December 12, 2014

American Institute of CPAs
Auditing Standards Board

Comments on Proposed SAS, “An Audit of Internal Control That is integrated with an Audit of Financial Statements”

Ladies and Gentlemen:

Here are my responses to the questions you raised, together with additional comments.

1. Are respondents aware of any unintended consequences that would result from moving the content of extant AT section 501 from the attestation standards into GAAS?

I support moving the content on integrated audits to the auditing standards. This will help achieve integration of these audits. (I support moving all the attestation standards to the auditing standards because the only difference between an audit and an attestation is the subject matter, not the basic principles of auditing). I am not aware of unintended consequences of this move.

2. Do respondents agree with the approach the ASB has taken in proposing a separate standalone SAS instead of addressing an integrated audit in each relevant existing AU-C section?

I strongly disagree with the approach of a separate standalone SAS rather than integrating the material into other AU-C sections. Integrating the material into each relevant AU-C section has these advantages:

- Conveys the message that an integrated audit is needed (a separate SAS focusing on internal control conveys the message that the internal control audit is a separate audit).
- Highlights what additional steps are necessary beyond those in a financial statement audit. With a standalone SAS, the only way the auditor gains this understanding is by comparing the separate SAS with individual AU-C sections. Even if a separate SAS is issued, that SAS should indicate clearly the additional steps required in an integrated audit not required in a financial statement audit. These additional steps are required testing of operating effectiveness of controls, evaluation of sufficiency of evidence on controls, additional wording of engagement letter and representation letter, and issuance of an integrated report. Integrating the material should include an example engagement letter and an example representation letter for an integrated audit.
- Keeps the standards shorter by removing duplicate material (discussion of internal control, deciding what is a material weakness, and definitions). One of the clarity goals was to shorten the standards.
Avoids the need to keep other AU-C sections consistent with the standalone SAS and vice versa. For example, the proposed SAS has material that applies also to a financial statement audit and therefore belongs in AU-C 265 (definition of deficiency), AU-C 315 (definitions, principles from COSO 2013 material, top-down approach), and other sections.

3. Do the respondents agree with the approach the ASB has adopted relating to the 2013 COSO framework?

I agree that the standard should refer to 2013 COSO framework (COSO 2013) as the framework normally used. I also like the reference to the GAO Green Book. However, there is not enough information about COSO 2013. COSO says that there are 17 principles of internal control that should be met to have effective internal control. Although the principles are under the “Evaluating the internal control components section”, they need to be labeled as such. (Although the proposed SAS talks about relevant principles, all 17 principles are relevant so the term relevant is not needed). If the SAS stays standalone, AU-C 315 should be modified to incorporate the 17 principles.

In addition, the relationship between the principles and material weakness needs to be made clear. COSO says that if a principle is not met or the components are not integrated, internal control is not effective. This means there is a material weakness and the opinion should be adverse. This needs to be clearly stated in the SAS and in the discussion of material weaknesses in AU-C 265. An easier to understand definition of material weakness would be, “a situation where one or more of the 17 COSO principles is not met.” This alternative definition should be in the application material.

Further, a listing of the 17 principles should be included as part of management’s assertion and as part of the representation letter. Management should assert that the entity meets each of the 17 principles in COSO. The auditor’s responsibility section of the auditor’s report should indicate that the auditor tested whether each of the 17 principles were met. The definitions section of the auditor’s report needs to indicate that effective internal control means that each of the 17 principles is met and no material weaknesses were found. Also, the definition section of the auditor’s report needs a definition of material weakness, since the term is used in the auditor’s responsibility section of the report without definition. If the auditor finds material weakness, the report and communication to those charged with governance should indicate the principles that were not met.

The report and management’s assertion should not assume that the reader knows what’s in COSO 2013. A better description of COSO 2013 in the report and in management’s assertion will help reduce the expectation gap.

4. Does the defined term significant class of transactions, account balance, or disclosure have the effect of better aligning terminology with minimal impact on practice?

Yes.

Additional comments

One Audit or Two Audits?

Although the exposure draft wants one integrated audit, the report and the SAS talk about two audits. The SAS and the report should refer to an integrated audit with 2 objectives: an opinion on financial statements and an opinion on controls. Referring to one integrated audit will give the message to auditors, clients, and users that two audits are not necessary.

This affects several aspects of the SAS:
Title

The title of the SAS should be changed to “An integrated audit of financial statements and internal control over financial reporting”.

Auditor’s report

The proposed SAS lets the auditor choose between separate reports on internal control and the financial statement and a combined report. I believe only the combined report should be permitted. The combined report sends the message to users and auditors that an integrated audit was performed. Separate reports signify separate audits. In addition, two ways of reporting in the same situation might be confusing to readers.

For the same reason, the report should use the phrase “integrated audit”. For example:

The title of the report should be “Independent Auditor’s Report on Integrated Audit”

The introduction should say

“We performed an integrated audit of:

a. Entity’s financial statements, which comprise ...
b. Entity’s internal control over financial reporting as of .....”

The discussion in the first paragraph under Auditor’s responsibility should use the phrase “integrated audit” (singular), not audits (plural). The second and third paragraph should be combined to discuss one audit, not two audits.

The opinion heading should be singular and “also” language should not be used. The "also" wording implies a less important opinion as well as a separate audit. For example:

“In our opinion:

a. Entity’s financial statements are presented fairly...
b. Entity maintained internal control that was effective in all material respects ... (the “in all material respects” needs to modify effective, not maintained).”

Illustrative written communication to those charged with governance

I am happy that this example uses the term “integrated audit”. However, the first paragraph still refers to two audits. This can be fixed by deleting “our audit of “in the second line.

Appendix A—Reporting Under FDICIA

I disagree with paragraph 7 requiring a restricted use paragraph. COSO is a well-known criterion for internal control. If the report and management’s assertion indicate the 17 principles as discussed above, readers will understand the auditor’s report. Further, the auditor is issuing an opinion. When the auditor issues an opinion, the report should be clear to typical readers and a restriction is not necessary. In addition, these reports are usually available to the public. Whenever a report is available to the public, a purpose of report paragraph is more appropriate than a restricted use paragraph (although neither is necessary in this situation).

Appendix A would be clearer if it were written in the clarity format.
Please contact me if you have questions about this letter.

Sincerely,

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Abraham D. Akresh, CPA, CGFM