

January 29, 2002

Mr. John Fisher
Department of Health and Human Services
Lucas Place, Room 514
323 West 8th Street
Kansas City, MO 64105

Subject: The *Orange Book* (Federal Cognizant Agency Audit Organization Guidelines) Exposure Draft

Dear Mr Fisher:

On behalf of the AGA, the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments on the exposure draft (ED) of the President's Council on Integrity and Efficiency's (PCIE) *Orange Book* (Federal Cognizant Agency Audit Organization Guidelines). The Orange Book will provide guidance to federal agencies for carrying out cognizant and oversight agency responsibilities in connection with Office of Management and Budget (OMB) Circular A-133.

The FMSB supports the PCIE's efforts to promote uniform guidance via the Orange Book. Our comments and recommendations are presented below.

The FMSB, comprised of 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 encouraged to comment separately.

GENERAL RECOMMENDATIONS

Further study and coordination among affected organizations will be beneficial: The Orange Book contains extremely important guidance and will potentially impact thousands, perhaps tens of thousands, of auditor and auditee organizations, the AICPA Ethics Division, state boards of accountancy, federal offices of inspectors general, and other federal agencies. We recommend that the PCIE consider establishing a short-duration task force to evaluate some of the issues we raise in this letter, particularly the issues related to AU Section 9339, the representation letter, and the ethics enforcement process. A task force composed of representatives from the FMSB, the AICPA Ethics

Division, the National State Auditors Association, the Auditing Standards Board, PCIE, OMB, and HHS will, we believe, be able to make major improvements not just in this guidance document but also in the federal agency/auditee/nonfederal auditor relationship.

Implementation and effective date guidance: Although professional guidance of this nature should provide the reader with an effective date for implementation, the draft Orange Book makes no mention of an effective date. We recommend that the final document include a paragraph that clearly states an effective date for implementation of the guidance in the Orange Book.

SPECIFIC RECOMMENDATIONS

Page 2, last sentence of the second paragraph, under Background: This sentence states, “When a Federal agency becomes the cognizant audit agency for an auditee through reassignment, an initial communication with auditee officials and their non-Federal auditor, if known, should be made 30 days after the agreement has been reached.” Because of the importance of this reassignment, we recommend that this communication should be in writing. We also recommend that a sample communication be included as an attachment to the final document.

Page 2, item (3) in the third paragraph, under Background: This section refers to the cognizant agency for audit’s responsibility for “coordinating a management decision for audit findings that affect the Federal programs of more than one Federal agency.” However, the Orange Book does not discuss the federal awarding agency’s responsibility relating to audit finding resolution. OMB Circular A-133, Sec. __400(c)(5), requires that the federal awarding agency “issue a management decision on audit findings within six months after receipt of the audit report...” We recommend that this requirement be included in the final document, perhaps in the Preliminary Screening discussion on Page 6.

Page 2, second and fourth sentences of the last paragraph: The second sentence states, “The Federal awarding agency that provided the predominant amount of direct funds has an oversight responsibility to provide technical assistance to the auditees and may assume all or some of the responsibilities performed by a cognizant agency for audit.” The fourth sentence appears to incorrectly paraphrase OMB Circular A-133, §__ .400(b). We recommend that the fourth sentence be deleted and that the second sentence be revised slightly to begin “Consistent with the guidance in OMB Circular A-133, the Federal awarding agency....”

Page 3, fourth paragraph under Federal Audit Clearinghouse: This states that “The Clearinghouse also maintains a list of incomplete reporting packages that have been received but have not been processed.” However, this section does not indicate whether the Clearinghouse is responsible for following up and resolving incomplete packages. We recommend that the Orange Book clearly state the Clearinghouse’s responsibility for resolution of incomplete reporting packages. If the reference to “Form SF-SAC submissions with errors” on Page 4 is intended to include incomplete reporting packages, the reference should be clarified in the final document.

Page 4, second sentence in the second paragraph, under National Single Audit Coordinator (NSAC): This states that “The NSAC should...be responsive to communications from other Federal agencies about single audit matters and an individual to whom any single audit inquiry or matter can be directed.” To recognize the frequent communications with auditees and nonfederal auditors, we recommend that this sentence be expanded slightly to read “The NSAC should...be responsive to communications from other Federal agencies, auditees, and non-Federal auditors about single audit matters and an individual to whom any single audit inquiry or matter can be directed.” Also, we recommend that this paragraph be expanded to require communication of the names, addresses, and telephone numbers of the respective NSACs to nonfederal auditors and auditees.

Pages 6 and 7: These sections discuss the three types of evaluations conducted on work performed by a nonfederal auditor—the preliminary screening, the initial review, and the quality control review. To ensure that these evaluations are performed on a timely basis, we recommend that the Orange Book include expected timetables for the completion of each evaluation. For example, perhaps the preliminary screening should be performed by the cognizant agency for audit within 30 days of receipt of the audit report.

Pages 6 and 7, fourth and fifth sentences of the third paragraph under Initial Review: These sentences state, “The management letter may be reviewed to determine if it contains findings that meet A-133 reporting criteria but were not included in the report. The cognizant agency for audit may choose to issue the report as substandard if findings meeting the criteria in A-133 were identified in the management letter and not included in the report.” We question whether this guidance is intended to only include the requirement in A-133, Sec. __505(d)(3) to report findings and questioned costs for federal awards as defined in A-133, Sec. __510(a), or is intended to also include the requirement in A-133, Sec. __505(d)(2) to report findings relating to

the financial statements required to be reported in accordance with *Government Auditing Standards*. Because the findings relating to the requirements of *Government Auditing Standards* are very subjective and rely heavily on auditor judgment, we recommend that this guidance be clarified in the final document to specifically reference *only* the reporting requirements of A-133, Sec. __505(d)(3) and Sec. __510(a).

Page 7, first sentence of the first paragraph: This states, “The cognizant agency for audit performing the initial review should inform other Federal agencies, applicable program officials, and, *when appropriate*, the non-Federal auditor and the entity, of the initial review results and make recommendations for follow-up action as needed (emphasis added).” In the past, nonfederal auditors have generally received a letter regarding the initial review and its results from the cognizant agency for audit. This is an important communication, and we would like to see this option included as a requirement in the final document. Therefore, we recommend that this sentence be revised slightly to read, “The cognizant agency for audit performing the initial review should inform other Federal agencies, applicable program officials, the non-Federal auditor, and the entity of the initial review results and make recommendations for follow-up action as needed.”

Page 8, Coordinating the QCR with the Non-Federal Auditor: This section contains the following sentence: "PCIE policy is that Federal agency representatives should not sign a Letter to the Regulator such as that found in AICPA Professional Standards, AU Section 9339, which the non-Federal auditor may ask the reviewer to sign."

We believe that it would be unfortunate to finalize the Orange Book with this potentially contentious issue unresolved. It would leave nonfederal auditors and quality control reviewers in an unnecessarily adversarial position. AU Section 9339 predates the Single Audit Act Amendments of 1996 and the current version of OMB Circular A-133. We believe that the Auditing Standards Board and the PCIE should try to find a compromise solution on this issue.

We recommend that the PCIE contact the ASB to discuss updating or clarifying AU Section 9339 to specifically address quality control reviews done pursuant to the Single Audit Act Amendments of 1996 and OMB Circular A-133.

Page 9, Coordinating QCR with Other Federal Agencies: This section states, “Multiple QCR dates are discouraged. All participating Federal agencies should plan to perform the QCR during the times specified by the lead Federal agency. However, if a Federal agency

requests to participate in the QCR, but cannot attend during the dates scheduled by the lead Federal agency, appropriate accommodations may be made for exceptions. The other Federal agency should generally start within one week before or after the dates the lead Federal agency has scheduled for the QCR.”

We believe that this section can be improved by making it more consistent with the spirit underlying the single audit concept. An underlying premise of the single audit concept is the need to alleviate the burden of multiple audits of federal grantees. The same spirit should extend to QCRs of single audit auditors.

We recommend that this section be revised to state that the lead federal agency should invite other federal agencies to either (1) participate on the QCR team or (2) send the lead federal agency any specific special concerns that they want addressed by the review team. Ideally, this section should state that all federal agencies (after having been given the chance to participate) would accept the QCR results of the lead federal agency. At a minimum, the guidance should state that in the event a second federal agency decides to undertake its own review, that second federal agency should ensure that its review builds upon the review work done by the lead federal agency.

We also recommend that the order of the process be changed slightly. The guidance as proposed on pages 8 and 9 indicates that the lead federal agency contacts the nonfederal auditor and schedules a mutually agreeable date and then (on page 9) under "Coordinating with Other Federal Agencies," the other federal agencies should be contacted after the date has been agreed upon with the nonfederal auditor. We recommend that the lead federal agency attempt to coordinate with other federal agencies on a proposed date *before* final agreement with the auditor on a QCR date.

To ensure sufficient lead-time and to minimize disruption of the auditor's normal activities, we further recommend that the first sentence of this section be expanded slightly to read “At least 30 days in advance of the anticipated date of review, the lead Federal agency should make contact with the non-Federal auditor to schedule a mutually agreeable date and place for the QCR.”

In addition, we recommend item 4 of the first paragraph, which would require that the nonfederal auditor provide copies of requested working papers by the end of each work day, be rewritten to read "(4) availability of requested working paper copies in a timely manner." Item 4 as written is a very specific requirement being placed on the auditor.

Although we understand the desirability of providing the requested working papers as promptly as practicable, we suggest a less stringent requirement for such requests.

Page 10, first paragraph: This paragraph quotes the *Uniform Quality Control Review Guide for A-133 Audits* to say, “it is intended that this checklist serve as the principle documentation...” We recommend that “principle” be replaced with “principal.”

Page 11, second paragraph: This paragraph states, “If determined necessary, the Federal reviewer may re-perform audit tests already performed by the non-Federal auditor. However, this is not required by the Guide and should only be used when there is a question concerning the adequacy and sufficiency of the testing performed.” We disagree that re-performing audit tests would resolve questions regarding the adequacy and sufficiency of audit testing. We believe that these questions would be more appropriately assessed through the review of the sampling plan and attributes/dollars tested. In our opinion, re-performing audit tests would appear to be necessary only if there were a concern whether the test work was actually performed. Any re-performance of audit work should be very carefully coordinated, because it would not only require the additional cooperation of the auditee, but also raise suspicions about the integrity of the nonfederal auditor. For these reasons, we strongly recommend that the second paragraph be revised to read, “Only when determined to be absolutely necessary, the Federal reviewer may re-perform audit tests already performed by the non-Federal auditor. However, this procedure is not required by the Guide and it should only be done when there is a question about whether the audit tests were actually performed.”

Page 11, first two sentences of the fourth paragraph: These sentences state, “QCRs should be performed on final audit reports. However, on rare occasions, an interim QCR may be performed after the non-Federal auditor’s field work is complete, but before a final report has been issued.” We are very concerned with this permissive guidance. Because the findings and recommendations in audit reports are subject to change at any time until the reports are subjected to auditor quality control reviews, approved, and issued, we strongly discourage allowing interim QCRs. We recommend that the fourth paragraph on Page 11 be deleted. If this paragraph is retained, at a minimum, it should be rewritten to (1) specifically define “rare occasions” and (2) permit an interim QCR to be performed *only* with the prior approval of the nonfederal auditor and auditee.

Page 11, third paragraph: This paragraph states that prior to the conclusion of the QCR, the reviewers, the nonfederal auditor, and if appropriate, representatives from the auditee should hold an exit conference and "During this time, the QCR reviewers should discuss noncompliance and related required corrective action." Later on this page, under the heading *Reporting Results of the QCR*, the draft guidance provides that the participating federal agencies should report the results of their review within 30 calendar days and that "Once the lead Federal agency has received all other Federal agency comments, the lead Federal agency should then issue an initial communication on the QCR results to the non-Federal auditor within thirty calendar days." The federal agencies should discuss with the auditor during the exit conference *all* items that will potentially be included in the report. The purpose of the exit conference is defeated if new items appear in the initial report two months later. We therefore recommend adding a provision that requires the discussion during the exit conference of all noncompliance and related required corrective action.

Page 11, last paragraph, and Page 12, first two paragraphs: These paragraphs outline the time frames and the process for reporting results of the QCR. We are concerned that the time frames provided at each step in the process may unnecessarily delay issuance of the final QCR report. For example, the first sentence in the last paragraph on Page 11 states, "Other Federal agencies that attended the QCR should submit a report of findings, recommendations, and noncompliance issues to the lead Federal agency within thirty calendar days of the completion of the QCR fieldwork." If those other federal agencies properly discussed their findings, recommendations, and noncompliance issues with the auditee during the QCR exit conference, we see no reason that it should take up to 30 calendar days to submit those same issues to the lead federal agency. We recommend that the lead federal agency be required to obtain all working papers and supporting documentation from the other federal agencies before leaving the review location at the completion of QCR fieldwork.

Page 11, Reviewed Firm Representations: Page 11 discusses a representation letter that the quality control reviewers will ask the reviewed firm to sign. Attachment 1 is an example of this letter. It says "we have made available to you all working papers and all other supporting documentation related to the audit under review." We believe that the representation letter is a good idea. But we are concerned that the phrase "and all other supporting documentation related to the audit" is too vague and overly broad. "All other supporting documentation" may be construed to include much

documentation that the auditor saw and relied upon during the audit, but did not include in the workpapers.

We recommend that the PCIE work with the Auditing Standards Board to arrive at mutually agreeable language that fulfills the objectives inherent in the representation letter concept.

Page 12, Resolution of Audit Quality Issues—Technically Deficient:

We believe that additional clarification in this section is needed. The guidance states, "Technically deficient audits contain deficiencies requiring corrective action that do not appear to affect the audit results." It then states that the nonfederal auditor may correct the audit and the federal agency may perform a second review of the revision, and if the revised audit meets standards, the revised audit would be issued as acceptable. If a deficiency does not affect the audit results, we do not understand why the audit would have to be reissued. This section also states (first paragraph on page 13), "If the audit is not corrected the Federal reviewer may issue the audit as technically deficient." We do not understand how or why the federal reviewer can issue the audit.

If what is meant is that the "Federal reviewer may issue the QCR report deeming the audit technically deficient," then we recommend that the guidance in this section be reviewed, with careful attention to the use of the words "audit" and "review." The QCR report that is issued by the reviewing agency should not be referred to as an audit.

Page 13, first paragraph: This paragraph states, "Acceptable audits contain no deficiencies or only minor deficiencies that do not require any changes or corrective action for the current audit. Audits that are in compliance with A-133 requirements are determined to be acceptable." Because the first sentence of that paragraph acknowledges that minor deficiencies are permissible, we recommend that the second sentence be revised slightly to read, "Audits that are in substantial compliance with A-133 requirements are determined to be acceptable." We also recommend a similar revision ("Any substantial noncompliance...") in the paragraph on Page 20 that addresses conditions for recommending sanctions.

Page 13, third and fourth sentences in the second paragraph: These sentences define technically deficient audits and state, "If the revised audit is found to meet standards after a second review, the revised audit would be issued as acceptable. If the audit is not corrected, the Federal reviewer may issue the audit as technically deficient." Our concern here is similar to the concern above regarding Page 12 (Resolution of Audit Quality Issues—Technically Deficient). Because a reviewer would not

issue an audit report, we believe these two sentences may confuse the audit report with the QCR report. For clarity, we recommend that these two sentences be revised to read “If the revised audit is found to meet standards after a second review, the revised audit should be considered acceptable. If the audit is not corrected, the Federal reviewer may consider the audit as technically deficient.”

Page 13, first sentence of the fourth paragraph: This sentence states, “It is PCIE policy to make referrals when the reviewer concludes the work of an individual audit was substandard....” To properly recognize who is making the referrals and to whom the referrals are made, we recommend that this sentence be revised slightly to read “It is PCIE policy for the cognizant agency for audit or lead Federal agency to make referrals to appropriate oversight organizations when the reviewer concludes that the work of an individual audit was substandard....”

Page 13, second sentence of the fifth paragraph: This sentence states, “After the AICPA Ethics Committee renders a decision, a referral may be made to the State Board of Accountancy, if appropriate.” However, the fourth sentence of that same paragraph appears to contradict that guidance by stating, “These referrals may be made concurrently to the AICPA Ethics Committee and the appropriate State Board of Accountancy, with a copy given to the AICPA Peer Review Committee.” We recommend that the appropriate time of the referral to the state board of accountancy (either *after* or *concurrently*) be clarified in the final document. The PCIE should note, however, that the AICPA’s ethics enforcement procedures allow its investigation to be deferred while the state board of accountancy investigation is carried out. Hence, making concurrent referrals will probably delay the AICPA investigation.

Pages 13 and 14, Referrals on Deficient Audits: This is a very important section for obvious reasons, and we believe it should be expanded. It will be helpful if this section refers to the Joint Ethics Enforcement Process (JEEP) used to administer joint AICPA and state CPA society ethics investigations. It will also be helpful to explain the limitations inherent in making referrals to the AICPA (i.e., the AICPA cannot investigate complaints against non-AICPA members and that the maximum sanction that the AICPA can impose on a practitioner is expulsion from the Institute). This section also does not contain any guidance on how referrals should be written. (The Orange Book’s attached “example referral letters” are only cover letters.) In 1988, the PCIE issued a “position statement” that defines what a referable action is and the procedures for and exact content of a referral from an OIG.

The Orange Book should strive to be consistent with that position statement.

We recommend adding the following to this part of the Orange Book:

- An explanation of the JEEP, why it was established (in part, at the specific request of the PCIE), how it operates, who participates, what the possible outcomes can be, and so forth. (We are confident that the AICPA Ethics Committee would agree to help draft this addition.)
- Guidance on what referrals should contain. For example, this section should note that the AICPA's JEEP standard is one of *prima facie* evidence. The referral process can be improved if the PCIE and QCR reviewers understand this *prima facie* evidence concept and are given examples of what should and should not be included in referrals. (Again, we are confident that the AICPA Ethics Committee would agree to help draft this.)

Page 14, Coordination of Reviews Other than A-133 Audits: This section introduces the term “non-Federal Auditee” but does not define what the term means. Consequently, the meaning of this section is unclear.

We recommend that the term “non-Federal Auditee” be defined and included among the list of definitions in the appendix or replaced by a more generally recognized term such as “recipient of Federal awards.” We also recommend clarifying the purpose and meaning of this section.

Page 18, last sentence of the first paragraph: This sentence states, “The cognizant agency for audit should also coordinate the decision to grant or deny the waiver with the affected Federal agencies.” However, the last sentence of the second paragraph, also on Page 18, states, “The cognizant agency for audit shall consider whether to coordinate the waiver with the Federal agencies and pass-through agencies having Type A programs at the auditee requesting the waiver.” Because “should” is a much stronger requirement than “shall consider,” we recommend that the inconsistency between these two sentences be corrected.

Page 19, first paragraph: This paragraph lists three pieces of optional information that the auditee may be required to include with its request for waiver. The second introductory sentence states, “The cognizant agency for audit shall consider whether the auditee should provide this

information.” To provide the cognizant agency for audit with clearer guidance, and to ensure that all requests for waiver are treated consistently, we recommend that this paragraph be expanded to provide the criteria or circumstances to be considered in making the decision to require additional information.

Page 19, last sentence of the fourth paragraph: This sentence states, “The cognizant agency for audit should periodically review blanket waivers for possible modification or cancellation.” Because each federal agency may interpret “periodically” differently, we recommend that this sentence include a specific time frame, such as the following: “At least biennially, the cognizant agency for audit should review blanket waivers for possible modification or cancellation.”

Page 19, Acknowledgment of Waiver, Item (5): The term "extraordinary conditions" is used when discussing the Blanket waiver. In an earlier paragraph on the same page under the heading "Blanket Waivers," there is no discussion of a requirement that "extraordinary conditions" must exist in order to obtain a blanket waiver. It does not appear appropriate to introduce the term here in this paragraph where it is simply listing the items that the OIG's acknowledgement letter should contain. We recommend either deleting the phrase "extraordinary conditions" or revising the earlier paragraph to discuss that extraordinary conditions must exist in order to obtain the waiver.

Page 20, second paragraph, Conditions to Recommend Sanctions : The second sentence of the paragraph which begins "For example, if the auditee . . ." is not a complete sentence. We recommend that this be revised to read “Instances of noncompliance with an administrative requirement would include the auditee not filing its audit report timely or improperly procuring the non-Federal auditor.”

Page 22, Appendix, definition of initial review: In the reference to the "Act," we recommend that the title of the Act be included, especially because the "Act" is not included in the glossary. Also, under this same definition, it refers to "Standards for Audits of Governmental Organizations, Programs, Activities and Functions issued by the Comptroller General of the United States." That is the old name for the yellow book, which is now titled *Government Auditing Standards*.

Page 25, Attachment 2, first sentence of the third paragraph: This prompts the reader to insert appropriate language in “...we believe the audit work performed on the [Auditee] [opinion] the requirements....” Because the QCR reviewer is not issuing an opinion, we recommend that this phrase be revised slightly to read “...we believe the audit work

performed on the [Auditee] [insert results of review] the requirements....”

Page 27, Attachment 4a: This is a sample referral letter to the AICPA Ethics Division. The guidance on Page 13 provides that the cognizant agency for audit should refer the audit report to the AICPA Ethics Division either previously or concurrently (see our comment above regarding Pages 13-14) with its referral to the state board of accountancy. We recommend that this sample referral letter be expanded to state clearly that the audit report has also been referred to the state board of accountancy. Similarly, we recommend that Attachments 4b and 4c also be revised to indicate to which oversight bodies the audit report is being referred.

Page 28, Attachment 4b, second sentence of the third paragraph: This sentence states, “Accordingly, we are referring the audit to the Professional Ethics Division of the *American Institute of Certified Public Accountants* for review and possible action.” We believe this letter should be a notification of action taken. Accordingly, we recommend that this sentence be revised to read, “Accordingly, on [provide date] we referred the audit to the Professional Ethics Division of the American Institute of Certified Public Accountants.” (We do not think that the name of the AICPA needs to be italicized.)

Page 29, Attachment 4c, Sample Referral Letter to State Board of Accountancy: This sample letter does not contain a place for the name of the audit firm being referred. Although it refers to the attached QCR report, we recommend that the name of the audit firm being referred be included in the sample cover letter.

Pages 31 and 32, Attachments 6a and 6b: These sample letters both request that the auditee forward a copy of the letters to the Federal Audit Clearinghouse. However, the Federal Audit Clearinghouse is already “cc'd” on the letters, meaning that the Clearinghouse will receive a copy of each letter at the same time it is sent to the auditee. To reduce the apparent duplication of effort, we recommend that the sample letters in Attachments 6a and 6b be revised to ensure that the Federal Audit Clearinghouse receives only one copy of each letter.

Page 36, Attachment 8b: This attachment is a sample acknowledgment letter in which a request for a waiver is denied. The second paragraph of the sample letter states that the auditee previously received a qualified opinion, indicates the reason for the qualified opinion, and concludes with the sentence “However, it is not in the best interest of the Federal government to grant this waiver.” Because we believe that

the first two sentences of the second paragraph already provide an adequate explanation why the waiver is not being granted, we question the language contained in the last sentence, as well as its link to the previous sentences. We recommend that the last sentence be revised to read, "Therefore, we deny the request for waiver."

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Again, the FMSB appreciates the opportunity to provide comments on this ED. Should you have any questions, or desire further details on FMSB's position, please contact me at (216) 583-8276 or james.williams17@ey.com, or Dave Cotton, the FMSB facilitator for this project, at (703) 836-6701 or dcotton@cottoncpa.com.

Sincerely,

James M. Williams, CPA, CGFM, Chair,
AGA Financial Management Standards Board

cc: Mr. Richard V. Norment, CGFM
AGA National President