



NORTH CAROLINA
DEPARTMENT OF STATE TREASURER

STATE TREASURER OF NORTH CAROLINA
DALE R. FOLWELL, CPA

Handwritten signature of Dale R. Folwell, CPA.

STATE AND LOCAL GOVERNMENT FINANCE DIVISION
AND THE LOCAL GOVERNMENT COMMISSION

GREGORY C. GASKINS
DEPUTY TREASURER

July 10, 2017

Mr. Gene L. Dodaro
Comptroller General of the United States
U. S. Government Accountability Office
441 G. St. N.W.
Washington, DC 20548

Dear Mr. Dodaro:

Thank you for the opportunity to respond to the *Governmental Auditing Standards* 2017 Exposure Draft. I am one of three Directors in the State and Local Government Finance Division of the North Carolina Department of State Treasurer (Division). Our Division has the statutory responsibility to provide fiscal oversight of units of local governments and public authorities in North Carolina. This involves monitoring their fiscal health as well as their operations and providing guidance when necessary. The Division relies strongly on the statutorily required annual financial statements, prepared on a generally accepted account principles (GAAP) basis and audited by independent auditors, to inform us of deficiencies that exist in these entities. Audits are due to the Division within four months of each entity's fiscal year end, which for the vast majority of our units is June 30.

Of the approximately 1,350 units that the Division oversees, a significant majority are small to mid-size counties, municipalities, airports, water and sewer authorities, and charter schools that are required to have an audit performed under *Governmental Auditing Standards*. In North Carolina, a GAGAS audit is required if these units expended \$100,000 or more of combined federal and State financial assistance. Due to the size and budgetary constraints of these units, they typically rely on small accounting firms without a year-round dedicated governmental auditing staff to perform their audits, often at a reduced cost compared to the cost of an audit by a regional or national firm.

Over the past several years the Division has seen a measurable delay in the timely completion of audits. I believe this is due to a number of issues, including the increasing complexity of GASB standards, the lack of availability of adequately trained finance staff in many parts of our State, the lack of public accountants interested in performing governmental audits, and the pricing pressures that exist on auditing firms to keep the cost of the audits down. The Division is currently conducting research into possible solutions to these and other challenges that negatively impact the timely delivery of audited financials. While I certainly do not want the quality of audits to suffer, a lack of timeliness also is a negative that reduces the usefulness of the audits. Many of the comments I am including below are framed by this over-arching issue.

While I am not able to comment on each of the discussion items noted in the exposure draft, I am commenting on several areas as noted below. I have indicated the discussion item number(s) as appropriate.

- The revised format that the 2017 exposure draft has incorporated greatly improves the readability of the standards, especially separating the requirements and the application guidance related to those requirements. How GAO has reorganized the chapters also is an enhancement to the standards. [Discussion item 1]
- The revisions related to non-audit services clearly explain what is required and prohibited under GAGAS. However, based on my reading of paragraph 3.89, auditors that perform non-audit services in the area of financial statement preparation will need to not only evaluate the threats to their independence but also sufficiently document the evaluation as well as the steps they have taken to mitigate or eliminate the threats. While I certainly agree that auditors must remain independent, the burden of the additional documentation on smaller audit firms in particular will negatively impact their ability to complete audits in a timely manner. It also will increase the cost of the audits as a result of the increased time spent on documentation. Conversely, audit firms may simply stop writing financials and require their clients to hire outside help to draft the statements, which could prove costly as well. Finally, audit firms might simply step away from governmental auditing all together. None of these outcomes will improve the timeliness of the audits. Application guidance that reduces the documentation requirements would be beneficial to all firms but particularly to those smaller firms that conduct so many of the audits of North Carolina local governments. [Discussion item 2]
- There are roles between entry level and supervisory level that are not addressed in paragraph 4.10. The statement in paragraph 4.10 that describes roles on the engagement – “Work situations for these auditors are characterized by levels of ambiguity, complexity, and uncertainty” - is somewhat vague. Relating the role levels to the responsibility of planning, directing, performing, and reporting as described in paragraph 4.11 seems more appropriate. [Discussion item 3]
- Adding topics for Continuing Professional Education specifically related to GAGAS is a good addition that provides clarity to auditors. [Discussion item 4]
- Chapter 5 on Quality Control and Peer Review adds requirements for audit performance, documentation, and reporting. These added requirements are going to require more time from the audit firm, especially the small firms. Paragraph 5.29 provides good guidance to small audit organizations for documenting policies and procedures. Similar guidance for small firms in paragraphs 5.38, 5.59, and 5.62 would be beneficial. [Discussion item 6]
- The external peer review requirements for each category of audit organization are clear. [Discussion item 7]

In summary, I support efforts to improve audit quality and the more specific guidance provided in certain sections of the exposure draft is appreciated. I believe that whenever the GAO has the opportunity to provide specific guidance it should do so; I believe this improves

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audit organization compliance with the standards by reducing ambiguity. I also ask that the GAO be mindful of the time requirements that added documentation brings along with the possible unintended consequence of reducing audit timeliness. The added strain of increased documentation requirements may cause firms to step back from governmental auditing, reducing the pool of qualified auditors and negatively impacting the ability of local governments to have a timely audit.

Thank you again for the opportunity to respond to the *Government Auditing Standards* 2017 Exposure Draft. Please do not hesitate to contact me if I can be of further assistance.

Sincerely,

A handwritten signature in black ink that reads "Sharon Edmundson". The signature is written in a cursive style with a large, looped initial "S".

Sharon G. Edmundson, MPA, CPA
Director, Fiscal Management Section
State and Local Government Finance Division