

July 15, 2017
James Dalkin
Director, Financial Management and Assurance
United States Government Accountability Office
441 G St. N.W.
Washington, DC 20548

Via email to YellowBookComments@gao.gov

RE: Government Auditing Standards Exposure Draft (GAO-17-313SP)

Dear James:

Our comments come individuals from within academia. We speak as individuals connected through the Governmental and Non-Profit Accounting Section and do not represent an official position of the American Accounting Association.

Discussion Items

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.

The combination of the requirements and application in a side by side presentation was helpful to read. There is limited research on the presentation of standards. However, there is a substantial body of academic research examining the impacts of recognition versus disclosure of information in financial statements (e.g. Ahmed, Kilic, and Lobo 2006; Davis-Friday, Folami, Liu, and Mittelstaedt 1999; Fredrickson, Hodge and Pratt 2006; Michels 2017). Overall, this research indicates that users appear to react more strongly to recognition than disclosure which is consistent with the information searching costs exist to reading the financial statement notes. Applied to this setting, one might extrapolate that the current presentation might result in more consistent application as the reader does not have to search for some basic application guidelines. However, further research would need to be done to determine if overall quality would improve due to the decreased information search costs.

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.

Paragraphs 3.88 and 3.89 clearly lay out parameters for the typical audit related activities. The general provisions for non-audit services are going to be less straight forward due to the wide, variety of activities that could be requested of the auditing firm by the auditee. The examples of safeguards (paragraph 3.77) is a limited list and allows the audit firm to still provide any services as long as no personnel overlap on the engagement. Does this extend to the partner level? How strict do firewalls within the firm need to be for this type of work i.e., are knowledge spillovers possible? Prior literature has explored benefits to knowledge spill overs (e.g., Simunic 1984; Kishnan and Yu 2011) from audit to non-audit services and vice-versa.

Specifically concerning independence for governmental audits, Reinstein, Abdolmohammadi, Tate and Miller (2014) survey governmental financial officials and auditors to examine the application of SOX independence requirements to governmental entities. They find that there is some support for the extension of the same ideas which is clearly incorporated in this Yellow Book revision.

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?

The tasks and complexity of works situation are clearly outlines in paragraphs 4.10 and 4.11, satisfying the roles and description requirement. However, the level of proficiency are stated as basic, intermediate, and advanced. Without delineating required items within each level, then one individual’s perception of intermediate might be someone else’s definition of advanced, at least along one of the performance areas (reporting, directing, planning, etc.). In a situation where an individual may have mixed exposures to varying phase of an engagement, considerations for proficiency may be difficult. Requiring documentation supporting past performance along these dimensions, similar to CPE tracking, may help to establish a record of successful performance. This type of documentation, providing a supervisor has the correct training intent, would be helpful and more directly assessing someone’s capability to perform a solid engagement, than the CPE.

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.

The basic proficiency for executing GAGAS engagements could be enhanced by a checklist of actual activities an individual must have experience in prior to being a supervisor or partner on a particular engagement (unless grandfathered in). Understanding the differences and similarities between GAGAS and GAAS or PCAOB Auditing Standards will help to provide context to an experienced auditor. Also, other auditors may be more familiar with a regulatory framework that could also be used as a base comparison to GAGAS. These types of comparison sessions may enhance the professional judgment guidelines for a current practitioner.

Thomas, Davis and Seaman (1998) provide some evidence that CPE is important in doing a proficient governmental audit. However, it has yet to be extensively studied how particular topics of CPE relate to subsequent performance of audits.

5. The content from the 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?

The new version appears to substantially incorporate most paragraphs of the predecessor document. The subject matter list (GAO-05-568G paragraph 19) could be included in the new standard if there were specific areas that entities appear to have personnel with deficient skills (as noted in peer reviews or through other quality control processes).

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?

Quality control procedures do appear to be in line with other standards. However, as written, a small firm can attest to another small firm’s execution of audits. Prior GAO work (GAO/AFMD-86-33) reflects the issues that smaller firms have with executing

high quality audits. Deis and Byus (2016) detail a trend of governmental entities being audited by smaller firms. Thus, without changing this requirement to having a larger firm execute the peer review, there may be limited opportunity to improve the audit quality of the smaller firms. The larger firms are more likely to have audit methodologies across offices that help to promote more consistent quality. These similar tools could be implemented across a group of smaller audit firms participating in this line of service (e.g., forming an association).

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

It is clear that there are established criteria for peer reviews by acceptable, alternative organizations are delineated. There is some guidance for other individuals performing peer reviews that are not associated with the external bodies.

We do not have any specific contributions for questions number 8 and 9. We appreciate the opportunity to provide comments regarding the changes to the Yellow Book. Please feel free to contact the corresponding author for any questions or clarification.

Respectfully submitted,

Governmental and Non Profit Accounting Section Members, American Accounting Association

Contributing Members

Renee Flasher, Ball State University, [REDACTED] (corresponding author)

Dara Marshall, Texas A&M – Central Texas, [REDACTED]

Denise Juvenal, [REDACTED]

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