

November 20, 2020

Attn: CommentLetters@aicpa-cima.com

Re: Proposed Statement on Auditing Standards – Understanding the Entity and Assessing the Risks of Material Misstatement

The views expressed herein are written on behalf of the Professional Standards Committee (PSC) of the Texas Society of CPAs. The PSC has been authorized by the Texas Society of CPAs' Board of Directors to submit comments on matters of interest to the membership. The views expressed in this document have not been approved by the Texas Society of CPAs' Board of Directors or Executive Board and, therefore, should not be construed as representing the views or policy of the Texas Society of CPAs. Please find our responses below to the amendments proposed in the above-referenced exposure draft.

Request for Comments:

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

Response: The PSC believes that the proposal does not appear to provide adequate scalability for small entities, such as those with too few employees to prevent adequate segregation of duties. The current and proposed risk assessment requirements are an unnecessary burden for the auditor and an excessive fee burden for the client. The goal appears to be satisfaction of peer review requirements rather than to add value to the audit process. Cost benefit should be considered as compared to the required extent of risk assessments performed. If the auditor has knowledge that there is not an effective system of internal control in place, then inherent risk would be assessed as high. In this case, risk assessment procedures should be minimal, but documented sufficiently, and audit procedures would be performed to mitigate the high inherent risk.

2. Do the proposals made relating to the auditor's understanding of the entity's system of internal control assist with understanding the nature and extent of the work effort required and the relationship of the work effort to the identification and assessment of the risks of material misstatement?

Specifically: a. Have the requirements related to the auditor's understanding of each component of the entity's system of internal control been appropriately enhanced and clarified? Is it clear why the understanding is obtained and how this informs the risk identification and assessment process?

Response: The PSC thinks that the requirements related to each component of the entity's system of internal control needs additional clarification. There appears to be only minor enhancements in wording of the requirements. Currently, peer review results indicate a lack of risk assessment documentation. Therefore, the proposed guidance should place greater emphasis on the requirements to document risk assessment procedures and correlation to actual audit procedures. Auditors of small entities have a challenge with risk assessment of separation of duties and with assessing independence. The PSC believes that this proposed SAS will not improve this issue for audits of small

privately owned companies. While the proposed SAS has clarified requirements, the information provided in this proposal would be vague to those practitioners who do not perform many audits.

b. Have the requirements related to the auditor's identification of controls that address the risks of material misstatement been appropriately enhanced and clarified? Is it clear how controls that addressed the risks of material misstatement are identified, particularly for audits of smaller and less complex entities?

Response: The proposed SAS does not clarify the risk of material misstatement to the users of the audited financial statements. Auditor responsibility is to the users of the financial statements; therefore, audit procedures should be developed in consideration of users' needs.

c. Given that COSO's 2013 Internal Control—Integrated Framework (COSO framework) is often used by entities subject to the AICPA's generally accepted auditing standards, is the terminology in paragraphs 21–27 and related application material of the proposed SAS clear and capable of consistent interpretation for audits of entities that use the COSO framework?

The PSC thinks that the terminology provided in paragraphs 21-27 is clear and provides consistent interpretation for audits of entities that use the COSO framework. However, the material provided does not reference or consider the 2017 Enterprise Risk Management Integrated Framework, which focuses on an entity's consideration of risks, including inherent risk.

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

Response: The PSC believes that the enhanced requirements and application materials provided regarding the IT environment provides consideration for clients using canned software and allows auditors to reduce assessment and related procedures for those software products.

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

Response: The PSC supports the inclusion of definitions of significant classes of transactions, account balances, and disclosures and relevant assertions. The more information provided to practitioners regarding relevancy of assertions and how assertions are determined, the higher the probability that material misstatements will be detected.

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

Response: The PSC supports the introduction of the spectrum of inherent risk into the proposed SAS. The PSC thinks that different inherent risks exist for different audit areas and should be considered for the entity as a whole, as well as specific areas of the financial statements.

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

Response: The PSC supports separate assessments of inherent risk at entity level and at the assertion level.

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

Response: The PSC thinks that conclusions about control risk must be documented, even if the auditor plans the audit assuming no reliance on internal controls. There should be a direct correlation between the risk assessment and audit work, with consideration given to the size and complexity of the entity.

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

Response: The PSC thinks that the provided clarification in paragraph 26d is improved but thinks that additional emphasis would be helpful. Internal control over journal entries is a common problem in entities of all sizes and is an area that needs additional guidance. Therefore, any guidance and clarification would be helpful.

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

Response: The PSC thinks that the revised definition and related material on determination of significant risks needs simpler language in order to improve understandability and consistent application. It would be helpful to include definitions of material risk vs. significant risk.

10. What are your views about the proposed stand-back requirement in paragraph 36 of the proposed SAS and the conforming amendments proposed to paragraph .18 of AU-C section 330?

Response: The PSC thinks that the stand-back requirement in paragraph 36 is necessary at the conclusion of audit procedures in order to review work performed in its entirety. Auditors should document evaluation of any high-level evaluation performed. Paragraph 36 should be expanded to clarify evaluation of financial statements with regard to material vs. significant audit observations.

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

Response: The PSC thinks that the clarity and appropriateness of the documentation requirements are somewhat improved but could benefit from further enhancements. Specific issues of concerns were identified in the responses to the questions put forth for comment.

We appreciate the opportunity to provide input into the standards-setting process.

Sincerely,

A handwritten signature in black ink, appearing to read "Lyle C. Joiner". The signature is written in a cursive style with a prominent flourish at the end.

Lyle C. Joiner  
Chair, Professional Standards Committee  
Texas Society of Certified Public Accountants