



Ernst & Young LLP
5 Times Square
New York, NY 10036

Tel: +1 212 773 3000
ey.com

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

21 July 2017

Re: Government Auditing Standards 2017 Exposure Draft (GAO-17-313SP)

Dear Mr. Dalkin,

Ernst & Young LLP (EY) is pleased to provide comments on the exposure draft (ED) issued by the Government Accountability Office (GAO) that would update the generally accepted government auditing standards (GAGAS), also known as the Yellow Book.

EY supports the ED and commends the GAO for its continued efforts to update and modify GAGAS and align them with other auditing standards. This will help auditors more effectively and consistently apply GAGAS in financial audits and attestation engagements.

We support many of the proposed changes and believe they would help auditors better understand the requirements they are expected to meet. However, we believe some of the proposed changes require further consideration, including those changes that would affect the independence standards relating to financial statement preparation, non-audit services, the new GAGAS continuing professional education (CPE) requirement, auditor qualifications to conduct financial audits of entities operating outside of the US, the addition of a new auditor responsibility for waste and review engagements.

Appendix A of this letter contains our responses to selected questions in the proposal. In Appendix B, we provide additional feedback and editorial suggestions.

We appreciate your consideration of EY's recommendations and views and would welcome the opportunity to discuss our comments with the GAO at your convenience.

Very truly yours,

A handwritten signature in black ink that reads 'Ernst & Young LLP'. The signature is written in a cursive, flowing style.

Appendix A – Responses to questions in the proposed ED

Revised format of GAGAS

We agree with the revised format of the GAGAS that would distinguish between requirements and guidance related to those requirements. Because this format is similar to one used by other audit standard setters, it should be familiar to most auditors and would allow them to quickly identify and differentiate requirements and application guidance related to those requirements.

Revisions to non-audit services

We agree with the inclusion of ethical principles and independence guidance in a single chapter and the reorganization of the independence content into requirements and application guidance. We also agree with the inclusion of examples in the application material rather than in an appendix. This reorganization would improve the organization of GAGAS and align with the restructuring of the International Ethics Standards Board for Accountants (IESBA) Code of Ethics to further facilitate harmonization of auditor independence rules.

We also believe that the explanation and examples in paragraph 3.24 would clarify the auditor independence requirements when the engaging party differs from the responsible party and align with American Institute of Certified Public Accountants (AICPA) guidance for review and examination-level attestation.

We support the clarification in paragraph 3.29 that would require auditors to reconsider independence when they become aware of new information or changes in facts and circumstances that could affect whether a previously identified significant threat has been eliminated or reduced to an acceptable level. We support the new provision's encouragement of auditor alertness to independence issues and the continued application of the independence framework throughout an audit and professional engagement period.

We have the following additional comments on certain new provisions contained in chapter 3 of the ED.

Guidance related to professional services in government

We believe the last sentence in paragraph 3.80 could be interpreted as exempting government auditors providing professional services under a two- or three-party service arrangement from all GAGAS independence requirements, and this would be inconsistent with the overall principles of the GAGAS independence framework and other independence standards governing the audit profession.

Paragraph 3.80 states that unless the government auditor is "set[ting] direction or accept[ing] responsibility for key processes or controls," services provided in the context of these arrangements would not create management participation threats. This does not seem consistent with paragraph 3.73, which lists setting strategic direction and accepting responsibility for controls as two of 10 activities that would be considered management responsibilities. This could lead to an interpretation that the auditor's performance of one or more of the other activities listed in paragraph 3.73 (for example, the activity listed in 3.73(f), "accepting responsibility for management of an audited entity's project") would not create a management participation threat.

In addition, as outlined in the current Yellow Book and the ED, the GAGAS independence framework would require that threats other than management participation, including self-review threats, be identified and evaluated. However, paragraph 3.80 suggests that these other threats would not need to be considered when a governmental auditor is providing services to an entity it is auditing in a two- or three-party arrangement. For example, if a member of the engagement team had recently been employed by the audited entity in a position to exert significant influence over the subject matter of the engagement, the auditors would not be obligated to identify or evaluate such a circumstance as a potential threat to independence.

We believe that the proposed additional guidance for governmental auditors in paragraph 3.80 would be too broad and would not align with the overall GAGAS requirements. We recommend omitting this paragraph from the final rules and requiring government auditors to apply the proposed requirements in paragraphs 3.67 through 3.101 and application guidance (specifically paragraph 3.87, which would outline the application of the conceptual framework) with respect to the provision of non-audit services to audited entities.

Preparing accounting records and financial statements

We believe the proposed revision regarding requirements for preparing accounting records and financial statements would be too broad and the documentation requirement would be burdensome for services that do not in substance create a threat to independence.

Paragraph 3.89 would direct auditors to conclude that the provision of certain services, including those listed in 3.89(a)-(d), would create significant threats to independence and require the application of safeguards to reduce the threats to an acceptable level. It would also direct auditors to document those threats and the safeguards applied to eliminate the threats or reduce them to an acceptable level, or to decline to perform the services. However, the text does not define the types of threats to independence these services would pose.

We believe it would be difficult for the auditor to develop safeguards that are appropriate for such threats and capable of reducing them to an acceptable level when the nature of the threats and the cause for the significance determination isn't defined. This would be particularly challenging since paragraph 1.295.120 of the AICPA Code specifies that these particular services are permissible if the general requirements for performing non-audit services in paragraph 1.295.040 are met. The IESBA Code also would permit an auditor to perform such services for a non-listed audit client.

In addition, the services listed in paragraph 3.89(a)-(d) include categories in which the activities performed may vary widely. For example, paragraph 3.89(b) addresses "preparation of financial statements based on information in the trial balance." It is unclear whether this would include activities like word processing, printing or binding of the financial statements for the audited entity. Neither the AICPA Code nor the IESBA Code would automatically view such administrative activities as significant threats to independence.

While paragraph 290.163 of the IESBA Code indicates that such administrative services do not generally create a threat to independence since they “require little or no professional judgment and are clerical in nature,” the IESBA Code acknowledges that there may be instances where management is not capable of fulfilling its responsibilities and requires such administrative services to be evaluated using the conceptual framework, which is consistent with the 2011 revision of GAGAS and the AICPA Code.

We recommend that no change be made to current GAGAS with respect to these services. We believe the required evaluation of such services using the provisions in paragraphs 3.81–3.85, including evaluation of the existence and significance of any threats using the conceptual framework, should be sufficient to mitigate any potential concerns.

However, if the GAO believes that the proposed requirement would be appropriate because these specific services (or some subset of them) are deemed to create significant threats to independence by their nature, we believe the GAGAS provisions should be clarified to define the type(s) of threats that are created that result in the significance determination so that the threats can be meaningfully evaluated and appropriate safeguards can be implemented to address them. In addition, the flowchart in Figure 1 in the ED should be revised to include an added prompt to consider whether the non-audit service is addressed in paragraph 3.89, where the per se conclusion is that the service is a significant threat to independence.

Roles and level of proficiency descriptions related to GAGAS engagements

We recommend that the GAO establish a plain-English definition of basic, intermediate and advanced regarding the auditor’s level of proficiency to clarify the level of proficiency expected for each role in an engagement. This would help to eliminate ambiguity for individuals attempting to evaluate the roles in an engagement in paragraph 4.10 (i.e., entry level, supervisory, and partners and directors).

GAGAS four-hour CPE requirement

We believe the four-hour CPE proposal would have significant impact. We strongly believe that audit teams performing GAGAS engagements should be collectively competent. While we are not opposed to the GAO establishing a CPE requirement for GAGAS-specific topics, we believe there are a number of areas that need to be reconsidered or clarified to promote a consistent understanding and a smooth transition. The areas of concern and our recommendations related to each are covered in the following subsections.

Applying the CPE requirement to all staff levels

We recommend that GAO consider limiting the GAGAS qualification requirement to a subset of supervisory, partner and director roles as defined in paragraph 4.10. We believe that staff in entry-level and most supervisory roles would be better served obtaining CPE in the broader “standards, statutory requirements, regulations, criteria, and guidance applicable to auditing or the objectives for the GAGAS engagement(s) being conducted” category.

The unique aspects of GAGAS financial audit and attestation engagement standards that are incremental to AICPA auditing standards and attestation standards, respectively, can be small relative to the scale of the relevant AICPA literature that GAGAS is incorporating. Also, the incremental differences in GAGAS general standards, financial audit standards and attestation standards are primarily in the areas of independence, CPE, peer review and many aspects of reporting but less so in the actual areas of performance of internal control testing and substantive testing. As a result, we feel it is less important for most supervisory and entry-level staff to meet the four-hour GAGAS qualification, provided that the team collectively has the appropriate competence.

Applicability of CPE requirement to internal auditors, specialists and others

As we note in Appendix B, we believe the definitions of the terms "auditor" and "specialists" need clarification to make sure there is an appropriate understanding about which internal auditors/specialists and others would be subject to the CPE requirements, in general, as well as the new four-hour GAGAS qualification requirement.

In addition, the proposal does not have a provision similar to the one in chapter 3.81 of the 2011 GAGAS revision related to internal specialists who act as part of the audit team, which 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." Absent this provision, is it the GAO's intent that internal specialists that act as part of the audit team have to obtain CPE based on requirements in the ED that do not include training in their area of specialty?

We believe it would be problematic to require internal specialists whose expertise in the audit is limited to only specialized areas of the engagement such as an actuary assisting an engagement team in auditing pension liabilities to meet the four-hour GAGAS qualification and have 24 hours of CPE and, if applicable, the additional 56 hours in audit and accounting-related topics in areas outside their specialization.

Exemptions from the GAGAS four-hour qualification in specified circumstances

Many times on very large financial statement audit engagements subject to GAGAS, audit personnel within the same firm will perform only in a discrete area of the audit that may not be related to the governmental assistance the entity received that triggered the GAGAS audit requirement. Because the discrete area of the financial statement audit engagement may not significantly involve or require as high a level of proficiency in the unique aspects of GAGAS, we recommend that auditors be allowed to exercise professional judgment based on the facts and circumstances to determine who should have to comply with the four-hour GAGAS qualification.

Factors to be considered should include each engagement team member's role on the engagement, the nature of the areas they work on, the extent of GAGAS proficiency such roles require, the nature of the entity and the materiality of the federal assistance that triggered the financial statement audit requirement to the entity as a whole. As an alternative, the number of required CPE hours could be reduced to meet the GAGAS qualification for individuals meeting certain criteria, or an option could stipulate that at least two supervisory, partner or director-level individuals would have to meet the four-hour GAGAS qualification on each GAGAS engagement.

GAGAS four-hour qualification should not be limited to GAGAS topics in certain circumstances

Many individuals work solely on specialized compliance audits and other audits that require application of GAGAS such as the Uniform Guidance and the US Department of Housing and Urban Development Consolidated Audit Guide. We recommend that if it is retained in its current form, the four-hour GAGAS qualification for individuals working on such engagements be applied to training specific to the unique aspects of such engagements to reinforce the importance of this highly specialized training.

Time frame for complying with the GAGAS qualification

We recommend that the GAO clarify its intent in paragraph 4.15 by replacing the “before completing work” time frame reference with the following text: “before the date of the GAGAS report related to their first engagement is issued.”

Subsequent implementation issues of the GAGAS four-hour qualification

Paragraph 4.15 states that “to update their GAGAS Qualification, auditors should complete at least four hours of CPE in GAGAS topics each time the Comptroller General issues a revision of GAGAS.” We believe it is difficult to predict the nature and extent of future changes to GAGAS and the extent of training that will be needed to effectively update professionals on those changes. 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. We recommend that GAO consider whether additional work is needed to confirm that four hours is the appropriate requirement in all cases and to better explain the future update process.

GAGAS CPE application guidance

Paragraphs 4.26-4.30 “exceptions and exemptions” in the proposal do not contain 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” as included in paragraph 8d of the *Government Auditing Standards Guidance on GAGAS Requirements for Continuing Professional Education (GAGAS CPE Guidance)*. Is it the intent of the GAO to include individuals of this nature in the definition of auditor in paragraph 1.23(e)? On certain larger audits, we use these individuals to assist the engagement team in collecting information for the related analysis of Service Organization Controls reports, distribution of engagement audit documentation templates, compliance with independence standards and CPE requirements. We recommend that this exception be included in the final GAGAS.

Paragraphs 25-26 in the current GAGAS CPE Guidance related to the relationship between GAGAS and other CPE requirements were not included in the ED. Such guidance has proved helpful in assisting understanding of the GAGAS CPE requirements in the past, and we recommend that it be included in the proposed application guidance.

Quality control and peer review changes

We believe that the changes to the quality control and external peer review paragraphs are appropriate but recommend that paragraph 5.53 be revised to indicate that reviews of the work prior to the date of the report, performed by those independent of the engagement team members, could be formulated to be considered monitoring procedures. We believe that such a formulation is possible for in-process engagements and would be in the public interest so that problems can be fixed before a report is issued.

Requirements and guidance for reviews of financial statements performed in accordance with GAGAS

We agree with the expanded requirements and application guidance related to review engagements; however, while we agree that an auditor may not inherently develop findings in a limited assurance engagement, we do not agree with the GAO's position in paragraph 7.04 that that the auditor can't develop such findings.

We recommend that the GAO consider reasons other than those related to confidential/sensitive matters described in paragraph 7.80 to limit report distribution. Please refer to comment on paragraph 6.61.

Internal control on performance audits

We believe this chapter clearly describes ways auditors assess internal control on performance audits. We recommend that paragraph 8.47 be more explicit to indicate that if internal control is not part of the performance audit objectives, it would not be addressed. We believe this clarification is important because there would be no understanding and evaluation of internal control if the auditors concluded that they could meet the objectives of the performance audit without performing any procedures on internal control.

Appendix B – Other comments and recommendations

Chapter 1 – Government auditing: foundation and principles for the use and application of Generally Accepted Government Auditing Standards

We recommend that the term “prospective analyses” in paragraph 1.21 be defined and the GAO challenge whether these prospective analyses are audits depending on the context used in the ED. Examples of prospective analyses in paragraph 2.11 (d) of the 2007 GAGAS revision were not brought forward to the ED and may be a helpful addition if the discussion of prospective analyses is retained.

Definition of an auditor and a specialist

While a principles-based approach to making sure that an audit team is appropriately resourced to complete a particular engagement provides flexibility, we believe the application of the rules-based CPE requirements, which differ based on the role of the individual, merits further clarification of the definitions of an auditor and a specialist in paragraphs 1.23(e) and 1.23(o), respectively, and how they apply in practice.

It is our understanding that auditors are subject to tracking and reporting of CPE, including specific training requirements. In general, specialists are not. We recommend that the definitions of “auditor” and “specialist” be revised to make it clearer that internal specialists acting as part of the engagement team are considered auditors, whereas internal specialists who are not acting as part of the engagement team, but are acting as consultants to the engagement team, are considered specialists.

This clarification is important because paragraphs 3.80-3.81 in the 2011 Yellow Book are not included in the ED. These paragraphs made it clear that internal specialists that are acting as part of the engagement team were subject to the CPE requirements, whereas internal specialists that were acting consultatively to the engagement team were not subject to the CPE requirements.

Internal auditors

We believe the application of aspects of the guidance on internal auditors should be clarified to appropriately reflect the use of their work product on particular engagements. However, it is unclear to us how an internal auditor would fit into the auditor and specialist definitions. For example, it would seem that an internal auditor providing direct assistance on GAGAS audits would fall under the definition of auditor. It would also seem that an internal auditor whose work is being used as evidence on GAGAS audits should not be considered an auditor and should be evaluated under applicable guidance. We believe this is an important distinguishing factor as it relates to meeting the CPE requirements of GAGAS and merits clarification.

Others

It is unclear to us whether the work of others (beyond internal auditors) in a direct assistance capacity is within the scope of the definitions. We believe this complicates assessment of the applicability of CPE requirements.

For example, in the Public Company Accounting Oversight Board standards, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* (Auditing Standard 2201.16-17), subject to specific requirements, auditors are permitted to receive direct assistance from company personnel (in addition to internal auditors) and third parties working under the direction of management or the audit committee that provide evidence about the effectiveness of internal control over financial reporting at the audited entity (e.g., a Sarbanes-Oxley-type group).

Thus, highly specialized individuals can be used to perform direct assistance in the areas of walkthroughs and certain types of tests of internal control over financial reporting, and the auditor also may use this work to obtain evidence supporting the auditor's assessment of control risk for purposes of the audit of the financial statements. These financial statement audits also can be required to be performed in accordance with GAGAS.

Chapter 2 – General requirements for complying with *Government Auditing Standards*

We believe that the current linkage to the AICPA Code with its definitions and interpretive guidance makes GAGAS more robust and comprehensive, enables greater consistency in the application of GAGAS and should be retained. We recommend that the GAO consider the effect of removing the reference to the AICPA Code in paragraph 2.13 on the clarity and applicability of the GAGAS independence framework.

We also recommend that the ED be clarified to include guidance on breaches so that there is a clear protocol to be followed in the event of identified independence or other breaches of GAGAS provisions, or alternatively, that it refer to the breaches provisions of the AICPA Code.

While the GAGAS conceptual framework for Independence can stand on its own, it does not include definitions and interpretive guidance that can help facilitate consistent application of the framework to many of the types of relationships that may pose threats to independence. For example, while the current GAGAS independence standards and the ED identify personal financial interests, employment relationships and unpaid fees as examples of circumstances that create threats for an auditor, the standards do not include the related detailed interpretive guidance found in the AICPA Code.

Absent the references to the AICPA's definitions, current GAGAS and the ED would not include definitions of some of the terms used in those documents. For example, paragraph 3.49(a) identifies familiarity threats associated with employment of an engagement team member's close or immediate family member at the audited entity; however, the terms "close" or "immediate family member" are not defined in paragraph 1.23. We also believe the de-linking of the AICPA Code from GAGAS in paragraph 2.13 would cause confusion and potentially certain unintended consequences in applying GAGAS. For example, neither the current GAGAS nor the ED contain separate provisions relating to breaches of the GAGAS independence requirements.

The AICPA Code generally addresses breaches of the Code in paragraph 0.200.020.06, and in section 1.298.010 contains specific requirements for the assessment of breaches of the independence provisions of the Code, including required actions by the auditor to address and document breaches and communicate breaches with those charged with governance. Similarly the IESBA Code of Ethics for Professional Accountants (IESBA Code) addresses breaches generally in Paragraph 100.10 and

describes specific protocol for addressing independence breaches in Sections 290.39 through 290.49. If GAGAS is to be applied without reference to the AICPA's breaches provisions, and in the absence of specific breaches provisions elsewhere in GAGAS, the resulting implementation of GAGAS would be unclear.

One possible interpretation of paragraph 3.32 is that termination of the GAGAS engagement is the only available action to remedy independence breaches, regardless of materiality or significance. This is an extreme result, considering that some breaches of the GAGAS independence requirements might be minor or technical breaches that do not in substance impair the auditor's objectivity and integrity. It is also inconsistent with other independence standards, including AICPA, IESBA and other regulatory regimes.

Chapter 3 – Ethics, independence, and professional judgment

We have the following additional comments on certain provisions contained in chapter 3, which are consistent with the 2011 revision of GAGAS.

Use of external specialists

We believe there is an opportunity to further harmonize GAGAS with AICPA and IESBA by simplifying the GAGAS requirement for external specialists. We believe clarifying guidance is necessary for external specialists who often perform services that are prohibited under the auditor independence rules such as appraisals, legal services and actuarial computations.

Paragraph 3.30 would require engagement teams, as defined in paragraph 1.23, that intend to use the work of specialists to "assess the independence of [such] specialists," even though such specialists, as defined in paragraph 1.23, would not be performing any auditing. While this requirement is not new, we note that there is no similar requirement for external specialists in the AICPA or IESBA independence rules. Both the AICPA and the IESBA codes require audit/attest engagement team members to be independent under the relevant standards, but they exclude specialists (experts) who are external to the firm from such requirement.

AU-C Section 620.09 requires the auditor to evaluate the specialist's competence, capabilities and objectivity for the auditor's purpose prior to using that specialist's work as audit evidence. AU-C Sections 620.A20-A21 provide clarifying guidance to explain that the specialist's role and the significance of the specialist's work in the context of the audit should be considered as well as the types of interests and relationships that are relevant to the evaluation of objectivity. The International Auditing and Assurance Standards Board standards use a similar approach in International Standard on Auditing 620, *Using the work of an auditor's expert*, paragraph 9. We recommend that the GAO provide similar guidance or consider adopting the AICPA's and the International Federation of Accountants' approach for external specialists.

Guidance related to application of the GAGAS conceptual framework

We recommend that application guidance be provided, in addition to what is described in paragraph 3.64, on what consideration should be given to an audited entity's system of controls when determining whether a potential threat to independence is at an acceptable level.

We also recommend that the GAO consider the IESBA's current safeguards project, which has reevaluated the concept of safeguards and redefines safeguards as actions imposed by the auditor, not by the audited entity. Better conceptual alignment with IESBA might be achieved if entity controls were presented in paragraphs 3.64 and 3.65 only as considerations potentially relevant to the existence and significance of threats, rather than available safeguards.

Paragraph 3.65 notes that auditors may be able to place limited reliance on controls that an audited entity has put in place, but may not solely rely on such controls as safeguards to eliminate or reduce independence threats to an acceptable level. While this provision is not new to the GAGAS independence standards, we believe clarification guidance would eliminate uncertainty in applying the GAGAS conceptual framework. For example, whether there are any circumstances where an audited entity's controls may be sufficient to lead to a determination that no threat to independence exists or that the threat is so insignificant that the auditor need not impose additional safeguards.

Guidance related to management responsibilities

Paragraph 3.73 lists specific activities that are considered "management responsibilities." Under paragraph 3.81, when providing non-audit services, the auditor must obtain assurance that "management responsibilities" (i.e. the activities listed in paragraph 3.73) are performed by the audited entity's management. While the responsibilities identified in paragraph 3.73 are not new to GAGAS, the characterization of the activity in paragraph 3.73(h) as a "management responsibility" is unique to GAGAS because there is no similar example in the IESBA Code's list of management responsibilities (Section 290.160) or in the AICPA Code (Section 1.295.030.02).

We believe that the activity described in paragraph 3.73(h), while not a management responsibility, presents a potential self-review threat that should be evaluated using the conceptual framework. The AICPA Code, for example, in section 1.295.150.06, *Internal Audit*, identifies management's reliance on the auditor's work "as the primary basis for the attest client's assertions on the design or operating effectiveness of internal controls" – as a threat that would not be at an acceptable level separate from management's responsibilities.

We believe the activity described in 3.73(h) should be removed from paragraph 3.73 and included elsewhere in the application guidance as subject to evaluation using the GAGAS framework considering the scope or extent of the service in relation to the scope of the audit when evaluating the significance of the threat, similar to the approach in paragraph 3.94. However, if the GAO believes paragraph 3.73(h) represents a management responsibility, we recommend clarifying the management participation threat inherent in this activity.

Internal control evaluation as a non-audit service

We agree with the premise of paragraph 3.93, that providing or supervising ongoing monitoring procedures over an entity's system of internal controls would impair independence. We also agree that while separate evaluations may be performed by individuals who are not directly involved in the operation of the controls without creating a management participation threat, the frequency of the separate evaluations and the scope and extent of the controls being tested should be considered in evaluating the significance of any threat as noted in paragraph 3.94.

While the requirements in paragraphs 3.93 and 3.94 are not new to GAGAS and are consistent with the AICPA and IESBA codes, we find the application guidance in paragraph 3.96 confusing where it states that monitoring (which is prohibited under paragraph 3.93) involves "the use of either ongoing monitoring procedures or separate evaluations to gather and analyze persuasive information supporting conclusions about the effectiveness of the internal control system" (emphasis added). This suggests that the performance of separate evaluations of an entity's controls amounts to prohibited monitoring procedures, regardless of the frequency or extent of such separate evaluations, which seems inconsistent with or contradictory to the requirements paragraphs preceding it.

We recommend clarifying that separate evaluations do not *per se* present a management participation threat. Further, we suggest clarifying how providing or supervising ongoing monitoring activities would differ from separate evaluations and providing examples of circumstances in which the latter would and would not be considered monitoring.

Information technology services

Although it is not new to the GAGAS provisions, we believe that paragraph 3.97, without further clarification, may lead to an unnecessarily broad prohibition on information technology (IT) services performed by auditors of an entity's financial statements.

Specifically, paragraph 3.97(a) prohibits the design or development of "an audited entity's financial information system or other IT system that will play a significant role in the management of an area of operations that is or will be the subject matter of the audit." We understand and support the restriction on "other IT systems" in nonfinancial statement audits performed under the GAGAS standards, including performance audits. However, while many IT applications may *play a significant role in management of an area of operations* of an audit client, we believe the prohibition in paragraph 3.97 is intended, in the case of financial statement audit clients, to apply to such systems that are related to the audited entity's financial statements or accounting records; services related to other IT systems for a financial statement audit client would be subject to evaluation using the GAGAS conceptual framework. If this interpretation is correct, we recommend the addition of application guidance for financial statement audits in line with the AICPA Code, Section 1.295.145.02(c).

We also recommend that the application guidance be expanded with examples where services related to other IT systems would cause self-review threats that are so significant that no application of safeguards could reduce the risk to an acceptable level.

Other comments on Chapter 3

All of the examples in paragraph 3.56(d) as they relate to external audit organizations that are structurally located within governments that may be subject to various categories of safeguards to mitigate structural independence threats are from the context of a legislative auditor. We believe there should be examples provided for circumstances when a governor's auditor is auditing a legislative program.

Similar to our comment above, we recommend that edits be made to the Category III safeguards in paragraph 3.57 as they relate to other organization formulations that exist with audit organizations that are structurally located within the executive branch of governments.

We also recommend that the standards consider guidance or safeguards to prevent general use reports being issued by internal auditors internally in the context under paragraph 3.58 becoming available without third parties knowing that there is a structural independence issue. Paragraph 3.58 provides criteria where government internal auditors who work under the direction of the audited entity's management are considered structurally independent for purposes of reporting internally. We believe this paragraph could be revised to indicate that this reporting is appropriate only for reports that are not intended for a non-internal audience.

As it relates to paragraph 3.60, we also recommend that the GAO think about revisions which may be appropriate in circumstances when an internal audit group within the government could audit their contractors and the form of reporting that may be appropriate given the relationship of the parties.

Chapter 4 – Competence and continuing professional education

We are concerned that paragraph 4.24, "Standards, Statutory Requirements, Regulations, Criteria, and Guidance Applicable to Auditing or the Objectives for the GAGAS Engagement(s) Being Conducted (24-Hour Requirement)," may be difficult to apply to various aspects of industry training.

For example, there may be training content related to general industry trends and risks in the for-profit education industry that may not be directly traceable to standards, statutory requirements, regulations, criteria and guidance noted in the list of items that qualify within paragraph 4.24. Is it the GAO's intent that such general industry training not count toward the 24-hour requirement? If so, it may be difficult to practically bifurcate the time related to such general industry training from an overall industry training event to identify the portion that does not count toward the 24-hour requirement.

Chapter 5 – Quality control and peer review

Paragraph 5.75 states, "An internal audit organization that reports internally to management and those charged with governance should provide a copy of its peer review report to those charged with governance." We believe this concept only works if the internal audit organization's reports are intended to be restricted use and will not be made available externally. Under the formulation proposed, external users would not have access to the peer review report. We believe this paragraph should be revised accordingly.

Chapter 6 – Standards for financial audits

Auditor qualifications to conduct financial audits of entities operating outside of the US

We recommend that paragraph 6.05(b) end with “6.04 as applicable for their respective countries, or.”

We also recommend that the GAO clarify whether auditors who appropriately meet all the requirements of paragraph 6.05(a) in countries that do not require a peer review under GAGAS must have a peer review in accordance with the proposed requirements (paragraphs 5.80–5.113) for audit organizations not affiliated with recognized organizations or whether it would be acceptable for the auditor to report that the engagement was performed in accordance with GAGAS by including an explanatory sentence in the auditor’s report with respect to the respective country not requiring peer review.

Waste

Paragraph 6.16 states, “Also, if auditors become aware of waste or abuse that could be significant to the entity’s operations, they should consider the potential effect on the entity’s operations.” We are concerned that it will be difficult for auditors to determine significance with respect to an entity’s operations. We believe the threshold for significance for abuse and waste should continue to be the financial statements or other financial data significant to the audit objectives. The threshold for determining the significance of abuse, which triggers 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.

We also observed that the definitions of abuse and waste seem to overlap. We believe the GAO should clarify the definitions in both areas so that auditors are able to understand the difference. We are concerned that the additional notion of waste expressed in the second sentence of paragraph 6.17 would require the use of extensive judgment and it would be difficult to distinguish between abuse and noncompliance. The objective of not receiving reasonable value for money in connection with a government-funded activity appears to be a more appropriate concept of a performance audit objective than a financial audit.

Because of the subjective nature of waste, we believe the GAO should include several examples of situations of waste. This would give auditors a better understanding of the concept and promote more consistent practice.

We also believe that the proposal should make it clear that the auditor has no responsibility to perform procedures to detect waste in financial audits. 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 the GAO’s intent for the waste responsibility is consistent with its intent for abuse and recommend that a similar sentence be added in the waste section in the ED.

Other comments

It is unclear how the following language in paragraph 6.06 would be applied: “specifically identifies the entities to be audited.” Does that mean that the entity should be identified by name (which may be rare) in the law or regulation, and that either the law or the regulation designates, as the writers of such law or regulation could, a requirement that mirrors this reporting requirement and designates a specific oversight committee or other body as charged with governance for the entity named? Are internal policies by an agency also considered a regulation under the meaning of this requirement? Is it the intent to impute a role of “charged with governance” in the first section of paragraph 6.06 and require the communications, even if the related entities and oversight committees have not explicitly themselves required such reporting?

We believe the intent of the required guidance can be met without including the sentence with this language and recommend omitting it from the ED.

We believe the concept of full access to audit documentation referenced in paragraph 6.31 should be clarified. The AICPA auditing standards provide for the auditor to exercise professional judgment in determining the extent of audit documentation that is made available to successor auditors. Many firms also have policies regarding the notion of restricted audit documentation, including amounts related to billing and fees, that is not to be provided to others.

It is unclear whether the GAO intends to change practice with its addition of the word “potential” in paragraph 6.39, and we request that the GAO clarify its intent. We also recommend that the GAO consider including a flowchart with the requirements related to GAGAS reporting similar to the one in chapter 4 of the AICPA Audit Guide, *Government Auditing Standards and Single Audits*.

Paragraph 6.40 provides an expanded view on internal control with respect to GAGAS financial audits that the understanding of internal control “involves understanding significant controls that the audited entity designed, implemented, and operated as part of its responsibility for oversight of public resources.” While entities that reference the Green Book or other applicable regulation may have such an undertaking, this is not universally the case, especially when a governmental law or regulation does not prescribe additional internal control responsibilities on the audited entity. We suggest that this paragraph be modified as appropriate.

Paragraphs 6.63-6.64 provide for reporting confidential or sensitive information that justifies classified or limited use reporting. We recommend that the GAO consider that insufficient context in findings in general can be an issue and another reason for providing for limited use/distribution reports.

We also believe the context of the criteria to allow limited use reports referenced in paragraph 6.61 should be more thoroughly developed.

Chapter 7 – Standards for attestation engagements and reviews of financial statements

Paragraph 7.42 states: “When auditors *detect potential instances of noncompliance* with provisions of laws, regulations, contracts, or grant agreements or fraud, waste, or abuse that have an effect on the subject matter or an assertion about the subject matter that are less than material but warrant the attention of those charged with governance, they should communicate findings in writing to audited entity officials.” Refer to our comment above on paragraph 6.39 regarding the GAO’s intent with regard to the reporting of potential matters.

We recommend that the phrase “When the audit concludes that” be inserted at the beginning of paragraphs 7.48(a) and 7.48(b) to connect this requirement to a condition that the auditor concludes has occurred.

Please refer to the comments on paragraph 6.05. We recommend similar changes as they apply to licensing and certification requirements for examination engagements in paragraph 7.08, review attestations and reviews of financial statements in paragraph 7.70 and agreed-upon procedures engagements in paragraph 7.83.

Paragraph 7.42 on examination engagements, paragraph 7.73 on review attestations and reviews of financial statements and paragraph 7.84 on agreed-upon procedures engagements propose reporting potential matters. Please refer to comment previously on paragraph 6.39 where we recommend that the GAO clarify what its intent is with reporting of “potential matters”.

It is not clear to us why paragraph 7.04 does not allow for the communication of findings for a review engagement if Paragraph 7.84 requires auditors to communicate significant deficiencies and material weaknesses and the potential instances of noncompliance, among other matters, to those charged with governance in writing for an agreed-upon procedures engagement. We recommend that the GAO clarify its intent in paragraph 7.04 so that these two paragraphs are in alignment.

We also recommend that the GAO add, in paragraph 7.91 (and in all other places in the ED where report distribution requirements are addressed), additional guidance indicating that having general distribution reports may not be appropriate when the user community lacks context for the report and could misunderstand the subject matter.

Chapter 8 – Fieldwork standards for performance audits

We recommend that the following phrase be added to the final sentence in paragraph 8.14: “except to the extent that auditors conclude that obtaining such an assertion in writing will constitute significant audit documentation within the context of the performance audit.”

Paragraph 8.18 lists examples of suitable criteria. Due to the reporting risk associated with criteria that may be misunderstood by certain users, we recommend that the GAO establish a framework for restricted use/purpose alert reporting in certain circumstances.

We are also concerned that paragraph 8.78 could be construed as an indirect way to require evaluation of internal controls in any performance audit where execution of the audit objectives against the subject matter results in findings. We suggest that language be added that clarifies that if the auditor becomes aware of such matters, they should be reported, but auditors are not otherwise required to search for such matters unless the audit objectives for the performance audit explicitly include evaluation of internal control.

We recommend that paragraph 8.79 be modified with further context. We believe the current language could be construed to support designing an audit with customized criteria that the audited entity "passes" based on the modified objectives, without necessarily knowing the changes made to the audit objectives, or possible implications of the implied issues regarding data availability/data quality and internal control deficiencies that were accommodated for by changing the scope of the engagement.

Paragraph 8.95 states, "Auditors may request that management provide written representations as to the accuracy and completeness of information provided. However, this step is not a requirement for GAGAS performance audits."

We believe that paragraph 8.95 should be replaced with a paragraph requiring some management representations in a performance audit. We believe that obtaining representations from management is important in performance audits because audit objectives can vary widely and there are opportunities for misunderstanding between responsible parties and auditors. Representation letters are also required by the International Auditing and Assurance Standards Board for auditors conducting assurance engagements other than audits or reviews of historical financial information.

If the GAO does not agree with this view, we recommend deleting the second sentence in paragraph 8.95 that emphasizes that representation letters are not required. The language proposed in paragraph 8.95 would undermine auditors who wish to obtain a representation letter in a performance audit and could be used by audited entities to not provide a representation letter.

We recommend revising paragraph 8.113(b) to be more nuanced because it could be misinterpreted as a method to redefine the audit to sidestep an issue.

While we understand the need for the guidance in paragraph 8.121 to explain that inclusion of certain elements of the finding would not be necessary to achieve the objectives of the audit, we recommend adding cautionary language in this paragraph about having general distribution reports in circumstances that are this nuanced and susceptible to inappropriate interpretations and/or reliance by users.

Chapter 9 – Reporting standards for performance audits

While we believe the language in paragraph 9.25 may be overly broad, we recommend that the GAO consider additional places in the ED where language like this is recommended to reduce the risk of misunderstandings in the context of general use distribution. Conceptually, we believe that there should be more of this type language in general distribution reports if more nuanced limited distribution reports are not used.

We question why the phrase “which may include a legal determination or adjudication by a court” is included in paragraph 9.32 as guidance for assisting the auditor in determining the requirements for reporting fraud, waste or abuse in the auditor’s report in the performance auditing standards that is not included in the similar requirements in the financial audit and attestation standards. Is there a reason for the difference, and if so, why would there be a potentially higher bar for an auditor to report such matters in performing a performance audit engagement that includes a reminder that sufficient, appropriate evidence may include a legal determination or adjudication by a court?

Paragraph 9.53 states the following: “Distribution of reports completed in accordance with GAGAS depends on the auditors’ relationship with the audited organization and the nature of the information contained in the reports. Auditors should document any limitation on report distribution. Auditors should make audit reports available to the public, unless distribution is specifically limited by the terms of the engagement, law, or regulation.”

We recommend that the second sentence above be revised to incorporate the notion that auditors should also document the nature of intended users and the appropriateness of the language used to convey any limitations to those who may receive the report but may not understand many of the nuanced criteria.

Editorial suggestions

We believe the final sentence of paragraph 1.08 should end with the term “voluntarily adopted” to be more grammatically clear and correct.

Paragraph 1.11 discusses reasons to voluntarily adopt GAGAS. We believe this information should be in paragraph 1.08. If GAO believes it is necessary as a separate paragraph, it should be inserted directly after paragraph 1.08.

We recommend that the phrase “is the threat significant” in the flowchart in paragraph 3.112 Figure 1 refer back to paragraph 3.44 for guidance on the meaning of “significant” in this context.

We believe the word “commissioning” in paragraph 3.64 should be replaced with “contracting.” Commissioning is a word that is more prevalent in the United Kingdom than in the US.