



April 21, 2004

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

RE: PCAOB Release No. 2004-002 – Proposed Auditing Standard – Conforming Amendments to PCAOB Interim Standards Resulting from the Adoption of PCAOB Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements.

To Whom It May Concern:

One of the expressed goals of the Texas Society of Certified Public Accountants (TSCPA) is to speak on behalf of its membership when such action is in the best interest of its members and serves the cause of certified public accountants in Texas, as well as the public interest. The TSCPA has established the Professional Standards Committee to represent those interests on accounting and auditing issues. This communication is in accordance with that goal.

Two Questions Related to the Addition of References

Question 1: "Are references useful in assisting auditors when performing an integrated audit of financial statements and internal control over financial reporting? If not explain."

Comment: The references are useful to the extent they let the auditor know how the proposed standard has changed existing standards. The references would be much more useful if the effects of the proposed standards could actually be physically integrated into the existing AICPA standards.

Since the AICPA standards are applicable to audits of non-public entities, and have been adopted as interim auditing standards by the PCAOB for SEC registrants, such physical integration is not likely to take place in the near future. The process of having to trace the references from the proposed standard to the AICPA literature is time consuming and, therefore, may not be performed as it should.

Question 2: "Have any references been omitted from the proposed auditing standard that commenters believe would be beneficial? If so explain."

Comment: We are not aware of any references that have been omitted from the proposed auditing standard.

Auditing Standards

AU 310, Appointment of the Independent Auditor

Comment: We believe the amendment related to this standard is appropriate and should be followed by the practitioner engaged to perform both the audit of the financial statements and the audit of internal control.

AU 319, Consideration of Internal Control in a Financial Statement Audit

Comment: On first reading, one might conclude that this is not a substantive change because under existing standards where a very low level of combined inherent risk and control risk results in an acceptable level of detection risk, the auditor is not permitted to omit substantive auditing procedures related to an assertion. However, as detection risk is the product of test-of-details risk and analytical-procedures risk, many auditors have concluded that where there is very low control risk the substantive tests requirement can be met by applying analytical procedures.

Because analytical procedures are considered substantive tests, it could be argued that the proposed amendment to AU 319 has not changed existing standards. However, the proposed amendment to AU 329, Analytical Procedures, addressed later in this comment letter, will add the following language: "For significant risks of material misstatement, it is unlikely that audit evidence obtained from substantive analytical procedures alone will be sufficient." This amendment, coupled with the one discussed herein, could be interpreted to mean that the substantive tests to be performed, "regardless of the assessed level of control risk" would have to be tests of details.

If this is the intent of the PCAOB, the proposed amendment may be necessary. It appears many material misstatements have not been discovered due to the failure of some auditors to apply enough substantive auditing procedures to overcome management override of controls and other types of fraudulent financial reporting.

AU 325, Communication of Internal Control Related Matters Noted in an Audit

Comment: This amendment finds AU 325 superseded for an audit of financial statements and internal control over financial reporting for a public company. As a result, new paragraphs are added for circumstances that involve only an audit of a public company's financial statements. We believe this update of AU 325 requiring communications of material weaknesses to management and the audit committee is appropriate.

AU 326, Evidential Matter

Comment: This amendment requires that an auditor's substantive procedure include reconciling the financial statements to the accounting records and examining material

adjustments made during the course of preparing financial statements. While we fully agree with the necessity of such procedures, we consider it unfortunate that such an amendment must be spelled out in a professional standard. One would hope that such procedures would be a normal part of an audit, whether specifically required or not.

AU 329, Analytical Procedures

Comment: We believe the amendment to AU 329 provides excellent guidance for auditors when performing analytical procedures.

Additional Questions Related to the Proposed Amendments to Auditing Standards

Question 3: "Do the proposed amendments clearly describe the new requirements that apply when the auditor is engaged to audit only the financial statements?"

Comment: We believe the amendments are clear regarding the requirements that apply when the auditor is engaged to audit only the financial statements.

Question 4: "Are there any additional requirements that are applicable in an integrated audit of financial statements and internal control over financial reporting that should be applicable when the auditor is engaged to audit only the financial statements?" For example:

- A. Should the auditor be required to report all internal control deficiencies (i.e., including internal control deficiencies that are less severe than significant deficiencies and material weaknesses) to management not previously communicated in writing by the auditor or by others?

Comment: We do not believe the reporting of such deficiencies meets the cost/benefit test and as such should not be a part of the auditor's required communications to management.

- B. Should the auditor evaluate the effectiveness of the audit committee's oversight of the external financial reporting process and the internal control over financial reporting?

Comment: It is our understanding that under the proposed amendment, the auditor does not have an explicit requirement to make this evaluation, but would be required to report in writing to the board of directors a conclusion that the audit committee's oversight is ineffective, even if the auditor did not perform an evaluation to reach that conclusion. We believe that a significant lack of appropriate oversight and involvement on the part of an audit committee is detrimental to the effective functioning of an auditor. In such situations, the auditor should report such behavior to the full board. However, guidance regarding the appropriate oversight and involvement on the part of an audit committee is currently lacking in our professional literature. We strongly encourage the

PCAOB to develop or adopt guidance that will assist the auditor in evaluating the effectiveness of an audit committee's oversight of the external financial reporting process and the internal control over financial reporting. Such guidance would also serve to inform the audit committee of its responsibilities in these areas.

Question 5: "Are there any circumstances in which the proposed amendments in an audit of financial statements are not appropriate or should not be made? If so, what are those circumstances, and why do they indicate that the proposed amendment is not appropriate?"

Comment: See our comments under part B of question 4 above.

Attestation Standards

Comment: The three questions posed in this section of the proposed standard dealing with attestation standards ask: (1) are there any circumstances in which issuers would want or need to file an AT 501 report with the commission; (2) should AT 501 be amended rather than superseded; and (3) is there need for an auditor's report on internal control in addition to the auditor's report on the integrated audit of financial statements and internal control over financial reporting?

With respect to each of the three questions posed in this section, our committee submits an answer of NO to each of them.

Independence Standards

Comment: This proposed addition to the independence standards would provide that a registered public accounting firm and its associated persons must not accept an engagement to provide internal control-related services to an issuer for which the registered public accounting firm also audits the financial statements unless that engagement has been specifically pre-approved by the audit committee.

We believe the addition to the independence standards should prohibit such services in all circumstances rather than permit them with pre-approval of the audit committee. To allow such an amendment would imply that the lack of independence in appearance can be overcome by pre-approval! However, we believe communication between the entity engaged to assist management with the assessment and documentation of internal control and the external auditor does not constitute a separate engagement for the auditor. Such communication is a part of the financial statement audit and would be necessary to clarify issues related to the entity's internal control.

Comments on Appendix

Comment: All the proposed changes and amendments were traced from the proposed standard to the existing professional standards. We believe the language and the placement of the changes are consistent with the existing literature and are logical when read in conjunction with existing standards.

We do believe the following points should be considered:

Page A-7, item 7.b: The sentence that is added at the end of paragraph 2 should also be considered for addition at the end of Paragraph 3. While this may seem redundant, it would stress the importance of this issue.

Page A-11: Communications about Control Deficiencies in An Audit of Financial Statements, that continues to Page A-16 and consists of Paragraphs numbered 1 through either 10 or 11, should be set forth as an appendix to this standard as its current placement is confusing. Also, paragraph 5 on Page A-14 is 77 words long and very difficult to follow. Some editing here would be helpful.

Page A-18, Paragraph 17: The note added here consists of a sentence that is approximately 72 words long. Any sentence that long is hard to follow and interpret. For example, this sentence states, ". . . should necessarily *inform* (emphasis added) the auditor's decisions." We question whether such phraseology lends itself to understanding by most practitioners.

We appreciate the opportunity to comment on the proposed standard.

Sincerely,

A handwritten signature in black ink, appearing to read "C. Jeff Gregg". The signature is written in a cursive, somewhat stylized font.

C. Jeff Gregg, CPA
Chair, Professional Standards Committee
Texas Society of Certified Public Accountants