



National State Auditors Association

April 30, 2009

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Ms. Sherry Hazel
Audit and Attest Standards
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Hazel:

On behalf of the National State Auditors Association, we appreciate the opportunity to respond to the AICPA Auditing Standards Board's proposed Statements on Auditing Standards (SAS) entitled, *Audit Evidence (Redrafted)*; *Materiality in Planning and Performing an Audit (Redrafted)*; *Evaluation of Misstatements Identified During the Audit, Planning an Audit (Redrafted)*; *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Redrafted)*; and *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (Redrafted)*.

We generally agree with the provisions in the proposed statements. As requested, we offer the following responses to the questions posed by the ASB:

1. Are the auditor's objectives appropriate?

Yes, the auditor's objectives are appropriate.

2. Are revisions from the existing standards to converge with the ISAs, appropriate?

Yes, the revisions from existing standards to converge with the ISAs are appropriate. However, we do have the following suggestions:

Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Redrafted):

- Paragraph 4 – The definition of internal control would be clearer if the word “designed” was replaced with “designed, implemented, and maintained.”
- Paragraph A110 – For the most part, we agree with the revisions to this paragraph. For example, we do acknowledge that in state and local governments, management does assert that transactions are made in accordance with laws and regulations. Additionally, auditors consider those laws and regulations when auditing transaction cycles or balances affected by those laws and regulations. However, to suggest, as has been done in the last sentence of this paragraph, that the auditor has to consider that assertion in all financial statement audits reaches too far. We believe that this paragraph has the effect of adding yet one more assertion in all state and local government audits to the lengthy list of assertions that exists now. We contend that there is a difference between a) specifically considering compliance when required to do so, for example when the auditor is auditing in accordance with *Government Auditing Standards*, and b) adding another assertion to the list in **all** state and local government audits. Accordingly, we recommend that the Board simply insert the word “may” back into the last sentence of paragraph A110.

3. Are the differences between the proposed SASs and the ISAs, identified in exhibit A, and other language changes, appropriate?

Yes, the differences between the proposed SASs and the ISAs, identified in exhibit A, and other language changes, are appropriate.

4. Have considerations for audits of smaller, less complex entities and governmental entities been dealt with appropriately?

Yes, considerations for audits of smaller, less complex entities and governmental entities have been dealt with appropriately.

In addition to our responses above, we have the following general comments:

Materiality in Planning and Performing an Audit (Redrafted)

- Paragraphs 9 and A14 – The proposed SAS introduces the term *performance materiality*. While we understand the general concept of performance materiality, the standard does not clearly indicate the expectations of the Board as to how the auditor should determine performance materiality. In paragraph 9 of the Definition section of the standard, the Board defines performance materiality using the term “amounts”. However, in paragraph A14 of the Application and Other Explanatory Material section, the Board indicates that “performance materiality is not a simple mechanical calculation.”

We believe the requirements and explanatory sections are inconsistent regarding whether performance materiality is an amount or something other than an amount. We recommend the Board clarify the requirements surrounding the determination of performance materiality, and if necessary provide additional explanatory material to assist auditors in understanding and meeting this requirement.

- Paragraphs 9, 10, and 14 – The whole notion of establishing, measuring, and evaluating materiality for disclosures has been one of the trickier requirements of these standards. To that point, in this proposed SAS, paragraphs 9, 10, and 14 establish requirements for auditors to come up with the amount that represents materiality for, among other elements of financial statements, disclosures. However, many disclosures only include, or also include, very important information that is narrative rather than numeric. Nothing in the requirements or application sections of this proposed SAS explain to the auditor what materiality is for non-numeric disclosures and how to establish materiality for them. We recommend the Board address this in the requirements section and in application guidance that explains to auditors the expectations of this proposed standard as it relates to determining materiality for disclosures. With this additional information, auditors could understand how they will appropriately meet the requirements of paragraphs 9, 10, 14 with respect to non-numeric disclosures.
- Paragraphs A2 and A3 – For clarity, we suggest the Board reverse the order of these paragraphs and make the following revisions:

~~A3:~~ A2. For most state or local governments, a governmental entity’s applicable financial reporting framework is based on multiple reporting units and generally, the auditor expresses or disclaims an opinion on a government’s financial statements as a whole by providing opinions or disclaimers of opinion on each opinion unit. That is, a state or local governmental entity’s applicable financial reporting framework requires the presentation of financial statements for its varied activities in various reporting units. ~~its business-type activities, and each of its major governmental and enterprise funds.~~ Consequently, a reporting unit, or aggregation of reporting units, of the governmental entity represents an opinion unit to the auditor. Accordingly, in these cases, materiality is established for each opinion unit. In this context, the auditor is responsible for the detection of misstatements that are

~~material to an opinion unit within a governmental entity, but is not responsible for the detection of misstatements that are not material to an opinion unit.~~

A2. A3. In the case of a governmental entity, legislators and regulators are often the primary users of its financial statements. Furthermore, the financial statements may be used to make decisions other than economic decisions. The determination of materiality for ~~opinion units the financial statements as a whole~~ (and, if applicable, materiality level or levels for particular classes of transactions, account balances, or disclosures) in an audit of the financial statements of a governmental entity is, therefore, influenced by legislative and regulatory requirements.

- Paragraph A9 – We would like to commend the Board for its decision to not include specific percentages in the standard to avoid misapplication of the guidance.

Evaluation of Misstatements Identified During an Audit

- The proposed SAS does not include any discussion of the correlation between the proposed SAS and SAS No. 115 – *Communicating Internal Control Related Matters Identified in an Audit*. We recommend the Board include a requirement that when an auditor identifies material misstatements, they should consider the impact on the communications regarding internal control required by SAS No. 115.
- Paragraphs 11 and A16 – Paragraph 11 establishes the auditor's responsibility to determine whether the effect of uncorrected misstatements are material. Paragraph A16 explains that other locations and audit work performed by other auditors are part of this evaluation, and we agree with that application guidance. We observe that in audits of state and local governments, this evaluation can be a common occurrence. We also note that some auditors struggle with practical solutions for meeting the requirements of paragraph 11 in situations in which there are as many as several dozen other auditors supporting the principal auditor's opinion. It would be helpful if the Board could provide some guidance in this regard. We believe the explanation could be lengthy and there may be multiple ways to accomplish the requirements in paragraph 11, as it relates to paragraph A16. Therefore, perhaps the AICPA's State and Local Government Expert Panel should be asked to incorporate guidance about this matter in the AICPA State and Local Government Accounting and Audit Guide. We would be happy to discuss our thoughts with the Board, the Task Force, or the Expert Panel on some of the ways this issue has been addressed in the states.
- Paragraph A16 – We would like to commend the AICPA for its decision to move information from footnote 18 of AU Section 312 into paragraph A16. We advocate including information in the standard as opposed to a footnote if it is necessary for the auditor to understand or appropriately apply the standard.

We also have several editorial comments as noted below.

Audit Evidence (Redrafted)

- Paragraph A33 – This paragraph should be modified for consistency with other references to Professional Standards as follows: "Paragraphs .15-.16 of AU section 329, *Analytical Procedures* (AICPA, *Professional Standards*, vol. 1) provide further guidance..."
- Paragraph A34 – This paragraph refers to paragraph A9 in AU section 316; however, it seems it should be referenced to paragraph A10 of the redrafted AU Section 316.

Materiality in Planning and Performing an Audit

- Paragraphs A10 and A11 – Page 7 headers for paragraphs A10 and A11 should be revised to include the parenthetical reference to paragraph 10 similar to the heading for paragraph A12.

Ms. Sherry Hazel
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Evaluation of Misstatements Identified During the Audit

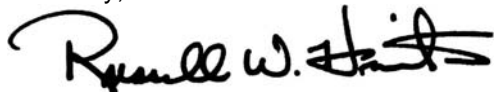
- Paragraph A1 – The header for this paragraph should be corrected to reference paragraph 4 (not 4a).
- Paragraph A23 – This paragraph should be revised to read “In the case of an audit of a governmental entity, the evaluation **of** whether a misstatement...”

Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement
(Redrafted):

- Paragraph A47 – This paragraph should be revised to remove the words “as follows” from the end of the sentence.

We appreciate the opportunity to respond to such an important document. Should you have any questions or need additional information regarding our response, please contact Sherri Rowland of NSAA at (859) 276-1147 or me at (404) 656-2174.

Sincerely,

A handwritten signature in black ink that reads "Russell W. Hinton". The signature is written in a cursive style with a large initial 'R' and a stylized 'H'.

Russell W. Hinton
President, NSAA