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Mr. Ken Siong
Technical Director
International Ethics Standards Board for Accountants
529 Fifth Avenue, 6th Floor
New York, NY 10017

GAO's Response to the International Ethics Standards Board for Accountants' May 2015 Exposure Draft, *Responding to Non-Compliance with Laws and Regulations*

Dear Mr. Siong:

This letter provides GAO's response to the exposure draft, *Responding to Non-Compliance with Laws and Regulations* (NOCLAR). GAO promulgates generally accepted government auditing standards (GAGAS) in the United States. GAGAS provide a framework for conducting high-quality audits of government awards with competence, integrity, objectivity, and independence. GAGAS's use is required of auditors of both domestic and international U.S. government awards. Therefore, we anticipate that International Federation of Accountants' member professional accountants (PA) will be required to practice in accordance with GAGAS and the new International Ethics Standards Board for Accountants (IESBA) standard simultaneously. Our comments reflect the importance we place on reinforcing the values promoted in both the IESBA code and GAGAS.

General Matters

1. Where law or regulation requires the reporting of identified or suspected NOCLAR to an appropriate authority, do respondents believe the guidance in the proposals would support the implementation and application of the legal or regulatory requirement?

We believe this is best answered by those in jurisdictions with laws or regulations as described in the question.

2. Where there is no legal or regulatory requirement to report identified or suspected NOCLAR to an appropriate authority, do respondents believe the proposals would be helpful in guiding PAs in fulfilling their responsibility to act in the public interest in the circumstances?

We believe the drafted language would succeed in guiding PAs in fulfilling their responsibility to act in the public interest.

3. The Board invites comments from preparers (including TCWG), users of financial statements (including regulators and investors) and other respondents on the practical aspects of the proposals, particularly their impact on the relationships between:

- (a) Auditors and audited entities;
- (b) Other PAs in public practice and their clients; and
- (c) PAIBs and their employing organizations.

As auditors in government, we believe that management and those charged with governance at audited entities that have responsibility for expending government funds generally understand the role of an audit as an accountability mechanism for the governments providing those funds. Therefore, we believe that the impact of the proposed revisions on the relationship between auditors and audited entities that expend government funds would not be significant.

Specific Matters

4. Do respondents agree with the proposed objectives for all categories of PAs?

The proposed objectives provide a good framework for PAs who may need to consider alerting key stakeholders, specifically management and those charged with governance, of identified or suspected NOCLAR. As we discuss in the General Comments section below, for entities expending government-provided funds, an additional key stakeholder is the government that provided the funding on behalf of that government's constituency. We recommend revising the objectives to allow for consideration of oversight bodies other than management or those charged with governance. In conjunction with revisions made in consideration of our comments under General Comments, the following edit to paragraph 225.3 would accomplish this:

When responding to non-compliance or suspected non-compliance with laws and regulations, the objectives of the professional accountant are:

- (a) To comply with the fundamental principles of integrity and professional behavior;
- (b) By alerting management or, where appropriate, those charged with governance of the client or others charged with the client's oversight, to seek to:
 - (i) Enable them to rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or
 - (ii) Deter the commission of the non-compliance where it has not yet occurred;and
- (c) To take such further action as may be needed in the public interest.

5. Do respondents agree with the scope of laws and regulations covered by the proposed Sections 225 and 360?

Audited entities receiving resources from foreign governments may be subject to applicable laws and regulations of the donor governments. Of particular significance from GAO's perspective are grant funds provided by the U.S. government to entities in other countries to help meet program objectives such as ending extreme poverty and promoting resilient, democratic societies. Use of these funds may be governed in part by the laws and regulations of the United States. Additionally, use of these funds may be subject to the terms agreed to by the donor and recipient when the funding was granted. In such cases, donor governments may rely for accountability on financial audits performed by firms that have access to and knowledge of conditions in the regions benefiting from the funding. Therefore, we recommend that the IESBA add language to the code indicating that where applicable, consideration of identified or possible NOCLAR should be extended to include laws and regulations of other governments that may have an impact on the expenditure of donated funds. This language could also extend PAs' responsibility for reporting NOCLAR to include significant noncompliance with terms of contracts or grant agreements between donor governments and recipients.

6. Do respondents agree with the differential approach among the four categories of PAs regarding responding to identified or suspected NOCLAR?

We agree with the IESBA's conclusions on auditors' responsibility to respond to identified or suspected NOCLAR. We have no comment on the relationship of that responsibility to the responsibilities of the other categories of PAs described.

7. With respect to auditors and senior PAIBs:

(a) Do respondents agree with the factors to consider in determining the need for, and the nature and extent of, further action, including the threshold of credible evidence of substantial harm as one of those factors?

With respect to auditors, we believe that the discussion of factors to consider in determining the need for further action should include reference to whether funding was provided by a government and subject to the terms of contracts or grant agreements with that government. An appropriate place for such a reference may be in the list of factors to determine whether further action is needed in paragraph 225.21. We agree with the IESBA that credible evidence of substantial harm is an appropriate factor.

(b) Do respondents agree with the imposition of the third party test relative to the determination of the need for, and nature and extent of, further action?

With respect to auditors, we agree in principle with the third-party test as described. As indicated below, we believe that the IESBA could clarify paragraph 225.25, which describes this threshold, by using "relevant" instead of "specific." Doing so would facilitate application of the test by allowing the PA to consider a more realistic scenario: It is unlikely that a third party would be able to weigh "all the specific facts and circumstances available."

In determining the nature and extent of further action needed, the professional accountant shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific relevant facts and circumstances available to the professional accountant at the time, would be likely to conclude that the professional accountant has acted appropriately in the public interest.

(c) Do respondents agree with the examples of possible courses of further action? Are there other possible courses of further action respondents believe should be specified?

With respect to auditors, we agree with the possible courses of further action indicated in paragraph 225.24.

(d) Do respondents support the list of factors to consider in determining whether to disclose the matter to an appropriate authority?

With respect to auditors, we agree with the factors to consider in determining whether to disclose the matter to an outside authority indicated in paragraphs 225.27 through 225.29.

8. For PAs in public practice providing services other than audits, do respondents agree with the proposed level of obligation with respect to communicating the matter to a network firm where the client is also an audit client of the network firm?

We believe that the public would reasonably expect an auditor applying the third-party test to determine the appropriate response to NOCLAR to use all relevant information known within the network for this test. Consequently, we believe that information on identified or suspected NOCLAR should be shared within a network to the same extent that it would be shared within a firm in accordance with paragraph 225.39.

9. Do respondents agree with the approach to documentation with respect to the four categories of PAs?

We agree with the approach to documentation with respect to auditors in paragraph 225.32. We do not offer a comment on the documentation guidance for the other three categories of PAs.

Request for General Comments

(a) PAIBs working in the public sector—Recognizing that many PAIBs work in the public sector, the Board invites respondents from this constituency to comment on the revised proposals and, in particular, on their applicability in a public sector environment.

We are not professional accountants in business, but as auditors in the public sector and the issuers of GAGAS, we would like to provide some additional comments on the applicability of the revised proposals in a public sector environment. Stakeholders for audits of government funds include the citizens to whom the governments are accountable. This is true whether the funds are spent by the governments themselves or by entities that received the funds through grant awards. For this reason, audits performed in accordance with GAGAS include steps to help ensure that those charged with overseeing expenditures of government funds have the information necessary to perform that oversight effectively. In our view, the code would benefit from a discussion of how this principle of accountability for public funds can be enhanced by the new NOCLAR section. The following are some specific examples of how the code could incorporate guidance that helps auditors of government funds address the accountability concerns that accompany government-provided funding.

- Paragraph 225.17 discusses addressing identified or possible NOCLAR with those charged with governance. The IESBA might consider whether, if the PA determines that the NOCLAR is significant enough to warrant discussion with those charged with governance, responsible government officials should also be made aware of the NOCLAR. GAGAS address this principle with a requirement that NOCLAR significant enough to warrant the attention of those charged with governance be included in the auditor's report.
- Paragraph 225.27 provides some examples of circumstances under which the PA might determine that disclosure of NOCLAR to an appropriate authority should be made in the public interest. The revised code could point out that, if the NOCLAR involves government funds, the threshold for such disclosure may be lowered significantly. In some cases, the use of even a small amount of government funds for an unallowable expenditure could be significant to stakeholders, whereas the same expenditure might

generate little interest outside the government environment. Examples of expenditures of government funds that could be significant even in small amounts include expenditures for alcohol or some types of entertainment.

- Paragraph 225.32 discusses documentation requirements related to identified or suspected significant NOCLAR. PAs could be reminded that in audits of government funds, such documentation may be subject to inspection by government auditors.
- Auditors of government funds would benefit from guidance on appropriate steps to take after becoming aware of possible or suspected noncompliance with the terms of contracts or grant agreements. GAGAS extend the U.S. audit requirements pertaining to auditors' responsibilities for laws and regulations to also apply to consideration of compliance with provisions of contracts and grant agreements.

- (b) Developing Nations—Recognizing that many developing nations have adopted or are in the process of adopting the Code, the Board invites respondents from these nations to comment on the proposals, and in particular, on any foreseeable difficulties in applying them in their environment.**
- (c) Translations—Recognizing that many respondents may intend to translate the final pronouncement for adoption in their environments, the Board welcomes comment on potential translation issues respondents may note in reviewing the revised proposals.**

GAO has no comments on (b) and (c) above.

Thank you for the opportunity to comment on these important issues. If you have questions about this letter or would like to discuss any of the matters it addresses, please contact me at (202) 512-3133 or dalkinj@gao.gov or Eric Holbrook at (202) 512-5232 or holbrooke@gao.gov.

Sincerely yours,



James R. Dalkin
Director
Financial Management and Assurance