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Re: Government Auditing Standards 2017 Exposure Draft (GAS Exposure Draft)

The Governmental Accounting and Auditing Committee (GAA Committee) of the California Society of Certified Public Accountants (CalCPA) is pleased to provide our comments. The GAA Committee is a senior technical committee of CalCPA comprised of over forty members from international to local public accounting firms and state and local governments.

The CalCPA GAA Committee has reviewed the April 2017 Exposure Draft of the Government Auditing Standards (GAS) and would like to share our comments on the draft:

For Section 1.17 b. (3), we recommend that the GAS Exposure Draft clearly state that compliance and internal control can also be covered through Performance Audits or Attestations. Those sections indicate that they can cover these areas, but in the first reading it sounds like all compliance audits are financial audits.

Section 2.06, footnote 6 refers to GAO interpretations with a specific website reference. However, the web page cited contains no such interpretations. Perhaps the reference is intended for the future, but GAO should clearly state the current situation.

We also noted that Chapter 6 was amended to add provisions for an auditor to perform audit procedures to ascertain the potential effect on the financial statements significant to the audit objectives if the auditor becomes aware of waste that could be quantitatively or qualitatively significant to the audit objectives. Specifically, paragraphs 6.16, 6.35 and 6.39 address new responsibilities of an auditor to report on waste and abuse.

Waste is a very subjective concept and, while there could be an obvious situation encountered during an audit, many determinations will be influenced by an auditor’s personal experiences or lack thereof. An example considered waste for one governmental entity may not be deemed waste for another.

Although paragraph 6.17 provides a definition of waste as “the act of using or expending resources carelessly, extravagantly, or to no purpose,” that same paragraph explains that waste “can include activities that do not include abuse and does not necessarily involve a violation of law.” Those two segments of the definition do not provide the auditor with a clear basis on which to determine whether waste has occurred. Waste is an abstract concept that should be clearly defined or excluded from the requirements, as the auditor is already required to perform procedures regarding compliance with applicable laws, rules and regulations that would reveal any compliance exceptions.

As an example, some taxpayers in California may believe that public employees are grossly enriched with pay and benefits or that governing bodies spend resources carelessly and the term “waste” is often used, even though these salaries and benefits or other contract approvals were approved at an open meeting and vetted through a process where the public has an opportunity to object. Under the proposed change, the auditor will be put in a position of second-guessing the results of public legislative processes of the organization, even if a decision is made in compliance with the entity’s policies and procedures. It seems that the auditor should instead be required to evaluate the process to make sure that the public has an opportunity to weigh in on the validity of the decision, rather than evaluate the results. The auditor should not be put in a position of second guessing the results of a properly designed system.

Chapter 6 is supposed to be covering financial audits for which the objective is to determine if the financial statements are fairly presented in all material respects. These new requirements appear to be going beyond the scope of this purpose. That is not to say that there might not be a concern about waste, but it seems that perhaps this type of evaluation would be more appropriate for a different type of engagement, such as a performance audit. The financial statement audit should not be an engagement to cure all ills. If the expectations continue to expand for what is to be accomplished in a financial statement audit, it will eventually become impossible to accomplish. It seems that multiple different types of engagements are being merged into one, the financial statement audit.

In addition, Chapter 6: Standards for Financial Audits introduced “waste and abuse” in paragraph 6.16. Chapter 8: Fieldwork Standards for Performance Audits introduced “fraud, waste and abuse”. And, Chapter 8 paragraph 8.69 also states “...if auditors become aware of potential fraud, waste or abuse...”. Chapter 6 paragraph 6.18 states “Because the determination of abuse is subjective, auditors are not required to perform procedures to detect abuse in financial audits”. The GAS Exposure Draft seems to generate some confusion regarding “waste and abuse” and needs to improve and clarify its language in this area.

Specific to “Enclosure II: Questions for Commenters” included in the Exposure Draft, we have responded to each of the nine Discussion Items as follows:

- 1. Generally accepted government auditing standards (GAGAS) is presented in a revised format. This is intended to allow auditors to quickly identify requirements and application guidance related to those requirements. In addition, certain topics are regrouped within the chapters.**

Please comment on how the revised format of GAGAS affects the organization and readability of the standards.

We agree the new exposure draft does add clarity to the GAGAS by separating the standards from its application guidance.

The new format is an improvement. The new standards should also provide a table of contents and a reference index to aid the reader/practitioner in researching certain standards. As an example, waste and abuse are contained in more than one chapter, i.e. chapters 6 and 8.

2. **In Chapter 3 (“Ethics, Independence, and Professional Judgment”), additional requirements and guidance are provided concerning the provision of nonaudit services to audited entities, including further explanation of the responsibility to ensure that management of the audited entity possesses the appropriate skills, knowledge, and experience to oversee the nonaudit service and expanding discussion of nonaudit services that should be considered threats or impairments to an external auditor’s independence. (various paras. 3.67 through 3.101)**

Please comment on whether the revisions related to nonaudit services sufficiently and clearly explain what is required and prohibited under GAGAS.

Sections 3.67 to 3.69 clearly state the requirements which are not different from the last revision of the yellow book.

Section 3.101 includes some non-traditional nonaudit services. However, the revision does not address the following common nonaudit services:

1. Tax Compliance Services
2. Forensic Accounting Services
3. Expert Witness Services
4. Legal Consulting Services
5. Actuarial Services

We recommend the GAO consider the above nonaudit services and provide additional guidance in the current revision.

The GAS Exposure Draft makes clear that management must take responsibility for the preparation and presentation of the financial statements and must have the skills, knowledge and experience to do so. This is very important.

3. **In Chapter 4 (“Competence and Continuing Professional Education”), GAGAS discusses the levels of proficiency required for the roles on an engagement as well as a description of the tasks generally expected to be performed by auditors in these roles. (paras. 4.09 through 4.10)**

Do these roles and descriptions clarify the competence required of auditors conducting engagements in accordance with GAGAS? Is the level of proficiency expected for each of these roles clear?

As described in Section 4.10, the levels of proficiency required for each role on the engagement was defined. In our opinion, the language regarding the proficiency is ambiguous. We recommend the GAO consider adding language and definitions to the guidance as to the minimum qualifications of the basic level, the intermediate level, and the advanced level proficiencies.

4. **Chapter 4 (“Competence and Continuing Professional Education”) includes a requirement for auditors to complete at least 4 hours of continuing professional education (CPE) in GAGAS topics (“GAGAS Qualification”). This 4-hour requirement is a subset of the 24-hour CPE requirement and needs to be completed each time a GAGAS revision is issued. Application guidance provides examples of the types of topics that would qualify as GAGAS topics. (paras. 4.15 and 4.23)**

Please comment on any additional topics that could be included in the 4-hour GAGAS CPE requirement or other requirements that would enhance auditor proficiency in GAGAS.

In our opinion, the 4-hour GAGAS CPE requirement would not enhance auditors’ proficiency. In order to enhance audit quality on GAGAS engagements, GAO should be more specific or approving courses that are “GAGAS Qualified” in accordance with Section 4.23.

The GAS Exposure Draft refers to the 4-hour GAGAS CPE as “...needs to be completed each time a GAGAS revision is issued.” This policy seems inadequate, but should state that GAGAS CPE is required continuously for all professionals.

Paragraph 4.18 refers to the two-year, 80-hour CPE requirement. The GAS Exposure Draft should be clear that this is the general requirement for CPAs. The 24-hour CPE is the minimum for government, including GAGAS, CPE requirement. The GAS Exposure Draft should make this clear.

5. **The content from GAGAS guidance document on CPE (GAO-05-568G) is largely incorporated into chapter 4. We plan to retire the guidance document when the new GAGAS is issued. (paras 4.26 through 4.50)**

Is there any additional application guidance that should be included in the GAGAS revision to enable auditors and audit organizations to effectively implement the CPE requirements given the planned retirement of the CPE guidance document?

In our opinion, Chapter 4, *Competence and Continuing Professional Education*, provides enough guidance on the CPE requirements. However, we recommend maintaining the CPE guidance document if it continues to provide clarification of the requirements.

6. **In Chapter 5 (“Quality Control and Peer Review”), the sections on quality control and external peer review are expanded to harmonize with other standards and promote consistency in practice across the range of GAGAS auditors.**

Are the changes to the quality control and external peer review sections appropriate and reasonable?

In our opinion, Chapter 5, *Quality Control and Peer Review*, is consistent with the AICPA Statement of Quality Control Standards No. 8 and is appropriate and reasonable.

We recommend considering whether the Institute of Internal Auditors (IIA) should be added to the list in paragraph 5.64.

7. In Chapter 5 (“Quality Control and Peer Review”), peer review requirements are categorized by requirements for (1) audit organizations affiliated with recognized organizations and (2) other audit organizations. (paras. 5.63 through 5.113)

Are peer review requirements for each category of audit organization clear?

In our opinion, the requirements for each category of audit organization are clear.

8. Chapter 7 (“Standards for Attestation Engagements and Reviews of Financial Statements”) is expanded to incorporate by reference Statement on Standards for Accounting and Review Services No. 21, section 90, *Review of Financial Statements*, and includes additional requirements and guidance for reviews of financial statements conducted in accordance with GAGAS. (paras. 7.68 through 7.80)

Please comment on the expanded requirements and application guidance.

In our opinion, Chapter 7, *Standards for Attestation Engagements and Reviews of Financial Statements*, is consistent with the Statement on Standards for Accounting and Review Services No. 21, except for the additional requirements of reporting fraud, waste, abuse, non-compliance and internal control weaknesses under GAGAS. Similar to the financial audits, “Waste” is very subjective and is greatly expanded in Chapter 6 of this revision; please refer to our comment on page 1 and 2 of this letter.

9. In Chapter 8 (“Fieldwork Standards for Performance Audit”), internal control considerations are expanded to reference the 2014 *Standards for Internal Control in the Federal Government and Internal Control – Integrated Framework*. (paras. 8.37 through 8.65)

Do these sections clearly describe ways auditors assess internal control on performance audits?

In our opinion, these sections clearly describe ways auditors assess internal control on performance audits.

If you have any questions regarding our views and position, please contact the CalCPA GAA Committee Liaison, Linda McCrone at [REDACTED]

Sincerely,

Dennis Kauffman

Dennis Kauffman, Chair
Governmental Accounting and Auditing Committee
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