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Via E-mail: comments@pcaobus.org

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Re: PCAOB Release: Preliminary Staff Views - An Audit of Internal Control That Is Integrated with An Audit of Financial Statements: Guidance for Auditors of Smaller Public Companies

Dear Members and Staff of the Public Company Accounting Oversight Board:

BDO Seidman, LLP is pleased to respond to the Public Company Accounting Oversight Board's ("PCAOB") invitation to comment on the above-referenced publication, *Preliminary Staff Views – An Audit of Internal Control That Is Integrated with An Audit of Financial Statements: Guidance for Auditors of Smaller Public Companies*. Our comments reflect our unique perspective and insight, derived from our extensive experience in providing audit services to this group of issuers.

We fully support the PCAOB's commitment to providing guidance on scaling the audit of internal control for these issuers through publications such as this and through other venues, including the forums on auditing in the small business environment.

Our letter is organized such that we have first responded to your specific request for comments on the two questions posed in the invitation to comment, followed by additional commentary on other related matters. Within each response below, we have categorized, where appropriate, our comments into broad topics for ease of review.

1. Does the guidance in this publication, including the examples, appropriately consider the environment of the smaller, less complex company? If not, what changes are needed?

Overall we believe that the guidance, including the examples presented throughout the document, appropriately considers the environment and provides practical approaches to complying with Auditing Standard No. 5, for the smaller, less complex company. The guidance appropriately builds upon the principles first laid out in the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") publication, *Internal Control over Financial Reporting – Guidance for Smaller Public Companies*, and our comments below are intended to indicate where we believe the guidance could further enhance the implementation of these principles.



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Monitoring Controls

We believe that in the smaller, less complex company environment, monitoring controls are an important aspect of internal control over financial reporting. Monitoring activities may be routinely performed by managers in all size companies, both in running a business and also in providing feedback on the functioning of other components of internal control. However, in the smaller, less complex company environment, these monitoring activities can be particularly important to achieving an efficient and effective management assessment.

This draft guidance, Chapter 2 (page 13), describes one type of monitoring controls: namely, those controls that monitor the effectiveness of other controls. We also believe that monitoring the results of operations or account balances may, in certain circumstances, also be an effective entity level monitoring control. This second type of monitoring activity can directly act as a control and may, if properly implemented, also help mitigate an increased risk of management override that may exist at smaller companies. Because we believe this type of monitoring control is frequently used by many companies, including smaller companies, we recommend enhancing the guidance and providing an example demonstrating how such a control activity, operating at a sufficient level of precision to prevent or detect a material misstatement, would be sufficient to address or reduce the assessed risk of misstatement.

The Information Technology (IT) Environment

Chapter 5, *Auditing Information Technology Controls in a Less Complex IT Environment*, (page 26) describes the characteristics of less complex IT environments, such as those that are more likely to be found at smaller, less complex companies. We suggest adding additional discussion about how manual controls, as opposed to IT controls, are sometimes relied on more extensively in this environment and may serve to mitigate weaknesses in the IT environment.

Further, guidance about how Entity Level Controls can be used in a smaller company environment to monitor information produced by the IT systems and help reduce the risk of an IT control failure could also be presented.

This chapter also presents the IT-related risks affecting the reliability of financial reporting and lists the seven specific risks presented in AU sec. 319.19. As the importance of these risks may be assessed differently depending on the nature and characteristics of an entity's information system, we suggest adding such a discussion to the guidance to clarify that the nature and extent of these risks to internal control vary based on the unique characteristics of an entity, such that certain of these risks may not be applicable to the environment at smaller, less complex entities.



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2. Are there additional audit strategies or examples that the staff should consider including in this publication? If so, please provide details.

We have provided the following comments regarding additional examples that we believe will enhance the effectiveness of this publication related to testing the operating effectiveness of controls for less than the entire period and assessing end-user computing and spreadsheet controls.

Testing Operating Effectiveness for Less than the Entire Period

Chapter 1, *Scaling the Audit for Smaller, Less Complex Companies*, provides guidance about how to test operating effectiveness of controls in a smaller, less complex environment. For purposes of supporting the opinion on internal control, the first full paragraph on page 10 provides that evidence obtained may be for less than the entire period. For purposes of assessing control risk at less than maximum for the financial statement audit, the second paragraph indicates the period of testing of controls is the entire period for which the auditor intends to place reliance (which is not necessarily the entire year). Later in this section, an example is provided regarding controls over billing and collection and revenue recognition. We believe that it would be helpful if this example was enhanced to illustrate how the auditor might test controls for a period less than the entire year, perhaps only the last several months of the year, particularly when the period for which the controls are being relied on for the financial statements is less than the entire year, and/or the impact of the conclusions from tests of internal controls on the extent of substantive testing performed is unlikely to be significant. For example, the auditor might be able to conclude that controls over billings and collections are effective based on testing of those controls closer to year end. The auditor might also be able to reduce the number of confirmations of accounts receivable based on testing of those controls during this shorter period if the underlying receivables outstanding at year end primarily originated during the period of testing, which might only be two or three months.

Further, this chapter describes how the results of substantive tests can inform the auditor's risk assessment but how such tests alone do not provide sufficient evidence for the auditor to conclude on the operating effectiveness of controls. To clarify this concept and demonstrate the impact that substantive tests may have on the extent of tests of controls, we suggest providing an example.

End-User Computing Controls

End-user computing and spreadsheet controls are used heavily at smaller, less complex companies; this topic is presented in Chapter 5, starting on page 32. We recommend expanding this discussion to better describe the risks and the related auditing procedures,



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including the role that substantive testing can play when assessing risk with respect to these controls.

Additionally, the guidance (page 33) offers examples of tests of controls over end-user computing that include reviewing the procedures for backing up the applications and data. We believe that these types of procedures would not always be considered important to internal control over financial reporting (ICFR) at smaller companies. We suggest that this section be amended or that additional discussion about the relevance of these procedures to ICFR at smaller companies be provided to clarify the concept.

Additional Commentary

Selection of Controls to Test

The guidance in Chapter 1 lists two factors to consider in selecting controls to test, besides the overriding consideration of whether a control addresses the risk of misstatement. They are (1) whether the control is likely to be effective and (2) what evidence exists regarding the operation of the control. We believe it is clear that a control that provides an audit trail is preferable to select for testing over one that does not; however, it is unclear what factors should be considered when evaluating whether the control is likely to be effective. As such, we suggest elaborating how to assess this factor and additionally how this may be similar to, or differ from, assessing the design of a control.

Overall Response to Risk

Footnote 4 on page 50 explains that for accounts, disclosures and assertions not considered to be significant, where the auditor's assessment of the risk that undetected misstatements would cause the financial statements to be materially misstated is unacceptably high, the auditor may perform substantive procedures. This footnote should describe the circumstances where an account could be considered "not significant" while at the same time the risk of material misstatement in the account is unacceptably high. We suggest providing additional clarification on this point. Additionally, consider whether the inverse is true, that the auditor may perform control testing procedures related to accounts, disclosures and assertions that are not determined to be significant for the same reasons cited in the footnote.

Evaluating Mitigating Controls

Consider rephrasing the bullets in the third paragraph on page 19, as follows:

- Maintaining integrity and ethical values
- Audit committee oversight



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- Whistleblower programs
- Controls over certain journal entries

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We would be pleased to answer any questions you may have about our comments. Please contact Wayne Kolins, National Director of Assurance, at (212) 885-8595 or via electronic mail at wkolins@bdo.com with any questions.

Very truly yours,

/s/ BDO Seidman, LLP

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