

August 12, 2008

Ms. Sharon Macey
Audit and Attest Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

By e-mail: smacey@aicpa.org

Re: Proposed Statement on Auditing Standards: Communicating Internal Control Related Matters Identified in an Audit (Amends AU Section 325, *Communicating Internal Control Related Matters Identified in an Audit*)

Dear Ms. Macey:

The New York State Society of Certified Public Accountants, representing 30,000 CPAs in public practice, industry, government and education, welcomes the opportunity to comment on the above captioned exposure draft.

The NYSSCPA's Auditing Standards Committee deliberated the exposure draft and drafted the attached comments. If you would like additional discussion with us, please contact Robert N. Waxman, Chair of the Auditing Standards Committee at (212) 755-3400, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,



Sharon Sabba Fierstein
President

Attachment



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

**COMMENTS ON PROPOSED STATEMENT ON AUDITING STANDARDS:
COMMUNICATING INTERNAL CONTROL RELATED MATTERS
IDENTIFIED IN AN AUDIT (AMENDS AU SECTION 325, *COMMUNICATING
INTERNAL CONTROL RELATED MATTERS IDENTIFIED IN AN AUDIT*)**

August 12, 2008

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New York State Society of Certified Public Accountants

Auditing Standards Committee

Comments on

Proposed Statement on Auditing Standards: Communicating Internal Control Related Matters Identified in an Audit

The Auditing Standards Committee of the New York State Society of Certified Public Accountants has reviewed the above captioned Exposure Draft (“ED”) amending AU Section 325 and presents the following comments:

The Auditing Standards Board (“ASB”) requested comments on two specific topics:

Definition of Significant Deficiency

Question 1. Are these changes helpful in evaluating significant deficiencies? If not, how should the definition be amended?

We agree that paragraph 8 is clear in its definition of “severity,” but this paragraph is substantially weakened in the context of AU Section 325 by the use of “should” (a presumptively mandatory requirement) vs. an unconditional (must) requirement. If the objective of the ASB is to require that auditors to consider qualitative factors and exercise professional judgment in view of the definitions used in paragraphs 5-7 of the ED, then “severity” must be assessed. Paragraph should read:

“8. The auditor ~~should~~ must evaluate the severity of each deficiency in internal control (footnote omitted) identified as part of the audit”

Further, we are not aware of any peer reviewed study that supports the hypothesis (stated in the “Summary”) that removal of the “likelihood and magnitude” criteria from the definition of significant deficiency will encourage auditors to consider qualitative factors, and thus enhance professional judgment in determining if a deficiency is significant, or is a material weakness.

As for the definition of significant deficiency, the insertion of “in the auditor’s professional judgment” is superfluous and does not add anything. We suggest its deletion. This phrase would be equally applicable to the definition of a “material weakness” (so for example it would read “a material weakness is a deficiency...in internal control such that [in the auditor’s professional judgment] there is a reasonable possibility that a material misstatement...”). The auditing literature is replete with the phrase “professional judgment”, and is an overarching GAAS concept. AU Section 150, *Generally Accepted*

Auditing Standards, tells us “the nature of the 10 standards and the SASs requires the auditor to exercise professional judgment in applying them.”

Compensating Controls

Question 2. If the auditor identifies an improperly designed control, and is not testing the operating effectiveness of controls as part of the financial statement audit, is it sufficient for the auditor to evaluate the design of a compensating control, determine whether it has been implemented, and use that information as a basis for (1) considering the mitigating effects of the compensating control on the deficiency and (2) categorizing the deficiency for the purpose of communicating to management and those charged with governance?

Paragraph 14 of the ED says –

A compensating control can limit the severity of a deficiency and prevent it from rising to a significant deficiency or a material weakness. Although compensating controls can mitigate the effects of a deficiency, they do not eliminate the deficiency. The auditor is not required to consider the effects of compensating controls for the purpose of communicating significant deficiencies or material weaknesses. However, when the auditor decides to consider the effects of compensating controls for the purpose of communicating significant deficiencies or material weaknesses, he or she should

- *evaluate the design of the compensating controls to determine whether they are capable of preventing the deficiency from rising to a significant deficiency or a material weakness; and*
- *perform procedures to determine whether the compensating controls are implemented.*

No matter how discovered during the audit (i.e., during substantive procedures or otherwise) we believe that if the auditor considers the effects of compensating controls when communicating significant deficiencies or material weakness, the auditor must evaluate the design of the controls.

The question is – How do you define “perform procedures”? Does this mean testing of the compensating control(s), walkthroughs or just inquiry?

If the procedures performed are more than inquiry, we are concerned about justifying the costs incurred in testing controls that the auditor is not relying on. When making a required AU 325 communication, the auditor should communicate the nature of the work, if any, performed on the compensating control(s).

Other Comments

We agree with paragraph 26 which says the “auditor should not issue a written communication stating that no significant deficiencies were identified during the audit”;

however, the final Statement should state the (perhaps obvious) danger in such a communication, as audits are not specifically designed to detect deficiencies at any level of severity below a material weakness.

We also agree with paragraph 18, regarding written communications should be made no later than 60 days after the report release date, and paragraph 28 concerning the effective date as being on or after December 31, 2009, with earlier implementation permitted.