



July 6, 2017

Mr. James R. Dalkin, CPA
Director
Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Dalkin:

The American Institute of CPAs (AICPA) is the world's largest member association representing the CPA profession, with more than 418,000 members in 143 countries, and a history of serving the public interest since 1887. AICPA members represent many areas of practice, including business and industry, public practice, government, education and consulting. The Association of International Certified Professional Accountants combines the strengths of the AICPA and the Chartered Institute of Management Accountants to power opportunity, trust and prosperity for people, businesses and economies worldwide. It represents 650,000 members and students in public and management accounting and advocates for the public interest and business sustainability on current and emerging issues. With broad reach, rigor and resources, the Association advances the reputation and quality of CPAs, CGMAs, and accounting and finance professionals globally.

We appreciate the opportunity to comment on the Exposure Draft of the 2017 Revision of *Government Auditing Standards* (ED) and commend the GAO for its ongoing efforts to promote accountability, audit quality, and above all, protecting the public interest. We also support the GAO's efforts to update *Government Auditing Standards* (the Yellow Book or GAGAS) on a periodic basis.

With regard to this ED, we generally support many of the proposed changes. We are particularly pleased with the changes made to the peer review section of the standards to refer directly to certain recognized peer review programs, including the AICPA's program. We also believe the changes made to clarify the standards will promote a better understanding by auditors of the requirements they are expected to meet.

However, there are certain proposed changes that we believe need further consideration. They include changes made to the independence standards relating to financial statement preparation nonaudit services, the new continuing professional education (CPE) requirement, and the addition of a new responsibility for waste.

The following section of this letter includes our responses to the questions provided in the "Questions for Commenters" section of the ED. The Appendix to this letter further presents our "Other Comments and Recommendations" and "Editorial Suggestions."

AICPA Response to Questions for Commenters

Generally accepted government auditing standards (GAGAS) is presented in a revised format. This is intended to allow auditors to quickly identify requirements and application guidance related to those requirements. In addition, certain topics are regrouped within the chapters. Please comment on how the revised format of GAGAS affects the organization and readability of the standards.

We support the approach taken by GAO to clarify its standards using a format to distinguish between requirements and guidance related to those requirements. Distinguishing between requirements and application guidance is also consistent with Generally Accepted Auditing Standards promulgated by the Auditing Standards Board (ASB), as well as with the International Standards on Auditing promulgated by the International Auditing and Assurance Standards Board. However, we recommend that GAO consider using an “A” paragraph numbering identifier (e.g., A.2.07) approach for application guidance. This would be useful for several reasons. First, there are numerous paragraph cross-references throughout the ED. If the application guidance paragraphs were noted with an “A” paragraph identifier, it would be easier for readers to determine if such cross-references are referring to application guidance or requirements. Additionally, various sections of the Yellow Book are likely to be used or referred to in CPE publications or firm guidance. In those instances, use of the “A” paragraph identifier would make it clear whether what is being referred to is a Yellow Book requirement or application guidance.

Additionally, we noted several instances where application guidance appears to be providing an exception to a “boxed” requirement. For example, see paragraphs 3.25 and 4.26 – 4.30. The ASB clarity format avoids making exceptions to requirements in the application guidance such that requirements stand on their own. We are uncertain whether GAO intended to take the same clarity approach as ASB, but offer this comment for GAO consideration as it finalizes the standards.

In chapter 3 (“Ethics, Independence, and Professional Judgment”), additional requirements and guidance are provided concerning the provision of nonaudit services to audited entities, including further explanation of the responsibility to ensure that management of the audited entity possesses the appropriate skills, knowledge, and experience to oversee the nonaudit service and expanding discussion of nonaudit services that should be considered threats or impairments to an external auditor’s independence. (various paras. 3.67 through 3.101) Please comment on whether the revisions related to nonaudit services sufficiently and clearly explain what is required and prohibited under GAGAS.

We are concerned with the proposed change that would expand the nonaudit services that should be considered threats or impairments to always include financial statement preparation. Additionally, we believe the revisions made by the GAO to ensure that management of the audited entity possesses appropriate skills, knowledge, or experience (SKE) need further clarification.

Financial Statement Preparation. Chapter 3 expands the nonaudit services that should be considered threats or impairments by stating that any services performed by auditors related to preparing accounting records and financial statements, other than those defined as impairments to independence in paragraph 3.88, create significant threats to auditors’ independence. We disagree that, in all cases, the preparation of accounting records and financial statements would result in significant threats to independence. For example, an entity may request that its auditor prepare the financial statements as a matter of convenience, even though the entity has personnel with the necessary SKE to prepare the financial statements. Where this is the only non-audit service performed by the auditor and the audited entity’s books and records are substantially complete and accurate, we believe the requirements (i.e., safeguards) set forth in paragraphs 3.81 and 3.82 (e.g., the audited entity assumes all management responsibilities and designates an appropriate individual to oversee the service), are sufficient to reduce the self-review and management participation threats to an acceptable level and additional safeguards should not be necessary.

We understand that depending on the circumstances, particularly when the auditor performs multiple non-audit services for an audited entity, the threats created relating to financial statement preparation could be significant. However, in such cases, the auditor would use professional judgment to evaluate the threats using the conceptual framework. This approach is consistent with the AICPA Code of Professional Conduct (AICPA Code) and the International Ethics Standards Board for Accountants (IESBA) Code of

Ethics for Professional Accountants (IESBA Code) and recognizes that when evaluating threats under the conceptual framework, the auditor must take into consideration the nature and breadth of services to be performed. Under the GAO proposal, we believe it could be viewed that the preparation of one bank account reconciliation for an audited entity would result in a significant threat to independence and require the auditor to implement unnecessary safeguards. This could lead to a less efficient and more costly engagement.

If GAO believes that these specific services are deemed to create significant threats by their nature, we ask that GAO clarify the type(s) of threats created and reason(s) these threats are significant to allow the auditor to meaningfully evaluate and apply appropriate safeguards. Additionally, GAO should be more specific about what constitutes financial statement preparation. We assume it would not include situations where the auditor is only performing word processing, printing, or binding of the financial statements. But one could read “any services related to preparing...financial statements,” as including these types of administrative functions.

Consideration of Management’s Ability to Oversee the Nonaudit Service(s). The proposed ED adds additional evaluation criteria to the SKE required by management of the audited entity. Paragraph 3.67 of the ED indicates that the auditor should determine that the audited entity has designated an individual who possesses suitable SKE, and that the individual understands the services to be provided sufficiently to oversee them *and be capable of detecting a material error, omission, or misstatement*. In particular, we are concerned about the new part of this requirement regarding the capability of the individual to detect a material error, omission, or misstatement and how it would apply when a nonfinancial nonaudit service is being performed. GAO should provide clarification on this point in the final standard or remove the new part of the requirement that was added. Otherwise, we are concerned that this requirement may be applied inconsistently in practice.

In chapter 4 (“Competence and Continuing Professional Education”), GAGAS discusses the levels of proficiency required for the roles on an engagement as well as a description of the tasks generally expected to be performed by auditors in these roles. (paras. 4.09 through 4.10) Do these roles and descriptions clarify the competence required of auditors conducting engagements in accordance with GAGAS? Is the level of proficiency expected for each of these roles clear?

Paragraph 4.10 defines the roles for an engagement and links these roles to proficiency levels. While we agree that an individual needs the appropriate competence to perform a role, we have several recommendations relating to this paragraph.

First, with regard to the roles provided, there will likely be variation from firm to firm depending on firm size, their policies and procedures, etc. For example, consider the following excerpts from feedback we received from members on this paragraph:

- In our practice, “entry level” employees would not be responsible for planning the engagement.
- GAO is elevating the role of first year staff in its description of the “entry level” role.
- In our firm, the supervisory role includes a review of the engagement; this is not captured in the “supervisory” description.
- The entry level role in our practice “assists in planning and performing engagement procedures” rather than actually planning and performing.
- We are struggling to understand where a “senior” would fit into the various roles in 4.10.

Additionally, as written, 4.10 does not recognize that an individual could be in multiple roles depending on the situation. For example, a senior accountant who typically works on Yellow Book financial statement audits may meet the description of the supervisory role for that audit. However, if that same senior accountant becomes involved in a single audit for the first time, they may initially be at entry level. GAO should include additional application guidance around the roles discussion to clarify these situations. Another alternative would be for GAO to avoid establishing roles altogether, and instead, only reference the responsibilities performed on an engagement, which should be able to be identified on each engagement based upon assignments and work performed. For example, if GAO references engagement responsibilities in paragraph 4.10(a) (e.g., planning or performing engagement procedures), instead of labeling the role as “entry level,” then the responsibility could also be referenced in paragraphs 4.15 and 4.27 in the requirement for continuing professional education.

Second, paragraph 4.10 does not include definitions for the basic, intermediate, and advanced levels of proficiency. We propose that GAO add the following definitions in paragraph 4.11:

- Foundational level of proficiency: Individual is expected to remember and understand various aspects of a GAGAS engagement.
- Intermediate level of proficiency: Individual is expected to understand and apply various aspects of a GAGAS engagement, building upon foundational level proficiencies.
- Advanced level of proficiency: Individual is expected to apply and evaluate various aspects of a GAGAS engagement, building upon intermediate level proficiencies.

These definitions, which are output focused, are based on the [AICPA Competency Framework: Governmental Auditing](#) (the “Framework”) and Bloom’s Taxonomy. The AICPA published the Framework in September 2015 and developed it with the support from members serving on the AICPA Governmental Audit Quality Center (GAQC) Executive Committee and the State and Local Government Expert Panel. It is designed to help CPAs understand the knowledge and skills necessary to perform governmental audits and is available for free on the AICPA | CIMA Competency and Learning website. The Framework is underpinned by the need for objectivity, integrity, and ethical behavior, and includes a commitment to continuously acquire new skills and knowledge. The Framework’s technical competencies are organized into five core skill sets which include: Client acceptance; Engagement planning; Engagement analysis or testing; Concluding the engagement; and Guiding principles. The skills for each core skill set are provided for those at the foundational, intermediate, advanced and expert levels. The three proficiency level definitions that we are recommending above would align to the proficiency levels included in the Framework.

Competency models are foundational to the CPA profession. For example, the CPA exam is based upon a competency model, indicating which competencies one should possess to pass the exam and become a CPA. Additionally, firms and organizations use competency models to assess staff competency. GAO’s use of proficiency definitions that are consistent with the Framework will lead to greater consistency in competency evaluations.

Chapter 4 (“Competence and Continuing Professional Education”) includes a requirement for auditors to complete at least 4 hours of continuing professional education (CPE) in GAGAS topics (“GAGAS Qualification”). This 4-hour requirement is a subset of the 24-hour CPE requirement and needs to be completed each time a GAGAS revision is issued. Application guidance provides examples of the types of topics that would qualify as GAGAS topics. (paras. 4.15 and 4.23) Please comment on any additional topics that could be included in the 4-hour GAGAS CPE requirement or other requirements that would enhance auditor proficiency in GAGAS.

We strongly believe that audit teams performing Yellow Book engagements should be collectively competent. While we are not necessarily opposed to GAO establishing a CPE requirement for GAGAS-specific topics, we believe there are a number of areas that need reconsideration, clarification, or improvement to ensure consistent understanding and a smooth transition. The topic areas of concern and our recommendations related to each one are covered in the following subsections.

Applying the CPE Requirement to Staff at All Levels Not Effective or Efficient. We recommend that GAO consider limiting the GAGAS Qualification requirement to the partner and director roles as defined in paragraph 4.10. This recommendation is based on our belief that staff in “entry level” and “supervisory” roles would be better served obtaining CPE in the broader “Standards, Statutory Requirements, Regulations, Criteria, and Guidance” category. In general, the unique aspects of the GAGAS financial audit and attestation engagement standards that are incremental to the relevant professional standards are relatively small as compared to the scale of the professional literature that is incorporated into the Yellow Book. Also, the nature of the incremental differences that exist are heavily weighted in areas that partners and directors have responsibility for (e.g., independence, CPE, peer review, and reporting) and less so on the actual areas of incremental performance of internal control testing and substantive testing that other staff generally are responsible for. Therefore, we believe that the collective competence of engagement teams will be appropriate if the CPE requirement is limited to the partner/director roles. Another consideration, from an efficiency perspective, is that there would be a significant added administrative burden to track the additional 4-hour requirement for all staff. This would increase the overall cost of the audit service. Limiting the requirement to the partner/director roles would help in this regard as well.

Assignment Confusion. We have a number of questions on the requirements in paragraphs 4.02 and 4.03. With regard to paragraph 4.02, is GAO’s intent that all assigned staff must meet CPE requirements as of when they are “assigned,” or that they must have met the requirements as of the last measurement period? We believe guidance should be added to specify that staff who met the CPE requirement in a previous measurement period are deemed competent, as they may not yet have the required CPE in the current measurement period at the time of assignment. Paragraph 4.02 also discusses management only assigning auditors who are competent for their assigned roles at the time of “assignment.” Some firms schedule audits and assign individual auditors on Yellow Book audit engagement teams many months in advance of an actual engagement commencing. This is done for administrative purposes, as well as to allow entry-level auditors an opportunity to obtain any needed training. GAO should revise the requirements in 4.02 and 4.03 and/or add application guidance to provide clarity on these questions.

Applicability of CPE Requirement to Internal Auditors and Specialists Unclear. As noted in our comments titled “Internal Auditors” and “Internal Specialists” in the “Other Comments and Recommendations” section of the Appendix to this letter, the definition of the terms “auditor” and “specialists” need clarification to ensure an appropriate understanding of which internal auditors/specialists would be subject to the CPE requirements, in general, as well as the new 4-hour GAGAS Qualification requirement. Additionally, paragraph 3.81 of the current Yellow Book covers internal specialists who act as part of the audit team and states: “Because internal specialists apply specialized knowledge in government audits, training in their areas of specialization qualify under the requirement for 24 hours of CPE that directly relates to government auditing, the government environment, or the specific or unique environment in which the audited entity operates.” This provision was not carried forward and we are not clear as to why. If it is the GAO’s intent to change the existing requirement for internal specialists in this area, we would disagree with such a change.

Additional Clarity Needed on How the New 4-Hour Requirement Relates to the Other CPE Requirements.

As written, we believe that auditors may mistakenly conclude that the 4-hour requirement is in addition to the current 24-hour requirement. We also believe that confusion exists about to whom the requirement would apply and when. We strongly recommend that GAO develop a table or some other visual tool that clearly articulates how the 4-hour requirement relates to the 24-hour requirement, whom the 4-hour requirement applies to and when, and any differences between the GAGAS Qualification requirement versus the GAGAS Update requirement.

Additional Clarity Needed on Timeframe for the 4-Hour Requirement. We believe that significant confusion exists over the following sentences in the requirement in paragraph 4.15: “Auditors assigned to supervisory or partner and director roles should obtain GAGAS Qualification before completing work on their first GAGAS engagement. Entry-level staff should obtain GAGAS Qualification by the end of their first full 2-year CPE period.” First, as it relates to the “before completing work” timeframe for the partner/director role, there is concern about how an audit organization would monitor compliance on an individual basis due to the lack of clarity around what “completing work” means for each individual. GAO should consider revising this wording to link to a more definitive date. One option might be “before the date of the GAGAS report related to their first engagement is issued.” Second, as it relates to entry-level staff obtaining the CPE “by the end of their first full 2-year CPE period,” as well as similar wording in paragraph 4.17, we question who would establish the 2-year period. The individual auditor or the audit organization? We believe it would be the audit organization, but GAO should clarify this point.

56-Hour Requirement. Paragraph 4.18 of the ED indicates the 80 hours (including the 24-hour requirement) should be in subject matters or topics that directly enhance auditors’ professional expertise “to conduct GAGAS engagements.” The current Yellow Book describes the 56-hour requirements as enhancing the auditor’s professional proficiency to perform “audits,” in general, and not just GAGAS engagements. We are unsure if GAO intended a change here, but the ED wording could be read to be more restrictive. For example, one could interpret the entire 80 hours as needing to cover subject matters or topics related to a currently assigned or probable future engagement under GAGAS. In looking at the acceptable topics listed in the application guidance in paragraph 4.25, it appears no change is intended. GAO should consider providing clarification on this point to avoid confusion.

Transition and Effective Date. The ED does not discuss how the new 4-hour requirement will be transitioned and made effective. From discussions with GAO staff, we understand that current experienced Yellow Book auditors would be required to meet the new GAGAS Qualification requirement by taking a 4-hour course (i.e., there will be no grandfathering provision). The final standard should be very clear on this point and provide adequate time for implementation, both for CPE providers, and for audit organizations needing to train large numbers of staff.

Course Content Requirement. We are concerned about paragraph 4.16 for several reasons. First, it establishes a “should” requirement for CPE providers. This seems inappropriate since CPE providers are not subject to the Yellow Book. We recommend that GAO modify the statement to make the requirement applicable to individual auditors. For example, the following revised wording might be considered as an alternative:

4.16. Auditors should fulfill the GAGAS Qualification requirement using CPE that includes in the course content the relevant GAGAS topics listed in paragraph 4.23 and that includes in the course description wording that indicates that its purpose is to fulfill the GAGAS Qualification CPE requirement.

Second, as a CPE provider, we are uncertain as to the intent of GAO with regard to the course content to meet the 4-hour requirement overall. The topics suggested in paragraph 4.23 seem to be an in-depth list of everything covered in the Yellow Book. It would be helpful if GAO could clarify and re-evaluate which topics, and to what extent, need to be covered in this 4-hour GAGAS Qualification CPE requirement with the goal of increasing competency in GAGAS.

Also, in looking at the listing of topics in paragraph 4.23, we believe we already have a number of CPE courses that cover many of the topic areas either within our broad “governmental auditing” courses or our “Yellow Book” courses. Some of the courses are as long as 8 hours, depending on their format. Is GAO expecting that the AICPA and other CPE providers will need to modify existing Yellow Book courses to develop courses specifically to meet this requirement? We are unclear on this point.

Additionally, the requirement in paragraph 4.16 of the ED mentions course descriptions that indicate the purpose of the course is to fulfill the GAGAS Qualification requirement. We are also unclear as to what will be expected of the AICPA and other CPE providers in this regard. We typically indicate in our descriptions of CPE courses and at our various conferences that the courses/sessions may meet the requirements for the 24-hour requirement in *Government Auditing Standards* but that it is up to the individual auditor to determine ultimately what counts based on their facts and circumstances. Would GAO expect CPE providers to now provide multiple references stating that courses/session may meet the 4-hour requirement and/or the 24-hour requirement? Any clarification that can be provided would be helpful to us in meeting the needs of auditors that will have to apply the new rules.

Questions on Practical Implementation of the 4-Hour Requirement Going Forward. We have tried to walk through how the new 4-hour requirement will work in practice in the long run and are unclear. For purposes of this initial implementation, since GAO is requiring auditors to become qualified as a baseline, it may be that 4 hours of training in all of the topics listed in paragraph 4.23 is appropriate. However, going forward, we question whether an additional 4 hours will be appropriate for every future Yellow Book revision made by GAO. Paragraph 4.15 states that “to update their GAGAS Qualification, auditors should complete at least 4 hours of CPE in GAGAS topics each time the Comptroller General issues a revision of GAGAS.” We believe those auditors that become qualified upon issuance of this upcoming Yellow Book will only need information on what has changed when GAO makes future revisions. However, paragraph 4.15 requires “GAGAS topics” to be covered which, as we understand it, are the listing of topics in paragraph 4.23, regardless of whether they might have changed. Before proceeding with a final standard, we recommend that GAO consider whether 4 hours is the appropriate requirement in all cases and to better explain the future update process. It would not seem a good use of firm training resources to require basic Yellow Book training once an auditor has met the initial qualification requirement, nor the preferred training to further enhance that auditor’s competency.

Industry Trends Training. Certain aspects of industry training may not be directly traceable to the listing of topics in paragraph 4.24 covering acceptable training in the category of “Standards, Statutory Requirements, Regulations, Criteria, and Guidance.” For example, there may be content of training related to general industry trends and/or risk factors in the not-for-profit sector that does not appear to be directly traceable to the topics in paragraph 4.24. We would assume that such training would count towards the 24-hour requirement, but are not certain. Paragraph 4.24(i) states that “regulations, statutory requirements, criteria, or guidance relevant to the specific and unique environment in which the audited entity operates” would count. However, it does not seem that training covering industry trends and/or risk factors fits well into this description. It would be helpful if GAO could clarify this point.

Measurement of CPE. When applicable, within the “Application Guidance: Measurement of CPE” section, we suggest GAO align terminology and requirements to the Statement on Standards for Continuing

Professional Education Programs published jointly by the AICPA and the National Association of State Boards of Accountancy. While the Statement on Standards for Continuing Professional Education Programs is for CPE providers and CPE requirements for individuals vary by state, greater alignment will provide clarity and thus more effective and efficient compliance with the GAGAS competence and CPE requirements. For example, paragraph 4.35 is unclear about whether individual study program refers to a self-study program as defined by the Statement on Standards for Continuing Professional Education Programs, nor is it clear if the first one-half credit (25 minutes) is accepted for a self-study program given reference to “the number of hours granted.” Further, the ED does not reference or denote if nano learning programs, as approved in the August 2016 revision of the Statement on Standards for Continuing Professional Education Programs, will be allowed. Since it may be several years before the Yellow Book is updated again, we recommend GAO address nano learning with this revision. We would be happy to further discuss this area with GAO staff, including the supporting research associated with smaller time increments and learning.

The content from the GAGAS guidance document on CPE (GAO-05-568G) is largely incorporated into chapter 4. We plan to retire the guidance document when the new GAGAS is issued. (paras. 4.26 through 4.50) Is there any additional application guidance that should be included in the GAGAS revision to enable auditors and audit organizations to effectively implement the CPE requirements given the planned retirement of the CPE guidance document?

The application guidance in paragraphs 4.26 – 4.30 did not carry forward an exception from the CPE guidance document relating to performance of support services. Paragraph 8(d) of that document provided an exception for "Employees who assist in the audit or attestation engagement by performing support services, such as performing background research, data entry, writing/editing assistance, proofreading, or report production and distribution." On certain larger audits, audit organizations may use these individuals to assist the engagement team by collecting information for the analysis of SOC reports, distribution of engagement audit documentation templates, compliance with independence standards, and CPE requirements. We recommend that this exception be carried forward to the final Yellow Book.

In chapter 5 (“Quality Control and Peer Review”), the sections on quality control and external peer review are expanded to harmonize with other standards and promote consistency in practice across the range of GAGAS auditors. Are the changes to the quality control and external peer review sections appropriate and reasonable?

In general, we believe the changes to the quality control and external peer review sections are appropriate and reasonable and greatly appreciate the GAO’s efforts to harmonize with other standards, including those of the AICPA. We also believe the changes will promote consistency in practice across the range of GAGAS auditors and audit organizations. However, we have identified several areas that we believe need further clarification or revision to better harmonize with other standards or to improve implementation of the standards.

Monitoring Application Material. We believe the discussion of monitoring in paragraph 5.47 of the ED needs revision. It is inconsistent with the definition of monitoring in the ASB’s Statements on Quality Control Standards (i.e., QC sec. 10) and the description of monitoring in this paragraph also appears inconsistent with other paragraphs in chapter 5 of the ED. We believe this inconsistency will lead to confusion in the application of GAGAS.

We agree with the requirement in paragraph 5.43 that the audit organization should perform monitoring procedures that enable it to assess compliance with applicable professional standards and quality control

policies and procedures for GAGAS engagements. However, paragraph 5.47 describes monitoring as a “periodic assessment of work completed on engagements.” We have two concerns about this description. The first is that it limits monitoring to a *periodic assessment* and the second is that it limits that assessment to *work completed on engagements*.

Referring to monitoring as a *periodic assessment* differs from QC sec. 10 which requires the firm to establish an effective monitoring process that includes an *ongoing* consideration and evaluation of the firm’s system of quality control, including inspection or a *periodic* review of engagement documentation, reports, and clients’ financial statements for a selection of completed engagements. Ongoing monitoring activities are generally described as routine activities, built into the firm’s processes and performed on a real-time basis, reacting to changing conditions (e.g., ongoing monitoring of compliance with independence requirements) so that engagements are not conducted when independence has been impaired. Many monitoring activities are periodic; however, limiting monitoring to periodic assessments may prevent deficiencies in the system of quality control from being identified and remediated on a timely basis.

Secondly, the aspect of the GAO definition that describes monitoring as being an assessment of *work completed on engagements* is inconsistent with the QC sec. 10 definition of monitoring, which is a “process comprising an ongoing consideration and evaluation of the firm’s *system of quality control* including inspection or a periodic review of engagement documentation, reports, and clients’ financial statements for a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is designed appropriately and operating effectively.” It also appears to conflict with other paragraphs in chapter 5. For example, as noted above, paragraph 5.43 requires assessment of compliance with quality control policies and procedures for GAGAS engagements, and paragraph 5.51 discusses periodic consideration of the system of quality control. This suggests that the purpose of monitoring is to evaluate the system, not just engagements performed. In addition, paragraphs 5.51 and 5.52 state, in part, that matters assessed may include a review of selected administrative and personnel records pertaining to the quality control elements; the appropriateness of the audit organization’s guidance materials and any practice aids; and new developments in applicable professional standards and legal and regulatory requirements and how they are reflected in the audit organization’s policies and procedures, when appropriate. All of these matters are beyond *work completed on engagements*.

To alleviate these concerns, we recommend that GAO revise paragraph 5.47 to use the same definition of monitoring as used in QC sec. 10. If GAO does not accept this recommendation, we offer the following suggested revisions to paragraph 5.47 to address the areas of the description we believe need enhancement.

5.47 Monitoring of quality is ~~a periodic assessment~~ **an ongoing consideration and evaluation of the system of quality control work, including periodic inspection** of work completed on engagements, designed to provide management of the audit organization with reasonable assurance that the policies and procedures related to the system of quality control are suitably designed and operating effectively in practice.

Application Guidance: Initiation, Acceptance and Continuance of Audits. Paragraph 5.12 requires the audit organization to accept GAGAS engagements only if it meets standards and requirements and has the capabilities to do so. Additionally, paragraph 5.02 states: “An audit organization conducting engagements in accordance with GAGAS must establish and maintain a system of quality control that is designed to provide the audit organization with reasonable assurance that the organization and its personnel comply with applicable professional standards and legal and regulatory requirements, and that the reports issued by the audit organization are appropriate in the circumstances.” Periodically, the question arises as to the repercussions to an audit organization that receives a peer review report with a pass with deficiencies rating or a fail rating that relates to their GAGAS engagements, and whether the firm can accept and perform

future GAGAS engagements. We suggest that GAO add a requirement to reinforce that audit organizations should consider the effect of these situations before continuing to accept and/or perform a GAGAS engagement. The following is recommended language that GAO should consider for this purpose:

5.XX Audit organizations that receive a peer review rating of “pass with deficiencies” or “fail” that relates to their GAGAS engagements should critically evaluate the design and compliance with their system of quality control when determining the ability to accept and perform GAGAS engagements.

In chapter 5 (“Quality Control and Peer Review”), peer review requirements are categorized by requirements for (1) audit organizations affiliated with recognized organizations and (2) other audit organizations. (paras. 5.63 through 5.113) Are the peer review requirements for each category of audit organization clear?

Overall, we strongly support the approach taken in this area to distinguish between organizations subject to a recognized peer review program and those that are not. We believe the approach will also help audit organizations not subject to a recognized peer review program better comply with the GAGAS peer review requirements. We do have several observations for GAO’s consideration.

Confusion Regarding Applicability of Various Sections. We have a number of questions regarding paragraphs 5.63 through 5.113. First, we believe there is confusion that the sections apply to audit organizations subject to a recognized peer review program. We acknowledge that GAO includes clearly marked section headers above paragraphs 5.68 and 5.80 indicating which situation is being referred to. However, due to the length of the section for audit organizations not subject to a recognized peer review program, readers are confused. GAO may want to consider how to better remind readers about the section they are in throughout paragraphs 5.80 – 5.113 of the ED. For example, perhaps the various subheading titles could be revised to provide additional emphasis.

Description of Recognized Programs. Paragraphs 5.64 and 5.65 refer to audit organizations either being affiliated with a recognized organization or not affiliated with such an organization. Over the years, we have noted some organizations that are not subject to the AICPA Peer Review Program but use its standards and guidance to some extent for their own purpose, with or without permission from the AICPA. Organizations that use excerpts of our peer review standards and guidance without full consideration of all criteria, including, but not limited to, performing, scheduling, accepting, and oversight of reviews may fall short of GAO’s intent in this area. We offer the following revisions to paragraphs 5.64 and 5.64 to curtail this situation from occurring:

5.64 Audit organizations subject to an approved peer review program of ~~affiliated with~~ one of the following recognized organizations should comply with the respective organization’s peer review program requirements and the requirements listed in the “Additional Requirements for Audit Organizations Subject to ~~Affiliated with~~ Recognized Organizations” section (paras. 5.68 through 5.79).

- a. American Institute of Certified Public Accountants (including other peer review programs administered by entities fully involved in the administration of the AICPA Peer Review Program)
- b. Council of the Inspectors General on Integrity and Efficiency
- c. Association of Local Government Auditors
- d. International Organization of Supreme Audit Institutions
- e. National State Auditors Association

An approved peer review program means the recognized organizations' entire peer review process, including, where applicable, standards for administering, performing, and reporting on peer reviews, oversight procedures, training, and related guidance materials.

5.65 Any audit organization not affiliated with **subject to the peer review requirements of** an organization listed in paragraph 5.64 should meet the minimum GAGAS peer review requirements that follow in the "Requirements for Audit Organizations Not Affiliated with Recognized Organizations" section (paras. 5.80 through 5.113). **Such programs should, at a minimum, establish program requirements that include standards for administering; performing and reporting on peer reviews; oversight procedures; training; and related guidance materials.**

Providing Peer Review Report When Seeking to Perform GAGAS Engagement. We question whether GAO may have erroneously revised the current requirement in paragraph 3.106 of the Yellow Book that "audit organizations seeking to enter into a contract to perform an audit in accordance with GAGAS...should provide the audit organization's most recent peer review report when requested...." Paragraph 5.77 of the ED states that "an audit organization seeking to enter into a contract to conduct a performance audit in accordance with GAGAS should provide...the party contracting for such services...the audit organization's most recent peer review report when requested." We are unclear as to why this requirement would now be limited to performance audits. We suggest the following revision to make paragraph 5.77 consistent with the current requirement.

5.77 Because information in peer review reports may be relevant to decisions on procuring audit services, an audit organization seeking to enter into a contract to ~~conduct a performance audit~~ **perform an engagement** in accordance with GAGAS should provide the following to the party contracting for such services when requested:

- a. the audit organization's most recent peer review report and
- b. any subsequent peer review reports received during the period of the contract.

Chapter 7 ("Standards for Attestation Engagements and Reviews of Financial Statements") is expanded to incorporate by reference Statement on Standards for Accounting and Review Services No. 21, section 90, Review of Financial Statements, and includes additional requirements and guidance for reviews of financial statements conducted in accordance with GAGAS. (paras. 7.68 through 7.80) Please comment on the expanded requirements and application guidance.

We have no comments on the expanded requirements and application guidance for reviews of financial statements. However, see our comment titled, "Overarching Comment - References to AICPA Standards," in the "Other Comments and Recommendations" section of the Appendix to this letter for a general question about how GAO is referencing AICPA standards in this area, as well as others.

In chapter 8 ("Fieldwork Standards for Performance Audits"), internal control considerations are expanded to reference the 2014 Standards for Internal Control in the Federal Government and Internal Control – Integrated Framework. (paras. 8.37 through 8.65) Do these sections clearly describe ways auditors assess internal control on performance audits?

We have no comments to offer on Chapters 8 or 9 of the ED.

Mr. James M. Dalkin

July 6, 2017

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We appreciate the opportunity to provide these comments to you and would be happy to discuss them with GAO representatives.

Sincerely,

A handwritten signature in black ink, appearing to read "S Coffey". The signature is fluid and cursive, with a large initial "S" and a long, sweeping underline.

Susan S. Coffey, CPA, CGMA
Executive Vice President – Public Practice

Attachment

cc: Jim Brackens
Mary Foelster
Gary Freundlich
Kristy Illuzi
Charles E. Landes
Clar Rosso
Lisa Snyder

OTHER COMMENTS AND RECOMMENDATIONS

Overarching Comment - Glossary Would Improve Clarity. We believe the Yellow Book could be streamlined and enhanced by the inclusion of a glossary that includes all definitions. The ED includes some definitions in chapter 1, but that listing is not all inclusive as there are other definitions included throughout the other chapters. For example, paragraph 3.08 of the ED defines the term “public interest.” That definition could be removed from chapter 3 and included in the glossary. There are many other examples of definitions being included in various chapters. If GAO accepts this recommendation, each term that is included in the glossary could be bolded when first used to highlight that its definition can be found in the glossary.

Overarching Comment – Definitional Differences Between AICPA and GAO. We are concerned that GAO has modified the definition of certain common terms from those used by the ASB which we believe will lead to confusion. For example, we noted differences in the following definitions, among others: examination, control objective, engaging party, agreed-upon procedures, and review engagement. We are unclear about why these definitional changes were made and encourage GAO to align these common terms and their definitions more closely to the AICPA. These differences are particularly confusing since the Yellow Book incorporates the AICPA standards by reference. If there are reasons for the differences that we are unaware of, we would appreciate a follow-up discussion with GAO to better understand them.

Overarching Comment - References to AICPA Standards. We noted inconsistencies in how the ED references the incorporation of other standards that may cause confusion. For example, paragraph 2.12(c) states, “GAGAS incorporates by reference AICPA Statements on Auditing Standards and Statements on Standards for Attestation Engagements.” We believe this reference is appropriate. However, paragraph 7.01 limits the reference to other standards by stating: “GAGAS incorporates by reference the American Institute of Certified Public Accountants’ (AICPA) Statement on Standards for Attestation Engagements (SSAE) No. 18, *Attestation Standards: Clarification and Recodification*.” We believe the best approach is for GAO to refer to the standards in their entirety (i.e., AICPA Statements on Auditing Standards, Statements on Standards for Attestation Engagements, and Statements on Standards for Accounting and Review Services) throughout the Yellow Book unless there is a specific reason to limit the reference. Broadening the references will also help the Yellow Book stay current in the event the ASB or Accounting and Review Services Committee updates one of the specific standards currently referenced.

Nonaudit Services Definition Problematic. The revision made to the nonaudit services definition in the ED is problematic on several fronts. Therefore, we recommend GAO revert to the definition used in the current Yellow Book. The current Yellow Book refers to nonaudit services as, “professional services other than audits or attestation engagements.” However, paragraph 1.22 of the ED revises the definition to refer instead to “professional services provided on behalf of management at audited entities.” One concern is that the new definition could be construed to include audit and attestation engagements. Secondly, the new definition describes these services as being “performed on behalf of management.” This seems in direct conflict with paragraph 3.69 which states that “if the auditors were to assume management responsibilities for an audited entity, the management participation threats created would be so significant that no safeguards could reduce them to an acceptable level.” Our final concern is that the revised definition refers to services being performed “at audited entities.” There may be instances where an auditor provides nonaudit services at a third-party location (e.g., monitoring services). It could be read that the revised

nonaudit services definition would exclude the need to evaluate such a nonaudit service which we believe may not be GAO's intent.

Internal Auditors. Paragraph 1.23 includes definitions for auditors and specialists. It is unclear how an internal auditor would fit into these definitions. For example, it would seem internal auditors performing direct assistance on Yellow Book audits would fall into the definition of auditor. However, it would also seem that internal auditors whose work is being used as evidence on Yellow Book audits should not be considered auditors. This is an important distinguishing factor as it is determinative as to whether the CPE requirements of the Yellow Book need to be met. GAO should clarify the expectations for internal auditors in this regard.

Internal Specialists. We recommend that the definition of auditor and specialist in paragraph 1.23 be revised to clarify that internal specialists that are not acting as part of the engagement team, but rather are acting consultatively to the engagement team, are considered specialists. This clarification is important because paragraphs 3.80 and 3.81 of the current Yellow Book are not included in the ED. Those sections currently make it clear that internal specialists that are acting as part of the engagement team are subject to the CPE requirements, whereas internal specialists that are acting consultatively to the engagement team are not subject to the CPE requirements.

Complying with GAGAS Application Guidance. Paragraph 2.07 refers to auditors having a *responsibility* to “consider the entire text of GAGAS in carrying out their work and in understanding and applying the requirements in GAGAS.” GAO should consider whether this should be moved into the requirement section in paragraphs 2.02 – 2.06. If GAO moves this guidance, it may want to consider deleting the remainder of the paragraph as it seems duplicative of the related requirements description.

Independence of Specialists. Paragraph 3.30 of the ED requires auditors to assess the independence of specialists. The related application guidance in paragraph 3.43 of the ED states “Auditors’ assessment of the independence of specialists who perform audit work includes identifying threats and applying any necessary safeguards in the same manner as they would for auditors performing work on those engagements.” Both the AICPA Code and the IESBA Code specifically exclude external experts engaged by the firm from the definition of engagement team on the basis that it is not necessary to subject such individuals to the same independence requirements as the partners and employees of the firm who work on the engagement. The ASB auditing standards address the auditor’s requirements for evaluating an external specialist and require that the auditor evaluate the relationships of the specialist to the client, including circumstances that might impair the specialist's objectivity. Such circumstances include situations in which the client has the ability— through employment, ownership, contractual right, family relationship, or otherwise—to directly or indirectly control or significantly influence the specialist.

We believe that objectivity serves as an appropriate threshold for purposes of using an external specialist since the ability for such specialists to influence the audit engagement is unlikely and that any additional restrictions required under the independence framework are unnecessary. In addition, it may be impractical to require an external specialist that is used by the auditor on a one-off or infrequent basis to comply with the same independence requirements and restrictions as the partners and employees of the audit organization. Accordingly, we recommend that the GAO revise the proposal for specialists to be consistent with the AICPA and IESBA Codes in this area.

Guidance on Breaches of the Independence Standards Would Benefit from Enhancement. Paragraph 3.32 of the ED requires an auditor to terminate an engagement in process when independence is impaired. When

an engagement has been completed and an independence impairment is later identified, paragraph 3.38 of the ED indicates that the report should be retracted. Both IESBA Code (100.10; 290; and 291) and the AICPA Code (ET 1.298) provide for a process to evaluate breaches of independence. In many cases, withdrawal from a current audit engagement or retraction of previously issued financial statements is not warranted for minor technical violations. In those circumstances, those charged with governance at the client and the auditor may reach a conclusion that integrity, objectivity, and professional skepticism in the performance of the audit was not compromised and therefore, no further action is necessary. Because GAGAS does not incorporate the AICPA Code (see paragraph 2.13 of the ED), if GAGAS is applied without reference to the AICPA's breaches provisions, and in the absence of specific breaches provisions being added elsewhere in GAGAS, the resulting implementation is unclear. Requiring termination under paragraph 3.32 is an extreme result, considering that some breaches of the GAGAS independence requirements may be minor or technical breaches that do not in substance compromise the auditor's integrity, objectivity and professional skepticism. Furthermore, termination might not be in the public interest. We recommend that the ED be clarified to include guidance on breaches, so there is a clear path to be followed in the event of breaches of independence or other GAGAS provision. Alternatively, GAO could refer to the breaches provisions of the AICPA Code and/or remove exclusion of the AICPA Code in paragraph 2.13.

Licensing and Certification. Paragraph 6.05(b) states that auditors engaged to conduct financial audits of entities operating outside of the United States should meet the qualifications indicated in the previous paragraph [6.04] or “work for a nongovernment audit organization that *meets the organizational requirements of paragraph 6.04.*” GAO should clarify this statement as it is unclear how an audit organization would meet the requirement in paragraph 6.04 since that paragraph discusses a requirement for individual auditors. On a separate note, paragraphs 6.04 and 6.05 refer to “government audit organizations” and “non-government audit organizations” which are not defined. GAO may want to consider adding definitions for these terms.

New “Waste” Responsibility Unclear. We have several concerns with the proposed addition of a “trip over” responsibility for waste which have led us to question whether it should be included in the final standard. In considering this addition, we looked at the first part of the requirement to consider waste from the perspective of its materiality to the financial statements or other financial data significant to the audit objectives. Even if an auditor believes an entity may have wasted resources, if the transactions are appropriately recorded and classified in the financial statements, we question how this situation would be material. Additional guidance should be provided if GAO proceeds with this requirement. The second part of the requirement links the perspective to the consideration of waste that could be significant to the entity's operations. This seems outside of the spectrum of a financial audit and more operational or compliance driven. If retained, the threshold for determining the significance of waste [or abuse], for the purpose of triggering further audit procedures should be measured against the subject matter of the audit, as opposed to another threshold that may not relate to the audit objectives.

If GAO decides to proceed with this requirement, there are also several other areas that will need further clarification as follows:

- The definitions of abuse and waste seem duplicative/overlapping. GAO should clarify the definitions in both areas to ensure auditors are able understand the difference. Specifically, it is unclear how “using or expending resources carelessly, extravagantly, or to no purpose” would not also be considered “deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances.”

Also, in defining abuse, paragraph 6.18 states: “Abuse... excludes fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements.” This could lead one to assume that abuse includes waste.

- Because of the subjective nature of waste and how/whether it could ever be considered material, GAO should include several examples of situations where waste could have a material effect on the financial statements (or other subject matter) if the resources have been recorded and properly classified. Doing this will give auditors a better understanding of the concept and promote more consistent practice.
- More clarity is needed that the responsibility for waste is a “trip over” responsibility. In discussing abuse, paragraph 6.18 states: “Because the determination of abuse is subjective, auditors are not required to perform procedures to detect abuse in financial audits.” A similar statement is not included in the waste discussion. We believe that GAO’s intent for the waste responsibility is consistent and recommend a similar sentence be added in the waste section.

Communicating Potential Matters. Paragraph 4.26 of the current Yellow Book states: “When auditors detect instances of noncompliance with provisions of contracts or grant agreements or abuse that have an effect on the financial statements or other financial data significant to the audit objectives, that are less than material but warrant the attention of those charged with governance, they should communicate those findings in writing to audited entity officials.” Paragraphs 5.25, 5.49, and 5.59 of the current Yellow Book contains similar wording as it relates to attestation engagements. However, paragraphs 6.39, 6.43, 7.43, 7.74, and 7.85 of the ED include very similar wording except that they now refer to “*potential* instances of noncompliance with provisions of...” We are unclear if GAO intends a change in practice with the addition of the word “potential” and request that GAO clarify the intent of this change.

Use of “Auditor” in Chapter 7 Should be Revised. Chapter 7 of the ED covers attestation and review engagements. However, throughout the chapter it refers to “auditors.” We recommend that all instances of “auditors” be replaced with “practitioners.” This would make the Yellow Book more consistent with AICPA standards and avoid confusion.

Yellow Book Reporting Description Enhancements Needed. We believe the current Yellow Book is clearer regarding the requirements for Yellow Book reporting and suggest that GAO revisit the content and ordering of paragraphs 6.34 – 6.39. Paragraph 4.19 of the current Yellow Book begins with a clear statement that “when providing an opinion or a disclaimer on financial statements, auditors should also report on internal control over financial reporting and on compliance with provisions of laws, regulations, contracts, or grant agreements that have a material effect on the financial statements.” In reading paragraphs 6.34 – 6.39, they do not clearly articulate the reporting requirement. For example, paragraph 6.34 only talks about reporting internal control deficiencies in conjunction with the financial statement opinion. Paragraph 6.35 mentions a report on internal control over compliance and internal control which has not been introduced previously. When reading paragraph 6.37, it discusses reporting in “the same or separate report,” but it is not clear what “same” report is being referred to. Someone with experience in performing Yellow Book audits may get to the right answer with the re-write, but someone new to doing Yellow Book audits will likely be confused by the discussion.

Lack of Clarity About Reporting Others’ Findings. Paragraph 6.35 states: “When auditors...conclude, based on sufficient, appropriate audit evidence, that [noncompliance, fraud, waste or abuse] has occurred, they should include in their report on internal control or compliance the relevant information...” The

paragraph does not specifically address circumstances in which the noncompliance, fraud, waste or abuse has been reported by another party such as an Office of Inspector General (OIG). For example, if an auditor becomes aware of an OIG oversight report that was issued during the audit period for an auditee, the auditor uses that information in planning the audit for purposes of risk assessment and determining appropriate audit procedures. The question that arises, is whether the auditor is required to include the OIGs noncompliance, fraud, waste, or abuse findings in the auditors' report(s) if it would have a material effect on the financial statements or other financial data significant to the audit objectives. We sometimes receive questions from auditors when this scenario occurs in practice today and it would be helpful if GAO could clarify the expectation.

EDITORIAL SUGGESTIONS

Paragraph 1.08. We suggest the following revision for clarity: “and other nongovernmental entities when the use of GAGAS is required or ~~voluntary~~ **voluntarily adopted.**”

Paragraph 1.11. This paragraph discusses reasons to voluntarily adopt GAGAS. It would seem better placed within paragraph 1.08. Or, if GAO believes it is necessary as a separate paragraph, it should be included directly after paragraph 1.08.

Paragraph 3.25. GAO should consider whether the reference to paragraph 2.16 in this paragraph should be broadened to paragraphs 2.15 – 2.17 to cover the entire requirement section for “Stating Compliance with GAGAS in the Audit Report.”

Chapter 3, Figure 1. We recommend that the phrase "is the threat significant" in the flowchart refer back to paragraph 3.44 for guidance on the meaning of “significant” in this context.

Chapter 4, Paragraphs 4.15 and 4.26(b). We believe that the language in paragraphs 4.15 and 4.26(b) should more closely mirror the language used in the related requirement in paragraph 4.10 to avoid confusion. We offer the following suggested revisions. Paragraphs 4.15 and 4.26(b) should read as follows:

4.15: Auditors who plan, ~~direct,~~ **and** perform engagement procedures for, or **direct or** report on an engagement conducted in accordance with GAGAS should complete the GAGAS Qualification requirements as part of developing and maintaining their professional competence. GAGAS Qualification requires auditors to complete at least 4 hours of CPE in GAGAS topics. Auditors assigned to supervisory or partner and director roles should obtain GAGAS Qualification before completing work on their first GAGAS engagement. Entry-level staff should obtain GAGAS Qualification by the end of their first full 2-year CPE period

4.26(b): “...are only involved in **planning or** performing engagement procedures, but not involved in ~~planning,~~ directing or reporting on the engagement.”

Chapter 5, Figure 2. This figure seems out of context. We suggest adding a note or information directly on the figure explaining which section of the peer review requirements the figure relates to.

Paragraph 5.84. This paragraph should be revised to refer to “GAGAS peer review requirements” instead of “GAGAS.” This would be consistent with 5.103(e) requirements for the peer review report.

Mr. James M. Dalkin

July 6, 2017

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Paragraph 6.9. We recommend the following sentence be revised as follows to align with similar wording in paragraph 7.11: “Further, early communication is important to allow management to take prompt corrective action **to prevent further occurrences** when a control deficiency...”

Paragraph 6.26. We suggest the following sentence be revised as follows for clarity: “Regardless of the type of finding identified, the cause of a finding may relate to ~~an~~ **one or more** underlying internal control deficiencies...”

Paragraph 6.32. We suggest adding a reference to paragraphs 2.15 and 2.16 where citing compliance with GAGAS in the audit report is discussed.