



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

December 10, 2014

RE: Proposed Statement on Auditing Standards, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*

Dear Ms. Hazel:

We appreciate the opportunity to comment on the proposed Statement on Auditing Standards, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements* (the proposed SAS). We support moving the content of extant AT 501, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*, into generally accepted auditing standards (GAAS) and we are not aware of any unintended consequences that would result from moving it. We also support the Auditing Standards Board's (ASB) approach in drafting a separate standalone SAS instead of addressing an integrated audit in each relevant existing AU-C section.

We agree with the approach the ASB has adopted relating to the presumption that management uses the 2013 *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 COSO Framework) to evaluate the five components of internal control by assessing the principles in the 2013 framework, while continuing to allow the auditor to adapt and apply the proposed SAS when management applies a different internal control framework such as the U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* (the Green Book).

We support changing the term "significant account or disclosure" used in extant AT 501 to "significant class of transactions, account balance, or disclosure" to align with terminology used in extant GAAS and clarify that the risk factors the auditor is required to evaluate in the identification of significant classes of transactions, account balances, and disclosures and their relevant assertions are the same in the audit of internal control over financial reporting as in the audit of the financial statements. Accordingly, we agree with including the definition of "significant class of transactions, account balance, or disclosure" in the proposed amendments to AU-C 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AU-C 315). However, with the inclusion of the definition we encourage the AICPA staff to undertake a project to evaluate whether there is a distinction between significant class of transactions, account balances, or disclosures and material class of transactions, account balances, or disclosures which is used in AU-C 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (e.g., paragraph 18 of AU-C 330), and to recommend that the ASB consider changes to the standards or provide guidance to clarify if deemed necessary.

We offer the following suggestions for the ASB's consideration in finalizing the proposed SAS and the related conforming amendments.



Definitions

The proposed SAS does not include the definitions of material weakness and significant deficiency that are in extant AT 501 because these terms are already defined in AU-C 265, *Communicating Internal Control Related Matters Identified in an Audit* (AU-C 265). To be consistent, we also recommend deleting the definition of “deficiency in internal control” from the proposed SAS since it also appears in AU-C 265.

Appendix B of the proposed SAS includes proposed amendments to various sections in SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*. The first sentence of the conforming amendment related to the definition of “material weakness” in AU-C 265.07 is proposed to be amended by adding the words “over financial reporting,” as shown below:

.07 **Material Weakness.** A deficiency, or a combination of deficiencies, in internal control ***over financial reporting***, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected, on a timely basis.

To be consistent, we believe that the same change should also be made in the AU-C 265 definitions of “deficiency in internal control” and “significant deficiency.” Furthermore, there are many other instances throughout AU-C 265 where the phrase “over financial reporting” should be included. AU-C 315 defines internal control more broadly than just internal control over financial reporting as it includes internal controls related to operations and compliance with laws and regulations. AU-C 265, however, focuses on internal control deficiencies identified in the audit of the financial statements; therefore, the focus is on the internal controls related to financial reporting. As a result, we believe that the term internal control over financial reporting should be used in AU-C 265 instead of the term internal control.

Using the Work of Others

Paragraph 21 of the proposed SAS requires the external auditor to adapt and apply, as necessary, the requirements in AU-C 610, *Using the Work of Internal Auditors* (AU-C 610), when the external auditor plans to use the work of others in obtaining audit evidence or to provide direct assistance in the audit of ICFR. We believe the term “adapt and apply, as necessary,” is too vague with respect to this particular standard and may result in inconsistent application of AU-C 610 in using the work of others related to an audit of internal control over financial reporting that is integrated with an audit of the financial statements (integrated audit). We recommend that the proposed SAS either be specific as to what requirements in AU-C 610 relate to the integrated audit, or if the intent is that all of AU-C 610 applies, then change the requirement to state that.

Also, to improve the clarity of related application guidance in paragraph A28, we recommend editing the third sentence in that paragraph as shown below:

A28 . . . In addition, ***for purposes of evaluating the application of a systematic and disciplined approach, including quality control, as required by AU-C 610,*** others may have an approach that differs from that of an internal audit function, particularly with respect to the level of formality. However, it would be inappropriate to use the work of others that do not have a systematic and disciplined approach. AU-C 610 provides additional requirements and guidance in determining when to use the work, in which areas, and to what extent.



Subsequent Events

The requirement in paragraph 85 addresses conditions that did not exist at the as of date but arose subsequent to that date and before the release of the auditor’s report, whereas the related application guidance in paragraph A123 discusses events subsequent to the date of the auditor’s report, which also pertain to facts that become known to the auditor after the report is issued. AU-C 560, *Subsequent Events and Subsequently Discovered Facts*, discusses separately the auditor’s responsibilities for subsequently discovered facts that become known to the auditor after the report release date. To clarify that this guidance also applies in the proposed SAS, we recommend creating a requirement in a new paragraph 86, as shown below:

- 86. Although the auditor has no responsibility to keep informed of events subsequent to the date of the auditor’s report, the auditor should respond appropriately to facts that become known to the auditor after the release of the auditor’s report that, had they been known to the auditor at that date, might have affected the auditor’s opinion. (Ref: par. A123)

The last sentence in paragraph A123 would remain in application guidance linked to paragraph 86.

The Appendix to this letter includes additional editorial comments on the proposed SAS.

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We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions you may have. Please contact Marc Panucci (973-236-4885) regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP



APPENDIX

This Appendix provides our editorial comments on the proposed SAS. New language is in **boldface italics**; deleted text is in ~~strikethrough~~.

Table of Contents (TOC):

- The subheaders related to paragraphs 50-54 in the requirements and paragraphs A84-A94 in the application and other explanatory guidance sections of the TOC should be edited to read as follows so that they are consistent with the wording in the proposed SAS: “Evaluating the ~~Severity of Identified~~ Deficiencies in ICFR”
- The “Concluding Procedures” section in the application and other explanatory material ends with paragraph A102 rather than A103 as indicated in the TOC on page 9. All subsequent entries in the TOC should be renumbered accordingly.

Proposed SAS

- Par. A10: Add a period at the end of this paragraph.
- Par. A14: We recommend defining “2013 COSO framework” more fully as shown below at its first appearance in the ED:
 - A14 The ***Committee of Sponsoring Organizations of the Treadway Commission’s 2013 Internal Control—Integrated Framework*** (2013 COSO Framework) and the U.S. Government Accountability Office’s Standards for Internal Control in the Federal Government (“Green Book”) provide suitable and available criteria against which management may evaluate and report on the effectiveness of the entity’s ICFR.
- Par. 13: We recommend adding the phrase shown below to the last sentence of this paragraph to clarify the importance of integration with the financial statement audit when forming an opinion on the effectiveness of ICFR:
 - 13. . . . See paragraphs 55-56 for requirements on evaluating the effects of findings, ***including those from the financial statement audit***, when forming an opinion on the effectiveness of ICFR.
- Par. A21: We suggest including the title of AU-C section 315 in the last sentence of this paragraph as shown below:
 - A21. . . . The risk assessment procedures described in AU-C section 315, ***Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement***, support both the financial statement audit and the audit of ICFR.
- Par. 17: We recommend the edits shown below to improve the clarity of this paragraph and to make it more consistent with extant AT 501.27:



17. As part of identifying **and testing** entity-level controls, as discussed beginning at paragraph 24, and selecting **other** controls to test, as discussed beginning at paragraph 39, the auditor should evaluate whether the entity’s controls sufficiently address identified risks of material misstatement due to fraud and the risk of management override of controls.

- Par. A24: We suggest including the title of AU-C section 240 in the first sentence of this paragraph as shown below:

A24. AU-C section 240, **Consideration of Fraud in a Financial Statement Audit**, addresses the auditor’s identification and assessment of the risks of material misstatement due to fraud.

- Par. A40: This paragraph relates to the control environment and it should be moved so that it appears under the “Control Environment” subheader rather than the “Entity’s Risk Assessment Process” subheader. In addition, we suggest adding a parenthetical reference to par. A40 at the end of the introductory text preceding the bullets in par. 26 since par. A40 applies to all of the bullets.
- Par. A47: We suggest adding a semicolon after the first bullet point in this paragraph to be consistent with the presentation of the other bullet points.
- Par. A53: We suggest editing the last sentence in this paragraph as shown below to clarify that not all the procedures identified need be performed on every walkthrough, to be consistent with the first sentence of paragraph A68 of the proposed SAS, and to be consistent with extant AT 501.52:

A53. Walkthrough procedures **may** include a combination of inquiry, observation, inspection of relevant documentation, recalculation and control reperformance.

- Par. A87: In the first bullet point of this paragraph, delete the comma following “financial statement”
- Par. 60: Correct the alignment of subparagraphs (a)-(i).
- Par. A108: In footnote 30 to this paragraph, change “example 2” to “illustration 2” to conform to the wording in exhibit A.
- Par. A112: In footnote 31 to this paragraph, change “example 3” to “illustration 3” to conform to the wording in exhibit A.
- Par. A117: In footnote 34 to this paragraph, change “example 4” to “illustration 4” to conform to the wording in exhibit A.
- Par. 84: Delete the parenthetical reference to A121 at the end of this paragraph.
- Appendix A: Align footnote 3 to paragraph 3 with other footnotes in this section.
- Appendix B: In the conforming amendments to AU-C 265 change the second sentence of the first bullet point of paragraph .A11 as shown below to be consistent with the wording in par. A92 of the ED:



A11. For the purpose of this indicator, the term ‘senior management’ includes the **principal** ~~chief~~-executive and financial officers as well as any other members of senior management who play a significant role in the entity’s financial reporting process.

- Appendix B: In the conforming amendments to AU-C 905, *Alert That Restricts the Use of the Auditor’s Written Communication*, delete the extraneous character and add a space preceding “Alert” in the title. Also, align the subparagraphs in paragraph 11.
- Appendix B: In the conforming amendments to AU-C 935, *Compliance Audits*, paragraph .A41 we believe that the **Proposed Statement on Auditing Standards, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements**, should be added at paragraph .A41, “Appendix—AU-C Sections That Are Not Applicable to Compliance Audits.” We also believe that all paragraphs of the proposed SAS should be shown as not applicable to compliance audits.