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United States Government Accountability Office
Washington, DC 20548

May 4, 2009

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Audit and Attest Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
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Subject: AICPA Auditing Standards Board (ASB) December 2008 Exposure
Draft of Proposed Statement on Auditing Standards (SAS) entitled *Compliance Audits*

This letter provides the U.S. Government Accountability Office's (GAO) comments on the ASB's proposed SAS on compliance audits. We commend the ASB for taking on this project to clarify the requirements for compliance auditing. Overall, we support the proposed statement and believe that the revised SAS adds much-needed clarity in this area of practice.

While we agree with the overall approach of the exposure draft, we believe the SAS could be improved and have recommendations in the following areas:

- definition of material noncompliance,
- intended use reports,
- applicability,
- questioned costs, and
- dating of the auditor's report.

Comments on specific topics:

Definition of material noncompliance

GAO has suggestions for improving this discussion in two aspects: (1) clarifying the definition of material noncompliance and (2) clarifying auditor responsibility when law, regulation or government audit requirements specify a different definition of material noncompliance than the definition included in this standard.

The proposed standard defines material noncompliance in paragraph 11 as: "A failure to follow requirements or a violation of prohibitions included in the

applicable compliance requirements that results in noncompliance that is quantitatively or qualitatively significant, either individually or when aggregated with other noncompliance, to the affected government program.” This definition includes the term “significant,” but the meaning of significant is not clear from the proposed standard. There are conflicting definitions of “significant” in current auditing standards which could result in different interpretations of the intent of paragraph 11 and inconsistent application of the proposed standard. We suggest clarifying the definition of material noncompliance by incorporating language from the definition of significant deficiency in SAS 115, as follows:

“A failure to follow requirements or a violation of prohibitions included in the applicable compliance requirements that results in noncompliance related to the affected government program that is quantitatively or qualitatively significant either individually or when aggregated with other noncompliance. Significant, when used in this context, refers to noncompliance that merits attention by those charged with governance.”

We further suggest the ASB obtain concurrence from the Office of Management and Budget (OMB) regarding this definition.

The second sentence in the definition of noncompliance states that “Governmental audit requirements may provide an alternative definition of material noncompliance.” We recommend adding the following introductory phrase to the definition in paragraph 11 to clarify the auditor’s responsibility when governmental requirements for identifying and reporting noncompliance differ from this standard.

“In the absence of a definition of material noncompliance in the law, regulation, or governmental audit requirement, material noncompliance is defined as a failure to follow requirements or a violation of prohibitions...”

Intended use reports

We recommend revising paragraph 31i by replacing the term “restricted use” with “intended use.” Paragraph 31i refers to the provisions in paragraph 30n, which uses the term “intended use.” This change would make the wording in those two paragraphs consistent and would better reflect the intent of the requirements in both paragraphs.

We also suggest revising paragraph A24 to reflect use of the term “intended use.” We suggest revising A24 as follows: “Nothing precludes the auditor from indicating the intended users of any report.” Auditor reports on compliance ordinarily are general use reports intended for use by government agencies as well as for public accountability purposes. Reports for audits performed in accordance with generally accepted government auditing standards are frequently available for public inspection and likely to be posted on public Web

sites. Also, some government audit organizations are subject to public records laws that do not allow them to restrict the use of audit reports.

Applicability

The first paragraph of the proposed standard states that the standard's provisions apply to compliance audits performed in accordance with "a governmental audit requirement." We suggest adding clarification to paragraph 1 to describe the intended application of the standard, as follows: "Examples of governmental audit requirements include OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and department specific guidance such as the U.S. Department of Housing and Urban Development (HUD) *Audit Requirements Related to Entities Such as Public Housing Agencies, Nonprofit and For-Profit Housing Projects, and Certain Lenders.*"

Questioned costs

We commend the ASB for including in the proposed standard the concepts of known and likely questioned costs, which are necessary for auditors to properly evaluate and report on an entity's compliance with applicable requirements. Since some compliance auditors may be unfamiliar with those concepts, we recommend also providing guidance on addressing the risk of undetected questioned costs in the population beyond known and likely questioned costs, i.e., the risk that likely questioned costs are understated because of the related sampling risk. To accomplish this, we suggest adding a new paragraph to follow paragraph A22, as follows:

"The evaluation of likely questioned costs includes assessing the risk that questioned costs in the population could be higher than likely questioned costs due to sampling risk, which exists anytime the auditor uses sampling. When the auditor uses statistical sampling, the risk of undetected questioned costs can be measured using statistical methods. When non-statistical sampling is used, the risk of further questioned costs is estimated based on the auditor's professional judgment."

Dating of the auditor's report

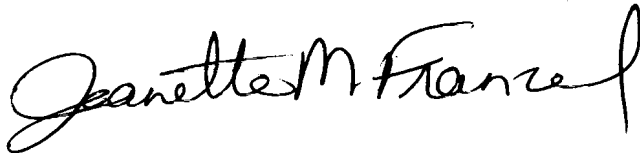
The proposed standard requires that the auditor's report on compliance identify the period covered by the report (paragraph 30d) and the date of the auditor's report (paragraph 30p); it does not, however, include requirements or guidance on the dating of the auditor's report. AU 530.01 states that "The auditor's report should not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence to support the opinion." AU section 530, footnote 1 states that "Among other things, sufficient appropriate audit evidence includes evidence...that management has asserted that they have taken responsibility for them [the financial statements]. We suggest adding

either (1) a reference to AU section 530, Dating of the Independent Auditor's Report, or (2) a requirement that the auditor's report on compliance should not be dated earlier than the date on which the auditor has obtained sufficient, appropriate evidence to support the opinion, including a management representation letter. Such an addition would promote consistency of practice and would help alert compliance auditors to the requirements of AU section 530.

In addition, we recommend including application guidance referenced to paragraph 30p advising auditors that when performing a compliance audit in accordance with OMB Circular No. A-133, the provisions of AU section 530 discussed in the preceding paragraph also apply to the Schedule of Expenditures of Federal Awards (SEFA).

We thank you for considering our comments on these important issues as we work together on issues of mutual interest to the accountability profession.

Sincerely yours,

A handwritten signature in black ink that reads "Jeanette M. Franzel". The signature is fluid and cursive, with the first letters of each name being capitalized and prominent.

Jeanette Franzel
Managing Director
Financial Management and Assurance

cc: Mr. Harold Monk, Chair
Auditing Standards Board

The Honorable Mark W. Olson, Chairman
Public Company Accounting Oversight Board