



National State Auditors Association

May 29, 2009

EXECUTIVE COMMITTEE

President
RUSSELL W. HINTON
State Auditor
Georgia

President-Elect
DEBBIE DAVENPORT
Auditor General
Arizona

Secretary/Treasurer
WALTER J. KUCHARSKI
Auditor of Public Accounts
Virginia

Immediate Past President
BRUCE A. MYERS
Legislative Auditor
Maryland

LYNN CANTON
Deputy Comptroller
State Services
New York

JANICE MUELLER
State Auditor
Wisconsin

DAVID A. VAUDT
Auditor of State
Iowa

NASACT EXECUTIVE DIRECTOR

R. KINNEY POYNTER
Lexington, Kentucky

CONTACT INFORMATION

Headquarters Office
449 Lewis Hargett Circle
Suite 290
Lexington, KY 40503-3590
(859) 276-1147
Fax (859) 278-0507

Washington Office
444 N. Capitol Street, NW
Suite 234
Washington, DC 20001
(202) 624-5451
Fax (202) 624-5473

www.nasact.org

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 Statement on Auditing Standards (SAS) entitled *Consideration of Laws and Regulations in an Audit of Financial Statements*.

We have reviewed the proposed SAS and generally agree with the provisions contained therein. We did note some areas where we believe the guidance could be clearer. Our comments are below.

Issue for Consideration

We believe that paragraph 12b, by not specifying that inquiries alone may fulfill the requirement, expands the auditor's responsibility as it implies the auditor should at least consider whether he/she needs to perform additional procedures beyond inquiries whereas the existing standard specifically only requires inquiries. However, we believe that this expansion of responsibility is appropriate, as there may be instances where inquiries alone do not provide sufficient information for the auditor to obtain an understanding.

Guide for Respondents

In response to the questions posed by the Board with regard to the proposed SAS, we believe the objectives; convergence revisions; differences between the proposed SAS and ISA 250; and considerations for smaller, less complex entities and governmental entities are appropriate.

Comments by Paragraph

- General – The Board includes the terms *compliance* and *noncompliance* throughout the proposed SAS. As the Board has issued another proposed SAS addressing *Compliance Audits*, we believe it should clearly make the distinction in this proposed SAS, between the two proposed SASs. In addition, we believe the Board should provide application and other explanatory material to indicate specific examples of common laws and regulations applicable to governmental entities. Some examples include:

Laws and regulations that could have a direct effect:

- Statutory formulas for expenditures from one level of government to another level of government
- Laws that describe how to calculate property tax revenues
- Laws and regulations for postemployment benefits

Laws and regulations that could have an indirect effect:

- Noncompliance with environmental regulations such as pollution remediation or landfill postclosure costs
- Noncompliance with IRS regulations such as 1099 reporting or employee/contractor determinations

- Paragraphs 5 and 17 – The second bullet of paragraph 5 alludes to the possibility that noncompliance with laws and regulations can result from fraudulent activity. We believe that it is essential for an auditor to consider this possible correlation in the evaluation of potential noncompliance. In order to emphasize this concept, we recommend the Board include a reference to *AU Section 316, Consideration of Fraud in a Financial Statement Audit*. In addition, we recommend the Board consider adding a requirement in paragraph 17 that when the auditor becomes aware of information concerning noncompliance he or she should consider whether the noncompliance was the result of fraud.
- Paragraph 5 – The third bullet contains the notion that ultimately, noncompliance is a matter of a court of law. However, the proposed standard addresses not only laws, but regulations. Further, in the U.S. environment, noncompliance with regulations, and to some extent on occasions, laws, is determined by other than a court of law (e.g., regulatory bodies and authorities). Accordingly, we believe the third bullet should be revised to better reflect what we see in the U.S. environment.
- Paragraph 11 – For the definition of noncompliance, we note that the definition in this proposed SAS is structured differently than the term material noncompliance as defined in proposed AU Section 801, *Compliance Audits*. We recognize that the usage of those similar terms is dependent on the context within each AU section that the terms are used. However, we ask the Board to compare those definitions, and make corresponding changes in each so that auditors will not be confused when they see these two definitions in close proximity to each other in the glossary of terms defined in the final codification.
- Paragraph 12 – This paragraph explains that the auditor must obtain a general understanding of the legal and regulatory framework applicable to the entity and the entity's compliance with that framework. However, the proposed SAS does not address the auditor's responsibilities, through gaining an understanding, to determine whether the entity has a history of noncompliance with laws and regulations. As we believe this is vital to gaining a sufficient understanding of the risk of noncompliance, we suggest the Board include an additional bullet in paragraph A7 regarding the entity's history of noncompliance.
- Paragraph 16 – We suggest changing the reference at the end of the sentence to "paragraphs 12-15."
- Paragraph 23 – We suggest changing the word "shall" to "should" to be consistent with the remainder of the proposed SAS.
- Paragraph A5 – This paragraph references AU 508 regarding reporting on compliance with certain laws or regulations. There is no guidance in AU 508 regarding reporting on compliance. However, it is in AU 623. Is it the intention of the Board that the location of this guidance will change as part of its clarity project? If not, we believe this paragraph should refer to AU 623, *Special Reports*.
- Paragraph A17 – The heading for paragraphs A16 and A17 references paragraph 15, but paragraph 15 refers only to paragraph A16. We suggest the reference in paragraph 15 be expanded to include paragraph A17.
- Paragraph A20 – The last sentence of the second bullet contains a reference to FASB Statement No. 5. In keeping with the current efforts to make the auditing standards accounting framework neutral, we recommend replacing "FASB" with "the applicable financial reporting framework."
- Paragraph A22 – We suggest changing the word "would" to "will" in the last sentence.
- Paragraph A24 – In this paragraph, a sentence was added (to the ISA version) from extant AU 317 describing factors. While we agree with its inclusion, its location in the paragraph makes the message

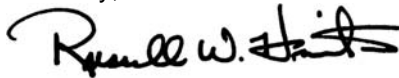
Ms. Sherry Hazel
May 29, 2009
Page 3

awkward. So that this paragraph reads as clearly as possible, we recommend that the sentence beginning with "Factors..." be moved to just after the first sentence.

- Paragraph A26 – This paragraph is confusing as we are unsure about how management can refuse to accept an audit opinion. At least in our circumstances as state audit organizations, management cannot refuse to accept the audit opinion. Secondly, withdrawal may not be an option. Again, in our specific circumstances, law doesn't allow withdrawal from an audit.
- Exhibit A – In the next to last paragraph there is an extra "s" in the first word ("Ssuch").

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, stylized initial "R".

Russell W. Hinton
President, NSAA