



November 24, 2020

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

via email to [CommentLetters@aicpa-cima.com](mailto:CommentLetters@aicpa-cima.com)

Members of the Board:

On behalf of the Association of Government Accountants (AGA) the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments to the Auditing Standards Board (Board) on its August 27, 2020 exposure draft (ED) of a proposed statement on auditing standards entitled *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement*.

We appreciate the Board's efforts to clarify existing auditing standards when practice monitoring identifies deficiencies, and we agree with the majority of the ED's provisions. We have addressed our comments to each of the eleven Request for Comment questions below.

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

Response: Yes, we consider the requirements as sufficiently scalable. We ask the Board to consider expanding the application material paragraphs A150 and A151 to provide an example applicable to a very small entity. Some FMSB members are aware of extremely small clients that would benefit from such examples.

We also ask the Board to 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, unless the Board intends to expand AU-C 940 with such guidance at a later date.

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

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

Response: We consider the requirements as appropriately enhanced and clarified. The SAS provides sufficient detail to understand how the understanding is obtained and how it relates to the risk identification and assessment process. We have no suggested changes.

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

Response: We think it would be helpful to 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. This would be inclusive of significant risks and controls over journal entries to address the significant risk of management override of controls.

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

We suggest the ASB include provisions to refer to the U.S. Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government*, also known as the Green Book, 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 31 U.S.C. §3512(c), (d), commonly known as the Federal Managers' Financial Integrity Act (FMFIA), in addition to the COSO Framework.

*3. Are the enhanced requirements and application material related to the auditor's understanding of the IT environment, the identification of the risks arising from the entity's use of IT, and the identification of general IT controls clear to support the auditor's consideration of the effects of the entity's use of IT on the identification and assessment of the risks of material misstatement?*

Yes, we consider the definitions and usage in the standard as appropriate and have no suggested changes. We also agree that it is not necessary for the auditor to identify risks from the use of IT or IT general controls unless they are relevant to the engagement.

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

We support the new concepts and definitions. One area of concern is the role analytical procedures will play in the risk assessment process. We suggest the Board expand inherent risk factors in Appendix B to include factors identified by analytical procedures and other risk assessment procedures that identify potential misstatements. For example:

Change	<ul style="list-style-type: none"> <li>Significantly different reported amounts or disclosures than previous years</li> </ul>
Abnormality	<ul style="list-style-type: none"> <li>Reported or omitted balances, classes of transactions or disclosures that are unusual or unexpected for the entity's industry</li> </ul>
Abnormality (continued)	<ul style="list-style-type: none"> <li>Reported or omitted balances, classes of transactions or disclosures that are unusual or unexpected given the events, conditions or activities of the entity during the period</li> </ul>

	<ul style="list-style-type: none"> <li>• Financial statement relationships that appear to be conflicting, unusual or unexpected</li> <li>• Reported or omitted amounts or disclosures that appear to conflict with other information obtained by the auditor as part of risk assessment procedures</li> </ul>
Susceptibility to misstatement as identified by past experience, management, or others	<ul style="list-style-type: none"> <li>• Past misstatements, history of errors, or a significant amount of adjustments at period end</li> <li>• Identification by the entity (for example, as part of the entity's risk assessment process or during inquiries with entity management) as being high risk or difficult to determine</li> <li>• Concerns raised by whistleblowers or outside parties regarding potential misstatements</li> </ul>

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

Several FMSB members consider 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".

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

Yes, we consider separate assessments of inherent risk and control risk as appropriate.

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

We consider the proposed language as clear and would continue the existing requirement to assess control risk even when not planning to test the operating effectiveness of controls.

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

We consider the provision as clear. We also appreciate the application paragraph A201 as it informs auditors that evaluating the design and determining the implementation of identified controls is not the same as, and "...is not sufficient", to test the operating effectiveness of the control. It is an important concept that even though an auditor may decide to assess control risk at maximum and not test the operating effectiveness of controls, an evaluation of the design and determination of the implementation of identified controls is still necessary.

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

We agree with the revised definition with the addition of the factors noted in our response to question 4.

*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?*

Several FMSB members consider the proposed stand-back requirement as unnecessary. The definition of "material" yields results that are too similar to "significant" class of transactions,

account balances or disclosures. The existing risk assessment process is already an iterative process, requiring evaluations of whether evidence obtained is sufficient and appropriate or if additional audit procedures are necessary to support an unmodified opinion.

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

We consider the documentation requirements as appropriate and have no suggestions for improvement.

If there are any questions regarding the comments in this letter, please contact me at (517) 334-8069.

Sincerely,

*Craig M. Murray*

Craig M. Murray, CGFM, CPA, CIA  
Chair, Financial Management Standards Board

cc: Wendy Morton-Huddleston, CGFM, PMP, AGA National President

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