GAO U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

December 10, 2014

Ms. Sherry Hazel
Audit and Attest Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Subject: American Institute of Certified Public Accountants Auditing Standards Board's September 2014 Exposure Draft for a Proposed Statement on Auditing Standards, Entitled *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*

Dear Ms. Hazel:

This letter provides the U.S. Government Accountability Office's (GAO) comments on the Auditing Standards Board's (ASB) proposed Statement on Auditing Standards (SAS), entitled *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*. We support ASB's efforts to apply clarity drafting conventions to extant Attestation Standards (AT) section 501, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*. Because examinations performed under extant AT section 501 are required to be integrated with audits of financial statements, we also support ASB's decision to move the content of extant AT section 501 from the attestation standards into the auditing standards. We also encourage ASB to develop an attestation standard addressing examinations of internal control other than examinations of internal control over financial reporting that are integrated with audits of financial statements. We believe that developing such an attestation standard would be helpful to address examinations of internal control over operations, compliance, and other reporting, such as privacy or information security, as well as examinations of internal control over financial reporting that are not integrated with audits of financial statements (e.g., examinations of specific areas of internal control over financial reporting, such as monitoring controls, or examinations that do not satisfy the preconditions for an audit of internal control over financial reporting because the as of date specified in management's assertion about internal control over financial reporting does not correspond to the balance sheet date).

ASB requested responses to the following questions. Our responses and additional comments on changes made by ASB in drafting the proposed SAS follow.

GAO's Responses to Specific Questions Posed by ASB

1. *Are the respondents aware of any unintended consequences that would result from moving the content of extant AT section 501 from the attestation standards into the auditing standards?*

As is noted above, we support ASB's decision to move the content of extant AT section 501 from the attestation standards into the auditing standards. Because examinations performed under extant AT section 501 are required to be integrated with audits of financial statements performed in accordance with generally accepted auditing standards, we believe this move will better facilitate the integration of audits of financial statements and internal control over financial reporting and encourage consistency of practice. We are not aware of any unintended consequences that would result from this move.

2. *Do respondents agree with the approach ASB has taken in proposing a separate standalone SAS instead of addressing an integrated audit in each relevant existing AU-C section?*

We agree with the approach ASB has taken in proposing a separate, standalone SAS for audits of internal control over financial reporting that are integrated with audits of financial statements. We also agree with ASB's proposed amendments to various sections in SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification,* for the purpose of integrating the proposed SAS into the auditing standards.

3. *Do respondents agree with the approach ASB has adopted relating to the 2013 Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 COSO framework)?*

The proposed SAS presumes the use of the 2013 COSO framework by management and includes specific requirements for the auditor to evaluate each of the five components of internal control. The 2013 COSO framework introduced the concept of principles related to the five components of internal control. These principles support the effective design, implementation, and operation of the related components and represent the requirements necessary to establish an effective internal control system. Because the proposed SAS presumes the use of the 2013 COSO framework, it also includes specific requirements for determining whether the relevant principles related to each of the five components of internal control exist in the design, implementation, and operation of internal control over financial reporting to achieve the entity's financial reporting objectives.

We appreciate the attention ASB has given to governmental entities in the proposed SAS by requiring the auditor to adapt and apply such specific requirements based on the framework used by management. Specifically, the proposed SAS identifies both the 2013 COSO framework and GAO's *Standards for Internal Control in the Federal Government* (the Green Book) as suitable and available criteria against which management may evaluate and report on the effectiveness of the entity's internal control over financial reporting. While we agree with the approach ASB has adopted relating to the 2013 COSO framework, we recommend that paragraphs 25 through 30 be revised as illustrated in enclosure I. Given that the proposed SAS presumes the use of the 2013 COSO framework by management, such suggested revisions are intended to enhance the consistency of the specific requirements in paragraphs 25 through 30 with the 2013 COSO framework, as well as the Green Book, and clarify the relationship between the entity's financial reporting objectives and the relevant assertions for significant classes of transactions, account balances, or disclosures.

4. *Does the defined term significant class of transactions, account balance, or disclosure have the effect of better aligning terminology with minimal impact on practice?*

We believe that the consistent use of "significant class of transactions, account balance, or disclosure" throughout the auditing standards and in lieu of "significant account or disclosure," as currently used in extant AT section 501, will have the effect of better aligning terminology with minimal impact on practice.

Additional GAO Comments

We found most of the substantive and language changes to extant AT section 501 appropriate. However, we have identified a number of potential issues that we believe ASB should consider as it moves forward. For example, we recommend that the presentation of the reporting requirements set forth in paragraph 67 of the proposed SAS be revised to provide greater flexibility with respect to the placement of certain required statements within the auditor's report and to better align with the presentation of the reporting requirements set forth in AU-C 700, paragraphs 22 through 43, which provide such flexibility. Other issues and our suggested revisions are included in enclosure II. We urge ASB to incorporate our suggested revisions into the proposed SAS as we believe that doing so will enhance the clarity and consistency of certain requirements and application guidance and better ensure consistency of practice.

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We thank you for considering our comments on these important issues as ASB applies the clarity drafting conventions to extant AT section 501 and moves the content of extant AT section 501 from the attestation standards into the auditing standards.

Sincerely yours,

James R. Dalkin
Director
Financial Management and Assurance

Enclosures - 2

GAO Comments and Suggestion Revisions for Paragraphs 25 through 30 of the Proposed SAS
(Green text with underline denotes new suggested language. ~~Red text with strikethrough~~ denotes suggested deletions.)

Requirement(s)	Application Guidance	GAO Comment
Evaluating the Internal Control Components 25. The auditor should perform the procedures required by paragraphs 26–30 to evaluate the five components and related ~~relevant~~ principles of internal control and determine whether (1) the five components and related ~~relevant~~ principles are present and functioning in the design, implementation, and operation of ICFR and (2) ~~whether~~ the five components are operating together in an integrated manner to achieve the entity's financial reporting objectives. When management uses a framework other than the ~~2013 Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (~~2013 COSO framework~~)~~, the auditor should adapt and apply the requirements in paragraphs 26–30, as necessary, based on the framework used by management . (Ref: par. A36–A37)	**Evaluating the Internal Control Components** A36. ~~This proposed SAS presumes management uses the 2013 COSO framework.~~ Paragraphs 26–30 include specific requirements for evaluating the five components of internal control ~~by assessing the principles in the 2013 COSO framework~~. The 2013 COSO framework introduced the concept of principles related to the five components of internal control. These principles support the effective design, implementation, and operation of the related components and represent the requirements necessary to establish an effective internal control system. To assist users in determining whether the five components and related principles are present and functioning, the 2013 COSO framework refers to "present" as the determination that the components and relevant principles exist in the design and implementation of the system of internal control to achieve specified objectives, and "functioning" as the determination that the components and relevant principles continue to exist in the operations and conduct of the system of internal control to achieve specified objectives. The 2013 COSO framework also refers to "operating	 Given that the proposed SAS presumes the use of the 2013 COSO framework by management, our suggested revisions are intended to enhance the consistency of the specific requirements in paragraphs 25 through 30 with the 2013 COSO framework, as well as the Green Book, and clarify the relationship between the entity's financial reporting objectives and the relevant assertions for significant classes of transactions, account balances, or disclosures. In addition to these revisions, ASB should consider amending AU-C 315 to better align its descriptions of each component of internal control with the descriptions presented in the 2013 COSO framework.

GAO Comments and Suggestion Revisions for Paragraphs 25 through 30 of the Proposed SAS
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	together" as the determination that all five components collectively reduce, to an acceptable level, the risk of not achieving an objective. Components should not be considered discretely; instead, they operate together as an integrated system. Components are interdependent with a multitude of interrelationships and linkages among them, particularly the manner in which principles interact within and across components. A37. The entity's financial reporting objectives, if achieved, provide the entity with reasonable assurance that material misstatements or omissions in the financial statements are prevented, or detected and corrected, on a timely basis. Such financial reporting objectives typically are disaggregated into individual control objectives designed to address the assessed risk of material misstatement to each relevant assertion for significant classes of transactions, account balances, or disclosures. ~~The principles are fundamental concepts associated with components that are suitable to all entities. The 2013 COSO framework indicates that components and relevant principles are requisite to an effective system of internal control. Entities select and develop controls within each component to effect relevant principles. Controls are~~	

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	~~interrelated and may support multiple objectives and principles.~~ A38~~A37~~. When management uses the Green Book or another framework to evaluate the effectiveness of the entity's ICFR, paragraph 25 requires the auditor to adapt and apply the requirements in paragraphs 26–30, as necessary, based on the framework used by management. For example, when management uses the Green Book, the auditor determines whether the related principles, as identified by the Green Book, exist in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives ~~assesses the relevant principles in the Green Book in lieu of the principles listed in paragraphs 26–30~~.	
Control Environment 26. The auditor is required to obtain an understanding of the control environment. In addition, the auditor should evaluate the control environment by determining whether the related ~~following~~ principles exist in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives.~~:~~ • ~~Whether the entity demonstrates a commitment to integrity and ethical values;~~ • ~~Whether those charged with~~	*Control Environment* A38. The 2013 COSO framework identifies the related principles for the control environment as • whether the entity demonstrates a commitment to integrity and ethical values; • whether those charged with governance demonstrate independence from management and exercise oversight of the development and performance of	Because the auditor may need to determine whether the related principles, as identified by the Green Book, exist in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives, we suggest relocating the listing of 2013 COSO framework principles to application guidance and including "related principles" in the requirement.

 Enclosure I

GAO Comments and Suggestion Revisions for Paragraphs 25 through 30 of the Proposed SAS
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Requirement(s)	Application Guidance	GAO Comment
~~governance demonstrate independence from management and exercise oversight of the development and performance of ICFR;(Ref: par. 0A38–A39)~~ ~~• Whether management establishes, with oversight of those charged with governance, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of the entity's financial reporting objectives;~~ ~~• Whether the organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with the entity's financial reporting objectives; and~~ ~~• Whether the entity holds individuals accountable for their ICFR responsibilities in the pursuit of the entity's financial reporting objectives (Ref: par. 36)~~	ICFR(Ref: par. 0A38–A39); • whether management establishes, with oversight of those charged with governance, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of the entity's financial reporting objectives; • whether the organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with the entity's financial reporting objectives; and • whether the entity holds individuals accountable for their ICFR responsibilities in the pursuit of the entity's financial reporting objectives. (Ref: par. A-36-A37) A39. The evaluation of whether those charged with governance demonstrate independence from management and exercise oversight of the development and performance of ICFR is performed in the context of the entity's governance structure. As described in AU-C section 260, The Auditor's Communication With Those Charged With Governance (AICPA, Professional Standards), governance structures may vary by entity, reflecting influences such as size and ownership characteristics. For example, in some	

GAO Comments and Suggestion Revisions for Paragraphs 25 through 30 of the Proposed SAS

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	smaller entities, those charged with governance and management may be the same people. In such smaller entities, the independence of those charged with governance from management may not be necessary to support the achievement of the entity's financial reporting objectives. ~~A39.~~ The Green Book refers to those charged with governance as the oversight body. A40. AU-C section 315 provides guidance with respect to the control environment.	
~~Entity's~~ Risk Assessment ~~Process~~ 27. The auditor is required to obtain an understanding of the entity's risk assessment process. In addition, the auditor should ~~also~~ evaluate the entity's risk assessment process by determining whether the related ~~following~~ principles exist in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives.~~:~~ • ~~Whether the entity specifies financial reporting objectives with sufficient clarity to enable the identification and assessment of risks related to these objectives;~~ • ~~Whether the entity identifies risks to the achievement of financial~~	*~~Entity's~~ Risk Assessment ~~Process~~* A##. The 2013 COSO framework identifies the related principles for risk assessment as • whether the entity specifies financial reporting objectives with sufficient clarity to enable the identification and assessment of risks related to these objectives; • whether the entity identifies risks to the achievement of financial reporting objectives across the entity and analyzes risks as a basis for determining how the risks need to be managed;	Because the auditor may need to determine whether the related principles, as identified by the Green Book, exist in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives, we suggest relocating the listing of 2013 COSO framework principles to application guidance and including "related principles" in the requirement.

GAO Comments and Suggestion Revisions for Paragraphs 25 through 30 of the Proposed SAS
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~~reporting objectives across the entity and analyzes risks as a basis for determining how the risks need to be managed;~~ • ~~Whether the entity considers the potential for fraud in assessing risks to the achievement of financial reporting objectives; and~~ • ~~Whether the entity identifies and assesses changes that could significantly impact ICFR (Ref: par. A41)~~	• whether the entity considers the potential for fraud in assessing risks to the achievement of financial reporting objectives; and • whether the entity identifies and assesses changes that could significantly impact ICFR. (Ref: par. A-36-A37) A41. AU-C section 315 provides guidance with respect to the entity's risk assessment processes.	
Information and Communication ~~*The Information System*~~ 28. The auditor is required to obtain an understanding of the entity's information and communication processes ~~system, including the related business processes relevant to financial reporting and communication~~. In addition, the auditor should evaluate the entity's information and communication processes ~~system~~ by determining whether the related ~~following~~ principles exist in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives.~~:~~ • ~~The entity obtains or generates and uses relevant, quality information to support the~~	*Information and Communication* ~~*The Information System*~~ A##. The 2013 COSO framework identifies the related principles for information and communication as follows: • The entity obtains or generates and uses relevant, quality information to support the functioning of ICFR. • The entity internally communicates information, including financial reporting objectives and responsibilities, necessary to support the functioning of ICFR. • The entity communicates with external parties regarding matters affecting the functioning of ICFR. (Ref: par. A-36-A37)	Because the auditor may need to determine whether the related principles, as identified by the Green Book, exist in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives, we suggest relocating the listing of 2013 COSO framework principles to application guidance and including "related principles" in the requirement.

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~~functioning of ICFR.~~ • ~~The entity internally communicates information, including financial reporting objectives and responsibilities, necessary to support the functioning of ICFR.~~ • ~~The entity communicates with external parties regarding matters affecting the functioning of ICFR. (Ref: par. A42)~~	A42. AU-C section 315 provides guidance with respect to the entity's information and communication processes ~~system, including the related business processes relevant to financial reporting and communication~~.	
Control Activities ~~Relevant to the Audit of ICFR~~ 29. The auditor is required to obtain an understanding of the entity's control activities relevant to the integrated audits of the financial statements and ICFR. ~~financial statement audit~~. In addition, the auditor should evaluate the entity's control activities relevant to the audit of ICFR by determining whether the related ~~following~~ principles exist in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives.~~:~~ • ~~The entity selects and develops control activities that contribute to the mitigation of risks to the achievement of financial reporting objectives to acceptable levels.~~ • ~~The entity selects and develops general control activities over~~	*Control Activities ~~Relevant to the Audit of ICFR~~* A##. The 2013 COSO framework identifies the related principles for control activities as follows: • The entity selects and develops control activities that contribute to the mitigation of risks to the achievement of financial reporting objectives to acceptable levels. • The entity selects and develops general control activities over technology to support the achievement of financial reporting objectives.. • The entity deploys control activities through policies that establish what is expected and procedures that put policies into action. (Ref: par. A-36-A37)	Because the auditor may need to determine whether the related principles, as identified by the Green Book, exist in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives, we suggest relocating the listing of 2013 COSO framework principles to application guidance and including "related principles" in the requirement.

 Enclosure I

GAO Comments and Suggestion Revisions for Paragraphs 25 through 30 of the Proposed SAS
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Requirement(s)	Application Guidance	GAO Comment
~~technology to support the achievement of financial reporting objectives. and~~ • ~~The entity deploys control activities through policies that establish what is expected and procedures that put policies into action. (Ref: par. A43–A44)~~	A43. AU-C section 315 provides guidance with respect to the entity's control activities relevant to the financial statement audit. Also see paragraph 12 ~~A16~~ of this proposed SAS. A44. Control activities relevant to the audit of ICFR include those related to each significant class of transactions, account balance, and disclosure and their relevant assertions (see paragraphs 33–35). ~~Paragraph 38 also requires the auditor to understand how IT affects the entity's flow of transactions.~~	
Monitoring ~~of Controls~~ 30. The auditor is required to obtain an understanding of the entity's monitoring of controls. In addition, the auditor should evaluate the entity's monitoring of controls ~~activities~~ by determining whether the related ~~following~~ principles exist in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives.~~:~~ • ~~The entity selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.~~ • ~~The entity evaluates and communicates deficiencies in ICFR~~	*Monitoring ~~of Controls~~* A##. The 2013 COSO framework identifies the related principles for monitoring as follows: • The entity selects, develops, and performs ongoing evaluations, separate evaluations, or both to ascertain whether the components of internal control are present and functioning. • The entity evaluates and communicates deficiencies in ICFR in a timely manner to those parties responsible for taking corrective action, including senior management and those charged with governance, as appropriate.	Because the auditor may need to determine whether the related principles, as identified by the Green Book, exist in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives, we suggest relocating the listing of 2013 COSO framework principles to application guidance and including "related principles" in the requirement.

GAO Comments and Suggestion Revisions for Paragraphs 25 through 30 of the Proposed SAS
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Requirement(s)	Application Guidance	GAO Comment
~~in a timely manner to those parties responsible for taking corrective action, including senior management and those charged with governance, as appropriate. (Ref: par. A45)~~	(Ref: par. A-36-A37) A45. AU-C section 315 provides guidance with respect to the entity's monitoring of controls. Additional guidance is provided in paragraphs A11–A12 of this proposed SAS.	

Additional GAO Comments on Proposed SAS by Paragraph

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<table>
<tr><th>Requirement(s)</th><th>Application Guidance</th><th>GAO Comment</th></tr>
<tr><td>Objectives

4. The objectives of the auditor in an audit of ICFR are to
a. obtain reasonable assurance about whether material weaknesses exist as of the date specified in management's assertion about ICFR (as of date), thereby enabling the auditor to express an opinion on whether effective ICFR was maintained, in all material respects, based on the criteria; and
b. report on ICFR, and communicate as required by GAAS, in accordance with the auditor's findings (Ref: par. A3–A5)</td><td>Objectives

A3. See AU-C section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards (AICPA, Professional Standards), for additional explanation related to the auditor's objective to obtain reasonable assurance.

A4. Effective ICFR provides an entity with reasonable assurance regarding ~~the reliability of financial reporting and~~ the preparation <u>and fair presentation</u> of financial statements in accordance with the applicable financial reporting framework. If one or more material weaknesses exist, the entity's ICFR cannot be considered effective. The evaluation of the effectiveness of the entity's ICFR required by this proposed standard encompasses all relevant control objectives of the entity's ICFR.

A5. The auditor is not required to search for deficiencies that, individually or in combination, are less severe than a material weakness.</td><td>

Suggested edits to enhance consistency with AU-C 210, paragraph 6. Similar edits suggested for the definition of internal control over financial reporting below.</td></tr>
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Additional GAO Comments on Proposed SAS by Paragraph
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Requirement(s)	Application Guidance	GAO Comment
Definitions **Internal control over financial reporting (ICFR).** A process effected by those charged with governance, management, and other personnel, designed to provide the entity with reasonable assurance regarding the preparation and fair presentation of ~~reliable~~ financial statements in accordance with the applicable financial reporting framework and includes those policies and procedures that i. pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; ii. provide reasonable assurance that transactions are recorded as necessary to permit the preparation and fair presentation of financial statements in accordance with the applicable financial reporting framework, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and iii. provide reasonable assurance regarding prevention, or ~~timely~~	**Definitions** A6. The auditor's procedures performed as part of the integrated audit are not part of an entity's ICFR. A7. Internal control, as defined by the framework used by management, may be more broadly defined than ICFR. Management may use the 2013 *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 COSO framework), the U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* (the Green Book), or another framework in fulfilling its responsibility to evaluate the effectiveness of the entity's ICFR using suitable and available criteria. Additionally, the definition of ICFR included in the auditor's report on an audit of ICFR will match the description of the entity's ICFR used by management it its report on ICFR. As such, the definition of ICFR included in the auditor's report on an audit of ICFR may differ from the definition of ICFR included in this proposed SAS. A8~~A7~~. For insured depository institutions (IDIs) subject to the internal control reporting requirements of Section 112 of	 To introduce the notion that internal control, as defined by the framework used by management, may be more broadly defined than ICFR, as defined by the proposed SAS.

Additional GAO Comments on Proposed SAS by Paragraph

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Requirement(s)	Application Guidance	GAO Comment
detection and correction on a timely basis of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements. ICFR has inherent limitations. ICFR is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. ICFR also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements will not be prevented, or detected and corrected, on a timely basis by ICFR. (Ref: par. A6–A8~~A7~~)	the Federal Deposit Insurance Corporation Improvement Act (FDICIA), ICFR includes controls over the preparation of the IDI's financial statements in accordance with generally accepted accounting principles (GAAP) and with the instructions to the Consolidated Financial Statements for Bank Holding Companies. ICFR also includes controls over the preparation of the IDI's financial statements in accordance with GAAP and controls over the preparation of schedules equivalent to the basic financial statements in accordance with the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income (call report instructions).	
Material weakness. A deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements or omission in relevant assertions, will not be prevented, or detected and corrected, on a timely basis. A reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined as follows: Reasonably possible. The chance of		To include definitions for material weakness and significant deficiency within the proposed SAS, given the significance of these terms to the content of the proposed SAS.

Additional GAO Comments on Proposed SAS by Paragraph
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Requirement(s)	Application Guidance	GAO Comment
the future event or events occurring is more than remote but less than likely. Probable. The future event or events are likely to occur. **Significant deficiency.** A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.		
6. Reference to criteria in this proposed SAS means the framework ~~benchmarks~~ used by management to measure or evaluate ICFR. Criteria are both suitable and available to the intended users of management's report on ICFR. Suitable criteria exhibit all of the following characteristics: • *Relevance*. Criteria are relevant to ICFR. • *Objectivity*. Criteria are free from bias. • *Measurability*. Criteria permit reasonably consistent measurements, qualitative or quantitative, of ICFR. • *Completeness*. Criteria are complete when the evaluation of the effectiveness of ICFR prepared		Paragraph 6 of the proposed SAS does not include requirements and appears to be out of place. We suggest that the contents of paragraph 6, as revised within this enclosure, be moved to application guidance and linked to the requirements set forth in paragraph 7a.ii. of the proposed SAS. Additionally, we suggest that application guidance regarding the characteristics of available criteria be developed and linked to the same requirements.

Additional GAO Comments on Proposed SAS by Paragraph

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Requirement(s)	Application Guidance	GAO Comment
in accordance with the criteria does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made on the basis of management's report on ICFR.		
Preconditions for the Audit of ICFR 7. AU-C section 210, Terms of Engagement (AICPA, Professional Standards), requires the auditor to establish whether the preconditions for an audit are present. In an audit of ICFR, the auditor should (Ref: par. A8) a. obtain the agreement of management that it acknowledges and understands its responsibility for i. designing, implementing, and maintaining effective ICFR. ii. evaluating the effectiveness of the entity's ICFR using suitable and available criteria. iii. providing management's assertion about ICFR in a report that accompanies the auditor's report (see paragraph 58). iv. supporting its assertion about the effectiveness of the entity's ICFR with sufficient evaluations and documentation. (Ref: par.	**Preconditions for the Audit of ICFR** A13. Ordinarily, the auditor is engaged to audit the effectiveness of the entity's ICFR as of the end of the entity's fiscal year, which typically corresponds to the balance sheet date (or period ending date) of the entity's financial statements; however, management may select a different date for its assertion about ICFR. If the auditor is engaged to audit the effectiveness of an entity's ICFR as of ~~at~~ a date different from the balance sheet date (or period ending date) of the entity's financial statements ~~the end of the entity's fiscal year~~, the engagement ~~audit~~ will not satisfy the preconditions for the audit of ICFR ~~is, nevertheless, required by paragraph 7a.iv to be integrated with a financial statement audit as of that date~~. In such circumstances, the engagement would be performed as an examination under the attestation standards.	If the auditor is required to determine that the as of date corresponds to the balance sheet date (or period ending date) of the period covered by the most recent financial statements presented, it follows that the auditor would not be able to perform an integrated audit under this proposed SAS. Additional suggested edits are included to clarify that the as of date specified in management's assertion about ICFR should correspond to the date of the most recent financial statements presented.

Additional GAO Comments on Proposed SAS by Paragraph
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Requirement(s)	Application Guidance	GAO Comment
A8–A12) b. determine that the as of date specified in management's assertion about ICFR corresponds to the balance sheet date (or period ending date) of the period covered by the most recent financial statements presented when more than one period's financial statements are presented. (Ref: par. A13)		
8. The auditor should evaluate the effectiveness of the entity's ICFR using the same suitable and available criteria used by management for its evaluation. (Ref: par. A14)	A14. The 2013 COSO framework and the ~~U.S. Government Accountability Office's Standards for Internal Control in the Federal Government (the~~ Green Book~~)~~ provide suitable and available criteria against which management may evaluate and report on the effectiveness of the entity's ICFR. The 2013 COSO framework and the Green Book describe an entity's internal control as consisting of five components: control environment, risk assessment, information and communication, control activities, and monitoring, each with related principles. If management selects another framework, see paragraph ~~6~~ *[see GAO comment on paragraph 6 – reference will need to be updated based on the placement of application guidance to be linked to paragraph 7a.ii. above]* for guidance on evaluating the suitability and availability of the framework selected by management.	Suggested edit resulting from the anticipated incorporation of other suggested edits into the proposed SAS. Specifically, see the GAO comment on paragraph 6 above.

Additional GAO Comments on Proposed SAS by Paragraph
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Requirement(s)	Application Guidance	GAO Comment
14. When concluding on the effectiveness of controls for the purpose of the financial statement audit, the auditor should evaluate the results of any additional tests of controls performed by the auditor to achieve the objective related to expressing an opinion on the entity's ICFR. (Ref: par. A18–A19) 14. When concluding on the effectiveness of controls for the purpose of the financial statement audit, the auditor should evaluate the results of any additional tests of controls performed by the auditor to achieve the objective related to expressing an opinion on the entity's ICFR. (Ref: par. A18–A19)	~~A18. To express an opinion on the financial statements, the auditor ordinarily performs tests of controls and substantive procedures. Tests of controls are performed when the auditor's risk assessment includes an expectation of the operating effectiveness of controls or when substantive procedures alone cannot provide sufficient appropriate audit evidence at the relevant assertion level. Tests of controls are designed to obtain sufficient appropriate audit evidence that the controls are operating effectively for the particular time or throughout the period of reliance. However, in a financial statement audit, the auditor is not required to test controls for all relevant assertions and, for a variety of reasons, the auditor may choose not to do so.~~ A19. Consideration of the results of tests of controls may cause the auditor to reassess the risk of material misstatement to each relevant assertion; alter the nature, timing, and extent of substantive procedures and to plan and perform further tests of controls, particularly in response to identified deficiencies; or both.	Since the contents of extant AT section 501 will be moved from the attestation standards into the auditing standards, paragraph A18 may not be needed.
32. As part of evaluating the period-end financial reporting process, the auditor should consider ~~assess~~ • the inputs, procedures performed, and outputs of the processes the		Suggested edit.

Additional GAO Comments on Proposed SAS by Paragraph
(Green text with underline denotes new suggested language. ~~Red text with strikethrough~~ denotes suggested deletions.)

Requirement(s)	Application Guidance	GAO Comment
entity uses to produce its financial statements; • the extent of IT involvement in the period-end financial reporting process; • who participates from management; • the locations involved in the period-end financial reporting process; • the types of adjusting and consolidating entries; and • the nature and extent of the oversight of the process by management and those charged with governance.		
Understanding Likely Sources of Misstatement 36. To further understand the likely sources of potential misstatements, and as a part of selecting the controls to test, the auditor should • Understand the flow of transactions related to the control objectives, or relevant assertions for significant classes of transactions, account balances, or disclosures, including how these transactions are initiated, authorized, recorded, processed, and reported.	**Understanding Likely Sources of Misstatement** A53. Performing walk-throughs will frequently be the most effective way of achieving the objectives in paragraph 36. A walk-through involves following a transaction from origination through the entity's processes, including information systems, until it is reflected in the entity's financial records~~, using the same documents and IT that entity personnel use~~. Walk-throughs are designed to inform the auditor's understanding of the design effectiveness and implementation of the	Suggested edits to provide one comprehensive definition of a walk-through, which was previously discussed separately in paragraphs A53, A54, A58, and A68 of the proposed SAS.

Additional GAO Comments on Proposed SAS by Paragraph
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Requirement(s)	Application Guidance	GAO Comment
• Identify the points within the entity's processes at which a misstatement, including a misstatement due to fraud, could arise that, individually or in combination with other misstatements, would be material (for example, points at which information is initiated, transferred, or otherwise modified). • Identify the controls that management has implemented to address these potential misstatements. • Identify the controls that management has implemented over the prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements. (Ref: par. A53-A54)	control activities as part of the auditor's risk assessment process and allow the auditor to identify the points within the processes at which a control activity that is not effectively designed and implemented, or operated (i.e., the control activity fails), could result in a material misstatement. Walk-throughs ~~procedures~~ include a combination of inquiry, observation, inspection, and collection of relevant documentation, recalculation, and control reperformance. With respect to inquiry, a walk-through includes questioning the entity's personnel about their understanding of what is required by the entity's prescribed procedures and control~~s~~ activities ~~at the points at which important processing procedures occur~~. Additionally, probing questions that go beyond a narrow focus on the single transaction used as the basis for the walk-through may provide an understanding of the different types of significant transactions handled by the process. ~~A54. A walkthrough includes questioning the entity's personnel about their understanding of what is required by the entity's prescribed procedures and controls at the points at which important processing procedures occur. These probing questions, combined with the other walkthrough procedures, allow the~~	

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Requirement(s)	Application Guidance	GAO Comment
	~~auditor to gain a sufficient understanding of the process and to be able to identify important points at which a necessary control is missing or not designed effectively. Additionally, probing questions that go beyond a narrow focus on the single transaction used as the basis for the walkthrough may provide an understanding of the different types of significant transactions handled by the process.~~	
Evaluating Design Effectiveness 39~~40~~. The auditor should evaluate the design effectiveness of controls by determining whether the entity's controls, if ~~they are applied~~ implemented and operated as prescribed by persons possessing the necessary authority and competence to perform the control effectively, satisfy the entity's control objectives, and can effectively prevent, or detect and correct, misstatements caused by errors or fraud that could result in material misstatements in the financial statements. (Ref: par. A58–A59)	**Evaluating Design Effectiveness** A56~~A58~~. Performing walk-throughs will frequently be the most effective way of achieving the objectives in paragraph 39~~40~~. ~~Procedures performed to evaluate design effectiveness may include a mix of inquiry of appropriate personnel, observation of the entity's operations, and inspection of relevant documentation. Walkthroughs that include these procedures ordinarily are sufficient to evaluate design effectiveness.~~	Suggested edits.
Testing Controls **Selecting Controls to Test** 40~~39~~. The auditor should test those controls that are important to the auditor's	**Testing Controls** **Selecting Controls to Test** A57~~A56~~. There might be more than one control that addresses the assessed risk of	Suggested edits to clarify what is meant by important and better link importance to the

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conclusion about whether (1) the entity's controls sufficiently address the assessed risk of material misstatement to each relevant assertion and (2) the five components of internal control are operating together in an integrated manner to achieve the entity's financial reporting objectives. (Ref: par. A56–A57)	material misstatement to a particular relevant assertion; conversely, one control might address the assessed risk of material misstatement to more than one relevant assertion. It may not be necessary to test all controls related to a relevant assertion nor necessary to test redundant controls, unless redundancy is, itself, a control objective. A58~~A57~~. The decision concerning whether a control is important to the auditor's conclusion and would be selected for testing depends on which controls, individually or in combination, sufficiently address the assessed risk of material misstatement to a given relevant assertion and collectively achieve the entity's financial reporting objectives, rather than on how the control is labeled (for example, entity-level control, transaction-level control, control activity, monitoring control, preventive control, or detective control).	entity's financial reporting objectives.
43. The auditor should obtain evidence about the effectiveness of selected controls for each relevant assertion. The auditor is not responsible for obtaining sufficient appropriate audit evidence to support an opinion about the effectiveness of each individual control. (Ref: par. A66–A72)	A68. Walkthroughs ~~may include a combination of inquiry of appropriate personnel, observation of the entity's operations, inspection of relevant documentation, recalculation, and reperformance of the control and~~ might provide sufficient appropriate audit evidence of operating effectiveness, depending on the risk associated with the	See comment above regarding suggested edits to provide one comprehensive definition of a walk-through, which was previously discussed separately in paragraphs A53, A54, A58, and A68 of the proposed SAS.

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	control being tested, the specific procedures performed as part of the walkthrough, and the results of those procedures.	
52. The auditor should evaluate the effect of <u>effectively designed and implemented</u> compensating controls when determining whether a deficiency, or combination of deficiencies, in ICFR is a material weakness as of the date specified in management's assertion about ICFR. The auditor should test the operating effectiveness of such compensating controls to determine whether they operate at a level of precision that would prevent, or detect and correct, a material misstatement. (Ref: par. A91)	A91. A<u>n effectively designed and implemented</u> compensating control can limit the severity of a deficiency in ICFR and prevent it from being a material weakness. Only compensating controls that operate at a level of precision that would prevent, or detect and correct a material misstatement are capable of having a mitigating effect. Although compensating controls can mitigate the effects of a deficiency in ICFR, they do not eliminate the deficiency.	Suggested edits to clarify that testing would only be performed for compensating controls that are effectively designed and implemented.