



At a glance

From the Audit & Attest Standards Team

Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

What happened?

Deficiencies in the auditor's risk assessment procedures are a common issue identified by practice monitoring programs in the United States and worldwide. In 2020 U.S. peer reviews, the currently effective AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, was the leading source of *matters for further consideration*.

In October 2021, the AICPA Auditing Standards Board (ASB) issued Statement on Auditing Standards No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

SAS No. 145 supersedes SAS No. 122, as amended, section 315 of the same title, and amends various AU-C sections in *AICPA Professional Standards*.

What is changing?

SAS No. 145, for example, enhances the following:

- requirements and guidance related to obtaining an understanding of the entity's system of internal control and assessing control risk; and
- guidance that addresses the economic, technological, and regulatory aspects of the markets and environment in which entities and audit firms operate.

SAS No. 145 also includes revised and new requirements and guidance, including the following:

- a revised definition of significant risk;
- revised requirements to evaluate the design of certain controls within the control activities component, including general information technology (IT) controls, and to determine whether such controls have been implemented;
- a new requirement to separately assess inherent risk and control risk;

SAS No. 145 does not fundamentally change the key concepts underpinning audit risk. Rather, it clarifies and enhances certain aspects of the identification and assessment of the risks of material misstatement to drive better risk assessments and, therefore, enhance audit quality.

- a new requirement to assess control risk at the maximum level such that, if the auditor does not plan to test the operating effectiveness of controls, the assessment of the risk of material misstatement is the same as the assessment of inherent risk;
- a new "stand-back" requirement intended to drive an evaluation of the completeness of the auditor's identification of significant classes of transactions, account balances, and disclosures;
- revised requirements relating to audit documentation;
- new guidance on scalability; and
- new guidance on maintaining professional skepticism.

Next steps?

SAS No. 145 is effective for audits of financial statements for periods ending on or after December 15, 2023. Early implementation is permitted.

SAS No. 145 is available for auditors to read and consider in order to adequately prepare for implementation, and can be viewed on the AICPA's website by clicking [here](#).