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February 24, 2007

Public Company Accounting Oversight Board
Attention: Office of the Secretary
1666 K Street, NW
Washington, DC 20006-2803

To Whom It May Concern:

The purpose of this letter is to comment on the Board's proposed auditing standard related to the audit of internal control over financial reporting issued on December 19, 2006 (Rulemaking Docket Matter No. 021). I am an associate professor of accountancy at Bentley College and a former CPA. The views expressed in this letter are my own, and do not necessarily represent the views of my employer.

The proposed standard represents an improvement over the previously issued guidance (Auditing Standard No. 2, or AS 2), particularly in the adoption of a risk-based framework for approaching the audit of internal controls. However, I have a few concerns regarding the proposed guidance regarding risk assessment. Specifically, I wish to address matters related to Questions 5 and 6 raised on page 8 of Release No. 2006-007.

My first concern relates to the "change in the direction on integrating the audits" referred to on page 7 of the Release and covered in more detail in Appendix B of the proposed standard. It is my understanding that one of the expected benefits of integrating the audit of internal controls over financial reporting with the financial statement audit is to inform the financial statement audit about the effectiveness of internal controls, so auditors can better assess the control risk component of the audit risk model and thus better design their audits of financial statements. Indeed in Appendix B of the proposed standard paragraph B1, it states that "the auditor should design his or her testing of controls to accomplish the objectives of both audits simultaneously," one of which is "to obtain sufficient evidence to support the auditor's control risk assessment for purposes of the audit of financial statements." The audit risk model is designed to determine the nature and extent of substantive testing needed to form an opinion on the financial statements, and control risk is a component of that model. To the extent that the audit of internal controls over financial reporting enables the auditor to assess control risk, then it necessarily has to precede the planning for the financial statement audit. Therefore, it is logically impossible for the findings of substantive tests to inform the audit of internal controls, since the substantive testwork would occur *after* the audit of internal controls. In this case, paragraph B11 seems to include a logical inconsistency in the following statement, "The absence of misstatements detected by substantive procedures, however, should inform the auditor's risk assessments in determining the testing necessary to conclude on the effectiveness of a control." Perhaps the standard is referring to the use of findings from past year's substantive audits in informing the planning of the audit of internal controls over financial reporting in the current year, but this should be clarified in the standard.

My second concern has to do with the issue directly addressed in Question 6 on page 8 of the Release regarding whether a walkthrough would be sufficient to test the design and operating effectiveness of some lower risk controls. Paragraph 50 of the proposed standard states that, "Procedures the auditor performs to test operating effectiveness include a mix of inquiry of appropriate personnel, observation of the company's operations, inspection of relevant documentation, walkthroughs, and reperformance of the control." This implies that a combination of inquiry and walkthrough for example, may be considered a sufficient test of operating effectiveness. Walkthroughs are performed as part of the process for gaining an understanding of controls and evaluating design. However, in order to properly determine operating effectiveness, the controls must be tested (as noted throughout the proposed standard). It may be the case that the control appears to be working properly based on a walkthrough, but when a sample of items is selected to test by inspection of relevant documentation, the auditor may find breakdowns in the controls that are not identified in the walkthrough. Therefore the walkthrough cannot be considered equivalent to a test of operating effectiveness, and would not enable the auditor to provide assurance regarding the operating effectiveness of that control.

If a control is of sufficiently low risk that the auditor concludes tests of operating effectiveness are not necessary, and the auditor feels a walkthrough is sufficient to evaluate the design of the control, then it would make more sense to document the rationale for foregoing tests of operating effectiveness (for example if it is determined that a deficiency in the control would be unlikely to lead to a material misstatement on the financial statements). Care should be taken not to provide any positive assurance regarding the operating effectiveness of the control, since tests of operating effectiveness were not performed.

I appreciate the opportunity to comment on these issues and I hope that you find this feedback helpful. If you have any questions, please contact me by e-mail at cearley@bentley.edu.

Sincerely,

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Bentley College