



National State Auditors Association

March 30, 2007

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Jeanette Franzel
Government Auditing Standards Comments
U.S. General Accounting Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Franzel:

On behalf of the members of the National State Auditors Association, we appreciate the opportunity to respond to the proposed revisions to the quality control and assurance and peer review section of the 2003 revision of *Government Auditing Standards* (GAGAS). Below are NSAA's responses to the three questions posed by GAO in its exposure draft. Following those responses are some issues we believe should be addressed to provide clarity in the standards.

Question 1 – System of Quality Control

We generally agree with the expanded discussion and elaboration on the elements that audit organizations should address through policies and procedures as part of a system of quality control.

We are concerned, however, with the element described in paragraph 3.53.c. This element elaborates on the initiation, acceptance, and continuance of audit and attest engagements, and provides that the audit organization will undertake audit and attest engagements only if it is independent and can comply with professional standards. This is inconsistent with the provisions in the recently issued 2007 revision to *Government Auditing Standards* and ignores the reality that state audit organizations must deal with.

Paragraphs 1.12.b. and 1.13 of the 2007 revision explain the provisions for reporting compliance with GAGAS in the auditor's report when auditing standards, including independence or applicable other standards, are not followed. These paragraphs, in our opinion, provide for performing audits even if independence is not met or applicable standards are not followed because auditors can explain in a modified compliance statement the applicable requirement(s) not followed. Paragraph 3.53.c. inappropriately implies that an auditor cannot perform audits if they cannot follow these standards.

In addition, state audit organizations usually perform their audits as a result of statutory requirements rather than entering into a contract for audit services. In these cases, an audit organization must perform the audits required regardless of any standards they may not be able to follow. Paragraph 3.53.c. does not allow for, or address, these situations state audit organizations are put in.

Accordingly, we strongly recommend paragraph 3.53.c. be revised to better reflect what is allowed by GAGAS paragraphs 1.12 and 1.13 and to better explain this element in terms that apply equally to state (and perhaps other government) audit organizations' typical situations.

Another concern we have relates to paragraph 3.53.e.(8). This example states that the quality control review must be completed before the report date. We believe it will be difficult to have the entire quality control process complete prior to the report date as SAS No. 103 requires that

the report be dated when the auditor has obtained sufficient appropriate audit evidence to support the opinion. In many cases, the report will still be in the QC process and there may be wording changes to the report. We believe it would be more appropriate for this example to read "...and that the review be completed before the **report release date.**"

Question 2 – External Peer Review Frequency

We disagree with the proposed frequency for peer reviews of performance audits.

From a performance audit perspective, the standards have changed dramatically every three years since 2000. If performance audit organizations are permitted to go to a five year cycle and the rapidity of change in standards continues as it has in prior years, those audit organizations could conceivably miss an update to the standards in the review cycle. Five years is too long to wait for an external peer review even if the internal quality assurance system is extensive and operating effectively. We believe that a three-year period is sufficient time for **any** audit organization to have an external peer review performed.

In addition, the longer period of time allowed between peer reviews for performance audits appears to imply that performance audits are somehow less important or have less credibility than financial audits and attestation engagements. We have been told as justification for allowing performance audits to have external reviews only every five years that performance audits are less risky than financial audits. In fact, the opposite is true. In many cases, performance audits are more controversial than other types of engagements and their results are more likely to be challenged. Performance audits are the reports most often scrutinized by legislators and auditees, given the highest profile by the public, and are subjected to more risk because performance audits can address much more subjective topics with more subjective criteria than do financial audits.

In the current operating environment of the auditing profession, extending the time allowed for external "oversight" through a peer review process does not send the correct message of accountability to the public. We believe in this instance, GAO would be relaxing the standards of accountability by allowing a five year review cycle of performance audits.

Finally, it appears from the description in GAO's Question 2 that a five-year external peer review cycle is being allowed to appease local government auditors so that it "will allow more local government audit organizations to comply with GAGAS." Auditing standards should be based on the notion of the highest regard for quality and accountability and the underlying message of this statement only weakens that notion.

For the reasons stated above, we encourage GAO to keep the three-year external peer review cycle requirement for all engagements performed in accordance with *Government Auditing Standards*.

Question 3 – Transparency of Peer Review Results

We support the requirement to make peer review reports publicly available. We also agree that if the peer review opinion is adverse and the condition leading to the adverse opinion are related to or impact audits performed under GAGAS, the audit organization should disclose in each GAGAS report the peer review results until such time as the adverse opinion is replaced by an unmodified or modified opinion.

However, we are unsure how this disclosure would be made in the auditor's report. Logically, this statement could be made in performance audits in the same location of the audit report that the compliance with GASAS statement is made, as described in paragraphs 8.30 and 8.31 of the 2007 revision of *Government Auditing Standards*. However, in financial audits, which typically use standard reporting language established by the AICPA, it is not clear how the adverse peer review results would be included. For clarity of standards, and consistency in their application, we recommend GAO specifically address this concern by revising paragraph 3.62.

In addition to the above concern, we do have a comment relating to the terminology used in the proposed standards. Paragraph 3.59.d. refers to “modified” opinions, while paragraph 3.62 refers to “unqualified” or “qualified” opinions. GAO should be consistent with the terminology used within the proposed standards. Further, we believe GAO should be consistent with the terminology used by the AICPA in its standards for performing and reporting on peer reviews. PR Section 100.91 refers to the following terminology: unmodified, modified, or adverse. Using consistent terminology would minimize confusion.

Other comments

Paragraphs 3.50, 3.53.d, and 3.53.e. – These paragraphs use the phrase “reports that are appropriate under the circumstances” or a similar phrase. We are unsure what this means and believe the language should be revised to provide a clearer indication of its meaning. Perhaps the language used in paragraph 3.53.e.(9) should be considered as a replacement.

Paragraph 3.52 – The phrase “matter of judgment” is insufficiently specific. While judgment is a term used frequently in the standards, this phrase could be interpreted differently by the audit organization and peer reviewer leading to conflicts on results of a review. To provide clarity, we recommend that this paragraph specifically state that this “matter of judgment” refers to the audit organization’s judgment so that it is apparent it is not referring to the peer reviewer’s judgment.

Paragraphs 3.53.e.(8) and 3.59.b. – Paragraph 3.53.e.(8) indicates that an audit organization should perform quality control reviews for “all engagements that meet established criteria.” In addition, paragraph 3.59.b. uses the phrase “based on specified standards or criteria.” However, GAO has not clearly indicated the “criteria” that the proposed standards are referencing. We are uncertain as to which criteria is relevant, other than *Government Auditing Standards*. We suggest the proposed language be revised to make this point clear.

Paragraph 3.53.f.(4) – We understand and agree with the first sentence in the parentheses. We believe the second sentence should state that the **results** of the pre-issuance reviews can be used as part of the analysis.

Paragraph 3.58 – This paragraph discusses the approaches the peer review team should use to select audits for review. Item (2) discusses selecting GAGAS audits and attestation engagements with greater emphasis on those GAGAS engagements with higher assessed levels of risk. It is unclear whether this “assessed level of risk” should be determined by the peer reviewer or the audit organization. If the risk is to be determined by the peer reviewer, we are unsure how the peer reviewer will determine and recognize the riskier audit projects considering their limited knowledge of the audits performed. If the peer reviewers rely on assessments of the audit organization, we believe this could allow the audit organization to overly influence the peer review team’s selection of audit projects, which could compromise the integrity of the peer review process. We believe GAO should revise this paragraph to provide specific guidance as to the type of risk being discussed and remove any opportunity for the audit organization to unduly influence the audits selected for review.

Paragraph 3.59.d. – This paragraph allows the review team to include matters that lead to a modified opinion in either the report itself or a separate letter of comment. Under AICPA guidelines, if there is a modification to the report, the deficiencies that resulted in a modified opinion are included in the report itself, and not in the letter of comments. Therefore, in this case, GAGAS requirements are inconsistent with the other standard setting bodies. We believe GAGAS should be consistent with the AICPA’s guidelines.

Paragraph 3.61 – A concern we have with this paragraph is that it states that a copy of the peer review report must be sent to all oversight bodies. Given the public availability of this report (for example, on the state audit organization’s web site), we do not see the need to require this to be sent to the oversight

bodies. We suggest the last sentence be rephrased to say "Government audit organizations should also communicate the availability of their external peer review reports to appropriate oversight bodies."

We appreciate the efforts of the GAO and the opportunity to provide our comments. 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 (401) 222-2435.

Sincerely,

A handwritten signature in cursive script that reads "Ernest A. Almonte". The signature is written in black ink and is positioned above the typed name and title.

Ernest A. Almonte
President, NSAA