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Via Internet to Julie Anne Dilley at jdilley@aicpa.org

Ms Julie Anne Dilley
Audit and Attest Standards
File Reference 3044
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms Dilley:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments on the AICPA Auditing Standards Board's (Board's) Proposed Statements on Auditing Standards (SAS), *Amendment to Statement on Auditing Standards No. 95 Generally Accepted Auditing Standards; Audit Evidence; Audit Risk and Materiality in Conducting an Audit; Planning and Supervision; Understanding the Entity and Its Environment and Assessing Risks of Material Misstatement; Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*; and *Amendment to Statement on Auditing Standards No. 39, Audit Sampling*. These proposed standards provide revisions, guidance, and examples of the fieldwork and reporting standards focusing on the audit risk assessment process.

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 also encouraged to comment separately.

General Comments

The FMSB generally agrees with the proposed standards. In many instances, the proposed standards simply provide an increased understanding of the provisions of existing standards by requiring additional documentation and providing additional guidance and examples. However, we believe that the exposure drafts, in conjunction



with SAS 99, *Consideration of Fraud in a Financial Statement Audit*, should achieve the goal of increasing audit effectiveness and may help restore the public's confidence in the audit industry after the corporate failures of recent years. We also believe this increase in audit effectiveness will occur with a significant increase in the number of audit hours necessary to meet these standards. Auditors confronted with contractual or statutory completion dates for audits will need to explore alternative practices such as conducting interim testing, hiring additional audit staff, or working longer hours.

Many of the FMSB members are concerned with the effect the Statements on Auditing Standards (SASs) have on governmental audits, particularly those of state and local governments. State and local government auditors are concerned primarily with two basic sources of auditing standards— generally accepted auditing standards (GAAS) promulgated by the AICPA and those promulgated by the United States General Accounting Office (GAO) in *Government Auditing Standards* (GAS). The phrase “financial statements taken as a whole” is used repeatedly throughout the proposed draft *Audit Risk and Materiality in Conducting An Audit*. With the implementation of the new financial reporting model, auditors of state and local governments no longer report on the fairness of the financial statements taken as whole. Since we do not think the Board's intention is to change the requirements for government audits, we suggest that a footnote be included to reference the AICPA Audit and Accounting Guide, *Audits of State and Local Governments* (GASB 34), paragraph 14.04 and its provision for basing an audit opinion on *opinion units*.

Additionally, given the number of auditors who perform financial statement audits for governments and not-for-profits, it is regrettable that there are no examples that apply specifically to a government or a not-for-profit organization. We recommend that the Board consider including some examples of governments or not-for-profit organizations.

Throughout the proposed standards, the term “reportable condition” is used to define a deficiency in internal control. Considering the recent exposure draft on internal control entitled *Communication of Internal Control Related Matters Noted in an Audit*, which replaces the term “reportable condition” with the term “significant deficiency,” we recommend that the proposed standards reflect that change.

In addition to the general comments, please note the following comments:

Audit Evidence

The assertion “accuracy” is listed under Paragraph 6(a) relating to classes of transactions and events and Paragraph 6(c) relating to assertions about presentation and disclosure but is not listed as an applicable assertion under 6(b) for assertions relating to account balances. It seems that the “accuracy” assertion is embedded or understood in all of the relevant assertions. For example, can management make an assertion relative to occurrence, completeness, cutoff, or classification and not also be making an assertion about the accuracy of the transactions and events. In

addition, if the “accuracy” assertion is relevant to assertions about transactions and events and assertions about presentation and disclosure, it is certainly also relevant to assertions about account balances. We recommend that the “accuracy” assertion either be removed from Paragraphs 6(a) and (c) or be added to Paragraph 6(b) as well.

In addition, the assertion “classification” is not included in Paragraph 6(b) for account balances. It appears that the “classification” assertion is as relevant for account balances as it is for transactions and events. For example, management’s classification of assets and liabilities as either current or noncurrent is important information. We recommend that the “classification” assertion be included in Paragraph 6(b) for account balances.

Audit Risk and Materiality in Conducting an Audit

Paragraph 26. We suggest that the second sentence include an example of a nonquantitative risk range, such as “...or in nonquantitative terms that range, for example, from a minimum to a maximum”.

Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained

Paragraph 4. We suggest deleting this paragraph because auditors performing audits in conformity with generally accepted auditing standards are expected to comply with all existing auditing standards.

Paragraphs 39 and 40. We suggest combining these two paragraphs to clarify the requirement for testing some controls each audit rather than testing all controls in one audit period. We suggest the new paragraph read as follows:

“39. Where there are a number of controls for which the auditor determines that it is appropriate to use audit evidence obtained in prior audits, the auditor should test the operating effectiveness of some controls each audit, ensuring that the operating effectiveness of all such controls are tested at least every third audit. The auditor is required to retest a control being relied on at least every third audit because the longer the time elapsed since the control was tested, the less audit evidence is provided about its operating effectiveness in the current audit period. The auditor should avoid testing all controls in a single audit period with no testing of controls in the subsequent two audit periods. In addition to providing audit evidence about the operating effectiveness of the controls being tested in the current audit, such tests provide collateral evidence about the continuing effectiveness of the control environment and, therefore, contribute to the decision about whether it is appropriate to rely on audit evidence obtained in prior audits. In considering the length of the time that may elapse before retesting a control, the auditor considers the control environment, the entity’s monitoring of controls,

general IT controls, and the effectiveness of the control and its application by the entity. Factors that decrease the period for retesting include a weak control environment, manual controls, personnel changes, or weak general controls. The higher the risk of material misstatement, or the greater the reliance on controls, the shorter the time elapsed should be.”

Paragraph 53. We suggest revising the last sentence to clarify the intent of the sentence, for example, “...or the substantive procedures should be performed as of the period end rather than on an interim basis.”

Paragraph 54. This paragraph provides that in circumstances where risks of material misstatement due to fraud are identified the auditor may want to change the timing of audit procedures. It states “For example, the auditor might conclude that, given the risks of intentional misstatement or manipulation, audit tests to extend audit conclusions from an interim date to the period-end reporting date would not be effective. In such circumstances, the auditor might conclude that substantive procedures should be performed at or near the end of the reporting period to best address an identified risk of material misstatement due to fraud.” The intended meaning is unclear. Is the Board’s intent that when risks of material misstatement due to fraud are identified, interim audit procedures should be abandoned in favor of period-end substantive procedures only? Or is it the Board’s intent that interim audit procedures should be abandoned in favor of period-end substantive procedures combined with tests of controls to cover the remaining period? We suggest revising the language to clarify the intention of this paragraph.

Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

Appendix A. We recommend that a discussion for governments and not-for-profits be included in the “Nature of the Entity” section.

Again, the FMSB appreciates the opportunity to provide comments on these exposure drafts. Should you have any questions, or desire further details on FMSB’s position, please contact me at (334) 242-9224 or Sharon.Russell@Examiners.state.al.us or Dianne McKay, its facilitator for this project at (615) 741-9743 or dianne.mckay@state.tn.us.

Sincerely,



Sharon R. Russell, CPA, CGFM, Chair
AGA Financial Management Standards Board

Cc William J. Anderson, Jr., CGFM
AGA National President