



COMMONWEALTH of VIRGINIA

Auditor of Public Accounts

WALTER J. KUCHARSKI
AUDITOR

POST OFFICE BOX 1295
RICHMOND, VIRGINIA 23218
(804) 225-3350

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

Subject: PCAOB Rulemaking Docket Matter No. 008

Dear Sirs:

We appreciate the opportunity to respond to the Public Company Accounting Oversight Board (PCAOB) Proposed Auditing Standard *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*.

We have provided a response to the issues/questions provided in the exposure draft, which includes several issues we would like to encourage the Board to consider when finalizing the standard.

Issue 1:

We agree with referring to the auditor's attestation of management's assessment of the effectiveness of internal control over financial reporting as the audit of internal control over financial reporting.

Issue 2:

We believe that the auditor should **not** be prohibited from performing an audit of internal control over financial reporting without also performing an audit of the financial statements. A company may desire to contract for such an audit in order to identify and correct internal control deficiencies. We see no need to prohibit that, as long as the auditor who performs the financial statement audit also performs an audit of internal controls. Perhaps the Board anticipates an auditor could do an internal control examination under AICPA Attestation Standards which would not require a concurrent audit of the financial statements in order to meet the company's needs.

Issue 3:

We believe that the work performed for internal controls should also be used for the purpose of expressing an opinion on the financial statements so long as the same auditor has performed both

audits. The internal control audit should supplement the financial statement audit, not the other way around. We do not see the purpose of performing work comparable to that required to complete the financial statement audit because we do not understand why you would not want to issue statements if you have done that level of work. Also, see the comments at issue 2 for further details.

Issue 4:

We believe that there isn't a difference between small or larger companies when expressing an opinion on or auditing internal controls since you still have to have controls for each assertion. In addition, we do not see in the standard itself where the Board sets forth its expectation that "the auditor will exercise reasonable professional judgment in determining the extent of the audit of internal control and perform only those tests that are necessary to ascertain the effectiveness of the company's internal control" (This quotation is from the paragraph immediately preceding Question 4 in the lead-in to the proposed standard.)

Issue 5:

We do not believe that the board should dictate a specific level of competency. We are comfortable with the guidance as set forth in the proposed standard as it seems consistent with the current field work standards. The Board needs to leave some leeway for the exercise of professional judgment.

Issue 6:

We agree with the scope of the audit. The auditor should have to directly obtain evidence about whether internal control over financial reporting is effective. However, we do not believe the standard is clear about what the auditor would do in a situation in which management believes that because of budget constraints or other reasons, it is not cost effective to implement a control and the auditor disagrees or in a situation in which management has not assessed certain controls that they feel are not critical but the auditor feels are critical.

Issue 7:

Yes, we agree.

Issue 8:

We agree that it is appropriate to state that inadequate documentation is an internal control deficiency and the auditor should evaluate the severity. We therefore disagree that inadequate documentation should automatically rise to the level of significant deficiency or material weakness in internal control.

Issue 9:

We agree if the term "walkthroughs" is used in the traditional sense of physical observation and verification of the flow of documents. However, in an automated environment, a "walkthrough"

may be difficult, if not impossible, to perform so there should be the opportunity for the auditor to achieve the same objectives using alternative approaches when necessary.

Issue 10:

We disagree. We believe that the walkthrough should not be required to be performed by the auditor him or herself. We believe that if the internal auditor is qualified and independent, the use of this internal audit documentation should be sufficient and reliable but only after verification. The use of a management walkthrough should never be used.

Issue 11:

To require the auditor to obtain evidence of the effectiveness of controls for all relevant assertions for all significant accounts and disclosures every year seems to be excessive and unnecessary. There should be an annual evaluation of risk and a documented cycle of rotation where evidence on the controls are obtained during the agreed upon cycle or whenever significant changes occur.

Issue 12:

The auditor should be permitted and **not** required to use the work of others. The auditor should have the flexibility to use auditor judgment when it pertains to the work of others. The Board should expand or provide more detail on its reference to the auditor using the work of management.

Issue 13:

Yes, they are appropriately defined.

Issue 14:

At times, the proposed standard does not give the appropriate recognition to the work of internal auditors. The internal auditor is prohibited from performing walkthroughs that are relied on by external auditors. We believe this is a situation that should be allowed, based on the external auditor's judgment.

Issue 15:

We believe that the flexibility in determining the extent of reliance of the work of others is important. We believe that to the extent that the auditor can reasonably verify the independence of others performing the work, it is not necessary to re-perform or perform additional work as long as the results satisfy the auditor's objectives.

Issue 16:

Yes, we agree.

Issue 17:

The definitions are subjective so we do not believe they will necessarily result in increased consistency in the evaluation of deficiencies; however, we have no suggestions to correct this inherent problem.

Issue 18:

Yes, we agree that the examples in Appendix D are helpful and don't have any other specific examples that would provide further interpretive help.

Issue 19:

No, we don't believe that it is necessary for the auditor to evaluate the severity of **all** identified internal control deficiencies. We believe that whether a deficiency is evaluated should be subject to the auditor's judgment as there may be a control that the auditor is not relying on that would make the deficiency irrelevant.

Issue 20:

Yes, it is appropriate.

Issue 21:

Yes, the matters are appropriately classified.

Issue 22:

Yes, we agree the auditor should evaluate the effectiveness of the audit committee's oversight.

Issue 23:

Yes, we believe the auditors should be able to effectively carry out their responsibility.

Issue 24:

No, it is not necessary for the auditor to withdraw from the audit engagement. It is important for the users of the financial statements to have access to the adverse opinion on the effectiveness of internal control.

Issue 25:

We agree. If management says controls are not effective then it would be confusing to the reader if the auditor did not issue an adverse opinion.

Issue 26:

No, either the controls work or they don't. For example if management gives an adverse opinion, the auditor cannot give an "except for" opinion. (See question 25)

Issue 27:

We agree because by the auditor's opinion speaking directly to the effectiveness of the internal control over financial reporting it prevents confusion on part of the reader.

Issue 28:

We believe that what the Board has provided in the standard is appropriate.

Issue 29:

Yes, there should be some internal control-related non-audit services that the auditor should be prohibited from providing. As an example, GAO's Government Auditing Standards, general standards for independence—section 3.17 note f., indicates that "...certain nonaudit services impair the audit organization's ability to meet either or both of the overarching principles in paragraph 3.13 for certain types of audit work. For example, if the audit organization has been responsible for designing, developing, and/or installing the entity's accounting system or is operating the system and then performs a financial statement audit of the entity, the audit organization would clearly be in violation..."

Issue 30:

Yes, they are appropriate.

Issue 31:

Yes, it is appropriate.

We appreciate the efforts of the Board and the opportunity to provide our comments. Should you have any questions or need additional information regarding our response, please contact me or Martha Mavredes at (804) 225-3350.

Sincerely,



Walter J. Kucharski
Auditor of Public Accounts