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May 24, 2006

Ms. Sharon Macey
Audit and Attest Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775
By e-mail: smacey@aicpa.org

Re: Auditing Standards Board's Exposure Draft of "*Proposed Statement on Standards for Attestation Engagements – Reporting on an Entity's Internal Control Over Financial Reporting*" (January 19, 2006).

Dear Ms. Macey:

The New York State Society of Certified Public Accountants, the oldest state accounting association, representing approximately 30,000 CPAs, that will implement the provisions proposed in the above captioned exposure draft. NYSSCPA thanks AICPA for the opportunity to comment on its exposure draft.

The NYSSCPA's Auditing Standards and Procedures Committee deliberated the exposure draft and prepared the attached comments. If you would like additional discussion with us, please contact Mark I. Mycio, the Chair of the Auditing Standards and Procedures Committee at (212) 372-1421, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,

Stephen F. Langowski
President

Attachment



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**NEW YORK STATE SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS TO THE AUDITING STANDARDS BOARD ON THE
PROPOSED SSAE, “REPORTING ON AN ENTITY’S INTERNAL
CONTROL OVER FINANCIAL REPORTING” (JANUARY 19, 2006)**

MAY 24, 2006

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General Comments

We appreciate the opportunity to comment on the Auditing Standards Board's proposed SSAE "Reporting on an Entity's Internal Control Over Financial Reporting." In general, we support the guidance provided in this exposure draft. Given the issuance of Auditing Standard No. 2 ("AS 2"), there has been a need for the ASB to provide updated guidance for practitioners reporting on the internal control over financial reporting of non-issuers. The following comments present our views on specific aspects of the proposed guidance, including areas which we believe require further clarification or amendment.

MATTERS ON WHICH THE EXPOSURE DRAFT REQUESTED SPECIFIC COMMENT

A Framework for Evaluating Control Exceptions and Deficiencies

In general, the document entitled "A Framework for Evaluating Control Exceptions and Deficiencies" is helpful in applying the SSAE and should be included as a permanent appendix to the SSAE. We do have the following specific comments on the document:

1. There are some instances of "editorializing" which we do not consider appropriate such as the reference to "extremely rare circumstances" [**page 97, second paragraph**] and "[T]he circumstances in which an evaluation would lead to the deficiency not being classified as a significant deficiency are rare." [**page 103, second paragraph**] Such statements may bias the practitioner and prevent him or her from forming an appropriate conclusion. Absent empirical evidence supporting such statements, we recommend that they be eliminated.
2. With respect to Chart 1: *Evaluating Exceptions Found in the Testing of Operating Effectiveness*, [**pages 93-95**] more guidance is needed, particularly as to how to determine the appropriate deviation rate. For non-statistical approaches to the determination of the effectiveness of a control, guidance on how to determine the deviation rate would be helpful to practitioners.
3. In evaluating deficiencies in an entity's internal control [**paragraphs 189-193**] and in determining the classification of a control deficiency in the decision tree charts [**Framework for Evaluating Controls**] the exposure draft discusses the impact of complementary, redundant and compensating controls on the evaluation process. We understand why compensating and complementary controls should be considered deficiencies in internal control since they have a role, together with the subject control, of accomplishing the control objective. However, the existence of a redundant control causes the subject control to be superfluous and irrelevant to the internal control system. Accordingly, while it may be a deficient control, it should not be considered a deficiency in the system of internal control.

OTHER SPECIFIC COMMENTS

1. **Allowing the examination of an entity's internal control and the audit of its financial statements to be performed by different practitioners**

While acknowledging that an examination of the design and operating effectiveness of an entity's internal control and the audit of its financial statements generally are performed by the same practitioner, the proposed SSAE permits each engagement to be performed by a different practitioner. It requires only that the entity's financial statements be audited for a practitioner to perform the examination of internal control and that the practitioner performing the examination of internal control contact the financial statement auditor to plan and coordinate the performance of the engagements, and to communicate findings. **[Pars. 4 and 53]**

In this respect, the proposed SSAE departs fundamentally from AS 2 which recognizes both the efficiency and the enhanced quality that results from an integrated examination of both an entity's financial statements and its internal control. AS 2 states that "[t]he auditor ... must audit the company's financial statements as of the date specified in management's assessment [of the effectiveness of the company's internal control over financial reporting] because the information the auditor obtains during a financial statement audit is relevant to the auditor's conclusion about the effectiveness of the company's internal control over financial reporting." **[AS 2, Par. 4]** The rationale of the PCAOB is clearly stated in AS 2:

Because of the potential significance of the information obtained during the audit of the financial statements to the auditor's conclusions about the effectiveness of internal control over financial reporting, the auditor cannot audit internal control over financial reporting without also auditing the financial statements. **[AS 2, Par. 27]**

We recognize that the proposed SSAE, in an attempt to justify its departure from this effective practical requirement of AS 2, imposes a requirement on the practitioner examining an entity's internal control to communicate with the entity's financial statement auditor and inquire about, among other matters, the financial statement auditor's findings about internal control and any material weaknesses, significant deficiencies, or known and likely misstatements, and whether they had initially been identified by the entity's internal control or by the financial statement auditor. We do not believe that such inquiries will adequately substitute for the knowledge about such matters obtained by a practitioner who also audits the financial statements. Indeed, it appears to us that the ASB is sympathetic to this viewpoint as evidenced by the following statements in the proposed SSAE:

The complexity of assessing deficiencies and the requirement to timely communicate with management may be exacerbated when the practitioner performing the examination of internal controls is not the auditor of the entity's financial statements. [Par. 55]

When performing an examination of internal control at a component, the auditor of the entity's financial statements would need to perform audit procedures sufficient to have enabled the auditor to report on the component's financial statements. [Par. 247]

We understand that the fundamental difference between the proposed SSAE and AS 2 is attributable to the fact that an engagement to report on internal control over financial reporting could place a great deal of emphasis on technology and that the ASB was concerned that the auditor of a small non-public company might lack the expertise to deal with the technology aspects of internal control. We appreciate that some practitioners may lack the requisite expertise to evaluate sophisticated, state-of-the-art internal control systems and that this might preclude them from continuing to act as the financial statement auditor for clients that have such systems were the SSAE to conform to AS 2. In such circumstances, however, the practitioner may compensate for any lack of expertise by engaging a specialist to work under his supervision in accordance with SAS 73, *Use of the Work of a Specialist*.

Therefore, we recommend that the proposed SSAE be changed to require a practitioner reporting on an entity's internal control over financial reporting to also audit the entity's financial statements and that the section of the proposed SSAE entitled "Using the Work of Others" be revised to adopt the guidance in SAS 73.

2. Reporting on Internal Control as of a Point in Time for a Period

The Proposed SSAE differs from AS 2 in that it permits the practitioner to report on the operating effectiveness of an entity's internal control over financial reporting as of a point in time or for a period. [Pars. 1 and 52] This difference is appropriate given the different circumstances faced by public and non-public companies. It would be helpful to practitioners, however, for the SSAE to provide clarification of and the rationale for this difference.

3. Reporting Standards

The proposed SSAE permits the practitioner to examine and report on the effectiveness of an entity's internal control or on management's written assertion about the effectiveness of internal control. It does not, however, address whether the practitioner can opine in one report on both the effectiveness of an entity's internal control and on management's written assertion about the effectiveness of internal control. We recommend that the SSAE clarify whether such a "dual report" can be given.

4. Reporting on an Element of an Entity's Internal Control

The proposed SSAE provides guidance with respect to the examination of the internal control of a component of an entity. [Par. 247] However, it does not address whether a practitioner can perform an examination of a process or sub-set of the internal control system (e.g., controls over inventory, receivables, the extension of credit to customers, etc.) Such examinations would be useful to various third parties. For example, a collateral lender would be interested in controls over inventory, accounts receivable, and fixed assets. An ability to adjust the scope of an internal control examination would greatly increase the utility of this standard, particularly for non-public, mid-market companies. We recommend that the Board seriously consider revising and expanding this standard to accommodate such scaled-down engagements.

5. Relationship of the Internal Control Auditor to the Financial Statement Audit

In situations where the financial statement audit and the internal control examination are performed by two different auditors, the exposure draft states the following: [Par. 53]

“...the practitioner performing the examination of internal control should contact the financial statement auditor to plan and coordinate the performance of the engagements, and to communicate findings. The practitioner should: [first bullet point] Coordinate with the auditor of the financial statements the timing of the work to be performed for both engagements...”

This language could be construed as placing a presumptive responsibility on the financial statement auditor to afford the internal control auditor with input and influence over the planning and conduct of the financial statement audit. We believe that this is inappropriate from a procedural standpoint. We also believe that it is an invalid formulation of authoritative guidance in that it appears to nestle an audit requirement within the attest standards. We recommend that the Board reconsider and revise this guidance.