



National Association of State Boards of Accountancy

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Auditing Standards Board
American Institute of Certified Public Accountants (AICPA)
1345 Avenue of the Americas
New York, NY 10105

Via email: CommentLetters@aicpa-cima.com

Re: *Proposed Statement on Auditing Standards – Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*

Dear Members of the AICPA Auditing Standards Board (ASB):

The National Association of State Boards of Accountancy (NASBA) appreciates the opportunity to offer comments on the proposed Statement on Auditing Standard (SAS) – Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (the proposed SAS). NASBA’s mission is to enhance the effectiveness and advance the common interests of the Boards of Accountancy that regulate all Certified Public Accountants (CPAs) and their firms in the United States and its territories which includes all audit, attest and other services provided by CPAs. State Boards are charged by law with protecting the public.

In furtherance of that objective, NASBA offers the following comments on the requests for comment for consideration as presented in the explanatory memorandum to the proposed SAS.

Request for Comment 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?

Yes. We believe that the requirements and application material of the proposed SAS are sufficiently scalable. We agree that the scalability is not just based on the overall size of an

organization. There can be very small organizations that are complex and vice versa. We also agree that, to assist with the scalability considerations, examples and application guidance should be included throughout the standard.

Request for Comment 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?

Yes, the requirements related to the auditor's understanding of each component of the entity's system of internal control have been appropriately enhanced and clarified. The proposed SAS is clear in that understanding certain aspects of the entity's system of internal control is integral to the auditor's identification and assessment of the risks of material misstatement, regardless of the auditor's planned controls reliance strategy.

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?

Yes, the requirements related to the auditor's identification of controls that address the risks of material misstatement have been appropriately enhanced and clarified. The proposed SAS is clear that the auditor obtains an understanding of each of the components of internal control by performing risk assessment procedures and that inquiry alone is not sufficient for this purpose. Paragraph 26 of the proposed SAS has been appropriately clarified to create a list of the types of control activities that, if applicable, are relevant to the risks of material misstatement.

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

Yes. We believe that the terminology in paragraphs 21-27 and related application material of the proposed SAS is clear and capable of consistent interpretation for audits of entities that use the COSO framework.

Request for Comment 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, 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 are clear.

Request for Comment 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?

Yes, we support the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures and their relevant assertions. The guidance appears sufficient.

Request for Comment 5:

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

Yes. We support the introduction of the "spectrum of inherent risk"; however, the term is not defined in the proposed SAS. While the meaning may be implied, we recommend including a definition of the term.

Request for Comment 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 support the separate assessments of inherent and control risk in relation to all risks of material misstatement at the assertion level.

Request for Comment 7:

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

We believe that Paragraph 34 clearly states that when the operating effectiveness of controls is not tested, then the auditor's assessment of control risk should be such that the risk of material misstatement is the same as the assessment of inherent risk.

Request for Comment 8:

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

We believe that the requirement in paragraph 26d of the proposed SAS to evaluate design and determine implementation of certain control activities, including the requirement related to controls over journal entries, is sufficiently clear.

Request for Comment 9:

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

We support the revised definition and related material on the determination of significant risks. We believe it incorporates considerations of significant risks in accordance with the requirements of AU-C sections such as AU-C section 240 and paragraph .18 of AU-C section 550.

We are supportive of how significant risks are determined based on the spectrum of inherent risk. However, as previously noted, we recommend including a definition of "spectrum of inherent risk" in the proposed SAS.

Request for Comment 10:

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

We are supportive of 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.

Request for Comment 11:

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

We believe that the documentation requirements are clear and appropriate.

Other Matters:

We offer the following general comments on the proposed SAS:

- Paragraph 21 section a.1 addresses management’s tone at the top but lacks examples of how management exercises its oversight of operations. Examples might be helpful.
- Paragraph A17 states that the application of professional skepticism by the auditor may include “questioning contradictory information and the reliability of documents.” We would recommend “questioning” be replaced with “considering”. Additionally, we would recommend that “reliability of documents” be addressed in a separate sentence or paragraph because this is a thought that applies to both information and contradictory information.
- We recommend Paragraph A38 be modified to state that risk assessment procedures may include observation or inspection of the behaviors and actions of management or those charged with governance (such as the participation in an audit committee meeting). .
- Paragraph A39 provides that automated tools or techniques may also be used to observe or inspect through the use of remote observation tools such as a drone, for example. Consider adding additional examples, such as cameras or other tools. .
- Paragraphs 15 and A42 state that other sources of information should include other engagements performed for the entity by the engagement partner. We believe this should be expanded to include any information the auditor may be aware of from engagements performed by others in the engagement partner’s firm such as tax services or other permissible non-audit services.
- Paragraph A62 provides that an understanding of the entity’s organizational structure and ownership may enable the auditor to understand the distinction between the owners, those charged with governance, and management. The examples contrast less-complex entities with larger entities with diverse ownership. In some large and complex entities, there may be a group of related shareholders that control the entity with significantly less than 51percent of the outstanding shares (or control with a two-class capital structure) and who are also principal members of management. This concept might also be addressed in A62.
- Paragraph A66 details matters that may be relevant for the auditor to consider in obtaining an understanding of the governance of the entity. We recommend the inclusion of whether or not directors, or others charged with governance, are considered independent.
- Paragraph A118 explains that an appropriate control environment is not necessarily an effective deterrent to fraud and provides the example of human resources policies and procedures directed towards hiring competent personnel which may not mitigate the override of controls by “senior management.” We recommend either not using “senior management” or expanding the example of overriding controls to include persons other

than management. Persons other than management may override or not apply controls for reasons that may include impacting their compensation or bonuses.

- Paragraph A123 provides that the auditor's evaluation of the entity's risk assessment process may assist the auditor in understanding where the entity has identified risks that may occur and how the entity has responded to those risks. It is not possible to determine how an entity has responded to a risk that may occur but has not yet occurred. Perhaps the language should be changed to state that the auditor should inquire about how management would address the issue if it were to occur.

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We appreciate the opportunity to comment on the Exposure Draft.

Very truly yours,



Laurie J. Tish, CPA
NASBA Chair



Ken L. Bishop
NASBA President and CEO