AICPA

Agenda Item 2B

The following table represents a comparison of the requirements in the proposed SAS, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* [marked from ISA 315 (Revised 2019)], extant AU-C section 315 of the same title, and selected paragraphs of PCAOB's AS 2110, *Identifying and Assessing Risks of Material Misstatements*. This comparison is not intended to be a full, comprehensive analysis of the differences between the proposed SAS, extant AU-Section 315, and AS 2110. In regard to AS 2210, this comparison only includes the relevant PCAOB paragraphs for purposes of this comparison.

Proposed SAS (marked for differences from ISA)	*Extant AU-C 315*	*AS 2110*
Introduction	**Introduction**	
Scope of this ~~ISA~~Proposed SAS	**Scope of This Section**	
1. This proposed Statement on Auditing Standards (SAS)~~International Standard on Auditing (ISA)~~ deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements.	.01 This section addresses the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements through understanding the entity and its environment, including the entity's internal control.	.01 This standard establishes requirements regarding the process of identifying and assessing risks of material misstatement[1] of the financial statements.
		.02 Paragraphs .04-.58 of this standard discuss the auditor's responsibilities for performing risk

		assessment procedures.[2] Paragraphs .59-.73 of this standard discuss identifying and assessing the risks of material misstatement using information obtained from performing risk assessment procedures.
Key Concepts in ~~this ISA~~this proposed SAS		
2. ~~ISA~~AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, addresses ~~deals with~~ the overall objectives of the auditor in conducting an audit of the financial statements,[1] including to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level.[2] Audit risk is a function of the risks of material misstatement and detection risk.[3] ~~ISA~~AU-C section 200 explains that the risks of material misstatement may exist at two levels:[4] the overall financial statement level; and the assertion level for classes of transactions, account balances and disclosures.		
3. ~~ISA~~AU-C section 200 requires the auditor to exercise professional judgment in planning and performing an audit, and to plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.[5]		
4. Risks at the financial statement level relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of material		

1 ~~ISA~~AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with* With Generally Accepted Auditing Standards~~*International Standards on Auditing*~~

2 ~~ISA~~AU-C section 200, paragraph ~~17~~19

3 ~~ISA~~AU-C section 200, paragraphs ~~13(c)~~14

4 ~~ISA~~AU-C section 200, paragraph ~~A36~~A38

5 ~~ISA~~AU-C section 200, paragraphs ~~15~~17–~~16~~ 18

misstatement at the assertion level consist of two components,[6] inherent and control risk:		
• Inherent risk is described as the susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.		
• Control risk is described as the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's system of internal control.		
5. ~~ISA~~AU-C section 200 explains that risks of material misstatement are assessed at the assertion level in order to determine the nature, timing and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence.[7] For purposes of generally accepted auditing standards (GAAS), a risk of material misstatement exists when (*a*) there is a reasonable possibility of a misstatement occurring (that is, its likelihood), and (*b*) if it were to occur, there is a reasonable possibility of the misstatement being material (that is, its magnitude).[8] For the identified risks of material misstatement at the assertion level, a separate assessment of inherent risk and control risk is required by ~~this ISA~~this proposed SAS. As explained in ~~ISA~~AU-C		

[6] Paragraph .14 of AU-C section 200.

6

[8] ~~ISA~~Paragraph .A43*a* of AU-C section 200~~,~~ and paragraph ~~A43a and ISA~~.06 of AU-C section 330, ~~*The Auditor's Responses*~~*Performing Audit Procedures in Response to Assessed Risks*~~, paragraph 6~~ *and Evaluating the Audit Evidence Obtained.*

section 200, inherent risk is higher for some assertions and related classes of transactions, account balances and disclosures than for others. The degree to which the level of inherent risk varies is referred to in ~~this ISA~~this proposed SAS as the 'spectrum of inherent risk.'		
6. Risks of material misstatement identified and assessed by the auditor include both those due to error and those due to fraud. Although both are addressed by ~~this ISA~~this proposed SAS, the significance of fraud is such that further requirements and guidance are included in ~~ISA~~AU-C section 240,[9] *Consideration of Fraud in a Financial Statement Audit,* in relation to risk assessment procedures and related activities to obtain information that is used to identify, assess and respond to the risks of material misstatement due to fraud.		
7. The auditor's risk identification and assessment process is iterative and dynamic. The auditor's understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control are interdependent with concepts within the requirements to identify and assess the risks of material misstatement. In obtaining the understanding required by this ~~ISA~~proposed SAS, initial expectations of risks may be developed, which may be further refined as the auditor progresses through the risk identification and assessment process. In addition, paragraph 37 of this ~~ISA~~proposed SAS and ~~ISA~~AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained,*[10] require the auditor to revise the risk assessments~~,~~ and modify further overall responses and further audit procedures, based on audit evidence obtained from performing further audit		

[9] ~~ISA~~AU-C section 240, *Consideration of Fraud in a Financial Statement Audit* ~~*The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*~~

[10] Paragraph .27 of AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained.*

procedures in accordance with ~~ISA~~AU-C section 330, or if new information is obtained.		
8. ~~ISA~~AU-C section 330 requires the auditor to design and implement overall responses to address the assessed risks of material misstatement at the financial [11]statement level.[12] ~~ISA~~AU-C section 330 further explains that the auditor's assessment of the risks of material misstatement at the financial statement level, and the auditor's overall responses, is affected by the auditor's understanding of the control environment. ~~ISA~~AU-C section 330 also requires the auditor to design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level.[13]		
Scalability		
9. ~~ISA~~AU-C section 200 states that some ~~ISAs~~AU-C sections include scalability considerations, which illustrate the application of the requirements to all entities regardless of whether their nature and circumstances are less complex or more complex.[14] This ~~ISA~~proposed SAS is intended for audits of all entities, regardless of size or complexity ~~and~~; therefore, the application material ~~therefore~~ incorporates ~~specific~~ considerations specific to both less and more complex entities, where appropriate. ~~While~~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.		

11

14 ~~ISA 200, paragraph~~ Paragraph .A65*a* of AU-C section 200.

Effective Date	**Effective Date**	
10. This ~~ISA~~proposed SAS is effective for audits of financial statements for periods ~~beginning~~ending on or after December 15, ~~2021~~2023.	.02 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.	
Objective	**Objective**	**Objective**
11. The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.	.03 The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and relevant assertion levels through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.	.03 The objective of the auditor is to identify and appropriately assess the risks of material misstatement, thereby providing a basis for designing and implementing responses to the risks of material misstatement.
Definitions	**Definitions**	
12. For purposes of the ~~ISA~~~~AU-C sections~~GAAS, the following terms have the meanings attributed below:	.04 For purposes of generally accepted auditing standards (GAAS), the following terms have the meanings attributed as follows:	
a. Assertions – Representations, explicit or otherwise, with respect to the recognition, measurement, presentation and disclosure of information in the financial statements which are inherent in management representing that the financial statements are prepared in accordance with the applicable financial reporting	**Assertions**. Representations by management, explicit or otherwise, that are embodied in the financial statements as used by the auditor to consider the different types of potential misstatements that may occur.	

framework. Assertions are used by the auditor to consider the different types of potential misstatements that may occur when identifying, assessing and responding to the risks of material misstatement. (Ref. Para: A1)		
b. *Business risk* – A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.	**Business risk**. A risk resulting from significant conditions, events, circumstances, actions, or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies or from the setting of inappropriate objectives and strategies.	Business risks - Risks that result from significant conditions, events, circumstances, actions, or inactions that could adversely affect a company's ability to achieve its objectives and execute its strategies. Business risks also might result from setting inappropriate objectives and strategies or from changes or complexity in the company's operations or management.
c. Controls – Policies or procedures that an entity establishes to achieve the control objectives of management or those charged with governance. In this context: (Ref: ~~Para.~~par. A2–A5)		
i. Policies are statements of what should, or should not, be done within the entity to effect control. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.		
ii. Procedures are actions to implement policies.		
d. *General information technology (IT) controls* – Controls over the entity's IT processes that support the continued proper operation of the IT environment, including the continued effective functioning of information processing controls and the integrity of information ~~(i.e., the completeness, accuracy and validity of~~		

~~information)~~ in the entity's information system. Also see the definition of IT environment. (Ref: par. A6)		
e. Information processing controls – Controls relating to the processing of information in IT applications or manual information processes in the entity's information system that directly address risks to the integrity of information (i.e., the completeness, accuracy and validity of transactions and other information). (Ref: ~~Para.~~par. A6-A7)		
f. Inherent risk factors – Characteristics of events or conditions that affect susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or other fraud risk factors15 insofar as they affect inherent risk. ~~(Ref: Para.par. A7–A8)~~ Depending on the degree to which the inherent risk factors affect the susceptibility to misstatement of an assertion, the level of inherent risk varies on a scale that is referred to as the *spectrum of inherent risk*. (Ref: par. A8–A10)		
~~*f.*~~*g.* IT environment – The IT applications and supporting IT infrastructure, as well as the IT		

[15] ~~ISA~~AU-C section 240, paragraphs ~~A24~~A28–~~A27~~A32

processes and personnel involved in those processes, that an entity uses to support business operations and achieve business strategies. For the purposes of this ~~ISA~~ definition:		
i. An IT application is a program or a set of programs that is used in the initiation, processing, recording and reporting of transactions or information. IT applications include data warehouses and report writers.		
ii. The IT infrastructure comprises the network, operating systems, and databases and their related hardware and software.		
iii. The IT processes are the entity's processes to manage access to the IT environment, manage program changes or changes to the IT environment and manage IT operations.		
~~*g.*~~ *h.* Relevant assertions – An assertion about a class of transactions, account balance or disclosure is relevant when it has an identified risk of material misstatement. A risk of material misstatement exists when (a) there is a reasonable possibility of a misstatement occurring (that is, its likelihood), and (b) if it were to occur, there is a reasonable possibility of the misstatement being material (that is, its magnitude).[16] The determination of whether an assertion is a relevant assertion is made before consideration of any related controls (i.e., the inherent risk). (~~i.e.,~~that is, the determination is based on inherent risk). (Ref: ~~Para. A9)~~par. A11)	**Relevant assertion.** A financial statement assertion that has a reasonable possibility of containing a misstatement or misstatements that would cause the financial statements to be materially misstated. The determination of whether an assertion is a relevant assertion is made without regard to the effect of internal controls. (Ref: par. .A131)	

[16] Paragraph .A15 of AU-C section 200.

~~h.~~i. Risks arising from the use of IT – Susceptibility of information processing controls to ineffective design or operation, or risks to the integrity of information (i.e., the completeness, accuracy and validity of transactions and other information) in the entity's information system, due to ineffective design or operation of controls in the entity's IT processes (see IT environment).		
~~i.~~j. Risk assessment procedures – The audit procedures designed and performed to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.	**Risk assessment procedures.** The audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and relevant assertion levels.	.A4 Risk assessment procedures - The procedures performed by the auditor to obtain information for identifying and assessing the risks of material misstatement in the financial statements whether due to error or fraud. Note: Risk assessment procedures by themselves do not provide sufficient appropriate evidence on which to base an audit opinion.
~~j.~~k. Significant class of transactions, account balance or disclosure – A class of transactions, account balance or disclosure for which there is one or more relevant assertions. (Ref: par. A12A).		
~~k.~~l. Significant *risk* – An identified risk of material misstatement: (Ref: ~~Para.~~par. A10)	**Significant risk.** An identified and assessed risk of material misstatement that, in the auditor's professional judgment, requires special audit consideration.	Significant risk - A risk of material misstatement that requires special audit consideration.
i. For which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential		

misstatement should that misstatement occur; or		
ii. That is to be treated as a significant risk in accordance with the requirements of other ~~ISA~~AU-C sections.[17]		
~~*l.*~~*m.* *System of internal control* – The system designed, implemented and maintained by those charged with governance, management and other personnel, to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. For the purposes of the ~~ISA~~AU-C sections, the system of internal control consists of five inter-related components:	**Internal control.** A process effected by those charged with governance, management, and other personnel that is designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over safeguarding of assets against unauthorized acquisition, use, or disposition may include controls relating to financial reporting and operations objectives. [fn 1]	
i. Control environment;		
ii. The entity's risk assessment process;		
iii. The entity's process to monitor the system of internal control;		
iv. The information system and communication; and		

[17] ~~ISA~~AU-C section 240, paragraph ~~27~~ 25 and ~~ISA~~AU-C section 550, *Related Parties*, paragraph 18

[fn 1] This section recognizes the definition and description of *internal control* contained in *Internal Control—Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.

v. Control activities.		
		The PCAOB also defines the following terms in Appendix A: • Company's objectives and strategies • Executive officer
Requirements	**Requirements**	
Risk Assessment Procedures and Related Activities	**Risk Assessment Procedures and Related Activities**	**Performing Risk Assessment Procedures**
13. The auditor ~~shall~~should design and perform risk assessment procedures to obtain audit evidence that provides an appropriate basis for: (Ref: ~~Para.~~par. A11–A18)	.05 The auditor should perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and relevant assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion. (Ref: par. .A1–.A5)	.04 The auditor should perform risk assessment procedures that are sufficient to provide a reasonable basis for identifying and assessing the risks of material misstatement, whether due to error or fraud,[3] and designing further audit procedures.[4]
a. The identification and assessment of risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels; and		
b. The design of further audit procedures in accordance with ~~ISA~~AU-C section 330.		
The auditor ~~shall~~should design and perform risk assessment procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards		

excluding audit evidence that may be contradictory. (Ref: ~~Para.~~par. A14)		
14. The risk assessment procedures ~~shall~~should include the following: (Ref: ~~Para.~~par. A19–A21)	.06 The risk assessment procedures should include the following:	
a. Inquiries of management and of other appropriate individuals within the entity, including individuals within the internal audit function (if the function exists). (Ref: ~~Para.~~par. A22–A26)	a. Inquiries of management, appropriate individuals within the internal audit function (if such function exists), others within the entity who, in the auditor's professional judgment, may have information that is likely to assist in identifying risks of material misstatement due to fraud or error (Ref: par. .A6–.A13)	.54 The auditor should inquire of the audit committee, or equivalent (or its chair), management, the internal audit function, and others within the company who might reasonably be expected to have information that is important to the identification and assessment of risks of material misstatement. Note: The auditor's inquiries about risks of material misstatement should include inquiries regarding fraud risks.
		.55 The auditor should use his or her knowledge of the company and its environment, as well as information from other risk assessment procedures, to determine the nature of the inquiries about risks of material misstatement.
b. Analytical procedures. (Ref: ~~Para.~~par. A27–A31)	b. Analytical procedures (Ref: par. .A14–.A17)	.46 The auditor should perform analytical procedures that are designed to: a. Enhance the auditor's understanding of the client's business and the significant transactions and events that have occurred since the prior year end; and b. Identify areas that might represent specific risks relevant to the audit, including the existence of unusual transactions and events, and amounts, ratios, and trends that warrant investigation.

		.47 In applying analytical procedures as risk assessment procedures, the auditor should perform analytical procedures relating to revenue with the objective of identifying unusual or unexpected relationships involving revenue accounts that might indicate a material misstatement, including material misstatement due to fraud. Also, when the auditor has performed a review of interim financial information in accordance with AS 4105, he or she should take into account the analytical procedures applied in that review when designing and applying analytical procedures as risk assessment procedures.
		.48 When performing an analytical procedure, the auditor should use his or her understanding of the company to develop expectations about plausible relationships among the data to be used in the procedure. When comparison of those expectations with relationships derived from recorded amounts yields unusual or unexpected results, the auditor should take into account those results in identifying the risks of material misstatement. [footnote internationally omitted]
c. Observation and inspection. (Ref: ~~Para.~~par. A32–A36)	c. Observation and inspection (Ref: par. .A18)	
Information from Other Sources		**Considering Information from the Client Acceptance and Retention Evaluation, Audit Planning Activities, Past Audits, and Other Engagements**
15. In obtaining audit evidence in accordance with		

paragraph 13, the auditor ~~shall~~should consider information from: (Ref: ~~Para.~~par. A37–A38)		
a. The auditor's procedures regarding acceptance or continuance of the client relationship or the audit engagement; and	.07 The auditor should consider whether information obtained from the auditor's client acceptance or continuance process is relevant to identifying risks of material misstatement.	.41 *Client Acceptance and Retention and Audit Planning Activities*. The auditor should evaluate whether information obtained from the client acceptance and retention evaluation process or audit planning activities is relevant to identifying risks of material misstatement. Risks of material misstatement identified during those activities should be assessed as discussed beginning in paragraph .59 of this standard.
b. When applicable, other engagements performed by the engagement partner for the entity.	.08 If the engagement partner has performed other engagements for the entity, the engagement partner should consider whether information obtained is relevant to identifying risks of material misstatement.	.44 Other Engagements. When the auditor has performed a review of interim financial information in accordance with AS 4105, Reviews of Interim Financial Information, the auditor should evaluate whether information obtained during the review is relevant to identifying risks of material misstatement in the year-end audit.
		.45 The auditor should obtain an understanding of the nature of the services that have been performed for the company by the auditor or affiliates of the firm[25] and should take into account relevant information obtained from those engagements in identifying risks of material misstatement.[26]
	.09 During planning, the auditor should consider the results of the assessment of the risk of material misstatement due to fraud [fn 2] along with other information gathered in the process of identifying the risks of	

	material misstatements.	
16. When the auditor intends to use information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, the auditor ~~shall~~should evaluate whether such information remains relevant and reliable as audit evidence for the current audit. (Ref: ~~Para.~~par. A39–A41)	.10 When the auditor intends to use information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, the auditor should determine whether changes have occurred since the previous audit that may affect its relevance to the current audit. (Ref: par. .A19–.A20)	.42 *Past Audits.* In subsequent years, the auditor should incorporate knowledge obtained during past audits into the auditor's process for identifying risks of material misstatement, including when identifying significant ongoing matters that affect the risks of material misstatement or determining how changes in the company or its environment affect the risks of material misstatement, as discussed in paragraph .08 of this standard.
		.43 If the auditor plans to limit the nature, timing, or extent of his or her risk assessment procedures by relying on information from past audits, the auditor should evaluate whether the prior years' information remains relevant and reliable.
Engagement Team Discussion		**Conducting a Discussion among Engagement Team Members Regarding Risks of Material Misstatement**
17. The engagement partner and other key engagement team members ~~shall~~should discuss the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement. (Ref: ~~Para.~~par. A42–A47)	11 The engagement partner and other key engagement team members should discuss the susceptibility of the entity's financial statements to material misstatement and the application of the applicable financial reporting framework to the entity's facts and circumstances. The engagement partner should determine which matters are to be communicated to engagement team	.49 The key engagement team members should discuss (1) the company's selection and application of accounting principles, including related disclosure requirements, and (2) the susceptibility of the company's financial statements to material misstatement due to error or fraud. Note: The key engagement team members should discuss the potential for material misstatement due to fraud either as part of the discussion regarding risks of material

	members not involved in the discussion. (Ref: par. .A21–.A23)	misstatement or in a separate discussion.28 Note: As discussed in paragraph .67, the financial statements might be susceptible to misstatement through omission of required disclosures or presentation of inaccurate or incomplete disclosures. .50 Key engagement team members include all engagement team members who have significant engagement responsibilities, including the engagement partner. The manner in which the discussion is conducted depends on the individuals involved and the circumstances of the engagement. For example, if the audit involves more than one location, there could be multiple discussions with team members in differing locations. The engagement partner or other key engagement team members should communicate the important matters from the discussion to engagement team members who are not involved in the discussion. Note: If the audit is performed entirely by the engagement partner, that engagement partner, having personally conducted the planning of the audit, is responsible for evaluating the susceptibility of the company's financial statements to material misstatement. .51 Communication among the engagement team members about significant matters affecting the risks of material misstatement should continue throughout the audit, including when conditions change. [footnote internationally omitted].

18. When there are engagement team members not involved in the engagement team discussion, the engagement partner ~~shall~~should determine which matters are to be communicated to those members.	See paragraph 11	
Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control (Ref: ~~Para.~~par. A48)	**Understanding the Entity and Its Environment, Including the Entity's Internal Control**	
Understanding the Entity and Its Environment, and the Applicable Financial Reporting Framework (Ref: ~~Para.~~par. A50–A55)		
	The Entity and Its Environment (Ref: par. .A24)	**Obtaining an Understanding of the Company and Its Environment**
19. The auditor ~~shall~~should perform risk assessment procedures to obtain an understanding of:	.12 The auditor should obtain an understanding of the following:	.07 The auditor should obtain an understanding of the company and its environment ("understanding of the company") to understand the events, conditions, and company activities that might reasonably be expected to have a significant effect on the risks of material misstatement. Obtaining an understanding of the company includes understanding:
a. a) The following aspects of the entity and its environment:		
i. The entity's organizational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT; (Ref: ~~Para.~~par. A56–A67)	b. The nature of the entity, including i. its operations; ii. its ownership and governance structures; iii. the types of investments that	[.07] b. The nature of the company;

	the entity is making and plans to make, including investments in entities formed to accomplish specific objectives; and iv. the way that the entity is structured and how it is financed, to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements. (Ref: par. .A30–.A34)	
ii. Industry, regulatory and other external factors; (Ref: ~~Para.~~par. A68–A73) and	a. Relevant industry, regulatory, and other external factors, including the applicable financial re-porting framework. (Ref: par. .A25–.A29)	[.07] a. Relevant industry, regulatory, and other external factors;
iii. The measures used, internally and externally, to assess the entity's financial performance; (Ref: ~~Para.~~par. A74–A84)	e. The measurement and review of the entity's financial performance. (Ref: par. .A43–.A48)	[.07] e. The company's measurement and analysis of its financial performance.
b. b) The applicable financial reporting framework, and the entity's accounting policies and the reasons for any changes thereto; (Ref: ~~Para.~~par. A82–A84) and		
	d. The entity's objectives and strategies and those related business risks that may result in risks of material misstatement. (Ref: par. .A36–.A42)	[7] d. The **company's objectives and strategies** and those related **business risks** that might reasonably be expected to result in risks of material misstatement
c. (c) How inherent risk factors affect susceptibility of assertions to misstatement and the degree to which they do so, in the preparation of the financial statements in accordance with		

the applicable financial reporting framework, based on the understanding obtained in (a) and (b). (Ref: ~~Para.~~par. A85–A88)		
20. The auditor ~~shall~~should evaluate whether the entity's accounting policies are appropriate and consistent with the applicable financial reporting framework.	c. The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor should evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry. (Ref: par. .A35)	[.07] c. The company's selection and application of accounting principles, including related disclosures; .12 As part of obtaining an understanding of the company's selection and application of accounting principles, including related disclosures, the auditor should evaluate whether the company's selection and application of accounting principles are appropriate for its business and consistent with the applicable financial reporting framework and accounting principles used in the relevant industry. Also, to identify and assess risks of material misstatement related to omitted, incomplete, or inaccurate disclosures, the auditor should develop expectations about the disclosures that are necessary for the company's financial statements to be presented fairly in conformity with the applicable financial reporting framework.
		.08 In obtaining an understanding of the company, the auditor should evaluate whether significant changes in the company from prior periods, including changes in its internal control over financial reporting, affect the risks of material misstatement.
Understanding the Components of the Entity's System of Internal Control (Ref: ~~Para.~~par. A89–A94)		

	The Entity's Internal Control	*Obtaining an Understanding of Internal Control Over Financial Reporting*
	.13 The auditor should obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial re-porting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit. (Ref: par. .A49–.A74)	
	Nature and Extent of the Understanding of Relevant Controls	
	.14 When obtaining an understanding of controls that are relevant to the audit, the auditor should evaluate the design of those controls and determine whether they have been implemented by performing procedures in addition to inquiry of the entity's personnel. (Ref: par. .A75–.A77)	.18 The auditor should obtain a sufficient understanding of each component of internal control over financial reporting ("understanding of internal control") to (a) identify the types of potential misstatements, (b) assess the factors that affect the risks of material misstatement, and (c) design further audit procedures. [footnote intentionally omitted]
		.19 The nature, timing, and extent of procedures that are necessary to obtain an understanding of internal control depend on the size and complexity of the company;9 the auditor's existing knowledge of the company's internal control over financial reporting; the nature of the company's controls, including the

		company's use of IT; the nature and extent of changes in systems and operations; and the nature of the company's documentation of its internal control over financial reporting. Note: The auditor also might obtain an understanding of certain controls that are not part of internal control over financial reporting, e.g., controls over the completeness and accuracy of operating or other nonfinancial information used as audit evidence.[10]
	Components of Internal Control	
Control Environment, the Entity's Risk Assessment Process and the Entity's Process to Monitor the System of Internal Control (Ref: ~~Para.~~par. A95–A97)		
Control Environment		Control Environment
21. The auditor ~~shall~~should, through performing risk assessment procedures, obtain an understanding of the control environment relevant to the preparation of the financial statements, by: (Ref: ~~Para.~~par. A98–A99)	.15 Control environment. The auditor should obtain an understanding of the control environment. As part of obtaining this understanding, the auditor should evaluate whether	.23 The auditor should obtain an understanding of the company's control environment, including the policies and actions of management, the board, and the audit committee concerning the company's control environment.
a. Understanding the set of controls, processes and structures that address: (Ref: ~~Para.~~par. A100–A101)		.24 Obtaining an understanding of the control environment includes assessing…
i. How management's oversight responsibilities are carried out, such as the entity's culture and management's commitment to integrity and ethical values;		[24] Whether management's philosophy and operating style promote effective internal control over financial reporting;

ii. When those charged with governance are separate from management, the independence of, and oversight over the entity's system of internal control by, those charged with governance;		[24] Whether the board or audit committee understands and exercises oversight responsibility over financial reporting and internal control. Note: In an audit of financial statements only, this assessment may be based on the evidence obtained in understanding the control environment, in accordance with paragraph .23, and the other relevant knowledge possessed by the auditor. In an integrated audit of financial statements and internal control over financial reporting, AS 220114 describes the auditor's responsibility for evaluating the control environment.
iii. The entity's assignment of authority and responsibility;		
iv. How the entity attracts, develops, and retains competent individuals; and		
v. How the entity holds individuals accountable for their responsibilities in the pursuit of the objectives of the system of internal control; and		
b. Evaluating, based on the auditor's understanding obtained in paragraph 21*a*, whether: (Ref: ~~Para.~~par. A103–A107)		
i. Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior;	a. management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior and	[24] Whether sound integrity and ethical values, particularly of top management, are developed and understood; and

ii. The control environment provides an appropriate foundation for the other components of the entity's system of internal control considering the nature and complexity of the entity; and	b. the strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control and whether those other components are not under-mined by deficiencies in the control environment. (Ref: par. .A78–.A88)	
iii. Control deficiencies identified in the control environment undermine the other components of the entity's system of internal control.		.25 If the auditor identifies a control deficiency[15] in the company's control environment, the auditor should evaluate the extent to which this control deficiency is indicative of a fraud risk factor, as discussed in paragraphs .65-.66 of this standard.
The Entity's Risk Assessment Process		**The Company's Risk Assessment Process**
22. The auditor ~~shall~~should, through performing risk assessment procedures, obtain an understanding of the entity's risk assessment process relevant to the preparation of the financial statements, by:	.16 The entity's risk assessment process. The auditor should obtain an understanding of whether the entity has a process for	.26 The auditor should obtain an understanding of management's process for: a. Identifying risks relevant to financial reporting objectives, including risks of material misstatement due to fraud ("fraud risks"); b. Assessing the likelihood and significance of misstatements resulting from those risks; and c. Deciding about actions to address those risks.
a. Understanding the entity's process for: (Ref: ~~Para.~~par. A108–A109)		.27 Obtaining an understanding of the company's risk assessment process includes obtaining an understanding of the risks of material misstatement identified and assessed

		by management and the actions taken to address those risks.
i. Identifying business risks, including the potential for fraud, relevant to financial reporting objectives; (Ref: ~~Para.~~par. A62)	a. identifying business risks relevant to financial reporting objectives,	
ii. Assessing the significance of those risks, including the likelihood of their occurrence; and	b. estimating the significance of the risks, c. assessing the likelihood of their occurrence, and	
iii. Addressing those risks; and	d. deciding about actions to address those risks. (Ref: par. .A89–.A90)	
b. (b) Evaluating, based on the auditor's understanding obtained in paragraph 22*a*, whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature and complexity of the entity. (Ref: ~~Para.~~par. A111–A120)		
	.17 If the entity has established a risk assessment process (referred to hereafter as the entity's risk assessment process), the auditor should obtain an understanding of it and the results thereof. If the auditor identifies risks of material misstatement that management failed to identify, the auditor should evaluate whether an underlying risk existed that the auditor expects would have been identified by the entity's risk assessment process. If such a risk exists, the auditor should obtain an	

	understanding of why that process failed to identify it and evaluate whether the process is appropriate to its circumstances or determine if a significant deficiency or material weakness exists in internal control regarding the entity's risk assessment process.	
	18 If the entity has not established such a process or has an ad hoc process, the auditor should discuss with management whether business risks relevant to financial reporting objectives have been identified and how they have been addressed. The auditor should evaluate whether the absence of a documented risk assessment process is appropriate in the circumstances or determine whether it represents a significant deficiency or material weakness in the entity's internal control. (Ref: par. .A91)	
23. If the auditor identifies risks of material misstatement that management failed to identify, the auditor ~~shall~~should:		
a. 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, obtain an understanding of why the entity's risk assessment process failed to identify such risks of material misstatement; and	See paragraph 17	
b. (b) Consider the implications for the auditor's		

evaluation in paragraph 22(b).		
The Entity's Process for Monitoring the System Of Internal Control		**Monitoring of Controls**
24.The auditor ~~shall~~should, through performing risk assessment procedures, obtain an understanding of the entity's process for monitoring the system of internal control relevant to the preparation of the financial statements, ~~through performing risk assessment procedures,~~ by: (Ref: ~~Para.~~par. A113–A114)	.23 *Monitoring of controls.* The auditor should obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting, including those related to those control activities relevant to the audit, and how the entity initiates remedial actions to deficiencies in its controls. (Ref: par. .A110–.A111)	.35 The auditor should obtain an understanding of the major types of activities that the company uses to monitor the effectiveness of its internal control over financial reporting and how the company initiates corrective actions related to its controls.[19]
a. Understanding those aspects of the entity's process that address:		
i. Ongoing and separate evaluations for monitoring the effectiveness of controls, and the identification and remediation of control deficiencies identified; (Ref: ~~Para.~~par. A115–A116) and		
ii. The entity's internal audit function, if any, including its nature, responsibilities and activities; (Ref: ~~Para.~~par. A117)	.24 If the entity has an internal audit function, [fn 3] the auditor should obtain an understanding of the nature of the internal audit function's responsibilities how the internal audit function fits in the entity's organizational structure, and the activities performed or to be performed. (Ref: par. .A113–.A120) [As amended, effective for audits of financial statements for periods ending on or after December 15,	

	2014, by SAS No. 128.]	
b. Understanding the sources of the information used in the entity's process to monitor the system of internal control, and the basis upon which management considers the information to be sufficiently reliable for the purpose; (Ref: ~~Para.~~par. A119–A120) and	25 The auditor should obtain an understanding of the sources of the information used in the entity's monitoring activities and the basis upon which management considers the information to be sufficiently reliable for the purpose. (Ref: par. .A121)	
c. (c) Evaluating, based on the auditor's understanding obtained in paragraph 24*a*-24*b*, whether the entity's process for monitoring the system of internal control is appropriate to the entity's circumstances considering the nature and complexity of the entity. (Ref: ~~Para.~~par. A121)		
Information System and Communication, and Control Activities (Ref: ~~Para.~~par. A123–A129)		**Information and Communication**
The Information System and Communication		
25. The auditor ~~shall~~should, through performing risk assessment procedures, obtain an understanding of the entity's information system and communication relevant to the preparation of the financial statements, ~~through performing risk assessment procedures,~~ by: (Ref: ~~Para.~~par. A130)	19 *The information system, including the related business processes relevant to financial reporting and communication.* The auditor should obtain an understanding of the information system, including the related business processes relevant to financial reporting, including the following areas:	.28 Information System Relevant to Financial Reporting. The auditor should obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including: Note: Appendix B discusses additional considerations regarding manual and automated systems and controls.
a. Understanding the entity's information processing activities, including its data and	a. The classes of transactions in the entity's operations that are	[28.] a. The classes of transactions in the company's operations that are significant to the

information, the resources to be used in such activities and the policies that define, for significant classes of transactions, account balances and disclosures: (Ref: ~~Para.~~par. A131–A142)	significant to the financial statements.	financial statements;
i. How information flows through the entity's information system, including how:		
a. Transactions are initiated, and how information about them is recorded, processed, corrected as necessary, incorporated in the general ledger and reported in the financial statements; and	b. The procedures within both IT and manual systems by which those transactions are initiated, authorized, recorded, processed, corrected as necessary, transferred to the general ledger, and re-ported in the financial statements.	[28.] b. The procedures, within both automated and manual systems, by which those transactions are initiated, authorized, processed, recorded, and reported;
b. Information about events and conditions, other than transactions, is captured, processed and disclosed in the financial statements;	d. How the information system captures events and conditions, other than transactions, that are significant to the financial statements.	[28.] d. How the information system captures events and conditions, other than transactions,[16] that are significant to the financial statements; and
ii. The accounting records, specific accounts in the financial statements and other supporting records relating to the flows of information in the information system;	c. The related accounting records supporting information and specific accounts in the financial statements that are used to initiate, authorize, record, process, and report transactions. This includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form.	[28.] c. The related accounting records, supporting information, and specific accounts in the financial statements that are used to initiate, authorize, process, and record transactions;
iii. The financial reporting process used to prepare the entity's financial statements, including disclosures; and	e. The financial reporting process used to prepare the entity's financial statements, including	[28.] f. The period-end financial reporting process.

	significant accounting estimates and disclosures.	
		Paragraph 28e. was intentionally omitted because it is addressed in AU-C 540.
i. The entity's resources, including the IT environment, relevant to (a)(i) to (a)(iii) above;		.29 The auditor also should obtain an understanding of how IT affects the company's flow of transactions. (See Appendix B.) Note: The identification of risks and controls within IT is not a separate evaluation. Instead, it is an integral part of the approach used to identify significant accounts and disclosures and their relevant assertions and, when applicable, to select the controls to test, as well as to assess risk and allocate audit effort.
		.B1 While obtaining an understanding of the company's information system related to financial reporting, the auditor should obtain an understanding of how the company uses information technology ("IT") and how IT affects the financial statements.1 The auditor also should obtain an understanding of the extent of manual controls and automated controls used by the company, including the IT general controls that are important to the effective operations of the automated controls. That information should be taken into account in assessing the risks of material misstatement.2
	f. Controls surrounding journal entries, including nonstandard journal entries used to record nonrecurring, unusual transactions, or adjustments. (Ref: par. .A92–	

	.A96)	
	This understanding of the information system relevant to financial reporting should include relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers. (Ref: par. A93-.A99) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 134]	
b. Understanding how the entity communicates significant matters that support the preparation of the financial statements and related reporting responsibilities in the information system and other components of the system of internal control: (Ref: ~~Para.~~par. A143–A144)	.20 The auditor should obtain an understanding of how the entity communicates financial reporting roles and responsibilities and significant matters relating to financial reporting, including	.33 *Communication.* The auditor should obtain an understanding of how the company communicates financial reporting roles and responsibilities and significant matters relating to financial reporting to relevant company personnel and others, including: ▪ Communications between management, the audit committee, and the board of directors; and ▪ Communications to external parties, including regulatory authorities and shareholders.
i. Between people within the entity, including how financial reporting roles and responsibilities are communicated;		
ii. Between management and those charged with governance; and	a. communications between management and those charged with governance and	

iii. With external parties, such as those with regulatory authorities; and	b. external communications, such as those with regulatory authorities. (Ref: par. .A97–.A98)	
c. Evaluating, based on the auditor's understanding obtained in paragraph 25*a*-25*b*, whether the entity's information system and communication appropriately support the preparation of the entity's financial statements in accordance with the applicable financial reporting framework considering the nature and complexity of the entity. (Ref: ~~Para.~~par. A144(a))		
Control activities		
26. The auditor ~~shall~~should, through performing risk assessment procedures, obtain an understanding of the control activities component, ~~through performing risk assessment procedures,~~ by applying the requirements in paragraphs 26A–26C: (Ref: ~~Para.~~par. A146–A156)	.21 *Control activities relevant to the audit.* The auditor should obtain an understanding of control activities relevant to the audit, which are those control activities the auditor judges it necessary to understand in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to assessed risks. An audit does not require an understanding of all the control activities related to each significant class of transactions, account balance, and disclosure in the financial statements or to every assertion relevant to them. However, the auditor should obtain an understanding of the process of reconciling detailed records to the general ledger for material account balances. (Ref: par. .A99–.A105)	.34 The auditor should obtain an understanding of control activities that is sufficient to assess the factors that affect the risks of material misstatement and to design further audit procedures, as described in paragraph .18 of this standard.18 As the auditor obtains an understanding of the other components of internal control over financial reporting, he or she is also likely to obtain knowledge about some control activities. The auditor should use his or her knowledge about the presence or absence of control activities obtained from the understanding of the other components of internal control over financial reporting in determining the extent to which it is necessary to devote additional attention to obtaining an understanding of control activities to assess the factors that affect the risks of material misstatement and to design further audit procedures. Note: A broader understanding of control

		activities is needed for relevant assertions for which the auditor plans to rely on controls. Also, in the audit of internal control over financial reporting, the auditor's understanding of control activities encompasses a broader range of accounts and disclosures than what is normally obtained in a financial statement audit.
26A. The auditor should ~~Identifying~~identify the following controls that address risks of material misstatement at the assertion level~~ in the control activities component as follows~~:		
a. Controls that address a risk that is determined to be a significant risk; (Ref: ~~Para.~~par. A157–A158)		.72 When the auditor has determined that a significant risk, including a fraud risk, exists, the auditor should evaluate the design of the company's controls that are intended to address fraud risks and other significant risks and determine whether those controls have been implemented, if the auditor has not already done so when obtaining an understanding of internal control, as described in paragraphs .18-.40 of this standard. [Footnote intentionally omitted] .73A The auditor should obtain an understanding of the controls that management has established to identify, authorize and approve, and account for and disclose significant unusual transactions in the financial statements, if the auditor has not already done so when obtaining an understanding of internal control, as described in paragraphs .18-.40 and .72-.73 of this standard.
b. Controls over journal entries and other		

adjustments as required by AU-C section 240[18]~~, including nonstandard journal entries used to record nonrecurring, unusual transactions, or adjustments~~ ; (Ref: ~~Para.~~par. A159–A160)		
c. Controls for which the auditor plans to test operating effectiveness in determining the nature, timing and extent of substantive ~~testing~~procedures, which ~~shall~~should include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; and (Ref: ~~Para.~~par. A161–A163)		.B6 When a company uses manual elements in internal control systems and the auditor plans to rely on, and therefore test, those manual controls, the auditor should design procedures to test the consistency in the application of those manual controls.
d. Other controls that, based on the auditor's professional judgment, the auditor considers are appropriate to enable the auditor to meet the objectives of paragraph 13 with respect to risks at the assertion level~~, based on the auditor's professional judgment~~; (Ref: ~~Para.~~par. A164)		
26B. Based on controls identified in 26A~~(a)~~, the auditor should identify~~ing~~ the IT applications and the other aspects of the entity's IT environment that are subject to risks arising from the use of IT; For such IT applications and other aspects of the IT environment identified in (b), identifying: ~~(Ref: Para.par. A165–A171)~~	.22 In understanding the entity's control activities, the auditor should obtain an understanding of how the entity has responded to risks arising from IT. (Ref: par. .A106–.A109)	.B4 The auditor should obtain an understanding of specific risks to a company's internal control over financial reporting resulting from IT. Examples of such risks include: B5 In obtaining an understanding of the company's control activities, the auditor should obtain an understanding of how the company has responded to risks arising from IT. B6 When a company uses manual elements in internal control systems and the auditor plans to rely on, and therefore test, those manual

[18] Paragraph 32(a)(i) of AU-C section 240.

		controls, the auditor should design procedures to test the consistency in the application of those manual controls.
~~For such IT applications and other aspects of the IT environment identified in (b), identifying:~~ (Ref: ~~Para.~~par. A167–A189)		
a. The related risks arising from the use of IT; and		
b. The entity's general IT controls that address such risks; and		
26C~~(d)~~ For each control identified in 26A~~(a)~~ or 26B*b*~~(c)(ii)~~, the auditor should: (Ref: ~~Para.~~par. A174–A180)		
a. ~~Evaluating~~ Evaluate whether the control is designed effectively to address the risk of material misstatement at the assertion level, or effectively designed to support the operation of other controls; and		.20 Obtaining an understanding of internal control includes evaluating the design of controls that are relevant to the audit and determining whether the controls have been implemented. Note: Procedures the auditor performs to obtain evidence about design effectiveness include inquiry of appropriate personnel, observation of the company's operations, and inspection of relevant documentation. Walkthroughs, as described in paragraphs .37-.38, that include these procedures ordinarily are sufficient to evaluate design effectiveness. Note: Determining whether a control has been implemented means determining whether the control exists and whether the company is using it. The procedures to determine whether a control has been implemented may be

		performed in connection with the evaluation of its design. Procedures performed to determine whether a control has been implemented include inquiry of appropriate personnel, in combination with observation of the application of controls or inspection of documentation. Walkthroughs, as described in paragraphs .37-.38, that include these procedures ordinarily are sufficient to determine whether a control has been implemented.
		.B5 In obtaining an understanding of the company's control activities, the auditor should obtain an understanding of how the company has responded to risks arising from IT.
b. ~~Determining~~ Determine whether the control has been implemented by performing procedures in addition to inquiry of the entity's personnel.		
Control Deficiencies Within the Entity's System of Internal Control		
27. Based on the auditor's evaluation of each of the components of the entity's system of internal control, the auditor ~~shall~~should determine whether one or more control deficiencies have been identified. (Ref: ~~Para.~~par. A181–A182)		
Identifying and Assessing the Risks of Material Misstatement	**Identifying and Assessing the Risks of Material Misstatement**	**Identifying and Assessing the Risks of Material Misstatement**
Identifying Risks of Material Misstatement		
28. The auditor ~~shall~~should identify the risks of material misstatement and determine whether they exist at: (Ref:	.26 To provide a basis for designing and performing further	.59 The auditor should identify and assess the risks of material misstatement at the financial

~~Para.~~par. A183–A191)	audit procedures, the auditor should identify and assess the risks of material misstatement at	statement level and the assertion level. In identifying and assessing risks of material misstatement, the auditor should: Note: Factors relevant to identifying fraud risks are discussed in paragraphs .65-.69 of this standard.
a. The financial statement level; (Ref: ~~Para.~~par. A192–A199) or	a. the financial statement level and (Ref: par. .A122–.A125)	
b. The assertion level for classes of transactions, account balances and disclosures. (Ref: ~~Para.~~par. A200)	b. the relevant assertion level for classes of transactions, account balances, and disclosures. (Ref: par. .A126–.A133)	
	.27 For this purpose, the auditor should a. identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, by considering the classes of transactions, account balances, and disclosures in the financial statements; (Ref: par. .A134–.A135) b. assess the identified risks and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions; c. relate the identified risks to what can go wrong at the relevant assertion level, taking account of	a. Identify risks of misstatement using information obtained from performing risk assessment procedures (as discussed in paragraphs .04-.58) and considering the characteristics of the accounts and disclosures in the financial statements. Note: Factors relevant to identifying fraud risks are discussed in paragraphs .65-.69 of this standard.

	relevant controls that the auditor intends to test; and (Ref: par. .A136–.A138) d. consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.	
29. The auditor ~~shall~~should determine the relevant assertions and the related significant classes of transactions, account balances and disclosures. (Ref: ~~Para.~~par. A201–A203)		[51.] e. Identify significant accounts and disclosures[33] and their relevant assertions[34] (paragraphs .60-.64 of this standard). Note: The determination of whether an account or disclosure is significant or whether an assertion is a relevant assertion is based on inherent risk, without regard to the effect of controls.
		Identifying Significant Accounts and Disclosures and Their Relevant Assertions
		.60 To identify significant accounts and disclosures and their relevant assertions in accordance with paragraph .59e, the auditor should evaluate the qualitative and quantitative risk factors related to the financial statement line items and disclosures. Risk factors relevant to the identification of significant accounts and disclosures and their relevant assertions include: • Size and composition of the account; • Susceptibility to misstatement due to error or fraud;

		• Volume of activity, complexity, and homogeneity of the individual transactions processed through the account or reflected in the disclosure; • Nature of the account or disclosure; • Accounting and reporting complexities associated with the account or disclosure; • Exposure to losses in the account; • Possibility of significant contingent liabilities arising from the activities reflected in the account or disclosure; • Existence of related party transactions in the account; and • Changes from the prior period in account and disclosure characteristics. .60A Additional risk factors relevant to the identification of significant accounts and disclosures involving accounting estimates include the following: a. The degree of uncertainty associated with the future occurrence or outcome of events and conditions underlying the significant assumptions; b. The complexity of the process for developing the accounting estimate; c. The number and complexity of significant assumptions associated with the process; d. The degree of subjectivity associated with significant assumptions (for example, because of significant changes in the related events and conditions or a lack of available observable inputs); and e. If forecasts are important to the estimate,

		the length of the forecast period and degree of uncertainty regarding trends affecting the forecast.
		.61 As part of identifying significant accounts and disclosures and their relevant assertions, the auditor also should determine the likely sources of potential misstatements that would cause the financial statements to be materially misstated. The auditor might determine the likely sources of potential misstatements by asking himself or herself "what could go wrong?" within a given significant account or disclosure.
		.62 The risk factors that the auditor should evaluate in the identification of significant accounts and disclosures and their relevant assertions are the same in the audit of internal control over financial reporting as in the audit of the financial statements; accordingly, significant accounts and disclosures and their relevant assertions are the same for both audits. Note: In the financial statement audit, the auditor might perform substantive auditing procedures on financial statement accounts, disclosures, and assertions that are not determined to be significant accounts and disclosures and relevant assertions.[35]
		.63 The components of a potential significant account or disclosure might be subject to significantly differing risks.
		.64 When a company has multiple locations or business units, the auditor should identify significant accounts and disclosures and their

		relevant assertions based on the consolidated financial statements.
Assessing Risks of Material Misstatement at the Financial Statement Level		
30. For identified risks of material misstatement at the financial statement level, the auditor ~~shall~~should assess the risks and: (Ref: ~~Para.~~par. A192–A199)	See paragraph 27*b*	
a. Determine whether such risks affect the assessment of risks at the assertion level; and		
b. Evaluate the nature and extent of their pervasive effect on the financial statements.		[59.] b. Evaluate whether the identified risks relate pervasively to the financial statements as a whole and potentially affect many assertions.
Assessing Risks of Material Misstatement at the Assertion Level		
Assessing Inherent Risk		
31. For identified risks of material misstatement at the assertion level, the auditor ~~shall~~should assess inherent risk by assessing the likelihood and magnitude of misstatement. In doing so, the auditor ~~shall~~should take into account how, and the degree to which: (Ref: ~~Para.~~par. A204–A216)	See paragraph 27*d*	[59] c. Evaluate the types of potential misstatements that could result from the identified risks and the accounts, disclosures, and assertions that could be affected. Note:In identifying and assessing risks at the assertion level, the auditor should evaluate how risks at the financial statement level could affect risks of misstatement at the assertion level. [59.] d. Assess the likelihood of misstatement, including the possibility of multiple misstatements, and the magnitude of potential misstatement to assess the possibility that the risk could result in material misstatement of the

		financial statements. Note: In assessing the likelihood and magnitude of potential misstatement, the auditor may take into account the planned degree of reliance on controls selected to test.32
a. Inherent risk factors affect the susceptibility of relevant assertions to misstatement; and		
b. The risks of material misstatement at the financial statement level affect the assessment of inherent risk for risks of material misstatement at the assertion level.		
	Risks That Require Special Audit Consideration	
32. The auditor ~~shall~~should determine whether any of the assessed risks of material misstatement are significant risks. (Ref: ~~Para.~~par. A217–A220)	.28 As part of the risk assessment described in paragraph .26, the auditor should determine whether any of the risks identified are, in the auditor's professional judgment, a significant risk. In exercising this judgment, the auditor should exclude the effects of identified controls related to the risk.	[51.] f. Determine whether any of the identified and assessed risks of material misstatement are significant risks (paragraphs .70-.71 of this standard).
		.70 To determine whether an identified and assessed risk is a significant risk, the auditor should evaluate whether the risk requires special audit consideration because of the nature of the risk or the likelihood and potential magnitude of misstatement related to the risk. Note: The determination of whether a risk of material misstatement is a significant risk is based on inherent risk, without regard to the

		effect of controls.
	29 In exercising professional judgment about which risks are significant risks, the auditor should con-sider at least a. whether the risk is a risk of fraud; b. whether the risk is related to recent significant economic, accounting, or other developments and, therefore, requires specific attention; c. the complexity of transactions; d. whether the risk involves significant transactions with related parties; e. the degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and f. whether the risk involves significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual. (Ref: par. .A139–.A143)	.71 Factors that should be evaluated in determining which risks are significant risks include: a. The effect of the quantitative and qualitative risk factors discussed in paragraph .60 on the likelihood and potential magnitude of misstatements; b. Whether the risk is a fraud risk; Note: A fraud risk is a significant risk. c. Whether the risk is related to recent significant economic, accounting, or other developments; d. The complexity of transactions; e. Whether the risk involves significant transactions with related parties; f. The degree of complexity or judgment in the recognition or measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and g. Whether the risk involves significant unusual transactions.
	.30 If the auditor has determined that a significant risk exists, the auditor should obtain an	.72 When the auditor has determined that a significant risk, including a fraud risk, exists, the auditor should evaluate the design of the

	understanding of the entity's controls, including control activities, relevant to that risk and, based on that understanding, evaluate whether such controls have been suitably designed and implemented to mitigate such risks. (Ref: par. .A144–.A146)	company's controls that are intended to address fraud risks and other significant risks and determine whether those controls have been implemented, if the auditor has not already done so when obtaining an understanding of internal control, as described in paragraphs .18-.40 of this standard.[36]
		.73 Controls that address fraud risks include (a) specific controls designed to mitigate specific risks of fraud, e.g., controls to address risks of intentional misstatement of specific accounts and (b) controls designed to prevent, deter, and detect fraud, e.g., controls to promote a culture of honesty and ethical behavior.37 Such controls also include those that address the risk of management override of other controls.
		.73A The auditor should obtain an understanding of the controls that management has established to identify, authorize and approve, and account for and disclose significant unusual transactions in the financial statements, if the auditor has not already done so when obtaining an understanding of internal control, as described in paragraphs .18-.40 and .72-.73 of this standard.
	Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence	
33. The auditor ~~shall~~should determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the risks of material	.31 In respect of some risks, the auditor may judge that it is not possible or practicable to obtain	

misstatement at the assertion level. (Ref: ~~Para.~~par. A221–A224)	sufficient ap-propriate audit evidence only from substantive procedures. Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions or account balances, the characteristics of which often permit highly automated processing with little or no manual intervention. In such cases, the entity's controls over such risks are relevant to the audit, and the auditor should obtain an understanding of them. (Ref: par. .A147–.A150)	
Assessing Control Risk		
34. If the auditor plans to test the operating effectiveness of controls, the auditor ~~shall~~should assess control risk. If the auditor does not plan to test the operating effectiveness of controls, the auditor's assessment of control risk ~~shall~~should be such that the assessment of the risk of material misstatement is the same as the assessment of inherent risk. (Ref: ~~Para.~~par. A225–A228)		.39 The objective of obtaining an understanding of internal control, as discussed in paragraph .18 of this standard, is different from testing controls for the purpose of assessing control risk or for the purpose of expressing an opinion on internal control over financial reporting in the audit of internal control over financial reporting. The auditor may obtain an understanding of internal control concurrently with performing tests of controls if he or she obtains sufficient appropriate evidence to achieve the objectives of both procedures. Also, the auditor should take into account the evidence obtained from understanding internal control when assessing control risk and, in the audit of internal control over financial reporting, forming an opinion about the effectiveness of internal control over financial reporting.

		[footnotes intentionally omitted]
Evaluating the Audit Evidence Obtained from the Risk Assessment Procedures		
35. The auditor ~~shall~~should 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. If not, the auditor ~~shall~~should perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis. In identifying and assessing the risks of material misstatement, the auditor ~~shall~~should take into account all audit evidence obtained from the risk assessment procedures, whether corroborative or contradictory to assertions made by management. (Ref: ~~Para.~~par. A229–A231)		
Classes of Transactions, Account Balances and Disclosures that Are Not Significant, but Which Are Material		
36. For material classes of transactions, account balances or disclosures that have not been determined to be significant classes of transactions, account balances or disclosures, the auditor ~~shall~~should evaluate whether the auditor's determination remains appropriate. (Ref: ~~Para.~~par. A232–A234)		
Revision of Risk Assessment	**Revision of Risk Assessment**	**Revision of Risk Assessment**
37. If the auditor obtains new information which is inconsistent with the audit evidence on which the auditor originally based the identification or assessments of the risks of material misstatement, the auditor ~~shall~~should revise the identification or assessment. (Ref: ~~Para.~~par. A235)	.32 The auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained. In circumstances in which the auditor	.74 The auditor's assessment of the risks of material misstatement, including fraud risks, should continue throughout the audit. When the auditor obtains audit evidence during the course of the audit that contradicts the audit evidence on which the auditor originally based his or her

	obtains audit evidence from performing further audit procedures or if new information is obtained, either of which is inconsistent with the audit evidence on which the auditor originally based the assessment, the auditor should revise the assessment and modify the further planned audit procedures accordingly. (Ref: par. .A151)	risk assessment, the auditor should revise the risk assessment and modify planned audit procedures or perform additional procedures in response to the revised risk assessments.38
Documentation	**Documentation**	
38. The auditor ~~shall~~should include in the audit documentation:[19] (Ref: ~~Para.~~par. A239–A241)	.33 The auditor should include in the audit documentation [fn 4] the	
a. The discussion among the engagement team and the significant decisions reached; in accordance with paragraphs 17 and 18;	a. discussion among the engagement team required by paragraph .11, the significant decisions reached, how and when the discussion occurred, and the audit team members who participated;	
b. Key elements of the auditor's understanding in accordance with paragraphs 19, 21, 22, 24 and 25; the sources of information from which the auditor's understanding was obtained; and the risk assessment procedures performed;	b. key elements of the understanding obtained regarding each of the aspects of the entity and its environment specified in paragraph .12 and each of the internal control components specified in paragraphs .15–.25, the sources of information from which the understanding was obtained, and the risk assessment procedures performed;	

[19] ~~ISA~~AU-C section 230, *Audit Documentation*, paragraphs 8–~~11~~12, and ~~A6~~A8–~~A7~~A9

c. The evaluation of the design of identified controls, and determination whether such controls have been implemented, in accordance with ~~the requirements~~ in paragraph 26; and		
d. The identified and assessed risks of material misstatement at the financial statement level and at the assertion level, including significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made.	c. identified and assessed risks of material misstatement at the financial statement level and at the relevant assertion level, as required by paragraph .26; and	
	d. risks identified and related controls about which the auditor has obtained an understanding as a result of the requirements in paragraphs .28–.31. (Ref: par. .A152–.A155)	