



# National State Auditors Association

August 18, 2006

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Jeffrey C. Steinhoff  
Government Auditing Standards Comments  
U.S. General Accounting Office  
441 G Street, NW  
Washington, DC 20548

Dear Mr. Steinhoff:

On behalf of the members of the National State Auditors Association, we appreciate the opportunity to respond to the exposure draft (ED) of the 2006 Revision to *Government Auditing Standards* (GAGAS). Below are NSAA's comments on GAO's specific questions, as well as comments on other major issues we have identified with the revised standards. Additionally, we are providing comments on ways the draft standards could be revisited to improve overall understanding or clarity; these comments are enclosed as an attachment.

While we acknowledge the effort that GAO has put forth in revising GAGAS, our general impression of the draft revision is that the discussion of these standards is becoming increasingly difficult to read and understand. Where many previous versions of *Government Auditing Standards* were written in plain English in a manner that was easy to both read and understand, this draft contains sections that are especially difficult to comprehend and view from a practical standpoint. In some ways, the draft is more like a text book on government auditing than a description of standards, containing an unbalanced proportion of auditing theory to actual instruction. We believe that considerable effort is needed to make the language in the standards as clear and unambiguous as possible.

In addition, the format is not as user-friendly as it could be. The current revision contains paragraph after paragraph of explanatory text without ever clearly identifying the standard, making it very difficult to determine exactly what each standard is. The proposed revisions contain no numbering of the standards, no bolding of text of the standards, and no references to specific statements as standards. Improving the format of the document may help resolve these problems. To do that, we suggest that each standard be clearly and concisely stated and shown in bold face type. Explanatory text should follow in separate paragraphs and should be concise and clear as in the current version and in past versions of the Yellow Book.

Again, we appreciate the opportunity to provide input on proposed GAGAS revisions. Below are NSAA's responses to GAO's specific questions and additional input on each chapter.

## CHAPTER 1: Use and Application of GAGAS

### **Question 1: Use of Terminology to Define Professional Requirements**

We generally agree with the use, meaning and placement of the terms "must," "should," "may," "might," and "could" throughout the proposed revision. We find it helpful that the Yellow Book defines the difference between these terms, and we are pleased that these standards are consistent with standards established by the American Institute of Certified Public Accountants and the Public Company Accounting Oversight Board.

However, we believe GAO should address the use of this terminology as indicated in the following paragraphs:

3.04 – We believe the sentence “...audit organization consider three general classes of impairments” should be clarified by adding “must,” “should,” or “may.”

3.16 – So there will be no confusion as to the discussion about independence for the different types of organizational structures as either a requirement versus guidance, we suggest the second sentence be revised to insert “should” between “structures” and “provide.”

3.67 – Should these be presumptive requirements, as currently worded, or unconditional?

5.08-5.09 – We believe that GAO should replace the term “should” with “must,” as these are unconditional reporting requirements.

7.15.f and 7.47 – There appears to be an inconsistency between these two paragraphs as they relate to preparing an audit plan. The former paragraph states “should” and the latter states “must.” We suggest these paragraphs be consistent.

### **Question 2: Citing Compliance with GAGAS**

1.13 and 1.15 – We do not agree with having three categories for citing compliance with GAGAS, as is required in paragraph 1.13. Further, the descriptions in paragraphs 1.15, a.-c. are described as a matter of professional judgment, however are explained as a series of presumptive requirements to determine the appropriate statement under different circumstances—unqualified, qualified, or adverse. The descriptions, however, may not be consistent and clear.

Readers of auditors' reports need to know that the auditors either complied with or did not comply with GAGAS. It is not clear from the proposed standards what language is appropriate in an auditor's report to differentiate that the compliance with GAGAS was qualified or negative. We believe in either situation, to make the level of compliance more meaningful to the reader, the reader needs to know what was complied with, as well as what was not complied with. Accordingly, in either situation, an auditor will be explaining which standard(s) they did not comply with, if any, and that all other standards were followed. For that reason, we believe there is no difference in a qualified or negative statement. Consequently, we strongly believe that there should be only two options for the auditor—unqualified or modified.

Furthermore, based on the currently proposed three categories, paragraph 1.15 requires the auditor to assess the significance of not following standards, and ultimately to determine whether and to what extent to disclose the condition in the report. It then requires the auditor to consider modifying the GAGAS compliance statement, and adds a sentence that this is a matter of professional judgment. Paragraph 1.15.a, however, precludes an unqualified statement, and paragraph 1.15.c isn't specific if both unqualified and qualified are available to the auditor if a negative statement is not appropriate. We believe the language in a. contradicts the notion of professional judgment and c. needs to be clarified. Paragraph 1.15.b can be interpreted two ways. One interpretation might be that, based on the first sentence, an auditor can use his or her judgment to indicate an unqualified or qualified statement when only *some* presumptive requirements are not followed *for whatever reasons*. A second interpretation might be that, based on the second sentence, the auditor *might be able to* indicate an unqualified statement in these cases if the auditors have justified why they didn't follow the presumptive requirements. The first interpretation is much broader than the more narrow nature of this second interpretation. Therefore, this discussion should be clarified to ensure the intended application of this presumptive requirement is followed.

By only requiring two categories of citing compliance, paragraph 1.15 can be made simple, clear and useful to readers of our reports by discussing what to include in the report when it is other than unqualified.

### ***Additional Comments on Chapter 1***

1.04 – We are concerned with the vagueness of “If auditors hold themselves out as complying with GAGAS.” It seems that this has always meant “if auditors are representing to others that they followed GAGAS in an audit”. However, because of the nature of many of this exposure draft’s revisions, we believe this is likely to be misconstrued or misinterpreted by auditors and report users. We are concerned that readers, auditors, and others (like peer review members) will believe that an auditor followed GAGAS and did not properly report as such in cases in which an auditor’s work and report look similar to a GAGAS audit, even when the auditor did not have to, and chose not to, follow GAGAS. Accordingly, we recommend the second sentence be revised to simply state, “If **auditors** are required to, or choose to, follow GAGAS, the auditors should . . .”

1.18.a – Footnote 7 on page 7 of Chapter 1 states, “Because GAGAS incorporate the field work and reporting standards of the AICPA for financial audits performed in which U.S. auditing standards are to be followed, auditors are not required to cite compliance with the AICPA standards when citing compliance with GAGAS, although both sets of standards may be cited.” We suggest that GAO add language to the above paragraph to make it clearly evident that audit organizations (other than public accounting firms) that follow the option to cite compliance with the AICPA standards are required to follow the AICPA general standards in addition to the general standards of the Yellow Book.

1.19, 1.31, 1.32 – Overall, the standards seem to include a significant amount of redundant information, not only within the document as a whole, but within the same chapter in some cases. For example, paragraphs 1.19, 1.31, and 1.32 appear to make the same point. We suggest these redundancies be removed.

1.35 – Performance audits that aren’t conducted in accordance with standards may not provide reasonable assurance that auditors have “sufficient, appropriate evidence...” Performance audits conducted in accordance with standards, such as GAGAS, provide that assurance. This should be clarified.

## **CHAPTER 2: Auditor’s Ethical Responsibilities**

### ***Question 3: Comments on Framework for Ethical Responsibilities of Government Auditors***

We agree with the addition of a separate chapter on ethical responsibilities and believe it will heighten the awareness of an issue critical to the work of government auditors. However, in all but one occurrence, GAO chose to avoid “must” and “should” language, despite the chapter’s title as “Auditors’ Ethical Responsibilities.” Since GAGAS should be about standards, this section should be revised to state this framework in terms of what the auditor *must*, or *should* be doing. Otherwise, we wonder why it is necessary to devote an entire chapter to something that is other than standards.

### ***Additional Comments on Chapter 2***

2.02 – Intuitively auditors should know that this is a must, but GAO may consider including “must” in paragraph 2.02. Instead of “it is essential” that government auditors observe overarching ethical concepts, state government auditors “must” observe overarching ethical concepts.

2.14 – “...information acquired . . . as a result of business and personal relationships” is too broad and encompasses relationships that may have nothing to do with work/duties, but may still have been developed through professional organization or interest. We suggest this be described in a way that relates to a narrower scope of business and personal relationships in the conduct of duties.

2.16 – The use of “knowledgeable person” here is too broad and can extend into different areas of knowledge. We suggest that GAO use the language in the second sentence of paragraph 3.03, “reasonable and objective third parties with knowledge of the relevant facts and circumstances.”

## **CHAPTER 3: General Standards**

### ***Question 4: Description and Categorization of Nonaudit Services and Their Impact on Auditor Independence***

We generally agree with the overall description and categorization of nonaudit services. However, we do have some concerns as noted below.

The nonaudit services discussed in the appendix paragraphs A3.02 through A3.03 (referred to in footnote 28) seem to add an additional category to those discussed in paragraph 3.30, as the appendix does not specifically indicate which category the nonaudit services fit into. Since the appendix says that the nonaudit services would “generally not impair auditor independence,” they seem to fall under the category discussed in paragraph 3.31; they do not, however, seem to fit the description in that paragraph. We strongly agree that these types of nonaudit services should not impair independence. The explanation and examples in paragraph 3.31 and 3.32 should be expanded to include these services.

Also in reference to paragraph A3.03, item I, whether the work conducted represents a “full-scope GAGAS audit” is not a valid criterion for declaring something a nonaudit service. For example, auditors may choose or be called on to conduct a limited-scope performance audit or attestation engagement. In such cases, the audit organization would conduct that work as an audit or attestation engagement in accordance with all applicable standards. Stated another way, you cannot acknowledge throughout the standards that the work to be performed depends on the audit objectives, then say in A3.03 that audit objectives which are limited in scope (i.e., not a full-scoped GAGAS audit) are really nonaudit services. We suggest GAO define a “full-scope audit” versus an audit which is less than a full-scope.

3.33.a – We are concerned about the absoluteness of the example in this category and its conflict with GAO’s “Answers to Independence Questions” document (Q&A). In some circumstances, if the auditor’s work in preparing draft statements is relatively simple, we believe the requirement to follow *all* supplemental safeguards is excessive. GAO’s Q&A provides an example of these situations. First, Question 30 of the Q&A provides for not needing the safeguard of precluding nonaudit services personnel from performing the audit when such work is under 40 hours. Second, the primary answer to Question 46 of the Q&A provides that as long as the overarching principles are followed, the same audit team can do both the service and the audit. We agree with the answers to both of these questions and believe that the exposure draft does not reflect these answers but should.

Because this nonaudit service is commonly applied, and has a range that fits in multiple categories within paragraph 3.30 of the exposure draft, we believe the final standards need to accurately reflect the range of decisions that an auditor can make. This treatment would be similar to the exposure draft discussion of internal control nonaudit services described in paragraphs 3.33.h and 3.34.j.

3.33.g – This paragraph is inconsistent with the Q&A. This paragraph lists preparing routine tax filings as one of the nonaudit services that would not impair independence if supplemental safeguards are implemented. However, the answer to question 81 in the Q&A indicates that preparing tax returns generally would be considered routine advice that would not violate the overarching principles, and an audit organization would not be required to apply the safeguards. This inconsistency also exists in the 2003 version of the Yellow Book. GAO should correct this inconsistency by either amending the Yellow Book or the Q&A.

3.33.h – The general description provided may call into question the appropriateness of the example residing in this category. The appropriateness seems to depend on the intended use of the information provided by the nonaudit service. If the auditor is documenting processes and internal controls for

management's use and those controls will be considered and tested by the auditor, this would seem to violate the overarching principles, because the auditor would be deciding which controls are important and the auditor would later audit his or her own work. On the other hand, if the subject matter of this nonaudit service relates to areas that are not relevant to, or material to, the auditor's objectives, this example's placement may be appropriate. Given that a distinction has been made in paragraph 3.34.j regarding this subject matter, we believe this example should be elaborated upon so that it is clear under what conditions this type of nonaudit service would not impair independence if safeguards are applied.

3.35.c – This paragraph lists the following as one of the safeguards: “The audit organization precludes personnel who provided the nonaudit services from planning, conducting, or reviewing audit work of the subject matter of the nonaudit service under the overarching independence principle that auditors must not audit their own work.” GAO should add a footnote to inform readers that two exceptions exist to this safeguard as noted in Q&A questions 30 and 46.

***Question 5: Expanded Discussion of Audit Quality and the Related Elements***

The expanded discussion of audit quality and the related elements is appropriate.

***Question 6: Transparency Requirements and the Risk-Based Approach to Peer Review Timeframes***

*Transparency Requirements*

3.68 – A concern we have with this paragraph is that it states that a copy of the peer review report must be sent to all oversight bodies. This could potentially require a lot of copies. Perhaps the last sentence could be rephrased to say “Government audit organizations should also communicate the availability of their external peer review reports to appropriate oversight bodies.”

*Risk-Based Approach to Peer Review Timeframes*

Although we commend GAO's efforts to recognize the importance of quality assurance, we are not convinced the revision of the peer review time frames, specifically the five-year peer review cycle, adds significant value to the peer review process. In addition, we believe the cost savings would be insignificant, and five years is too long to wait for an external peer review even if the internal quality assurance system is extensive and operating effectively. We are also concerned that the revised timeframes are inconsistent with regulatory bodies (state boards of accountancy), other standards setters (AICPA) and other established external peer review programs (e.g., NSAA's peer review program).

Given the frequency of changes in auditing standards and accounting standards, we believe the current three-year cycle is a benefit to all audit organizations. It provides an independent, external look at how audit organizations have interpreted and implemented standards to ensure compliance.

Furthermore, in the current operating environment of the auditing profession, extending the time allowed for external “oversight” through a peer review process does not send the correct message of accountability to the public. A move to a five-year peer review cycle and the self-reporting nature of an audit entity's compliance with its QA process, seems to be at odds with recent concerns over audit oversight and quality, which seek more scrutiny.

Although we question the need for revising the peer review timeframes, if GAO moves forward with the five-year cycle, paragraph 3.70 should be modified to indicate whether an audit organization is required to return to the three-year cycle if its internal reviews indicate deficiencies in its audits. In addition, we believe transition relief/guidance should be provided for criteria outline in paragraph 3.70.c, perhaps in the form of a footnote. Audit organizations undergoing peer reviews in 2007 will not have had time to implement the enhanced criteria, so the audit organization cannot meet this provision to have its 2007 peer review include a review of the annual inspection process. As a result, the audit organization would

have to undergo the next peer review in three years. Perhaps various alternatives are appropriate in these circumstances so that audit organizations with a certain level of demonstrated quality can elect the five-year review cycle if they so choose.

### ***Additional Comments on Chapter 3***

3.64, footnote 40 – The deadline for having a peer review isn't clear. The footnote establishes a "cutoff date" for an organization's peer review (3 years from the beginning of the organization's first GAGAS audit). Then it says that peer reviews generally are completed within 6 months of the "cutoff date." Under extraordinary circumstances, GAO can extend the "time frames beyond 3 months after the peer review completion deadline." It is not clear what this means. Is the completion deadline the same as the cutoff date (if so, they should use the same term)? Or is it 6 months after the cutoff date (if that's the case, then everyone really gets a 9-month grace period)? This should be clarified.

3.66.b – We are concerned with the absoluteness of the requirement in this paragraph that a review team member cannot review the "audit organization" that conducted its most recent review. This provision does not fit all peer review models. It seems this restriction is designed to prevent two audit firms from agreeing to perform each other's peer review, and thus limiting independence. This risk has little, if any, applicability if the peer review is made up of auditors from various peer organizations as is the case with NSAA's program.

As such, if we are forced to apply this concept as proposed, it will severely hamper administration of the NSAA program unnecessarily. In the state audit community, one state audit organization does not review another state audit organization. Instead, teams are comprised of individuals from several states (and often a representative from the federal community). The team is led by a team leader and concurring reviewer. In effect, individuals from a variety of other state audit organizations cumulatively review a "peer" audit organization.

Given the model described above, individual review team members cannot individually or unilaterally influence a review's outcome. The team must reach consensus on the reviewed organization's compliance with quality control policies and procedures. We acknowledge that a team leader and concurring reviewer (conceptually, although not likely) certainly could provide inappropriate influence to direct the review's outcome. For that reason, we believe that in the NSAA model, reciprocity prohibitions should only apply to the leadership of the team, i.e., the team leader and concurring reviewer. It should not apply to team members. For example, the peer review team leader of organization A should not come from organization B if the team leader of the peer review of organization B came from organization A. However, organization B should be able to provide a team member for organization A's review. We believe that GAO should revise this paragraph to limit reciprocal participation to the team leader or concurring reviewer when review teams are made up of individuals from different organizations.

Alternatively, if just limiting the team leader and concurring reviewer in conducting reciprocal reviews is not sufficient, this provision could restrict team leaders and concurring reviewers as stated in the proposed paragraph, and add a condition that a review team member cannot be assigned to review the *work of an individual* from the audit organization undergoing the peer review, if *that individual* participated in the review team member's most recent peer review.

3.67.d – This paragraph allows the review team to include matters that lead to a modified opinion in either the report itself or a separate letter of comment. Under AICPA guidelines, if there is a modification to the report, the deficiencies that resulted in a modified opinion are included in the report itself, and not in the letter of comments. Therefore, in this case, GAGAS requirements are inconsistent with the other standard setting bodies.

3.69-3.70 – First, we are concerned that the language used to describe the peer review time frames does not explicitly indicate that a three-year cycle peer review product is equivalent to a five-year cycle peer review product. In fact, the introductory language in 3.70 and encouragements therein give the

impression that a three-year cycle peer review is inferior or the audit organization is at a lesser level of compliance with GAGAS. The mere introduction of the enhanced quality assurance criteria, even as an option, suggests that it might become required at a later date. By not adopting these criteria, there could be an inference that an organization's system of quality, despite an unqualified peer review, is somehow deficient. And, in 3.62, while the phrase "when practical" has been added; it has been excluded from 3.70.

Second, we understand that these provisions are intended to improve audit quality. However, we cannot agree that adopting these additional requirements will be cost beneficial (even considering the lengthening of the period between peer reviews) and result in any significant improvement in audit quality. The specific requirements under paragraph 3.70 presumptively require certain criteria for the enhanced quality assurance program. These seem to contradict the tenor of 3.60, which gives audit organizations flexibility in designing quality control policies and procedures as long as they are "...appropriately comprehensive and suitably designed in relation to the audit organization's size, number of offices, the knowledge and experience of its personnel, the nature and complexity of the audit work, and appropriate cost-benefit considerations."

We believe these shortcomings in the proposed standards need to be corrected so that the three-year cycle is an equal, acceptable option to a five year cycle.

3.70.b.(3) – It is unclear what elements should be included in an audit organization's written assertion. Since assertions are usually expected to be in relation to some criteria, either referenced or specified, we believe that this provision should make clear exactly what elements should be included in the required written assertions. Such a requirement/guidance would also ensure consistency in how this standard is applied.

3.72 – Requiring the audit organization to make the results of its peer review public makes it easier for other auditors, who are relying on the audit organization's work, to obtain a copy of the peer review results, as required by this paragraph. Accordingly, we suggest that this paragraph be revised to acknowledge that auditors could also obtain a copy of the audit organization's latest peer review results from their Web site, or if not available on the Web site, request a copy.

#### **Question 7: Adoption of AICPA SAS No. 103, Audit Documentation**

We agree with GAO's adoption of SAS No. 103, *Audit Documentation*. However, we question the need for GAO to repeat the requirements of SAS 103 within the Yellow Book standards. Paragraphs 4.22 through 4.39 appear to repeat many of the AICPA standards, which makes it difficult for auditors to identify the additional GAGAS standards. With the exception of additional requirements in paragraph 4.40 and 4.41 and a few other wording changes, the underlying requirements of SAS 103 are unchanged within the exposure draft.

Paragraph 1.26 states that for financial audits, GAGAS incorporates the AICPA fieldwork and reporting standards, unless specifically excluded. Since SAS 103 has not been specifically excluded, it is already incorporated into GAGAS. We believe GAO should provide requirements and guidance beyond that required by AICPA, as already stated in paragraph 1.26 of the revised document, and not repeat these standards. We suggest that GAO revise the audit documentation requirement of Chapter 4 to only provide requirements beyond those included in SAS 103.

#### **Question 8: Definitions of Material Weakness and Significant Deficiency**

5.12 – Footnote 65 references item 2, but it appears to more appropriately describe items 1 and 3. We suggest the footnote reference be moved to the end of the sentence. If the intent of the footnote really is for only item 2, then we suggest the footnote better describe what is intended.

5.15 – In practice, these deficiencies might be reported in an appendix or attachment, for example, in a single audit report (a component of the schedule of findings and questioned costs) or merely as an attachment to the auditor's signed report (letter). We believe this presumptive requirement should specifically allow the use of such appendices or attachments. Perhaps a footnote could be added to explain this.

5.18 – This provision attempts to establish a presumptive reporting requirement for deficiencies less than a significant deficiency and more than clearly inconsequential. However, in doing so, this presumptive requirement creates some confusion. A significant deficiency is defined as a deficiency that has at least a possibility of misstating financial statements in more than an inconsequential way. The two factors considered are likelihood and magnitude of effect. So, a deficiency would not be significant if (1) it only has a remote chance to be more than inconsequential, or (2) it is possible that a misstatement could occur, but would not be consequential. It seems then, the second situation would never rise above more than inconsequential and would, therefore, never need to be reported. However, the first situation would seem to fit this presumptive reporting requirement. If this analysis is accurate, then we believe the presumptive requirements should more explicitly state what types of deficiencies are required to be reported rather than the currently proposed language. Further, if GAO anticipates additional items that should be reported here, more explicit language should be provided.

5.22 – The same concept described in our comment to paragraph 5.18 applies here, and our recommendation is consistent with that description.

5.44 – This paragraph should include language to indicate that auditors can distribute audit reports in accordance with applicable statutory guidelines such as Freedom of Information criteria in place within many governmental entities. Public documents are generally available to the public at large.

5.46 – This paragraph does not address those situations in which audit organizations are subject to public records laws that make all such information available to the public, regardless of limited-use language used in the report. Therefore, we believe this paragraph should also acknowledge this situation and discuss how an audit organization might handle it. For example, maybe very general information can be provided in the public report and verbal communication of details can be made with the audited entity.

### ***Comments on Chapter 6***

6.37 – This paragraph does not include a set number of days to complete final assembly of attest engagement files. The financial statement audit standards specifically state 60 days (paragraph 4.35). We believe the time frames should be consistent.

6.65 – The same concept described in our comment to paragraph 5.46 applies here, and our recommendation is consistent with that description.

## **CHAPTERS 7 and 8: Performance Audits**

### ***Question 9: Levels of Assurance, Significance, Audit Risk, and Their Application***

7.04-7.05 – By bringing this discussion to the front of the chapter, presumably to discuss significance as it relates to field work and reporting, there is a mixture of explanatory guidance and presumptive requirements. Further, paragraph 7.01 identifies four field work standards, and significance is not one of them. We suggest this be more clearly introduced and explicit in its intent to lay out basic premises or concepts so auditors will know what this section is trying to tell them and not presume it to be additional standards.

7.06-7.07 – Similar to our comments on paragraphs 7.04 and 7.05, except as it relates to audit risk and sufficient appropriate evidence, we suggest that these paragraphs be better explanations of how these

concepts are used in the four field work standards that follow. We think care should be taken to avoid the use of “must” language here if the information is only explanatory.

7.09 – Often our audit objectives are established by statute or legislative oversight. It is not clear, then, how we can clearly and completely meet this presumptive requirement when we do not have the ability to stray from our audit objective. In these cases, our assessments of significance and risk may relate to scope and methodology, but not audit objectives. We suggest providing guidance, clarification, or footnote information to address what we believe is a common performance audit issue.

#### **Question 10: Sufficient Appropriate Evidence**

The clarity of standards and discussion of sufficient and appropriate evidence is generally appropriate. However, we have exception with some specific wording.

7.64.a – This paragraph states that the greater the audit risk, the greater the quantity of evidence required. We disagree with this statement. The exposure draft says in the very next sentence (7.64.b) that “stronger evidence may allow for less evidence to be used.” We suggest paragraph 7.64.a be changed to something like “the greater the audit risk, the greater [the level of assurance] or [strength/quality of evidence] required.”

7.84, 7.85 – These two paragraphs discuss matters already described in paragraph 7.77. We believe this creates redundancy and confusion. We suggest footnote 111 be moved to paragraph 7.84, and the redundancies be removed.

7.89 – First, we are concerned because the first sentence implies that the report release date is the documentation completion date. Second, we are concerned by the vagueness of the term “timely basis.” This could be interpreted in many ways. We suggest this be consistent with the 60-day requirement in paragraph 4.35.

#### **Comments on Chapter 8**

8.09 – The proposed standard requires the auditor to state what the report is expected to accomplish. This is a general, vague comment that needs to be explained or elaborated on so that the nature and extent of this report element is clear.

8.35 – We agree that an auditor should evaluate the audited entity’s responses; however, we disagree that the auditor should include an evaluation of those views *in the report*. First, without further clarification or guidance, this may be implemented in way too much detail, or not enough. Second, the audited entity’s views should be able to be represented without an auditor “commentary” on each view. But third, and most important, auditors should not have to comment on the responses in every audit for every finding. The auditor should only have to comment on the audited entity’s response when the auditor disagrees or sees inconsistencies and has not been able to resolve the matter with the audited entity.

8.42 – The same concept described in our comment to paragraph 5.46 applies here, and our recommendation is consistent with that description.

8.44 – This paragraph should include language to indicate that auditors can distribute audit reports in accordance with applicable statutory guidelines such as Freedom of Information criteria in place within many governmental entities. Public documents are generally available to the public at large.

#### **Question 11: Clarity of the Definition of Abuse**

The clarity of the definition of abuse is as clear as it can probably be made. As noted in paragraph 4.18.b, the determination of abuse is subjective. Even in the example used (footnote 104) there could be arguments that the “renovation of senior management’s offices far exceed usual space specifications” are

appropriate. For example, at a university, the management might be expected to entertain prospective donors in their office and feel the added expense is justified.

However, we do recommend that GAO include additional guidance on evaluating qualitative factors surrounding abuse for the auditors to consider when assessing the potential impact on the audit entity.

***Question 12: Usefulness and Need for Appendix***

We believe the appendix would be useful guidance to assist auditors in complying with standards. We think that much of it could be helpful to auditors, especially those newer to the government auditing environment. However, the information needs to be reviewed for instances where entirely new information is added to GAGAS in the appendix. An example is noted in our response to Question 4 above. The appendix should be used for additional explanation or clarification, but not to add new concepts or ideas.

***Other Comments on the Appendix***

Paragraph A.03 should be modified to be consistent with SAS 112 paragraph 19, which states that the example deficiencies should at least be considered significant deficiencies.

We appreciate the efforts of the GAO and the opportunity to provide our comments. 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 (401) 222-2435.

Sincerely,

A handwritten signature in cursive script that reads "Ernest A. Almonte".

Ernest A. Almonte  
President, NSAA

**National State Auditors Association**  
**General Comments on *Government Auditing Standards*, 2006 Revision**  
**Attachment**

Paragraph	Comment
<b>Overall</b>	The concept of “potential fraud” is used throughout the document. It is not feasible to disclose “potential” fraud, because it is just that – potential and not proven. Further, legal restrictions may prevent the auditor from disclosing specific fraud cases that are pending adjudication. Therefore, GAO should review the fraud discussions and consider modifying the phrase to say “potential <i>for</i> fraud,” where the auditor would report on fraud risks but not specific fraud cases.
<b>Chapter 1</b>	
<b>1.04</b>	Should the ending phrase be modified as follows: “...and refer to compliance with GAGAS in their reports as set forth...?”
<b>1.07</b>	The second sentence, “Rather, the professional requirements...” is difficult to understand. Of course the standards are communicated by the language and words used in GAGAS. What is this statement really trying to convey to the reader? Its meaning is not obvious at all.
<b>1.25.c</b>	We suggest deleting this type of engagement as we cannot see why auditors engaged to issue letters to underwriters would cite <i>Government Auditing Standards</i> , nor how such engagements would apply chapters 4 and 5.
<b>1.28 and 1.29</b>	The reference to footnote 10 is currently in paragraph 1.28 after the term “attestation engagement.” However, the information in the footnote is not relevant until the term “auditor” is used in the first sentence of paragraph 1.29. GAO should consider moving the reference to the footnote to follow “auditor” in paragraph 1.29.
<b>1.30</b>	Include “grant agreements” between “contracts, or other requirements.” Also, item <i>f</i> , should state “grant agreements” instead of just “grants.”
<b>1.36</b>	In the last sentence, the last phrase should be “...the underlying <i>sufficient appropriate audit</i> evidence” to maintain consistency with AICPA terminology.
<b>1.38.n</b>	It is difficult to see how analyzing a budget proposal can be a performance audit objective, as described in example n. We suggest it be reworded to “assessing the reliability, validity, or relevance of budget proposals...”
<b>1.41</b>	We recommend GAO revise this paragraph to indicate “Prospective analysis audit objectives provide analysis or conclusions,” which is consistent with the category title used in paragraph 1.37.
<b>1.43</b>	The last sentence states that the audit organization has a responsibility to communicate with requesters of nonaudit services that those services do not constitute an audit under GAGAS. Since nonaudit services may include such things as training and serving on an advisory committee, this requirement seems a little excessive. Perhaps the words “when appropriate” need to be moved after the word “communicate.”
<b>Chapter 2</b>	
<b>2.01</b>	At the end of the next-to-last sentence, we suggest “positive work environment” be reworded to say “positive ethical environment.”
<b>2.09</b>	We suggest that the phrase “above reproach” in this paragraph be revised. This term comes across as dated, and all auditors, government or otherwise, are held to high standards of professional behavior. Similarly, we suggest that paragraph 2.12 be modified to remove the reference to “government” auditing as the paragraph implies that the credibility of government auditing is different than the credibility of auditing outside of government.
<b>2.10</b>	Perhaps the last sentence concerning the audit entity’s confidentiality laws should be broadened since the audit organization might have its own confidentiality laws to consider as well.
<b>2.13</b>	Is there a reason why the phrase “not misused for the auditor’s personal gain” could not be phrased “not <u>used</u> for the auditor’s personal gain?” Is there a distinction that is being made?

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Paragraph	Comment
<b>Chapter 3</b>	
<b>3.04</b>	The last sentence becomes confusing because the discussion moves back and forth between an individual auditor's capabilities and the audit organization's need to resolve or disclose. While this sentence, as worded, accurately reflects a sole practitioner, it is less clear for an audit organization. We suggest this discussion be made clearer by reflecting the disclosure is the audit organization's responsibility.
<b>3.04</b>	Independence impairments in appearance do not necessarily "affect an individual auditor's capability to perform the work and report results impartially," as the text states. Impairments in appearance are simply perceptions on the part of others that the auditor cannot perform and report impartially. We believe that the wording of this section needs to be clarified to better explain this distinction. A suggestion is to reword the second sentence to say, "If one or more of these impairments affects <i>or can be perceived to affect</i> an individual auditor's capability to perform the work and report results impartially..."
<b>3.05 and 3.06</b>	It seems that attestation engagements should be included to make it clear that these standards apply to those engagements as well.
<b>3.10.d</b>	For better clarity, we suggest inserting "external" to the beginning of this bulleted item.
<b>3.24</b>	This paragraph is clear in its intent and in placing the judgment required in proper context. However, we suggest the guidance also include clarification that individual auditors ought to refer these matters or consult with the knowledgeable and experienced person within the audit organization or audit team.
<b>3.61.d</b>	With regard to the expansion of the section "Quality Control and Assurance," we suggest combining several of the items under paragraph 3.61.d because they appear to address the same issue. For example, items 4 and 5 both discuss review of the work performed.
<b>Chapter 4</b>	
<b>4.12</b>	Requiring the auditor to "write a memorandum" is outdated, considering the use of electronic working papers. We believe this should be revised to indicate the auditor's requirement to document the summaries and explanations expected from this paragraph.
<b>4.31.b</b>	We recommend that a sentence or footnote be added similar to the wording in AU 339.19 to clarify that this requirement does not require each work paper to include the documentation of a review.
<b>4.37</b>	The financial statement audit standard is appropriate. However, the documentation for adding audit documentation after the documentation completion date (paragraph 4.37) does not match the requirements in a performance audit (paragraph 7.91). Paragraph 7.91 includes the additional step to document "an audit trail that clearly shows the specific changes." We see no reason that step should not be included for financial statement audits.
<b>4.38-4.39</b>	The exposure draft sets out different standards for controls over retention of audit documentation and appears to set a higher standard for electronic audit documentation. Paragraph 4.38 uses the undefined term "sound computer security" for audit documentation that is retained only electronically, and paragraph 4.39 uses the term "appropriate controls for audit documentation" to describe controls over safeguarding documentation. SAS 103 uses the term "appropriate and reasonable" related to controls over audit documentation, without regard to format, and provides specific goals for those safeguards (AU 339.34). We believe the additional requirements related to retention of electronic records creates ambiguity between the standards and that the requirements of SAS 103 adequately address all types of audit documentation.

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Paragraph	Comment
<b>Chapter 5</b>	
<b>5.16</b>	Chapter 5 includes paragraphs providing guidance for reporting on elements of findings. Although the document labels this information as guidance, the applicable paragraphs appear to mandate this approach. We recommend revising these paragraphs to state that the auditor should only consider the guidance, to emphasize the fact that not all audit findings fit into this format. Using this format for all findings could impair the effectiveness of the auditor's communication.
<b>5.19</b>	We are assuming that the requirement to notify the client in writing of any potential fraud or illegal acts that are not inconsequential does not refer to instances of potential fraud the client had identified and communicated to the auditor during the audit process. It seems unreasonable to include in the report issues that the client identified and resolved unless they affect audit opinions. Perhaps this issue should be clarified in this paragraph.
<b>5.51</b>	Requiring the auditor to "write a memorandum" is outdated, considering the use of electronic working papers. We believe this should be revised to indicate the auditor's requirement to document the summaries and explanations expected from this paragraph.
<b>Chapter 6</b>	
<b>General</b>	While some of the requirements in Chapter 6 on attestation engagements clarify that they are applicable only for a specified type of attestation engagement (examination, review or agreed-upon procedures), not all requirements clarify the type of engagement to which they apply. We recommend that all requirements in Chapter 6 clearly indicate to which type of attestation engagement they are applicable.
<b>6.11 and 6.71</b>	The same concept described in our comment to paragraph 5.51 applies here, and our recommendation is consistent with that description.
<b>Chapter 7</b>	
<b>7.04</b>	This paragraph begins with the words, "Auditors use the concept of significance..." The use of the word "use" is somewhat confusing in this statement. Should it say that auditors "should use?" "must use?" Also, how (do? should? must?) they use it?  The third sentence in this paragraph uses the words "relative magnitude." Relative to what? Should this wording just say "magnitude?" This sentence also includes the wording "the nature and effect of the matter." Should it address relevance instead of or in addition to the nature and effect of the matter?  Finally, we suggest defining "significance" at the very beginning of this section.
<b>7.04, fn 95 and 7.05</b>	This footnote indicates that the term significant is synonymous with material. This statement is difficult for non-accountants to understand because materiality is not a concept that non-accountants (many of whom are employed as performance auditors or evaluators) are familiar with. We suggest that some other means of getting the meaning of "significant" across be used. In addition, we recommend deleting the words "material or" in the last sentence of paragraph 7.05 since it is duplicative of the term significant, which is also used in the same sentence.
<b>7.05</b>	We have three concerns about the wording of this section, which may cause confusion to the reader. First, the first sentence of this section says that <i>auditors consider</i> the quantitative or qualitative factors. Does this mean that auditors do consider these things or that they should consider them? Clarification is needed here. Second, at the end of the third line, the draft states, "... would be affected by the matter if the matter had been omitted..." How can it be affected by the matter if the matter was omitted? Third, at the beginning of the eighth line, the wording says "and disclosed in the audit report." How can it be disclosed in the report if it was omitted from the analysis? Overall, we

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Paragraph	Comment
	found this section to be somewhat confusing. We suggest some wordsmithing for this section to make it clear to the reader exactly what is meant. It may be helpful to break the section into two sections: (1) significance as it relates to the findings, conclusions, and recommendations and (2) significance as it relates to report users.
7.06	We suggest that GAO modify the first sentence of this paragraph to state, “auditors must plan the audit to reduce audit risk to a level that is sufficient for the auditors to provide reasonable assurance.” The current paragraph implies the auditor is required to plan the audit to achieve low audit risk.
7.11	The scope discussion in this paragraph no longer includes the availability of information. Paragraph 7.12 now addresses the <i>appropriateness</i> of available information. To avoid confusion about how to consider availability of information, we suggest availability of information be included in the scope discussion in this paragraph.
7.12 and 7.13	To avoid inconsistent interpretation and application of this requirement, we suggest that GAO better explain which “relevant” risks they are referring to in the first sentence (e.g., audit risk, risk of fraud, violations, etc., specific risks noted during planning, or all of them).
7.13	This section is easier to understand than others. However, could we just say, “Develop a scope and methodology that allows auditors to answer objectives with valid and reliable evidence”?
7.13	The first sentence of this paragraph is repetitive. The phrase “while addressing the relevant risks” at the end of the sentence should be deleted.
7.18	The first sentence of this paragraph is confusing. We suggest the GAO review it for clarity.
7.18-7.24	The text should integrate information system controls into the section on internal controls. Since information system controls are an integral part of any modern control environment, it is inappropriate to address the requirements separately.
7.21	We believe footnote 100 should be moved to 7.18, where internal control is first mentioned.
7.25, fn 102	The brevity of this footnote makes it unclear as to its meaning. On one hand, reliable IS processing is dependent on IS controls. On the other hand, IS controls could be described as controls embedded in an IS process. We suggest that this be clarified.
7.26.a	Similar to our comment on paragraph 7.25, footnote 102, this discussion is unclear when it suggests that internal controls are dependent on reliable information. It would appear that reliable information is dependent on internal controls. We suggest this description be revised to be clearer.
7.31 – 7.34	We understand the importance of fraud and abuse identification, and we can follow these standards to some degree. However, would it be possible to get to the point better and provide practical guidance? That is, tell auditors what they need to do in a step-by-step manner rather than trying to do so in what appears to be academic text.
7.36.b	This statement is hard to understand. Measurability would seem to mean something that is specific, targeted, time bound, etc. We do not understand the statement that is included in this section.
7.36.c	We do not understand this statement either. “Completeness” would seem to mean that something includes everything that it should include.
7.46	The same concept described in our comment to paragraph 5.51 applies here, and our recommendation is consistent with that description.
7.91	We suggest inserting additional language to address what auditors should (must?) do <i>to the audit report</i> if changes in auditor documentation take place after the documentation completion date. An alternate would be to address this issue in Chapter 8 and include a reference in Section 7.91 to that section of Chapter 8.

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<b>Paragraph</b>	<b>Comment</b>
<b>Chapter 8</b>	
<b>8.03</b>	Paragraph 8.02 in the current GAGAS states that “auditors should prepare audit reports,” indicating a presumptively mandatory requirement. Paragraph 8.03 of the proposed standards states that “auditors must prepare audit reports,” indicating an unconditional requirement. We recommend GAO consider whether there are circumstances where it would be appropriate for the auditor to not issue an audit report and modify this section accordingly.
<b>8.12</b>	The final sentence refers to “demands of access . . .” We suggest that it be revised to more accurately reflect the impairment, for example, reworded to say, “denials of requests for access . . .”
<b>8.17</b>	The final three sentences do little to explain reporting the cause of findings. It seems that this is more suited for developing the cause, which is more appropriate in Chapter 7 rather than here.
<b>8.17</b>	Chapter 8 includes paragraphs providing guidance for reporting on elements of findings. Although the document labels this information as guidance, the applicable paragraphs appear to mandate this approach. We recommend revising these paragraphs to state that the auditor should only consider the guidance, to emphasize the fact that not all audit findings fit into this format. Using this format for all findings could impair the effectiveness of the auditor’s communication.
<b>8.34</b>	Second line: We suggest replacing the words, “with all applicable GAGAS general and auditing standards” with “with all applicable GAGAS general, fieldwork, and reporting standards.”
<b>8.36</b>	Ninth line: What is meant by “technical comments,” and how are they “in addition to” the auditee’s written comments (i.e., aren’t they part of the auditee’s written comments)? This wording is confusing.
<b>EDITORIAL</b>	
<b>Table of Contents</b>	The Table of Contents is missing Chapter 3 and has two Chapter 4 sections.
<b>6.07</b>	This paragraph leaves out “or detect” at one point when saying “...to prevent errors in assertions ...”
<b>6.22</b>	This paragraph says “qualitative and qualitative factors” in the last sentence instead of “qualitative and quantitative.”
<b>6.34</b>	This paragraph refers to “the audit” instead of the “attest engagement.”
<b>7.27</b>	The sentence, “Weaknesses in general controls can result in unauthorized changes to applications and data that can circumvent or impair the effectiveness of application controls” appears in the paragraph twice.
<b>7.61</b>	Last sentence, last phrase should state that “...data <u>are</u> [is] sufficient and appropriate...”
<b>7.62</b>	Eleventh line, third word: The word “includes” (plural) should be “include” (singular).