



Agenda Item 2

Proposed SAS, Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment

Objective of Agenda Item

To vote to approve as a final standard the proposed SAS, *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment*. This proposed SAS has been revised to take into consideration the issues identified in the comment letters received in response to the exposure draft and the feedback provided by the Auditing Standards Board (ASB or the Board) at the January, March, May, and July meetings.

Task Force

The Task Force members are as follows:

- Maria Manasses–GT, Chair (succeeded Tracy Harding)
- Diane Hardesty–EY
- Kathy Healy–PwC
- Susan Jones–KPMG
- April King–RSM
- Tania Sergott–Deloitte
- Dan Wernke–Clark Schaefer Hackett

Agenda Materials

Agenda Item 2: Cover Memo

Agenda Item 2A: Proposed SAS, *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment*, **marked from ASB meeting**

Agenda Item 2B: Proposed SAS, *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment*, **clean**

Agenda item 2C: Comparison Matrix of Requirement Paragraphs, which includes the proposed SAS marked from ISA 315 (Revised 219), extant AU-C section 315, and AS 2110, *Identifying and Assessing the Risks of Material Misstatement*

Agenda item 2D: Draft of Executive Summary

Ms. Manasses will use Item 2A in leading the discussion.

July ASB Meeting

The ASB discussed the proposed SAS, which had been revised to take into consideration the issues identified in the comment letters received in response to the Exposure Draft and the feedback received from the ASB to date. . During the July 2021 meeting, the ASB performed a detailed review of the proposed standard (paragraph by paragraph) and provided further suggestions and refinements to the proposed SAS. A supplemental document was provided during that meeting where the ASB agreed to the following proposed revisions:

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. Error! Reference source not found. – Error! Reference source not found.)	Controls over journal entries and other adjustments as required by AU-C section 240 ² (Ref: par. Error! Reference source not found. – Error! Reference source not found.)
A105 [Now A104]	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	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</i>

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

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

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

	<p><i>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></p>	<p><i>processes through observation or inspection of documents). The auditor exercises professional judgment to determine the nature and extent of the procedures to be performed to meet the requirements (see paragraph A22, A108, and A109).</i></p>
<p>A167</p>	<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 Error! Reference source not found.a–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 C³ sets out further considerations relating to the information system and communication component.</p>	<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 Error! Reference source not found.a–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><i>A166. 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, Error! Reference source not found., and Error! Reference source not found.). 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 Error! Reference source not found., while the auditor's identification and evaluation of controls in the control activities component as required by paragraph 30 is focused on information-processing 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></p>

³ Paragraphs 15–16 of appendix C.

⁴ Paragraphs 15–16 of appendix C.

Matter for the Attention of the ASB

Because the July meeting included a detailed discussion of the proposed SAS, the purpose of the August meeting is to discuss any fatal flaws and to vote on the proposed standard.

One issue that was discussed at the July meeting, for which the task force is reporting back has to do with the use of “relevant assertion level.” The following describes the background that was discussed at the July meeting:

The proposed SAS requires the auditor to assess the risks of material misstatements at the financial statement level and at the assertion level for classes of transactions, account balances, and disclosures. In this regard, inherent risk and control risk are assessed for relevant assertions. This is consistent with ISA 315 (Revised 2019). Extant AU-C section 315 requires the auditor to assess the risks of material misstatement at the *relevant* assertion level. The use of the term “relevant assertion level” has been used in GAAS since SAS Nos. 104 – 111 were issued by the ASB in 2006 (see Appendix A to this cover memo). The use of the term “relevant assertion level” has been identified as an issue by the Task Force because at the time SAS No. 143, *Auditing Accounting Estimates*, was issued, it aligned the term with extant AU-C section 315. This term is also prevalent within the AICPA Audit and Accounting Guides.

To address this issue, the Board discussed an approach in which the term “relevant assertion level” is retained in GAAS for various reasons, including to avoid potential confusion and unnecessary cost of revision. The Board supported an approach of including application material to explain the use of the term “relevant assertion level” in GAAS. Accordingly, , the Task Force suggests including the following sentence in paragraph .A231:

Assessed risks of material misstatement for the relevant assertions and the related significant classes of transactions, account balances, and disclosures are also referred to as “risks of material misstatement at the relevant assertion level.”

In addition, the Task Force reviewed how the term “relevant assertion level” was used throughout GAAS (see Appendix A to this cover memo). Based on input from the Board, when the term is used in the context of identifying and assessing the risks of material misstatement, the Task Force changed it to “assertion level.” When the term is used in the context of the assessed risks or responding to the assessed risks of material misstatement, the Task Force retained the term “relevant assertion level.”

Questions for the Board

Does the Board have any fatal flaw changes to the proposed SAS?

Does the Board agree with the task force’s conclusions related to the use of the term “relevant assertion level” as discussed herein?

Use of “Relevant Assertion Level” in GAAS

The following table summarizes references to “relevant assertion level” within GAAS by AU-C section. It includes the proposed disposition of such references. As discussed with the Board at the July ASB meeting, the Task Force evaluated each reference to “relevant assertion level” within GAAS. Generally, those references that pertain to either assessed risks or further audit procedures were retained.

AU-C Section	Paragraph	Disposition
200	<p>.A45 The assessment of the risks of material misstatement may be expressed in quantitative terms, such as percentages or nonquantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made. GAAS do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the risks of material misstatement. However, section 540, <i>Auditing Accounting Estimates and Related Disclosures</i>,^{fn 16} requires a separate assessment of inherent risk and control risk to provide a basis for designing and performing further audit procedures to respond to the assessed risks of material misstatement, including significant risks, for accounting estimates at the relevant assertion level in accordance with section 330, <i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i>.^{fn 17} In identifying and assessing risks of material misstatement for significant classes of transactions, account balances, or disclosures other than accounting estimates, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]</p>	No change proposed; further audit procedures are in the context of relevant assertions

^{fn 16} Paragraph .15 of section 540, *Auditing Accounting Estimates and Related Disclosures*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

^{fn 17} Paragraph .07b of section 330. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
300	<p>.09 The auditor should develop an audit plan that includes a description of the following:</p> <p><i>a.</i> The nature and extent of planned risk assessment procedures, as determined under section 315, <i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i></p> <p><i>b.</i> The nature, timing, and extent of planned further audit procedures at the relevant assertion level, as determined under section 330, <i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i></p>	No change proposed; further audit procedures are in the context of relevant assertions
300	<p>.A24 The documentation of the audit plan is a record of the planned nature, timing, and extent of risk assessment procedures and further audit procedures at the relevant assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programs or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.</p>	Recommend no change, even though this refers to risk assessment procedures, it is not necessary to change this reference, as the intent is that “at the relevant assertion level” is also in the context of further audit procedures
315	<p>.27 For this purpose, the auditor should</p> <p><i>a.</i> 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 (including the quantitative and qualitative aspects of such disclosures) in the financial statements; (Ref: par. .A139–.A143)</p> <p><i>b.</i> assess the identified risks and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;</p> <p><i>c.</i> relate the identified risks to what can go wrong at the relevant assertion level, taking account of relevant controls that the auditor intends to test; and</p>	To be superseded by the proposed SAS
315	<p>.33 The auditor should include in the audit documentation^{fn 4} the</p> <p><i>a.</i> 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;</p>	To be superseded by the proposed SAS

^{fn 4} Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 128, January 2015.]

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
	<p><i>b.</i> 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;</p> <p><i>c.</i> identified and assessed risks of material misstatement at the financial statement level and at the relevant assertion level, as required by paragraph .26; and</p>	
315	<p>.A130 Risks of material misstatement at the relevant assertion level for classes of transactions, account balances, and disclosures need to be considered because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence. In identifying and assessing risks of material misstatement at the relevant assertion level, the auditor may conclude that the identified risks relate more pervasively to the financial statements as a whole and potentially affect many relevant assertions.</p>	To be superseded by the proposed SAS
330	<p>Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Relevant Assertion Level</p>	No change proposed; further audit procedures are in the context of relevant assertions
330	<p>.06 The auditor should 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 relevant assertion level and in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory. When evaluating audit evidence with respect to the assessed risks of material misstatement, the auditor maintains professional skepticism, including when considering information that may be used as audit evidence and what procedures would be appropriate in the circumstances. (Ref: par. .A4–.A9) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142.]</p>	No change proposed; further audit procedures are in the context of relevant assertions
330	<p>.07 In designing the further audit procedures to be performed, the auditor should</p> <p><i>a.</i> consider the reasons for the assessed risk of material misstatement at the relevant assertion level for each class of transactions, account balance, and disclosure, including</p> <p><i>i.</i> the likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (the inherent risk) and</p>	No change proposed; further audit procedures are in the context of relevant assertions

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
	<p>ii. whether the risk assessment takes account of relevant controls (the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (that is, the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures), and (Ref: par. .A10–.A19)</p> <p>b. obtain more persuasive audit evidence the higher the auditor’s assessment of risk. (Ref: par. .A20)</p>	
330	<p>.08 The auditor should design and perform tests of controls to obtain sufficient appropriate audit evidence about the operating effectiveness of relevant controls if</p> <p>a. the auditor’s assessment of risks of material misstatement at the relevant assertion level includes an expectation that the controls are operating effectively (that is, the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures) or</p> <p>b. substantive procedures alone cannot provide sufficient appropriate audit evidence at the relevant assertion level. (Ref: par. .A21–.A26)</p>	No change proposed; further audit procedures are in the context of relevant assertions
330	<p>.20 The auditor should use external confirmation procedures for accounts receivable, except when one or more of the following is applicable: (Ref: par. .A55)</p> <p>a. The overall account balance is immaterial.</p> <p>b. External confirmation procedures for accounts receivable would be ineffective. (Ref: par. .A54 and .A56)</p> <p>c. The auditor’s assessed level of risk of material misstatement at the relevant assertion level is low, and the other planned substantive procedures address the assessed risk. In many situations, the use of external confirmation procedures for accounts receivable and the performance of other substantive procedures are necessary to reduce the assessed risk of material misstatement to an acceptably low level.</p>	No change proposed; further audit procedures (in this case, external confirmation procedures) are in the context of relevant assertions
330	<p>.22 If the auditor has determined that an assessed risk of material misstatement at the relevant assertion level is a significant risk, the auditor should perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures should include tests of details. (Ref: par. .A58–.A59)</p>	No change proposed; further audit procedures are in the context of relevant assertions

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
330	.27 Based on the audit procedures performed and the audit evidence obtained, the auditor should evaluate, before the conclusion of the audit, whether the assessments of the risks of material misstatement at the relevant assertion level remain appropriate. (Ref: par. .A74–.A75)	No change proposed, consistent with other AU-C section 330 references
330	.30 The auditor should include in the audit documentation ^{fn 5} <i>a.</i> the overall responses to address the assessed risks of material misstatement at the financial statement level and the nature, timing, and extent of the further audit procedures performed; <i>b.</i> the linkage of those procedures with the assessed risks at the relevant assertion level ; and <i>c.</i> the results of the audit procedures, including the conclusions when such conclusions are not otherwise clear. (Ref: par. .A77)	No change proposed; further audit procedures are in the context of relevant assertions
330 (Application material)	Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the relevant assertion level	No change proposed; further audit procedures are in the context of relevant assertions
330	.A4 The auditor’s assessment of the identified risks at the relevant assertion level provides a basis for considering the appropriate audit approach for designing and performing further audit procedures. For example, the auditor may determine that <i>a.</i> in addition to the substantive procedures that are required for all relevant assertions, in accordance with paragraph .18, an effective response to the assessed risk of material misstatement for a particular assertion can be achieved only by also performing tests of controls. <i>b.</i> performing only substantive procedures is appropriate for particular assertions, and therefore, the auditor excludes the effect of controls from the relevant risk assessment. This may be because the auditor’s risk assessment procedures have not identified any effective controls relevant to the assertion or because testing controls would be inefficient, and therefore, the auditor does not intend to rely on the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures.	No change proposed; further audit procedures are in the context of relevant assertions

^{fn 5} Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
	<i>c.</i> a combined approach using both tests of controls and substantive procedures is an effective approach.	
330	.A8 Designing and performing further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion level provides a clear linkage between the auditor’s further audit procedures and the risk assessment.	No change proposed; further audit procedures are in the context of relevant assertions
330	.A25 In some cases, the auditor may find it impossible to design effective substantive procedures that, by themselves, provide sufficient appropriate audit evidence at the relevant assertion level . ^{fn 9} This may occur when an entity conducts its business using IT and no documentation of transactions is produced or maintained, other than through the IT system. In such cases, paragraph .08 <i>b</i> requires the auditor to perform tests of relevant controls.	No change proposed; further audit procedures are in the context of relevant assertions
330	.A31 <i>Extent of tests of controls.</i> When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control. In addition to the degree of reliance on controls, matters the auditor may consider in determining the extent of tests of controls include the following: <ul style="list-style-type: none"> • The frequency of the performance of the control by the entity during the period • The length of time during the audit period that the auditor is relying on the operating effectiveness of the control • The expected rate of deviation from a control • The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the relevant assertion level • The extent to which audit evidence is obtained from tests of other controls related to the relevant assertion <p>However, the rate of expected deviation may indicate that obtaining audit evidence from the performance of tests of controls will not be sufficient to reduce the control risk at the relevant assertion level. If the rate of expected deviation is expected to be high, tests of controls for a</p>	No change proposed; further audit procedures are in the context of relevant assertions

^{fn 9} Paragraph .31 of section 315.

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
	particular assertion may not provide sufficient appropriate audit evidence. Section 530, <i>Audit Sampling</i> , contains further guidance on the extent of testing.	
330	<p>.A36 <i>Using audit evidence obtained during an interim period (Ref: par. .12).</i> Relevant factors in determining what additional audit evidence to obtain about controls that were operating during the period remaining after an interim period, include the following:</p> <ul style="list-style-type: none"> • The significance of the assessed risks of material misstatement at the relevant assertion level • The specific controls that were tested during the interim period and the results of those tests • Significant changes to the controls since they were tested, including changes in the information system, processes, and personnel • The degree to which audit evidence about the operating effectiveness of those controls was obtained • The length of the remaining period • The extent to which the auditor intends to reduce further substantive procedures based on the reliance of controls • The effectiveness of the control environment 	No change proposed; further audit procedures are in the context of relevant assertions
330	<p>.A44 The concept of effectiveness of the operation of controls recognizes that some deviations in the way controls are applied by the entity may occur. Deviations from prescribed controls may be caused by such factors as changes in key personnel, significant seasonal fluctuations in volume of transactions, and human error. The detected rate of deviation, in particular, in comparison with the expected rate, may indicate that the control cannot be relied on to reduce risk at the relevant assertion level to that assessed by the auditor.</p>	No change proposed; further audit procedures are in the context of relevant assertions
330	<p>.A77 The auditor’s conclusion of whether sufficient appropriate audit evidence has been obtained is both at the relevant assertion level as well as the financial statement level. Section 500 enables the auditor to evaluate the results of audit procedures to inform the auditor’s overall conclusion about whether sufficient appropriate audit evidence has been obtained as required by paragraph .28. The auditor’s professional judgment about what constitutes sufficient appropriate audit evidence is influenced by the following additional factors:</p>	No change proposed; further audit procedures are in the context of relevant assertions

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
	<ul style="list-style-type: none"> • Significance of the potential misstatement in the relevant assertion and the likelihood of its having a material effect, individually or aggregated with other potential misstatements, on the financial statements (see section 450, Evaluation of Misstatements Identified During the Audit) • Effectiveness of management’s responses and controls to address the risks • Experience gained during previous audits with respect to similar potential misstatements • Whether the audit procedures that were performed identified specific instances of fraud or error • Understanding of the entity and its environment, including its internal control <p>[Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142.]</p>	
500	<p>.A2 Paragraph .02 states that this section should be read in conjunction with other AU-C sections. For example, the objective of section 330 is for the auditor to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement through designing and implementing appropriate responses to those risks. ^{fn 9} Section 330 also states that the auditor is required to do the following:</p> <ul style="list-style-type: none"> • 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 relevant assertion level. ^{fn 10} • Obtain more persuasive audit evidence the higher the auditor’s assessment of risk. ^{fn 11} • Conclude whether sufficient appropriate audit evidence has been obtained. ^{fn 12} 	No change proposed; further audit procedures are in the context of relevant assertions

^{fn 9} Paragraph .03 of section 330.

^{fn 10} [Paragraph .06](#) of section 330.

^{fn 11} [Paragraph .07b](#) of section 330.

^{fn 12} [Paragraph .28](#) of section 330.

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
	<ul style="list-style-type: none"> Attempt to obtain further audit evidence if the auditor has not obtained sufficient appropriate audit evidence about a relevant assertion.^{fn 13} <p>In addition, section 700, <i>Forming an Opinion and Reporting on Financial Statements</i>, requires the auditor to conclude whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. The conclusions required by section 700 take into account, among other things, whether sufficient appropriate audit evidence has been obtained in accordance with section 330.^{fn 14}</p>	
505	<p>.03 Other AU-C sections recognize the importance of external confirmations as audit evidence; for example</p> <ul style="list-style-type: none"> section 330 discusses the auditor’s responsibility (a) to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level and (b) 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 relevant assertion level.^{fn 3} In addition, section 330 requires that, irrespective of the assessed risks of material misstatement, the auditor design and perform substantive procedures for all relevant assertions related to each material class of transactions, account balance, and disclosure.^{fn 4} The auditor is required to consider whether external confirmation procedures are to be performed as substantive audit procedures and is required to use external confirmation procedures for accounts receivable unless <ul style="list-style-type: none"> the overall account balance is immaterial, external confirmation procedures would be ineffective, or 	<p>No change proposed; further audit procedures are in the context of relevant assertions</p> <p>However, there is an additional conforming amendment to align with the changes related to material classes of transactions, account balances, and disclosures (see Agenda Item 2A).</p>

^{fn 13} [Paragraph .29](#) of section 330.

^{fn 14} [Paragraph .13a](#) of section 700.

^{fn 3} Paragraphs .05–.06 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

^{fn 4} Paragraph .18 of section 330.

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
	— the auditor’s assessed level of risk of material misstatement at the relevant assertion level is low, and the other planned substantive procedures address the assessed risk. ^{fn 5}	
520	<p><i>Evaluation of Whether the Expectation Is Sufficiently Precise (Ref: par. .05c)</i></p> <p>.A21 In evaluating whether the expectation is sufficiently precise when performing a substantive analytical procedure, it is appropriate for the auditor to take into account whether substantive analytical procedures are the only substantive procedures planned to address a particular risk of misstatement at the relevant assertion level or whether the risk will be addressed through a combination of substantive analytical procedures and tests of details. A less precise expectation may be appropriate when evidence obtained from performing the substantive analytical procedure will be combined with audit evidence from performing tests of details. A more precise expectation, however, is necessary when the substantive analytical procedure is the only procedure planned to address a particular risk of misstatement for a relevant assertion.</p>	No change proposed; further audit procedures are in the context of relevant assertions
540	<p>.04 Section 315 requires the auditor to assess the risk of material misstatement at the relevant assertion level. For this purpose, this section requires inherent risk and control risk to be assessed separately for accounting estimates. Depending on the nature of a particular accounting estimate, the susceptibility of an assertion to a misstatement that could be material may be subject to or affected by estimation uncertainty, complexity, subjectivity, or other inherent risk factors, and the interrelationship among them. As explained in section 200, <i>Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards</i>, ^{fn 2} inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. Accordingly, the assessment of inherent risk depends on the degree to which the inherent risk factors affect the likelihood or magnitude of misstatement and varies on a scale that is referred to in this section as the <i>spectrum of inherent risk</i>. In assessing control risk, the auditor takes into account whether the auditor’s further audit procedures contemplate planned reliance on the operating</p>	No change proposed; risk is assessed for relevant assertions, and further audit procedures are in the context of relevant assertions

^{fn 5} Paragraphs .19–.20 of section 330.

^{fn 2} Paragraph .A42 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
	effectiveness of controls. If the auditor does not perform tests of controls, the auditor’s assessment of the risk of material misstatement at the relevant assertion level cannot be reduced for the effective operation of controls with respect to the particular assertion. (Ref: par. .A8–.A10, .A65–.A66, and app. A)	
540	.06 This section emphasizes that the auditor’s further audit procedures (including, when appropriate, tests of controls) need to be responsive to the reasons for the assessed risks of material misstatement at the relevant assertion level , taking into account the effect of one or more inherent risk factors and the auditor’s assessment of control risk.	No change proposed; risk is assessed for relevant assertions
540	.15 In identifying and assessing the risks of material misstatement relating to an accounting estimate and related disclosures at the relevant assertion level , as required by section 315, ^{fn 5} the auditor should separately assess inherent risk and control risk. The auditor should take the following into account in identifying the risks of material misstatement and assessing inherent risk: (Ref: par. .A64–.A71)	Suggest removing “relevant” since this refers to identifying as well as assessing
540	17 As required by section 330, ^{fn 8} the auditor’s further audit procedures should be responsive to the assessed risks of material misstatement at the relevant assertion level , ^{fn 9} considering the reasons for the assessment given to those risks. The auditor’s further audit procedures should include one or more of the following approaches: <i>a.</i> Obtaining audit evidence from events occurring up to the date of the auditor’s report (see paragraph .20 of this section) <i>b.</i> Testing how management made the accounting estimate (see paragraphs .21–.26 of this section) <i>c.</i> Developing an auditor’s point estimate or range (see paragraphs .27–.28 of this section)	No change proposed; further audit procedures are in the context of relevant assertions

^{fn 5} Paragraphs .26–.27 of section 315.

^{fn 8} Paragraphs .06–.15 and .18 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

^{fn 9} Paragraphs .06–.07 and .22 of section 330.

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
	The auditor’s further audit procedures should take into account that the higher the assessed risk of material misstatement, the more persuasive the audit evidence needs to be. ^{fn 10} The auditor should design and perform further audit procedures in a manner that is not biased toward obtaining audit evidence that may be corroborative or toward excluding audit evidence that may be contradictory. (Ref: par. .A81–.A84)	
540	.18 As required by section 330, ^{fn 11} the auditor should design and perform tests to obtain sufficient appropriate audit evidence about the operating effectiveness of relevant controls, if <i>a.</i> the auditor’s assessment of risks of material misstatement at the relevant assertion level includes an expectation that the controls are operating effectively, or <i>b.</i> substantive procedures alone cannot provide sufficient appropriate audit evidence at the relevant assertion level . In relation to accounting estimates, the auditor’s tests of such controls should be responsive to the reasons for the assessment given to the risks of material misstatement. In designing and performing tests of controls, the auditor should obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control. ^{fn 12} (Ref: par. .A85–.A89)	No change proposed; risk is assessed for relevant assertions, and further audit procedures are in the context of relevant assertions
540	.31 The auditor should design and perform further audit procedures to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement at the relevant assertion level for disclosures related to an accounting estimate, including those procedures related to estimation uncertainty addressed in paragraphs .25 <i>b</i> and .28 <i>b</i> .	No change proposed; risk is assessed for relevant assertions
540	.33 In applying section 330 to accounting estimates, ^{fn 16} the auditor should evaluate, based on the audit procedures performed and audit evidence obtained, whether (Ref: par. .A137–.A138)	No change proposed, consistent with how this is used in AU-C section 330

^{fn 10} Paragraph .07*b* of section 330.

^{fn 11} Paragraph .08 of section 330.

^{fn 12} Paragraph .09 of section 330.

^{fn 16} Paragraphs .27–.28 of section 330.

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
	<p><i>a.</i> the assessments of the risks of material misstatement at the relevant assertion level remain appropriate, including when indicators of possible management bias have been identified;</p> <p><i>b.</i> management’s decisions relating to the recognition, measurement, presentation, and disclosure of these accounting estimates in the financial statements are in accordance with the applicable financial reporting framework; and</p> <p><i>c.</i> sufficient appropriate audit evidence has been obtained.</p>	
540	<p>.38 The auditor should include the following in the audit documentation: ^{fn 22} (Ref: par. .A148–.A151)</p> <p><i>a.</i> Key elements of the auditor’s understanding of the entity and its environment, including the entity’s internal control related to the entity’s accounting estimates</p> <p><i>b.</i> The linkage of the auditor’s further audit procedures with the assessed risks of material misstatement at the relevant assertion level, ^{fn 23} taking into account the reasons given to the assessment of those risks</p> <p><i>c.</i> The auditor’s responses when management has not taken appropriate steps to understand and address estimation uncertainty</p> <p><i>d.</i> Indicators of possible management bias related to accounting estimates, if any, and the auditor’s evaluation of the implications for the audit, as required by paragraph .32</p> <p><i>e.</i> Significant judgments relating to the auditor's determination of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework or are misstated</p>	No change proposed; further audit procedures are in the context of relevant assertions
540	<p>.A10 An important consideration for the auditor in assessing control risk at the relevant assertion level is the effectiveness of the design of the controls that the auditor intends to rely on and the extent to which the controls address the assessed inherent risks at the relevant assertion level. The auditor’s evaluation that controls are effectively designed and have been implemented supports an expectation about the operating effectiveness of the controls in determining whether to test them.</p>	No change proposed; risk is assessed for relevant assertions

^{fn 22} Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

^{fn 23} Paragraph .30*b* of section 330.

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
540	.A64 Identifying and assessing risks of material misstatement at the relevant assertion level relating to accounting estimates includes not only accounting estimates that are recognized in the financial statements but also those that are included in the notes to the financial statements.	Suggest removing “relevant” since this refers to identifying as well as assessing
540	.A65 Section 200 ^{fn 38} states that GAAS do not ordinarily refer to inherent risk and control risk separately. However, this section requires a separate assessment of inherent risk and control risk to provide a basis for designing and performing further audit procedures to respond to the risks of material misstatement, including significant risks, at the relevant assertion level for accounting estimates in accordance with section 330. ^{fn 39} See paragraphs .A148–.A149 of this section for discussion about documentation of inherent risk factors.	No change proposed; further audit procedures are in the context of relevant assertions
540	.A66 As discussed in paragraph .04 of this section, section 200 ^{fn 40} explains that inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. In identifying the risks of material misstatement and in assessing inherent risk, the auditor is required to take into account the degree to which the accounting estimate is subject to or affected by estimation uncertainty, complexity, subjectivity, or other inherent risk factors. The auditor’s consideration of the inherent risk factors may also provide information to be used in determining the following: <ul style="list-style-type: none"> • Where inherent risk is assessed on the spectrum of inherent risk • The reasons for the assessment given to the risks of material misstatement at the relevant assertion level, and that the auditor’s further audit procedures in accordance with paragraph .18 of this section are responsive to those reasons The interrelationships between the inherent risk factors are further explained in appendix A.	No change proposed; risk is assessed for relevant assertions, and further audit procedures are in the context of relevant assertions

^{fn 38} Paragraph .A44 of section 200.

^{fn 39} Paragraph .07b of section 330.

^{fn 40} Paragraph .A42 of section 200.

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
540	<p>.A67 The reasons for the auditor’s assessment of inherent risk at the relevant assertion level may result from one or more of the inherent risk factors of estimation uncertainty, complexity, subjectivity, or other inherent risk factors. Examples follow:</p> <ul style="list-style-type: none"> • Accounting estimates of expected credit losses are likely to be complex because the expected credit losses cannot be directly observed and may require the use of a complex model. The model may use a complex set of historical data and assumptions about future developments in a variety of entity-specific scenarios that may be difficult to predict. Accounting estimates for expected credit losses are also likely to be subject to high estimation uncertainty and significant subjectivity in making judgments about future events or conditions. Similar considerations apply to insurance contract liabilities. • An accounting estimate for an obsolescence provision for an entity with a wide range of different inventory types may require complex systems and processes but may involve little subjectivity, and the degree of estimation uncertainty may be low, depending on the nature of the inventory. • Other accounting estimates may not be complex to make but may have high estimation uncertainty and require significant judgment, for example, an accounting estimate that requires a single critical judgment about a liability, the amount of which is contingent on the outcome of the litigation. 	No change proposed; risk is assessed for relevant assertions
540	<p>.A70 Events occurring after the date of the financial statements may provide additional information relevant to the auditor’s assessment of the risks of material misstatement at the relevant assertion level. For example, the outcome of an accounting estimate may become known during the audit. In such cases, the auditor may assess or revise the assessment of the risks of material misstatement at the relevant assertion level,^{fn 41} regardless of the degree to which the accounting estimate was subject to or affected by estimation uncertainty, complexity, subjectivity, or other inherent risk factors. Events occurring after the date of the financial statements also may influence the auditor’s selection of the approach to testing the accounting estimate in accordance with paragraph .18. For example, for a simple bonus accrual that is based on a straightforward percentage of compensation for selected employees, the auditor may</p>	No change proposed; risk is assessed for relevant assertions

^{fn 41} Paragraph .32 of section 315.

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
	conclude that there is relatively little complexity or subjectivity in making the accounting estimate and, therefore, may assess inherent risk at the relevant assertion level at the lower end of the spectrum of inherent risk. The payment of the bonuses subsequent to period-end may provide sufficient appropriate audit evidence regarding the assessed risks of material misstatement at the relevant assertion level .	
540	<p>.A88 Circumstances when risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence at the relevant assertion level may exist include</p> <ul style="list-style-type: none"> • when controls are necessary to mitigate risks relating to the initiation, recording, processing, or reporting of information obtained from outside of the general and subsidiary ledgers. • information supporting one or more assertions is electronically initiated, recorded, processed, or reported. This is likely to be the case when there is a high volume of transactions or data, or a complex model is used, requiring the extensive use of IT to ensure the accuracy and completeness of the information. A complex expected credit loss provision may be required for a financial institution or utility entity. For example, in the case of a utility entity, the data used in developing the expected credit loss provision may comprise many small balances resulting from a high volume of transactions. In these circumstances, the auditor may conclude that sufficient appropriate audit evidence cannot be obtained without testing controls around the model used to develop the expected credit loss provision. <p>In such cases, the sufficiency and appropriateness of the audit evidence may depend on the effectiveness of controls over the accuracy and completeness of the information.</p>	No change proposed; further audit procedures are in the context of relevant assertions
540	<p>.A149 In documenting the linkage of the auditor’s further audit procedures with the assessed risks of material misstatement at the relevant assertion level, in accordance with section 330, this section requires that the auditor take into account the reasons given to the risks of material misstatement at the relevant assertion level. Those reasons may relate to one or more inherent risk factors or the auditor’s assessment of control risk. However, the auditor is not required to document how every inherent risk factor was taken into account in identifying and assessing the risks of material misstatement in relation to each accounting estimate.</p>	No change proposed; risk is assessed for relevant assertions, and further audit procedures are in the context of relevant assertions

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
540	<p>.A152, Appendix A— Inherent Risk Factors</p> <p>Introduction</p> <p>1. In identifying, assessing, and responding to the risks of material misstatement at the relevant assertion level for an accounting estimate and related disclosures, this section requires the auditor to take into account the degree to which the accounting estimate is subject to estimation uncertainty; the degree to which the selection and application of the methods, assumptions, and data used in making the accounting estimate; and the degree to which the selection of management’s point estimate and related disclosures for inclusion in the financial statements are affected by complexity, subjectivity, or other inherent risk factors.</p>	Suggest removing “relevant” since this refers to identifying as well as assessing
610	<p>.A20 In accordance with section 330, the external auditor is required to design and perform further audit procedures whose nature, timing, and extent are based on, and responsive to, the assessed risks of material misstatement at the relevant assertion level.^{fn 9} Further audit procedures comprise tests of controls and substantive procedures. Procedures planned or performed by the internal audit function may be the same as, or be similar to, the further audit procedures that the external auditor would design and perform. Accordingly, subject to the requirements of this section, the external auditor may determine that it is appropriate to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of further audit procedures to be performed directly by the external auditor. The internal audit function may have performed, or may be planning to perform</p> <ul style="list-style-type: none"> • tests of relevant controls upon which the external auditor intends to rely in determining the nature, timing, and extent of substantive procedures. For example, the work of the internal audit function may include tests of relevant controls that address the risks of material misstatement related to the completeness of accounts payable. The results of the internal audit function’s tests may provide evidence about the effectiveness of controls and, accordingly, the external auditor may be able to use such tests of controls performed by the internal audit function to modify the nature or timing, or reduce the extent of, testing of controls the external auditor would otherwise have performed directly. 	No change proposed; further audit procedures are in the context of relevant assertions

^{fn 9} Paragraph .06 of section 330.

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
	<ul style="list-style-type: none"> • substantive procedures. For example, the internal audit function, as part of its work, may confirm certain accounts receivable and observe certain physical inventories. By using such work of the internal audit function in obtaining audit evidence, the external auditor may be able to change the timing of the confirmation procedures, the number of accounts receivable to be confirmed, or the number of locations of physical inventories to be observed. <p>The internal audit function’s plan may also include procedures related to financial information of components of a group. The external auditor may coordinate work with the internal auditors (in accordance with paragraph .20 of this section) and reduce the number of the entity's components at which the external auditor would otherwise need to perform audit procedures in accordance with the requirements of section 600, <i>Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)</i>.</p>	
620	<p>.A5 An auditor’s specialist may be needed to assist the auditor in one or more of the following:</p> <ul style="list-style-type: none"> • Obtaining an understanding of the entity and its environment, including its internal control • Identifying and assessing the risks of material misstatement • Determining and implementing overall responses to assessed risks at the financial statement level • Designing and performing additional audit procedures to respond to assessed risks at the relevant assertion level, which may comprise tests of controls or substantive procedures • Evaluating the sufficiency and appropriateness of audit evidence obtained in forming an opinion on the financial statements 	No change proposed; further audit procedures are in the context of relevant assertions
703	<p>.20 When designing and performing audit procedures, the auditor should consider relevant plan provisions that affect the risk of material misstatement at the relevant assertion level for classes of transactions, account balances, and disclosures. (Ref: par. .A25–.A28)</p>	No change proposed with respect to “relevant;” further audit procedures are in the context of relevant assertions.

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
		However, modified to refer to “significant” classes of transactions, account balances, and disclosures.
703	.A18 Section 300, <i>Planning an Audit</i> , requires the auditor to establish an overall audit strategy that sets the scope, timing, and direction of the audit and that guides the development of the audit plan. ^{fn 20} The audit plan should include a description of the nature and extent of planned risk assessment procedures as determined under section 315; the nature, timing, and extent of planned further audit procedures at the relevant assertion level as determined under section 330; and other planned audit procedures that are required to be carried out so that the engagement complies with GAAS. ^{fn 21}	No change proposed; further audit procedures are in the context of relevant assertions
703	.A20 Section 315 requires the auditor to 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. ^{fn 23} The consideration of risks of material misstatement at the relevant assertion level for classes of transactions, account balances, and disclosures directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence.	Suggest deleting the first reference to “relevant” as it also refers to identification of risks at the assertion level. No change proposed with respect to the second reference to “relevant;” further audit procedures are in the context of relevant assertions. However, modified to refer to “significant” classes of

^{fn 20} Paragraph .07 of section 300, *Planning an Audit*.

^{fn 21} Paragraph .09 of section 300.

^{fn 23} Paragraph .05 of section 315.

Risk Assessment Issues Paper
ASB Meeting, August 18, 2021

AU-C Section	Paragraph	Disposition
		transactions, account balances, and disclosures.
703	.A21 Section 330 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 relevant assertion level . ^{fn 24} Further audit procedures consist of tests of the operating effectiveness of controls and substantive procedures. Additionally, section 330 requires the auditor to evaluate whether the overall presentation of the financial statements, including the related disclosures, is in accordance with the applicable financial reporting framework. ^{fn 25}	No change proposed; further audit procedures are in the context of relevant assertions
703	.A27 Because of the nature of ERISA plan engagements, it would be rare for the auditor, based upon the assessed risks of material misstatement at the relevant assertion level , not to test any relevant plan provisions.	No change proposed; risk is assessed for relevant assertions, and further audit procedures are in the context of relevant assertions
703	.A153 Paragraph .20 of this section requires the auditor to consider relevant plan provisions that affect the risk of material misstatement at the relevant assertion level for classes of transactions, account balances, and disclosures when designing and performing audit procedures. The relevant plan provisions will vary for each type of plan and the circumstances of each engagement. When designing audit procedures, the testing of relevant plan provisions may be coordinated among the various audit areas to which they relate.	No change proposed with respect to “relevant;” further audit procedures are in the context of relevant assertions. However, modified to refer to “significant” classes of transactions, account balances, and disclosures.

^{fn 24} Paragraph .06 of section 330.

^{fn 25} Paragraph .26 of section 330.