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2208 Mount Vernon Ave  
Alexandria, VA 22301

(703) 684-6931  
(703) 548-9367 (fax)



August 15, 2006

Mr. Jeffrey C. Steinhoff  
Managing Director  
Financial Management and Assurance  
GAO-06-729G  
United States Government Accountability Office  
Washington, DC 20548

Dear Mr. Steinhoff:

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 (ED) of the 2006 revisions of *Government Auditing Standards* issued in June 2006. 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.

In general, the FMSB concurs with the proposed revisions contained in the ED. We do have the following comments in response to the “Questions for Commenters” contained in the ED, and a few additional comments not specifically solicited.

### **Chapter 1 – Use and Application of GAGAS**

We agree with the proposed changes regarding the application and use of the terminology defining professional requirements in GAGAS. We were pleased to see clarifying language which is consistent with the AICPA’s guidance on use of terminology such as “must; or “is required” and “should.” We like the differentiation between unconditional (must), presumptively mandatory (should), and explanatory materials (may).

We also concur with the proposed guidance concerning “Citing Compliance with GAGAS in the Auditor’s Report.” We believe the proposed guidance provides the necessary level of guidance but allows for the use of professional judgment. It would be beneficial if it were to “push” auditors to do a better evaluation of the procedures that must/should be performed in an audit/attestation engagement. It may help reduce the number of “low quality” government audits.

We agree with the revision’s addressing and recognizing other standards in addition to the AICPA and the IIA (such as the IAASB and the PCAOB).

Paragraph 1.35 – the lead-in sentence is somewhat confusing. It does not seem that, “Performance audits provide reasonable assurance that the auditors have sufficient, appropriate evidence....” Instead, it seems that, “Following the standards provides reasonable assurance that the auditors have sufficient appropriate evidence....” While the rest of the paragraph is logical, the reader can get confused about the meaning /context of the first sentence.

Paragraph 1.36 – We do not think this is limited just to performance audits. These elements and description are, to a great extent, applicable to any independent audit process and engagement. We suggest that this could at least be acknowledged, perhaps in a footnote.

## **Chapter 2 – Auditor’s Ethical Responsibilities**

We support the proposed principles-based framework for ethics.

## **Chapter 3- General Standards**

Nonaudit Services – Overall, we concur with the streamlined language and reorganization of the nonaudit services discussion. The section appears to be clear and presented logically. The addition of the examples in Appendix A of nonaudit services unique to the government environment are particularly helpful and will provide additional clarification. However, we feel that the exposure draft could be improved by consideration of the following specific comments.

Paragraph 3.05 – It would be helpful if the guidance would specify whether the representations from the specialist regarding their independence must be in writing or can be oral.

Paragraph 3.18 – It is not clear what is meant by adding the phrase “or to those charged with governance.” Evidently, there are some anticipated instances when the head or deputy head of a government will not be the ones charged with governance. A footnote to explain this (with examples) would be helpful.

Paragraph 3.35 – For clarification, the word “each” should be added on the last sentence, as in, “...the audit organization must comply with each of the following safeguards.”

Paragraph 3.52 – We realize that it is taken from the PCAOB terminology, but suggest that clarification be added as to the meaning of the term, “non-issuer” in the first sentence.

Paragraphs 3.30-3.35 – The discussion could be clearer with regard to situations where the government auditor is required by law to perform the work, even if there is an independence impairment. We suggest the addition of guidance and/or an example of the content of the report in that situation. There should also be guidance that states that when you are in this situation, you should still be required to be as independent as possible, even if there is a perceived impairment. The GAO should consider if certain safeguards should be required.

Quality Control and Assurance – We concur with the expanded discussion which includes specific elements which need to be present in an audit organization’s system of quality control. However, we are not sure what is to be accomplished by making the description of the overall system of quality assurance public (Paragraph 3.70a). We have no objection with making it available to oversight bodies, but do not see the benefits in providing it to the public. Perhaps GAO could consider adding some description of the benefits which will be provided by the new transparency requirement.

External Peer Review Guidance – Overall, we like the concept of the risk-based peer review time frames. We concur with the proposed revisions allowing audit organizations that meet certain specified criteria to have reviews performed once every five years rather than every three years. However, we believe that the guidance contained on Page 61, Paragraph 3.70(c) should be clarified by providing answers to the following. How would this be initially implemented? Would an entity have to implement

and follow such an inspection program for three years, and then undergo an external review that validated the success of that program? Would the entity then wait five years before its next external peer review?

We are not sure what type of “Internal Inspection Program” would be necessary in certain circumstances. Would a separate “inspection” system have to be set up if a small audit shop already had a review process that addressed GAGAS standards for each separate engagement, immediately after an engagement is completed? If a small audit shop incorporates a review process that checks to make sure applicable standards were followed for each separate engagement (e.g. through completion of standards checklists), would a separate inspection system have to be incorporated? The proposed guidelines seem to be a potentially duplicative requirement and an inefficient use of resources in re-reviewing audits in relatively small audit shops that essentially perform substantive quality control audits and where audit management is actively involved and aware of “general requirement” issues/standards. We suggest this situation be addressed and the guidance clarified.

The guidance provides that as one of the conditions for going to a five-year cycle the “most recent external peer reviewers identified no significant deficiencies in the internal quality inspection process.” The definition of “significant deficiency” should be clarified. Does it mean that there is no letter of comment item involving the audit organization’s annual internal quality inspection process? Or, alternatively, is the criteria still considered as having been met if there was a letter of comment item regarding the internal quality inspection process but the opinion was unmodified? Some additional clarification on this item would eliminate the potential for inconsistent interpretation.

Paragraph 3.68 – We have no problem providing the peer review reports (results) to those charged with governance and other appropriate oversight bodies, or to the third parties to whom an audit organization reports. But we question the need and appropriateness of providing those reports to the public. The public is not trained to necessarily comprehend or place in proper perspective an external peer review report. We suggest before such a requirement is added, that education be provided to those members of the public who GAO thinks will make use of these reports.

**Chapters 4 and 5, Financial Audits** – We strongly support the adoption of the AICPA SAS No. 103 Audit Documentation provisions as well as the update of the reporting standards to conform with the ASB’s and PCAOB’s definitions of material weakness and significant deficiency in internal controls. We applaud GAO’s efforts to ‘harmonize’ the standards for financial audits in these chapters. Consistency in guidance is a worthy goal to strive for. However, we do have one specific comment. Sometimes government auditors are faced with a circumstance that would never affect the financial statements, and even seem inconsequential, but because of the government’s fiduciary duty related to the funds, a lack of care or some transgression related to the funds is something the public would consider reportable. An example would be lack of care over funds held in trust for nursing home residents. It is not clear from the exposure draft text where these fiduciary responsibilities circumstances would fall when discussing items that are reportable in an audit report. We suggest the GAO add some guidance on this before the standard becomes effective.

**Chapter 7, Performance Audits** – In general we agree with the discussion of levels of assurance, significance, audit risk, and their application. We think that certain parts could be rewritten to be clearer, however.

Paragraph 7.05 – the last sentence contains the phrase “material or significant” in explaining what should be reported. But footnote 95 to paragraph 7.04 explains that significant for performance audits is

synonymous with material. This is confusing as the phrase in paragraph 7.05 implies that material is different from significant.

One member who does many performance audits stated that it was very difficult to comprehend the specific changes GAO is proposing in the performance field work audit standards. We strongly recommend this be addressed. It would be extremely helpful if the GAO were to clearly distinguish what is required by this chapter that is not already required by current GAO performance fieldwork audit standards. For example:

a. The reader cannot determine from reading this chapter exactly what type of a new separate “risk assessment” is required (see paragraph 7.77b) and what form that risk assessment would take in the auditor’s work papers. Is this an assessment that the audit evidence obtained was adequate (sufficient and appropriate) such that the audit risk is sufficiently “low”? Or would the assessment consist of documentation of the items listed in paragraph 7.14? And, if the answer to that is yes, then how would that be different from the requirement in paragraph 7.77g?

b. What type of risk assessment is addressed in paragraphs 7.13 and 7.14? Does it cover audit risks (i.e., risks that the audit does not detect significant issues) or risks relating to noncompliance, inadequate controls, and inefficient or ineffective programs?

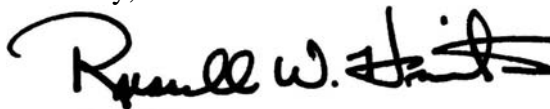
c. Various sections of this chapter are hard to follow. We suggest that consideration be given to rewriting these to flow more easily and be easier to follow. Paragraph 7.06, for example, seems very incomplete in places as to what the author is trying to say, as is paragraph 1.35.

d. Paragraph 7.77 is supposed to be items that are in addition to the items in paragraph 7.76. There seems to be unintentional overlapping. For example, it would appear that item d in paragraph 7.77 is the same as item a in paragraph 7.76. We recommend an explanation be provided as to what is different between the two items.

Appendix – Some of the information in the Appendix is very useful. Some topics in the Appendix appear to be new guidance that might be better represented in the body of the text of the standards, rather than separate and hidden away at the end of the document. We suggest the use of footnotes or references to incorporate such new information.

The FMSB appreciates the opportunity to comment on the exposure draft. No members objected to the issuance of this comment letter. We would be pleased to discuss the issues in 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. Jeffrey S. Hart, CGFM, CFE  
AGA National President

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