



October 31, 2005

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Dear Ms. Macey:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments on the exposure draft of the proposed Statement on Auditing Standards (SAS) titled *Communication of Internal Control Related Matters Noted in an Audit*. The FMSB, comprising 21 members with accounting and auditing backgrounds in federal, state, and local government, academia, and public accounting, reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are also encouraged to comment separately.

We commend the AICPA Auditing Standards Board (ASB) for a proposed standard that is, overall, “on target” and easy to read. It is a well-done document with good examples. We support the ASB’s efforts to synchronize report definitions with those of the PCAOB to create a common understanding of terminology among users of financial reports. We agree with the proposed characterizations of “significant deficiencies” and “material weaknesses” although we think they could be expressed in simpler language. We find the Appendix and Framework appropriate and logical and would support the incorporation of the accompanying Framework as a permanent appendix to the SASs. We agree with the effective date proposed by the Board and request that the Board encourage early implementation. However, we do have some specific comments/questions listed below that we offer for your consideration.

### **Major Concerns**

Our first concern is about the concept of the auditor considering whether people with general business knowledge and experience would agree with the auditor’s conclusion as to the type of deficiency before making a final decision (various paragraphs, including the summary and paragraphs 9, 10 & 14 on pages 10 and 12). This concept assumes that the auditor would know or understand how such people would feel about specific issues. In most cases auditors, even very senior auditors, do not have experience as “people with general business knowledge and experience”. They cannot come to a conclusion about what people with that kind of experience would conclude about specific instances unless they have asked such individuals. We do not think the ED contemplates such a “survey” of “people with general business knowledge and experience” to determine what they believe. Thus, we do not know how the auditor makes this judgment.

Also, this can be interpreted as stating that the auditor’s conclusion based on professional judgment should be subrogated to what the auditor believes people with general business knowledge and experience think or believe. Chart 2 in Box 8 on page 34 reinforces this conclusion. Specifically, it infers that if the auditor concludes



a significant deficiency is not a material weakness based on Boxes 1 through 6, but then finds that people with a general business knowledge and experience would conclude otherwise, then the deficiency should be classified as a material weakness. The proposed standard seems to say that the auditor's perception of the general business community's conclusion outweighs the auditor's professional judgment.

We do not have a concern with the auditor considering what experience/knowledgeable business people would think. We do think that the proposed standard needs to specifically clarify that this consideration should not be the overriding factor in the final conclusion. We would also like the Board to specifically explain why consideration of "people with general business knowledge and experience" should be part of the evaluation (Boxes 7 and 8, pages 24, 27 and 28) for Chart 2 if they believe that is a valid step.

Secondly, we suggest that when an auditor repeats reporting of deficiencies that management has assessed and which management has concluded would not be cost beneficial to correct (that is, that the risk is acceptable) that the auditor acknowledge in the auditor's report the fact that management has acted on the auditor's finding and reached a conclusion. At a minimum the auditor should report that the matter has been considered by management and management has concluded that the risk is acceptable. Continued reporting without such an explanation conveys the impression that management has not acted on prior auditor recommendations when in fact management has exercised its judgment and taken no or limited action.

Thirdly, we are very concerned about the very complex definitions of "significant deficiency" and "material weakness" since they appear to be "auditor-speak" not readily understood by the public. The Board may want to consider developing a more simple way of expressing the definitions. Likewise, in paragraph 4, the explanation for "inconsequential" is very difficult to understand. The Board may want to consider revising the language there also.

### **Other Comments/Suggestions**

Paragraph 1, page 7 – We suggest the ASB consider incorporating more examples applicable to state and local governments since the auditors of these entities have become a more important "consumer" of AICPA standards since the creation of the PCAOB. For instance, in paragraph 1, the list of examples of entities that provide governance might include a governor, a school superintendent or a school board.

Paragraph 6 and 12, pages 9 and 10 – The third sentence in paragraph 6 provides that "professional judgment" is required in the determination of whether the internal control deficiencies are significant deficiencies. In paragraph 12, the first sentence provides that evaluating whether a significant deficiency constitutes a material weakness is a "subjective process." We wholeheartedly agree with both sentences and terms. But we would recommend that the language be changed in both paragraphs to acknowledge that both determinations/evaluation "require professional judgment, which is inherently a subjective process." This concern may be unfounded but our opinion is that such a change as recommended would reinforce that the auditor's professional judgment is required in both circumstances.

Paragraphs 9 and 14, pages 10 and 12 – The text in these paragraphs does not provide the auditor with a suggested course of action when a person with general business knowledge does not agree with the

auditor's conclusion. Chart 2 provides a course of action but we suggest this guidance be included in the paragraphs and not just Chart 2.

Paragraph 16, page 12 – We support the provision in this paragraph that allows the auditor to communicate matters that he or she views to be of value to management yet should not be deemed significant deficiencies. Auditors do routinely communicate issues of this nature during audits.

Paragraph 17, page 13 – We support the 60-day grace period to communicate the significant deficiencies and material weaknesses and request that no shorter period requirement be implemented.

Paragraphs 19 and 20, page 13 – We support the provision allowing auditors to communicate other matters related to internal control as noted in paragraph 19 of the ED. If the auditor chooses to communicate control deficiencies that are not significant or other internal control matters in writing, we request the ASB provide guidance on the presentation of these issues within the report on internal control. Since paragraph 20 sets forth what the written communication "should" include, we request the ASB expand upon the format of paragraph 20 and state what the communication "may" include. Additional examples in paragraph 22 that include such optional communications would also be helpful.

We would consider such communications as consistent with AU 325.03 and AU325.19 and support the continued reporting of these matters within the context of this exposure draft.

Paragraph 24, page 14 – We recognize that the proposed statement addresses only those instances in which clients are required to report to “governmental authorities” under generally accepted auditing standards, however, we feel that the statement should acknowledge the differing scope of internal control work and reporting required by Government Auditing Standards and OMB Circular A-133. Audits in accordance with Government Auditing Standards and OMB Circular A-133 are often mandated by “governmental authorities.” We feel that the difference in these engagement standards should be acknowledged and clarified by adding additional wording to paragraph 24 or by footnote as appropriate. Such an acknowledgment would lessen confusion regarding communications “to be submitted by the client to governmental authorities.”

Appendix – Other than the last example on page 17, each of the examples describe “negative actions” that would result in a control deficiency. To be consistent, we recommend that the language in the last example on page 17 be revised in words to the effect of “for example, not safeguarding inventory through physical controls (e.g., using security devices) and/or not performing timely periodic physical counts.”

Chart 1, Box 3 terminology – Is “test objective” the correct term for this box? Based on the definition in glossary (page 31) it appears that the test objective is to determine if controls are operating as designed. If the auditor's test results showed the controls are NOT working as designed, then we would interpret that the test objectives were still met, i.e., the auditor found controls were not working. However, if it meant that the test objective is to obtain a level of assurance that controls are working effectively so control risk can be assessed at less than maximum (see first sentence in second full paragraph on page 22, then we would agree the term “test objective” in Chart 1, Box 3, is appropriate. In conclusion, we recommend that the term “test objective” be clarified and, if appropriate, that the language be revised accordingly.

## Editorial Comments

Page 11, paragraph 13, seventh bullet – This reads awkwardly. We recommend rewording, e.g., “Failure by management or those charged with governance to assess the effect of a significant deficiency previously communicated to them, and failure to correct the deficiency or conclude that it will not be corrected.” The second sentence is fine.

Page 25 – Insert the acronym “ITGC” after “Evaluating Information Technology General Control” in the heading.

Page 28, second sentence under Box 1 – It would be best to restate the circumstances referenced under paragraphs 8 and 13 of SAS No. XXX.

Page 28, Boxes 3, 4, and 5 section, second bullet – A parenthesis needs to be added after “responsibilities.”

Page 30, second sentence of definition for “Adjusted Exposure” – The word “in” needs to be inserted between “designed that result” and “an exception rate”.

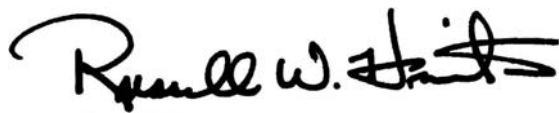
Page 34, Box 4 – The font size for Box 4 needs to be changed to be consistent with the rest of the page.

Page 34, Box 5 – The arrow sign which is now inside the box needs to be deleted or moved.

Page 35, Deficiency 1 – It can probably be argued either way, but we believe ‘interentity’ should be spelled inter-entity.”

The FMSB appreciates the opportunity to comment on the exposure draft. No members objected to its issuance. This response letter represents a consensus of the views of the FMSB members. We would be pleased to discuss this letter with you at your convenience. You can contact me at [hintonrw@audits.state.ga.us](mailto:hintonrw@audits.state.ga.us) or (404) 656-2174 or Anna D. Gowans Miller, CPA, AGA’s Technical Manager and facilitator for this project, at [amiller@agacgfm.org](mailto:amiller@agacgfm.org) or (703) 684-6931, ext. 313.

Sincerely,



Russell W. Hinton, CGFM, Chair,  
AGA Financial Management Standards Board

cc. Sam M. McCall, MPA, CGFM, CPA, CIA, CGAP  
AGA National President

**Association of Government Accountants  
Financial Management Standards Board**

**July 2005 – June 2006**

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