



November 18, 2020

[Via electronic mail – CommentLetters@aicpa-cima.com](mailto:CommentLetters@aicpa-cima.com)

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

The members of the New Jersey Society of Certified Public Accountants (NJCPA) Accounting and Auditing Standards Interest Group (the Group) appreciate the chance to comment on the proposed Statement on Auditing Standards (SAS) referred to above. The NJCPA has a membership of over 14,000 CPAs and prospective CPAs from public practice and private industry. The Group was formed to address technical topics affecting a wide range of reporting entities. The members have reviewed the proposed standard and worked together to prepare this comment letter to the Auditing Standards Board (ASB). The following comments are based on the views of the Group and may not reflect the opinions of all NJCPA members.

Overall

The Group understands the critical importance of the auditor’s risk assessment process in a financial statement audit and recognizes the need in addressing noted deficiencies in obtaining the required understanding of internal control. The group also appreciates the initiative of the ASB to improve audit quality in this area.

The Group took considerable time in preparing these responses and has the following comments on the fundamental aspects of the proposed SAS.

Request for Comment 1 – Scalability

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

RESPONSE

The Group believes the requirements and application material of the proposed SAS are capable of being applied to all entities regardless of size and complexity. This proposed SAS is intended for audits of all entities, regardless of size or complexity; therefore, the application material incorporates considerations specific to both less and more complex entities, where appropriate. Although the size of an entity may be an indicator of its complexity, some smaller entities may be complex, and some larger entities may be less complex. It is the level of complexity in the nature of an entity and its financial reporting that is the primary driver in the application of the proposed SAS. The placement of guidance specific to less complex entities at the start of relevant sections will enable auditors of such entities to more appropriately plan their audit approach to a smaller entity.



Request for Comment 2 – III. Understanding the Entity’s System of Internal Control

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 assessment process?

RESPONSE

The Group believes the requirements related to the auditor’s understanding of each component have been appropriately enhanced and clarified. The ASB has acknowledged it continues to believe that the five components of internal control, comprising the entity’s system of internal control, remain an appropriate structure to describe the auditor’s understanding of the system of internal control. In its deliberations, the ASB agreed that the auditor needs to obtain an understanding of certain aspects of all the components, specifically whether and how they have been addressed by the entity, and has revised the requirements for each of the components to be clearer about the specific matters relating to that component that need to be understood. The proposed SAS makes it 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. In its deliberations about obtaining an understanding about the components of the system of internal control, the ASB agreed that differentiating the nature of each of the components would help the auditor recognize how the understanding provides the basis for the auditor’s identification and assessment of the risks of material misstatement.

The Group believes the requirements of the proposed SAS properly update the risk identification process and are clear.

- 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

The Group believes the requirements related to the auditor’s identification of controls that address the risks of material misstatement have been appropriately enhanced and clarified. To assist the auditor with identifying controls that address the identified risks of material misstatement, the related requirement (paragraph 26 of this proposed SAS) has been clarified to list of the types of control activities that, if applicable, the ASB believes are always relevant to the risks of material misstatement. Recognizing that entities have a wide variety of circumstances, in addition to the specifically



enumerated types of controls in this component, auditors are required to use professional judgment to determine if there are any other controls where it is necessary to evaluate their design and determine whether they have been implemented to enable the auditor to identify and assess risks of material misstatement. The Group believes these requirements of the proposed SAS properly update the risk identification process and are clear.

The Group appreciates the additional clarification that controls which address the risks of material misstatement at the assertion level are primarily direct controls, residing in the control activities component, and that the auditor may identify certain controls that address the risks of material misstatement at the assertion level in other components of the system of internal control.

- c. Given the 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 entities that use the COSO framework?

RESPONSE

The Group believes the terminology in paragraphs 21-27 and related application material of the proposed SAS are clear and capable of consistent interpretation for entities that use the COSO framework. The ASB has acknowledged it continues to believe that the five components of internal control, comprising the entity's system of internal control, remain an appropriate structure to describe the auditor's understanding of the system of internal control. The Group appreciates the ASB's focus on the COSO framework to guide auditors in documenting their understanding of the system of internal control.

Request for Comment 3 – Enhanced Guidance Related to IT

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

RESPONSE

The Group believes the enhanced requirements 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. The proposed enhancements and application material included in the new appendix E provide possible risks the auditor may consider in addressing the risk of material misstatement. The Group appreciates the application material included in the proposed SAS, and believes that this material will lead to more consistent and appropriate documentation by auditors of the IT environment as it relates to the system of internal controls.



Request for Comment 4 through 8 – IV. Identifying and Assessing the Risks of Material Misstatement

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

RESPONSE

The Group concurs with the ASB that a clearer description of the required risk identification and assessment process will help drive a more consistent and focused audit approach and will improve audit documentation.

However, the Group believes professional judgement is critical when identifying a significant transaction, account balance or disclosure, and the relevant assertions. The Group believes introducing more concepts adds to the complexity of the proposed SAS, whereas an emphasis on professional judgement, proper documentation of the determination of significant audit areas, and examples of appropriate documentation to illustrate these requirements may be more helpful.

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

RESPONSE

The Group appreciates the clarification of the spectrum of inherent risk as the combination of the likelihood of a misstatement and the magnitude of a misstatement in the assessment of inherent risk. The Group believes that, by providing a frame of reference for auditors to apply their professional judgement about the inherent risk of material misstatement, the proposed standard will facilitate greater consistency in practice.

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

RESPONSE

The Group supports consistent guidance in relation to the requirement to perform a separate assessment of all risks of material misstatement at the assertion level. Given the questions that have arisen in both AU-C Sections 540 and 315 requiring combined assessments compared to the requirements in 330 providing for separate assessments there was a clear need to be have consistency that aligns with requirements of SAS 143. However, the Group believes 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. The ASB has acknowledged that the order in which the requirements related to the identification of the risks of material misstatement are to be applied should not be prescribed. This will enable auditors to use judgement and discretion in how the assessments are applied.

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

RESPONSE

The Group believes the ASB has made it clear that if the auditor does not contemplate testing the operating effectiveness of controls, or is not required to test controls, control risk should be assessed at maximum. The Group understands the requirement to evaluate the design and implementation (D&I) of the applicable controls, regardless of the auditor's decision to test the operating effectiveness of the controls, because obtaining a sufficient understanding of D&I may affect the identification and assessment of risks of material misstatement and the nature and extent of substantive procedures.

The Group believes that 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.

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

RESPONSE

The Group believes the requirement to evaluate the design and determine implementation of certain controls, including journal entries, will impact the auditor's identification of risks and the assessment of control risk. The Group believes the auditor should apply professional judgement in determining the nature, timing, and extent of testing of journal entries. The Group believes the requirement of paragraph 26d is clear.

Request for Comment 9 – Significant Risks

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

RESPONSE



The Group supports the revised definition on the determination of significant risks. The lack of consistency noted during inspections is attributed to the current definition which has been consistently misinterpreted by practitioners. The current definition is focused on the response to a risk rather than the nature. The Group also concurs with the ASB that by revising the definition the auditor will focus on those risks that are closer to the upper end of the spectrum of inherent risk. A risk at the upper end of the spectrum would have a higher likelihood of occurrence and higher magnitude of potential misstatement.

As mentioned above the Group believes professional judgement is necessary to determine significant risk on an assertion by assertion basis.

The Group believes the determination of significant risks is a matter of professional judgement which is informed by the spectrum of inherent risk.

Request for Comment 10 – Stand-Back and Paragraph .18 of AU-C section 330

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?

RESPONSE

The Group believes the proposed stand-back requirement will enable the auditor to continue to focus on material classes of transactions, account balances or disclosures that have not been determined to be significant throughout the course of the audit. This requirement will enable the auditor to determine the completeness of the identification of risks of material misstatement. The requirement does not replace auditor judgement in determining the significance of material classes of transactions, account balances or disclosures, but instead focuses the auditor's attention on the need to continue to evaluate assessments made as new information becomes available during the performance of the audit.

Request for Comment 11 – V. Audit Documentation

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

RESPONSE

The Group believes the requirements are appropriate. Requiring key matters to be included in the audit documentation will enable the auditor to support their risk assessment and report on the financials statement. The Group believes audit documentation is particularly important and can be achieved in several ways which typically includes the use of practice aids. Audit documentation should be helpful in determining the auditor's reasoning about their conclusions. When using practice aids documentation can become redundant and fail to achieve the purpose. Audit documentation should be evaluated before being incorporated as part of audit evidence. Otherwise, the Group believes the audit documentation requirements are clear and appropriate



The Group appreciates the AICPA for requesting our professional views on the Proposed Statement on Auditing Standards. The Group would like to thank the ASB for taking the time to read this comment letter submitted on behalf of the members of the New Jersey Society of Certified Public Accountants Accounting and Auditing Standards Interest Group.

Respectfully submitted,

Accounting and Auditing Standards Interest Group
New Jersey Society of Certified Public Accountants

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