



# National State Auditors Association

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December 21, 2009

Ms. Sherry Hazel  
Audit and Attest Standards  
AICPA  
1211 Avenue of the Americas  
New York, NY 10036-8775

Dear Ms. Hazel:

On behalf of the National State Auditors Association, we appreciate the opportunity to respond to the AICPA Auditing Standards Board's proposed Statement on Auditing Standards entitled *Reporting on Compliance with Aspects of Contractual Agreements or Regulatory Requirements in Connection with Audited Financial Statements* (Redrafted).

We have reviewed the proposed SAS and generally agree with the provisions contained therein. Below we have provided our response to the three issues for consideration and the guide for respondents noted in the exposure draft. We have also provided, by paragraph, comments or suggestions that we believe the Board should consider as it finalizes this document.

### *Issues for Consideration*

1. *Should the auditor provide negative assurance when the auditor has identified items of noncompliance?*

We agree with paragraph 10 of the proposed standard that allows the auditor to provide negative assurance when the auditor has identified items of noncompliance that are not pervasive provided the auditor has identified the instances of noncompliance in the report.

2. *When the items of noncompliance are pervasive, should the auditor be precluded from issuing negative assurance?*

We have differing opinions about this issue; however, we do recognize that judgment is needed if an auditor finds pervasive items of noncompliance. In addition to pervasiveness, we believe the auditor should consider the nature and extent of the items of noncompliance when determining whether to issue negative assurance. Pervasiveness alone should not preclude an auditor from issuing negative assurance.

3. *If the auditor was precluded from issuing negative assurance in the situation in question 2, what form of report should the auditor issue in relation to reporting on compliance with aspects of contractual agreements or regulatory requirements in connection with the audit of financial statements?*

If the auditor is precluded from issuing negative assurance due to the pervasiveness of the items of noncompliance, we believe the Board should consider one of the following:

- Including a declarative statement in the report indicating that the entity did not comply with the required aspects of the contractual agreement or regulatory requirements and provide a description of the instances of noncompliance.

- Including a statement in the report indicating that "...we were not able to provide negative assurance because of the pervasive extent of items of noncompliance we identified during our audit of the financial statements. However, the items of noncompliance we identified are *(describe items of noncompliance)*."

In all cases, we believe a description of the instances of noncompliance should be included in the report.

#### *Guide for Respondents*

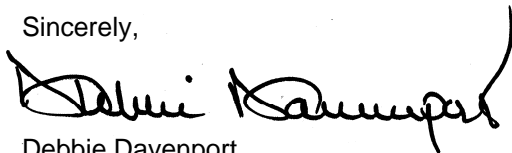
In response to the questions posed by the Board with regard to the proposed SAS, we believe the objectives; convergence revisions; and considerations for audits of smaller, less complex entities and governmental entities are appropriate.

#### *Other Comments*

- *Paragraph 7.b* – The proposed standard indicates that "*the applicable covenants relate to matters that have been subjected to the audit procedures applied in the audit of financial statements.*" While we agree with this concept, we believe in practice that the term "*subjected to the audit procedures*" has been, and under this proposed SAS will be, interpreted in varied ways. To avoid inappropriate interpretations, we recommend the ASB add a guidance paragraph to clarify what it means by "*subjected to the audit procedures applied in the audit of the financial statements.*" We believe that any such guidance should be fairly conservative, focusing on the notion that tests of controls, tests of details, and other audit procedures actually included transactions that were subject to the compliance requirement.
- *Paragraph A8 Appendix, Illustration 2* – We question why it is necessary to include an emphasis of matter if the matter has nothing to do with what is being reported on in the compliance report. This should be clarified.
- We request additional illustrative report examples be added to the Appendix as follows:
  - Example of a report where the auditor has identified items of noncompliance, but still plans to provide negative assurance after determining the items of noncompliance are not significant and pervasive.
  - Example of a report when the auditor cannot provide negative assurance.

We appreciate the opportunity to respond to such an important document. Should you have any questions or need additional information regarding our response, please contact Sherri Rowland of NSAA at (859) 276-1147 or me at (602) 553-0333.

Sincerely,



Debbie Davenport  
President, NSAA