



# Office of the Washington State Auditor Pat McCarthy

June 30, 2017

Via Electronic Mail

Mr. James Dalkin  
Director, Financial Management Assurance  
U.S. Government Accountability Office

RE: Response to *Government Auditing Standards – 2017 Exposure Draft*

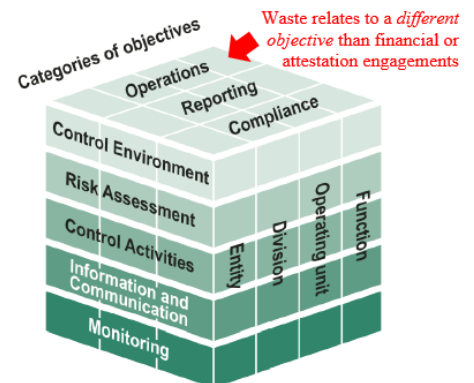
Dear Mr. Dalkin:

The Office of the Washington State Auditor appreciates the opportunity to provide input on the *Government Auditing Standards* (GAGAS) exposure draft. Our comments are organized in three separate sections related to: (1) the addition of requirements for identifying and reporting waste, (2) specific questions for commenters, and (3) detailed comments on specific paragraphs in the exposure draft.

### Section 1 - Proposed requirements related to identifying and reporting waste

We disagree with proposed requirements to identify and report waste in financial audits and attestation engagements. We believe these new requirements are not appropriate for financial audits and attestation engagements because they are (1) outside the scope of these engagements and (2) highly subjective in nature, such that only a performance audit would result in sufficient, appropriate evidence for conclusions.

Professional literature, such as *Standards for Internal Control in the Federal Government* (also known as the Green Book), defines the efficient and effective operations as a separate objective from the financial reporting and compliance objectives. Further, waste is expressly identified as not being relevant to a financial audit by generally accepted auditing standards published by the AICPA (AU-C 315.A72-A73). This is because waste is a judgment about the efficiency or effectiveness of valid transactions.



Sources: COSO and GAO. | GAO-14-704G

In contrast, fraud and abuse are recognized as a sub-set of all three objectives because they relate to the validity of transactions (for example, see discussion in the Green Book OV2.24). Non-compliance is also recognized to overlap with the other audit objectives because it too relates to the validity of transactions (for example, see AU-C 250).

Secondly, defining waste is highly subjective. Reasonable people regularly disagree on whether a transaction, program or unit of government is essential or wasteful. In contrast, fraud, abuse or non-compliance are all reasonably objective matters. Therefore, to properly evaluate and conclude on waste would require the auditor to research and develop suitable methodology, criteria and evidence, as discussed for performance audits in paragraphs 8.16-.18 of the exposure draft. Given that potential waste could be (and regularly is) alleged to be virtually everywhere in government, auditors would consistently be in a position of choosing to either a) conclude on waste based on the auditor's impressions, but without sufficient evidence, or b) plan and carry out a performance audit as part of the financial audit or attestation engagement. Since waste is outside the objective of a financial audit or attestation engagement, such work would be a separate endeavor with little to no relevance or relationship to other procedures the auditor performs for the engagement.

We believe that only a performance audit would provide the sufficient, appropriate evidence needed to publicly report a conclusion on waste, particularly if all the elements of a finding (i.e. cause, effect, criteria and recommendations) need to be developed. The fact that GAGAS has separate audit standards for performance audits, which have no counterpart in auditing standards published by AICPA, demonstrates the need for separate audits to address this distinct objective related to efficiency and effectiveness.

### Section 2 - Questions for commenters

1. *Please comment on how the revised format of GAGAS affects the organization and readability of the standards.*

We have no concerns with the revised format and find it enhances readability and understanding of the requirements.

2. *Please comment on whether the revisions related to nonaudit services in Chapter 3 sufficiently and clearly explain what is required and prohibited under GAGAS.*

In general, the additions clearly explain the requirements. However, we felt the term and definition of "professional services" in paragraph 3.80 was confusing. We suggest defining these as "investigative services or responding to legislative inquiries." This would include fraud, whistleblower and other investigations regarding performance, compliance or safeguarding of public resources that may be conducted in accordance with state law or by request rather than under professional standards. It would also include providing testimony at hearings or estimating the fiscal impact of a proposed legislation. By their nature, these assurance services are recognized to not create management participation threats so long as auditors do not set direction or accept responsibility for key processes or controls.

3. *Do these roles and descriptions in Chapter 4 clarify the competence required of auditors conducting engagements in accordance with GAGAS? Is the level of proficiency expected for each of these roles clear?*

We suggest an additional role for paragraph 4.10 to cover those with experience, but who are not serving in a supervisory capacity. For example:

Experienced: Auditors with experience greater than entry level, but who are not responsible for supervising the engagement. Work situations for these auditors are

characterized by increased or moderate levels of ambiguity, complexity, and uncertainty, and may involve assignments to provide training for the supervisory role.

We further suggest that the supervisory role include supervising other auditors in the description. For example:

“Supervisory: Auditors in supervisory roles plan engagements, perform engagement procedures, assign and supervise other staff, review audit work and judgments, or direct engagements.”

4. *Please comment on any additional topics that could be included in the 4-hour GAGAS CPE requirement discussed in Chapter 4 or other requirements that would enhance auditor proficiency in GAGAS.*

We agree with the new 4-hour requirement and of the strong competency and CPE requirements that support high quality audits for government entities and programs. We have no suggestions for additional topics for this new requirement.

We do, however, have other detailed suggestions related to continuing professional education (CPE) in Attachment A. In particular, we believe greater convergence with CPE standards published by the AICPA and the National State Boards of Accountancy (NASBA) is necessary, such as allowing for CPE to be earned in increments of 10 minutes, rather than 50 minutes, to enable use of nano training.

5. *Is there any additional application guidance that should be included in the GAGAS revisions in Chapter 4 to enable auditors and audit organizations to effectively implement the CPE requirements given the planned retirement of the CPE guidance document?*

Paragraph 18 of the 2005 CPE guidance stated:

“The 24-hour requirement calls for auditors to obtain at least 24 hours of CPE in subjects and topics directly related to the government environment, government auditing, or the specific or unique environment in which the audited entity operates.”

We note that “the government environment” is not included in proposed paragraph 4.24. Further, subparagraph 18(a) of the 2005 CPE guidance listed subjects and topics considered appropriate for the 24-hour requirement. We would also suggest inclusion of the following topics:

- Information technology auditing topics applicable to a government environment, such as obtaining evidence, risk assessment, specialized audit methodologies or techniques, and applicable authoritative standards or sources of criteria.
- Fraud auditing topics applicable to a government environment, such as obtaining evidence, risk assessment, and specialized audit methodologies or techniques.
- Topics directly related to the government environment, such as the nature of government (structures, financing and operations), economic or other conditions

and pressures facing governments, common government financial management issues, measurement or evaluation of government financial or program performance and application of general audit methodologies or techniques to a government environment or program.

We believe these topics should qualify for the 24-hour requirement because they are considered essential to gaining an understanding of a government and its environment sufficient to plan and perform an audit (AU-C 315.12). If the proposed 4.24(i) is intended to encompass these topics, then we would suggest it be clearer in this regard.

6. *Are the changes to the quality control and external peer review sections in Chapter 5 appropriate and reasonable?*

For the most part, yes. However, we have a number of detailed comments for Chapter 5 in Attachment A.

7. *Are the peer review requirements in Chapter 5 for each category of audit organization clear?*

Yes. We do, however, have other detailed comments for Chapter 5 in Attachment A.

8. *Please comment on the expanded requirements and application guidance in in Chapter 7 for reviews of financial statements (paras. 7.68 through 7.80).*

As described above, we do not believe the concept of waste is appropriate to address in an attestation engagement.

We also note that paragraphs 7.01, 7.05, 7.68, 7.79, 7.81 and 7.90 all reference specific statements (SSAE 18 and SSARS 21) rather than SSAEs and SSARs generally. We suggest a general reference to the applicable sets of standards to avoid confusion or obsolesce if SSAE 18 or SSARS 21 are amended, augmented or replaced with additional attestation or review standards.

In addition, we have other detailed comments for Chapter 7 in Attachment A.

9. *Do the updated sections in Chapter 8 (paras. 8.37 through 8.65) clearly describe ways auditors assess internal control on performance audits?*

These sections could be improved as follows:

- 8.38(c) and (d) - 39 - suggest referencing 1.23 for the definition of the “three categories of entity objectives” so as not to cause confusion with how these categories are defined in COSO or the Green Book. Also suggest referencing COSO or the Green Book for the definition of the “five components of internal control.”
- 8.46 – We suggest the paragraph be edited to reinforce scope of control understanding: “Obtaining an understanding of internal control assists auditors in identifying an audited entity’s key controls relevant to audit objectives. ...”

- 8.47 – This paragraph implies that design implementation and operating effectiveness must all be assessed and documented, whereas application guidance in 8.48 implies that the extent of assessment may vary. These paragraphs should be clarified.
- 8.51 – Consider adding guidance to indicate that if the design of controls is found to be deficient, there would be no reason for auditors to test the implementation or operational effectiveness of internal controls. This idea is similar to requirements for audits of federal grant programs in 2 CFR 200.514(c)(4).

Further, the proposed reporting requirement on internal controls in paragraph 9.24 indicates that auditors should describe in the report how they considered the concept of accountability for the use of public resources. We believe this is self-evident from the auditor's description of the objective and are unclear what additional language would be necessary in the report. For the same reason, we are unclear what additional procedures would be necessary to meet this requirement, since there is no parallel discussion in paragraphs 8.37 thru 8.65.

Finally, the proposed reporting requirement on internal controls in paragraph 9.25 requires language that would imply that the auditor's consideration of controls significant to the engagement as required in 8.47 was incorrect or somehow incomplete. Moreover, we believe such language should be unnecessary in a performance audit because it will be evident from the auditor's description of the objective. If such a statement is considered necessary, the standards may as well require all performance audits to include a statement that had the auditor's objective been different, then additional or different findings may be reported.

### Section 3 - Other detailed comments

Additional comments about specific paragraphs not related to the questions above are included in Attachment A.

Thank you for the opportunity to provide our comments. Any inquiries may be directed to me at

[REDACTED]

Sincerely,



Pat McCarthy  
**Washington State Auditor**

## Attachment A: Detailed Comments by Chapter

### Chapter 1 – Foundation and Principles

- 1.03 – suggested edit “~~As reflected in applicable laws, regulations, agreements and standards,~~ management and officials of government programs are responsible for providing reliable, useful, and timely information for transparency and accountability of these programs and their operations. ...” Suggested edit is to make the sentence clearer and to not imply that management’s responsibility for subject matter must be established in law since that isn’t clearly the case for all state agency and local government engagements.
- 1.04 – suggested edit “Those charged with governance refers to the individuals responsible for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting **objective process**, subject matter, or program under audit, including related internal controls. Those charged with governance may also be part of the entity’s management. ~~In some audited entities, multiple parties may be charged with governance, including oversight bodies, members or staff of legislative committees, boards of directors, audit committees, or parties contracting for the engagement.~~” First edit suggested to align with Green Book terminology. Suggest cutting the last sentence because it seems to confuse the definition of “those charged with governance” more than it clarifies.
- 1.07 – suggested edit “... GAGAS contains requirements and guidance to assist auditors in objectively **obtaining** ~~acquiring~~ and evaluating sufficient, appropriate evidence and reporting the results. ...”
- 1.22 (and 3.79) implies that the types of engagements covered by GAGAS (financial, attestation and performance) would be considered audit services. However, it would be helpful if this were directly stated in the definition of non-audit services either in this paragraph or in 1.23.
- 1.23.o – suggested edit to converge with AU-C 620 definitions “Specialist – An individual or organization possessing expertise in a field other than auditing **or accounting** that assists auditors in conducting engagements.”

### Chapter 2 – General Requirements

- 2.03-04 – suggest combining these two sentences to make it easier to read and to clarify what “must” and “should” be done (since 2.04 currently contains two “must” requirements, one of which is corollary to the “should” requirement in 2.03): “In rare circumstances, auditors and audit organizations may determine it necessary to depart from a relevant presumptively mandatory requirement. In such rare circumstance, auditors **must document their justification for the departure and** should perform alternative procedures to achieve the intent of that requirement. ~~If, in rare circumstances, auditors judge it necessary to depart from a relevant presumptively mandatory requirement, they must document their justification for the departure~~ and how the

#31 alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement.”

- 2.10 – suggest edit because first sentence is unnecessary and shouldn’t cite application guidance in the requirement: “~~When auditors cite compliance with GAGAS and another set of standards, such as those listed in paragraphs 2.12, 2.14, 6.01 and 7.01, auditors should refer to paragraph 2.16 for the requirements for citing compliance with GAGAS.~~ In addition to citing GAGAS, auditor may also cite the use of other standards in their reports when they have also met the requirements for citing compliance with other standards. Auditors should refer to the other set of standards for the basis for citing compliance with those standards.

### Chapter 3 – Ethics, Independence and Judgment

- 3.04 - suggested edit: “... Ethical principles apply in preserving auditor independence,<sup>9</sup> only taking on ~~only~~ work that the audit organization is competent to perform,<sup>10</sup> performing high-quality work, ...”
- 3.13 - suggested edit to include defined terms: “Government information, resources, and positions are to be used for official purposes and not illegally, abusively or inappropriately for the auditors’ personal gain ~~or in a manner contrary to law~~ or detrimental to the legitimate interests of the audited entity or the audit organization. This concept includes the proper handling of sensitive or classified information or resources.
- 3.54 - suggested edit to make language parallel to 3.62 description of safeguards “External audit organizations that are structurally located within governments may be subject to one or more of the following three categories of safeguards to mitigate eliminate or reduce structural independence threats to an acceptable level.”
- 3.58 - a header is needed to clarify where Category III ends.
- 3.63 - consider adding more examples of potential safeguards, such as dedicated funding by law, procurement of the audit by a third party such as a legislative oversight agency, jointly conducting the audit with another audit organization, and/or audit organization policy for periodic supervisor or audit team rotation.
- 3.99 - suggested edit to generalize this requirement “...are material to the ~~audited entity’s financial statements~~ subject matter of the engagement.”

- 4.16 - referencing application guidance (4.23) as part of a requirement is at odds with its placement as application guidance.
- 4.20-50 - application materials contain a lot of specific instructions. These should be categorized as requirements if they are intended to be followed without deviation. For example, the guidance in 4.48 on maintaining documentation would need to be a requirement in order for an audit organization to demonstrate compliance, and a peer review to effectively evaluate compliance (as required in 5.80.e).
- 4.22 - should be eliminated as unnecessary. Combine with 4.21 if desired and reference 4.24 and 4.25.
- 4.24.c – we are unclear why only parts of the AICPA’s Statements on Standards for Attestation Engagements are cited as qualifying topics and find the description of this limitation confusing.
- 4.30 - exemptions should be prorated in the same manner as described in 4.28.
- 4.31 - previously the language was “structured educational activities with learning objectives”. The new language is “structured educational activities *or* programs with learning objectives,” making it unclear as to what should be considered a structured educational activity.
- 4.32.j - suggested edit to align with the AICPA and NASBA’s *Statement on Standards for Continuing Professional Education Programs* S20-03: “developing or technical review of courses or the course materials for programs that qualify for CPE hours; or”
- 4.31 - strongly suggest convergence with the AICPA and NASBA’s *Statement on Standards for Continuing Professional Education Programs* to allow CPE for nano-learning programs (that is, in 10 minute increments, rather than a minimum of 50 minutes with 25 minute increments thereafter). The AICPA’s [Future of Learning](#) research makes the case for changes such as this.
- 4.49 - inappropriately suggests that a peer review could act as an audit organization’s monitoring controls. Like an audit, external reviews provide feedback on the organization’s internal controls, but are not a substitute for controls.

**Chapter 5 – Quality Control and Peer Review**

- 5.03 - currently describes quality control using only control environment and control activities elements. We were expecting quality control to be described as including all five components from the COSO or Green Book framework, including risk assessment, information / communications and monitoring (which in the case of a quality control system, would entail overall oversight of the quality control function and follow-up on identified weaknesses or issues).



- #31 • 5.23 - suggest edit to make this requirement appropriately firm: “The audit organization should establish quality control procedures to ~~help ensure~~ provide reasonable assurance that auditor who are performing work in accordance with GAGAS meet the continuing professional education (CPE) requirements...”
- 5.31 - does not appear to add relevant application guidance.
  - 5.51 – suggest including the following additional potential monitoring procedures:
    - root cause analysis of potential audit failures, such as report re-issuance or material prior period adjustments
    - tracking audit quality indicators
    - review and follow-up on exception reports indicating potential quality issues
    - pre- or post-issuance inspection of engagement documentation or reports
    - cross-cutting reviews of specific requirements or topics
  - 5.53 – this guidance appears to be at odds with AU-C 220 in that it would preclude “engagement quality control reviews,” from being considered a monitoring activity since these are defined in AU-C 220.21.c as being pre-issuance. Rather than precluding any pre-issuance reviews from the definition of monitoring, we would suggest focusing on the core concept that monitoring is not a substitute for regular quality control procedures and therefore should be conducted in addition to regular controls. This would normally require monitoring to be done either simultaneously or after application of regular quality control procedures.
  - 5.55 - suggest including the following additional factors which may impact the nature, timing and extent of engagement inspections:
    - whether any high risk or specialized engagements are performed.
    - nature and extent of any changes to standards or policies.
  - 5.70-79 - could be moved to general peer review requirements in order to eliminate duplication with requirements for audit organizations not affiliated with recognized organizations.
  - 5.70-72 – we understand that the language in these requirements are intended to match the AICPA’s peer review guidance in PRP 1000.70. However, the terms “deficiency” and “significant deficiency” are defined differently here than their common usage or use in chapters 6 and 7 and in AU-C 265. We believe the terms “significant deficiency” and “material weakness” should be used instead since they are more aligned with other chapters and more appropriate for the opinions given in those circumstances (that is, qualified and adverse).

## Chapter 6 – Financial Audits

- 6.05 – this requirement already invokes the previous paragraph (“... should meet the qualifications indicated in the previous paragraph or ...”) and therefore does not need to repeat sub-point b and c.

- #31 • 6.39 - suggested edit to avoid implying that requirements for findings in 6.35-58 would apply to immaterial matters not presented in the auditor's report: "Auditors should communicate ~~findings~~ in writing to audited entity officials when ..."

## Chapter 7 – Attestation Engagements

- 7.08, 7.70 and 7.83 – these requirements already invoke the previous paragraph ("... should meet the qualifications indicated in the previous paragraph or ...") and therefore does not need to repeat sub-point b and c.
- 7.09 – it is not clear whether the requirement only applies if an individual entity is specifically named in a law or if a category of entities is identified (for example, "air pollution control authorities", of which there may be 9). If this is intended to clarify existing (5.04) requirements, we suggest that extant language be retained with the following edits: "~~In addition to the AICPA requirements for auditor communication, when performing a GAGAS examination engagement,~~ auditors should communicate pertinent information that in the auditors' professional judgment needs to be communicated to individuals contracting for or requesting the examination engagement, and to cognizant legislative committees ~~when auditors perform the examination engagement pursuant to a law or regulation, or they conduct the work for the legislative committee~~ that ~~has~~ have direct oversight of the audited entity."
- 7.42 - suggested edit to avoid implying that requirements for findings in 7.45-58 would apply to immaterial matters not presented in the auditor's report: "...they should communicate those ~~findings matters~~ in writing to audited entity officials."
- 7.73 and 7.84 - suggested edit to make requirements parallel "... auditors should communicate such matters in writing to those charged with governance and audited entity officials ..."

## Chapter 8 – Fieldwork for Performance Audits

- 8.04 - suggested edit for alignment with AU-C 200 "Auditors must plan the audit to reduce audit risk to an acceptably low appropriate level for the auditors to obtain reasonable assurance to support their findings and conclusions."
- 8.20-22 – requirements only appear to cover the beginning of the audit and do not contain requirements to communicate audit results, including findings or other matters identified, significant difficulties encountered during the audit or significant disagreements with management (such as those required by AU-C 260).
- 8.35 – suggested edit to avoid assumption that the audit organization does not have authority to initiate performance audits "If the audit was performed based on authorization or request, then one group of users of the audit report is government officials or other parties who have authorized or requested the audit..."
- 8.36.g - suggested edit for readability: "...Outcomes also include a program's unexpected ~~and effects~~, unintentional effects, ~~or both of a program~~, both positive and negative."

- #31 • 8.89 - suggest convergence with AU-C 500 by using only relevance and reliability to describe the appropriateness of evidence. As defined in 8.100.b, the concept of validity seems duplicate of relevance and reliability.
- 8.101 - consider adding additional example as follows: “The audit objectives might focus on evaluating prospective information such as estimates, forecasts or projections. In such cases, auditors may analyze the methods or models used, support for key assumptions, sensitivity of estimates, and management’s rationale for rejecting any alternative models or assumptions, as well as the reliability of underlying data used. Clear disclosure of the nature and extent of estimation uncertainty will likely be necessary to place evidence in context for report users.”
- 8.128 - suggest adding the following requirements to align with AU-C 230:
  - who performed the audit work and the date such work was completed
  - who reviewed the audit work performed and the date of such review

## Chapter 9 – Reporting for Performance Audits

- Suggest adding a paragraph following 9.20 to address communication requirements for insignificant issues, parallel to financial and attest guidance. For example:

“When auditors detect deficiencies in internal control, potential instances of noncompliance with provisions of laws, regulations, contracts or grant agreements or fraud, waste or abuse that is not significant to within the context of the audit objectives, the auditors’ determination of whether and how to communicate such instances to audited entity officials is a matter of auditor judgment.”
- 9.59 - Due to confidentiality issues, some audit reports omit certain sensitive information (such as IT security issues), which may include improper and illegal practices. In some cases, revising the report language to “minimize the risk that report users will draw inappropriate conclusions” as the proposed language would require may not be possible without disclosing sensitive information that could potentially bring harm to the auditee and the public. We suggest adding that in some circumstances, one way auditors may avoid misleading the reader is by disclosing that additional confidential matters have been disclosed to executive management under a separate letter.
- 9.65 - suggest (1) making the auditor’s responses conditional upon a belief that there are users currently relying on or likely to rely on the previously issued report (like AU-C 585.07) and (2) allowing issuance of a follow-up performance audit with appropriate disclosure of the matter (ie: AU-C 560.A21). Convergence on these points will allow for more appropriate handling of situations where issues with an old performance audit are discovered as part of a follow-up audit, or issues are discovered with a performance audit that is obsolete (for example, a performance audit on a program that no longer exists).
- Suggest application guidance following 9.65 to explain that auditors have no responsibility to remove old performance audits with new performance audits to address the effects of subsequent events or corrective action taken after the period covered by the report.