June 16, 2022

Ms. Sherry Hazel
American Institute of Certified Public Accountants
1345 Avenue of the Americas, 27th Floor
New York, NY 10105

GAO’s Response to the AICPA’s Exposure Draft, Proposed Statement on Auditing Standards – Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors), March 2022

Dear Ms. Hazel:

This letter provides GAO’s response to the American Institute of Certified Public Accountants’ (AICPA) Auditing Standards Board’s (ASB) exposure draft, Proposed Statement on Auditing Standards – Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors).

GAO provides standards for performing high-quality audits of government organizations, programs, activities, and functions and of government assistance received by contractors, nonprofit organizations, and other nongovernment organizations with competence, integrity, objectivity, and independence. These standards, often referred to as generally accepted government auditing standards (GAGAS), are to be followed by auditors and audit organizations when required by law, regulation, agreement, contract, or policy. For financial audits, GAGAS incorporates by reference the AICPA’s Statements on Auditing Standards (SAS).

The ASB seeks to supersede SAS No. 122, Statements on Auditing Standards: Clarification and Recodification, as amended, section 600, Audits of Group Financial Statements (Including the Work of Component Auditors) (AU-C section 600) with the requirements proposed in the exposure draft.

We support the ASB’s overall strategy to converge its standards with those of the International Auditing and Assurance Standards Board by

- using the corresponding International Standard on Auditing to develop its standards,
- making certain changes to the language to use terms or phrases that are more common in the United States, and
- tailoring examples and guidance to the U.S. environment.

The ASB seeks comment on 13 specific questions. Our responses to the questions and additional comments follow in the enclosure to this letter.

Thank you for the opportunity to comment on these important issues. If you have questions about this letter or would like to discuss any of the matters it addresses, please contact me at (202) 512-3133 or daljinj@gao.gov.

Sincerely yours,

James R. Dalkin
Director
Financial Management and Assurance

Enclosure
Enclosure: GAO Responses to the American Institute of Certified Public Accountants’ Auditing Standards Board’s (ASB) Request for Comments

1. With respect to the linkages to other AU-C sections

a. does the proposed SAS have appropriate linkages to other AU-C sections and to the proposed SQMSs?

b. does the proposed SAS sufficiently address the special considerations in a group audit as they relate to applying the requirements and application material in other relevant AU-C sections, including the proposed QM SAS? Are there other special considerations for a group audit that you believe have not been addressed in the proposed SAS?

c. does the proposed SAS result in a group audit that achieves the objectives of the proposed QM SAS?

Our review of the proposed Statement on Auditing Standards (SAS) found that the linkage to other AU-C sections and to the proposed Statement on Quality Management Standards (SQMS) is sufficient. We believe that the proposed SAS sufficiently addresses the special considerations in a group audit with respect to applying the requirements and application material in other relevant AU-C sections. We also believe that the proposed SAS results in a group audit that achieves the objectives of the proposed SQMS.

2. With respect to the structure of the proposed SAS, do you support the placement of sub-sections throughout the proposed SAS that highlight the requirements when component auditors are involved or when reference is made to the audit of a referred-to auditor in the auditor’s report on the group financial statements?

It is helpful to users of the standard to include subsections on the requirements when component auditors are involved or when a referred-to auditor’s audit is mentioned in the auditor’s report on the group financial statements. The ASB can take additional measures to make the subsections related to component auditors and referred-to auditors clearer within the requirements. For example, using icons, underlining, or other formatting could visually highlight the component auditor and referred-to auditor subsections.

3. Is the scope and applicability of the proposed SAS clear? In that regard, is the definition of group financial statements, including the linkage to a consolidation process, clear?

The scope and applicability of the proposed SAS are clear. We support the definition of group financial statements, including the linkage to a consolidation process.

4. With respect to the scalability of the proposed SAS

a. do you believe the proposed SAS is scalable to groups of different sizes and complexities, recognizing that group financial statements, as defined in the proposed SAS, include the financial information of more than one entity or business unit? If not, what suggestions do you have for improving the scalability of the proposed SAS?
b. do you believe that the guidance in exhibit A, “Relevancy of Requirements in Various Group Audit Scenarios,” of the proposed SAS is understandable and provides clarity on the relevancy of certain requirements of the proposed SAS in various group audit scenarios? Would the relevancy of certain requirements of the proposed SAS in various group audit scenarios be clear without exhibit A?

We believe the proposed SAS is scalable to groups of different sizes and complexities. The guidance in exhibit A is understandable and provides needed clarity on the relevancy of certain requirements of the proposed SAS in various group audit scenarios, and it should be retained.

5. Do you support the enhanced requirements and application material on documentation, including the linkage to the requirements of AU-C section 230? In particular

a. are there specific matters that you believe should be documented other than those described in paragraph 76 of the proposed SAS?

b. do you agree with the application material in paragraphs A203–A219 of the proposed SAS relating to the group auditor’s audit documentation?

We support the enhanced requirements and application materials on documentation. We did not identify any additional matters that should be documented outside of those described in paragraph 76. We agree that the information in paragraphs A203–A219 is helpful application material.

6. Are the definitions of the terms referred-to auditor, component auditor, and group auditor clear, including as they relate to the definition of the term engagement team in the proposed QM SAS?

The definitions of the terms referred-to auditor, component auditor, and group auditor are clear, including as they relate to the definition of “engagement team” in the proposed SQMS.

7. Is the requirement in paragraph 11 clear? Are there additional requirements or application material relating to paragraph 11 that are needed, and if so, what should they be?

The requirement in paragraph 11 is clear. There are no additional requirements or application material needed relating to paragraph 11.

8. Do you agree with the deletion of this requirement and the related application paragraph? Do you have other suggestions for considering components in interim reviews now that the concept of “significant components” has been eliminated?

We agree with the deletion of the concept of “significant components” requirement and related application paragraph. We have no other suggestions.

9. Do you agree with the application material in paragraphs A47–A49 of the proposed SAS relating to a noncontrolling interest in an entity that is accounted for by the equity method? Are there additional requirements or application material relating to EMIs that are needed in the proposed SAS, and if so, what should they be?
We agree with the application material in paragraphs A47–A49 of the proposed SAS relating to a noncontrolling interest in an entity that is accounted for by the equity method. There are no additional requirements or application material relating to Equity Method Investments that are needed in the proposed SAS.

10. Do you support retaining the option that exists in extant AU-C section 600 for the group engagement partner to make reference to the audit of a referred-to auditor (a component auditor per extant AU-C section 600) in the auditor’s report on the group financial statements?

We strongly support the option to allow the auditor to make reference to the audit of a referred-to auditor (a component auditor per extant AU-C section 600) in the auditor’s report on group financial statements. When an audit is performed in accordance with the requirements of this proposed SAS, referring to other auditors (divided responsibility) can improve audit efficiency for the group auditor without sacrificing effectiveness. It also preserves transparency by explaining in the group auditor’s report the portions of the audit performed by the referred-to auditor.

Although this represents a difference from international standards, we believe this difference is necessary. In some situations, the group auditor making reference to the audit of the referred-to auditor is the only option for completing the audit that is practical, feasible, or both. For example, a component of a government entity may be required by law or regulation to have its financial statements audited by auditors other than the group auditor, or management of the group may not have the authority to select the referred-to auditor. In such cases, making reference to the work of the referred-to auditor may be the best or only option available to the group auditor.

Conversely, eliminating the option of divided responsibility would likely cause an increase in situations in which an auditor must qualify or disclaim an audit opinion, rather than having the option of reporting on the group financial statements and disclosing the division of responsibility among auditors. For example, the size, complexity, and diversity of the audit of the U.S. government’s consolidated financial statements, in which withdrawal is not a viable option, make eliminating the option to make reference to a referred-to auditor problematic. The same situation holds true for large and complex state and local governments. For these reasons, we strongly believe that the option of referring to other auditors in the group auditor’s report remains crucial.

11. Are the specific requirements relating to referred-to auditors clear, appropriate, and easily identifiable within the proposed SAS, including when considering exhibit A?

The specific requirements relating to referred-to auditors are clear, appropriate, and easily identifiable within the proposed SAS, including when considering exhibit A. Generally, one area that could be clarified relates to paragraph 60 of the proposed SAS regarding the group engagement partner determining whether to name a referred-to auditor, and to present the referred-to auditor’s report, in the auditor’s report on the group financial statements. This could be clarified by noting that this determination is a matter of professional judgment, including references to other relevant AU-C sections the group engagement partner should consider in making this determination.

12. Is the last sentence of paragraph A41 clear? Is there additional application material that is needed, and if so, what should it be?
The last sentence of paragraph A41 is sufficiently clear in the context of paragraphs 19–20 and related application material. No additional application material is needed.

13. Does the proposed effective date provide sufficient time for preparers, auditors, and others to adopt the new standard and related conforming amendments, including sufficient time to support effective implementation of the proposed SAS?

We believe that the proposed effective date provides sufficient time for preparers, auditors, and others to adopt the new standard and related conforming amendments, including sufficient time to support effective implementation of the proposed SAS.

GAO’s Additional Comments:

We believe that the proposed standard can be further clarified by making changes to the title and selected headings to enhance the auditor’s understanding and ensure continuity in terminology and interconnectedness within the standard.

We also suggest that the ASB consider updating the headings in the proposed SAS to be consistent with and descriptive of the respective content and to enhance the auditors’ understanding and ability to apply the standards consistently. We suggest the following as possible considerations for improving clarity and consistency.

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<thead>
<tr>
<th>Proposed SAS</th>
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<tr>
<td>Scope of This Proposed Statement on Auditing Standard</td>
<td>Scope of This Proposed Statement on Auditing Standards (page 20)</td>
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<td>Evaluating the Component Auditor’s Communications and the Adequacy of The Work</td>
<td>Evaluating the Component Auditor’s Communications and the Adequacy of the Component Auditor’s Work (page 36)</td>
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<td>Exhibit A — Relevancy of Requirements in Various Group Audit Scenarios (Ref: par. 12, 58a, A64)</td>
<td>Exhibit A — Relevancy of Requirements in Various Group Audit Scenarios (Ref: par. 12, 58a, A164) (page 104)</td>
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