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United States Government Accountability Office
Washington, DC 20548

April 30, 2010

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Audit and Attest Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
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Subject: AICPA Auditing Standards Board (ASB) December 2009 Exposure Draft for a proposed Statement on Auditing Standards (SAS), entitled “*Communicating Internal Control Related Matters Identified in an Audit (Redrafted)*.”

This letter provides the U.S. Government Accountability Office’s (GAO) comments on the ASB’s proposed SAS on communicating internal control related matters identified in an audit.

In general we support the proposed revisions to SAS 115 to converge with Internal Standard on Auditing (ISA) 265 and to implement the clarity drafting conventions. We especially support the new requirement for the auditor to include in the written communication of significant deficiencies and material weaknesses identified an explanation of the potential effects of those deficiencies. This important new requirement to inform management and those charged with governance of the potential effects will help them to determine appropriate remedial action.

We do, though, have one major concern with the proposed standard. In our December 22, 2009 letter to the ASB, we expressed concern over restricted use requirements and guidance in the proposed SAS *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report* because they are not consistent with requirements and guidance in *Government Auditing Standards* and do not always serve the public interest. Audited financial statements and related auditor reports of government entities are public documents. Government audits provide key information to stakeholders and the public and help maintain accountability for the use of public resources. Public access to these auditor reports is an important element of this process.

In addition, the restricted use requirements and guidance are not in ISA 265 and we are not aware of any compelling reasons to include them in the proposed SAS. In exhibit D, the comparison of the proposed SAS with ISA 265, the restricted use requirements are identified as a difference between the standards but no rationale for this difference is given.

For these reasons, we recommend making the following changes to the proposed SAS::

- Delete paragraph 14d or move it to the guidance section.
- Delete the reference to paragraph 14d in paragraph 15.
- Delete paragraph A32 and the last two sentences in paragraph A36. In our December 22, 2009 letter we requested deletion of similar wording in the proposed SAS *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*; these proposed changes to paragraphs A32 and A36 are consistent with our December 22, 2009 request.
- Delete the restricted use paragraphs from the illustrative written communications in Exhibits A and B.

The following outlines our requested changes to the proposed standard:

14. The auditor should include in the written communication of significant deficiencies and material weaknesses (Ref: par A30–A33)

a. the definition of the term material weakness and, when relevant, the definition of the term significant deficiency.

b. a description of the significant deficiencies and material weaknesses and an explanation of their potential effects. (Ref: par. A30)

c. sufficient information to enable those charged with governance and management to understand the context of the communication. In particular, the auditor should include in the communication the following elements that explain (Ref: par. A31)

i. the purpose of the audit was for the auditor to express an opinion on the financial statements.

ii. the audit included consideration of internal control over financial reporting in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of internal control.

iii. the auditor is not expressing an opinion on the effectiveness of internal control.

iv. the auditor's consideration of internal control was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses, and therefore, deficiencies, significant deficiencies, or material weaknesses may exist that were not identified.

~~*d. in accordance with the proposed SAS *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*,³ a restriction regarding the use of the communication to management, those charged with governance, others within the organization, and any specified governmental authority to which the auditor is required to report. (Ref: par. A32)*~~

15. When the auditor issues a written communication stating that no material weaknesses were identified during the audit, the communication should include the matters in paragraph 14(a); and (c).; ~~and (d).~~ (Ref: par. A34–A36)

~~Restriction on Use (Ref: par. 14(d))~~

~~A32. Law or regulation may require the auditor or management to furnish a copy of the auditor's written communication on significant deficiencies and material weaknesses to specified governmental authorities. When this is the case, the auditor's written communication may identify such governmental authorities in the restricted use paragraph. Because the written communication is a by-product of the audit, the proposed SAS Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report does not permit the auditor to add other parties as specified parties.¹⁰ Also, the inclusion of the restricted use written communication in a document that contains a general use report does not affect the intended use of the communication or the general use report.¹¹ The restricted use communication remains restricted regarding use, and the general use report continues to be for general use.~~

Considerations Specific to Governmental Entities

A36. A written communication indicating that no material weaknesses were identified during the audit may be required to be furnished to appropriate governmental authorities. ~~As described in paragraph A32, the auditor's written communication may identify the governmental authority as a specified party in the restricted use paragraph. The auditor is not permitted to add other parties as specified parties.~~

Exhibit A

~~This communication is intended solely for the information and use of management, [identify the body or individuals charged with governance]; others within the organization, and [identify any specified governmental authorities] and is not intended to be, and should not be, used by anyone other than these specified parties.~~

Exhibit B

~~This communication is intended solely for the information and use of management, [identify the body or individuals charged with governance]; others within the organization, and [identify any specified governmental authorities] and is not intended to be, and should not be, used by anyone other than these specified parties.~~

If our recommendations are not adopted, we ask the ASB at a minimum to include in the proposed standard a new consideration specific to government entities to explain

that the restricted use paragraphs do not apply in audits performed in accordance with *Government Auditing Standards*. This paragraph could be worded as follows:

Consideration Specific to Government Entities

Government Auditing Standards require auditors to report on the audited entity's internal control over financial reporting and compliance with laws and regulations and provisions of contracts and grant agreements. These reports, which are normally public documents, are an integral part of GAGAS audits and therefore are not subject to restricted use requirements.

Finally, in our December 22, 2009 letter we encouraged creation of a task force to review and revise AU section 532. We believe that this standard would also be part of the task force's deliberation. We hope the Board will give prompt consideration to this request. We are eager to work with the Board to find appropriate resolution of this issue.

Comments on Changes Resulting from Applying the Clarity Drafting Conventions and Convergence with ISA No. 265

Our comments on changes resulting from applying the clarity drafting conventions and from converging with the International Standard on Auditing (ISA) are detailed below.

(1) We believe that the objectives to be achieved by the auditor as stated in the proposed SAS are appropriate.

(2) We agree with the revisions made to the existing standard to converge with ISA No. 265.

(3) We agree with the differences between the proposed SAS and ISA No. 265.

(4) Except as noted in our comments above, we agree with the governmental considerations included in the proposed standard.

We thank you for considering our comments on these important issues.

Sincerely yours,



James R. Dalkin
Director
Financial Management and Assurance