



Agenda Item 2D

Risk Assessment Supplemental Discussion Document

(distributed July 21, 2021)

The following table is provided for further discussion based on matters discussed by the Board as part of Agenda Item 2B.

Paragraph Number	Paragraph in Agenda Item 2A (July 2021)	Proposed Revised Paragraph
27b	Controls over journal entries and other adjustments, including controls over nonstandard journal entries used to record nonrecurring, unusual transactions , as required by AU-C section 240 ¹ (Ref: par. A182–A183)	Controls over journal entries and other adjustments as required by AU-C section 240 ² (Ref: par. A182–A183)
28	Based on controls identified in paragraph 27, the auditor should identify 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 the identified IT applications and other aspects of the IT environment, the auditor should identify the following: (Ref: par. A189–A200) a. the related risks arising from the use of IT, and b. the entity’s general IT controls that address such risks.	Based on controls identified in paragraph 27, the auditor should identify the IT applications and the other aspects of the entity’s IT environment that are subject to risks arising from the use of IT. NEW PARA 29: For the IT applications and other aspects of the IT environment identified in paragraph 28 , the auditor should identify the following: (Ref: par. A189–A200) a. the related risks arising from the use of IT, and b. the entity’s general IT controls that address such risks.
41a	the discussion among the engagement team and the significant decisions reached in accordance with paragraphs 17 and 18 ;	the discussion among the engagement team in accordance with paragraphs 17 and 18 and the significant decisions reached;

¹ Paragraph 32(a)(i) of AU-C section 240.

² Paragraph 32(a)(i) of AU-C section 240.

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A19 (first bullet)	<p>The application of professional skepticism by the auditor may include the following:</p> <ul style="list-style-type: none"> • Taking into account the reliability of information to be used as audit evidence 	<p>Examples of maintaining professional skepticism by the auditor include the following:</p> <ul style="list-style-type: none"> • Considering information that may be used as audit evidence
A102 (second sentence)	<p>The components of the entity's system of internal control for the purpose of this proposed SAS may not necessarily reflect how an entity designs, implements, and maintains its system of internal control, or how it may classify any particular component. Management might use an internal control framework with components that differ from the components identified in this proposed SAS, or those specified by COSO or the Green Book, when designing, implementing, and maintaining the entity's system of internal control. In some instances, management may not use a framework at all. For the purpose of an audit, the auditor may use the framework used by management or may use different terminology or frameworks to describe the various aspects of a system of internal control and their effect on the audit, provided all the components described in this proposed SAS are addressed.</p>	<p>The components of the entity's system of internal control for the purpose of this proposed SAS may not necessarily reflect how an entity designs, implements, and maintains its system of internal control, or how it may classify any particular component. Management might use an internal control framework specified by COSO, the Green Book, or another internal control framework with components that differ from the components identified in this proposed SAS when designing, implementing, and maintaining the entity's system of internal control. In some instances, management may not use a framework at all. For the purpose of an audit, the auditor may use the framework used by management or may use different terminology or frameworks to describe the various aspects of a system of internal control and their effect on the audit, provided all the components described in this proposed SAS are addressed.</p>
A105	<p>For the control environment, the entity's risk assessment process, and the entity's process to monitor the system of internal control components, the auditor's understanding includes the ongoing tasks and activities, or processes, geared to the achievement of the entity's financial reporting objectives. For the information system and communication component, the auditor's understanding includes the flows of transactions and other aspects of the entity's information-processing activities as well as the entity's communication of significant matters, as required by paragraph 25a-b. Inquiry alone may not be sufficient to obtain the required understanding of these components and to perform the evaluation required by paragraphs 21b, 22b, 24c, and 25c. Accordingly, audit evidence for the auditor's understanding and evaluation may be obtained through a combination of inquiries and other risk assessment procedures (for example, corroborating inquiries about the</p>	<p>For the control environment, the entity's risk assessment process, and the entity's process to monitor the system of internal control components, the auditor's understanding includes the ongoing tasks and activities, or processes, geared to the achievement of the entity's financial reporting objectives. For the information system and communication component, the auditor's understanding includes the flows of transactions and other aspects of the entity's information-processing activities as well as the entity's communication of significant matters, as required by paragraph 25a-b. <i>Audit evidence for the auditor's understanding and evaluations required by this proposed SAS may be obtained through a combination of inquiries and other risk assessment procedures (for example, corroborating inquiries about the entity's processes through observation or inspection of documents).</i> The auditor exercises professional judgment to</p>

	<i>entity's processes through observation or inspection of documents).</i>	<i>determine the nature and extent of the procedures to be performed to meet the requirements (see paragraph A22, A108, and A109).</i>
A167	The auditor's evaluation of whether the entity's information system and communication appropriately supports the preparation of the financial statements is based on the understanding obtained in paragraph 25a–b. The evaluation is focused on the matters included in paragraph 25c, and therefore, does not require evaluating the design or determining the implementation of individual controls within the information system and communication. Appendix C ³ sets out further considerations relating to the information system and communication component.	<p>The auditor's evaluation of whether the entity's information system and communication appropriately supports the preparation of the financial statements is based on the understanding obtained in paragraph 25a–b. The evaluation is focused on the matters included in paragraph 25c, and therefore, does not require evaluating the design or determining the implementation of individual controls within the information system and communication component. Appendix C⁴ sets out further considerations relating to the information system and communication component.</p> <p>NEW PARA A168 (Option 1 with reference to A170): <i>Controls within the information system and communication component are primarily more direct in addressing assertion-level risks but may also be indirect controls (see paragraphs A5, A106, and A141). In particular, information-processing controls, also known as transaction controls, directly support the actions to mitigate information-processing risks in an entity's business processes (see paragraphs A7-A8 and A170).</i></p> <p>NEW PARA A168 (Option 2 with additional sentence referring to A170): <i>Controls within the information system and communication component are primarily more direct in addressing assertion-level risks but may also be indirect controls (see paragraphs A5, A106, and A141). In particular, information-processing controls, also known as transaction controls, directly support the actions to mitigate information-processing risks in an entity's business processes (see paragraphs A7-A8). As described in paragraph A170, while the auditor's identification and evaluation of controls in the control activities component is focused on information-processing</i></p>

³ Paragraphs 15–16 of appendix C.

⁴ Paragraphs 15–16 of appendix C.

		<i>controls, the auditor is not required to identify and evaluate all information-processing controls related to the entity's policies that define the flows of transactions and other aspects of the entity's information-processing activities for the significant classes of transactions, account balances, and disclosures.</i>
A182 (last sentence)	How an entity incorporates information from transaction processing in the general ledger ordinarily involves the use of journal entries, whether standard or non-standard, or automated or manual. AU-C section 240 requires the auditor to obtain an understanding of the entity's financial reporting process and controls over journal entries and other adjustments, <i>including controls over nonstandard journal entries used to record significant unusual transactions in response to the risk of management override of controls.</i>	How an entity incorporates information from transaction processing in the general ledger ordinarily involves the use of journal entries, whether standard or non-standard, or automated or manual. AU-C section 240 requires the auditor to obtain an understanding of the entity's financial reporting process and controls over journal entries <i>recorded in the general ledger</i> and other adjustments <i>made in the preparation of the financial statements.</i> ⁵
References to "understanding and evaluation"		
A105	See above	See above
A112	The auditor's understanding and evaluation of the components of the entity's system of internal control provides a preliminary understanding of how the entity identifies business risks relevant to financial reporting and how it responds to them. It may also influence the auditor's identification and assessment of the risks of material misstatement in different ways (see paragraph A97). The auditor's identification and assessment of the risks of material misstatement assists the auditor in designing and performing further audit procedures, including any plans to test the operating effectiveness of controls. Examples follow:	The auditor's understanding and evaluation of the components of the entity's system of internal control <i>required by this proposed SAS</i> provides a preliminary understanding of how the entity identifies business risks relevant to financial reporting and how it responds to them. It may also influence the auditor's identification and assessment of the risks of material misstatement in different ways (see paragraph A97). The auditor's identification and assessment of the risks of material misstatement assists the auditor in designing and performing further audit procedures, including any plans to test the operating effectiveness of controls. Examples follow:
A115 (Par. A98 in ISA 315)	Because these components are foundational to the entity's system of internal control, deficiencies in their operation could have pervasive effects on the preparation of the financial statements. Therefore, the auditor's understanding and	Because these components are foundational to the entity's system of internal control, deficiencies in their operation could have pervasive effects on the preparation of the financial statements. Therefore, the auditor's understanding and

⁵ Paragraph 32a(i) of AU-C section 240.

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	<p>evaluations of these components affect the auditor's identification and assessment of risks of material misstatement at the financial statement level and may also affect the identification and assessment of risks of material misstatement at the assertion level (see paragraphs A119, A128, and A139). Risks of material misstatement at the financial statement level affect the auditor's design of overall responses, including, as explained in AU-C section 330, an influence on the nature, timing, and extent of the auditor's further procedures.⁶</p>	<p>evaluations of these components required by this proposed SAS affect the auditor's identification and assessment of risks of material misstatement at the financial statement level and may also affect the identification and assessment of risks of material misstatement at the assertion level (see paragraphs A119, A128, and A139). Risks of material misstatement at the financial statement level affect the auditor's design of overall responses, including, as explained in AU-C section 330, an influence on the nature, timing, and extent of the auditor's further procedures.⁷</p>
A119	<p>The auditor's evaluation of how the entity demonstrates behavior consistent with the entity's commitment to integrity and ethical values; whether the control environment provides an appropriate foundation for the other components of the entity's system of internal control; and whether identified control deficiencies undermine the other components of the system of internal control, assists the auditor in identifying potential issues in the other components of the system of internal control . This is because the control environment is foundational to the other components of the entity's system of internal control. This evaluation may also assist the auditor in understanding risks faced by the entity and, therefore, in identifying and assessing the risks of material misstatement at the financial statement and assertion levels (see paragraph A112). The auditor may also identify control deficiencies in the control environment, the severity of which may be indicative of a fraud risk factor. In addition, the auditor's understanding and evaluation of the control environment may influence the controls the auditor might identify in accordance with paragraphs 27–28 based on the auditor's knowledge of the presence or absence of such controls in other components.</p>	<p>The auditor's evaluation of how the entity demonstrates behavior consistent with the entity's commitment to integrity and ethical values; whether the control environment provides an appropriate foundation for the other components of the entity's system of internal control; and whether identified control deficiencies undermine the other components of the system of internal control, assists the auditor in identifying potential deficiencies in the other components of the system of internal control . This is because the control environment is foundational to the other components of the entity's system of internal control. This evaluation may also assist the auditor in understanding risks faced by the entity and, therefore, in identifying and assessing the risks of material misstatement at the financial statement and assertion levels (see paragraph A112). The auditor may also identify control deficiencies in the control environment, the severity of which may be indicative of a fraud risk factor. In addition, the auditor's understanding and evaluation of the control environment required by this proposed SAS may influence the controls the auditor might identify in accordance with paragraphs 27–28 based on the auditor's knowledge of the presence or absence of such controls in other components.</p>
A142	<p>The auditor is required to understand the entity's information system and</p>	<p>No change</p>

⁶ Paragraphs .A1–.A3 of AU-C section 330.

⁷ Paragraphs .A1–.A3 of AU-C section 330.

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(Para. A124 in ISA 315)	communication because understanding the flows of transactions and other aspects of the entity's information-processing activities relevant to the preparation of the financial statements, and evaluating whether the component appropriately supports the preparation of the entity's financial statements, supports the auditor's identification and assessment of risks of material misstatement at the assertion level. This understanding and evaluation may also result in the identification of risks of material misstatement at the financial statement level when the results of the auditor's procedures are inconsistent with expectations about the entity's system of internal control that may have been set based on information obtained during the engagement acceptance or continuance process (see paragraph A112).	
A144 (header) (Para. A126 in ISA 315)	The Iterative Nature of the Auditor's Understanding and Evaluation of the Information System and Communication, and Control Activities	No change
A145 (Para. A127 of ISA 315)	The auditor's understanding of the information system includes understanding the policies that define flows of information relating to the entity's significant classes of transactions, account balances, and disclosures, and other related aspects of the entity's information-processing activities. This information and the information obtained from the auditor's evaluation of the information system may confirm or further influence the auditor's expectations about the significant classes of transactions, account balances, and disclosures initially identified (see paragraph A144).	The auditor's understanding of the information system includes understanding the policies that define flows of information relating to the entity's significant classes of transactions, account balances, and disclosures, and other related aspects of the entity's information-processing activities. This information and the information obtained from the auditor's evaluation of the information system and communication component required by this proposed SAS may confirm or further influence the auditor's expectations about the significant classes of transactions, account balances, and disclosures initially identified (see paragraph A144).
A232	Risks of material misstatement are assessed at the assertion level for significant classes of transactions, account balances, or disclosures in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. An approach to identifying and assessing risks of material misstatement may begin at the financial statement level and, with the auditor's overall understanding through risk assessment procedures, work down to	Risks of material misstatement are assessed at the assertion level for significant classes of transactions, account balances, or disclosures in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. An approach to identifying and assessing risks of material misstatement may begin at the financial statement level and, with the auditor's overall understanding through risk assessment

	<p>significant classes of transactions, account balances, and disclosures and their relevant assertions. Further, determining the significant classes of transactions, account balances, and disclosures provides the basis for the scope of the auditor's understanding of the entity's information system required to be obtained in accordance with paragraph 25a. As described in paragraph A145, the information obtained from the auditor's understanding and evaluation of the information system may confirm or further influence the auditor's expectations about the significant classes of transactions, account balances, and disclosures initially identified. This understanding may further assist the auditor in identifying and assessing risks of material misstatement (see paragraph A97).</p>	<p>procedures, work down to significant classes of transactions, account balances, and disclosures and their relevant assertions. Further, determining the significant classes of transactions, account balances, and disclosures provides the basis for the scope of the auditor's understanding of the entity's information system required to be obtained in accordance with paragraph 25a. As described in paragraph A145, the information obtained from the auditor's understanding and evaluation of the information system and communication component required by this proposed SAS may confirm or further influence the auditor's expectations about the significant classes of transactions, account balances, and disclosures initially identified. This understanding may further assist the auditor in identifying and assessing risks of material misstatement (see paragraph A97).</p>
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Other references that use the phrase “auditor’s evaluation”

The following includes a list of other paragraphs that refer to the “auditor’s evaluation.” The Task Force does not propose changes to this reference, as appropriate context is provided within the related requirement(s) or application guidance.

- Paragraph 23
- Paragraph 30 (this is a requirement)
- Paragraph A119
- Paragraph A120 (and header)
- Paragraph A124
- Paragraph A128 (and header)
- Paragraph A129
- Paragraph A139
- Paragraph A140
- Paragraph A167
- Paragraph A209
- Paragraph A224
- Paragraph A256
- AU-C section 540, Paragraph A10
- AU-C section 540, Paragraph A35