

December 17, 2007

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Via email to comments@pcaobus.org

RE: Preliminary Staff Views – October 17, 2007. *An Audit of Internal Control That is Integrated With An Audit of Financial Statements: Guidance for Auditors of Smaller Companies.*

Dear Board Members:

The Auditing Standards Committee of the Auditing Section of the American Accounting Association welcomes the opportunity to comment on the Preliminary Staff Views – October 17, 2007 – *An Audit of Internal Control That is Integrated With An Audit of Financial Statements: Guidance for Auditors of Smaller Companies*. We very much appreciate the opportunity to provide input.

The views expressed in this letter and attachments are those of the Auditing Standards Committee members and do not reflect an official position of the American Accounting Association. In addition, the comments reflect the overall consensus view of the Committee, not necessarily the views of every individual member.

We hope that our attached comments and suggestions are helpful and will assist in finalizing the proposed guidance. If the Board has any questions about our input, please feel free to contact our committee chair for additional follow-up.

Respectfully submitted,

Auditing Standards Committee
Auditing Section - American Accounting Association

Committee Members:

Chair – Thomas M. Kozloski, Wilfrid Laurier University, tel: 519-884-0710 ext. 2679,
int: tkozloski@wlu.ca

Past Chair - Robert D. Allen, University of Utah
Vice Chair – Randal J. Elder, Syracuse University
Ed O'Donnell, University of Kansas
Robert J. Ramsay, University of Kentucky
Sandra Shelton, DePaul University
Jay Thibodeau, Bentley College

Auditing Standards Committee
Auditing Section – American Accounting Association

General Comments

The Committee commends the PCAOB (“the Board”) staff for providing preliminary staff views regarding audits of internal control (integrated with audits of financial statements) for auditors who audit smaller public companies. We believe this guidance, in conjunction with other recently published guidance from the Committee of Sponsoring Organizations (“COSO”) regarding internal control in smaller companies, addresses very important issues and concerns facing practitioners in public accounting who serve smaller clients. Among many other desirable qualities, the guidance seems to seek to enhance efficiency in audits of internal control over financial reporting at smaller companies without comprising effectiveness.

The Board staff views presented in this document (“the publication”) are very well presented, and are consistent with and well-anchored to previous standards and guidance provided by both the Board and COSO. As such, this should facilitate the wide acceptance of this guidance as an important part of the overall body of standards and guidance in the area of internal control and audits of internal control at smaller companies.

The following section presents a number of specific comments or suggestions relating to the publication.

Specific Comments

Clarification of important terms

We suggest a very minor clarification/elaboration to be placed somewhere in the front of the document: namely that all references to the audit of internal control in the publication refer to the audit of internal control over financial reporting (“ICFR”).

In addition, the term “precision” is used frequently in Chapter 2 and other places in the publication (and in AS 5). Although the meaning of the term might be inferred from context and the examples provided, specifically defining the term would strengthen the publication.

Effects of results of substantive tests on testing ICFR

On page 11 of the publication the staff indicates that, “The results of substantive tests of accounts and disclosures do not provide sufficient evidence for the auditor to conclude on the operating effectiveness of controls. However, the results of substantive tests could affect the auditor’s risk assessments associated with the internal controls. Risk assessments, in turn, affect the nature, timing, and extent of procedures performed in evaluating the effectiveness of internal control.”

Auditing Standards Committee
Auditing Section – American Accounting Association

The Committee understands this statement to mean that the successful results of substantive tests do not allow the auditor to conclude that controls are effective, although unsuccessful results could be used as evidence that controls are not effective, necessitating a revision in the risk assessment, testing judgments, or conclusion regarding deficiency relating to the relevant control. We believe the quoted section of the publication could be more clearly stated, and more readily understood, by including language in the body of the document that is similar to the language used to explain this concept in the appendix (see page 51).

Use of prior audit experience at client as source of information and/or evidence

As discussed in the document, the auditor will use knowledge gained in prior audit engagements with the client as a source of information about the client. This information will impact risk assessments and decisions about the nature, timing, and extent of audit testing. References to the use of this previously acquired knowledge seem to be presented primarily in a negative frame – i.e., if the auditor’s previously acquired knowledge indicates problems in a certain area, then she can modify her planning appropriately. (See bottom of page 34 for an example in the area of competency.)

However, the auditor’s previous knowledge may alternatively indicate that certain areas of financial reporting have been well-controlled in the past. The Committee believes that the publication might benefit from some clarification regarding the use of such “positive” knowledge gained in prior audits, and the extent to which this knowledge can constitute competent evidence for the audit of internal control.

Competence and objectivity of others whose work is used by the auditor

Chapter 6 of the publication alludes to the assessment of the competence of outside professionals by the auditor, but does not mention an assessment of objectivity. (See bottom of page 35/top of page 36.) Chapter 7 (footnote 6) mentions the need to assess the competence and objectivity when using the work of others although in a different context from the mention in Chapter 6. Even though, as footnote 6 in Chapter 7 indicates, AS 5 comments on the need to assess both competence and objectivity, the current publication might be enhanced by an explicit mention of the need to assess both characteristics regarding outsiders whose work is used by the auditor, and to make this mention in the body of the publication.

Audit committees in smaller companies

On page 12, footnote 2 of the publication states: “If no audit committee exists, all references to the audit committee in this publication apply to the entire Board of Directors of the company.” We contend that this statement conveys a message about internal control and governance at smaller companies that may not be in the best interest of ICFR. An audit committee in a smaller public company serves as an important component of the control environment and can play a key oversight role. This oversight

Auditing Standards Committee
Auditing Section – American Accounting Association

role is especially relevant to mitigating the risk of management override and serving as a mechanism to achieve the goals of segregation of duties.

We encourage smaller public companies (and indeed all companies) to ensure the existence of a properly staffed and functioning audit committee.

Effects of deficiencies in general controls on automated (application) controls

On page 29 of the publication, the staff offers an example of a situation where an automated control may be tested and considered effective even in the presence of a deficient general (program change) control. It would seem that this particular situation could manifest itself only if the testing of the automated control was performed at the absolute end of the period (i.e., the last day of the fiscal year) – otherwise the automated control might have been changed.

We believe the auditor should be cautioned about the interpretation of the results of testing of automated controls in the presence of deficient general controls. In addition, perhaps the example provided in the publication and noted above could be changed or removed.