and assessment of inherent risk factors – which is one-and-the same with the determination of significant classes of transactions, account balances, or disclosures. (Michigan Auditor, Washington Auditor, AGA, NSAA)

   c. We believe that practitioners will struggle with the concept of a stand-back provision apart from the other risk assessment procedures. If risk assessment procedures are completed appropriately, what additional identification would be accomplished in the stand-back provision? It appears that the provision is intended to address items missed while performing other risk assessment procedures thereby indicating that other procedures were not completed correctly or sufficiently. Also, it is unclear how the stand-back provision would be documented. (Eide Bailly)

   d. If the auditor has concluded material classes of transactions, account balances, or disclosures have been determined not to be significant classes of transactions - then the auditor's professional judgement should prevail over requiring a stand-back evaluation. (Firriolo)

Task Force Views

The Task Force discussed the fact that several responders did not support the proposed stand-back requirement. In addition, several responders had significant comments related to such requirement. The Task Force considered (a) keeping the requirement and providing further clarification, (b) eliminating the requirement, which would also be consistent with PCAOB standards, or (c) considering revisions to the requirement or application guidance in the context of paragraph 35, which requires the auditor to evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement. The Task Force notes that PCAOB standards do not include a stand-back requirement. The Task Force also discussed the need to consider how the guidance related to the stand-back requirement (in particular, the link to materiality) interplays with AU-C section 600.

With respect to AU-C 330.18, the Task Force notes that, overall, responders were supportive. However, comments were received with respect to the need to perform substantive procedures for all relevant assertions related to significant classes of transactions, account balances, or disclosures. The comments focused on the nature of the response, recognizing that certain automated tools and techniques or data analytics may be sufficient and appropriate to respond to the identified risk of material misstatement (that is, questioning whether substantive procedures would always be required). The Task Force notes that the proposed requirement is consistent with PCAOB standards.

Questions for the ASB

8. What are the ASB's views with respect to either keeping the stand-back requirement with some clarification, eliminating the requirement, or considering revisions to the requirement in paragraph 35?

9. What are the ASB's views with respect to the requirement in AU-C 330.18? Should the requirement be retained as proposed to require substantive procedures?

II. Matters Raised by Responders that Contain the Task Force's Preliminary Views

Understanding Internal Control

Request for Comment No. 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:

Request for Comment No. 2a

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?

Summary of Results

Agree	15	
Agree with Comments	12	1. Graham 2. Cotton 3. Michigan Auditor 4. CRI 5. TIC 6. KPMG 7. PwC 8. GT 9. MRA 10. Firriolo 11. EY 12. Illinois
Disagree	3	1. Texas 2. Landes 3. Anders
Did not answer	2	

Excerpts from Comment Letters

1. The proposed standard needs to be more aligned with COSO 2013 because it is not clear that all principles of COSO are reflected in the application material (that is, it is not clear that all 17 principles are identified and specifically distinguished as principles). Alignment would encourage more consistent and efficient practice. One omission that stands out is Principle 8 (on entity fraud risk assessment). Similarly, Principle 9 addresses change, which might be addressed but is still relevant; do not see a parallel to Principle 6 (the articulation of objectives), and Principle 12 (using relevant, quality information) seems to be missing. While Principles 6 and 8 are in the application guidance, application guidance is not supposed to establish requirements. The Guide has enumerated and identified the specific COSO 17 Principles; current vendor forms list the Principles as concepts. (Graham)

2. Do not change the term to "system of internal control" because it is well understood in practice, does not add value or substance to the definition, and the audit community has grown accustomed to "internal control" and its underlying meaning (Cotton, Michigan Auditor). Also, split "information system" from "communication" because the information system usually contains direct controls, while communication is an indirect control. (Cotton) In addition, clarity that most monitoring is usually a direct control, such as a bank reconciliation. (Cotton)

3. The proposal is ambiguous and unclear as to the requirements for understanding the components of internal control; given that relevant controls exist in each component, the requirements for gaining an understanding should be consistent. The work effort related to internal control is not clear because the difference of how the requirements for the indirect components of internal control and the control activities component are articulated (obtain an understanding and evaluate versus determine whether they are implemented). (CRI, TIC) The description of risk assessment procedures in paragraph 14 and the application guidance in A36 to A38 could be interpreted to mean a similar level of effort would be required for other internal control components as intended for control activities in paragraph 26d. (TIC)

4. Outlining the various components within the standard without reference to a framework makes it difficult for the auditor to evaluate the components of internal control. In order to drive a consistent and thorough understanding of an entity's system of internal control, the auditor should use a suitable, recognized framework. Additionally, further guidance is needed to (1) include requirements to identify controls within the various components, (2) address how controls identified within each component should be evaluated, and (3) articulate the impact this evaluation has on the nature, timing, and extent of audit procedures. The requirements do not provide the auditor guidance to determine what procedures should be performed to obtain a sufficient "understanding" of the various components. Extant AU-C 315.14 explicitly states that when obtaining an understanding of internal controls that are relevant to the audit, the auditor should evaluate the design of those controls and determine whether they have been implemented. Relevant controls exist in all 5 components of internal control; we suggest retaining the concept in AU-C 315.14. In addition, it is important to delineate "processes" and "controls" within the risk assessment, monitoring, and information and communication components. Suggest referring to "the set of controls, processes, and structures" relevant to each component. (KPMG)

5. We have concerns that the required procedures do not sufficiently assist the auditor with grasping how this understanding impacts the auditor's risk assessment or related responses. Specifically, the notion of "evaluation" of the appropriateness of each component is unclear, particularly in relation to paragraph 27 related to control deficiencies. Need application guidance that clearly indicates that the evaluation required for each component takes into consideration control deficiencies that may be identified by the auditor. We do not believe it is the board's intent to imply an evaluation of design or implementation; identified control deficiencies inform the required evaluation (as opposed to the evaluation informing the identification of control deficiencies). (GT)

6. Need more guidance and implementation tools in helping auditors understand the importance of gaining an understanding and assessing internal control. (MRA)

7. I believe it is important to take a consistent approach when obtaining an understanding of each component of the entity's system of internal control. I believe the requirements of the proposed SAS are clear. (Firriolo)

8. We recommend adding a more direct statement to paragraphs A115, A124 and A135 of the proposed SAS to explain that the auditor's "evaluation" of certain components of the entity's system of internal control does not include evaluating the design and determining the implementation of controls as required by paragraph 26a(ii) of the proposed SAS. EY provided detailed editorial suggestions. (EY)

9. Support that understanding certain aspects of the entity's system of internal control is integral to the identification and assessments of the risks of material misstatement, regardless of the planned controls reliance strategy. This message should be reinforced in training and education when the proposed SAS is finalized. (PwC)

10. For control activities, the Committee seeks clarification on the interaction between Paragraph 26.a.iv, Paragraph 13 and some of the application material. Specifically, Paragraph 26.a.iv and its connection to Paragraph 13 appears to indicate that all risks of material misstatement identified require an evaluation of control activities, which is in line with what the Committee believes to be existing guidance/practice and that also aligns with A143 in the proposed SAS. However, the application and other explanatory material at A181 provides examples and instances that the auditor may consider in applying Paragraph 26.a.iv. While we appreciate the additional application material, at A181, the Committee is not certain that it clearly articulates, when read in connection with Paragraph 26 and 13, that only certain control activities require design and implementation evaluation when assessing risk. The responder included additional comments related to specific paragraphs. (Illinois)

11. Three responders disagreed with this guidance.

    a. A responder stated that the enhancements to the extant requirements were minimal and do not go far enough in helping auditors; the information provided in the proposal would be vague to those practitioners who do not perform many audits. Currently, peer review results indicate a lack of risk assessment documentation. Therefore, the proposed guidance should place greater emphasis on the requirements to document risk assessment procedures and correlation to action audit procedures. Auditors of small entities have a challenge with risk assessment of separation of duties and with assessing independence. (Texas)

b. The work effort to gain an understanding of the indirect controls are not clear because 'evaluate' without determining whether the controls are designed and implemented is not appropriate. Stated simply, my perception from reading this ED is that the ASB believes an auditor should perform an evaluation based merely on his or her understanding of controls without also evaluating whether such controls (at least those relevant to the audit) have been designed appropriately and have been implemented. If my read and perception is incorrect and the ASB does not intend to eliminate or change existing auditor responsibilities, then I believe the ASB needs to revisit these requirement and application paragraphs to make its expectations clear. Also, as a former COSO board member who issued the 2013 COSO framework, we spent a tremendous amount of time dealing with control environment element and the five principles that need to be present in order for the control environment to be effective. As COSO points out so clearly, it is critical that each of the five components and relevant principles are present and functioning (which in audit speak means that there are controls designed and implemented to achieve the object). Why would GAAS not require auditors to make those same present and functioning evaluations? (Landes).

c. The requirements related to the auditor's understanding of each component of the entity's system of internal control suggests that the auditor is required to understand the entity more than management. The ASB should consider providing more clarity on what is required to understand. (Anders)

Task Force Views

The following are the Task Force's preliminary views:

- In obtaining an understanding of the components of internal controls (paragraphs19, 21, 22, 24–26), the auditor should not be required to perform procedures to evaluate whether the controls therein are effectively designed or determine whether the controls are implemented (D&I procedures). Such understanding is intended to be at the component level and not at the controls level. There is a misunderstanding with respect to the extant requirement, which is being applied differently by different auditors. Based on individuals that participated in IAASB discussions, the extant requirement to evaluate design and determine implementation is only intended to apply to control activities.

- Consider the term "evaluate" and its clarity in the context of obtaining an understanding of the components of internal control (other than control activities). The intent is that the "evaluation" is part of the "understanding" – not that the "understanding" is necessary to perform the "evaluation." This includes the "work effort" with respect to the information system and communication component. Based on discussions with an IAASB Task Force member, it is noted that the term "evaluate" is intended to be part of the "understanding" rather than a separate evaluation of the component that is based on the "understanding."

- Make clarifications related to paragraph 26 a.iv (other controls that the auditor may identify as addressing the risks of material misstatement at the assertion level). See Request for Comment No. 2b.

Questions for the ASB

10. Does the ASB agree not to require D&I procedures with respect to the control environment, the entity's risk assessment process, the entity's monitoring, and the information system and communication components?

11. Does the ASB believe that the Task Force needs to further consider the clarity of the requirement to "evaluate" these components?

Request for Comment No. 2b

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?

Summary of Results

Agree	13	
Agree with Comments	9	1. TIC 2. AGA 3. KPMG 4. Eide Bailly 5. NSAA 6. PwC 7. GT 8. Washington Auditor 9. Illinois
Disagree	2	1. Texas 2. CRI
Did not answer	8	

Excerpts from Comment Letters

1. Clarify the requirement in paragraph 26a to directly state that the auditor should identify controls that address relevant assertions for significant classes of transactions, account balances and disclosures. (AGA, Washington Auditor)

2. Clarify the requirement and guidance in paragraph 26a to be clear that an understanding of control activities is not required for all significant classes of transactions, account balances, or disclosures. (TIC)

3. Provided comments related to requirements to shift the focus on scalability away from "smaller" entities. (KPMG)

4. The requirements are overly complex in their presentation. Suggest combining paragraphs 26.b and 26.c to make the requirements and related application material easier to follow. We would further suggest that the auditor's understanding of the IT environment and general IT controls that address such risks be clearly linked to the proper functioning of the controls identified in paragraph 26.a. We think it would be clearer to directly state that the auditor's understanding of controls identified in paragraph 26.a includes identifying the IT applications and other relevant aspects of the entity's IT environment, including any general IT controls, that are required for the proper functioning of the control to address the risk. (NSAA, Washington Auditor)

5. More explicitly acknowledge that, as the auditor obtains an understanding of other components of the system of internal control, the auditor is also likely to obtain knowledge about some control activities (more consistent with paragraph 34 of AS 2110). Also, make additional enhancements to promote greater consistency in the auditor's determination of whether there are other controls that address risks of material misstatement at the assertion level whose design and implementation the auditor should understand. (PwC)

6. Could provide better guidance for smaller and less complex entities as well as identification of which controls should be evaluated; see responses to Questions 1 and 8. (Eide Bailly)

7. Could be enhanced with respect to controls related to journal entries; see response to Question 8. (GT)

8. The Committee feels that the requirement to identify controls and examples of such control activities is enhanced in the proposed standard, but as noted in the responses to Questions 2a and 8, does have some concern with respect to the clarity of the requirements and its application by the auditor. The responder included additional comments related to specific paragraphs. (Illinois)

9. Two responders disagreed.

    a. The proposed SAS does not clarify the risk of material misstatement to the users of the audited financial statements. Auditor responsibility is to the users of the financial statements; therefore, audit procedures should be developed in consideration of users' needs. (Texas)

b. The language in the proposed SAS lacks clarity in illustrating 1) how to appropriately identify controls addressing the risk of material misstatement and 2) the requirements for some of those controls, particularly at smaller and less complex entities. The proposal does not define or specify what constitutes a control "relevant to the audit." In addition, paragraph 26 suggests that no walkthroughs are necessary for controls related to significant classes of transactions, account balances, or disclosures, unless the criteria in paragraph 26 are met. (CRI)

Task Force Views

The Task Force will consider and respond to the specific comments. In particular, the Task Force will consider additional guidance or examples of other controls that the auditor may consider appropriate based on the auditor's professional judgment.

Question for the ASB

12. Does the ASB agree with the Task Force's preliminary views to include additional guidance or examples of other controls that the auditor may consider appropriate based on the auditor's professional judgment?

Request for Comment No. 2c

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?

Summary of Results

Agree	14	
Agree with Comments	9	1. Michigan Auditor 2. Texas 3. AGA 4. GAO 5. KPMG 6. NSAA 7. PwC 8. Firriolo 9. Tennessee
Disagree	1	1. CRI

Did not answer	8	

Excerpts from Comment Letters

1. Recommend adhering to the terminology established in the Internal Control Integrated Framework, acknowledge the Green Book, and other frameworks. (Washington Auditor, AGA, GAO, NSAA, Michigan Auditor, Tennessee) Also suggest referring to the Financial Audit Manual of the GAO and the Council of the Inspectors General on Integrity and Efficiency as well as the internal control criteria established under the Federal Managers' Financial Integrity Act (FMFIA). (AGA)

2. The material does not reference or consider COSO's 2017 Enterprise Risk Management Framework. (Texas)

3. Recommend including language in paragraph A102 allowing the auditor to identify and use a suitable framework to evaluate the control components (KPMG).

4. Include additional application material or implementation guidance to explain the interaction between terms described in the proposed SAS, such as information-processing controls and information system controls relevant to financial reporting, and well-understood terminology used in the COSO framework, such as application controls, automated controls, manual controls, technology general controls, and transaction controls. Also, explain the additional language in the definition of controls. The definition notes that policies may be documented, explicitly stated in communications, or implied through actions and decisions. It may be helpful to provide implementation guidance to demonstrate how the auditor would evaluate the design and implementation of controls that are implied through actions and decisions in accordance with paragraph 26. (PwC)

5. The COSO framework includes six attributes – Governance, Strategy, Planning, Execution, Monitoring and Adapting. I believe auditors of entities using the COSO framework should consider what the entity looks to achieve (the mission) when performing risk assessment procedures as well as how the entity is adapting to changing environments. However, I believe the terminology is clear. (Firriolo)
6. A responder disagreed due to the lack of clarity and consistency of terminology and requirements in paragraphs 21-27 and related application material, as they relate to the components of internal control. (CRI)

Task Force Views

The following are the Task Force's preliminary views:

- Include a reference to the Green Book in the application material, similar to AU-C 940.
- Do not align the requirements with the COSO principles but evaluate whether additional application guidance is necessary such that the COSO principles are all addressed. The intent is not to mandate an understanding based on the COSO principles, as this may

imply a broader understanding than may be necessary for purposes of a financial statement audit. In addition, there are some differences between COSO and the Green Book. Consideration will be given to the guidance in AU-C 940.

- With respect to the entity's risk assessment process related to fraud, include essential guidance within the requirements section; the proposed SAS currently includes the "link" to the related requirements in AU-C 240 within the application guidance.

Questions for the ASB

13. Does the ASB agree with the Task Force's preliminary views related to COSO and the Green Book?

14. Does the ASB also agree with including essential guidance within the requirements with respect to the entity's risk assessment process and the link to AU-C section 240?

Other Matters Relevant to Understanding the Entity's System of Internal Control

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

Request for Comment No. 4

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?

Summary of Results

Support	13	
Support with Comments	12	1. Florida 2. Michigan Auditor 3. Washington Auditor 4. CliftonLarsen 5. TIC 6. AGA 7. GAO 8. Eide Bailly 9. Anders 10. GT 11. Firriolo 12. Maryland

Does not Support	2	1. Virginia Auditor 2. Illinois
Did not answer	5	

Excerpts from Comment Letters

1. The addition of examples of the practical application of these concepts would be beneficial. (Florida)

2. 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. (Michigan Auditor)

3. The only aspect that remains unclear is the role of risk assessment procedures that may provide direct indications of the potential for misstatement, such as analytical procedures. Analytical procedures are clearly for risk assessment purposes and are not a control risk factor, yet they are not included in the list of inherent risk factors. Therefore, suggest the Board expand the inherent risk factors in Appendix B to include factors identified by analytical procedures and other risk assessment procedures that may provide direct indications of the potential for misstatement. At question is how information obtained as part of required risk assessment procedures is factored into the auditor's considerations regarding the reasonable possibility of misstatement. (Washington Auditor, AGA)

4. There is not enough clarity to be able to determine what assertions are relevant assertions and therefore what classes of transactions, account balances or disclosures are a significant class. In paragraph 12, a relevant assertion is when there is an identified risk of material misstatement, which appears to be based on an inherent risk assessment. However, paragraph 31 says that for identified risks of material misstatement the auditor should assess inherent risk. Therefore, it is unclear about the definition of relevant assertion and whether inherent risk is part of determining that there is an identified risk of material misstatement and therefore a relevant assertion. It also is unclear whether it is expected that the inherent risk would have higher risk on the spectrum if it's deemed to be relevant. (Maryland, TIC, Eide Bailly)

5. The term "reasonable possibility" in paragraph A.11 is not sufficiently clear; it would enhance the auditor's understanding and ability to consistently apply the proposed standard. (Maryland, CliftonLarsen, TIC, GAO, MACPA) More guidance should be provided to clarify where reasonable possibility lies on the spectrum of inherent risk; some auditors consider all assertions relevant, while others believe a typical assessment will identify one or two assertions to be relevant. (CliftonLarsen) Some might interpret that as "more than remote"; therefore, almost all assertions and all classes of transactions and account balances would be significant classes. (MACPA) Reasonable possibility is not related to the spectrum of inherent risk (neither is significant class or relevant assertion).

6. Suggest clarification of the spectrum of inherent risk. Acknowledge that it may be too prescriptive to specify where exactly on the spectrum reasonable possibility or relevant assertion might occur. However, clearly indicating that a low inherent risk and low RMM might not result in a relevant assertion even though the inherent risk is on the spectrum would be an important enhancement to the definition. It also would help if this requested clarification was part of the definition and not just application guidance (TIC).

7. The term "classes of transactions" could be clarified by providing examples in the application material. (CliftonLarsen)

8. This is not significantly different than what is done currently in practice (Anders).

9. The guidance could be enhanced by clarifying that the approach to identifying and assessing the risks of material misstatement begins at the financial statement level with the auditor's overall understanding of the entity and its environment and works down to the significant classes of transactions, account balances and disclosures and their relevant assertions (see the top-down approach in AU-C 940, which is also consistent with PCAOB standards). We are concerned that auditors may feel compelled to identify everything that is simply above the determined materiality amount as a significant class of transactions, account balance, or disclosure. (GT)

10. Professional judgement is critical when identifying a significant transaction, account balance or disclosure, and the relevant assertions. I believe introducing more concepts adds to the complexity of the proposed SAS whereas an emphasis on professional judgement and examples may be more helpful. (Firriolo)

11. In the case of account balances, is it expected that if the balance is material (or could potentially be material such as n understated liability), that the account balance would always have a risk of material misstatement, and accordingly, would have relevant assertions? For example, prepaids typically have a lower inherent risk, but it is unclear whether prepaids would have relevant assertions. Similarly, we believe there is uncertainty about whether an assertion is relevant when classes of transactions have material volume or disclosures are material but are assesses as having lower inherent risk. We recommend providing clarity in the standard as well as providing examples. (Eide Bailly)

12. Two responders do not support the guidance.

    a. There is a lack of clarity and further examples are needed for identifying the risks of material misstatement. Conventional practice has historically been to identify material transactions, account balances, and disclosures and assess the risk of material misstatement within that activity. The proposed statement appears to have transitioned the applicability of the risk assessment requirements to significant, rather than material, activity. It is unclear to us how materiality and significance interrelate or the primary factors that would allow an auditor to differentiate between low inherent risk and no reasonable possibility of material misstatement. If the goal of the proposed statement is to improve the risk assessment process, the wording "reasonable possibility" included in Paragraph A207 may undermine the objective of the statement by providing practitioners an excuse not to perform a sufficient assessment of risk based on judgment. (Virginia Auditor)

b. Auditors may have difficulty applying these revised definitions in the manner the definitions are presented. Auditors will typically first decide whether a class of transactions, account balance or disclosure is "significant" and then perform the necessary analysis to determine which audit assertions apply to that item. If "significant" is defined as one "for which there is one or more relevant assertions," the implication is that the auditor must first determine which assertions apply to all transaction classes, balances and disclosures and then determine "relevance," which would appear to greatly increase the level of analysis required. Our concern is that practitioners may perceive that the proposed definitions only serve to make an already complex process more complex instead of clarifying and simplifying the risk assessment process, which we understood to be one of the goals of this standard. (Illinois)

Task Force Views

The Task Force will consider and respond to these comments. The Task Force does not intend to eliminate the phrase "significant class of transactions, account balance, or disclosure," which is not only consistent with the ISAs but also the phrase used in AU-C 940. The Task Force will consider the "interplay" between the definitions from a clarity perspective. The Task Force agrees that additional clarification may assist with understandability, including potentially restructuring the proposed SAS. A case study may further assist with understanding and operationalizing the requirements.

Questions for the ASB

15. Does the ASB agree with retaining the phrase "significant class of transactions, account balance, or disclosure"?

16. Does the ASB also agree that the Task Force should consider the "interplay" between the definitions to provide greater clarity?

Spectrum of Inherent Risk

Request for Comment No. 5

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

Summary of Results

Support	15	

Support with Comments	13	1. Cotton 2. Florida 3. Washington Auditor 4. TIC 5. KPMG 6. Hunter 7. NSAA 8. PwC 9. GT 10. MRA 11. Firriolo 12. NASBA 13. Illinois
Does not Support	2	1. AGA 2. Anders
Did not answer	2	

Excerpts from Comment Letters

1. Should enhance the standard in the following ways:

    - Be clear that the auditor should evaluate inherent risk before evaluating control risk. Evaluating inherent risk helps the auditor determine what could go wrong if there were no controls. Auditors should use the results of the assessment of inherent risk to identify controls that will prevent or detect these misstatements and to focus their evaluation of the design and effectiveness of internal control. We therefore recommend that the Board move the discussion of inherent risk assessment in paragraphs 31 through 33 after paragraph 20.

    - Clarify that auditors should assess the direction of inherent risk. Are the incentives such that misstatements are likely to be overstatement or understatement of income? This will help the auditor determine the inherent risk by assertion.

    - Clarify that auditors should assess inherent risk at the financial statement level and at the account and assertion level. This will help the auditor assess the risk of material misstatement at these levels.

    - Clarify that when inherent risk is low, the auditor is not required to obtain a detailed understanding or perform tests of controls. Low inherent risk means that—even if there were no controls—there would be only a low risk of material misstatement. If there is low inherent risk, the entity probably does not need controls to prevent or detect material misstatements. (Cotton)

2. Although the use of examples within the guidance can be misconstrued as a requirement, the Committee does believe that some practical application examples would be valuable for practitioners. (Florida)

3. However, we feel the definition of inherent risk is sufficient and there is no need for a separate "spectrum" concept. To separately identify this concept begs the question of why there are no separate concepts to describe this attribute of all other risks included in the standards; the reason is that risk are already understood to exist on a spectrum and that separately defining such concept is unnecessary. (Washington Auditor)

4. One point of view is that the spectrum of inherent risk goes from no risk on the lowest end to extremely high risk on the upper end. That means that assertions for which inherent risk is deemed to be low might not be considered relevant assertions. The other point of view is that the spectrum starts on the lower end at a level of inherent risk which would result in a RMM giving rise to a relevant assertion, and therefore inherent risk that would not result in a relevant assertion is not even on the spectrum. TIC recognizes the latitude to develop methodologies, which might mean that a methodology could adopt either interpretation and still comply. Accordingly, this issue could be an important clarification. (TIC)

5. The Proposed SAS only mentions that inherent risk can be higher or lower. This may cause confusion and suggest to auditors that inherent risk only consists of these two categories. While we do not think risk levels should be explicitly described within the standard, it would be beneficial to add the concept to paragraphs A230 – A236 that a risk associated with an assertion could fall anywhere from no/remote risk to significant risk and that categories other than "higher" and "lower" may be identified. Further it should be specified in this section of the application guidance that auditors can apply judgment to determine the categories to be used to reflect a risk's relativity on the spectrum (e.g. low, medium, elevated, high, significant, etc.) (KPMG). We suggest that a clear definition of the degree of variation within the SAS suggested "Spectrum" should be established in the proposed change. (Hunter)

6. Suggest that the Board include additional examples of where certain risks might be categorized along the spectrum to help auditors make more consistent inherent risk assessments. (NSAA)

7. There are similar risk factors articulated in AS 2110. While we do not believe it is necessary to incorporate the concept of likely sources of potential misstatements from PCAOB standards into the proposed SAS, requiring auditors to take into account how inherent risk factors affect the susceptibility of relevant assertions to misstatement could result in a more robust consideration of what is driving the risk of material misstatement and therefore a more appropriate and tailored response. We caution, however, that making the concept of a spectrum of inherent risk more explicit in the proposed SAS should not be viewed as driving specific documentation requirements about where on the spectrum an assessed risk of material misstatement falls. Additional implementation guidance may be helpful to illustrate different ways in which the auditor's identification and assessment of risks of material misstatement may be documented. (PwC)

8. We believe the profession could benefit from examples illustrating what the spectrum of inherent risk may comprise in the updated risk assessment audit guide. In many circumstances, audit firms have adopted a spectrum approach in their methodologies today. Therefore, we would expect that audit firms' current practice would satisfy the new requirements, and that the introduction of the spectrum of risk would not necessarily significantly change practice for such auditors. (GT)

9. We encourage the Board reinforce the need to assess change by making the following enhancements.

   - Expand the discussion of change in Appendix B, paragraph 2

   - Reframe the requirements of paragraph 16

   - Reconsider and expand the guidance in appendix A paragraph 2 and linking that guidance to Appendix B, paragraph 2 (MRA)

10. If considering a spectrum as two extreme points when identifying a risk in the proposed SAS, I believe professional judgement always takes precedence. I do not support or oppose the introduction of the spectrum of inherent risk into the proposed SAS. (Firriolo)

11. The term "spectrum of inherent risk" is not defined; while the meaning may be implied, recommend including a definition of the term. (NASBA)

12. The Committee is concerned that the concept may have impacts that may be adverse in practice and to practitioners. We believe that there should be equality of outcomes with audits among auditors. That is, two independent auditors should come to the same or similar conclusions regarding inherent risk and, in most cases, perform the same or similar procedures to address those risks. Introducing the spectrum of inherent risk could introduce complexities that could lead to different outcomes in procedures that auditors would perform and potential unreliability in the quality of audits across the industry. For example, sampling techniques are currently heavily reliant on the assessments of risk. With disparate methods of assessing inherent risks across the industry, sample sizes and testing procedures could be significantly different. Additionally, we would appreciate if the Board addressed the specifics of scalability of this concept, as it may introduce unnecessary documentation requirements for auditors when auditing less complex businesses. The introduction of spectrum may be best utilized in areas a spectrum would make the assessment more effective. The spectrum of inherent risk would appear to be most effective for large or highly complex entities, as these entities tend to have a greater number of significant classes of transactions, account balances and disclosures, where the greater precision afforded by the spectrum concept may produce more meaningful assessments of risk. (Illinois)

13. Two responders disagreed with the guidance.

    - The introduction of the term as unnecessary as inherent risk is already understood to exist at varied levels. We consider the definition of inherent risk as sufficient without introducing the term "spectrum". (AGA).

- The introduction of the spectrum of inherent risk will lead to inconsistencies and divergence in practice. The linkage to audit procedures will be too vague to understand and there is not enough context on what a spectrum consists of (low/med/high, 1-10, low/low-med/med/med-high/high, a moving dot on a line) and how to use it. (Anders)

Task Force Views

There was overall support from the responders. The Task Force will consider and respond to the specific comments, including considering additional guidance. The Task Force plans to retain the "spectrum of inherent risk."

Question for the ASB

17. Does the ASB agree with retaining the "spectrum of inherent risk"?

Identifying and Assessing the Risks of Material Misstatement

Request for Comment No. 6

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

Summary of Results

Support	21	
Support with Comments	6	1. Graham 2. NJ 3. RSM 4. KPMG 5. GT 6. Illinois
Does not Support	1	1. Firriolo
Did not answer	4	

Excerpts from Comment Letters

1. When discussing the other factors to be considered particularly in the Application sections (A8-A10) it would be helpful to re-iterate in some way the "before controls" definition concept. (Graham)

2. It is important to emphasize auditor judgement over additional prescribed requirements. The Group acknowledges that in the case of a complex audit area or area of significant risk, that a separate assessment by assertion is important. For less complex areas, the auditor may determine that assertion level assessment is not needed, and instead can assess risk at the audit area level. (NJ)

3. 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. 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. (RSM)

4. The proposed requirements do not link the objective of obtaining an understanding of the components of internal control to how it affects risk assessment. While inherent risk should not be dependent on the existence or operating effectiveness of control activities, the auditor's understanding of the system of internal control can influence the nature, timing, and extent of planned procedures. When there are deficiencies identified in other components of internal control, it may highlight an increased chance of material misstatements occurring. We suggest adding this concept to the relevant application guidance starting at paragraph A227. (KPMG)

5. We support the requirement to perform separate assessments of inherent and control risk at the assertion level. However, we have concerns about when control risk is required to be assessed at maximum; refer to our response to Question 7 below. (GT)

6. The Committee believes that if separate assessments of inherent and control risk are required, more guidance should be provided to the auditor in determining the risk of material misstatement from a combination of inherent and control risk. Many auditors, particularly when auditing less complex entities, choose not to test controls, so inherent risk ends up being the primary determinant of overall risk of material misstatement. We believe the separate assessments may result in risk assessment errors and unnecessary complexity in the process, particularly for smaller entities. (Illinois)

7. A responder does not support this guidance because. Professional judgement is important to emphasis because it plays a major part in determining risk. I believe separate assessments of inherent and control risk in relation to all risks of material misstatement at the assertion level is not necessary. (Firriolo)

Task Force Views

There was overall support from the responders. The Task Force will consider and respond to the specific comments, including considering additional guidance in AU-C 540 that may assist with further clarifying the requirement. The Task Force plans to retain the separate inherent and control risk assessments.

Question for the ASB

18. Does the ASB agree with retaining the separate inherent and control risk assessments?

Assessment of Control Risk

Request for Comment No. 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?

Summary of Results

Support	13	
Support with Comments	10	1. Florida 2. NJ 3. Texas 4. RSM 5. TIC 6. KPMG 7. Eide Bailly 8. PwC 9. Firriolo 10. Illinois
Does not support	4	1. Virginia 2. GAO 3. GT 4. MRA
Did not answer	5	

Excerpts from Comment Letters

1. The clarity of the requirement to assess control risk is outlined very clearly in the list of requirements, however additional clarity would be beneficial in other sections of the SAS. Specifically, as noted in paragraph 34 within the requirements section of the SAS, it is very clear how the auditor should assess control risk when test of controls will not be performed. The Committee noted that this clarity does not extend to the more detailed guidance later in

the SAS. Specifically, in paragraphs A248 – A252, there is no mention of how the control risk should be assessed in the circumstance in which the auditor does not intend to test controls. Furthermore, this clarity is, again, not noted in the proposed adjustments outlined in Appendix G. While the intention is clear in the overall review of this SAS, the codified guidance should be updated to reflect this clarity to ensure that it properly reflects the intent of the Board. (Florida)

2. The standard and application materials could be better organized and simplified and contain clearer definitions of key terminology and concepts to enhance the auditor's understanding of the standard and implementation. (NJ)

3. The conclusions about control risk must be documented, even if the auditor plans the audit assuming no reliance on internal controls. There should be a direct correlation between the risk assessment and audit work, with consideration given to the size and complexity of the entity. (Texas)

4. 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. (RSM)

5. While paragraph 34 outlines the effect of not testing operating effectiveness of controls on the auditor's control risk assessment, it is not clear that if we plan to test operating effectiveness, our control risk assessment is based on our understanding of the design and implementation of the controls and an expectation that the controls are operating effectively. Paragraph A248 discusses this concept; however, we believe it should be explicitly stated in the requirements. (KPMG)

6. In the definition of paragraph 12, inherent risk is to be assessed "before consideration of controls." Paragraph 31b discusses the that the risk of material misstatement at the financial statement level affects the assessment of inherent risk at the assertion level. Paragraph A238 similarly connects the financial statement-level risks to inherent risk considerations. However, paragraph A217 states that the financial statement risk "is influenced" by the understanding of internal controls. Consequently, the guidance in paragraph A217 indirectly links certain control considerations to inherent risk through the financial statement-level assessment. We believe this is a conflict in the ED that should be clarified. (Eide Bailly)

7. We support the discussion in paragraph A249 of the proposed SAS that the auditor's assessment of control risk may be performed in different ways, depending on preferred audit techniques or methodologies. Suggest making clarifications to paragraph A249. (PwC)

8. With all due respect – I did have to read the material a few times, but it eventually became clear. I believe D&I should be well defined and the text of the proposed SAS should be simplified. (Firriolo)

9. Overall, the Committee believes that the proposed standard is clear with respect to the need to assess control risk. However, the Committee does have a suggestion regarding the explanatory and other application guidance on how to assess control risk in situations where the auditor does not plan to test the operating effectiveness of controls. Currently, Paragraph 34 and the Explanatory Memorandum states 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)". The Committee has a concern that the parenthetical statement could be misconstrued and result in an auditor erroneously assessing control risk at the same level as its assessment of inherent risk - versus meaning that control risk is automatically set at 100%. The Committee suggests that the parenthetical statement be removed to avoid confusion or, in lieu of that, add explanatory and other application material showing a mathematical application such as the following is suggested:
    - Risk of material misstatement = inherent risk x control risk
    - Example with not testing operating effectiveness of internal controls
        - 75% (RMM) = 75% (inherent risk) x 100% (control risk)
    - Example with testing operating effectiveness of internal controls
        - 37.5% (RMM) = 75% (inherent risk) x 50% (control risk) (Illinois)

10. Four responders disagreed with the guidance.

    a. There is some confusion on why there is a need to identify and understand the client's internal controls, if there will be no reliance on the effectiveness of controls, A252. A requirement to gain an understanding and identify controls that will then be ignored seems to be an inefficient way to run an audit. Also, a walkthrough of controls that provides no audit evidence that reduces overall risk seems to be an inefficient use of resources. (Virginia)

    b. We suggest better clarifying the requirement to assess control risk when the auditor does not plan to test the operating effectiveness of controls. In our view, further clarification is needed to assist auditors in correctly and consistently applying this requirement. Paragraph 34 of the proposed SAS states, "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 auditor's assessment of the risks of material misstatement is the same as the assessment of inherent risk." It is our view that this language is unclear. Such language may imply that the auditor is not required to assess control risk when the auditor does not plan to test the operating effectiveness of controls. A requirement that is presumptively mandatory should state what the auditor is to do versus not to do. (GAO)

    c. Concerned that the requirements, as drafted, are overly limiting because they do not allow for situations where the entity has controls in place that are effectively design and implemented. Effective design and implementation could be an input or consideration in designing the appropriate response. Control risk is an entity risk that exists independently of the audit. Operationally, control risk can be assessed by determining control reliance. We believe there should be a difference between an audit response where design and implementation are effective and where they are not.

Suggest clarification of how the auditor's understanding of controls impacts the auditor's response to risks of material misstatement and the design of audit procedures that address those risks, as a control risk assessment of "maximum" is clearly evident only when applying audit sampling. (GT)

d. What is confusing is the phrase "the auditor's assessment of control risk should be such that …" In practice, many auditors take a formulaic approach to risk assessment, e.g., "moderate" IR and "high" CR = "high" RMM. When auditors read paragraph 34, I'm afraid that most of them will think through their formulas and try to figure out how to "plug" their CR assessment so that IR = RMM. This seems like an unproductive line of thought. (MRA)

Task Force Views

There was overall support from the responders. The Task Force will consider and respond to the specific comments. In particular, the Task Force will consider the effect on the auditor's responses when the auditor does not plan to test the operating effectiveness of controls (that is, how evaluating the design and determining the implementation of control activities can influence the design of the auditor's further audit procedures).

The Task Force acknowledges that the IAASB intended to address the influence of the auditor's evaluation of the design and determination of the implementation of controls in ISA 315, and the same application material was retained in the exposure draft, specifically in paragraphs A23, A138, A141, A167, A174, A179, A200, A201, A202, A252. The more relevant guidance from the exposure draft is provided below:

> **A138.** The auditor is required to identify specific controls in the control activities component, and evaluate the design and determine whether the controls have been implemented, because it assists the auditor's understanding about management's approach to addressing certain risks; therefore, it provides a basis for the design and performance of further audit procedures responsive to these risks as required by AU-C section 330. The higher on the spectrum of inherent risk a risk is assessed, the more persuasive the audit evidence needs to be. Even when the auditor does not plan to test the operating effectiveness of identified controls, the auditor's understanding may still affect the design of the nature, timing, and extent of substantive procedures that are responsive to the related risks of material misstatement.
>
> **A202.** When the auditor does not plan to test the operating effectiveness of identified controls, the auditor's evaluation of the design and determination of the implementation of certain controls may still assist in the design of the nature, timing, and extent of substantive procedures that are responsive to the related risks of material misstatement. Examples are as follows:
>
> - The results of these risk assessment procedures may provide a basis for the auditor's consideration of possible deviations in a population when designing substantive procedures.
> - Performance of these risk assessment procedures may lead the auditor to identify a fraud risk related to inadequate segregation of duties in the payroll function, and the auditor may decide to perform certain substantive procedures to address the risk of fictitious employees as a result.

- During the process of evaluating the design of certain controls related to sales, the auditor may become aware that the entity enters into bill-and-hold transactions with customers, and the auditor may design specific substantive procedures related to the agreements with the customers to test appropriateness of revenue recognition under the applicable financial reporting framework.

A252. Regardless of whether the auditor plans to test the operating effectiveness of controls for the purpose of assessing control risk, the auditor's understanding of the entity and its environment, the financial reporting framework, and the entity's internal control informs the auditor's design of further audit procedures. Examples follow:

- The auditor's understanding of internal control may indicate that controls are not designed or implemented appropriately, or the entity's control environment does not support the effective operation of control. In this case, there is no point in testing controls; the further audit procedures will consist solely of substantive procedures. If the auditor determines, pursuant to paragraph 33, that substantive procedures alone cannot provide sufficient appropriate audit evidence, the auditor may need to consider the effect on the auditor's report, as described in AU-C section 330.[62] [61]Paragraphs .A32–.A33 of AU-C section 330.
- The auditor's understanding of the entity's information system and communication will inform the auditor about the nature of documentation available for testing. For example, if the entity's records are all electronic, the auditor may design audit procedures differently than if the entity's records are in paper format.

It is important to note that the auditor's understanding of controls cannot positively influence the auditor's inherent risk assessment (that is, reduce inherent risk); inherent risk is assessed absent consideration of controls. Likewise, in accordance with the proposed SAS, the auditor's understanding of controls cannot influence the auditor's assessment of the risk of material misstatement (that is, the combined assessment of inherent risk and control risk), as design and implementation alone require the auditor to default to inherent risk (that is, the combined risk of material misstatement assessment with control risk set at maximum).

The "interplay" between inherent risk and control risk as well as the related impact on the auditor's further audit procedures can only be "clearly" evidenced in sampling theory (that is, through the inputs to a sampling calculator and the resulting extent of the items to be selected for testing). The Task Force notes that the Audit Sampling Guide, which is based on the audit risk model, currently recognizes how the auditor's evaluation of design and determination of implementation may influence the design of further audit procedures. In particular, the current guide states the following:

> When the auditor has performed only an assessment of design and implementation and assessed the design as effective and has obtained evidence that the controls have been implemented, the auditor might use a slightly lower confidence level for detailed substantive procedures (for example, 92 percent or 93 percent rather than a 95 percent confidence level if that was the level that the auditor would have otherwise planned for tests of details had the design or implementation of controls been assessed as ineffective).

The guide also states:

> When the auditor has performed only an assessment of design and implementation of internal controls and assessed the design as effective and has obtained evidence that the controls have been implemented, the auditor might accept a slightly higher risk of incorrect acceptance (lower confidence level) for substantive tests of details than had the design or implementation of controls been assessed as ineffective.

These paragraphs recognize that the sufficiency and appropriateness of audit evidence that is necessary may differ when controls are effectively designed and implemented compared to situations in which controls are not implemented or are ineffective. While the guide is focused on the extent of testing (that is, when applying audit sampling), the same concepts would apply to the nature and timing of testing. All of the auditor's understanding obtained as a result of risk assessment procedures is taken into account in designing the nature, timing, and extent of further audit procedures.

Questions for the ASB

19. Given

a. the application material in the exposure draft,

b. the requirement in paragraph 34 of the exposure draft stating that if the auditor does not plan to test the operating effectiveness of controls, the assessment of the risk of material misstatement is the same as the assessment of inherent risk, and

c. the guidance in the Audit Sampling Audit Guide,

does the ASB believe that further guidance is needed to clarify the circumstance in which the auditor may adjust the nature, timing and extent of substantive procedures when concluding that controls are appropriately designed and implemented but does not plan to test the operating effectiveness of controls?

Design and Implementation (D&I) Procedures

Request for Comment No. 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)?

Summary of Results

Support	13	
Support with Comments	12	1. Virginia Auditor 2. Michigan Auditor

		3. Texas 4. CRI 5. RSM 6. CliftonLarsen 7. TIC 8. Eide Bailly 9. GT 10. EY 11. KPMG 12. Illinois
Does not support	-	
Did not answer	7	

Excerpts from Comment Letters

1. The requirement is overly complex in its presentation. We suggest removing the phrase 'based on controls identified in (a)' from part (b) since control activities identified to address the risk of material misstatement at the assertion level may not necessarily relate to relevant IT applications. We further recommend combining parts (b) and (c) into one part covering the identification of relevant IT applications and related risks and controls. (Virginia Auditor)

2. 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. (Michigan Auditor)

3. The clarification provided in paragraph 26d is improved but additional emphasis would be helpful. Internal control over journal entries is a common problem in entities of all sizes and is an area that needs additional guidance. Therefore, any guidance and clarification would be helpful. (Texas)

4. The requirements in paragraph 26 of the proposed SAS regarding evaluation of the design and implementation of control activities are unclear. See our response to Question 2b above as to our rationale. (CRI)

5. Support but provided suggestions to the application guidance to clarify the requirement. (KPMG)

6. 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. Suggests edits to paragraph A197 to clarify point. (RSM)

7. We believe the proposed standard needs to further clarify the phrase higher in the spectrum of inherent risk for determining whether the auditor is required to perform an evaluation of the design and implementation of control activities for identified relevant assertions (references paragraphs 26a.iv, A181, and 26d). (CliftonLarsen)

8. Clarity in paragraph 26a regarding significant classes of transactions, account balances, or disclosures is important to understand when paragraph 26d applies (TIC).

9. Paragraph 26d provides appropriate clarity that areas identified in 26a and 26c should include procedures in addition to inquiry to verify whether control activities are implemented. However, we believe the full scope of what controls should include an observation procedure is uncertain. Paragraph 26a, items i-iii names significant risks, journal entries, and testing of controls. However, item iv of 26a is vague, and the application guidance in A181 provides some additional considerations, but the scope remains unclear. We believe this may result in less observation procedures in practice. Also, the flow is difficult to follow; it would be easier to follow if 26d was a lead-in paragraph of 26 preceding items a-c. (Eide Bailly)

10. As proposed, the requirement related to understanding the journal entries process is handled more broadly under the Information and Communication component. It is unclear to what extent an auditor would need to understand journal entries at the assertion level. As structured in a sub-bullet to paragraph 26a, the journal entries requirement implies that an auditor may need to "go deeper" on controls over journal entries. Because the notion is broader than the other sub-bullets to paragraph 26a, we recommend making the controls over journal entries its own separate bullet under paragraph 26 and clarifying the associated application guidance. Paragraph 26d would then require revision to incorporate the new, separate bullet on controls over journal entries. (GT)

11. The proposed SAS may be further improved by clarifying the language in paragraph 26.a.ii related to identifying controls over journal entries. This requirement, as written, requires an auditor to identify and then to evaluate the design and determine implementation for controls over all journal entries affecting a significant class of transaction, account or disclosure. We don't believe that is the intent of the Board. Also, we suggest the Board also consider the requirement in AU-C 240.32 to test the appropriateness of journal entries as a response to management override of controls and whether there is a need to clarify the scope of journal entries intended to be included in this requirement. EY provided specific suggestions. (EY)

12. The Committee feels that the clarity on the requirements in Paragraph 26d of the proposed SAS are clear for the need to evaluate the design and implementation of certain control activities, with the exception of Paragraph 26.a.iv. Refer to our response to Question 2. The Committee also provide comments related to an inconsistency related to the performance of

walkthroughs within paragraph A197 and A196 as well as paragraph A61 of AU-C 940 (specifically related to the use of re-performance to evaluate design and implementation). (Illinois)

Task Force Views

There was overall support from the responders. The Task Force will consider and respond to the specific comments. The Task Force particularly agrees with the need to clarify the requirement related to journal entries, including the interplay between journal entries and general IT controls. In addition, the Task Force will consider the clarity of the guidance related to walkthroughs as well as clarifying that the auditor is not required to evaluate design and determine implementation for all relevant assertions related to significant classes of transactions, account balances, or disclosures.

Question for the ASB

20. Does the ASB agree with the need to clarify a) the requirement related to journal entries, b) the guidance related to walkthroughs, and c) the guidance related to performing D&I procedures? Does the ASB have specific views related to such clarifications?

Audit Documentation

Request for Comment No. 11

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

Summary of Results

Support	11	
Support with Comments	17	1. Graham 2. Florida 3. Texas 4. CRI 5. Maryland 6. TIC 7. GAO 8. KPMG 9. Eide Bailly 10. BDO 11. Anders 12. NSAA 13. PwC 14. Firriolo

		15. EY 16. Tennessee 17. Illinois
Does not support	0	
Did not answer	4	

Excerpts from Comment Letters

1. My suggestion would be to make it crystal clear that documentation of the system of controls is expected. Entity plus auditor documentations of process and controls combined can satisfy this requirement. If auditors would focus on distinguishing controls from process, this task and the documentation requirement would be simpler to perform and be more effective. In addition, if the intent is to require the basis and evidence supporting IR assessments along the “spectrum” I do not think this is crystal clear, and has been a weakness in vendor practice aids leading to a lack of practice documentation and misunderstanding of the need to document support for assessments. (Graham)

2. The Committee concurs with the requirement for inclusion of key matters, and rationale for identifying certain risk assessments in audit documentation will provide significantly improved guidance on the required documentation. A full practice aid to walk through the key matters is requested in the future. (Florida)

3. The PSC thinks that the clarity and appropriateness of the documentation requirements are somewhat improved but could benefit from further enhancements. (Texas)

4. The guidance in A263 is very helpful. However, anything to make the expected minimum documentation requirements clearer would be helpful to smaller practitioners. (Maryland)

5. Paragraph A259 states, “for recurring audits, certain documentation may be carried forward, updated as necessary to reflect changes in the entity’s business or processes.” This may lead to confusion as practitioners may interpret this to imply that walkthroughs, as an example, aren’t required each year to indicate a control has been implemented. Suggest either removing this sentence or specifying what may be carried forward for documentation purposes. In addition, TIC was concerned about what, if any, additional documentation would be required related to paragraphs 36 and 37, particularly since the performance of the stand-back requirements could result in no change to the risk assessments. (TIC)

6. The documentation requirements in paragraph 38 should be enhanced and broadened to fully capture (1) the auditor’s understanding and evaluation of the entity and its environment and (2) the entity’s information system and communication. The requirements require the auditor to document the understanding rather than the

understanding and evaluation. In addition, the documentation requirements omit information system and communication. (GAO)

7. The documentation requirements should include the auditor's understanding of the framework as well as their evaluation as to whether the framework is appropriate. Suggest including paragraph 20 in the documentation requirement. Paragraph 23 addresses circumstances when the auditor identifies risks of material misstatement that management failed to identify, including requirements to determine whether any such risks are of a kind that the auditor expects would have been identified by the entity's risk assessment process and, if so, obtaining an understanding of why the entity's risk assessment process failed to identify such risks of material misstatement. These items should also be documented by the auditor and thus, paragraph 23 should be included in the documentation requirements of paragraph 38b. Paragraph 25 requires obtaining an understanding of the information system and communication and, in particular, paragraph 25c requires an evaluation of the information gleaned from obtaining this understanding to determine if the information system is appropriate. As paragraph 38c specifically addresses control activities in paragraph 26, we believe the reference in paragraph 38b should be to paragraph 25 instead, which would be consistent with ISA 315. (KPMG)

8. The proposed standard could be clearer on the documentation expectations to support the final conclusions reached on inherent risk at the assertion level. To elaborate, upon identifying and documenting the risk factors for a given relevant assertion, an auditor must then apply their judgement to such factors in determining where the risk falls on the spectrum. This is implied in paragraph 31 but should more clearly state that upon "assessing the likelihood and magnitude of misstatement", the auditor should document their judgement to support their determination of specifying where the risk falls on the spectrum. (Eide Bailly)

9. It is unclear how the stand-back provision would be documented. (Eide Bailly)

10. Support, except with regard to issues related to controls relevant to the audit (see response regarding Question 2b). (CRI)

11. The ASB should develop further implementation guidance in the form of examples or case studies in this area to further illustrate the scalability considerations. (BDO)

12. Paragraph A263 of the application material is worded poorly, in that it provides for a practitioner not to document certain basic audit considerations that should be documented by auditors of less complex entities. There should be a minimum documentation that doesn't take into consideration the complexity of the entity. (Anders)

13. For consistency, we suggest that the Board refer to paragraphs 17 and 18 in paragraph 38(a). (NSAA)

14. The nature and extent of expected documentation is unclear. In such cases, it would be helpful for the ASB and the Peer Review Board to discuss what may be expected with regard to documentation and provide additional implementation guidance to assist practitioners in understanding the scalability of the requirement in paragraph 28 (we

would expect the auditor's documentation of the key elements of the auditor's understanding of the components of the entity's system of internal control to potentially be brief when elements of the system of internal control are less formalized, such as for less complex entities). More broadly, paragraph 33(c) of extant AU-C section 315 requires the auditor to document identified and assessed risks of material misstatement at the financial statement level and at the relevant assertion level. We appreciate the explicit acknowledgment that "the auditor is not required to document every inherent risk factor that was taken into account in identifying and assessing the risks of material misstatement at the assertion level." We believe this should apply to audits of all entities, not just less complex ones. If the concept of documentation of inherent risk factors is misunderstood in practice, there is a possibility that auditors may be driven towards a significant amount of additional documentation without incremental benefit. In addition, the ASB should monitor whether the IAASB develops specific guidance on documentation, as indicated in the IAASB's Basis for Conclusions. (PwC)

15. Audit documentation is important and is typically achieved using practice aides. Audit documentation should be helpful in determining the auditor's reasoning about their conclusions. When using practice aides audit documentation can become redundant and fail to achieve the purpose. Audit documentation should be evaluated before being recorded as part of audit evidence. Otherwise I believe the audit documentation requirements are clear and appropriate. (Firriolo)

16. We have some concerns about the related application guidance and believe it would be helpful to clarify that formal documentation on how each inherent risk factor has been considered would not be required. Accordingly, EY proposed revisions to paragraph A263 of the proposed SAS because the guidance is intended to apply to audits of all entities rather than only to audits of less complex entities. (EY)

17. We agree the documentation requirements are clear and appropriate. However, for consistency, we suggest the Board refer to paragraphs ¶17 and ¶8 in ¶38(a). (Tennessee)

18. Paragraphs 38 and A259-263 have expanded additional guidance to assist the auditor in preparing appropriate documentation based on the risks identified and the complexity of the entity. Paragraph A263, in particular, describes examples in which an auditor of a less-complex entity may be able to combine risk assessment documentation with the auditor's existing documentation of overall strategy. We believe additional examples of this sort will greatly aid auditors at small and mid-sized firms who may not have the same resources as the larger firms, as discussed in question 1. (Illinois)

Task Force Views

The Task Force believes that additional clarification may be necessary with respect to audit documentation. The Task Force will consider the comments received and also how the requirements and related guidance interplays with AU-C section 600.

Automated Tools and Techniques

Excerpt from Comment Letters

The use of automated tools and techniques can contribute to the effectiveness and efficiency of an audit; suggest including guidance on how to incorporate automated tools and techniques when performing risk assessment procedures. (CliftonLarsen)

Task Force Views

The Task Force will consider this comment. In addition, the Task Force will review the recently issued Questions and Answers published by the IAASB that are intended to provide additional guidance with respect to automated tools and techniques. The Task Force does not believe that significant changes are needed.

III. Matters Raised by Responders to be Addressed by the Task Force after the ASB Meeting

Enhanced Guidance Related to IT

Request for Comment No. 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?

Summary of Results

Agree	17	
Agree with Comments	10	1. Florida 2. Washington Auditor 3. CRI 4. CliftonLarsen 5. TIC 6. KPMG 7. Anders 8. PwC 9. GT 10. EY
Disagree	-	
Did not answer	5	

Excerpts from Comment Letters

1. May be an area to revisit and incorporate additional examples in appendix E if there are significant changes in the IT environment from emerging technologies. (Florida)
2. Clarify that it is not necessary for the auditor to identify risks arising from use of IT or general IT controls, unless they are determined to be relevant. (Washington Auditor)
3. As the risks arising from IT are predicated on an entity's inappropriate reliance on IT applications or systems that are 1) inaccurately processing data, 2) processing inaccurate data, or 3) both, the proposed SAS should include application controls (i.e. direct

controls) in conjunction with general IT controls (i.e. indirect controls) as those that address the risks arising from IT. (CRI)

4. The requirements may prove challenging because the IT environment has almost an infinite number of configurations; auditor judgments will vary regarding the extent of risk assessment procedures to perform the amount of documentation required. The proposed SAS lists a significant number of examples of what can go wrong in the IT environment but does not provide examples and guidance of acceptable ways an audit can be more efficiently performed if the auditor concludes the entity's information system and communication component appropriately supports the preparation of the financial statements. The proposed SAS will increase the cost of performing risk assessment procedures as they relate to the auditor's evaluation and understanding of the IT environment. It would be helpful if the proposed SAS also included scalable examples of tests of controls that could be performed to reduce substantive procedures when the auditor concludes the IT environment is properly designed and implemented. (CliftonLarsen)

5. Many of the auditors of less complex entities will need additional training and tools on the use of IT in audits and risk assessment to effectively implement these enhanced requirements. Assistance in the form of tools such as checklists, like the AICPA checklist for the use of SOC reports, and other training and guidance provided by the ASB in coordination with others will be important. (TIC)

6. Obtaining an understanding of and evaluating IT is a part of a robust risk assessment process. However, we note that the proposed SAS is inconsistent in its descriptions of risks arising from IT, GTICs, IT applications, and information processing. We believe that the standard should focus on the automated control activities implemented within IT applications and how GITCs support the consistent functioning of those controls. Additionally, the appendices focused on IT include unspecified assumptions that may mislead auditors trying to identify the relevant aspects of IT systems and controls in scenarios of varying complexity. (KPMG)

7. The term "information processing controls" is used throughout the proposed SAS. The definition of information processing controls has been changed significantly from that in extant AU-C 315 and appears to introduce a new control category that includes a subset of manual and automated controls. It is unclear within the proposed standard what is the link between GITCs and information processing controls given that information processing controls can be manual, and how this impacts risks associated with IT. Suggest focusing on application controls and GITC and including additional guidance in the control activity section regarding the need to identify and evaluate controls over the input, integrity, and extraction of information from the information systems. Further, paragraphs A184 and A251 address testing operating effectiveness of GITCs and the impact that may have on control risk and planned audit response. However, these paragraphs do not clearly state that an auditor should not rely on application controls without effective GITCs Paragraph A187 and paragraph 10 of Appendix E allow the

auditor an option to directly test the inputs and outputs of the report generation process, or to test management's controls over the completeness and accuracy of the report. It is not clear whether direct testing could be applied both in cases when the auditor is not relying on controls and when the auditor is relying on controls. Suggests edits to appendices E-F for more clarity, including suggestions related to directly testing the inputs and outputs of the report generation process or to test management's controls over the completeness and accuracy of reports. (KPMG)

8. Understand the intention of the requirement but find the scope and scalability are unclear. Should consider providing details of what at a minimum need to be understood of the IT environment. Based on the scalability considerations, some engagements would not need any understanding of the IT environment (Anders).

9. The requirement in paragraph 26(b) is not sufficiently clear, which could have unintended consequences. In an audit of a less complex entity, if there are no significant risks and the auditor does not plan to test the operating effectiveness of controls, we believe there is a risk that the auditor could potentially determine that there are no IT applications that are subject to risks arising from the use of IT, since the requirement in paragraph 26(b) is only applicable based on the controls identified in paragraph 26(a). As a result, the auditor may not evaluate the design and implementation of any general IT controls. It is unclear whether that was the ASB's intent in drafting the requirements. (PwC)

10. Concerned that the prescription of these requirements reduces their scalability. Also concerned that the structure of the requirements could create operational challenges for auditors without further application guidance. Specifically, we are concerned that the structure of the requirements implies separate documentation of general IT controls within each component (in practical application, auditors obtain and document the understanding overall). In addition, we disagree with the application guidance provided in A251. This proposed guidance suggests that it could be appropriate in some circumstances not to test general IT controls and may be read as being contradictory to proposed paragraph A35 of AU-C section 330. If an auditor plans to test the operating effectiveness of an automated control, relevant general IT controls would need to be tested as well. (GT)

11. The definition of "risks arising from the use of IT" and its use throughout the document would be confusing because it defines risks in terms of controls. We believe risks exist regardless of the existence of controls, and this view is reinforced by the application guidance included in paragraph A268 (Appendix E, paragraph 18). EY included some suggested edits to this guidance, particularly in Appendix E and Appendix F of the proposed SAS. (EY)

Status

The Task Force did not have time to discuss these comments in great detail. The Task Force agreed that this is an area that may need further clarification, including the interplay with the requirements related to understanding control activities related to journal entries (as mentioned previously).

Significant Risks

Request for Comment No. 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?

Summary of Results

Support	14	
Support with Comments	13	1. Graham 2. Cotton 3. Washington Auditor 4. CliftonLarsen 5. KPMG 6. Eide Bailly 7. Anders 8. Hunter 9. GT 10. PwC 11. Firriolo 12. AGA 13. Illinois
Does not support	2	1. Virginia Auditor 2. Texas
Did not answer	3	

Excerpts from Comment Letters

1. The Board will improve practice with its proposed revisions to better define the term “significant risk.” Clarifying the magnitude and likelihood may lead to more consistent judgments since the parameters of the assessment will need to be articulated and can be

reviewed. However, using the term significant risk may itself contribute to confusion, as it been a source of misapplication in practice. The term “significant” is widely used by auditors and in the auditing literature (e.g., “significant” accounts, etc.), but in many cases significant risk is simply confused with high risk. The term is intended to apply to “special risks” not all “high risks.” Simply re-naming the concept of this risk as, say, a “critical risk” or “key risk” would avoid any confusion. (Graham)

2. Although we believe the revised definition is clearer than the current definition, further clarification is necessary. We suggest the following: Change the term “significant risk” to “significant inherent risk” (and making conforming changes to other standards to clarify whether “significant risk” refers to “significant inherent risk” or a “risk of material misstatement,” including with respect to fraud risk in AU-C 240 as well as reporting “key audit matters”) This will remind auditors that the concept refers to an inherent risk, not a significant risk of material misstatement (significant inherent risk becomes a significant risk of material misstatement only if the entity has not designed sufficient controls to overcome this risk). The standard should also define “significant risk of material misstatement” as a very high risk of material misstatement… Eliminate the term “spectrum of inherent risk,” as this is not a common term and could be easily misunderstood. (Cotton)

3. As described in our response to question 4, clarification is needed as to whether results of analytical procedures and other risk assessment procedures that provide direct indications of misstatements would be considered inherent risk factors. In our experience, significant risks are often identified in part or in whole due to analytical procedures, review of governing body minutes, review of news articles, correspondence with regulatory or oversight bodies and other similar procedures that are not currently included as inherent risk factors in Appendix B. (Washington Auditor)

4. We believe the revised definition of significant risk and the associated examples provided in paragraphs A242 and A243 will provide helpful clarification related to understanding the nature of a significant risk. We do not believe that the introduction of the spectrum of inherent risk would result in a change in audit approach or identify any new significant or fraud risks. (CliftonLarsen)

5. Generally, support the revised definition and related material. Suggest the edits to Paragraph A240 to reflect that reporting key audit matters is only applicable if we are so engaged, and that timely review by the engagement partner is not dependent on the risk spectrum. (KPMG)

6. It is important to recognize that the determination of whether a risk is a significant risk is a matter of professional judgment; there may be unintended consequences in applying the definition if the phrase “close to the upper end of the spectrum of inherent risk” is interpreted to mean that there must be a ranking of risks and assumption that every engagement must have a significant risk. (PwC)

7. We believe the definition of significant risks could be confusing for auditors when determining the difference between relevant assertions and significant risks. (Eide Bailly)

8. We agree with the revised definition with the addition of the factors noted in our response to question 4 (expand inherent risk factors to include factors identified by analytical procedures and other risk assessment procedures that identify potential misstatements). (AGA)

9. The ASB should be more specific in application material and implementation guides on how significant risks are determined based on the spectrum of inherent risk. We believe this will be interpreted differently based on the auditor, leading to inconsistencies in practice. (Anders)

10. A clear definition of the degree of variation within the SAS suggested "Spectrum" should be established in the proposed change. As suggested earlier, we need further guidance as to the acceptable degree of lower and upper end of the "Spectrum" should define a clear measurable scope to determine the "spectrum" on inherent risk. (Hunter)

11. While we appreciate the Board's views regarding convergence with the international standard, we are concerned about the potential inconsistencies the new definition of "significant risk" could create in the US jurisdiction when compared to the definition used by the PCAOB. We believe such inconsistency could create operational challenges for firms whose methodologies contemplate both AICPA and PCAOB standards. We do not believe the Board intends for auditors to identify significant risks differently under US GAAS than under PCAOB standards. Therefore, our concerns would be alleviated by adding application guidance that bridges the notion of "special audit consideration" used in the PCAOB's definition of significant risk to the proposed definition in the ED. (GT)

12. Professional judgement is necessary to determine significant risk. Considering differences in professional judgement are likely to happen when determining significant risk, I do not support or oppose the revised definition and related material on the determination of significant risks. I believe determining significant risks is not affected by introducing a spectrum of inherent risk. (Firriolo)

13. The Committee agrees with the Board's revised definition. Significant risks should not be determined based on an auditor's response, but the underlying nature of the risk. See question 5 above for discussion of spectrum of inherent risk discussion. The Committee's opinion is that introducing additional assessments of risks (assessment of magnitude and likelihood of occurrence) by incorporating spectrums of inherent risk unnecessarily complicate the process of identifying significant risks. (Illinois)

14. Two responders disagreed with the guidance

    a. Question whether the determination of significant risk is still necessary with the introduction of the spectrum of inherent risk. If a detailed risk assessment is performed at the financial statement and assertion levels, and procedures are linked that are adequately responsive to those risks, we are not convinced that the subjective exercise of labeling certain risks as 'significant' will necessarily improve audit practice. (Virginia Auditor)

b. The revised definition and related material on determination of significant risks needs simpler language in order to improve understandability and consistent application. It would be helpful to include definitions of material risk vs. significant risk. (Texas)

Status

The Task Force did not have time to address each of the comments received. The Task Force recognizes, however, that it is important to converge on the definition of a significant risk, including bridging to PCAOB standards. Additional application guidance may be necessary for understandability.

Excerpts of general comments

1. The proposed standard appears to be mainly clarification or clearer description of existing requirements rather than a substantial change to requirements. We would therefore suggest the Board allow for early implementation of the revised standard. (Washington Auditor)

2. Additional guidance is helpful but continue to have concerns about the ability to operationalize some aspects of the requirements. Specifically, we foresee continuing challenges in meeting the performance and documentation requirements related to the identification of relevant assertions and obtaining an understanding of controls (particularly those that address risks of material misstatement at the relevant assertion level in the control activities component). (CliftonLarsen)

3. The application guidance includes various paragraphs headed “Considerations Specific to Governmental Entities” and observed that those paragraphs could also provide guidance to other regulated entities. For example, see paragraphs A28, A30, and A52. (TIC, Eide Bailly)

4. Coordinate with Peer Review Board to determine whether other actions may be necessary to complement the proposed SAS to further promote high-quality risk assessments and address audit deficiencies noted in peer review. (PwC)

5. There are weaknesses in the practice of obtaining an understanding of internal control and appreciate the AICPA’s plan to improve audit quality. Over the years auditor’s risk assessment procedures have become overwhelming, time consuming and driven by practice aides. I believe obtaining an understanding of internal control and assessing risk is a skill involving an art and a science, which is ultimately a product of experience and professional judgement. (Firriolo)

Status

These are the remaining general comments by responders. The Task Force will evaluate these matters in the context of other changes as well as specific paragraph-level comments.

Question for the ASB

21. Does the ASB have any views about the Exposure Draft and related responses that have not been addressed by this issues paper or other questions herein?

Appendix

The following is the list of the comment letters received.

1. National Association of State Boards of Accountancy (“NASBA”)
2. Lynford Graham (“Graham”)
3. Cotton & Company “(Cotton”)
4. Virginia State Auditor (“Virginia Auditor”)
5. Florida Institute of Certified Public Accountants (“Florida”)
6. Michigan Office of the Auditor General (“Michigan Auditor”)
7. New Jersey Society of CPAs (“NJ”)
8. Washington State Auditor (Washington Auditor”)
9. Texas Society of CPAs (“Texas”)
10. Carr, Riggs & Ingram (“CRI”)
11. The Virginia Society of CPAs (“Virginia”)
12. Maryland Association of Certified Public Accountants (“MACPA”)
13. RSM US LLP (“RSM”)
14. CliftonLarsonAllen LLP (“CliftonLarsen”)
15. Chuck Landes (“Landes”)
16. AICPA Technical Issues Committee (“TIC”)
17. Association of Government Accountants (“AGA”)
18. U.S. Government Accountability Office (“GAO”)
19. KPMG LLP (“KPMG”)
20. Eide Bailly LLP (Eide Bailly”)
21. BDO USA, LLP (“BDO”)
22. Anders Minkler Huber & Helm LLP (“Anders”)
23. Hunter College (“Hunter”)
24. National State Auditors Association (“NSAA”)
25. PricewaterhouseCoopers LLP (“PwC”)
26. Deloitte & Touche LLP (“Deloitte”)
27. Grant Thornton LLP (“GT”)
28. MRA Learning (“MRA”)
29. Susan Firriolo (“Firriolo”)
30. Ernst & Young LLP (“EY”)
31. Tennessee Comptroller of the Treasury (“Tennessee”)
32. Illinois CPA Society (“Illinois”)