

*new york state society of*

**NYSSCPA**

*certified public accountants*

530 fifth avenue, new york, ny 10036-5101  
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November 21, 2003

Office of the Secretary  
PCAOB  
1666 K Street, N.W.  
Washington, DC 20006-2803

By e-mail: [comments@pcaobus.org](mailto:comments@pcaobus.org)

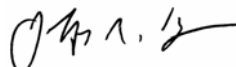
Re: Proposed Auditing Standard – An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements

PCAOB Release No. 2003-017  
PCAOB Rulemaking Docket Matter No. 008

The New York State Society of Certified Public Accountants, the oldest state accounting association, representing approximately 30,000 CPAs, welcomes the opportunity to comment on the Proposed Auditing Standard referenced above.

The NYSSCPA Auditing Standards and Procedures Committee deliberated the Exposure Draft and, with assistance from the Technology Assurance Committee, prepared the attached comments. If you would like additional discussion with the committee, please contact Margaret Wood, chair of the Auditing Standards and Procedures Committee, at (212) 542-9528, or Robert Colson, NYSSCPA staff, at (212) 719-8350.

Sincerely,



Jeffrey R. Hoops  
President

Attachment

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**COMMENTS ON PCAOB PROPOSED AUDITING STANDARD**

**An Audit of Internal Control over Financial Reporting Performed in  
Conjunction with an Audit of Financial Statements**

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November 21, 2003

**Principal Drafters**

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## **General Comments**

The proposed rules appropriately integrate the audits of internal control over financial reporting with the audits of financial statements. The proposed rules are clearly written. They provide understandable guidance on the conduct of an audit of internal control over financial reporting. See the specific comments that follow for responses to the Board's request for feedback on 31 specific questions.

## **Specific Comments**

### **Question 1.**

It is appropriate to characterize the auditor's attestation of management's assessment of the effectiveness of internal control as an audit of internal controls over financial reporting. Currently, professional standards distinguish between auditing standards and other attestation standards for agreed-upon procedures and other non-financial statement engagements. Attestation standards generally indicate a level of assurance less than an audit. Labeling the engagement covered in these proposed rules something other than an "audit" would lead to additional problems with the expectations gap. The intent of the proposed rules implies a level of assurance consistent with an audit.

### **Question 2.**

The two functions identified in this question are integral. Although they can be separate, the requirement that the auditor opine on the financial statements virtually requires that the same auditor has performed the audit of the internal controls over financial reporting because the integrity of the internal controls leads to the integrity of the financial reports.

### **Question 3.**

The audit of internal controls over financial reporting is not sufficient to ensure that the financial statements are free from material misstatements that would only be detected by the completion of an audit of the financial statements. Paragraph 15 of the proposed rules identifies circumstances where a circumvention of internal controls would only be discovered by a complete financial statement audit.

### **Question 4.**

Appendix E provides an excellent discussion of the nature of internal controls over financial reporting in small and medium-size companies. Nonetheless, the contents of Appendix E are not adequately addressed in the situations covered in Appendix B or in the section on Performing an Audit of Internal Control over Financial Reporting.

**Question 5.**

It would be inappropriate to specify competence or experience levels within a specific standard because such a practice would promote a “check list” mentality whereby procedures could be narrowly defined to allow the letter of the law to be followed but the spirit violated. Rather, competence and experience should be covered in a general standard, and auditors should be assigned according to the knowledge and skills needed for a specific engagement. In fulfillment of any such general standard, it would not be appropriate for an inexperienced auditor to have primary responsibility for activities such as the one identified in the question.

**Question 6.**

The auditor must evaluate management’s assessment and directly obtain evidence about the effectiveness of internal over financial reporting in order to satisfy audit and legal requirements. The latter is required because the auditor must have such direct evidence in order to express the opinion required by the proposed rules. The former is required because the statute and SEC regulations on which the proposed rules are based require assurance concerning management’s assessment process. Nonetheless, the auditor must take care to not simply re-perform the same tests of internal control that are in management’s assessment.

**Question 7.**

Yes, it is appropriate that the PCAOB provide such criteria.

**Question 8.**

Paragraphs 46 and 47 of the proposed rules appropriately deal with this question. Paragraph 46 indicates that there could be varying degrees of inadequate documentation. The determination of whether an inadequacy of documentation should rise to the level of a significant deficiency or a material weakness should be left to the judgment of the auditor based on the definitions in paragraphs 7 – 9.

**Question 9.**

It is clear that the proposed rules require a walkthrough. The proposed rules should be clarified to ensure that the walkthrough commences at the boundary event that starts the transaction and follows its processing through the system to the financial statements. Such a complete walkthrough will require different skills for different tasks, and special attention will be necessary to ensure that a walkthrough is performed through the IT system as well as through controls around the IT system.

**Question 10.**

Walkthroughs should be performed by members of the audit team, with specialists performing those aspects of walkthroughs that demand special knowledge, with particular attention to IT knowledge and skills.

**Question 11.**

While the auditor should be encouraged to use all knowledge gained from previous experience with the client's internal control over financial reporting in the planning and implementation of the current year's audit, it remains necessary to perform test in each period to obtain sufficient, competent evidence that the system is functioning properly.

**Question 12 and Question 13.**

The criteria listed in paragraphs 103 – 106 of the proposed rules are appropriate for guiding the auditor's use of the work of management and others.

**Question 14.**

Paragraph 108 – 110, along with the examples in Appendix B (B20 and B23), gives the appropriate recognition to the degree of reliance on the work of internal auditors.

**Question 15.**

The auditor should be given flexibility in determining the extent that re-performance of management's tests of internal control over financial reporting is necessary. Paragraph 109 appropriately requires the auditor perform enough testing himself or herself so the auditor's own work provides the principal evidence.

**Question 16.**

Yes, although some may want more guidance on what constitutes "principal evidence."

**Question 17.**

The definitions in paragraphs 8 and 9 use terms familiar to accountants from SFAS 5, *Accounting for Contingencies*. The definitions improve the standards as compared to what is in current use. In the final analysis, there will always be subjective judgments, but the proposed definitions will increase the consistency in the evaluation of deficiencies.

**Question 18.**

- The examples in Appendix D are helpful. Other examples include:
- Lack of documentation of one of the five components of internal control.
  - Access rights that allow personnel to change accounting records without detection.
  - Weak password controls.
  - Weak or non-existent security controls over critical IT assets that are pervasive to internal control.

**Question 19.**

Yes, otherwise the auditor would not have an adequate basis for determining whether a deficiency was a significant deficiency or a material weakness.

**Question 20.**

The auditors should communicate all identified internal control deficiencies to management in writing.

**Question 21.**

Paragraphs 126 and 127, and the examples in Appendix D, appropriately classify strong indicators that a material weakness in internal control exists. It would be helpful for the Board to update paragraph 126 and Appendix D on a periodic basis.

**Question 22.**

There is an inherent conflict of interest when the auditors evaluate the effectiveness of the audit committee that hires them.

**Question 23.**

The auditor is not in a position to effectively evaluate the effectiveness of the audit committee's oversight. This is a responsibility that rests with the company's board of directors, the SEC, or some other body that is not in the employ of the audit committee.

**Question 24.**

Withdrawal from an audit of internal control over financial reporting should result only after the auditor determines that management, the audit committee, and the board does not respond appropriately to identified material weaknesses.



**Question 25.**

Yes. The alternative would be confusing if not misleading.

**Question 26.**

No. "Except for" opinions would result in further confusion.

**Question 27.**

The auditor should speak directly to the effectiveness of internal control over financial reporting in the opinion.

**Question 28.**

Independence is a foundational concept for auditors. Guidance on independence should come in a separate document.

**Question 29.**

This question addresses independence issues, and it should be addressed separately in an independence standard.

**Question 30.**

It is appropriate to require a different level of work at the quarter than at year end; however, the proposed rules appropriately require the auditor to obtain an understanding of, and to test by inquiry and observation, changes in the internal control over financial reporting on quarterly basis.

**Question 31.**

Yes, the scope of the auditor's quarterly responsibilities is clearly stated and appropriate.