

GAO

**By the Comptroller General of the
United States**

June 2006

**Government
Auditing
Standards**

2006 Revision

Exposure Draft





United States Government Accountability Office
Washington, DC 20548

June 2006

TO AUDIT OFFICIALS AND OTHERS INTERESTED IN GOVERNMENT AUDITING STANDARDS

GAO invites your comments on the accompanying proposed changes to *Government Auditing Standards* (GAGAS), commonly known as the “Yellow Book.” These changes propose revisions throughout the entire set of standards. This letter describes the process used by GAO for revising GAGAS, summarizes the proposed major changes, discusses proposed effective dates, and provides instructions for submitting comments on the proposed standards.

Process for Revising GAGAS

To help ensure that the standards continue to meet the needs of the audit community and the public it serves, the Comptroller General of the United States appointed the Advisory Council on Government Auditing Standards to review the standards and recommend necessary changes. The Advisory Council includes experts in financial and performance auditing drawn from all levels of government, private enterprise, public accounting, and academia. This exposure draft of the standards includes the Advisory Council’s suggestions for proposed changes. We are currently requesting public comments on the proposed revisions in the exposure draft.

Summary of Major Changes

The proposed 2006 revision to GAGAS will be the fifth revision since the standards were first issued in 1972. The 2006 Yellow Book exposure draft seeks to emphasize the critical role of high quality government audits in achieving credibility and accountability in government. The overall focus of the proposed 2006 revised standards includes an increased emphasis on audit quality and ethics and an extensive update of the performance audit standards to include a specified level of assurance within the context of risk and materiality. In addition, this proposed revision modernizes GAGAS, with updates to reflect major developments in the accountability and audit environment. Finally, clarifications have been made throughout the standards.

The standards are organized by separate chapters as follows:

- Chapter 1 – Use and Application of GAGAS
- Chapter 2 – Auditor’s Ethical Responsibilities
- Chapter 3 – General Standards
- Chapter 4—Field Work Standards for Financial Audits

Chapter 5—Reporting Standards for Financial Audits
Chapter 6 – General, Field Work, and Reporting Standards for Attestation Engagements
Chapter 7 – Field Work Standards for Performance Audits
Chapter 8 – Reporting Standards for Performance Audits
Appendix – Explanatory materials that do not represent GAGAS requirements.

Effective Dates

When issued in final, the 2006 revision will supersede the 2003 revision of the standards. We anticipate that, when finalized, standards will become effective for audits beginning on or after July 1, 2007. For financial audits, certain standards issued by the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants have earlier effective dates. For financial audits performed under GAGAS, the effective dates of the new ASB standards will apply.

Instructions for Commenting

The draft of the proposed changes to *Government Auditing Standards, 2006 Revision*, is only available in electronic format and can be downloaded from GAO's Yellow Book Web Page at <http://www.gao.gov/govaud/ybk01.htm>.

We are requesting comments on this draft from audit officials and financial management at all levels of government, the public accounting profession, academia, professional organizations, public interest groups, and other interested parties. To assist you in developing your comments, specific issues are presented in an enclosure to this letter, along with a detailed list of proposed changes. We encourage you to comment on these issues and any additional issues that you note. Please associate your comments with specific references to issue numbers and/or paragraph numbers in the proposed standards and provide your rationale for any proposed changes, along with suggested revised language. Please send your comments electronically to yellowbook@gao.gov no later than August 15, 2006.

If you need additional information please call Michael Hrapsky, Senior Project Manager, Financial Management and Assurance at (202) 512-9535, or Jeanette Franzel, Director, at (202) 512-9471.

Sincerely yours,



Jeffrey C. Steinhoff
Managing Director
Financial Management and Assurance

Enclosures

Questions for Commenters

The following discussion and questions are provided to guide users in commenting on the proposed 2006 revision of *Government Auditing Standards*. We encourage you to comment on these issues and any additional issues that you note. Please associate your comments with specific references to issue numbers and/or paragraph numbers in the proposed standards.

Chapter 1 – Use and Application of GAGAS

1. The section entitled, “Use of Terminology to Define Professional Requirements in GAGAS” was added to clarify the auditor’s responsibilities and to achieve consistency with other standard setting bodies. This new section is consistent with the AICPA Statement on Auditing Standards (SAS) No. 102, *Defining Professional Requirements in Statements on Auditing Standards* issued by the Auditing Standards Board (ASB) of the American Institute of CPAs (AICPA) and with the approach taken by the Public Company Accounting Oversight Board (PCAOB). GAGAS requirements have also been rewritten in accordance with the terminology set forth in this section. This approach is intended to clarify auditors’ responsibilities and assist auditors in applying the standards.

Please comment on the application and use of this terminology throughout the proposed revision to GAGAS.

2. The section entitled “Citing Compliance with GAGAS in the Auditor’s Report” was added to clarify auditor responsibilities and to provide guidance to auditors in situations where they are unable to follow or chose not to follow certain standards. Complementary guidance is also provided in chapters 5 and 8.

Please comment on the application and use of this guidance for citing compliance with GAGAS in auditors’ reports.

Chapter 2 – Auditor’s Ethical Responsibilities

3. Chapter 2 is devoted solely to emphasizing the ethical responsibilities of government auditors. In the 2003 revision, GAGAS made reference to ethical responsibilities throughout Chapter 1. This 2006 revision adds clarity and emphasis to the discussion of ethical responsibilities of government auditors to uphold and protect the public trust. This chapter employs a principles-based framework of concepts that government auditors use to guide all of their work.

Please comment on the framework discussed in this chapter.

Chapter 3 – General Standards

4. The discussion of nonaudit services and their impact on auditor independence has been significantly streamlined and reorganized from the 2003 revision of the standards to provide clarity. The discussion is in paragraphs 3.30 through 3.35. Additional information on nonaudit services that are generally unique to government audit organizations is presented in the appendix, paragraphs A3.02 through A3.03.

Please comment on the description and categorization of nonaudit services and their impact on auditor independence.

5. The section entitled “Quality Control and Assurance” has been expanded to describe the elements that should be present in an audit organization’s system of quality control. The addition of the specific elements is intended to strengthen the standards and to emphasize consistency of quality control standards among government audit organizations.

Please comment on the expanded discussion of audit quality and the related elements.

6. The section dealing with external peer review includes the following changes: (1) a transparency requirement that external audit organizations performing GAGAS audits make their results of an external peer review public, and (2) revision of peer review time frames based on risk and the underlying quality assurance system.

The transparency requirement is intended to increase accountability and emphasize the importance of quality for audit organizations that perform audits under GAGAS. The revisions to peer review time frames are risk based and emphasize quality and a rigorous annual inspection program. (The previous standard set the same requirement for all audit organizations, regardless of peer review results or the underlying quality assurance system.)

Please comment on the transparency requirements and the risk-based approach to peer review time frames.

Chapters 4 and 5 – Financial Audits

7. The audit documentation standard has been updated and expanded based on the ASB’s revised standard, SAS No. 103, *Audit Documentation*. Paragraphs 4.22 through 4.39 are consistent with the AICPA standard. Paragraphs 4.40 and 4.41 are additional GAGAS standards to deal with unique issues associated with auditing in the government environment. The use of these standards is consistent for attest engagements (chapter 6) and performance audits (chapter 7). The overall goal of these revisions was consistency with the ASB standard and among the different types of GAGAS audits.

Please comment on the adoption of this standard.

8. The financial audit reporting standards have been updated to conform with the ASB's and PCAOB's definitions of material weakness and significant deficiency in internal controls. The definitions and related guidance are provided in paragraphs 5.13 and 5.14. The overall goal of adopting these revised definitions is to achieve consistency with the other standards setters. These definitions may be further clarified in the future by the other standards-setters, and we will continue to work closely with them. The application of these new definitions could affect the number and type of internal control weaknesses reported in GAGAS audits.

Please comment on additional clarity or guidance that would assist in implementing these new definitions.

Chapters 7 and 8 – Performance Audits

9. The standards for performance audits have been significantly revised to include a specified level of assurance within the context of audit risk and significance (materiality).

The level of assurance for performance audits is defined in paragraph 1.35 and incorporated throughout the performance audit standards in chapters 7 and 8. The level of assurance for performance audits is achieved within the context of significance (materiality) and audit risk. The description of significance and audit risk is included in paragraphs 7.04 through 7.06, and the standards in chapters 7 and 8 have been written within this context.

Please comment on the discussion of levels of assurance, significance, audit risk, and their application throughout the performance audit standards.

10. Significant discussion has been added to chapters 7 and 8 about the level of evidence needed to achieve the audit objectives in a performance audit. This discussion uses the terminology "sufficient, appropriate evidence" for consistency with other auditing standards setters. The intent of the discussion of sufficient, appropriate evidence is to provide clarity and guidance for making professional judgments about the levels of evidence needed to achieve the audit objectives.

Please comment on the clarity of the standards and the discussion of sufficient appropriate evidence.

Overall

11. The auditor's responsibility for abuse for financial audits (paragraphs 4.18 through 4.20), attestation engagements (6.17 through 6.22), and performance audits (7.34) has been clarified, but no change was made to the auditor's responsibility for abuse. The changes were in response to questions received about implementing the standard on abuse.

Please comment on the clarity of the definition of abuse. Please include in your comments any specific examples of abuse you have identified, along with supporting audit reports.

12. An appendix has been added to provide supplemental guidance to assist auditors in the implementation of GAGAS. This guidance does not establish any additional auditor requirements.

Please comment on the usefulness and need for the appendix.

Summary of Major Changes

Chapter 1 – Use and Application of GAGAS

Introduction and Purpose and Applicability of GAGAS were rewritten to emphasize the role of auditing in government accountability and the role of GAGAS in achieving improved government operations and accountability. (1.01 – 1.05)

Use of Terminology to Define Professional Requirements in GAGAS was added to modernize, harmonize, and clarify language used in the standards. (1.06 – 1.12)

- The Public Company Accounting Oversight Board (PCAOB), International Auditing and Assurance Standards Board (IAASB), and the American Institute of Certified Public Accountants (AICPA) have adopted similar standards to clarify auditors' responsibilities. GAGAS terminology is consistent with the AICPA's Statement on Auditing Standards No. 102, *Defining Professional Requirements in Statements on Auditing Standards*.
- All chapters were significantly revised to clarify auditors' responsibilities and to avoid the confusion that existed in previous versions of GAGAS through the use of the passive voice and other references that were unclear as to the requirement placed on the auditors.

Citing Compliance with GAGAS in the Auditors' Report provides guidance on citing GAGAS in the auditors' report when auditors do not comply with all unconditional or all presumptively mandatory requirements. (1.13 – 1.15)

Relationship Between GAGAS and Other Professional Standards has been updated to recognize that other sets of professional standards, such as those issued by the PCAOB and the IAASB, the Institute of Internal Auditors, and others can be used in conjunction with GAGAS and provides related guidance. (1.16 – 1.20)

Types of Government Audits and Attestation Engagements has been modified to re-write the description of a performance audit to clarify the level of assurance and evidence needed. The concept of equity as a potential performance audit objective was incorporated, and examples of the types of performance audits were updated. (1.21 – 1.42)

Chapter 2 – Auditors' Ethical Responsibilities

Chapter 2 has been completely revised to focus solely on audit organizations' overall ethics responsibilities and auditors' need to observe overarching ethical concepts in performing their work. (2.01 – 2.16) Other materials that had previously been in Chapter 2 have been included in Chapter 1 of the draft.

- Several of the ethical concepts in this chapter were included in the 2003 GAGAS revision in Chapter 1 under "Auditors' Responsibilities," but they were not separately labeled as ethical responsibilities.

- The revised Chapter 2 describes the following ethical concepts that auditors use to guide their work:
 - the public interest (2.05 – 2.07)
 - professional behavior (2.08 – 2.09)
 - integrity (2.10 – 2.11)
 - objectivity (2.12)
 - proper use of government information, resources, and position (2.13 – 2.16)

Chapter 3 – General Standards

Independence was reorganized and the guidance on nonaudit services was clarified to facilitate implementing the standard. The standard on nonaudit services was not changed. Specifically, the discussion of nonaudit services was moved from “personal” to “organizational” impairments because it is often the audit organization’s independence that is impaired rather than that of the individual auditor, reorganized the guidance into three categories of nonaudit services, and consolidated and streamlined examples that had previously been interspersed throughout the independence section. (3.02 – 3.35)

- The three distinct categories of nonaudit services are:
 1. Nonaudit services that do not impair auditor independence and, therefore, do not require compliance with the supplemental safeguards. (3.30a and 3.31 – 3.32)
 2. Nonaudit services that would not impair independence if supplemental safeguards are implemented. (3.30b and 3.33)
 3. Nonaudit services that impair independence (3.30c and 3.34)
- Additional guidance in the appendix was included to deal with nonaudit services that are frequently conducted by government audit organizations. (A3.02 – A3.03)

Professional Judgment was expanded to emphasize its importance and relate it to key steps in performing an audit. (3.36 – 3.45)

Competence was expanded and clarified. (3.46 – 3.58)

Quality Control and Assurance was expanded to describe five elements that should be present in an audit organization’s system of quality control: (1) ethics, (2) initiation and continuance of engagements, (3) human capital, (4) performance and reporting, and (5) monitoring quality. (3.61)

External Peer Review has been changed to include a transparency requirement that audit organizations that report externally to third parties make peer review results publicly available (3.68). The section also establishes new peer review time frames based on risk and the underlying quality assurance system (3.69). Audit organizations are required to have a peer review

- within 18 months, if the most recent peer review opinion is adverse or modified, and every 18 months thereafter until the audit organization receives an unmodified opinion
- every 3 years if the audit organization has an unmodified peer review opinion and does not meet the enhanced quality assurance criteria for a 5-year cycle or does not chose a 5-year period
- every 5 years if the audit organization has an unmodified peer review opinion and elects to meet the enhanced quality assurance criteria in 3.70.
- developed required enhanced quality assurance criteria for audit organizations electing a 5-year peer review cycle, including
 - a publicly available description of the audit organization’s quality assurance system (3.70a),
 - an effective annual internal quality inspection process that meets stated criteria (3.70b), and
 - a publicly available annual written assertion that is consistent with the results of the audit organization’s monitoring and inspection processes about the effectiveness of its quality assurance program [3.70b(3)].

Chapter 4—Field Work Standards for Financial Audits

The following changes have been made to update and clarify the standards for field work:

- update of the AICPA field work standards cited to reflect recent AICPA changes (4.04)
- addition of a clear and prominent discussion on consideration of fraud and illegal acts which clarifies the existing standard (4.07 – 4.08),
- clarifications to the description of abuse and the existing standard on the auditors’ responsibility for abuse in a financial audit that is material, either qualitatively or quantitatively (4.18 – 4.19), and
- update of the audit documentation standard for consistency with AICPA’s new standard (4.22 – 4.41).

Chapter 5—Reporting Standards for Financial Audits

The following changes have been made to update and clarify the reporting standards:

- update of definitions and terminology for internal control deficiencies to achieve consistency with PCAOB and AICPA terminology (5.12 – 5.15),
- clarification of reporting requirements for internal control deficiencies, illegal acts, violations of provisions of contracts or grant agreements, or abuse (5.12 – 5.27),
- addition of a section on emphasizing significant matters in the auditors’ report (5.28 – 5.31),
- addition of a section on reporting on restatement of previously-issued financial statements (5.32 – 5.38), and
- clarification of the auditors’ responsibilities for reporting views of responsible officials (5.39 – 5.44) and for issuing and distributing reports (5.48 – 5.51).

Chapter 6 – General, Field Work, and Reporting Standards for Attestation Engagements

Conforming changes were made to chapter 6 for consistency with changes in chapters 4 and 5.

Chapter 7 – Field Work Standards for Performance Audits

The field work standards for performance audits have been significantly revised within a framework related to significance (materiality), audit risk, and reasonable assurance. The following changes were made:

- addition of a section on the concept of significance in a performance audit (7.04 – 7.05),
- addition of a section discussing audit risk (7.06),
- definition of the level of assurance associated with a performance audit as providing reasonable assurance that auditors have adequate support to achieve the audit objectives and reach conclusions (7.13),
- clarification throughout chapter 7 of the levels of evidence needed to achieve audit objectives, recognizing that objectives vary and, therefore, so will the nature of evidence needed,
- incorporation of the concept of risk into the auditors’ planning and evaluation process,
- inclusion of a section on information systems controls for the purpose of assessing audit risk and planning the audit (7.25 – 7.27),
- emphasis of auditors’ professional judgment and the focus of audit work in relation to the audit objectives,
- clarification of the auditors’ responsibility for responding to indications of potential fraud (7.31 – 7.33),
- clarification of the auditors’ responsibility for abuse (7.34),

- incorporation throughout the standard of the concept of “sufficient, appropriate evidence” to replace “sufficient, competent, and relevant evidence.” This terminology is consistent with other standards setters. (7.53 – 7.69)
 - Appropriateness is defined as a measure of quality, which encompasses relevance, reliability, and validity in providing support for audit objectives. (7.56 – 7.62)
 - Sufficiency is defined as a measure of quantity and is evaluated based on the collective audit evidence supporting findings, conclusions, or recommendations related to the audit objectives. (7.63 – 7.64),
- description of and emphasis on the overall assessment of evidence to avoid confusion about how to apply the standards (7.65 – 7.69), and
- revision of the audit documentation section to conform with chapter 4. (7.74 – 7.92)

Chapter 8 – Reporting Standards for Performance Audits

The reporting standards were streamlined and conforming changes were made to reflect changes in Chapter 7. The auditors’ responsibilities for reporting the views of responsible officials (8.35 – 8.40) and report issuance and distribution (8.44 – 8.47) were clarified.

Appendix

An appendix has been added to provide supplemental guidance to assist auditors in the implementation of GAGAS. This guidance does not establish additional GAGAS requirements.

CONTENTS

LETTER.....	i
QUESTIONS FOR COMMENTERS.....	iii
SUMMARY OF MAJOR CHANGES.....	vii
CHAPTER 1.....	1
USE AND APPLICATION OF GAGAS	1
Introduction	1
Purpose and Applicability of GAGAS.....	1
Use of Terminology to Define Professional Requirements in GAGAS.....	3
Citing Compliance with GAGAS in the Auditors’ Report	5
Relationship Between GAGAS and Other Professional Standards	6
Types of Government Audits and Attestation Engagements.....	8
Financial Audits.....	9
Attestation Engagements.....	10
Performance Audits.....	12
Nonaudit Services Provided by Audit Organizations.....	18
CHAPTER 2.....	19
AUDITORS’ ETHICAL RESPONSIBILITIES.....	19
Introduction	19
Overarching Ethical Concepts	20
The Public Interest.....	21
Professional Behavior.....	21
Integrity.....	22
Objectivity	22
Proper Use of Government Information, Resources, and Position	23
GENERAL STANDARDS	25
Introduction	25

Independence	25
Personal Impairments.....	27
External Impairments.....	30
Organizational Independence.....	31
Organizational Independence When Reporting Externally to Third Parties:.....	32
Organizational Independence When Reporting Internally to Management (as an internal audit function).....	34
Organizational Independence When Performing Nonaudit Services.....	36
Professional Judgment	45
Competence	47
Technical Knowledge and Competence.....	48
Additional Qualifications for Financial Audits and Attestation Engagements.....	49
Continuing Professional Education.....	50
Quality Control and Assurance	52
System of Quality Control.....	52
External Peer Review.....	55
CHAPTER 4	63
CHAPTER 4	63
FIELD WORK STANDARDS FOR FINANCIAL AUDITS	63
Introduction	63
AICPA Field Work Standards	63
Additional Considerations for Financial Audits in Government.....	64
Consideration of Potential Fraud in a Financial Statement Audit and Illegal Acts by Auditees.....	65
Additional GAGAS Standards	66
Auditor Communication.....	67
Previous Audits and Attestation Engagements.....	69
Detecting Material Misstatements Resulting from Violations of Contract Provisions or Grant Agreements, or from Abuse.....	70
Developing Elements of a Finding.....	71
Audit Documentation.....	72
CHAPTER 5	78
REPORTING STANDARDS FOR FINANCIAL AUDITS	78
Introduction	78

AICPA Reporting Standards	78
Additional GAGAS Reporting Standards for Financial Audits.....	79
Reporting Auditors' Compliance with GAGAS	80
Reporting on Internal Control and on Compliance with Laws, Regulations, and Provisions of Contracts or Grant Agreements.....	81
Reporting Deficiencies in Internal Control, Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse	82
Reporting Deficiencies in Internal Control.....	82
Reporting Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse.....	86
Direct Reporting of Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse.....	88
Emphasizing Significant Matters in the Auditors' Report	89
Reporting on Restatement of Previously-Issued Financial Statements	91
Reporting Views of Responsible Officials	95
Reporting Privileged and Confidential Information.....	97
Issuing and Distributing Reports.....	97
 CHAPTER 6.....	 100
 GENERAL, FIELD WORK, AND REPORTING STANDARDS FOR ATTESTATION ENGAGEMENTS.....	 100
Introduction	100
AICPA General and Field Work Standards for Attestation Engagements	100
Additional Considerations for Attestation Engagements in Government.....	101
Additional GAGAS Field Work Standards for Attestation Engagements.....	102
Auditor Communication	103
Previous Audits and Attestation Engagements.....	104
Internal Control	105
Detecting Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse That Could Have a Material Effect on the Subject Matter.....	106
Developing Elements of Findings for Attestation Engagements.....	109
Attest Documentation.....	110
AICPA Reporting Standards for Attestation Engagements.....	116
Additional GAGAS Reporting Standards for Attestation Engagements.....	117
Reporting Auditors' Compliance with GAGAS	117
Reporting Deficiencies in Internal Control, Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse	118
Reporting Deficiencies in Internal Control.....	118
Direct Reporting of Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse.....	121
Reporting Views of Responsible Officials	123

Reporting Privileged and Confidential Information.....	124
Issuing and Distributing Reports.....	125
CHAPTER 7.....	127
FIELD WORK STANDARDS FOR PERFORMANCE AUDITS.....	127
Introduction	127
Significance in a Performance Audit.....	127
Audit Risk	128
Sufficient, Appropriate Evidence.....	129
Planning	129
Nature and Profile of the Program.....	132
Internal Control	135
Information Systems Controls.....	138
Legal and Regulatory Requirements, Contract Provisions, or Grant Agreements, Potential Fraud, or Abuse.....	140
Legal and Regulatory Requirements, Contracts, and Grants.....	141
Fraud	141
Abuse	143
Previous Audits and Attestation Engagements.....	144
Identifying Audit Criteria.....	144
Identifying Sources of Audit Evidence and the Amount and Type of Evidence Required	145
Considering Work of Others.....	146
Assigning Staff and Other Resources.....	147
Communicating with Management, Those Charged with Governance, and Others....	148
Preparing the Audit Plan	149
Supervision	150
Obtaining Sufficient, Appropriate Evidence	151
Appropriateness.....	151
Sufficiency.....	154
Overall Assessment of Evidence	155
Audit Findings.....	158
Audit Documentation.....	159
CHAPTER 8.....	166
REPORTING STANDARDS FOR PERFORMANCE AUDITS	166
Introduction	166

Reporting	166
Report Contents	167
Objectives, Scope, and Methodology	167
Findings	169
Reporting Deficiencies in Internal Control.....	172
Reporting Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse.....	173
Direct Reporting of Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse.....	174
Conclusions.....	175
Recommendations.....	176
Statement on Compliance with GAGAS	176
Reporting Views of Responsible Officials	177
Reporting Privileged and Confidential Information.....	179
Report Issuance and Distribution	180
APPENDIX	181
Introduction	181
Overall Supplemental Guidance	181
Examples of Significant Deficiencies in Internal Control.....	181
Examples of Abuse.....	183
Examples of Indicators of Fraud Risk.....	183
Determining Whether Laws, Regulations, or Provisions of Contracts or Grant Agreements Are Significant to Audit Objectives	184
Information to Accompany Chapter 1.....	185
The Role of Those Charged with Governance in Accountability	186
Management’s Role in Accountability.....	186
Laws, Regulations, and Guidelines that Require Use of GAGAS.....	188
Information to Accompany Chapters 3	189
Nonaudit Services.....	190
Information to Accompany Chapter 7.....	192
Types of Evidence	192
Appropriateness of Information in Relation to the Audit Objectives.....	193
MEMBERS OF THE COMPTROLLER GENERAL’S ADVISORY COUNCIL ON GOVERNMENT AUDITING STANDARDS.....	196

Chapter 1

Use and Application of GAGAS

Introduction

1.01 Government auditing is essential to the government’s responsibility of accountability to the public. Government audits are intended to provide an independent, objective, nonpartisan assessment of the stewardship, performance, and cost of government policies, programs, and operations.

1.02 The concept of accountability for use of public resources and government authority is key in our nation’s governing processes. Government officials entrusted with public resources are responsible for carrying out public functions efficiently, economically, effectively, ethically, equitably,¹ and legally. Government managers are responsible for providing reliable and useful information for accountability of government programs and their operations.² Legislators, government officials, and the public need to know whether (1) government manages public resources and uses its authority properly and in compliance with laws and regulations, (2) government programs are achieving their objectives and desired outcomes, (3) government services are being provided efficiently, economically, effectively, ethically, and equitably, and (4) government managers are held fully accountable for their use of public resources. Government auditing provides independent assessments of that information for the benefit of those charged with oversight and for the public.

Purpose and Applicability of GAGAS

1.03 The professional standards and guidance contained in this document, often referred to as generally accepted government auditing standards (GAGAS), are intended

¹ The term equity in this context refers to the approaches used by a government organization to provide services to citizens in a fair manner within the context of the statutory parameters of the specific government programs.

² For additional information on management’s responsibility, see appendix paragraphs A1.01-A1.05.

for use by auditors³ of government entities and audit organizations⁴ to help ensure that they perform high quality work with competence, integrity, objectivity, and independence in planning, conducting, and reporting on government audits. Auditors and audit organizations use GAGAS when required by law, regulation, contract, grant agreement, or policy.

1.04 The standards and guidance in this document apply to auditors who conduct audits and attestation engagements of government entities, programs, activities, and functions, and of government assistance administered by contractors, nonprofit entities, and other nongovernmental entities. If auditors hold themselves out as complying with GAGAS, regardless of whether the auditors are required to follow such standards, the auditors should follow all applicable GAGAS standards, and refer to compliance with GAGAS as set forth in paragraphs 1.13 through 1.15.

1.05 GAGAS contain standards dealing with ethics, independence, auditors' professional competence and judgment, quality control, the performance of field work, and reporting. GAGAS are intended to help ensure that audits and attestation engagements performed under GAGAS provide reasonable assurance about the information needed for oversight and accountability of government programs and operations by requiring auditors to objectively acquire and evaluate evidence and report the results. When auditors perform their work in this manner and comply with GAGAS in reporting the results, their work can lead to improved government management, decision making and oversight, effective and efficient operations, and accountability for resources and results. Government auditing is also a key element in fulfilling the government's duty to be accountable to the public.

³ The term "auditor" throughout this document includes individuals performing work under GAGAS, and therefore, individuals who may have the titles auditor, analyst, evaluator, inspector, or other similar titles.

⁴ The term "audit organizations" is used throughout the standards to refer to government audit organizations as well as independent public accounting firms that perform audits using GAGAS.

Use of Terminology to Define Professional Requirements in GAGAS

1.06 GAGAS contain professional requirements together with related guidance in the form of explanatory material.⁵ Auditors have a responsibility to consider the entire text of GAGAS in carrying out their work on an engagement and in understanding and applying the professional requirements of the relevant standards.

1.07 Not every paragraph of GAGAS carries a professional requirement that the auditors are expected to fulfill. Rather, the professional requirements are communicated by the language and the meaning of the words used in GAGAS.

1.08 GAGAS use two categories of professional requirements, identified by specific terms, to describe the degree of responsibility they impose on auditors, as follows:

a. Unconditional requirements. The auditor is required to comply with an unconditional requirement in all cases in which the circumstances exist to which the unconditional requirement applies. GAGAS use the words *must* or *is required* to indicate an unconditional requirement.

b. Presumptively mandatory requirements. The auditor is also required to comply with a presumptively mandatory requirement in all cases in which the circumstances exist to which the presumptively mandatory requirement applies; however, in rare circumstances, the auditor may depart from a presumptively mandatory requirement provided the auditor documents his or her justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. GAGAS use the word *should* to indicate a presumptively mandatory requirement.

⁵ The terminology used in GAGAS to designate professional requirements and explanatory material is consistent with the AICPA's Statement on Auditing Standard No. 102, *Defining Professional Requirements in Statements on Auditing Standards*.

1.09 If GAGAS provide that a procedure or action is one that the auditor “should consider” the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not. The professional requirements of GAGAS are to be understood and applied in the context of the explanatory material that provides guidance for their application.

1.10 Explanatory material is defined as the text within GAGAS that may:

- a.** provide further explanation and guidance on the professional requirements; or
- b.** identify and describe other procedures or actions relating to the activities of the auditor.

1.11 Explanatory material that provides further explanation and guidance on the professional requirements is intended to be descriptive rather than imperative. That is, it may explain the objective of the professional requirements (where not otherwise self-evident); explain why the auditor might consider or employ particular procedures, depending on the circumstances; or provide additional information for the auditor to consider in exercising professional judgment in performing the engagement.

1.12 Explanatory material that identifies and describes other procedures or actions relating to the activities of the auditor is not intended to impose a professional requirement on the auditor to perform the suggested procedures or actions. How and whether the auditor carries out such procedures or actions in the engagement depends on the exercise of professional judgment in the circumstances consistent with the objective of the standard. The words *may*, *might*, and *could* are used to describe these actions and procedures.

Citing Compliance with GAGAS in the Auditors' Report

1.13 Auditors should include one of the following types of GAGAS compliance statements in reports on GAGAS engagements, as appropriate, based on the provisions of paragraphs 1.14 through 1.15.

a. Unqualified GAGAS compliance statement. The auditors state that the engagement was performed in accordance with GAGAS.

b. Qualified GAGAS compliance statement. The auditors state that the engagement was performed in accordance with GAGAS, except for specific applicable standards that were not followed.

c. Negative GAGAS compliance statement. The auditors state that the engagement was not performed in accordance with GAGAS.

1.14 When auditors comply with all applicable unconditional and presumptively mandatory GAGAS requirements, they should include an unqualified GAGAS compliance statement in the audit report. (See paragraphs 5.05, 6.47, and 8.33.)

1.15 When auditors did not comply with applicable unconditional and/or presumptively mandatory requirements, they should assess the significance of not following the requirement to the scope of the audit and the auditors' overall compliance with GAGAS and document the assessment, along with the reasons for not following the standard. Based on this assessment, the auditors should determine whether and to what extent to disclose in the report the applicable standard(s) not followed, the reasons for not following the standard(s), and how not following the standards affected, or could have affected the audit. In addition, auditors should consider modifying the GAGAS compliance statement as follows. These determinations are a matter of professional judgment:

- a.** When auditors do not comply with all unconditional requirements that are applicable based on the audit objectives, they should determine whether to include a qualified GAGAS compliance statement or a negative GAGAS compliance statement in the report.

- b.** When auditors do not comply with all presumptively mandatory requirements that are applicable based on the audit objectives, they should determine whether to include a qualified GAGAS compliance statement or an unqualified GAGAS compliance statement in the report. When auditors have justification for not following a presumptively mandatory requirement, an unqualified GAGAS statement may be appropriate.

- c.** When auditors did not comply with multiple presumptively mandatory requirements, they should determine whether they should include a negative GAGAS compliance statement in the report.

Relationship Between GAGAS and Other Professional Standards

1.16 Auditors may use GAGAS in conjunction with professional standards issued by other authoritative bodies. If there are conflicts between the standards, and the auditors cannot satisfy both standards, the auditors should provide disclosure in the auditors' report about any standards not followed and the impact on the audit. (See paragraphs 5.06, 6.47 and 8.34)

1.17 Auditors use professional judgment in determining how to follow GAGAS and the other standards, and how to handle any inconsistencies between GAGAS and other standards.

1.18 For financial audits, GAGAS incorporate other professional standards, as follows:

- a.** The American Institute of Certified Public Accountants (AICPA) has established professional standards that apply to financial audits and attestation engagements for

nonissuers⁶ performed by certified public accountants (CPA). For financial statement audits, GAGAS incorporate the AICPA's field work and reporting standards and the related statements on auditing standards (SAS) unless specifically excluded or modified by GAGAS.⁷

b. The International Auditing and Assurance Standards Board (IAASB) has established professional standards that apply to financial audits and attestation engagements that are conducted internationally. Auditors may use GAGAS in conjunction with the IAASB standards and the related statements on International Statements on Auditing (ISA).

c. The Public Company Accounting Oversight Board (PCAOB) has established professional standards that apply to financial audits and attestation engagements for issuers. Auditors may use GAGAS in conjunction with the PCAOB standards.

1.19 For attestation engagements, GAGAS incorporate the AICPA's general standard on criteria, and the field work and reporting standards and the related statements on the standards for attestation engagements (SSAE), unless specifically excluded or modified by GAGAS.

1.20 For performance audits, auditors may use other professional standards in conjunction with GAGAS, such as the following:

a. *International Standards for the Professional Practice of Internal Auditing*, The Institute of Internal Auditors, Inc.;

⁶Under the Sarbanes-Oxley Act of 2002 (Public Law 107-204), issuers (generally, publicly traded companies with securities registered under the Securities and Exchange Act of 1934) and their public accounting firms are subject to rules and standards of the Public Company Accounting Oversight Board. Nonissuer refers to any entity other than an issuer under Federal securities laws, such as privately held companies, not-for-profit entities, and government entities.

⁷ Because GAGAS incorporate the field work and reporting standards of the AICPA for financial audits performed in which U.S. auditing standards are to be followed, auditors are not required to cite compliance with the AICPA standards when citing compliance with GAGAS, although both sets of standards may be cited.

- b. *Guiding Principles for Evaluators*, American Evaluation Association;
- c. *The Program Evaluation Standards*, Joint Committee on Standards for Education Evaluation; and
- d. *Standards for Educational and Psychological Testing*, American Psychological Association.

Types of Government Audits and Attestation Engagements

1.21 This section describes the types of audits and attestation engagements that audit organizations may perform under GAGAS. This description is not intended to limit or require the types of audits or attestation engagements that may be performed under GAGAS.

1.22 All engagements begin with objectives, and those objectives determine the type of work to be performed and the applicable standards to be followed. The types of work, as defined by their objectives that are covered by GAGAS, are classified in this document as financial audits, attestation engagements, and performance audits.

1.23 In some engagements, the standards applicable to the specific audit objective will be apparent. For example, if the audit objective is to express an opinion on financial statements, the standards for financial audits apply. However, some engagements may have multiple or overlapping objectives. For example, if the objectives are to determine the reliability of performance measures, this work can be done in accordance with either the standards for attestation engagements or for performance audits. In cases where there is a choice between applicable standards, auditors should evaluate users' needs and the auditors' knowledge, skills, and experience in deciding which standards to follow.

Financial Audits

1.24 Financial audits provide an independent assessment of whether an entity's reported financial condition, results, and use of resources are presented fairly in accordance with recognized criteria. Reporting on financial audits performed in accordance with GAGAS also includes reports on internal control, compliance with laws and regulations, and provisions of contracts and grant agreements as they relate to financial transactions, systems, and processes.

1.25 The primary purpose of a financial audit is to provide an opinion (or disclaim an opinion) about whether an entity's financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP),⁸ or with a comprehensive basis of accounting other than GAAP. Other types of financial audits, which provide for different levels of assurance and entail various scopes of work, may include:

- a. providing special reports, such as for specified elements, accounts, or items of a financial statement;⁹
- b. reviewing interim financial information;
- c. issuing letters for underwriters and certain other requesting parties;
- d. reporting on the processing of transactions by service organizations; and

⁸ The three U.S.-based authoritative bodies for establishing accounting principles and financial reporting standards are the Federal Accounting Standards Advisory Board (federal government), the Governmental Accounting Standards Board (state and local governments), and the Financial Accounting Standards Board (nongovernmental entities).

⁹ Special reports apply to auditors' reports issued in connection with the following: (1) financial statements that are prepared in conformity with a comprehensive basis of accounting other than generally accepted accounting principles; (2) specified elements, accounts, or items of a financial statement; (3) compliance with aspects of contractual agreements or regulatory requirements related to audited financial statements; (4) financial presentations to comply with contractual agreements or regulatory requirements; or (5) financial information presented in prescribed forms or schedules that require a prescribed form of auditors' report. (See *AICPA Professional Standards*, AU 623.)

e. auditing compliance with regulations relating to federal award expenditures and other governmental financial assistance in conjunction with or as a by-product of a financial statement audit.

1.26 For financial statement audits, GAGAS incorporate the AICPA’s field work and reporting standards and the related statements on auditing standards unless specifically excluded or modified by GAGAS. GAGAS establish ethical responsibilities, independence standards, general standards, and additional field work and reporting standards beyond those provided by the AICPA when performing financial audits. (See chapters 2, 3, 4, and 5 for standards and guidance for auditors performing a financial audit in accordance with GAGAS.)

1.27 For financial statement audits, GAGAS can also be used in conjunction with standards issued by the PCAOB or IAASB. (See paragraphs 1.16–1.18.)

Attestation Engagements

1.28 The primary purpose of an attestation engagement¹⁰ is to report on a subject matter or management’s assertions about a subject matter compared with stated criteria. Attestation engagements can cover a broad range of financial or nonfinancial objectives and may provide different levels of assurance about the subject matter or assertion depending on the users’ needs.

1.29 In an attestation engagement, auditors issue an examination, a review, or an agreed-upon procedures report on a subject matter or on an assertion about a subject matter, that is the responsibility of another party. Attestation engagements can cover a broad range of financial or nonfinancial objectives and can be part of an audit or a separate engagement. The three levels of attestation engagements include the following:

¹⁰ For consistency within GAGAS, the word “auditor“ is used to describe individuals conducting and reporting on attestation engagements.

a. Examination: Auditors perform sufficient testing to express an opinion on whether the subject matter is based on (or in conformity with) the criteria in all material respects or the assertion is presented (or fairly stated), in all material respects, based on the criteria.

b. Review: Auditors perform sufficient testing to express a conclusion about whether any information came to the auditors' attention on the basis of the work performed that indicates the subject matter is not based on (or in conformity with) the criteria or the assertion is not presented (or fairly stated) in all material respects based on the criteria.¹¹

c. Agreed-Upon Procedures: Auditors perform testing to issue a report of findings based on specific procedures performed on subject matter.

1.30 The subject matter of an attestation engagement may take many forms, including historical or prospective performance or condition, physical characteristics, analyses, internal controls, systems and processes, or compliance with laws, regulations, contracts, or other requirements. Possible subjects of attestation engagements could include reporting on:

a. prospective financial or performance information;

b. quantity, condition, and/or valuation of inventory or assets;

c. management's discussion and analysis (MD&A) presentation;

d. an entity's internal control over financial reporting;

¹¹ As stated in the AICPA SSAEs, auditors should not perform review-level work for reporting on internal control or compliance with laws and regulations.

e. the effectiveness of an entity's internal control over compliance with specified requirements, such as those governing the bidding for, accounting for, and reporting on grants and contracts;

f. an entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants; and

g. specific procedures performed on a subject matter (agreed-upon procedures).

1.31 For attestation engagements, GAGAS incorporate the AICPA's general standard on criteria, and the field work and reporting standards and the related Statements on Standards for Attestation Engagements (SSAE), unless specifically excluded or modified by GAGAS. GAGAS establish ethical responsibilities, independence standards, general standards and additional field work and reporting standards beyond those provided by the AICPA for attestation engagements. (See chapters 2, 3, and 6 for standards and guidance for auditors performing an attestation engagement in accordance with GAGAS.)

1.32 As discussed in paragraph 1.19, GAGAS incorporate the AICPA's general standard on criteria, the field work and reporting standards and the related statements on the standards for attestation engagements when performing attestation engagements.

Performance Audits

1.33 Performance audits provide assurance or conclusions relating to audit objectives that provide an evaluation against objective criteria, such as specific requirements or measures, or good business practices.¹² Performance audits provide objective analysis so that management and those charged with governance and oversight may improve

¹² Data gathering without auditor evaluation or verification of the data is not a performance audit, but a nonaudit service.

program¹³ performance, operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability. Performance audits can also provide descriptive information in response to audit objectives to describe a process or a condition. The term performance audit includes audits classified by some audit organizations as program or performance evaluations, program effectiveness and results audits, economy and efficiency audits, operational audits, management audits, compliance audits, and value-for-money audits.

1.34 Audit objectives for performance audits may vary widely and may encompass a variety of objectives, including assessing program economy, efficiency, effectiveness, results, or equity; internal control;¹⁴ compliance with legal, policy, procedural, or other requirements; and providing assurance about prospective analyses, guidance, or summary information. These overall objectives are not mutually exclusive. Thus, a performance audit may have more than one overall objective. For example, often a performance audit with an initial objective of program effectiveness may also involve an underlying objective of evaluating internal controls to determine the reasons for a program's lack of effectiveness or how effectiveness can be improved.

1.35 Performance audits provide reasonable assurance that the auditors have sufficient, appropriate evidence concerning the achievement of the audit objectives and the conclusions reached. For descriptive audit objectives, the audit provides reasonable assurance about the descriptive information. The levels of evidence and tests of evidence will vary based on the audit objectives and conclusions. Objectives for performance audits range from narrow to broad and may involve specific evidence or extensive evidence. In some engagements, sufficient, appropriate evidence is easily obtained, and in others, information may have limitations. Auditors use professional judgment in determining the audit scope and methodology needed to address the audit's

¹³ The term "program" is used in this document to include government entities, organizations, programs, activities, and functions.

¹⁴ The term "internal control" in this document is synonymous with the term management control and, unless otherwise stated, covers all aspects of an entity's operations (programmatic, financial, and compliance).

objectives, while providing the appropriate level of assurance that the evidence obtained is sufficient and appropriate to meet the audit's objectives.

1.36 A performance audit is a dynamic, iterative process which includes consideration of the applicable standards taken as a whole throughout the course of the audit. An ongoing reassessment of the objectives, audit risk, audit procedures, and evidence during the course of the audit facilitates the auditors' determination of what to report and the proper context for the audit conclusions, including discussion about the nature, type, and quality of evidence being used as a basis for the audit conclusions. Performance audit conclusions logically flow from all of these elements, and include the proper context based on the underlying evidence.

1.37 The audit objectives for performance audits generally fall into the following categories: program effectiveness and results, economy and efficiency, internal control, compliance, and prospective analysis.

1.38 Program effectiveness and results audit objectives are frequently interrelated with economy and efficiency objectives. Audit objectives that focus on program effectiveness and results address the effectiveness of a program and typically measure the extent to which a program is achieving its goals and objectives. Audit objectives that focus on economy and efficiency address the costs and resources used to achieve program results. Examples of audit objectives in these categories include:

- a.** assessing the extent to which legislative, regulatory, or organizational goals and objectives are being achieved;
- b.** assessing the relative ability of alternative approaches to yield better program performance or eliminate factors that inhibit program effectiveness;

- c.** analyzing the relative cost effectiveness of a program or activity;¹⁵

- d.** determining whether a program produced intended results or produced results that were not consistent with the program's objectives;

- e.** determining whether a program provides equitable access to or distribution of public resources within the context of statutory parameters;

- f.** assessing the extent to which programs duplicate, overlap, or conflict with other related programs;

- g.** evaluating whether the audited entity is following sound and equitable procurement practices;

- h.** assessing the reliability, validity, or relevance of performance measures concerning program effectiveness and results, or economy and efficiency;

- i.** assessing the reliability, validity, or relevance of financial information related to the performance of a program;

- j.** determining whether government resources (inputs) are obtained at reasonable costs while meeting timeliness and quality considerations;

- k.** determining whether appropriate value was obtained based on the cost or amount paid;

- l.** determining whether government services and benefits are accessible to those citizens who have a right to access those services and benefits;

¹⁵ These objectives focus on combining cost information with information about outputs or the benefit provided and outcomes or the results achieved.

m. determining whether and how the government program's unit costs can be decreased or its productivity increased; and

n. analyzing budget proposals or budget requests to assist legislatures in the budget process.

1.39 Internal control audit objectives relate to an assessment of the component of an organization's system of internal control that is designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, and compliance with applicable laws and regulations. Internal control objectives are also relevant when determining the cause of unsatisfactory program performance. Internal control comprises the plans, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal control includes the processes and procedures for planning, organizing, directing, and controlling program operations, and management's system for measuring, reporting, and monitoring program performance. Examples of audit objectives related to internal control include an assessment of the extent that internal control provides reasonable assurance that:

a. organizational missions, goals, and objectives are achieved effectively and efficiently;

b. resources are used in compliance with laws, regulations, or other requirements;

c. resources are safeguarded against unauthorized acquisition, use, or disposition;

d. management information and public reports that are produced, such as performance measures, are complete, accurate, and consistent to support performance and decision making;

e. the integrity of computerized information and information systems are achieved, and

f. contingency planning for information systems provides essential back-up to prevent unwarranted disruption of activities and functions the systems support.

1.40 Compliance audit objectives relate to compliance criteria established by laws, regulations, contract provisions, grant agreements, and other requirements¹⁶ that could affect the acquisition, protection, and use of the entity's resources and the quantity, quality, timeliness, and cost of services the entity produces and delivers. Compliance objectives include determining whether

a. the purpose of the program, the manner in which it is to be conducted, the services delivered, the outcomes, or the population it serves are in compliance with laws, regulations, contract provisions, grant agreements, and other requirements;

b. government services and benefits are distributed or delivered to citizens based on the citizens' right to obtain those services and benefits; and

c. incurred or proposed costs are in compliance with applicable laws, regulations, and contract or grant agreement terms.

1.41 Prospective audit objectives provide analysis or conclusions about information that is based on assumptions about events that may occur in the future along with possible actions that the audited entity may take in reaction to the future events. Examples of objectives pertaining to this work include providing analysis or conclusions about:

a. current and projected trends and future potential impact on government programs and services;

b. program or policy alternatives, including forecasting program outcomes under various assumptions;

¹⁶ Compliance requirements can be either financial or nonfinancial in nature.

- c. policy proposals for decision makers;
- d. prospective information prepared by management;
- e. forecasts that are based on (1) assumptions about expected future events and (2) management's expected reaction to those future events; and
- f. management's assumptions on which prospective information is based.

1.42 As discussed in paragraphs 1.16 through 1.17 and 1.20, other professional standards may be used in conjunction with GAGAS when conducting performance audits.

Nonaudit Services Provided by Audit Organizations

1.43 GAGAS do not cover nonaudit services since such services are not audits or attestation engagements. Therefore, auditors should not report that the nonaudit services were conducted in accordance with GAGAS. However, audit organizations may report that nonaudit services were conducted in compliance with the audit organization's internal quality control system and/or with any other applicable standards, guidance, or generally accepted practices. When performing nonaudit services, audit organizations have a responsibility to communicate with requestors and other users, as appropriate, in order to clarify that the scope of work performed does not constitute an audit under GAGAS.

1.44 Audit organizations that provide nonaudit services should evaluate whether providing nonaudit services creates an independence impairment either in fact or appearance with respect to the entities they audit. Further discussion of nonaudit services and potential impact on auditor independence is included in Chapter 3, paragraphs 3.24 through 3.35 and in the appendix, paragraphs A3.02 through A3.03.

Chapter 2 **Auditors' Ethical Responsibilities**

Introduction

2.01 Because government auditing is essential to government accountability to the public, government auditors have ethical responsibilities to uphold and protect the public trust. The public expects audit organizations and auditors in the government environment to conduct their audit work in accordance with ethical principles. Management of the audit organization sets the tone for ethical behavior throughout the organization by maintaining an ethical culture, clearly communicating acceptable behavior and expectations to each employee, and creating a positive work environment. The ethical values maintained and demonstrated by management and staff are an essential element of a positive ethical environment for the audit organization.

2.02 While audit organizations have overall responsibility for creating the environment to promote conducting audit work in accordance with ethical principles, ethics are also a matter of personal responsibility. It is essential that government auditors observe overarching ethical concepts in the performance of their professional responsibilities. Ethical concepts apply in preserving auditor independence,¹⁷ taking on work that the auditor is competent to perform, performing high quality work, and following applicable standards when cited in the audit report. Integrity and objectivity are maintained when auditors complete their work and make decisions that are consistent with the broader interest of those relying on the auditors' report, including the public.

¹⁷ Independence requirements are discussed in chapter 3.

Overarching Ethical Concepts

2.03 The overarching ethical concepts contained in the following sections provide the overall framework for application of the GAGAS standards, including general standards, field work standards, and reporting standards for auditors' use in performing their professional responsibilities. It is essential that government auditors conduct their work in such a manner that these concepts are observed throughout all of their professional activities. Each concept is presented in a descriptive manner, rather than setting forth a series of requirements, so that auditors can consider the facts and circumstances of each situation within the framework of these ethical concepts. Auditors also have a responsibility to understand and comply with other ethical requirements or codes of professional conduct, when applicable.¹⁸

2.04 The ethical concepts that guide the work of government auditors include:

- a.** The Public Interest;
- b.** Professional Behavior;
- c.** Integrity;
- d.** Objectivity; and
- e.** Proper Use of Government Information, Resources and Position.

¹⁸ Individual auditors who are members of professional organizations or are licensed or certified professionals may also be subject to ethical requirements of those professional organizations or licensing bodies. Auditors in government audit organizations may also be subject to government ethics laws and regulations.

The Public Interest

2.05 The public interest is defined as the interests of those relying on the auditors' work, including the public. In discharging their professional responsibilities, auditors observe the principles of serving the public interest by maintaining the highest degree of integrity, objectivity, and independence. These principles are fundamental to the responsibilities of auditors and critical in the government environment.

2.06 A distinguishing mark of a professional auditor is acceptance of responsibility toward the public interest. This responsibility is critical when auditing in the government environment. Therefore, it is critical that auditors in the government environment act in a way that will serve the public interest and honor the public trust. GAGAS embody the concept of accountability for public resources, which is fundamental to serving the public interest.

2.07 In discharging their professional responsibilities, auditors may encounter conflicting pressures from management of the audited entity, various levels of government, and others who rely on the auditors' work. In resolving those conflicts, auditors have a responsibility to act with integrity, guided by the precept that when auditors fulfill their responsibilities, the public interest is best served.

Professional Behavior

2.08 It is essential that auditors' professional behavior include compliance with laws and regulations and acting in a manner consistent with the high expectations for their profession, while avoiding any conduct that might bring discredit to their work, including actions that would cause a reasonable and informed third party, having knowledge of all relevant information to conclude that the conduct or work performed by the government auditors or audit organization was professionally deficient. Professional behavior includes auditors putting forth an honest effort in the performance of their duties and

carrying out their professional services in accordance with the relevant technical and professional standards.

2.09 The professional behavior of auditors practicing in the government environment is expected to be above reproach. Professional behavior is realized when auditors conduct themselves in a manner that avoids having their actions and work misinterpreted or that gives the appearance of being biased or misleading. By observing ethical principles, auditors promote confidence in the integrity of government operations and programs.

Integrity

2.10 Public confidence in government is maintained and enhanced by accountability professionals such as auditors performing their professional responsibilities with the highest degree of integrity. Integrity includes auditors conducting their work with an attitude that is objective, fact-based, nonpartisan, and non-ideological with regard to audited entities and users of the auditors' reports. It is crucial for auditors to be honest, candid, and constructive with the audited entity and users of the auditors' work in the conduct of their work, within the constraints of the audited entity's confidentiality laws, rules, or policies.

2.11 Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of the principles of fairness and objectivity to personal gains. In applying the principle of integrity, it is essential that auditors observe both the form and the spirit of the relevant ethical standards.

Objectivity

2.12 The credibility of government auditing is based on auditors' objective attitude in discharging their professional responsibilities. Objectivity includes being independent in fact and appearance when providing audit and attestation services, maintaining an

attitude of impartiality, having intellectual honesty, and being free of conflicts of interest. It is crucial that auditors avoid conflicts that may in fact or appearance impair auditors' objectivity in performing the audit or attestation engagement. Maintaining objectivity includes a continuing assessment of relationships with audited entities and other stakeholders in the context of the auditors' responsibility to the public.

Proper Use of Government Information, Resources, and Position

2.13 Government information, resources, or positions are to be used for official purposes and not misused for the auditor's personal gain or in a manner that would be contrary to the law or detrimental to the legitimate interests of the audited entity or the audit organization. This concept also includes the proper handling of sensitive or classified information or resources.

2.14 In the government environment, the public's right to the transparency of government information has to be balanced with the proper use of government information. To accomplish this balance, it is important that auditors exercise prudence in the use of information acquired in the course of their duties or as a result of professional and business relationships. Auditors should not disclose any such information to third parties without proper and specific authority, unless there is a legal and professional right or obligation to disclose.

2.15 As government accountability professionals, auditors are accountable to the public for their own proper use and prudent management of government resources. It is important that auditors protect and conserve government resources and not use them for other than authorized activities.

2.16 It is a fundamental responsibility of government auditors to conduct themselves in such a manner that they do not misuse their positions for personal gain. It is important that auditors not take any action that could be perceived by a knowledgeable person as benefiting their personal financial interests or those of an immediate or close family

member; a general partner; an organization for which the auditor serves as an officer, director, trustee, or employee; or a person or organization with which the auditor is negotiating or has an arrangement concerning future employment. (See paragraph 3.06 through 3.09 for further discussion of personal impairments to independence.)

Chapter 3

General Standards

Introduction

3.01 This chapter establishes general standards and provides guidance for performing financial audits, attestation engagements,¹⁹ and performance audits under GAGAS. These general standards, along with the overarching ethical concepts presented in chapter 2, establish a foundation that adds credibility to auditors' work. Credibility is essential to all audit organizations performing work that government leaders and others use for making decisions and achieving government accountability. Credibility is what the public expects of information provided by government auditors. These general standards emphasize the independence of the audit organization and its individual auditors; the exercise of professional judgment in the performance of work and the preparation of related reports; the competence of audit staff; audit quality control and assurance; and external peer reviews.

Independence

3.02 In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, must be free both in fact and appearance from personal, external, and organizational impairments to independence.

3.03 Auditors and audit organizations must maintain independence so that opinions, conclusions, judgments, and recommendations will be impartial and will be viewed as impartial by knowledgeable third parties. Auditors have a responsibility to avoid situations that could lead reasonable and objective third parties with knowledge of the relevant facts and circumstances to conclude that the auditors are not able to maintain

¹⁹ See chapter 6 for an additional general standard applicable to an attestation engagement.

independence and, thus, are not capable of exercising objective and impartial judgment on all issues associated with conducting the audit and reporting on the work.

3.04 When evaluating whether independence impairments exist either in fact or appearance with respect to the entities for which audit organizations perform audit or attestation services, audit organizations consider three general classes of impairments to independence—personal, external, and organizational.²⁰ If one or more of these impairments affects an individual auditor’s capability to perform the work and report results impartially, the auditor should either decline to perform the work—or in those situations in which the auditor, because of a legislative requirement or for other reasons, cannot decline to perform the work—the auditors must disclose the impairment or impairments in the scope section of the audit report.

3.05 When auditors use the work of a specialist,²¹ auditors should assess the specialist’s ability to perform the work and report results impartially. In conducting this assessment, auditors should provide external specialists with the GAGAS independence requirements and obtain representations from the specialist regarding the specialist’s independence from the activity or program under audit. Internal specialists who are members of the audit team should follow the same standards and processes as the other members of the audit team.

²⁰ When applicable, auditors also follow the AICPA code of professional conduct and the code of professional conduct of the state board with jurisdiction over the practice of the public accountant and the audit organization. Auditors have a responsibility to be aware of and comply with any applicable government ethics laws and regulations and any other ethics requirements (such as those of the state boards of accountancy) associated with their activities.

²¹ Specialists to whom this section applies include, but are not limited to, actuaries, appraisers, attorneys, engineers, environmental consultants, medical professionals, statisticians, and geologists.

Personal Impairments

3.06 Auditors participating on an audit assignment must be free from personal impairments to independence.²² Personal impairments of staff members result from relationships and beliefs that might cause auditors to limit the extent of the inquiry, limit disclosure, or weaken or slant audit findings in any way. Individual auditors should notify the appropriate officials within their audit organizations if they have any personal impairments to independence. Examples of personal impairments of individual auditors include, but are not limited to, the following:

- a.** immediate family or close family member²³ who is a director or officer of the audited entity, or as an employee of the audited entity, is in a position to exert direct and significant influence over the entity or the program under audit;
- b.** financial interest that is direct, or is significant though indirect, in the audited entity or program;²⁴
- c.** responsibility for managing an entity or decision making that could affect operations of the entity or program being audited; for example as a director, officer, or other senior position of the entity, activity, or program being audited, or as a member of management in any decision making, supervisory, or ongoing monitoring function for the entity, activity, or program under audit;

²² This includes those who review the work or the report, and all others within the audit organization who can directly influence the outcome of the audit. The period covered includes the period covered by the audit, and the period in which the audit is being performed and reported.

²³ Immediate family member is a spouse, spouse equivalent, or dependent (whether or not related). A close family member is a parent, sibling, or nondependent child.

²⁴ Auditors are not precluded from auditing pension plans that they participate in if (1) the auditor has no control over the investment strategy, benefits, or other management issues associated with the pension plan and (2) the auditor belongs to such pension plan as part of his/her employment with the audit organization, provided that the plan is normally offered to all employees in equivalent employment positions.

d. concurrent or subsequent performance of an audit by the same individual who maintained the official accounting records when such services involved preparing source documents or originating data, in electronic or other form; posting transactions (whether coded by management or not coded); authorizing, executing, or consummating transactions (for example, approving invoices, payrolls, claims, or other payments of the entity or program being audited); maintaining an entity's bank account or otherwise having custody of the audited entity's funds; or otherwise exercising authority on behalf of the entity, or having authority to do so;

e. preconceived ideas toward individuals, groups, organizations, or objectives of a particular program that could bias the audit;

f. biases, including those induced by political, ideological, or social convictions, that result from employment in, or loyalty to, a particular type of policy, group, organization, or level of government; and

g. seeking employment during the conduct of the audit with an audited organization or an individual or entity with a direct interest in the outcome of the audit.

3.07 Audit organizations and auditors may encounter many different circumstances or combination of circumstances that could create a personal impairment. Therefore, it is impossible to identify every situation that could result in a personal impairment.

Accordingly, audit organizations should include as part of their internal quality control system procedures to identify personal impairments and help ensure compliance with GAGAS independence requirements. At a minimum, audit organizations should:

a. establish policies and procedures to identify personal impairments to independence (see paragraph 3.06);

- b.** communicate the audit organization's policies and procedures to all auditors in the organization and help ensure understanding of the policies and procedures through training or other means such as auditors periodically acknowledging their understanding;
- c.** establish internal policies and procedures to monitor compliance with the audit organization's policies and procedures;
- d.** establish a disciplinary mechanism to promote compliance with the audit organization's policies and procedures;
- e.** stress the importance of independence and the expectation that auditors will always act in the public interest; and
- f.** maintain documentation of the steps taken to identify potential personal independence impairments as well as actions taken to resolve any impairments.

3.08 When the audit organization identifies a personal impairment to independence prior to or during an audit, the audit organization should take action to resolve the impairment in a timely manner. In situations in which the personal impairment is applicable only to an individual auditor on a particular assignment, the audit organization may be able to mitigate the personal impairment by requiring the auditor to eliminate the personal impairment. For example, the auditor could sell a financial interest that created the personal impairment, or the audit organization could remove that auditor from any work on that audit assignment. If the personal impairment cannot be mitigated through these means, the audit organization should withdraw from the audit. In situations in which government auditors cannot withdraw from the audit, they should follow the requirement in paragraph 3.04.

3.09 If the audit organization identifies a personal impairment to independence after the audit report is issued, the audit organization should assess the impact on the audit. The audit organization should consider whether, given the impact on the audit, to notify

regulatory agencies that have jurisdiction over the audited entity and persons known to be using the audit report about the independence impairment and the impact on the audit. Auditors should make such notifications in writing.

External Impairments

3.10 Audit organizations must be free from external impairments to independence. Factors external to the audit organization may restrict the work or interfere with auditors' ability to form independent and objective opinions and conclusions. External impairments to independence occur when auditors are deterred from acting objectively and exercising professional skepticism by pressures, actual or perceived, from management and employees of the audited entity or oversight organizations. For example, under the following conditions, auditors may not have complete freedom to make an independent and objective judgment, thereby adversely affecting the audit:

- a.** external interference or influence that could improperly limit or modify the scope of an audit or threaten to do so, including exerting pressure to reduce inappropriately the extent of work performed in order to reduce costs or fees;
- b.** external interference with the selection or application of audit procedures or in the selection of transactions to be examined;
- c.** unreasonable restrictions on the time allowed to complete an audit or issue the report;
- d.** restriction on access to records, government officials, or other individuals needed to conduct the audit;
- e.** external interference over the assignment, appointment, and promotion of audit personnel;

- f.** restrictions on funds or other resources provided to the audit organization that adversely affect the audit organization's ability to carry out its responsibilities;
- g.** authority to overrule or to inappropriately influence the auditors' judgment as to the appropriate content of the report;
- h.** threat of replacement over a disagreement with the contents of an audit report, the auditors' conclusions, or the application of an accounting principle or other criteria; and
- i.** influences that jeopardize the auditors' continued employment for reasons other than incompetence, misconduct, or the need for audit services.

3.11 Audit organizations should include, as part of their internal quality control system for compliance with GAGAS independence requirements, internal policies and procedures for reporting and resolving external impairments.

Organizational Independence

3.12 In addition to the preceding paragraphs that address personal and external impairments, a government audit organization's ability to perform the work and report the results impartially can be affected by its place within government and the structure of the government entity that the audit organization is assigned to audit as well as by nonaudit services it has provided to audited entities. Whether performing work to report externally to third parties outside the audited entity or internally to top management within the audited entity, audit organizations must be free from organizational impairments to independence with respect to the entities they audit.

Organizational Independence When Reporting Externally to Third Parties:

3.13 Government auditors reporting externally to third parties can be presumed to be free from organizational impairments to independence if their audit organization is organizationally independent from the audited entity. Government audit organizations can meet the requirement for organizational independence in a number of ways.

3.14 First, a government audit organization reporting externally to third parties may be presumed to be free from organizational impairments to independence from the audited entity, if the audit organization is:

a. assigned to a level of government other than the one to which the audited entity is assigned (federal, state, or local), for example, federal auditors auditing a state government program, or

b. assigned to a different branch of government within the same level of government as the audited entity; for example, legislative auditors auditing an executive branch program.

3.15 Second, a government audit organization reporting externally to third parties may also be presumed to be free from organizational impairments if the audit organization's head meets any of the following criteria:

a. directly elected by voters of the jurisdiction being audited;

b. elected or appointed by a legislative body, subject to removal by a legislative body, and reports the results of audits to and is accountable to a legislative body;

c. appointed by someone other than a legislative body, so long as the appointment is confirmed by a legislative body and removal from the position is subject to oversight or

approval by a legislative body,²⁵ and reports the results of audits to and is accountable to a legislative body; or

d. appointed by, accountable to, reports to, and can only be removed by a statutorily created governing body, the majority of whose members are independently elected or appointed and come from outside the organization being audited.

3.16 In addition to the presumptive criteria in paragraphs 3.14 and 3.15, GAGAS recognize that there may be other organizational structures under which a government audit organization could be considered to be free from organizational impairments and thereby be considered organizationally independent for reporting externally. These other structures provide safeguards to prevent the audited entity from interfering with the audit organization's ability to perform the work and report the results impartially. For an audit organization to be considered free from organizational impairments for reporting externally under a structure different from the ones listed in paragraphs 3.14 and 3.15, the audit organization should have all of the following safeguards:

a. statutory protections that prevent the abolishment of the audit organization by the audited entity;

b. statutory protections that require that if the head of the audit organization is removed from office, the head of the agency reports this fact and the reasons for the removal to the legislative body;

c. statutory protections that prevent the audited entity from interfering with the initiation, scope, timing, and completion of any audit;

²⁵ Legislative bodies may exercise their confirmation powers through a variety of means so long as they are involved in the approval of the individual to head the audit organization. This involvement can be demonstrated by approving the individual after the appointment or by initially selecting or nominating an individual or individuals for appointment by the appropriate authority.

- d.** statutory protections that prevent the audited entity from interfering with the reporting on any audit, including the findings, conclusions, and recommendations, or the manner, means, or timing of the audit organization's reports;
- e.** statutory protections that require the audit organization to report to a legislative body or other independent governing body on a recurring basis;
- f.** statutory protections that give the audit organization sole authority over the selection, retention, advancement, and dismissal of its staff; and
- g.** statutory access to records and documents that relate to the agency, program, or function being audited and government officials or other individuals needed to conduct the audit.²⁶

3.17 If the head of the audit organization concludes that the organization meets all the safeguards listed in paragraph 3.16, the audit organization may be considered free from organizational impairments to independence when reporting the results of its audits externally to third parties. In such situations, the audit organization should document how the safeguards discussed in paragraph 3.16 were satisfied and provide the documentation to those performing quality control monitoring and to the external peer reviewers to determine whether all the necessary safeguards have been met.

Organizational Independence When Reporting Internally to Management (as an internal audit function)

3.18 Certain federal, state, or local government audit organizations or audit organizations within other government entities employ auditors to work for management of the audited entities. These auditors may be subject to administrative direction from persons involved in the government management process. Such audit organizations are

²⁶ Statutory authority to issue a subpoena to obtain the needed records is one way to meet the requirement for statutory access to records.

internal audit organizations and are encouraged to follow the IIA International Standards for the Professional Practice of Internal Auditing. In addition, under GAGAS, a government internal audit organization can be presumed to be free from organizational impairments to independence when reporting internally to management if the head of the audit organization meets all of the following criteria:

- a.** accountable to the head or deputy head of the government entity or to those charged with governance,
- b.** reports the results of the audit organization's work to the head or deputy head of the government entity and to those charged with governance,
- c.** located organizationally outside the staff or line management function of the unit under audit, and
- d.** has access to those charged with governance.

3.19 If the conditions of paragraph 3.18 are met, the audit organization may be considered free of organizational impairments to independence to audit internally and report objectively to the entity's management and those charged with governance. Further distribution of reports outside the organization may be made in accordance with applicable law, rule, regulation, or policy. In these situations, auditors must clearly disclose in their reports the fact that they are auditing in their employing organizations.

3.20 The placement of the internal audit organization is essential so that auditors are sufficiently removed from political pressures such that they can conduct their audits objectively and report their findings, opinions, and conclusions objectively without fear of political repercussions. An internal audit organization's independence is enhanced when its personnel system for compensation, job tenure, and advancement is based on performance.

3.21 The audit organization should report regularly to the entity’s independent audit committee and/or the appropriate government oversight body.

3.22 When internal audit organizations that are free of organizational impairments to independence, under the criteria in paragraph 3.18, perform audits external to the government entities to which they are directly assigned, such as auditing contractors or outside party agreements, and no personal or external impairments exist, they may be considered independent of the audited entities and free to report objectively to the heads or deputy heads of the government entities to which they are assigned, to those charged with governance, and to parties outside the organizations in accordance with applicable law, rule, regulation, or policy.

3.23 The audit organization should document the conditions that allow it to be considered free of organizational impairments to independence to report internally and provide the documentation to those performing quality control monitoring and to the external peer reviewers to determine whether all the necessary safeguards have been met.

Organizational Independence When Performing Nonaudit Services

3.24 Audit organizations at times perform other professional services (nonaudit services) that are not performed in accordance with GAGAS. Audit organizations that provide nonaudit services must evaluate whether providing nonaudit services creates an independence impairment either in fact or appearance with respect to entities they audit.²⁷ Based on the facts and circumstances, auditors exercise professional judgment in determining whether a nonaudit service would impair an audit organization’s independence with respect to entities they audit. Auditors also exercise professional

²⁷ GAO has issued further guidance in the form of questions and answers to assist in implementation of the standards associated with nonaudit services. This guidance, *Government Auditing Standards: Answers to Independence Standard Questions*, GAO-02-870G (Washington, DC: June 2002), can be found on GAO’s Government Auditing Standards Web page (<http://www.gao.gov/govaud/ybk01.htm>).

judgment in determining whether any previously performed nonaudit services would impair an audit organization's independence with respect to entities they audit. Those within the audit organization with sufficient knowledge, experience, and competence to fully understand the current and future issues the audit organization may face should make this determination.

3.25 Government audit organizations generally have broad audit responsibilities and therefore should establish policies and procedures for accepting engagements to perform nonaudit services so that independence is not impaired with respect to entities they audit.²⁸ Independent public accountants may provide audit and nonaudit services (commonly referred to as consulting) under contractual commitments to an entity and should consider whether nonaudit services they have provided or are committed to provide have a significant or material effect on the subject matter of the audits.

3.26 Nonaudit services are an important consideration in an audit organization's internal quality control monitoring and its external peer reviews. Audit organizations should disclose nonaudit services described in paragraph 3.30b related to individual audits selected for review in an internal inspection or peer review and provide the documentation required by paragraphs 3.35a through 3.35e to inspectors/reviewers.

Overarching Independence Principles

3.27 The following two overarching principles apply to auditor independence when assessing the impact of performing a nonaudit service for audited entities: (1) audit organizations must not provide nonaudit services that involve performing management functions or making management decisions and (2) audit organizations must not audit

²⁸ See appendix, paragraphs A3.02 through A3.03 for examples of nonaudit services that are generally unique to government audit organizations.

their own work or provide nonaudit services in situations where the nonaudit services are significant/material to the subject matter of audits.²⁹

3.28 In considering whether audits performed by the audit organization can be significantly or materially affected by the nonaudit service, audit organizations should evaluate (1) ongoing audits; (2) planned audits; (3) requirements and commitments for providing audits, which includes laws, regulations, rules, contracts, and other agreements; and (4) policies placing responsibilities on the audit organization for providing audit services.

3.29 If requested³⁰ to perform nonaudit services that would impair the audit organization's ability to meet either or both of the overarching independence principles for certain types of audit work, the audit organization should inform the requestor and the audited entity that performing the nonaudit service would impair the auditor's independence with regard to subsequent audit or attestation engagements.

Types of Nonaudit Services

3.30 Nonaudit services generally fall into one of the following categories:³¹

a. Nonaudit services that would not impair auditor independence with respect to entities they audit and, therefore, do not require compliance with the supplemental safeguards in paragraph 3.35. (See paragraph 3.31 through 3.32.)

²⁹ The concepts of significance and materiality includes quantitative as well as qualitative measures in relation to the subject matter of the audit.

³⁰ The requestor of nonaudit services could be the management of the audited entity or a third party such as a legislative oversight body.

³¹ See appendix, paragraphs A3.02 through A3.03 for examples of nonaudit services that are generally unique to government audit organizations.

b. Nonaudit services that do not impair the audit organization’s independence with respect to entities they audit as long as the supplemental safeguards in paragraph 3.35 are complied with. (See paragraph 3.33.)

c. Nonaudit services that would impair the audit organization’s independence. Compliance with the supplemental safeguards will not overcome this impairment. (See paragraph 3.34.)

Nonaudit Services That Do Not Impair Auditor Independence

3.31 In this type of nonaudit service, auditors provide technical advice based on the auditors’ technical knowledge and expertise. This type of nonaudit service does not impair auditor independence with respect to entities they audit and does not require the audit organization to apply the supplemental safeguards. However, auditor independence would be impaired if auditors made management decisions or performed management functions.

3.32 Examples of the types of services in this category include the following:

a. Participating in activities such as commissions, committees, task forces, panels, and focus groups as an expert in a purely advisory, non-voting capacity to:

(1) advise entity management on issues based on the knowledge and skills of the auditors, and

(2) address urgent problems or policy issues.

b. Providing tools and methodologies, such as guidance and good business practices, benchmarking studies, and internal control assessment methodologies that can be used by management.

c. Providing targeted and limited technical advice to the audited entity and management to assist them in activities such as (1) answering technical questions and/or providing training, (2) implementing audit recommendations, (3) performing internal control self-assessments, and (4) providing information on good business practices.

Nonaudit Services That Would Not Impair Independence if Supplemental Safeguards Are Implemented.

3.33 These services would not impair the audit organization's independence with respect to the entities they audit so long as they comply with the supplemental safeguards. Examples of the types of services in this category include the following:

a. Providing basic accounting assistance limited to services such as preparing draft financial statements that are based on management's chart of accounts and trial balance and any adjusting, correcting, and closing entries that have been approved by management; preparing draft notes to the financial statements based on information determined and approved by management; preparing a trial balance based on management's chart of accounts; maintaining depreciation schedules for which management has determined the method of depreciation, rate of depreciation, and salvage value of the asset.³²

b. Providing payroll services when payroll is not material to the subject matter of the audit or to the audit objectives. Such services are limited to using records and data that have been approved by entity management.

³² If the audit organization has prepared draft financial statements and notes and performed the financial statement audit, the auditor obtains documentation from management in which management acknowledges the audit organization's role in preparing the financial statements and related notes and management's review, approval, and responsibility for the financial statements and related notes in the management representation letter. The management representation letter that is done as part of the audit may be used for this type of documentation.

c. Providing appraisal or valuation services limited to services such as reviewing the work of the entity or a specialist employed by the entity where the entity or specialist provides the primary evidence for the balances recorded in financial statements or other information that will be audited; valuing an entity's pension, other post-employment benefits, or similar liabilities provided management has determined and taken responsibility for all significant assumptions and data.

d. Preparing an entity's indirect cost proposal³³ or cost allocation plan provided that the amounts are not material to the financial statements and management assumes responsibility for all significant assumptions and data.

e. Providing advisory services on information technology limited to services such as advising on system design, system installation, and system security if management, in addition to the safeguards in paragraph 3.35, acknowledges responsibility for the design, installation, and internal control over the entity's system and does not rely on the auditors' work as the primary basis for determining (1) whether to implement a new system, (2) the adequacy of the new system design, (3) the adequacy of major design changes to an existing system, and (4) the adequacy of the system to comply with regulatory or other requirements.

f. Providing human resource services to assist management in its evaluation of potential candidates when the services are limited to activities such as serving on an evaluation panel of at least three individuals to review applications or interviewing candidates to provide input to management in arriving at a listing of best qualified applicants to be provided to management.

g. Preparing routine tax filings in accordance with federal tax laws, rules, and regulations of the Internal Revenue Service, and state and local tax authorities, and any

³³ The Office of Management and Budget prohibits an auditor who prepared the entity's indirect cost proposal from conducting the required audit when indirect costs recovered by the entity during the prior year exceeded \$1 million under OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Subpart C.305(b), revised June 27, 2003.

other applicable tax laws that do not violate the overarching independence principles. For example, preparing tax returns, including IRS form 990, “Return of Organization Exempt from Income Tax,” based on information provided by the audited entity, providing advice on deposits due to a taxing authority, and representing an audit entity in IRS matters such as in an IRS audit or in obtaining IRS rulings or other agreements, ordinarily would be included in this category of nonaudit services.³⁴

h. Documenting existing processes and internal controls.

Nonaudit Services That Impair Independence

3.34 Compliance with the supplemental safeguards will not overcome independence impairments in this category. By their nature, certain nonaudit services directly support the entity’s operations and impair the audit organization’s ability to meet either or both of the overarching independence principles in paragraph 3.27 for certain types of audit work.

Examples of the types of services under this category include the following:

- a.** Maintaining or preparing the audited entity’s basic accounting records or maintaining or taking responsibility for basic financial or other records that the audit organization will audit.
- b.** Posting transactions (whether coded or not coded) to the entity’s financial records or to other records that subsequently provide input to the entity’s financial records.

³⁴ An audit organization’s independence for performing financial statement audits would not be impaired by representing the audited entity in IRS matters or in obtaining IRS rulings or other agreements. However, these nonaudit services would impair auditor independence with respect to performance audits of tax compliance since the audit organization would be auditing its own work.

- c.** Determining account balances or determining capitalization criteria.

- d.** Designing, developing, installing, or operating the entity's accounting system or other information system that are material or significant to the subject matter of the audit.

- e.** Providing payroll services that (1) are material to the subject matter of the audit or the audit objectives, and/or (2) involve making management decisions.

- f.** Providing appraisal or valuation services that exceed the scope described in paragraph 3.33 c.

- g.** Recommending a single individual for a specific position that is key to the entity or program under audit, or otherwise ranking or influencing management's selection of the candidate; or conducting an executive search or a recruiting program for the audited entity.

- h.** Developing an entity's performance measurement system when that system is material or significant to the subject matter of the audit.

- i.** Performing the entity's internal control self-assessment process or developing the internal control system.

- j.** Developing an entity's policies, procedures, and internal controls.

- k.** Providing services that are used as management's primary basis for making decisions that are significant to the subject matter under audit.

- l.** Internal audit functions, when performed by external auditors.

- m.** Serving as voting members of an entity's management committee or board of directors, making policy decisions that affect future direction and operation of an entity's programs,

supervising entity employees, developing programmatic policy, authorizing an entity's transactions, or maintaining custody of an entity's assets.³⁵

Supplemental Safeguards for Maintaining Auditor Independence When Performing Nonaudit Services Described in Paragraph 3.33

3.35 Performing nonaudit services described in paragraph 3.33 will not impair independence if the overarching independence principles stated in paragraph 3.27 are not violated. For these nonaudit services, the audit organization must comply with the following safeguards.

a. The audit organization documents its consideration of the nonaudit services, including its conclusions about the impact on independence.

b. Before performing nonaudit services, the audit organization establishes and documents an understanding with the audited entity regarding the objectives, scope of work, and product or deliverables of the nonaudit service. The audit organization also establishes and documents an understanding with the audited entity that its management is responsible for (1) the subject matter of the nonaudit services, (2) the substantive outcomes of the work, (3) making any decisions that involve management functions related to the nonaudit service and accepting full responsibility for such decisions.

c. The audit organization precludes personnel who provided the nonaudit services from planning, conducting, or reviewing audit work of the subject matter of the nonaudit service under the overarching independence principle that auditors must not audit their own work.³⁶

³⁵ Entity assets are intended to include all of the entity's property including bank accounts, investment accounts, inventories, equipment or other assets owned, leased, or otherwise in the entity's possession, and financial records, both paper and electronic.

³⁶ Personnel who provided the nonaudit service are permitted to convey to the audit assignment team the documentation and knowledge gained about the audited entity and its operations.

d. The audit organization does not reduce the scope and extent of the audit work below the level that would be appropriate if the nonaudit work were performed by an unrelated party.

e. The audit organization's quality control systems for compliance with independence requirements should include: (1) policies and procedures to consider the effect on the ongoing, planned, and future audits when deciding whether to provide nonaudit services, and (2) a requirement to document the understanding with management of the audited entity discussed above. The understanding should be communicated to management in writing and can be included in the engagement letter. In addition, the documentation should specifically identify management's responsibilities discussed above.

Professional Judgment

3.36 Auditors must use professional judgment, including professional skepticism and reasonable care and diligence, in planning and performing audits and attestation engagements and in reporting the results.

3.37 As a key component of professional judgment, auditors exercise professional skepticism, which is an attitude that includes a questioning mind and a critical assessment of evidence. Professional skepticism includes a mindset where auditors neither assume that management is dishonest nor of unquestioned honesty, and auditors are not to be satisfied with less than persuasive evidence because of a belief that management is honest.

3.38 Auditors use their professional knowledge, skills, and experience to diligently perform, in good faith and with integrity, the gathering of information and the objective evaluation of the sufficiency and appropriateness of evidence. Professional judgment and competence are interrelated, since judgments made are dependent upon the competence of personnel.

3.39 Professional judgment represents the application of the collective knowledge, skills, and experiences of all the personnel involved with an audit engagement, as well as the professional judgment of individual auditors. In addition to personnel directly involved in the audit, professional judgment may involve collaboration with other stakeholders, outside experts, and management in the audit organization.

3.40 Auditors use professional judgment in all aspects of carrying out professional responsibilities, including following the independence standards, maintaining objectivity and credibility, assigning competent audit staff to the engagement, and maintaining appropriate quality control over the engagement process.

3.41 Auditors also use professional judgment in planning and performing a GAGAS audit, including determining the type of assignment to be performed and the standards that apply to the work; defining the scope of work; selecting the methodology; determining criteria suitable to the audit objectives; determining the type and amount of data or information to be gathered; selecting and performing the tests and procedures; assessing the appropriateness of information and sufficiency of evidence obtained; and evaluating and reporting the results of the work.

3.42 Auditors use professional judgment in determining the required level of the understanding of the audit subject matter and related circumstances. This includes consideration about whether their collective experience, training, knowledge, skills, abilities, and overall understanding are sufficient to assess the risks that the subject matter under audit may contain a significant inaccuracy or could be misinterpreted.

3.43 Auditors also consider the risk level of each assignment, including the risk that they may come to an improper conclusion. Within the context of this overall audit risk, auditors exercise professional judgment in determining the sufficiency and appropriateness of information to be used to support the findings and conclusions based on the audit objectives and any recommendations reported.

3.44 By its nature, the exercise of professional judgment is subjective. As such, auditors should document significant decisions affecting the audit’s objectives, scope, methodology, and findings; conclusions, and recommendations resulting from professional judgment. Since professional judgment is subjective, different auditors may differ as to the audit approach.

3.45 While this standard places responsibility on each auditor and audit organization to exercise professional judgment in planning and performing an assignment, it does not imply unlimited responsibility, nor does it imply infallibility on the part of either the individual auditor or the audit organization. Absolute assurance is not attainable because of the nature of evidence and the characteristics of fraud. Professional judgment does not mean eliminating all possible limitations or weaknesses associated with a specific audit, but rather identifying, considering, minimizing, mitigating, and explaining them.

Competence

3.46 The staff assigned to perform the audit or attestation engagement must collectively possess adequate professional competence for the tasks required.

3.47 Competence is an essential dimension of the human capital management component of an audit organization’s system of quality control. (See paragraph 3.61c.) The audit organization’s management should assess skill needs to consider whether its workforce has the essential skills that match those necessary to successfully achieve the audit mandate or scope of audits to be performed. Accordingly, audit organizations should have a process for recruitment, hiring, continuous development, assignment, performance evaluation, advancement and compensation of staff to assist the organization in maintaining a workforce that has adequate competence. The nature, extent, and formality of the process will depend on various factors such as the size of the audit organization, its work, and its structure.

3.48 Competence is derived from a synthesis of education and experience. It begins with a mastery of the common body of knowledge. Competencies are not necessarily measured by years of auditing experience because such a quantitative measurement may not accurately reflect the kinds of experiences gained by an auditor in any given time period. Auditors maintain competence through a commitment to learning and development throughout an auditor’s professional life. Competence enables an auditor to make sound professional judgments.

3.49 In planning or performing an audit, auditors may employ the skills and knowledge of a specialist to assist with complex or subjective issues.

3.50 Auditors have a continuing duty to maintain professional knowledge and skill to provide competent professional service based on current developments in applicable technical and professional standards practice, legislation, and techniques.

Technical Knowledge and Competence

3.51 Staff members assigned to conduct an audit or attestation engagement under GAGAS must collectively possess the technical knowledge, skills, and experience necessary to be competent for the type of work being performed before beginning work on that assignment. In assigning personnel to engagements, audit organizations consider the workload requirements of an engagement, the skills, competence, and experience needed in relation to the complexity or other needs of an engagement, and the extent of supervision to be provided. Staff members should collectively possess:

- a.** knowledge of GAGAS applicable to the type of work they are assigned and the education, skills, and experience to apply such knowledge to the work being performed;
- b.** general knowledge of the environment in which the audited entity operates and the subject matter under review;

c. skills to communicate clearly and effectively, both orally and in writing; and

d. skills appropriate for the work being performed. For example:

(1) staff or specialists with statistical sampling skills if the work involves use of statistical sampling;

(2) staff or specialists with information technology skills if the work involves review of information systems;

(3) staff or specialists with engineering skills if the work involves review of complex engineering data;

(4) staff or specialists with skills in specialized audit methodologies or analytical techniques, such as the use of complex survey instruments, actuarial-based estimates, or statistical analysis tests, if the work calls for such skills; or

(5) staff or specialists with skills in specialized subject matters, such as scientific, medical, environmental, educational, or any other specialized subject matter, if the work calls for such expertise.

Additional Qualifications for Financial Audits and Attestation Engagements

3.52 Auditors performing financial audits in which U.S. auditing standards for non-issuers are to be followed should be knowledgeable in generally accepted accounting principles (GAAP) and the AICPA's generally accepted auditing standards for field work and reporting and the related Statements on Auditing Standards (SAS) and any other accounting principles or basis of accounting used, and they should be competent in applying these standards and SAS to the task assigned. Also, if auditors use GAGAS in conjunction with standards of the IAASB or PCAOB, they should be knowledgeable and competent in applying these standards.

3.53 Similarly, for attestation engagements in which U.S. attestation engagement standards are to be followed, GAGAS incorporate the AICPA's attestation standards. Auditors should be knowledgeable in the AICPA general attestation standard related to criteria and the AICPA attestation standards for field work and reporting and the related Statements on Standards for Attestation Engagements (SSAE), and they should be competent in applying these standards and SSAE to the task assigned.

3.54 Auditors engaged to perform financial audits or attestation engagements should be licensed certified public accountants or persons working for a licensed certified public accounting firm or a government auditing organization. Public accountants and accounting firms are also subject to licensing requirements provisions of public accountancy law and rules of the jurisdiction(s) where the audit is being performed, and the jurisdiction(s) in which the public accountants and their firms are licensed.

Continuing Professional Education

3.55 Auditors performing work under GAGAS, including planning, directing, performing field work, or reporting on an audit or attestation engagement under GAGAS, must maintain their professional competence through continuing professional education (CPE). Therefore, each auditor performing work under GAGAS should complete, every 2 years, at least 80 hours of CPE that enhance the auditor's professional proficiency to perform audits and/or attestation engagements. Auditors should take subjects directly related to government auditing, the government environment, or the specific or unique environment in which the audited entity operates for at least 24 of the 80 hours of CPE.³⁷ Auditors should complete at least 20 hours of the 80 in any 1 year of the 2-year period.

³⁷ Auditors who are only involved in performing field work but not involved in planning, directing, or reporting on the audit or attestation engagement and who charge less than 20 percent of their time annually to GAGAS audits and attestation engagements are subject to the 24 hour requirement for government related CPE in each 2-year period but do not have to comply with the remainder of the 80-hour CPE requirement.

3.56 CPE programs are structured educational activities with learning objectives designed to maintain or enhance participants' knowledge, skills, and abilities in areas applicable to performing audits or attestation engagements. Determining what subjects are appropriate for individual auditors to satisfy both the 80-hour and the 24-hour requirements is a matter of professional judgment to be exercised by auditors in consultation with appropriate officials within their audit organizations. Among the considerations in exercising that judgment are the auditors' experience, the responsibilities they assume in performing GAGAS audits or attestation engagements, and the operating environment of the audited entity.

3.57 Individual auditors have primary responsibility for improving their competencies and for meeting CPE requirements. The audit organization should have quality control procedures to help ensure that auditors meet the continuing education requirements, including documentation of the CPE completed. GAO has developed guidance pertaining to CPE requirements to assist auditors and audit organizations in exercising professional judgment in complying with the CPE requirements.³⁸

3.58 External specialists assisting in performing a GAGAS assignment should be qualified and should maintain professional competence in their areas of specialization but are not required to meet the CPE requirements described here. However, auditors who use the work of external specialists should assess the professional qualifications of such specialists and document their findings and conclusions. Internal specialists who are part of the audit organization and perform as a member of the audit team, should comply with GAGAS, including the CPE requirements.

³⁸ This guidance, *Government Auditing Standards: Guidance on GAGAS Requirements for Continuing Professional Education*, GAO-05-586G (Washington, D.C.: Apr. 2005), can be found on GAO's Government Auditing Standards Web page (<http://www.gao.gov/govaud/ybk01.htm>).

Quality Control and Assurance

3.59 Each audit organization performing audits and/or attestation engagements in accordance with GAGAS must have an internal quality control system in place that is designed to provide reasonable assurance that the organization and its personnel comply with professional standards and regulatory and legal requirements, and that reports issued are in accordance with professional standards.

System of Quality Control

3.60 An audit organization's system of quality control encompasses the audit organization's structure and the policies adopted and procedures established to provide the organization with reasonable assurance of complying with applicable professional standards governing audits and attestation engagements. The audit organization should design the nature, extent, and formality of its quality control policies and procedures to be appropriately comprehensive and suitably designed in relation to the audit organization's size, number of offices, the knowledge and experience of its personnel, the nature and complexity of the audit work, and appropriate cost-benefit considerations. Thus, the systems established by individual audit organizations and the extent of their documentation of the systems will vary based on an audit organization's circumstances.

3.61 An audit organization should include policies and procedures in its system of quality control addressing each of the following elements:

a. Ethics: Policies and procedures designed to provide reasonable assurance that the audit organization and its personnel comply with relevant ethical concepts which include: the public interest; professional behavior; integrity; objectivity; and proper use of government information, resources, and position. (See chapter 2 for the overarching

ethical concepts that apply to auditors in conducting their work in accordance with GAGAS.)

b. Initiation and continuance of audit and attest engagements: Policies and procedures for the initiation and continuance of audit work, designed to provide reasonable assurance that the audit organization will only undertake or continue relationships and engagements where it:

(1) is competent to perform the engagement and has the capabilities, time and resources to do so,

(2) is independent and can comply with professional standards and ethical principles, and

(3) is within the legal mandate or authority of the audit organization.

c. Human capital management: Policies and procedures designed to provide the audit organization with reasonable assurance that it has sufficient personnel with the competence necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements, and to enable the audit organization to issue reports that are appropriate in the circumstances. Policies and procedures related to competence of personnel address the following:

(1) recruitment of qualified personnel;

(2) assignment of personnel with the competence and independence³⁹ needed for specific engagements;

³⁹ See paragraphs 3.06 through 3.09, and 3.35c for specific quality control requirements related to personal impairments and performing nonaudit services, respectively.

(3) performance evaluation, professional development, continuing professional education, promotion, and compensation.

d. Engagement performance and reporting: Policies and procedures designed to provide the audit organization with reasonable assurance that engagements are performed in accordance with professional standards and regulatory and legal requirements, and that the audit organization issues reports that are appropriate in the circumstances include the following:

(1) information and communication provided to engagement teams so that team members sufficiently understand the objectives of their work;

(2) processes for engagement planning and supervision;

(3) processes for complying with applicable engagement-related standards;

(4) reviewing the work performed, the significant judgments made and the resulting report;

(5) appropriate documentation of the work performed and review of audit documentation, including appropriate management-level reviews;

(6) communication at the appropriate professional level with individuals within or outside the audit organization to resolve a difficult or contentious matter;

(7) procedures for resolving disagreements among team members and between the team and those consulted; and

(8) reporting that is appropriate to circumstances associated with the engagement, is supported by the work performed, and is in accordance with applicable professional standards and regulatory and legal requirements.

e. Monitoring of quality: Policies and procedures designed to provide management of the audit organization with reasonable assurance that the policies and procedures relating to the system of quality control are suitably designed and operating effectively in practice. Audit organizations should have monitoring procedures that include an ongoing consideration and evaluation of the audit organization's system of quality control for achieving the objectives in (a) through (d) above, including

(1) relevance and adequacy of the organization's policies and procedures,

(2) appropriateness of the organization's guidance materials, and

(3) compliance with the organization's policies and procedures.

3.62 Where practical, audit organizations are strongly encouraged to implement monitoring procedures that include the enhanced quality assurance criteria discussed in paragraph 3.70.

3.63 Each audit organization should prepare documentation for its system of quality control as well as documentation to demonstrate compliance with its policies and procedures for a period of time sufficient to enable those performing monitoring procedures and peer reviews to evaluate the extent of the audit organization's compliance with the quality control policies and procedures. The form and content of such documentation is a matter of judgment.

External Peer Review

3.64 Audit organizations performing audits and attestation engagements in accordance with GAGAS must have an external peer review of their auditing and attestation

engagement practices in accordance with the time frames set forth in paragraph 3.69.⁴⁰

3.65 The external peer review must determine whether, during the period under review, the reviewed audit organization's internal quality control system was adequate and whether quality control policies and procedures, including the monitoring process, were being complied with to provide the audit organization with reasonable assurance of conforming with applicable professional standards. Audit organizations should take remedial, corrective actions as needed based on the results of the peer review.

3.66 Members of the external peer review team should meet the following requirements:

a. The review team collectively has current knowledge of GAGAS and of the government environment relative to the work being reviewed.

b. Each review team member is independent (as defined in GAGAS) of the audit organization being reviewed, its staff, and the audits and attestation engagements selected for the external peer review. A review team or a member of the review team does not review the audit organization that conducted its audit organization's most recent external peer review.

c. The review team collectively has sufficient knowledge of how to perform a peer review. Such knowledge may be obtained from on-the-job training, training courses, or a combination of both. Having personnel on the peer review team with prior experience on a peer review or internal inspection team is desirable.

⁴⁰ The external peer review requirement is effective within 3 years from the date an audit organization begins field work on its first assignment in accordance with GAGAS. This 3-year period refers to the cut-off ("as of") date for the peer review. Generally, peer reviews are completed within 6 months of the cut-off date. Extensions of these time frames beyond 3 months after the peer review completion deadline are granted by GAO, and in cooperation with the cognizant peer review program, to meet the external peer review requirements for extraordinary circumstances.

3.67 Audit organizations should obtain a peer review that meets the following requirements:

a. The peer review includes a review of the audit organization’s internal quality control policies and procedures, including related monitoring procedures, audit and attestation engagement reports, audit and attest documentation, and other necessary documents (for example, independence documentation, CPE records, and personnel management files related to compliance with hiring, performance evaluation, advancement, compensation, and assignment policies). The review also includes interviews with various levels of the reviewed audit organization’s professional staff to assess their understanding of and compliance with relevant quality control policies and procedures.

b. The review team uses one of the following approaches to selecting audits and attestation engagements for review: (1) select audits and attestation engagements that provide a reasonable cross-section of the assignments performed by the reviewed audit organization in accordance with GAGAS or (2) select audits and attestation engagements that provide a reasonable cross-section of the reviewed audit organization’s work subject to its quality control system, including assignments performed in accordance with GAGAS.⁴¹

c. The peer review is sufficiently comprehensive to provide a reasonable basis for concluding whether the reviewed audit organization’s system of quality control was complied with to provide the organization with reasonable assurance of conforming with professional standards in the conduct of its work, and the peer review includes consideration of the adequacy and results of the reviewed audit organization’s monitoring efforts.

⁴¹ For audit organizations that perform only a small number of GAGAS audits in relation to other types of audits, at least one or more GAGAS audits is selected for review. In these cases, one or more GAGAS audits may represent more than what would be selected when looking at a cross-section of the audit organization’s work as a whole.

d. The review team prepares a written report(s) communicating the results of the external peer review. The report indicates the scope of the review, including any limitations thereon, and includes an opinion on whether the system of quality control of the reviewed audit organization's audit and/or attestation engagement practices was adequately designed based on specified standards or criteria and whether the audit organization's quality control policies and procedures were being complied with during the year reviewed to provide the audit organization with reasonable assurance of conforming with professional standards. The report states the professional standards or criteria to which the reviewed audit organization is being held. The report also describes the reasons for any modification of the opinion. When there are matters that resulted in a modification to the opinion, the report includes a detailed description of the findings and recommendations, either in the peer review report or in a separate letter of comment, to enable the reviewed audit organization to take appropriate actions. The written report refers to the letter of comment if such a letter is issued along with a modified report.

3.68 An audit organization that reports externally to third parties should make the results of its most recent external peer review publicly available; for example, by posting the peer review opinion on an external Web site.⁴² Internal audit organizations that report internally to management should provide a copy of the external peer review report to those charged with governance. Government audit organizations should also transmit their external peer review reports to appropriate oversight bodies.⁴³

3.69 Audit organizations should have an external peer review conducted according to the following time frames:

⁴² If the audit organization does not have a website, then it uses the same mechanism it uses to make other information public.

⁴³ The transparency requirement in paragraph 3.68 does not include the letter of comment.

- a.** within 18 months, if the most recent external peer review opinion is adverse or modified, with continued peer reviews every 18 months until the audit organization receives an unmodified opinion;
- b.** every 3 years if the audit organization has an unmodified peer review opinion from its recent peer review, and does not qualify for or does not elect a 5-year period; or
- c.** every 5 years if the audit organization's most recent external peer review opinion was unmodified and the audit organization elects to meet the enhanced quality assurance and other criteria in paragraph 3.70.⁴⁴

3.70 The following represents the enhanced quality assurance criteria for audit organizations that elect a 5-year peer review cycle. Audit organizations that do not elect a 5-year peer review cycle are strongly encouraged to adopt these criteria as a means to strengthen quality assurance. In order to qualify for a 5-year peer review cycle, the audit organization should meet the following criteria:

- a.** The audit organization makes public on its Web site a description of the overall system of quality assurance used to provide the organization with reasonable assurance of complying with applicable standards governing audits and attestation engagements.⁴⁵ The audit organization provides the description of its system of quality assurance to the oversight organization's bodies who receive the external peer review report under paragraph 3.68.

⁴⁴ Independent public accountants and audit organizations may be subject to requirements of other professional organizations or licensing bodies.

⁴⁵ This high-level description includes the major policies regarding ethical requirements, initiation and continuance of audit work, human capital management, engagement performance and reporting, and monitoring, as discussed in paragraph 3.61.

b. The audit organization has an effective annual internal⁴⁶ quality inspection process that meets the following criteria:

(1) The objective of the inspection process is to evaluate the adequacy of the audit organization's quality control policies and procedures, and the extent of the audit organization's compliance with its quality control policies and procedures.

(2) The annual inspection includes the following elements:

1. a review of selected administrative and personnel records pertaining to the quality control elements of independence and human capital management;

2. a review of audit documentation for an appropriately sized, representative sample of engagements and reports by qualified management-level individuals and other audit personnel who are not directly associated with the performance of the engagement;

3. discussions or interviews with the audit organization's personnel;

4. a summary of the findings from the inspection procedures in a formal report to top management of the audit organization;

5. a discussion in the report of the systemic causes of any findings that indicate improvements are needed and recommendations for corrective actions to be taken or improvements to be made with respect to the specific engagements reviewed and the audit organization's quality control policies and procedures;

6. communication of the identified findings to the appropriate management officials and personnel of the audit organization;

⁴⁶ The audit organization can use internal or third-party resources to conduct the inspection. If a third party is used to conduct the inspection, that party is not independent to conduct the peer review.

7. consideration of inspection findings by appropriate management personnel of the audit organization who are in a position to take actions necessary, including necessary modifications to the quality control system, on a timely basis; and

8. retention of appropriate inspection documentation at least until the completion of the next peer review.

(3) The audit organization annually makes public a written assertion about the effectiveness of its internal quality assurance program, which is consistent with the results of the monitoring and inspection processes and is provided to the peer reviewers as part of the peer review process.⁴⁷ Government audit organizations should also transmit their written assertions to their oversight organizations, councils, or committees.

c. The audit organization's most recent external peer review included a review of the effectiveness of the audit organization's annual inspection process, and the peer reviewers identified no significant deficiencies in the internal quality inspection process.

d. The audit organization determines whether it qualifies for the 5-year peer review cycle and documents the rationale for its decision if it believes it qualifies. The audit organization may consult with its external peer reviewers in making this determination.

3.71 Information in external peer review reports and letters of comment may be relevant to decisions on procuring audit or attestation engagement services. Therefore, audit organizations seeking to enter into a contract to perform an assignment in accordance with GAGAS should provide the following to the party contracting for such services:

⁴⁷ Peer reviewers read the assurance statements for each year since the previous peer review and compare them with the inspection results for those years. Peer reviewers evaluate management's assertion and the underlying monitoring and inspection processes for the year under review.

a. the audit organization's most recent external peer review report and any letter of comment, and

b. any subsequent peer review reports and letters of comment received during the period of the contract.

3.72 Auditors who are relying on another audit organization's work should request a copy of the audit organization's latest peer review report and any letter of comment, and the audit organization should provide these documents when requested.

Chapter 4
Field Work Standards for Financial Audits

Introduction

4.01 This chapter establishes field work standards and provides guidance for financial audits conducted in accordance with generally accepted government auditing standards (GAGAS). For financial audits, GAGAS incorporate the AICPA's field work and reporting standards and the related statements on auditing standards unless specifically excluded or modified by GAGAS.⁴⁸ This chapter identifies the AICPA field work standards and prescribes additional standards for financial audits performed in accordance with GAGAS.

4.02 See paragraphs 1.16 through 1.18 for a discussion about the use of GAGAS with other financial audit standards.

4.03 See paragraphs 1.24 through 1.27 for an overall description of the nature and objectives of financial audits.

AICPA Field Work Standards

4.04 The three AICPA generally accepted standards of field work are as follows:

a. The auditor must adequately plan the work and must properly supervise any assistants.

⁴⁸ To date, the Comptroller General has not excluded any field work standards or SASs.

b. The auditor must obtain a sufficient understanding of the entity and its environment, including its internal control⁴⁹ to assess the risk of material misstatement⁵⁰ of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures.

c. The auditor must obtain sufficient appropriate audit evidence by performing procedures to afford a reasonable basis for an opinion regarding the financial statements under audit.

Additional Considerations for Financial Audits in Government

4.05 Additional considerations for financial audits in government apply in audits of a government entity or an entity that receives government awards. For example, auditors may need to set lower materiality levels than in audits in the private sector because of the public accountability of the audited entity, various legal and regulatory requirements, and the visibility and sensitivity of government programs. In applying professional judgment when applying auditing standards, auditors also consider the needs of users

⁴⁹ The AICPA standards incorporate the concepts contained in *Internal Control - Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As discussed in the COSO framework, internal control consists of five interrelated components, which are (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring. The objectives of internal control relate to (1) financial reporting, (2) operations, and (3) compliance. Safeguarding of assets is a subset of these objectives. In that respect, management designs internal control to provide reasonable assurance that unauthorized acquisition, use, or disposition of assets will be prevented or timely detected and corrected. In addition to the COSO document, the publication, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: Nov. 1999), which incorporates the relevant guidance developed by COSO, provides definitions and fundamental concepts pertaining to internal control at the federal level and may be useful to other auditors at any level of government. The related *Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C.: Aug. 2001), based on the federal internal control standards, provides a systematic, organized, and structured approach to assessing the internal control structure.

⁵⁰ In accordance with AICPA Statement on Auditing Standards No. 107, *Audit Risk and Materiality in Conducting an Audit*, the auditor's consideration of materiality is a matter of professional judgment and is influenced by the auditor's perception of the needs of users of financial statements. Materiality is defined as "the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement." This definition is from Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 2. *Qualitative Characteristics of Accounting Information*.

and the concerns of oversight officials regarding previously identified risks, previously reported deficiencies in internal control of the audited entity, and current and emerging risks and uncertainties facing the government entity or program.

4.06 An important element of financial audits in government is the reporting of deficiencies in internal control so that the audited entity can take corrective actions necessary under the circumstances. (See paragraphs 5.13 through 5.18.) A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective is not met. A deficiency in operation exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

Consideration of Potential Fraud in a Financial Statement Audit and Illegal Acts by Auditees

4.07 Under both the AICPA standards⁵¹ and GAGAS, auditors should plan and perform the audit to obtain reasonable assurance⁵² about whether the financial statements are free of material misstatement, whether caused by error or fraud.⁵³ Auditors conduct the audit with a mindset that recognizes the possibility that a material misstatement due to

⁵¹ See *AICPA Professional Standards*, AU 316 (Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit*).

⁵² In accordance with AICPA Statement on Auditing Standard No. 104, *Amendment to Statement on Auditing Standard No. 1, Codification of Auditing Standards and Procedures (“Due Professional Care in the Performance of Work”)*, paragraph 2, “the high, but not absolute, level of assurance that is intended to be obtained by the auditor is expressed in the auditor’s report as obtaining reasonable assurance about whether the financial statements are free of material misstatement (whether caused by error or fraud).

⁵³ Two types of misstatements are relevant to the auditors’ consideration of fraud in an audit of financial statements—misstatements arising from fraudulent financial reporting and misstatements arising from misappropriation of assets. The primary factor that distinguishes fraud from error is whether the underlying action that results in the misstatement in the financial statements is intentional or unintentional.

potential fraud could be present. However, absolute assurance is not attainable and thus even a properly planned and performed audit may not detect a material misstatement resulting from fraud.

4.08 Auditors should design the audit to provide reasonable assurance of detecting material misstatements resulting from direct and material illegal acts.⁵⁴ Auditors also consider the possibility that indirect illegal acts may have occurred. If specific information comes to the auditors' attention that provides evidence concerning the existence of possible illegal acts that could have a material indirect effect on the financial statements, the auditors should apply audit procedures specifically directed to ascertaining (1) whether an illegal act has occurred⁵⁵ and (2) the potential financial statement effect.

Additional GAGAS Standards

4.09 GAGAS establish field work standards for financial audits in addition to the requirements contained in the AICPA SAS. Auditors should comply with these additional standards when citing GAGAS in their audit reports. The additional GAGAS standards relate to

- a.** auditor communication (see paragraphs 4.10 through 4.15);
- b.** previous audits and attestation engagements (see paragraphs 4.16 through 4.17);

⁵⁴ See *AICPA Professional Standards*, AU 317 (Statement on Auditing Standards No. 54, *Illegal Acts by Clients*). Direct and material illegal acts are violations of laws and regulations having a direct and material effect on the determination of financial statement amounts.

⁵⁵ Whether a particular act is, in fact, illegal may have to await final determination by a court of law or other adjudicative body. Thus, auditors may disclose matters that have led them to conclude that an illegal act is likely to have occurred; they do not make a determination of illegality.

- c. detecting material misstatements resulting from violations of contract provisions or grant agreements, or from abuse (see paragraphs 4.18 through 4.20);
- d. developing elements of a finding (see paragraph 4.21); and
- e. audit documentation (see paragraphs 4.22 through 4.41).

Auditor Communication

4.10 Auditors should communicate information regarding their responsibilities under GAGAS and the level of assurance to those charged with governance and to the individuals contracting for or requesting the audit and document the communications.

4.11 Under AICPA standards and GAGAS, auditors should establish a written understanding with those charged with governance⁵⁶ and communicate with audit committees. Under GAGAS, auditors should communicate specific information in writing during the planning stages of a financial audit, including any potential restriction of the auditors' reports, to reduce the risk that the needs or expectations of the parties involved may be misinterpreted. Auditors use professional judgment when determining the form, content, and frequency of the communication. Auditors may use an engagement letter or a proposal, if appropriate, to communicate the information.

4.12 When auditors perform the audit under a contract with a party other than the officials of the audited entity, or pursuant to a third-party request, auditors should also communicate in writing with the individuals contracting for or requesting the audit, such as contracting officials or members or staff of legislative committees, in addition to communicating with the audited entity. When auditors are performing the audit pursuant

⁵⁶ Those charged with governance are those responsible for overseeing the strategic direction of the entity and the entity's fulfillment of its accountability obligations. In situations in which those charged with governance are not clearly evident, the auditor documents the process followed and conclusions reached for identifying the appropriate individuals to receive the required auditor communications. (See appendix, paragraph A1.02 for additional information.)

to a law or regulation and they are conducting the work directly for the legislative committee who has oversight for the audited entity, auditors should communicate with the members or staff of that legislative committee. Auditors should coordinate communications with the responsible government audit organization and/or management of the audited entity. If an audit is terminated before it is completed, auditors should write a memorandum for the audit documentation that summarizes the results of the work and explains the reasons why the audit was terminated. In addition, depending on the facts and circumstances, auditors should consider the need to communicate the reason for terminating the audit to those charged with governance, management of the audited entity, the entity requesting the audit, and other appropriate officials, preferably in writing.

4.13 When communicating responsibilities under GAGAS and the level of assurance provided, auditors should specifically address their planned work and reporting responsibilities related to testing internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements. During the planning stages of an audit, auditors should communicate their responsibilities for testing and reporting on internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements. Auditors should also communicate the nature of any additional testing of internal control and compliance required by laws, regulations, and provisions of contracts or grant agreements, or otherwise requested, and whether the auditors will provide opinions on internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements.

4.14 Under financial auditing standards, tests of internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements in a financial statement audit contribute to the evidence supporting the auditors' opinion on the financial statements or other conclusions regarding financial data. However, such tests generally are not sufficient in scope to provide an opinion on the effectiveness of internal control over financial reporting or compliance with laws, regulations, and

provisions of contracts or grant agreements. To meet certain audit report users' needs, laws and regulations sometimes prescribe testing and reporting on internal control over financial reporting and compliance with laws, regulations, and provisions of contracts and grant agreements to supplement coverage of these areas.⁵⁷

4.15 Even after auditors perform and report the results of additional tests of internal control over financial reporting and compliance with laws, regulations, and provisions of contracts and grant agreements, those charged with governance, officials of the audited entity or individuals contracting for or requesting the audit may desire additional procedures or reporting. Auditors may meet these needs by performing further tests of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements as an attestation engagement (see chapter 6), or a performance audit (see chapters 7 and 8), to achieve these objectives.

Previous Audits and Attestation Engagements

4.16 When planning the audit, auditors should determine whether the results of previous audits and attestation engagements that directly relate to the objectives of the audit being undertaken have an impact on the current engagement, including whether related recommendations have been implemented.

4.17 Auditors should identify previous financial audits, attestation engagements, performance audits, or other studies related to the objectives of the audit being undertaken and ask management of the audited entity to identify corrective actions

⁵⁷ For example, when engaged to perform audits under the Single Audit Act, as amended, for state and local government entities and nonprofit entities that receive federal awards, auditors follow Office of Management and Budget (OMB) Circular No. A-133 on single audits. The act and circular include specific audit requirements, mainly in the areas of internal control and compliance with laws and regulations, that go beyond the requirements in chapters 4 and 5 of GAGAS. Audits performed pursuant to the Chief Financial Officers Act of 1990, as expanded by the Government Management Reform Act of 1994 and the Accountability of Tax Dollars Act of 2002, also have specific audit requirements prescribed by OMB in the areas of internal control and compliance. In addition, some state and local governments may have additional audit requirements that the auditors would need to follow in planning the audit.

taken to address significant findings and recommendations,⁵⁸ including those related to significant deficiencies, including material weaknesses.⁵⁹

Detecting Material Misstatements Resulting from Violations of Contract Provisions or Grant Agreements, or from Abuse

4.18 The standard related to violations of contract provisions or grant agreements or abuse for financial audits performed in accordance with GAGAS is:

a. Auditors should design the audit to provide reasonable assurance of detecting misstatements resulting from violations of provisions of contracts or grant agreements that have a material effect on the determination of financial statement amounts or other financial data significant to the audit objectives.

b. If during the course of the audit, auditors become aware of indications of abuse that could be quantitatively or qualitatively material, auditors should apply audit procedures specifically directed to ascertain whether material abuse has occurred and the potential effect on the financial statements or other financial data significant to the audit objectives. Based on the facts and circumstances, the auditors may find it helpful to identify specific risks, situations, or transactions that are susceptible to abuse. In addition, auditors remain alert throughout the audit to situations or transactions that could be indicative of abuse. However, because the determination of abuse is subjective, auditors are not required to provide reasonable assurance of detecting abuse.

4.19 Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member

⁵⁸ Significant findings and recommendations are those matters that, if not corrected, could affect the results of the auditors' work and the auditors' conclusions and recommendations about those results.

⁵⁹ See paragraph 5.13 for definitions of significant deficiency and material weakness.

or business partner. Abuse is distinct from fraud, illegal acts, and violations of provisions of contracts or grant agreements in that abuse does not necessarily involve violation of laws, regulations, or provisions of a contract or grant agreement. If auditors encounter such situations, they should assess the risk of whether these situations or transactions could be indicative of qualitatively or quantitatively material abuse. When information comes to the auditors' attention (through audit procedures, allegations received through a fraud hotline, or other means) indicating that material abuse may have occurred, auditors should perform audit procedures, as necessary, to (1) determine whether the abuse occurred and, if so, (2) determine its effect on the financial statements or other financial data. Auditors assess both quantitative and qualitative factors in making judgments regarding the materiality of possible abuse.

4.20 In pursuing indications of potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse, auditors should avoid interfering with potential investigations and/or legal proceedings. In some circumstances, laws, regulations, or policies require auditors to report indications of certain types of potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse to law enforcement or investigatory authorities before performing additional audit procedures. In cases where an investigation is initiated or in process, it may be appropriate for the auditors to withdraw from or defer further work on the engagement or a portion of the engagement to avoid interfering with an investigation.

Developing Elements of a Finding

4.21 When deficiencies are identified, auditors should plan audit procedures to develop the elements of a finding necessary to achieve the audit objectives. Audit findings, such as deficiencies in internal control, potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse, contain the elements of criteria, condition, cause, and effect or potential effect. Thus, a finding or set of findings is complete to the extent that the auditors believe that the audit objectives are satisfied. (See paragraph 5.16 for a description of the elements of a finding.)

Audit Documentation

4.22 The auditor must prepare audit documentation in connection with each engagement in sufficient detail to provide a clear understanding of the work performed (including the nature, timing, extent, and results of audit procedures performed), the audit evidence obtained and its source, and the conclusions reached. Audit documentation:

- a. provides the principal support for the statement in the auditor's report that the auditor performed the audit in accordance with GAGAS and any other standards cited, and
- b. provides the principal support for the auditors' conclusions.

4.23 Audit documentation is an essential element of audit quality. Although documentation alone does not guarantee audit quality, the process of preparing sufficient and appropriate documentation contributes to the quality of an audit.

4.24 The auditor should prepare audit documentation that enables an experienced auditor,⁶⁰ having no previous connection to the audit, to understand:

- a. the nature, timing, and extent of auditing procedures performed to comply with GAGAS and other applicable standards and requirements,
- b. the results of the audit procedures performed and the audit evidence obtained,
- c. how the audit evidence relates to the audit conclusions, and

⁶⁰ An experienced auditor means an individual (whether internal or external to the audit organization) who possesses the competencies and skills that would have enabled him or her to perform the audit. These competencies and skills include an understanding of (a) audit processes, (b) GAGAS and applicable legal and regulatory requirements, (c) the environment in which the entity operates, and (d) auditing and financial reporting issues relevant to the audited entity's environment.

d. the conclusions reached on significant matters.

4.25 In addition to the audit documentation requirements listed in the previous paragraph, the auditor should document the following for financial audits performed under GAGAS :

a. the objectives, scope, and methodology of the audit, and

b. evidence of supervisory review, before the audit report is issued, of the work performed that supports findings, conclusions, and recommendations contained in the audit report.

4.26 Auditors should document matters specific to a particular audit in the audit documentation file for that audit. Certain matters, such as auditor independence and staff training, that are not engagement specific, may be documented either centrally in the audit organization or in the documentation for the audit.

4.27 The form, content, and extent of audit documentation depend on the circumstances of the engagement and the audit methodology and tools used. Oral explanations on their own do not represent sufficient support for the work the auditor performed or conclusions the auditor reached but may be used by the auditor to clarify or explain information contained in the audit documentation. It is, however, neither necessary nor practicable to document every matter the auditor considers during the audit.

4.28 The auditor should document significant findings or issues, actions taken to address them (including any additional evidence obtained), and the basis for the final conclusions reached. Judging the significance of a finding or issue requires an objective analysis of the facts and circumstances.

4.29 The auditor should document discussions of significant findings or issues with management and others, including the significant findings or issues discussed, and when and with whom the discussions took place.

4.30 If the auditor has identified information that contradicts or is inconsistent with the auditor's final conclusions regarding a significant finding or issue, the auditor should document how the contradiction or inconsistency was addressed in forming the conclusion.

4.31 In documenting the nature, timing, and extent of audit procedures performed, the auditor should record:

a. who performed the audit work and the date such work was completed, and

b. who reviewed specific audit documentation and the date of such review.

4.32 When the auditor does not comply with applicable unconditional or presumptively mandatory GAGAS requirements, the auditor should document the justification for the departure, the impact on the audit, and how alternative procedures performed in the circumstances were sufficient to achieve the objectives of the requirements. The auditor should also follow the requirements in paragraphs 1.13 through 1.15.

4.33 The report should not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence to support the reported information, conclusions, or opinions. Among other things, sufficient appropriate audit evidence includes evidence that the audit documentation has been reviewed and that the entity's financial statements, including disclosures, have been prepared and that management has asserted that it has taken responsibility for them.

4.34 The audit organization should adopt reasonable procedures to retain and access audit documentation for a period of time sufficient to meet the needs of the audit

organization and to satisfy any applicable legal or regulatory requirements for records retention. Such retention period, however, should not be shorter than five years⁶¹ from the report release date.

4.35 The auditor should complete the assembly of the final audit file on a timely basis, but within 60 days following the report release date (document completion date).⁶² Statutes, regulations, or the audit organization's quality control policies may state a specific time in which the assembly process should be completed.

4.36 At any time prior to the documentation completion date, the auditor may make changes to the audit documentation to:

- a. complete the documentation and assembly of audit evidence that the auditor has obtained, discussed, and agreed with relevant members of the audit team prior to the date of the audit report,
- b. perform routine file-assembling procedures such as deleting or discarding superseded documentation and sorting, collating, and cross-referencing final audit documentation,
- c. sign-off on audit documentation completion checklists prior to completing and archiving the audit documentation, and
- d. add information received after the date of the report, for example, an original document that was previously faxed.

4.37 After the documentation completion date, the auditors must not delete or discard audit documentation before the end of the specified retention period, as discussed in paragraph 4.34. When the auditor finds it necessary to make an addition (including

⁶¹ The five-year requirement is from AICPA Statement on Auditing Standards No. 103, *Audit Documentation*.

⁶² The 60-day requirement is from AICPA Statement on Auditing Standards No. 103, *Audit Documentation*.

amendments) to audit documentation after the documentation completion date, the auditor should document the addition by including the following in the documentation:

- a. when and by whom such additions were made and, where applicable, reviewed,
- b. the specific reasons for the changes, and
- c. the effect, if any, of the changes on the auditors' conclusions.

4.38 Audit documentation allows for the review of audit quality by providing the reviewer with documentation, either in written or electronic formats, of the evidence supporting the auditors' significant judgments and conclusions. If audit documentation is retained only electronically, the audit organization should safeguard the electronic documentation through sound computer security so that it is capable of being accessed throughout the specified retention period established for audit documentation.

4.39 Whether audit documentation is in paper, electronic, or other media, the integrity, accessibility, and retrievability of the underlying data may be compromised if the documentation could be altered, added to, or deleted without the auditors' knowledge, or could be permanently lost or damaged. Accordingly, the auditor should apply appropriate controls for audit documentation to safeguard audit documentation from alteration, destruction, and unauthorized access.

4.40 Underlying GAGAS audits is the premise that federal, state, and local government audit organizations and independent accounting firms engaged to perform a financial audit in accordance with GAGAS cooperate in auditing programs of common interest so that auditors may use others' work and avoid duplication of audit efforts. Auditors should make appropriate audit staff and individuals, as well as audit documentation available, upon request, in a timely manner to other auditors or reviewers. It is also essential that contractual arrangements for GAGAS audits provide for full and timely

access to audit staff and individuals, as well as audit documentation without restriction to facilitate reliance by other auditors or reviewers on the auditors' work.

4.41 Consistent with applicable laws and regulations, audit organizations should develop clearly defined policies and criteria to deal with situations where requests are made by outside parties to obtain access to audit documentation. The audit organization should include in its policies and procedures guidance for dealing with situations where an outside party attempts to obtain indirectly through the auditor information that it is unable to obtain directly from the audited entity and how to respond to requests for access to audit documentation before the audit is complete. The audit organization should also include flexibility in its policies and procedures to consider the individual facts and circumstances surrounding such requests, for instance, cases when granting access or providing certain information could adversely affect the audit organization's ability to successfully perform similar audits in the future.

Chapter 5

Reporting Standards for Financial Audits

Introduction

5.01 This chapter establishes reporting standards and provides guidance for financial audits conducted in accordance with generally accepted government auditing standards (GAGAS). For financial audits, GAGAS incorporate the AICPA's field work and reporting standards and the related statements on auditing standards unless specifically excluded or modified by GAGAS.⁶³ This chapter identifies the AICPA reporting standards and prescribes additional standards for financial audits performed in accordance with GAGAS.

5.02 See paragraphs 1.16 through 1.18 for a discussion about the use of GAGAS with other financial audit standards.

AICPA Reporting Standards

5.03 The four AICPA generally accepted standards of reporting are as follows:⁶⁴

[AICPA is currently in the process of revising the reporting standards to use clarified language. GAO will monitor the status of AICPA's efforts in order to include the most up-to-date AICPA standards in the final 2006 Revision of Government Auditing Standards.]

a. The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles.

⁶³ To date, the Comptroller General has not excluded any reporting standards or SASs.

⁶⁴ See *AICPA Professional Standards*, AU 410 - 431 and 504.

b. The report shall identify those circumstances in which such principles have not been consistently observed in the current period in relation to the preceding period.

c. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.

d. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's work, if any, and the degree of responsibility the auditor is taking.

Additional GAGAS Reporting Standards for Financial Audits

5.04 GAGAS establish additional reporting standards for financial audits in addition to the requirements contained in the AICPA SAS. Auditors should comply with these additional standards when citing GAGAS in their audit reports. The additional GAGAS standards relate to:

a. reporting auditors' compliance with GAGAS (see paragraphs 5.05 through 5.07);

b. reporting on internal control and on compliance with laws, regulations, and provisions of contracts or grant agreements (see paragraphs 5.08 through 5.11);

c. reporting deficiencies in internal control, potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse (see paragraphs 5.12 through 5.27);

d. emphasizing significant matters in the auditors' report (see paragraphs 5.28 through 5.31);

- e. reporting on restatement of previously-issued financial statements (see paragraphs 5.32 through 5.38);
- f. reporting views of responsible officials (see paragraphs 5.39 through 5.44);
- g. reporting privileged and confidential information (see paragraphs 5.45 through 5.47);
and
- h. issuing and distributing reports (see paragraphs 5.48 through 5.51).

Reporting Auditors' Compliance with GAGAS

5.05 When auditors comply with all applicable GAGAS standards, they should include a statement in the audit report that they performed the audit in accordance with GAGAS.

5.06 The statement of compliance with GAGAS indicates that the auditors have complied with all applicable GAGAS general and auditing standards, including the underlying AICPA standards. If the auditors did not follow applicable standards, or were not able to follow applicable standards due to access problems or other scope limitations, they should follow the requirements in paragraphs 1.13 through 1.15.

5.07 An audited entity receiving a GAGAS audit report may also request auditors to issue a financial audit report for purposes other than complying with requirements calling for a GAGAS audit. For example, the audited entity may need audited financial statements to issue bonds or for other financing purposes. GAGAS do not prohibit auditors from issuing a separate report conforming only to the requirements of AICPA or other standards. When a GAGAS audit is the basis for an auditors' subsequent report under the other standards, the auditors should consider including a reference to the GAGAS report, as that report will contain additional information on internal control, compliance with laws, regulations, and provisions of contracts or grant agreements, potential fraud, or abuse that GAGAS require.

Reporting on Internal Control and on Compliance with Laws, Regulations, and Provisions of Contracts or Grant Agreements

5.08 When providing an opinion or a disclaimer on financial statements, auditors should include in their report on the financial statements either a (1) description of the scope of the auditors' testing of internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements and the results of those tests or an opinion, if sufficient work was performed, or (2) reference to the separate report(s) containing that information. If auditors report separately, they should include a reference to the separate report containing this information in their opinion or disclaimer report and state that the separate report is an integral part of the audit and important for assessing the results of the audit.

5.09 For audits of financial statements in which auditors provide an opinion, auditors should report the scope of their testing of internal control over financial reporting and of compliance with laws, regulations, and provisions of contracts or grant agreements. Auditors should also indicate in the report whether or not the tests they performed provided sufficient evidence to support an opinion on the effectiveness of internal control over financial reporting and on compliance with laws, regulations, and provisions of contracts or grant agreements.

5.10 Auditors may report on internal control over financial reporting and on compliance with laws, regulations, and provisions of contracts or grant agreements in the opinion or disclaimer on the financial statements or in a separate report or reports. When auditors report on internal control over financial reporting and compliance as part of the opinion or disclaimer on the financial statements, they should include an introduction summarizing key findings in the audit of the financial statements and the related internal control and compliance work. Auditors should not issue this introduction as a stand-alone report.

5.11 When auditors report separately (including separate reports bound in the same document) on internal control over financial reporting and compliance with laws and regulations and provisions of contracts or grant agreements, they should state in the opinion or disclaimer on the financial statements that they are issuing those additional reports. They also should state that the reports on internal control over financial reporting and compliance with laws and regulations and provisions of contracts or grant agreements are an integral part of a GAGAS audit and important for assessing the results of the audit.

Reporting Deficiencies in Internal Control, Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse

5.12 For financial audits, including audits of financial statements in which auditors provide an opinion or disclaimer, auditors should report, as applicable to the objectives of the audit, (1) deficiencies in internal control considered to be material weaknesses or other significant deficiencies, (2) all instances of potential fraud and illegal acts unless clearly inconsequential,⁶⁵ and (3) material violations of provisions of contracts or grant agreements or abuse. In some circumstances, auditors should report potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly to parties external to the audited entity when other requirements provide for such reporting.

Reporting Deficiencies in Internal Control

5.13 For all financial audits, auditors should report deficiencies in internal control considered to be significant deficiencies, including material weaknesses, as follows:

⁶⁵If the auditor is performing an audit in accordance with OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, the thresholds for reporting are defined in the circular. Those reporting thresholds are sufficient to meet the requirements of GAGAS.

a. A significant deficiency is a deficiency in internal control, or combination of deficiencies, that adversely affects the entity’s ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote⁶⁶ likelihood that a misstatement of the entity’s financial statements that is more than inconsequential⁶⁷ will not be prevented or detected.

b. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

5.14 If control deficiencies are identified, an important part of the assessment is the consideration of significance of those deficiencies. In addition to qualitative considerations, auditors evaluate the following when concluding about the significance of a deficiency in internal control:

a. the likelihood that a deficiency, or combination of deficiencies, could result in a misstatement of an account balance or disclosure, and

b. the magnitude of the potential misstatement resulting from the deficiency or deficiencies.

5.15 Auditors should include all material weaknesses and other significant deficiencies in the auditors’ report on internal control over financial reporting. (See appendix A.03

⁶⁶ The term “more than remote” used in the definitions for significant deficiency and material weakness means “at least reasonably possible.” The following definitions apply. (1) Remote—The chance of the future events or their occurrence is slight. (2) Reasonably possible—The chance of the future events or their occurrence is more than remote but less than likely. (3) Probable—The future events are likely to occur.

⁶⁷ “More than inconsequential” indicates an amount that is less than material, yet has significance. A misstatement is “inconsequential” if a reasonable, objective person would conclude that the misstatement, either individually or when aggregated with other misstatements, would clearly be immaterial to the financial statements. If a reasonable, objective person could not reach such a conclusion, that misstatement is “more than inconsequential.”

for examples of matters that may be significant deficiencies, including material weaknesses.)

5.16 To the extent necessary to achieve the audit objectives, in presenting audit findings such as deficiencies in internal control, auditors should develop the elements of criteria, condition, cause, and effect to assist management or oversight officials of the audited entity in understanding the need for taking corrective action. In addition, if auditors are able to sufficiently develop the elements of a finding, they should provide recommendations for corrective action. Following is guidance for reporting on elements of findings:

- a. Criteria:** The required or desired state or what is expected from the program or operation. The criteria are easier to understand when stated objectively, explicitly, and completely, and the source of the criteria is identified in the audit report.⁶⁸
- b. Condition:** What the auditors found regarding the actual situation. Reporting the scope or extent of the condition allows the report user to gain an accurate perspective.
- c. Cause:** Evidence on the factor or factors responsible for the difference between condition and criteria. In reporting the cause, auditors may consider whether the evidence provides a reasonable and convincing argument for why the stated cause is the key factor or factors contributing to the difference as opposed to other possible causes, such as poorly designed criteria or factors uncontrollable by program management. The auditors also may consider whether the identified cause could serve as a basis for the recommendations. Often the causes of deficiencies in internal control are complex and involve multiple factors. In some cases, it may not be practical for auditors to fully develop or identify the causes of deficiencies. However, analyzing and identifying root

⁶⁸ Common sources for criteria include laws, regulations, policies, procedures, and best or standard practices. The *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: Nov. 1999) and *Internal Control—Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) are two sources of established criteria auditors can use to support their judgments and conclusions about internal control. The related *Internal Control Management and Evaluation Tool* (GAO-01-1008G, Aug. 2001), based on the federal internal control standards, provides a systematic, organized, and structured approach to assessing internal control.

causes of internal control deficiencies is key to making recommendations for corrective action.

d. Effect or potential effect: A clear, logical link to establish the impact or potential impact of the difference between what the auditors found (condition) and the required or desired state (criteria). Effect is easier to understand when it is stated clearly, concisely, and, if possible, in quantifiable terms. The significance of the reported effect can be demonstrated through credible evidence.

5.17 Auditors should place their findings in perspective by describing the nature and extent of the issues being reported and the extent of the work performed that resulted in the finding. To give the reader a basis for judging the prevalence and consequences of these findings, auditors may relate the instances identified to the population or the number of cases examined and quantify the results in terms of dollar value, as appropriate. If the results cannot be projected, auditors should limit their conclusions appropriately.

5.18 When auditors detect deficiencies in internal control that are not significant deficiencies (or material weaknesses) they should communicate those deficiencies separately in a management letter to officials of the audited entity unless the deficiencies are clearly inconsequential considering both quantitative and qualitative factors. Auditors should refer to that management letter (or to a management letter to be issued) in the report on internal control. Auditors use professional judgment when deciding whether or how to communicate to officials of the audited entity deficiencies in internal control that are clearly inconsequential. Auditors should include in their audit documentation evidence of communications to officials of the audited entity about deficiencies in internal control found during the audit.

Reporting Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse

5.19 Under AICPA standards and GAGAS, auditors should address the effect potential fraud or illegal acts may have on the audit report and to determine that those charged with governance are adequately informed about the potential fraud or illegal acts. Under GAGAS, auditors should provide this information in writing and also include reporting on (1) violations of provisions of contracts or grant agreements that have a material effect on the determination of financial statement amounts or other financial data significant to the audit, and (2) abuse that is material, either quantitatively or qualitatively.⁶⁹ Therefore, when auditors conclude, on the basis of evidence obtained, that any of the following either has occurred or is likely to have occurred,⁷⁰ they should include in their audit report the relevant information about⁷¹

- a. potential fraud and illegal acts that are greater than inconsequential;
- b. material violations of contracts or grant agreements; or
- c. material abuse.

5.20 When reporting instances of potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse, auditors should place their findings in perspective by describing the extent of the work performed that resulted in the finding. To give the reader a basis for judging the prevalence and consequences of these findings, auditors may relate the instances identified to the population or to the number of cases

⁶⁹ See paragraph 4.19 for a discussion of abuse.

⁷⁰ Whether a particular act is, in fact, illegal may have to await final determination by a court of law or other adjudicative body. Thus, when auditors disclose matters that have led them to conclude that an illegal act is likely to have occurred, they do not make a final determination of illegality.

⁷¹ Auditors include information about fraud or abuse in the audit reports required by paragraph 5.08 as applicable to internal control and compliance with laws, regulations, and provisions of contracts and grant agreements.

examined and quantify the results in terms of dollar value, as appropriate. If the results cannot be projected, auditors should limit their conclusions appropriately.

5.21 To the extent necessary to achieve the audit objectives, auditors should develop in their report the elements of criteria, condition, cause, and effect when potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse is found. The guidance for reporting deficiencies in internal control in paragraph 5.16 is designed to assist auditors in developing the elements of their findings.

5.22 When auditors detect immaterial violations of provisions of contracts or grant agreements or abuse, they should communicate those findings in a management letter to officials of the audited entity unless the findings are clearly inconsequential to the financial statements considering both qualitative and quantitative factors. Auditors should refer to that management letter in their audit report on compliance (or to a management letter to be issued). Auditors use professional judgment when determining whether and how to communicate to officials of the audited entity potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse that is clearly inconsequential. Auditors should include in their audit documentation evidence of communications to officials of the audited entity about potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse found during the audit.

5.23 When auditors conclude that potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse either have occurred or are likely to have occurred, they may consult with authorities and/or legal counsel about whether publicly reporting certain information about the potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse would compromise investigative or legal proceedings. Auditors should limit their public reporting to matters that would not compromise those proceedings, such as information that is already a part of the public record.

Direct Reporting of Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse

5.24 Auditors should report potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly to parties outside the audited entity in two circumstances, as discussed below.⁷² This reporting is in addition to any legal requirements for direct reporting of potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse. Auditors should follow these requirements even if they have resigned or been dismissed from the audit prior to its completion.

5.25 The audited entity may be required by law or regulation to report certain potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse to specified external parties, such as a federal inspector general or a state attorney general. When auditors have communicated such potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse to the audited entity and the audited entity fails to report them, then the auditors should communicate such an awareness to those charged with governance. When the audited entity does not make the required report as soon as possible after the auditors' communication with those charged with governance, then the auditors should report such potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly to the external party specified in the law or regulation.

5.26 When potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse involves awards received directly or indirectly from a government agency, auditors may have a duty to report directly if management fails to take remedial steps. When auditors conclude that such failure is likely to cause them to depart from the standard report on the financial statements or resign from the audit, they should communicate that conclusion to those charged with governance of the audited entity. If the audited entity does not report the potential fraud, illegal act, violation of provisions

⁷² Internal audit organizations do not have a duty to report outside that entity unless required by law, rule, regulation, or policy. See paragraph 3.19 for reporting requirements for internal audit organizations when reporting externally.

of contracts or grant agreements, or abuse in a timely manner to the entity that provided the government assistance, the auditors should report the potential fraud, illegal act, violation of provisions of contracts or grant agreements, or abuse directly to the awarding entity.

5.27 Auditors should obtain sufficient, appropriate evidence, such as confirmation from outside parties, to corroborate assertions by management that it has reported potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse. When auditors are unable to do so, they should report such potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly as discussed above.

Emphasizing Significant Matters in the Auditors' Report

5.28 Under both the AICPA standards⁷³ and GAGAS, auditors may emphasize a matter in the auditors' report regarding the financial statements. Due to the unique roles and responsibilities of governments and government entities, there may be situations where users and oversight organizations need information that is critical for understanding the financial statements in relation to the government's current and/or future operating environment, as well as information about unusual events and significant uncertainties. In addition, due to the unique nature of government responsibilities and operations, there may be situations where additional information would help facilitate the readers' understanding of the information in the auditors' report.

5.29 Auditors use professional judgment to determine whether to emphasize a matter in the auditors' report. Such explanatory material is presented in a separate paragraph or separate section of the auditors' report. Examples of matters that auditors should consider emphasizing when they become aware that such issues exist include the following:

⁷³ See *AICPA Professional Standards*, AU 508.19

a. Concerns or significant uncertainties about the fiscal sustainability of a government or program or other matters that could have a significant impact on the financial condition or operations of the government entity.⁷⁴ Such concerns or uncertainties may arise due to revenue and/or expenditure trends; economic dependency on other governments or other entities; the government’s current commitments, responsibilities, liabilities, or promises to citizens for future benefits that are not sustainable over the long-term; deficit trends; the relationship between the financial information and other key indicators; and other significant risks and uncertainties that call into question the long-term sustainability of current government programs in relation to the resources expected to be available.

b. Unusual or catastrophic events that will likely have a significant ongoing or future impact on the government’s financial condition or operations.

c. Significant uncertainties surrounding projections or estimations in the financial statements.

d. Any other matter that the auditors consider significant for communication in the auditors’ report to users and oversight bodies.

5.30 Auditors should obtain sufficient, appropriate evidence about any matter emphasized. In the case of significant uncertainties where sufficient appropriate evidence may not be available, auditors should describe the significant uncertainties and the possible impact on the reported information.

5.31 Auditors should consider emphasizing a matter even if management has disclosed the issue in the notes to the financial statements. In such cases, auditors refer to management’s disclosures, describe any deficiencies in management’s disclosures, and include additional detail as appropriate. In situations when management has not

⁷⁴ These types of matters go beyond the auditors’ responsibility in AU 341 to consider an entity’s ability to continue as a going concern.

disclosed the information, the auditors should encourage management to disclose such information.

Reporting on Restatement of Previously-Issued Financial Statements

5.32 Auditors have professional responsibilities when they become aware of actual or potential misstatements that might have affected their report on previously-issued financial statements. Under both AICPA standards⁷⁵ and GAGAS, auditors have the following responsibilities related to (1) potential material misstatements in previously-issued financial statements, and (2) restatement⁷⁶ of the previously-issued financial statements:

- a.** Auditors should determine if the previously-issued financial statements were materially misstated and should request management's cooperation in making this determination.
- b.** Auditors should determine if (a) the misstatement(s) may affect the auditors' report on the previously-issued financial statements and, (b) persons are currently relying or likely to rely on the financial statements.
- c.** Auditors should advise the audited entity to disclose the misstatement(s) and the related financial statement impact to persons relying or likely to rely on the financial statements and related auditors' report.
- d.** Auditors should determine whether the audited entity has appropriately disclosed the misstatement(s).

⁷⁵See *AICPA Professional Standards*, AU 561, "Subsequent Discovery of Facts Existing at the Date of the Auditor's Report."

⁷⁶As used in this standard, restatement means the correction of an error(s) in previously-issued financial statement(s).

e. When the audited entity refuses to disclose the misstatement(s), then:

(1) auditors should notify those charged with governance of the entity's refusal to disclose the misstatement,

(2) auditors should notify the audited entity that the related auditors' report can no longer be relied upon or associated with the previously-issued financial statements, and

(3) auditors should notify oversight or regulatory agencies that have jurisdiction over the audited entity and persons known to be relying on the financial statements that the auditors' report can no longer be relied upon.

5.33 GAGAS prescribe additional standards for reporting on restatement of previously-issued financial statements. When performing a financial statement audit in accordance with GAGAS, auditors should comply with these additional GAGAS standards and with the AICPA standards. The additional GAGAS standards and guidance are included in paragraphs 5.34 through 5.38.

5.34 The nature or amount of known or likely misstatement(s) in previously-issued audited financial statements may lead auditors to believe that the auditors' report would or could reasonably have been affected if they had known of the misstatements when they issued the auditors' report. When this condition exists, auditors should advise management to communicate the following information to those charged with governance, oversight bodies, funding agencies, and others who are relying or are likely to rely on the financial statements:

a. The nature and cause(s) of the known or likely material misstatement(s).

b. The amount(s) of known or likely material misstatement(s) and the related effect(s) on the previously-issued financial statements (e.g., disclosure of the specific financial statement(s) and line item(s) affected). If this information is not known, then the

disclosure includes information that is known and a statement that management cannot determine the amount(s) and the related effect(s) on the previously-issued financial statements without further investigation.

c. A notice that (1) previously-issued financial statements will or may be restated and, therefore, (2) the related auditors' report is no longer reliable.

5.35 Auditors should review the adequacy of management's communication information about the known or potential material misstatement(s) to report users, including those charged with governance, oversight bodies and funding agencies. When performing this review, auditors consider whether:

a. management acted timely to determine the financial statement effects of the potential material misstatement(s),

b. management acted timely to communicate with appropriate parties, and

c. management disclosed the nature and extent of the known or likely material misstatement(s) on Internet pages where the agency's previously-issued financial statements are published.

Auditors should notify those charged with governance if they believe that management is unduly delaying its determination of the effect(s) of the misstatement(s) on previously-issued financial statements.

5.36 Also, auditors should evaluate the timeliness and appropriateness of management's decision whether to issue restated financial statements. Management may separately issue the restated financial statements or may present the restated financial statements on a comparative basis with those of a subsequent period. Ordinarily, auditors would expect management to issue restated financial statements as soon as practicable. However, it may not be necessary for management to separately issue the restated

financial statements and auditors' report when issuance of the subsequent-period audited financial statements is imminent.⁷⁷

5.37 When management restates previously-issued financial statements, auditors should perform audit procedures sufficient to reissue or update the auditors' report on the restated financial statements. Auditors should fulfill these responsibilities whether the restated financial statements are separately issued or presented on a comparative basis with those of a subsequent period. Auditors should include the following information in an explanatory paragraph in the reissued or updated auditors' report on the re-issued financial statements:

a. a statement disclosing that the previously-issued financial statement(s) have been restated,

b. a statement that the previously-issued financial statements were materially misstated and that the previously-issued auditors' report (include report date) is withdrawn and replaced by the auditors' report on the restated financial statement(s), and

c. a reference to the note(s) to the restated financial statements that discusses the restatement, including

(1) the nature and cause(s) of the misstatement(s) that led to the need for restatement, and

(2) the specific amount(s) of the material misstatement(s) and the related effect(s) on the previously-issued financial statements (e.g., the specific financial statement(s) affected and line items restated) and the impact on the current-year financial statements.

⁷⁷ For purposes of this standard, imminent means within 90 days of determining the effect of the misstatement(s) on the previously-issued financial statements.

d. A discussion of any significant internal control deficiency that failed to prevent or detect the misstatement and what action management has taken about the deficiency.

5.38 Auditors should notify those charged with governance, oversight bodies, and funding agencies when management (1) does not take the necessary steps to promptly inform report users of the situation or (2) does not restate with appropriate timeliness the financial statements in circumstances when auditors believe they need to be restated. Auditors should inform these parties that the auditors will take steps to prevent future reliance on the auditors' report. The steps taken will depend on the facts and circumstances, including legal considerations.

Reporting Views of Responsible Officials

5.39 If the auditors' report discloses deficiencies in internal control, potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse, auditors should obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as planned corrective actions.

5.40 One of the most effective ways to provide a report that is fair, complete, and objective is to provide a draft report for review and comment by responsible officials of the audited entity and others, as appropriate. Including the views of responsible officials results in a report that presents not only the significant deficiencies in internal control, potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse the auditors identified, but also the perspectives of the responsible officials of the audited entity and the corrective actions they plan to take. Auditors should include in their report a copy of the officials' written comments and/or a summary of the comments received. In cases where the audited entity provides technical comments in addition to its written comments on the report, auditors use professional judgment in determining whether to include such comments or disclose in the report that such comments were provided.

5.41 Auditors ordinarily request that the responsible officials submit in writing their views on the auditors' reported findings, conclusions, and recommendations, as well as management's planned corrective actions. However, oral comments are acceptable, and, in some cases, may be the most expeditious way to obtain comments. Obtaining oral comments can be effective when, for example, there is a time-critical reporting date to meet a user's needs; auditors have worked closely with the responsible officials throughout the conduct of the work and the parties are familiar with the findings and issues addressed in the draft report; or the auditors do not expect major disagreements with the draft report's findings, conclusions, and recommendations, or perceive any major controversies with regard to the issues discussed in the draft report. If oral comments are provided by the responsible officials, auditors should prepare a summary of the oral comments and provide a copy of the summary to the responsible officials to verify that the comments are accurately stated prior to finalizing the report.

5.42 Auditors should fairly and objectively evaluate and recognize comments, as appropriate, in the final report. Auditors may note comments, such as a plan for corrective action, but should not accept them as justification for dropping a finding or a related recommendation without sufficient and appropriate evidence.

5.43 When the audited entity's comments oppose the report's findings, conclusions, or recommendations, and are not, in the auditors' opinion, valid, or when planned corrective actions do not adequately address the auditors' recommendations, the auditors should state objectively their reasons for disagreeing with the comments or planned corrective actions. Conversely, the auditors should modify their report as necessary if they find the comments valid.

5.44 If the audited entity refuses to provide comments or is unable to provide comments within a reasonable period of time, the auditors may need to issue the report without receiving comments from the audited entity. In such cases, the auditors should describe in the report the reasons that comments from the audited entity are not included.

Reporting Privileged and Confidential Information

5.45 If certain pertinent information is prohibited from general disclosure, auditors should disclose in the report that certain information has been omitted and the requirement that makes the omission necessary.

5.46 Certain information may be classified or may be otherwise prohibited from general disclosure by federal, state, or local laws or regulations. In such circumstances, auditors may issue a separate, classified or limited-official-use report containing such information and distribute the report only to persons authorized by law or regulation to receive it. Additional circumstances associated with public safety and security concerns could also justify the exclusion of certain information in the report. For example, detailed information related to computer security for a particular program may be excluded from publicly available reports because of the potential damage that could be caused by the misuse of this information. In such circumstances, auditors may issue a limited-official-use report containing such information and distribute the report only to those parties responsible for acting on the auditors' recommendations. The auditors may consult with legal counsel regarding any requirements or other circumstances that may necessitate the omission of certain information.

5.47 Auditors consider the broad public interest in the program or activity under review when deciding whether to exclude certain information from publicly available reports. When circumstances call for omission of certain information, auditors should evaluate whether this omission could distort the audit results or conceal improper or unlawful practices.

Issuing and Distributing Reports

5.48 Government auditors should submit audit reports to those charged with governance, to the appropriate officials of the audited entity and to appropriate officials of the organizations requiring or arranging for the audits, including external funding

organizations⁷⁸ such as legislative bodies, unless legal restrictions prevent it. Auditors should also send copies of the reports to other officials who have legal oversight authority or who may be responsible for acting on audit findings and recommendations and to others authorized to receive such reports. Auditors should clarify whether the report will be made available for public inspection. If the subject of the audit involves material that is classified for security purposes or not releasable to particular parties or the public for other valid reasons, auditors may limit the report distribution.⁷⁹ Auditors should document any limitation on report distribution.

5.49 When nongovernment auditors are engaged to perform an audit under GAGAS, they should clarify report distribution responsibilities with the engaging organization. If nongovernment auditors are to make the distribution, they should reach agreement with the party contracting for the audit about which officials or organizations should receive the report and the steps being taken to make the report available to the public.

5.50 Internal auditors may follow the IIA standards for report distribution, which state internal auditors also follow any applicable statutory requirements for distribution. The head of the internal audit organization should disseminate results to the appropriate parties. The head of the internal audit organization is responsible for communicating the final results to parties who are in a position to take appropriate corrective actions. Distribution of reports outside the organization ordinarily is made only in accordance with applicable laws, rules, regulations, or policy.

5.51 If an audit is terminated before it is completed but the auditors do not issue an audit report, auditors should write a memorandum for the record that summarizes the results of the work to the date of termination and explains why the audit was terminated. In addition, depending on the facts and circumstances, auditors should notify those charged with governance, management of the audited entity, the entity requesting the

⁷⁸ See the Single Audit Act, as amended, and Office of Management and Budget (OMB) Circular No. A-133 on single audits for the distribution of reports on single audits of state and local governmental entities and nonprofit organizations that receive federal awards.

⁷⁹ See paragraphs 5.45 through 5.47 for additional guidance on limited report distribution when reports contain privileged or confidential information.

audit, and other appropriate officials about the termination of the audit, preferably in writing. Auditors should document this communication.

Chapter 6

General, Field Work, and Reporting Standards for Attestation Engagements

Introduction

6.01 This chapter establishes standards and provides guidance for attestation engagements conducted in accordance with generally accepted government auditing standards (GAGAS). For attestation engagements, GAGAS incorporate the AICPA's general standard on criteria, and the field work and reporting standards and the related statements on standards for attestation engagements (SSAE), unless specifically excluded or modified by GAGAS.⁸⁰ This chapter identifies the AICPA general standard on criteria,⁸¹ field work and reporting standards for attestation engagements and prescribes additional standards for attestation engagements performed in accordance with GAGAS.

6.02 See paragraphs 1.16 through 1.17 and 1.19 for a discussion about the use of GAGAS with other professional standards.

6.03 See paragraphs 1.28 through 1.32 for an overall description of the nature and objectives of attestation engagements.

AICPA General and Field Work Standards for Attestation Engagements

6.04 The AICPA general standard related to criteria states the following:

[AICPA is currently in the process of revising the general standards to use clarified language. GAO will monitor the status of AICPA's efforts in order to include the most

⁸⁰ To date, the Comptroller General has not excluded any field work standards, reporting standards, or SSAEs.

⁸¹ GAGAS incorporate only one of the AICPA general standards for attestation engagements.

up-to-date AICPA standards in the final 2006 Revision of Government Auditing Standards.]

The practitioner [auditor] shall perform an engagement only if he or she has reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to users.

6.05 The two AICPA field work standards for attestation engagements are as follows:

[AICPA is currently in the process of revising the field work standards to use clarified language. GAO will monitor the status of AICPA's efforts in order to include the most up-to-date AICPA standards in the final 2006 Revision of Government Auditing Standards.]

- a. The work shall be adequately planned and assistants, if any, shall be properly supervised.
- b. Sufficient evidence shall be obtained to provide a reasonable basis for the conclusion that is expressed in the report.

Additional Considerations for Attestation Engagements in Government

6.06 Auditors use professional judgment when applying auditing and attestation standards and guidance to attestation engagements of a government entity or an entity that receives government awards. For example, auditors may need to set lower materiality levels than in attestation engagements in the private sector because of the public accountability of the audited entity, various legal and regulatory requirements, and the visibility and sensitivity of government programs. Auditors also consider the needs of users and the concerns of oversight official regarding previously identified risks, previously reported deficiencies in internal control of the entity, and current and emerging risks and uncertainties facing the government entity or program.

6.07 An important element of attestation engagements in government is the reporting of deficiencies in internal control related to the subject matter or objectives of the engagement so that the entity can take corrective actions necessary under the circumstances. (See paragraphs 6.49 through 6.53.) In an attestation engagement, a deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent errors in assertions made by management on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective is not met. A deficiency in operation exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

Additional GAGAS Field Work Standards for Attestation Engagements

6.08 GAGAS establish attestation engagement field work standards in addition to the requirements contained in the AICPA SSAE. Auditors should comply with these additional standards when citing GAGAS in their attestation engagement reports. The additional GAGAS field work standards relate to:

- a.** auditor communication (see paragraphs 6.09 through 6.11);
- b.** previous audits and attestation engagements (see paragraphs 6.12 through 6.13);
- c.** internal control (see paragraphs 6.14 through 6.16);
- d.** detecting potential fraud, illegal acts, violations of contract provisions or grant agreements, or abuse that could have a material effect on the subject matter (see paragraphs 6.17 through 6.22);

- e. developing elements of findings for attestation engagements (paragraph 6.23); and
- f. attest documentation (see paragraphs 6.24 through 6.43).

Auditor Communication

6.09 Auditors should communicate information regarding their responsibilities under GAGAS related to the subject matter or assertion about the subject matter, including the level of assurance to those charged with governance and to the individuals contracting for or requesting the attestation engagement and document the communications.

6.10 Under AICPA standards and GAGAS, auditors should establish a written understanding with those charged with governance⁸² and communicate with audit committees. Under GAGAS, auditors should communicate specific information in writing during the planning stages of an attestation engagement, including any potential restriction of the attestation reports, to reduce the risk that the needs or expectations of the parties involved may be misinterpreted. During the planning stages of an attestation engagement, auditors also should report (1) the nature, timing, and extent of testing and reporting, and (2) the level of assurance provided. Auditors use professional judgment when determining the form, content, and frequency of the communication. Auditors may use an engagement letter or a proposal, if appropriate, to communicate the information. If the attestation engagement is part of a larger audit, this information may be communicated as part of that audit.

6.11 When auditors perform an attestation engagement under a contract with a party other than the officials of the audited entity, or pursuant to a third-party request, auditors should also communicate in writing with the individuals contracting for or requesting the

⁸² Those charged with governance are those responsible for overseeing the strategic direction of the entity and the entity's fulfillment of its accountability obligations. In situations in which those charged with governance are not clearly evident, the auditor documents the process followed and conclusions reached for identifying the appropriate individuals to receive the required auditor communications. (See appendix, paragraph A1.02 for additional information.)

audit, such as contracting officials or members or staff of legislative committees, in addition to communicating with the audited entity. When auditors are performing the audit pursuant to a law or regulation and they are conducting the work directly for the legislative committee who has oversight for the audited entity, auditors should communicate with the members or staff of that legislative committee. Auditors should coordinate communications with the responsible government audit organization and/or management of the audited entity. If an audit is terminated before it is completed, auditors should write a memorandum for the audit documentation that summarizes the results of the work and explains the reasons why the audit was terminated. In addition, depending on the facts and circumstances, auditors should consider the need to communicate the reason for terminating the audit to those charged with governance, management of the audited entity, the entity requesting the audit, and other appropriate officials, preferably in writing.

Previous Audits and Attestation Engagements

6.12 When planning the engagement, auditors should determine whether the results of previous audits and attestation engagements that directly relate to the subject matter or the assertion of the attestation engagement being undertaken have an impact on the current engagement, including whether related recommendations have been implemented.

6.13 Auditors should identify previous financial audits, attestation engagements, performance audits, or other studies related to the subject matter or assertions of the attestation engagement being undertaken and ask management of the audited entity to identify corrective actions taken to address significant findings and recommendations,⁸³ including those related to significant deficiencies, including material weaknesses.⁸⁴

⁸³ Significant findings and recommendations are those matters that, if not corrected, could affect the results of the auditors' work and the auditors' conclusions and recommendations about those results.

⁸⁴ See paragraph 6.50 for definitions of significant deficiency and material weakness.

Internal Control

6.14 In planning examination-level attestation engagements, auditors should obtain a sufficient understanding of internal control that is material to the subject matter or assertion in order to plan the engagement and design procedures to achieve the objectives of the attestation engagement.

6.15 Auditors should obtain an understanding of internal control⁸⁵ as it relates to the subject matter or assertion to which the auditors are attesting. The subject matter or assertion may be financial or nonfinancial, and internal control material to the subject matter or assertion the auditors are testing may relate to:

- a.** effectiveness and efficiency of operations, including the use of an entity's resources;
- b.** reliability of financial reporting, including reports on budget execution and other reports for internal and external use;
- c.** compliance with applicable laws and regulations, provisions of contract, or grant agreements; and
- d.** safeguarding of assets.

6.16 A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect errors in assertions made by management on a

⁸⁵ Although not applicable to attestation engagements, the AICPA SASs may provide useful guidance related to internal control for auditors performing attestation engagements in accordance with GAGAS. In addition, auditors performing attestation engagements may wish to refer to the internal control guidance published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: Nov. 1999), which incorporates the relevant guidance developed by COSO, provides definitions and fundamental concepts pertaining to internal control at the federal level and may be useful to auditors at any level of government. The related *Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C.: Aug. 2001) based on the federal internal control standards, provides a systematic, organized, and structured approach to assessing internal control.

timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective is not met. A deficiency in operation exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

Detecting Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse That Could Have a Material Effect on the Subject Matter

6.17 The standard related to potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse for attestation engagements performed in accordance with GAGAS is:

- a.** In planning examination-level attestation engagements, auditors should design the engagement to provide reasonable assurance of detecting potential fraud, illegal acts, or violations of provisions of contracts or grant agreements that could have a material effect on the subject matter or assertion of the attestation engagement.
- b.** In planning review-level attestation engagements, auditors should be alert to situations or transactions that may be indicative of potential fraud, illegal acts, and violations of provisions of contracts or grant agreements.
- c.** In agreed-upon-procedures-level engagements, auditors perform limited testing in order to issue a report of finding based on specific procedures performed on a subject matter. Therefore, auditors are not expected to provide assurance of detecting potential fraud, illegal acts, or violations of contract or grant agreements for these types of engagements.
- d.** Auditors conduct the attestation engagement with the mindset that recognizes the possibility that a material misstatement in management's assertion could be present.

However, absolute assurance is not attainable and thus even a properly planned and performed examination-level attestation engagement may not detect a material misstatement resulting from fraud.

e. For all types of attestation engagements, auditors remain alert to situations or transactions that may be indicative of material abuse and follow the requirements in 6.20 through 6.21.

6.18 For examination-level attestation engagements, auditors design the engagement to provide reasonable assurance of detecting fraud⁸⁶, illegal acts, or violations of provisions of contracts or grant agreements that have a material effect on the subject matter or assertion of the attestation engagement. Auditors should assess the risk and possible effects of material fraud, illegal acts, or violations of provisions of contracts or grant agreements on the subject matter or assertion of the attestation engagement. Auditors should document their assessment of risk, and when risk factors are identified, auditors should also document:

a. those risk factors identified,

b. the auditors' response to those risk factors, individually or in combination, and

c. the auditors' conclusions.

6.19 For attestation engagements involving review-level reporting, auditors are alert to situations or transactions that may be indicative of potential fraud, illegal acts, or violations of provisions of contracts or grant agreements. When information comes to the auditors' attention (through audit procedures, allegations received through fraud

⁸⁶ Fraud is a type of illegal act involving the obtaining of something of value through willful misrepresentation. Although not applicable to attestation engagements, the AICPA SASs may provide useful guidance related to fraud for auditors performing attestation engagements in accordance with GAGAS.

hotlines, or other means) indicating that potential fraud, illegal acts, or violations of provisions of contracts or grant agreements that could materially affect the results of the attestation engagement exist, auditors should apply the audit steps and procedures, as necessary, to (1) determine if potential fraud, illegal acts, or violations of provisions of contracts or grant agreements are likely to have occurred and, if so, (2) determine their effect on the results of the attestation engagement. Because the scope of review-level engagements is limited, auditors are not expected to provide reasonable assurance of detecting potential fraud, illegal acts, or violations of contract or grant agreements for these types of engagements.

6.20 For all types of attestation engagements, if during the course of the engagement, auditors become aware of indications of abuse that could be quantitatively or qualitatively material, auditors should apply audit procedures specifically directed to ascertain whether material abuse has occurred and the potential effect on the engagement subject matter or objective. Based on the facts and circumstances, auditors may find it helpful to identify specific risks, situations, or transactions that are susceptible to abuse. In addition, auditors remain alert throughout the engagement to situations or transactions that could be indicative of abuse. However, because the determination of abuse is subjective, auditors are not required to provide reasonable assurance of detecting abuse.

6.21 Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances. Abuse also includes misuse of authority or position for personal financial interest or those of an immediate or close family member or business partner. Abuse is distinct from fraud, illegal acts, or violations of provisions of contracts or grant agreements in that abuse does not necessarily involve violation of laws, regulations, or provisions of a contract or grant agreement. If auditors encounter such situations, they should assess the risk of whether these situations or transactions could be indicative of qualitatively or quantitatively material abuse. When information comes to the auditors' attention (through attest procedures, allegations received through

a fraud hotline, or other means) indicating that material abuse may have occurred, auditors should perform procedures as necessary to (1) determine whether the abuse occurred and, if so, (2) determine its potential effect on the results of the attestation engagement. Auditors assess both qualitative and quantitative factors in making judgments regarding the materiality of possible abuse.

6.22 In pursuing indications of potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse, auditors should avoid interfering with potential investigations, and/or legal proceedings. In some circumstances, laws, regulations, or policies require auditors to report indications of certain types of potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse to law enforcement or investigatory authorities before performing additional audit procedures. In cases where an investigation is initiated or in process, it may be appropriate for the auditors to withdraw from or defer further work on the engagement or a portion of the engagement to avoid interfering with an investigation.

Developing Elements of Findings for Attestation Engagements

6.23 When deficiencies are identified, auditors should plan audit procedures to develop the elements of a finding necessary to achieve the objectives of the attestation engagement. Attest findings, such as deficiencies in internal control, potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse, contain the elements of criteria, condition, cause, and effect. The elements needed for a finding depend on the objectives of the attestation engagement. Thus, a finding or set of findings is complete to the extent that the objectives of the attestation engagement are satisfied. (See paragraphs 6.49 through 6.53 for a description of deficiencies in internal control and paragraph 6.51 for a description of the elements of a finding.)

Attest Documentation

6.24 The auditor must prepare attest documentation in connection with each engagement in sufficient detail to provide a clear understanding of the work performed (including the nature, timing, extent, and results of attest procedures performed), the attest evidence obtained and its source, and the conclusions reached. Attest documentation:

- a. provides the principal support for the statement in the auditor's report that the auditors performed the attestation engagement in accordance with GAGAS and any other standards cited, and
- b. provides the principal support for the auditors' conclusion.

6.25 Attest documentation is an essential element of audit quality. Although documentation alone does not guarantee audit quality, the process of preparing sufficient and appropriate documentation contributes to the quality of an attestation engagement.

6.26 The auditor should prepare attest documentation that enables an experienced auditor,⁸⁷ having no previous connection to the attestation engagement, to understand:

- a. the nature, timing, and extent of attest procedures performed to comply with GAGAS and other applicable standards and requirements,

⁸⁷ An experienced auditor means an individual (whether internal or external to the audit organization) who possesses the competencies and skills that would have enabled him or her to perform the attestation engagement. These competencies and skills include an understanding of (a) attestation engagement processes, (b) GAGAS and applicable legal and regulatory requirements, (c) the subject matter that the auditor is engaged to report on, (d) the suitability and availability of criteria, and (e) issues related to the audited entity's environment.

- b.** the results of the attest procedures performed and the attest evidence obtained,
- c.** how the attest evidence relates to the attestation engagement's conclusions, and
- d.** the conclusions reached on significant matters.

6.27 In addition to the attest documentation requirements listed in the previous paragraph, the auditor should document the following for attestation engagements performed under GAGAS:

- a.** the objectives, scope, and methodology of the attestation engagement;
- b.** evidence of supervisory review, before the attest report is issued, of the work performed that supports findings, conclusions, and recommendations contained in the attest report; and
- c.** the auditors' consideration that the planned attestation procedures are designed to achieve objectives of the attestation engagement when (1) evidence obtained is highly dependent on computerized information systems, (2) evidence is material to the objective of the engagement, and (3) the auditors are not relying on the effectiveness of internal control over those computerized systems that produced the information. Auditors should document (1) the rationale for determining the nature, timing, and extent of planned audit procedures; (2) the kinds and competence of available evidence produced outside a computerized information system, and/or plans for direct testing of data produced from a computerized information system; and (3) the effect on the attestation engagement report if evidence to be gathered does not afford a reasonable basis for achieving the objectives of the engagement.

6.28 Auditors should document matters specific to a particular attestation engagement in the attest documentation file. Certain matters, such as auditor independence and staff

training, that are not engagement specific, may be documented either centrally in the audit organization or in the documentation for the attestation engagement.

6.29 The form, content, and extent of attest documentation depend on the circumstances of the engagement and the attest methodology and tools used. Oral explanations on their own do not represent sufficient support for the work the auditor performed or conclusions the auditor reached but may be used by the auditor to clarify or explain information contained in the attest documentation. It is, however, neither necessary nor practicable to document every matter the auditor considers during the attestation engagement.

6.30 The auditor should document significant findings or issues, actions taken to address them (including any additional evidence obtained), and the basis for the final conclusions reached. Judging the significance of a finding or issue requires an objective analysis of the facts and circumstances.

6.31 The auditor should document discussions of significant findings or issues with management and others, including the significant findings or issues discussed, and when and with whom the discussions took place.

6.32 If the auditor has identified information that contradicts or is inconsistent with the auditor's final conclusions regarding a significant finding or issue, the auditor should document how the contradiction or inconsistency was addressed in forming the conclusion.

6.33 In documenting the nature, timing, and extent of attest procedures performed, the auditor should record:

- a.** who performed the attest work and the date such work was completed, and
- b.** who reviewed specific attest documentation and the date of such review.

6.34 When the auditor does not comply with applicable unconditional or presumptively mandatory GAGAS requirements, the auditor should document the justification for the departure, the impact on the audit, and how alternative procedures performed in the circumstances were sufficient to achieve the objectives of the requirements. The auditor should also follow the requirements in paragraphs 1.13 through 1.15.

6.35 The report should not be dated earlier than the date on which the auditor has obtained sufficient, appropriate attest evidence to support the reported information, conclusion, or opinion. Among other things, attest evidence includes evidence that the attest documentation has been reviewed and that the entity's assertions have been prepared and that management has asserted that it has taken responsibility for them.

6.36 The audit organization should adopt reasonable procedures to retain and access attest documentation for a period of time sufficient to meet the needs of the audit organization and to satisfy any applicable legal or regulatory requirements for records retention.

6.37 The auditor should complete the assembly of the final attestation engagement file on a timely basis, following the report release date (documentation completion date). Statutes, regulations, or the audit organization's quality control policies may state a specific time in which the assembly process should be completed.

6.38 At any time prior to the documentation completion date, the auditor may make changes to the attest documentation to:

a. complete the documentation and assembly of attest evidence that the auditor has obtained, discussed, and agreed with relevant members of the attest team prior to the date of the attestation report,

- b.** perform routine file-assembling procedures such as deleting or discarding superseded documentation and sorting, collating, and cross-referencing final attest documentation,
- c.** sign-off on the attest documentation completion checklists prior to completing and archiving the attestation engagement file, and
- d.** add information received after the date of the report, for example, an original document that was previously faxed.

6.39 After the documentation completion date, the auditors must not delete or discard attest documentation before the end of the specified retention period, as discussed in paragraph 6.36. When auditor finds it necessary to make an addition (including amendments) to attest documentation after the documentation completion date, the auditor should document the addition by including the following in the documentation:

- a.** when and by whom such additions were made and where applicable reviewed,
- b.** the specific reasons for the changes, and
- c.** the effect, if any, of the changes on the auditors' conclusions.

6.40 Attest documentation allows for the review of audit quality by providing the reviewer with documentation, either in written or electronic formats, of the evidence supporting the auditors' significant judgments and conclusions. If attest documentation is only retained electronically, the audit organization should safeguard the electronic documentation through sound computer security so that it is capable of being accessed throughout the specified retention period established for attest documentation.

6.41 Whether attest documentation is in paper, electronic, or other media, the integrity, accessibility, and retrievability of the underlying data may be compromised if the documentation could be altered, added to, or deleted without the auditors' knowledge, or could be permanently lost or damaged. Accordingly, the auditor should apply

appropriate controls to safeguard attest documentation from alteration, destruction, and unauthorized access.

6.42 Underlying GAGAS attestation engagements is the premise that federal, state, and local government audit organizations and independent accounting firms engaged to perform attestation engagements in accordance with GAGAS cooperate in auditing programs of common interest so that auditors may use others' work and avoid duplication of efforts. Auditors should make appropriate audit staff and individuals, as well as attest documentation available, upon request, in a timely manner to other auditors or reviewers. It is also essential that contractual arrangements for GAGAS attestation engagements provide for full and timely access to audit staff and individuals, as well as attest documentation without restriction to facilitate reliance by other auditors or reviewers on the auditors' work.

6.43 Consistent with applicable laws and regulations, audit organizations should develop clearly defined policies and criteria to deal with situations where requests are made by outside parties to obtain access to attest documentation. The audit organization should include in its policies and procedures guidance for dealing with situations where an outside party attempts to obtain indirectly through the auditor information that it is unable to obtain directly from the audited entity and how to respond to requests for access to audit documentation before the attestation engagement is complete. The audit organization should also include flexibility in its policies and procedures to consider the individual facts and circumstances surrounding such requests, for instance, cases when granting access or providing certain information could adversely affect the audit organization's ability to successfully perform similar attestation engagements in the future.

AICPA Reporting Standards for Attestation Engagements

6.44 As discussed in paragraph 1.29, the AICPA SSAE provide for different levels of reporting based on the type of assurance the auditors are providing.⁸⁸ The four AICPA reporting standards for all levels of reporting under attestation engagements are as follows:

[AICPA is currently in the process of revising the reporting standards to use clarified language. GAO will monitor the status of AICPA's efforts in order to include the most up-to-date AICPA standards in the final 2006 Revision of Government Auditing Standards.]

- a.** The report shall identify the subject matter or the assertion being reported on and state the character of the engagement.
- b.** The report shall state the practitioner's [auditor's] conclusions about the subject matter or the assertion in relation to the criteria against which the subject matter was evaluated.
- c.** The report shall state all of the practitioner's [auditor's] significant reservations about the engagement, the subject matter, and, if applicable, the assertion related thereto.
- d.** The report shall state that the use of the report is restricted to specified parties under the following circumstances:⁸⁹ (1) when the criteria used to evaluate the subject matter are determined by the practitioner to be appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria, (2) when the criteria used to evaluate the subject matter are available only to specified parties, (3) when reporting on subject matter and a written

⁸⁸ See AT sections 101.63 - 101.83.

⁸⁹ For application of this standard in the government environment, see paragraphs 6.67 through 6.71.

assertion has not been provided by the responsible party, and (4) when the report is on an attest engagement to apply agreed-upon procedures to the subject matter.

Additional GAGAS Reporting Standards for Attestation Engagements

6.45 GAGAS establish reporting standards for attestation engagements in addition to the requirements contained in the AICPA SSAE. Auditors should comply with these additional standards when citing GAGAS in their attestation engagement reports. The additional GAGAS standards relate to:

- a.** reporting auditors' compliance with GAGAS (see paragraphs 6.46 through 6.48);
- b.** reporting deficiencies in internal control, potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse (see paragraphs 6.50 through 6.57);
- c.** reporting views of responsible officials (see paragraphs 6.58 through 6.63);
- d.** reporting privileged and confidential information (see paragraphs 6.64 through 6.66);
and
- e.** issuing and distributing reports (see paragraphs 6.67 through 6.71).

Reporting Auditors' Compliance with GAGAS

6.46 When auditors comply with all applicable GAGAS standards, they should include a statement in the attestation report that they performed the engagement in accordance with GAGAS.

6.47 The statement of compliance with GAGAS indicates that the auditors have complied with all applicable GAGAS general and attestation engagement standards,

including underlying AICPA standards. If the auditors did not follow applicable standards, or were not able to follow applicable standards due to access problems or other scope limitations, they should follow the requirements in paragraphs 1.13 through 1.15.

6.48 GAGAS do not prohibit auditors from issuing a separate report conforming only to the requirements of other standards. When a GAGAS attestation engagement is the basis for an auditors' subsequent report under the AICPA or other standards, auditors should consider including a reference to the GAGAS report, as that report will contain additional information on internal control, compliance with laws, regulations, and provisions of contracts or grant agreements, potential fraud, or abuse that GAGAS require.

Reporting Deficiencies in Internal Control, Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse

6.49 For attestation engagements, auditors should report, as applicable to the objectives of the engagement, (1) deficiencies in internal control considered to be material weaknesses or other significant deficiencies, (2) all instances of potential fraud and illegal acts unless clearly inconsequential, and (3) violations of provisions of contracts or grant agreements or abuse that are material to the subject matter or assertion of the engagement. In some circumstances, auditors should report potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly to parties external to the entity. (See paragraphs 6.54 through 6.57.)

Reporting Deficiencies in Internal Control

6.50 For all attestation engagements, auditors should report deficiencies in internal control considered to be significant deficiencies, including material weaknesses, as follows:

a. In attestation engagements, a significant deficiency is a deficiency in internal control, or combination of deficiencies, that adversely affects the entity’s ability to initiate, authorize, record, process, or report data reliably in accordance with the applicable criteria or framework such that there is more than a remote⁹⁰ likelihood that a misstatement of the subject matter or assertion that is more than inconsequential⁹¹ will not be prevented or detected.

b. In attestation engagements, a material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement will not be prevented or detected.

6.51 To the extent necessary to achieve the engagement objectives, in presenting findings such as deficiencies in internal control, auditors should develop the elements of criteria, condition, cause, and effect to assist management or oversight officials of the audited entity in understanding the need for taking corrective action. In addition, if auditors are able to sufficiently develop the elements of a finding, they should provide recommendations for corrective action. Following is guidance for reporting on elements of findings:

a. **Criteria:** The required or desired state or what is expected from the program or operation. The criteria are easier to understand when stated fairly, explicitly, and

⁹⁰ The term “more than remote” used in the definitions for significant deficiency and material weakness means “at least reasonably possible.” The following definitions apply. (1) Remote—The chance of the future events or their occurrence is slight. (2) Reasonably possible—The chance of the future events or their occurrence is more than remote but less than likely. (3) Probably—The future events are likely to occur.

⁹¹ “More than inconsequential” indicates an amount that is less than material, yet has significance. A misstatement is “inconsequential” if a reasonable, objective person would conclude that the misstatement, either individually or when aggregated with other misstatements, would clearly be immaterial to the financial statements. If a reasonable, objective person could not reach such a conclusion, that misstatement is “more than inconsequential.”

completely, and the source of the criteria is identified in the attestation engagement report.⁹²

b. Condition: What the auditors found regarding the actual situation. Reporting the scope or extent of the condition allows the report user to gain an accurate perspective.

c. Cause: Evidence on the factor or factors responsible for the difference between condition and criteria. In reporting the cause, auditors may consider whether the evidence provides a reasonable and convincing argument for why the stated cause is the key factor or factors contributing to the difference as opposed to other possible causes, such as poorly designed criteria or factors uncontrollable by program management. The auditors also may consider whether the identified cause could serve as a basis for the recommendations. Often the causes of deficiencies in internal control are complex and involve multiple factors. In some cases, it may not be practical for auditors to fully develop or identify the causes of deficiencies. However, analyzing and identifying root causes of internal control deficiencies is key to making recommendations for corrective action.

d. Effect or potential effect: A clear, logical link to establish the impact or potential impact of the difference between what the auditors found (condition) and the required or desired state (criteria). Effect is easier to understand when it is stated clearly, concisely, and, if possible, in quantifiable terms. The significance of the reported effect can be demonstrated through credible evidence.

6.52 Auditors should place their findings in perspective by describing the nature and extent of the issues being reported and the extent of the work performed that resulted in the finding. To give the reader a basis for judging the prevalence and consequences of

⁹² Common sources for criteria including laws, regulations, policies, procedures, best or standard practices. *The Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: Nov. 1999) and *Internal Control—Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) are two sources of established criteria auditors can use to support their judgments and conclusions about internal control. The related *Internal Control Management and Evaluation Tool* (GAO-01-1008G, Aug. 2001), based on the federal internal control standards, provides a systematic, organized, and structured approach to assessing internal control.

these findings, auditors may relate the instances identified to the population or the number of cases examined and quantify the results in terms of dollar value, as appropriate. If the results cannot be projected, auditors should limit their conclusions appropriately.

6.53 When auditors detect deficiencies in internal control, potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse that are not material to the subject matter or assertion, they should communicate those findings in a management letter to officials of the audited entity unless they are clearly inconsequential considering both qualitative and quantitative factors. Auditors use professional judgment in determining whether and how to communicate to officials of the audited entity deficiencies in internal control, potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse that are clearly inconsequential. Auditors should include in their attest documentation evidence of communications to officials of the audited entity about potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse.

Direct Reporting of Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse

6.54 Auditors should report potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly to parties outside the audited entity in two circumstances, as discussed below.⁹³ This reporting is in addition to any legal requirements for direct reporting of potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse. Auditors should follow these requirements even if they have resigned or been dismissed from the attestation engagement prior to its completion.

⁹³ Internal audit organizations do not have a duty to report outside that entity unless required by law, rule, regulation, or policy. See paragraph 3.19 for reporting requirements for internal audit organizations when reporting externally.

6.55 The audited entity may be required by law or regulation to report certain potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse to specified external parties, such as a federal inspector general or a state attorney general. When auditors have communicated such potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse to the audited entity and the entity fails to report them, the auditors should communicate such an awareness to the governing body of the audited entity. When the audited entity does not make the required report as soon as possible after the auditors' communication with the those charged with governance, the auditors should report such potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly to the external party specified in the law or regulation.

6.56 When potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse involves awards received directly or indirectly from a government agency, auditors may have a duty to report directly if management fails to take remedial steps. When auditors conclude that such failure is likely to cause them to depart from the standard report on the attestation engagement or resign from the engagement, they should communicate that conclusion to those charged with governance. If the audited entity does not report the potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse in a timely manner to the entity that provided the government assistance, the auditors should report the potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly to the awarding entity.

6.57 Auditors should obtain sufficient, appropriate evidence, such as confirmation from outside parties, to corroborate assertions by management that it has reported potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse. When auditors are unable to do so, the auditors should report such potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly as discussed above.

Reporting Views of Responsible Officials

6.58 If the auditors' report on the attestation engagement discloses deficiencies in internal control, potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse, auditors should obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as planned corrective actions.

6.59 One of the most effective ways to provide a report that is fair, complete, and objective is to provide a draft report for review and comments by responsible officials of the audited entity and others, as appropriate. Including the views of responsible officials results in a report that presents not only the significant deficiencies in internal control, potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse the auditors identified, but also the perspectives of the responsible official of the audited entity and the corrective actions they plan to take. Auditors should include in their report a copy of the officials' written comments and/or a summary of the comments received. In cases where the audited entity provides technical comments in addition to its written comments on the report, auditors use professional judgment in determining whether to include such comments or disclose in the report that such comments were provided.

6.60 Auditors ordinarily request that the responsible officials submit in writing their views on the auditors' reported findings, conclusions, and recommendations, as well as management's planned corrective actions. However, oral comments are acceptable, and, in some cases, may be the most expeditious way to obtain comments. Obtaining oral comments can be effective when, for example, there is a time-critical reporting date to meet a user's needs; auditors have worked closely with the responsible officials throughout the conduct of the work and the parties are familiar with the findings and issues addressed in the draft report; or the auditors do not expect major disagreements with the draft report's findings, conclusions, and recommendations, or perceive any major controversies with regard to the issues discussed in the draft report. If oral

comments are provided by the responsible officials, auditors should prepare a summary of the oral comments and provide a copy of the summary to the responsible officials to verify that the comments are accurately stated prior to finalizing the report.

6.61 Auditors should fairly and objectively evaluate and recognize comments, as appropriate, in the final report. Auditors may note comments, such as a plan for corrective action, but should not accept them as justification for dropping a finding or a related recommendation without sufficient and appropriate evidence.

6.62 When the entity's comments oppose the report's findings, conclusions, or recommendations, and are not, in the auditors' opinion, valid, or when planned corrective actions do not adequately address the auditors' recommendations, the auditors should state objectively their reasons for disagreeing with the comments or planned corrective actions. Conversely, the auditors should modify their report as necessary if they find the comments valid.

6.63 If the audited entity refuses to provide comments or is unable to provide comments within a reasonable period of time, auditors may need to issue the report without receiving comments from the audited entity. In such cases, auditors should describe in the report the reasons that comments from the audited entity are not included.

Reporting Privileged and Confidential Information

6.64 If certain pertinent information is prohibited from general disclosure, auditors should disclose in the report that certain information has been omitted and the requirement that makes the omission necessary.

6.65 Certain information may be classified or may be otherwise prohibited from general disclosure by federal, state, or local laws or regulations. In such circumstances, auditors may issue a separate, classified or limited-official-use report containing such information and distribute the report only to persons authorized by law or regulation to receive it.

Additional circumstances associated with public safety and security concerns could also justify the exclusion of certain information in the report. For example, detailed information related to computer security for a particular program may be excluded from publicly available reports because of the potential damage that could be caused by the misuse of this information. In such circumstances, auditors may issue a limited-official-use report containing such information and distribute the report only to those parties responsible for acting on the auditors' recommendations. The auditors may consult with legal counsel regarding any requirements or other circumstances that may necessitate the omission of certain information.

6.66 Auditors consider the broad public interest in the program or activity under review when deciding whether to exclude certain information from publicly available reports. When circumstances call for omission of certain information, auditors should evaluate whether this omission could distort the engagement results or conceal improper or unlawful practices.

Issuing and Distributing Reports

6.67 Government auditors should submit attest reports to those charged with governance, to the appropriate officials of the entity and to appropriate officials of the organizations requiring or arranging for the engagement, including external funding organizations such as legislative bodies, unless legal restrictions prevent it. Auditors should also send copies of the reports to other officials who have legal oversight authority or who may be responsible for acting on the findings and recommendations and to others authorized to receive such reports. Auditors should clarify whether the report will be made available for public inspection. If the subject matter of the attestation engagement involves material that is classified for security purposes or not releasable to particular parties or the public for other valid reasons, auditors may limit the report distribution.⁹⁴ Auditors should document any limitation on report distribution.

⁹⁴ See paragraphs 6.64 through 6.66 for additional guidance on limited report distribution when reports contain privileged or confidential information.

6.68 Although AICPA standards require that a report on an engagement to evaluate an assertion based on agreed-upon criteria or on an engagement to apply agreed-upon procedures should contain a statement indicating it is intended to be used solely by the parties who have agreed upon such criteria or procedures, such a statement does not necessarily limit the report distribution in a government environment.

6.69 When nongovernment auditors are engaged to perform an attestation engagement under GAGAS, they should clarify report distribution responsibilities with the engaging organization. If nongovernment auditors are to make the distribution, they should reach agreement with the party contracting for the attestation engagement about which officials or organizations should receive the report and the steps being taken to make the report available to the public.

6.70 Internal auditors may follow the IIA's standards for report distribution, which state internal auditors also follow any applicable statutory requirements for distribution. The head of the internal audit organization should disseminate results to the appropriate parties. The head of the internal audit organization is responsible for communicating the final results to parties who are in a position to take appropriate corrective actions. Distribution of reports outside the organization ordinarily is made only in accordance with applicable laws, rules, regulations, or policy.

6.71 If an attestation engagement is terminated before it is completed but the auditors do not issue a report on the attestation engagement, auditors should write a memorandum for the record that summarizes the results of the work to the date of termination and explains why the attestation engagement was terminated. In addition, depending on the facts and circumstances, auditors should notify those charged with governance, management of the entity, the entity requesting the attestation engagement, and other appropriate officials, about the termination of the engagement, preferably in writing. Auditors should document this communication.

Chapter 7
Field Work Standards for Performance Audits

Introduction

7.01 This chapter establishes field work standards and provides guidance for performance audits conducted in accordance with generally accepted government auditing standards (GAGAS). The field work standards for performance audits relate to planning the audit; supervising staff; obtaining sufficient, appropriate evidence; and preparing audit documentation.

7.02 See paragraphs 1.16 through 1.17 and 1.20 for a discussion about the use of GAGAS with other standards.

7.03 See paragraphs 1.33 through 1.42 for an overall description of the nature and objectives of performance audits and paragraphs 3.36 through 3.45 for a description for professional judgment in these audits.

Significance in a Performance Audit

7.04 Auditors use the concept of significance⁹⁵ throughout a performance audit. Auditors consider significance when deciding the type and extent of audit work to perform, when evaluating results of audit work, and when developing the report. Significance is defined as the relative importance of a matter within the context in which it is being considered, including quantitative and qualitative factors. Such factors include relative magnitude, the nature and effect of the matter, and the needs and interests of intended users or recipients. Auditors use professional judgment when considering whether a matter is

⁹⁵ In the performance audit standards, the term “significant” is synonymous with “material.” “Material” is used in the AICPA standards for financial audits. The term “significant” is used in performance audits where the term “material” is generally not used.

significant within the context of the audit objectives. The auditors' consideration is influenced by the relationship of the matter to the audit objectives and the auditors' perception of the needs of users of the audit reports.

7.05 When making judgments about significance within the context of the audit objectives, auditors consider the quantitative or qualitative factors that make it probable that the auditors' findings, conclusions or recommendations would be affected by the matter if the matter had been omitted from the auditors' analysis. When making judgments about significance to the needs of report users, auditors consider whether it is probable that the judgment of a reasonable person relying on the auditors' report would have been changed or influenced if the matter was omitted from the auditors' analysis and disclosed in the audit report. This includes the probability that the matter would change or influence the decisions of intended users of the auditors' report; or, as another example, where the context is a judgment about whether to report a matter to those charged with governance, whether the matter would be regarded as important by those charged with governance in carrying out their duties. When reporting on the results of their work, auditors should disclose material or significant facts relevant to the objectives of their work and known to them which, if not disclosed, could mislead knowledgeable users, misrepresent the results, or conceal significant improper or unlawful practices.

Audit Risk

7.06 Auditors must plan the audit so that the auditors reduce audit risk to a level that is sufficiently low for the auditors to provide reasonable assurance that the evidence is sufficient and appropriate to achieve the audit objectives and support the conclusions reached. This determination is a matter of professional judgment. Audit risk is the risk that auditors may provide improper findings, conclusions, recommendations, or assurance because, for example, the information obtained is not sufficient or not appropriate, the audit process was inadequate, or intentional omissions or misleading information existed due to misrepresentation or fraud. Factors such as the time frames,

complexity, or sensitivity of the work, size of the program in terms of dollar amounts and number of citizens served, and access to records are considered in the risk determination. Audit risk involves qualitative and quantitative considerations. A component of audit risk is the risk that auditors will not detect a mistake, inconsistency, or significant error in the evidence supporting the audit. Auditors can reduce the audit risk by using additional evidence, higher quality evidence and/or alternative forms of evidence. When auditors cannot obtain alternative forms of evidence, they should clearly describe the scope of work and any limitations in the underlying information, so that (1) readers of the auditors' report are provided with a clear understanding as to what the auditors did or did not do and (2) the findings, conclusions and recommendations are not misleading. In such cases, auditors should also follow the guidance in paragraphs 1.06 through 1.15.

Sufficient, Appropriate Evidence

7.07 The concept of sufficient, appropriate evidence is integral to a performance audit. Appropriateness is the measure of the quality of information which encompasses its relevance, reliability, and validity in providing support for achieving audit objectives. In assessing the overall appropriateness of information, auditors should assess whether the information is relevant, valid, and reliable. Sufficiency is a measure of the quantity of evidence used to support the findings, conclusions, and recommendations related to the audit objectives. In determining the sufficiency of evidence, auditors should determine whether enough evidence exists to persuade a knowledgeable person of the reasonableness of the findings. Paragraphs 7.53 through 7.69 describe the auditors' assessment of appropriateness and sufficiency of evidence.

Planning

7.08 Auditors must adequately plan and document the planning of the work necessary to achieve the audit objectives.

7.09 In planning the audit, auditors should assess significance and risk in defining the audit objectives, and the scope and methodology to achieve those objectives. Audit objectives, scope, and methodology are not determined independently. Auditors determine these three elements of the audit plan together, as the considerations in determining each often overlap. Planning is a continuous process throughout the audit. Therefore, auditors may need to make adjustments to the audit objectives, scope, and methodology as work is being completed.

7.10 The objectives are what the audit is intended to accomplish. They identify the audit subject matter and performance aspects to be included, as well as the potential findings and reporting elements that the auditors expect to develop.⁹⁶ Audit objectives can be thought of as questions about the program⁹⁷ that auditors seek to answer based on evidence obtained and assessed against criteria or best practices.

7.11 Scope is the boundary of the audit and is directly tied to the audit objectives. The scope defines the subject matter that the auditors will assess and report on, such as a particular program or aspect of a program, the period of time reviewed, and the locations that will be included.

7.12 The methodology describes the nature and extent of audit procedures for gathering and analyzing information to achieve the objectives and address the relevant risks. Audit procedures are the specific steps and tests auditors will carry out to address the audit objectives. Auditors should design the methodology to provide sufficient, appropriate evidence to achieve the audit objectives and reduce audit risk to an acceptable level. Methodology includes both the nature and extent of audit procedures used to achieve the audit objectives. Auditors should also evaluate possible issues surrounding the appropriateness of available information in planning the audit.

⁹⁶ See discussion of the elements of a finding in paragraphs 7.36 through 7.37 and paragraphs 7.70 through 7.73.

⁹⁷ The term “program” is used in this document to include government entities, organizations, programs, activities, and functions.

7.13 Auditors should plan and conduct performance audits to address the relevant risks and to provide reasonable assurance that the auditors have sufficient, appropriate evidence to achieve the audit objectives while addressing the relevant risks. Thus, the levels of evidence and tests of evidence will vary based on the audit objectives and conclusions. Objectives for performance audits range from narrow issues requiring specific evidence and answers, to broad issues requiring extensive evidence to general questions which sometimes require general answers. In some engagements, sufficient, appropriate evidence is easily obtained, and in others, information may have limitations. Auditors use professional judgment in determining the audit scope and methodology needed to answer the audit's objectives, while providing the appropriate level of assurance that the obtained evidence is sufficient and appropriate to meet the audit's objectives.

7.14 During planning auditors should assess risk and significance by considering:

a. the nature and profile of the programs and the needs of potential users of the audit report (see paragraph 7.16 and 7.17);

b. internal control as it relates to the specific objectives and scope of the audit (see paragraphs 7.18 through 7.24);

c. information systems controls for purposes of assessing audit risk and planning the audit (see paragraphs 7.25 through 7.27);

d. legal and regulatory requirements, contract provisions, or grant agreements, potential fraud, or abuse that are significant within the context of the audit objectives (see paragraphs 7.28 through 7.34); and

e. the results of previous audits and attestation engagements that directly relate to the current audit objectives (see paragraph 7.35).

7.15 During planning, the auditors also should:

- a.** identify the potential criteria needed to evaluate matters subject to audit (see paragraph 7.36 through 7.37);
- b.** identify potential sources of audit evidence and consider the amount and type of evidence needed given risk and significance (see paragraph 7.38 through 7.39);
- c.** consider whether the work of other auditors and experts may be used to satisfy some of the audit objectives (see paragraphs 7.40 through 7.42);
- d.** assign sufficient staff and specialists with adequate collective professional competence and identify other resources needed to perform the audit (see paragraphs 7.43 through 7.44);
- e.** communicate about planning and performance of the audit to management officials, those charged with governance, and others as applicable (see paragraphs 7.45 and 7.46);
and
- f.** prepare an audit plan (see paragraphs 7.47 through 7.48).

Nature and Profile of the Program

7.16 Auditors should obtain an understanding of the nature and profile of the program or program component under audit and the potential use that will be made of the audit results or report as they plan a performance audit. The nature and profile of a program include:

- a.** visibility, sensitivity, and risks associated with the program under audit,
- b.** newness of the program or changes in its conditions,

- c. the size of the program in terms of total dollars and/or number of citizens impacted,
- d. role of the audit in providing information that can improve public accountability and decision making (see paragraphs 1.01 and 1.02), and
- e. level and extent of review or other forms of independent oversight.

7.17 Auditors obtain an understanding of the program under audit to help assess the risks associated with the program and the impact on the audit objectives, scope and methodology. The auditors' understanding may come from knowledge they already have about the program or knowledge they gain from inquiries and observations they make in planning the audit. The extent and breadth of those inquiries and observations will vary among audits based on the audit objectives, as will the need to understand individual aspects of the program, such as the following:

a. Laws, regulations, and provisions of contracts or grant agreements: Government programs usually are created by law and are subject to specific laws and regulations. For example, laws and regulations usually set forth what is to be done, who is to do it, the purpose to be achieved, the population to be served, and related funding guidelines or restrictions. Government programs may also be subject to provisions of contracts and grant agreements. Thus, understanding the laws and the legislative history establishing a program and the provisions of any contracts or grant agreements can be essential to understanding the program itself. Obtaining that understanding is also a necessary step in identifying provisions of laws, regulations, contracts, or grant agreements that are significant within the context of the audit objectives.

b. Purpose and goals: Purpose is the result or effect that is intended or desired from a program's operation. Legislatures usually establish the program purpose when they provide authority for the program. Entity officials may provide more detailed information on program purpose to supplement the authorizing legislation. Entity officials are sometimes asked to set goals for program performance and operations,

including both output and outcome goals. Auditors may use the stated program purpose and goals as criteria for assessing program performance or may develop additional criteria or best practices to use when assessing performance.

c. Internal control: Internal control, often referred to as management controls, in the broadest sense includes the plan, methods, and procedures adopted by management to meet its missions, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It includes the systems for measuring, reporting, and monitoring program performance. Internal control also serves as a defense in safeguarding assets and preventing and detecting errors; potential fraud; violations of laws, regulations, and provisions of contracts and grant agreements; or abuse. Paragraphs 7.18 through 7.24 contain guidance pertaining to internal control.

d. Efforts: Efforts are the amount of resources (in terms of money, material, personnel, etc.) that are put into a program. These resources may come from within or outside the entity operating the program. Measures of efforts can have a number of dimensions, such as cost, timing, and quality. Examples of measures of efforts are dollars, employee-hours, and square feet of building space.

e. Program operations: Program operations are the strategies, processes, and activities management uses to convert efforts into outputs. Program operations are subject to internal control.

f. Outputs: Outputs represent the quantity of goods or services produced by a program. For example, an output measure for a job training program could be the number of persons completing training, and an output measure for an aviation safety inspection program could be the number of safety inspections completed.

g. Outcomes: Outcomes are accomplishments or results of programs. For example, an outcome measure for a job training program could be the percentage of trained persons

obtaining a job and still in the work place after a specified period of time. Examples of outcome measures for an aviation safety inspection program could be the percentage reduction in safety problems found in subsequent inspections and/or the percentage of problems deemed corrected in follow-up inspections. Such outcome measures show progress in achieving the stated program purposes of helping unemployable citizens obtain and retain jobs, and improving the safety of aviation operations. Outcomes may be influenced by cultural, economic, physical, or technological factors outside the program. Auditors may use approaches drawn from other disciplines, such as program evaluation, to isolate the effects of the program from these other influences. An especially important type of outcome is unexpected effects which may be negative such as adverse drug reactions, or positive such as increased private investment in an area of service.

Internal Control

7.18 Auditors should obtain an understanding of internal control significant within the context of the audit objectives. For those internal control objectives that are significant within the context of the audit objectives, auditors should assess whether specific internal control procedures have been properly designed and placed in operation and conduct specific tests of the effectiveness of the internal control procedures. Based on the test results and the auditors' assessment, the auditors consider whether to modify the nature, timing,⁹⁸ or extent of their audit procedures. Officials of the audited entity are responsible for establishing effective internal control. The lack of administrative

⁹⁸Refer to the internal control guidance contained in *Internal Control--Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As discussed in the COSO framework, internal control consists of five interrelated components, which are (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring. The objectives of internal control relate to (1) financial reporting, (2) operations, and (3) compliance. Safeguarding of assets is a subset of these objectives. In that respect, management designs internal control to provide reasonable assurance that unauthorized acquisition, use, or disposition of assets will be prevented or timely detected and corrected. In addition to the COSO document, the publication, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: Nov. 1999), which incorporates the relevant guidance developed by COSO, provides definitions and fundamental concepts pertaining to internal control at the federal level and may be useful to other auditors at any level of government. The related *Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C.: Aug. 2001), based on the federal internal control standards, provides a systematic, organized, and structured approach to assessing the internal control structure.

continuity in government units because of changes in elected legislative bodies and in other government officials increases the need for effective internal control.

7.19 The following discussion of the principal types of internal control objectives is intended to help auditors better understand internal controls and determine their significance to the audit objectives:

a. Effectiveness and efficiency of program operations: Controls over program operations include policies and procedures that officials of the audited entity have implemented to provide reasonable assurance that a program meets its objectives and that unintended actions do not result. Understanding these controls can help auditors understand the program operations that convert efforts to outputs or outcomes.

b. Validity and reliability of information: Controls over the validity and reliability of information include policies and procedures that officials of the audited entity have implemented to provide themselves reasonable assurance that operational information they use and report is valid and reliable and fairly disclosed in reports. These controls help assure management that it is getting valid and reliable information about whether programs are operating properly on an ongoing basis. Understanding these controls can help auditors (1) assess the risk that the information gathered by the entity may not be valid or reliable and (2) design appropriate tests of the information considering the audit objectives.

c. Compliance with applicable laws and regulations and provisions of contracts or grant agreements: Controls over compliance include policies and procedures that officials of the audited entity have implemented to provide reasonable assurance that program implementation is consistent with laws, regulations, and provisions of contracts or grant agreements. Understanding the relevant controls concerning compliance with those laws and regulations and provisions of contracts or grant agreements that the auditors have

determined are significant can help auditors assess the risk of illegal acts,⁹⁹ violations of provisions of contracts or grant agreements, or abuse.

7.20 A subset of these categories of internal control objectives is the safeguarding of assets and resources. Controls over the safeguarding of assets and resources include policies and procedures that officials of the audited entity have implemented to reasonably prevent or promptly detect unauthorized acquisition, use, or disposition of assets and resources.

7.21 Auditors can obtain an understanding of internal control¹⁰⁰ through inquiries, observations, inspection of documents and records, review of other auditors' reports, or direct tests. The procedures auditors perform to obtain an understanding of internal control will vary among audits based on audit objectives and risk. For instance, poorly controlled or internally risky aspects of a program have a higher risk of failure, so auditors may want to focus their efforts in these areas. The extent of these procedures will vary based on the audit objectives, known or potential internal control risks or problems, and the auditors' knowledge about internal control gained in prior audits.

7.22 For those internal controls that are deemed significant within the context of the audit objectives, auditors should plan to obtain sufficient, appropriate evidence to support their assessment about the effectiveness of those controls. (See paragraph 1.39 for examples of internal control objectives.)

7.23 In performance audits, a deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect (1) impairments of effectiveness or efficiency of operations (2) misstatements in financial or performance

⁹⁹ Violations of laws or regulations are illegal acts.

¹⁰⁰ The term "internal control" in this document is synonymous with the term management control and, unless otherwise stated, covers all aspects of an entity's operations (programmatic, financial, and compliance).

information, or (3) violations of laws and regulations, on a timely basis.

7.24 Internal auditing is an important part of overall governance, accountability, and internal control.¹⁰¹ A key role of many internal audit organizations is to provide assurance that internal controls in place are adequate to mitigate risks and achieve program goals and objectives. When an assessment of internal control is called for, the work of the internal auditors may be used in assessing whether internal controls are effectively designed and functioning properly, and to prevent duplication of effort.

Information Systems Controls

7.25 Auditors should obtain a sufficient understanding of information systems controls¹⁰² necessary to assess audit risk and plan the audit. This assessment can be done in conjunction with the auditors' consideration of internal control as it relates to the specific objectives and scope of audit (see paragraphs 7.18 through 7.24), or as a separate audit objective or audit procedure, depending on the nature of the audit. Depending on the significance of information systems controls to the audit objectives, the extent of audit procedures to obtain such an understanding may be limited or extensive. In addition, the nature and extent of audit risk is impacted by the nature of the hardware and software used, the configuration of the entity's systems and networks, and the entity's information systems strategy, and the significance of information systems controls to the audit objectives.

7.26 Auditors should determine the extent of audit procedures related to information systems controls that are necessary to obtain sufficient, appropriate evidence to support the audit findings, conclusions, and recommendations. If auditors determine that it is necessary to assess the effectiveness of information systems controls in order to obtain

¹⁰¹ Many government entities have these activities identified by other names, such as inspection, appraisal, investigation, organization and methods, or management analysis. These activities assist management by reviewing selected functions.

¹⁰² Information systems controls consist of those internal controls that are dependent on information systems processing.

sufficient, appropriate evidence, then such information systems controls are significant to the audit. In making this determination, auditors consider the following:

a. The extent to which internal controls that are significant to the audit are processed by information systems or are dependent on the reliability of information generated by information systems. As part of assessing the effectiveness of such controls, auditors also should assess the effectiveness of information systems controls that impact the effectiveness of controls that are significant to the audit.

b. The availability of other evidence to support the findings, conclusions, and recommendations. It may not be possible for auditors to obtain sufficient, appropriate evidence without assessing the effectiveness of relevant information systems controls. For example, if information supporting the findings, conclusions, and recommendations is generated by information systems or its reliability is dependent on information systems controls there may not be sufficient supporting or corroborating information or documentary evidence that is available other than that produced by the information systems.

c. The relationship of information systems controls to data reliability testing. To obtain evidence about the reliability of computer-generated information, auditors may elect to assess the effectiveness of information systems controls as part of testing the reliability of the data. If information systems controls are determined to be effective, the extent of direct testing of supporting documentation may be reduced.

d. Assessing the effectiveness of information systems controls as an audit objective. When assessing the effectiveness of information systems controls is directly a part of an audit objective, auditors should perform the testing of information systems controls necessary to achieve the audit objectives. For example, the audit may involve the effectiveness of information systems controls related to certain systems, facilities, or organizations.

7.27 If information systems controls are considered to be significant to the audit, auditors should assess the effectiveness of such significant controls, including other information systems controls that impact their effectiveness or the reliability of information used in performing the significant control. Generally, if information systems controls are considered significant to the audit, the auditors' assessment of the effectiveness of information systems controls will include both application controls and general controls, because weaknesses in general controls can result in unauthorized changes to applications and data that can circumvent or impair the effectiveness of application controls. Application controls, sometimes referred to as business process controls, are those controls that help ensure the validity, completeness, accuracy, and confidentiality of transactions and data during application processing. Examples of application controls include controls over input, processing, output, master data, application interfaces, and data management system interfaces. Information systems general controls are the policies and procedures that apply to all or a large segment of an entity's information systems and help ensure their proper operation. Examples of general controls include security management, logical and physical access, configuration management, segregation of duties, and contingency planning. Weaknesses in general controls can result in unauthorized changes to applications and data that can circumvent or impair the effectiveness of application controls.

Legal and Regulatory Requirements, Contract Provisions, or Grant Agreements, Potential Fraud, or Abuse

7.28 In pursuing indications of possible fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse, auditors should avoid interfering with potential investigations, and/or legal proceedings. In some circumstances, laws, regulations, or policies require auditors to report and/or refer indications of certain types of fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse to law enforcement or investigatory authorities before performing procedures. In cases where an investigation is initiated or in process, it may be appropriate for auditors to withdraw

from or defer further work on the audit or a portion of the audit in order not to interfere with an investigation.

Legal and Regulatory Requirements, Contracts, and Grants

7.29 Auditors should determine which laws, regulations, and provisions of contracts or grant agreements are significant within the context of the audit objectives and assess the risk that illegal acts or violations of provisions of contracts or grant agreements could occur. Based on that risk assessment, the auditors should design and perform procedures to provide reasonable assurance of detecting instances of illegal acts or violations of provisions of contracts or grant agreements that are significant within the context of the audit objectives.

7.30 The auditors' assessment of risk may be affected by such factors as the complexity or newness of the laws, regulations, and provisions of contracts or grant agreements. The auditors' assessment of risk also may be affected by whether the entity has controls that are effective in preventing or detecting violations of laws, regulations, and provisions of contracts or grant agreements. If auditors obtain sufficient, appropriate evidence of the effectiveness of these controls, they can reduce the extent of their tests of compliance.

Fraud

7.31 In planning the audit, auditors should assess risks of potential significant fraud¹⁰³ within in the context of the audit objectives. Auditors should discuss with management and the audit team potential fraud risks, including potential fraud factors such as individuals' incentives or pressures to commit fraud, the opportunity for fraud to occur,

¹⁰³ Fraud is a type of illegal act involving the obtaining something of value through willful misrepresentation. Whether an act is, in fact, fraud is a determination to be made through the judicial or other adjudicative system and is beyond auditors' professional expertise and responsibility.

and rationalizations or attitudes that could allow individuals to commit fraud. Auditors gather and assess information necessary to identify potential fraud risks that are within the scope of the audit objectives or could affect the results of their audit. For example, auditors may obtain information through discussion with officials of the audited entity or through other means to determine the susceptibility of the program to potential fraud, the status of internal controls the entity has established to detect and prevent fraud, or the risk that officials of the audited entity could override internal control. An attitude of professional skepticism in assessing these risks will assist auditors in determining which factors or risks could significantly impact the audit objectives and/or the audit procedures needed to answer the audit objectives if fraud has occurred or is likely to have occurred.

7.32 When auditors identify factors or risks related to potential fraud that they believe are significant within the context of the audit objectives, they should design procedures to provide reasonable assurance of detecting potential fraud significant within the context of the audit objectives. Assessing the risk of potential fraud is an ongoing process throughout the audit and relates not only to planning the audit but also to evaluating evidence obtained during the audit.

7.33 When information comes to the auditors' attention (through audit procedures, allegations received through fraud hotlines, or other means) indicating that potential fraud may have occurred, auditors should determine whether the potential fraud is significant within the context of the audit objectives. If the potential fraud is significant within the context of the audit objectives, auditors should extend the audit steps and procedures, as necessary, to (1) determine if fraud likely has occurred and (2) if so, determine its effect on the audit findings. If the potential fraud is not significant within the context of the audit objectives, the auditors should consider whether to conduct additional audit work as a separate engagement, or refer the potential fraud to other parties with oversight responsibility or jurisdiction over such matters.

Abuse

7.34 Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances.¹⁰⁴ Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business partner. Abuse is distinct from fraud, illegal acts, or violations of provisions of contracts or grant agreements in that abuse does not necessarily involve violation of laws, regulations, or provisions of a contract or grant agreement. If during the course of the audit, auditors become aware of indications of abuse that could be quantitatively or qualitatively significant to the program under audit, auditors should apply audit procedures specifically directed to ascertain whether significant abuse has occurred and the potential effect within the context of the audit objectives. Based on the facts and circumstances, auditors may find it helpful to identify specific risks or situations that are susceptible to abuse. In addition, auditors remain alert throughout the audit to situations that could be indicative of abuse. When information comes to the auditors' attention (through audit procedures, allegations received through a fraud hotline, or other means) indicating that significant abuse may have occurred, they should perform audit procedures, as necessary, to (1) determine whether the abuse occurred and, if so, (2) determine its potential effect on the audit findings. If the abuse is not significant within the context of the audit objectives, the auditors should consider whether to expand the scope of the current audit, conduct additional audit work as a separate engagement, or refer the potential abuse to other parties with oversight responsibility or jurisdiction over such matters. Auditors assess both quantitative and qualitative factors in making judgments regarding the significance of possible abuse and whether they need to extend the audit steps and procedures. However, because of the subjectivity involved in determining abuse, auditors are not required to provide reasonable assurance of detecting abuse.

¹⁰⁴ For example, in a performance audit of management's efficient use of funds for office building maintenance, auditors might find abuse if renovation of senior management's offices far exceed usual office space specifications. While auditors might not view the renovation costs as quantitatively significant to the audit results, these expenses could be considered qualitatively significant to this audit objective.

Previous Audits and Attestation Engagements

7.35 Auditors should determine whether the results of previous audits and attestation engagements that directly relate to the audit objectives have an impact on the current engagement, including whether recommendations have been implemented. Auditors should identify previous financial audits, attestation engagements, performance audits, or other studies significant within the context of the audit objectives and ask management of the audited entity to identify corrective actions taken to address relevant findings, conclusions and recommendations.

Identifying Audit Criteria

7.36 Auditors should identify audit criteria including the standards, measures, expectations of what should exist, best practices, and benchmarks against which performance is compared or evaluated. Criteria provide a context for evaluating evidence and understanding the findings, conclusions, and recommendations included in the report. Auditors should use criteria that are objective, measurable, complete, and relevant to the objectives of the performance audit.

a. Objectivity –free from bias.

b. Measurability –permit reasonably consistent assessments, qualitative¹⁰⁵ or quantitative, of subject matter.

c. Completeness –include relevant factors that could change a conclusion about the subject matter

d. Relevant –related to the subject matter.

¹⁰⁵ Qualitative assessments can include expert judgment and reasonableness judgments about program performance, for example, whether program objectives reflect the needs of targeted beneficiaries and whether program performance adequately meets objectives.

7.37 The following are some examples of possible criteria:

- a.** purpose or goals prescribed by law or regulation or set by officials of the audited entity,
- b.** policies and procedures established by officials of the audited entity,
- c.** technically developed standards or norms,
- d.** expert opinions,
- e.** prior periods' performance,
- f.** performance of similar entities,
- g.** performance in the private sector, or
- h.** best practices of leading organizations.

Identifying Sources of Audit Evidence and the Amount and Type of Evidence Required

7.38 Auditors should identify potential sources of information that could be used as audit evidence. Auditors should determine the amount and type of evidence required to obtain sufficient, appropriate evidence to meet the audit objectives and adequately plan audit work.

7.39 If auditors believe that it is likely that sufficient, appropriate evidence will not be available, they should consider revising the audit objectives or modifying the scope and methodology and determine alternative procedures to meet the current audit objectives. Auditors should disclose in the audit report revisions made to the audit objectives due to the lack of sufficient, appropriate evidence. Auditors should also evaluate whether the

lack of sufficient, appropriate evidence is due to internal control deficiencies or other program weaknesses, and whether the lack of sufficient, appropriate evidence is the basis for audit findings. (See paragraphs 7.53 through 7.69 for standards concerning evidence.

Considering Work of Others

7.40 Auditors should determine whether other auditors have conducted, or are conducting, audits of the program that could be relevant to the current audit objectives. The results of other auditors' work may be useful sources of information for planning and performing the audit. If other auditors have identified areas that warrant further audit work or follow-up, their work may influence the auditors' selection of performance audit objectives, scope, and methodology.

7.41 If other auditors have completed audit work related to the objectives of the auditors' current audit, the current auditors may wish to rely on the work of the other auditors to support findings, recommendations or conclusions for the current audit and thereby, avoid duplication of audit efforts. If auditors rely on the work of other auditors, they should perform procedures regarding the specific work to be relied on that provide a sufficient basis for that reliance. Auditors should obtain evidence concerning the other auditors' qualifications and independence and should determine whether the scope and quality of the audit work performed by the other auditors is adequate for reliance in the context of the current audit objectives. Auditors can accomplish this by reviewing the report, audit plan, or audit documentation, or by performing supplemental tests of the other auditors' work. The nature and extent of evidence needed will depend on the significance of the other auditors' work, on the extent to which the auditors will rely on that work, and whether auditors plan to refer to that work in their work.

7.42 If the audit objectives necessitate the use of specialized techniques or methods that require skills or competence that the auditors do not possess, they may need to rely on

the work of specialists.¹⁰⁶ If auditors intend to rely on the work of specialists, they should obtain an understanding of the qualifications of the specialists. (See paragraph 3.05 for independence considerations when relying on the work of others.) Auditors consider the following in evaluating the professional qualifications of the specialist:

- a.** the professional certification, license, or other recognition of the competence of the specialist in his or her field, as appropriate;
- b.** the reputation and standing of the specialist in the views of peers and others familiar with the specialist's capability or performance; and
- c.** the specialist's experience and published work in the subject matter.

Assigning Staff and Other Resources

7.43 Audit management should assign sufficient staff and specialists with adequate collective professional competence to perform the audit. Staffing an audit includes, among other things:

- a.** assigning staff and specialists with the appropriate collective knowledge, skills, and experience for the job;
- b.** assigning an adequate number of staff and supervisors to the audit;
- c.** providing for on-the-job training of staff; and
- d.** engaging specialists when necessary.

¹⁰⁶ See paragraph 3.51 for a discussion of using specialists in a GAGAS audit.

7.44 If planning to use the work of a specialist, auditors should determine and articulate nature and scope of the work to be performed by the specialist, including

- a.** the objectives and scope of the specialist’s work;
- b.** the intended use of the specialist’s work to support the audit objectives;
- c.** documentation of the specialist’s procedures and findings so they can be evaluated and related to other planned audit procedures;
- d.** the assumptions and methods used; and
- e.** a comparison of how the methods and assumptions used compare with those used in prior, related work.

Communicating with Management, Those Charged with Governance, and Others

7.45 Auditors should communicate information about the objectives, scope and methodology, and timing of the performance audit and planned reporting to the following individuals:

- a.** the head of the audited entity;
- b.** those charged with governance;¹⁰⁷
- c.** the individual who possesses a sufficient level of authority and responsibility to

¹⁰⁷ Those charged with governance are those responsible for overseeing the strategic direction of the entity and the entity’s fulfillment of its accountability obligations. In situations in which those charged with governance are not clearly evident, the auditor documents the process followed and conclusions reached for identifying those charged with governance. (See appendix paragraphs A1.02 through A1.05.)

implement corrective actions in the program or activity being audited; and

d. the individuals contracting for or requesting audit services, such as contracting officials or legislative members or staff, if applicable.

7.46 Auditors use professional judgment to determine the form, content, and frequency of the communication, although written communication is preferred. Auditors may use an engagement letter to communicate the information. If an audit is terminated before it is completed, auditors should write a memorandum for the audit documentation that summarizes the results of the work and explains the reasons why the audit was terminated. In addition, depending on the facts and circumstances, auditors should consider the need to communicate the reason for terminating the audit to those charged with governance, management of the audited entity, the entity requesting the audit, and other appropriate officials, preferably in writing.

Preparing the Audit Plan

7.47 Auditors must prepare a written audit plan for each audit. The form and content of the written audit plan will vary among audits but may include an audit strategy, audit program or project plan, a memorandum, design matrix or paper, or other appropriate documentation of key decisions about the audit objectives, scope, and methodology and of the auditors' basis for those decisions. Auditors should update the plan, as necessary, to reflect any significant changes to the plan made during the audit.

7.48 A written audit plan provides an opportunity for the audit organization management to supervise audit planning and to determine whether:

a. the proposed audit objectives are likely to result in a useful report,

b. the audit plan adequately addresses relevant risks,

- c. the proposed audit scope and methodology are adequate to satisfy the audit objectives,
- d. available evidence is likely to be sufficient and appropriate for purposes of the audit, and
- e. sufficient staff with adequate collective professional competence and other resources are available to perform the audit and to meet expected time frames for completing the work.

Supervision

7.49 Audit supervisors must properly supervise audit staff.

7.50 Audit supervisors should provide sufficient guidance and supervision of staff assigned to the audit to accomplish the audit objectives and follow applicable standards. Audit supervisors should stay informed about significant problems encountered, review the work performed, and provide effective on-the-job training.

7.51 Supervision involves clearly communicating to staff members so they understand what work they are to do, why the work is to be conducted, and what the work is expected to accomplish. With experienced staff, supervisors may outline the scope of the work and leave details to the staff. With less experienced staff, supervisors may have to specify audit procedures to be performed as well as techniques for gathering and analyzing data.

7.52 The nature and extent of the review of audit work may vary depending on a number of factors, such as the size of the audit organization, the significance of the work, and the experience of the staff.

Obtaining Sufficient, Appropriate Evidence

7.53 Auditors must obtain sufficient, appropriate evidence to provide a reasonable basis for their findings, conclusions, and recommendations.

7.54 In assessing information, auditors should conclude whether the evidence taken as a whole is sufficient and appropriate for satisfying the audit objectives. As audit objectives may vary widely, the level of work necessary to assess sufficiency and appropriateness may likewise vary widely. For example, in establishing the appropriateness of evidence, auditors may test the reliability by obtaining supporting information, using statistical testing or by obtaining corroborating evidence. Auditors consider the concepts of audit risk and significance in evaluating the audit evidence.

7.55 Auditors use professional judgment in determining sufficiency and appropriateness of evidence. Auditors typically interpret, summarize, or analyze information in the process of determining its appropriateness and sufficiency and in reporting the results of the work. When appropriate, auditors may use statistical methods to analyze and interpret information to assess its sufficiency and appropriateness.

Appropriateness

7.56 Appropriateness is the measure of the quality of evidence, which encompasses its relevance, reliability, and validity in providing support for achieving audit objectives.¹⁰⁸ In assessing the overall appropriateness of evidence, auditors consider the relevance, validity, and reliability of the evidence.

¹⁰⁸ See appendix paragraph A7.03 for additional guidance regarding assessing the appropriateness of information in relation to the audit objectives.

a. Relevance refers to the extent to which the information has a logical relationship with, and importance to, the issue being addressed.

b. Validity refers to how well the information actually represents what the auditors are trying to evaluate.

c. Reliability refers to the consistency of results achieved and includes the concepts of being verifiable or supported.

7.57 To assess the appropriateness of information, auditors consider the different types of information and the source of the information. Evidence may be obtained by observation, inquiry, or inspection. Each type of evidence¹⁰⁹ has its own strengths and weaknesses. The following contrasts are useful in judging the appropriateness of information. In each contrast, the first item generally provides a higher quality of evidence. However, these contrasts are not to be considered adequate in themselves to determine appropriateness. The nature and types of evidence required to support auditors' findings, conclusions, and recommendations is a matter of the auditors' professional judgment based on the audit objectives.

a. Evidence obtained when internal control is effective versus information obtained when internal control is weak or nonexistent.

b. Information obtained through the auditors' direct physical examination, observation, computation, and inspection versus information obtained indirectly.

c. Examination of original documents versus copies.

d. Testimonial information obtained under conditions where persons may speak freely versus information obtained where the persons may be intimidated given the circumstances.

¹⁰⁹ See appendix paragraph A7.02 for additional guidance regarding the types of evidence.

e. Testimonial information obtained from an individual who is not biased and has direct knowledge about the area versus testimonial information obtained from an individual who is biased or has indirect or partial knowledge about the area.

f. Information obtained from a knowledgeable, credible, and unbiased third party versus from management or other officials of the audited entity.

7.58 Testimonial evidence is often useful in interpreting or corroborating documentary or physical information. Auditors should evaluate the objectivity, credibility and reliability of the testimonial evidence. (See 7.57 d and e above.) Similarly, documentary evidence is used to help verify, support or challenge testimonial information.

7.59 Evidence from surveys is generally self-reported information that is frequently used to obtain information about existing conditions or programs. Auditors should evaluate the objectivity, credibility, and reliability of the self-reported information as well as the survey design and administration.

7.60 When sampling is used, the method of selection that is most appropriate will depend on the audit objectives. For example, when a representative sample is appropriate, the use of statistical sampling approaches would result in stronger evidence than that obtained from non-statistical techniques. In cases where a representative sample is not appropriate, a targeted selection may be more effective if the auditors have isolated certain risk factors or other criteria used to target the selection.

7.61 Auditors may use data gathered by officials of the audited entity as part of their evidence. Before auditors use this type of information, they should determine what the officials of the audited entity or other auditors did to provide assurance over the reliability of the information. If the procedures completed by officials of the audited entity were adequate to support using the information in relation to the audit objectives and if the results of such work are current, auditors may be able to use the work to

reduce their audit procedures if, based on testing the work done by agency officials, the data is sufficient and appropriate, in combination with other evidence.

7.62 When computer-processed information is used to support findings, conclusions, and recommendations, auditors should perform procedures for assessing the appropriateness of the information. Auditors should assess the sufficiency and appropriateness of this type of data regardless of whether computer-processed information is provided to auditors or auditors independently extract them. The nature, timing and extent of audit procedures to assess sufficiency and appropriateness is affected by the effectiveness of the entity's internal controls over the information, including information system controls, and the significance of the information and the level of detail presented in the auditors' findings, conclusions, and recommendations in light of the audit objectives. Audit procedures to evaluate the effectiveness of selected system controls includes (1) gaining a detailed understanding of the system as it relates to the information and (2) identifying and evaluating the general controls and application controls that are critical to ensuring the reliability of the information required for the audit.

The nature and extent of audit procedures to evaluate the effectiveness of information system controls will vary based on the following:

- a.** the extent to which the information systems controls are significant to the auditors' overall assessment of appropriateness of information; and
- b.** the availability of other evidence to support the auditors' findings, conclusions, and recommendations.

Sufficiency

7.63 Sufficiency is a measure of the quantity of evidence used to support the findings, conclusions, and recommendations related to the audit objectives. Sufficiency is also

dependent on the appropriateness of the evidence. In determining the sufficiency of evidence, auditors should determine whether enough evidence exists to support the findings, conclusions, and recommendations.

7.64 The following presumptions are useful in judging the sufficiency of evidence. The sufficiency of evidence required to support the auditors' findings, conclusions, and recommendations is a matter of the auditors' professional judgment.

- a. The greater the audit risk, the greater the quantity of evidence required.
- b. Stronger evidence may allow less evidence to be used. The appropriateness test (see 7.56 through 7.62) is closely interrelated with decisions about sufficiency.
- c. Having a large volume of audit evidence does not compensate for a lack of relevance, validity and/or reliability.

Overall Assessment of Evidence

7.65 Auditors use professional judgment to determine whether evidence is sufficient and appropriate and the nature and extent of testing necessary, in relation to the objectives of the audit. Professional judgments about the sufficiency and appropriateness of evidence are closely intertwined, as auditors interpret the results of audit testing and evaluate whether the nature and extent of the evidence obtained is sufficient and appropriate given the audit objectives. Auditors perform an overall assessment of the collective evidence used to support findings, conclusions, or recommendations. This overall assessment also includes the results of any specific assessments conducted to conclude on the validity and reliability of specific evidence.

7.66 Appropriateness and sufficiency of evidence are relative concepts, which may be thought of in terms of a continuum, rather than as absolutes. However, it may be helpful for auditors to consider the overall appropriateness and sufficiency in terms of:

(1) sufficient and appropriate (2) not sufficient and appropriate, or (3) of undetermined sufficiency and appropriateness in relation to the audit objectives. Auditors consider sufficiency and appropriateness in the context of the findings, conclusions, and recommendations. For example, even though the auditors may have some uncertainty about the sufficiency or appropriateness of the evidence, the auditors may nonetheless determine that there is sufficient and appropriate evidence given the findings, conclusions, or recommendations. (See paragraph 7.77 through 7.92 for documentation requirements.)

a. Evidence is considered to be sufficient and appropriate when using the evidence provides the basis for an analysis that achieves the audit objectives and provides a reasonable basis for their findings, conclusions, or recommendations.

b. Evidence is considered to be not sufficient and appropriate when (1) using the evidence carries an unacceptably high risk that it could lead to an incorrect or improper conclusion or (2) the information has significant or potentially significant limitations, given the objectives and intended use of the information.

c. Evidence is considered to be of undetermined sufficiency and appropriateness when (1) the auditors do not have an adequate basis to conclude whether it achieves the audit objectives and provides a reasonable basis for the findings, conclusions, and recommendations or (2) the information has significant or potentially significant limitations of unknown impact, given the objectives and the intended use.

7.67 Auditors should assess the appropriateness and sufficiency of evidence, in the aggregate, to provide a reasonable basis for the findings, conclusions, and recommendations. When assessing the appropriateness and sufficiency of evidence, auditors should evaluate the expected significance within the context of the audit objectives and conclusions, available corroborating evidence, and the level of risk. The steps required to assess information may depend on the nature of the information, how the information is used in the audit, and the audit objectives.

7.68 When the auditors' tests disclose errors in the information, or when auditors use information of undetermined appropriateness, they should apply additional procedures, as appropriate. Such procedures include

a. seeking independent, corroborating evidence from other sources so that the evidence is sufficient and appropriate;

b. clearly indicating in the report the limitations of the information, while refraining from using the information to make unwarranted findings, conclusions or recommendations, and considering whether to report the limitations of the information as an audit finding;
or

c. redefining the audit objectives or limiting the audit scope to eliminate the need to use the information and fully disclosing in the audit report revisions made to the audit objectives due to the lack of sufficient, appropriate evidence.

7.69 How the use of information of undetermined sufficiency and appropriateness affects the auditors' report depends on the significance of the information to the auditors' findings, conclusions, or recommendations in light of the audit objectives. For example, auditors may use such information to provide background information. In cases where auditors use information of undetermined sufficiency and appropriateness to support audit findings conclusions, or recommendations, auditors should fully disclose the fact that such information is being used, assess the impact of using such information, and use professional judgment to determine whether and to what extent to qualify the audit findings and conclusions. Auditors use professional judgment in determining the impact on the audit objectives and compliance with GAGAS. (See paragraphs 1.13 through 1.15.)

Audit Findings

7.70 The elements needed for developing a finding depend on the objectives of the audit. A finding or set of findings is complete to the extent that the audit objectives are satisfied and the report clearly relates those objectives to the elements of a finding. Audit findings often have been regarded as containing the elements of criteria, condition, cause, and effect. Criteria are discussed in paragraph 7.36 through 7.37, and the other elements of a finding—condition, effect, and cause—are discussed in the following paragraphs:

7.71 Condition: Condition is a situation that exists. The auditors determine and document condition during the audit. Generally, a description of the condition is necessary to convey the nature and extent of the finding to the reader.

7.72 Effect or Potential Effect: The effect or potential effect identifies the outcomes or consequences of the condition. When the auditors' objectives include identifying the actual or potential consequences of a condition that varies (either positively or negatively) from the criteria identified in the audit, "effect" is a measure of those consequences. Auditors often use effect or potential effect to demonstrate the need for corrective action in response to identified problems or risks. When the auditors' objectives include estimating the extent to which a program has caused changes in physical, social, or economic conditions, "effect" is a measure of the impact achieved by the program. In this case, effect is the extent to which positive or negative changes in actual physical, social, or economic conditions can be identified and attributed to program operations.

7.73 Cause: The cause identifies the reason or explanation for the condition. When the auditors' objectives include explaining why a particular type of positive or negative program performance, output, or outcome identified in the audit occurred, they are referred to as "cause." Identifying the cause of problems can assist auditors in making constructive recommendations for correction. Because problems can result from a

number of plausible factors or multiple causes, the recommendation can be more persuasive if auditors can clearly demonstrate and explain with evidence and reasoning the link between the problems and the factor or factors they have identified as the cause. When the auditors' objectives include estimating the program's effect on changes in physical, social, or economic conditions, auditors seek evidence of the extent to which the program itself is the "cause" of those changes. Auditors may identify deficiencies in internal control that are significant to the subject matter of the performance audit as the cause of deficient performance. In reporting this type of finding, the deficiencies in internal control would be described as the "cause." Often the causes of deficiencies in internal control are complex and involve multiple factors, including fundamental, systemic root causes. In some cases, it may not be practical or possible for auditors to fully develop or identify the causes of deficiencies. However, analyzing and identifying root cause of deficiencies is key to making recommendations for corrective actions.

Audit Documentation

7.74 The auditor must prepare audit documentation in connection with each engagement in sufficient detail to provide a clear understanding of the work performed (including the nature, timing, extent, and results of audit procedures performed), the audit evidence obtained and its source, and the conclusions reached. Audit documentation:

a. provides the principal support for the statement in the auditors' report that the auditors performed the audit in accordance with GAGAS and any other standards cited, and

b. provides the principal support for the auditors' conclusions.

7.75 Audit documentation is an essential element of audit quality. Although documentation alone does not guarantee audit quality, the process of preparing sufficient and appropriate documentation contributes to the quality of an audit.

7.76 The auditor should prepare audit documentation that enables an experienced auditor,¹¹⁰ having no previous connection to the audit, to understand:

- a.** the nature, timing, and extent of auditing procedures performed to comply with GAGAS and other applicable legal and regulatory requirements,
- b.** the results of the audit procedures performed and the audit evidence obtained,
- c.** how the audit evidence supports the audit findings and conclusions, and
- d.** the conclusions reached on significant matters.

7.77 In addition to the audit documentation requirements listed in the previous paragraph, auditors should document the following for performance audits:

- a.** the planning, objectives, scope, and methodology of the audit, including sampling and other selection criteria used;
- b.** the auditors' risk assessment;
- c.** the auditors' determination that certain standards did not apply or that an applicable standard was not followed, the reasons supporting their determinations, and the known effect that not following the applicable standard had, or could have had, on the audit;

¹¹⁰ An experienced auditor means an individual (whether internal or external to the audit organization) who possesses the competencies and skills that would have enabled him or her to perform the performance audit. These competencies and skills include an understanding of (a) the performance audit processes, (b) GAGAS and applicable legal and regulatory requirements, and (c) the subject matter associated with achieving the audit objectives.

- d.** the work performed to support significant judgments, findings, conclusions and recommendations, including descriptions of transactions and records examined;¹¹¹
- e.** evidence of supervisory reviews, before the audit report is issued, of the work performed that supports findings, conclusions, and recommendations contained in the audit report;
- f.** work performed as part of the appropriateness assessment, including the following items, as applicable: testing, information review, analysis, and knowledge gained related to the quality of the information;
- g.** decisions made during the overall assessment of evidence, including the auditors' final assessment of whether the information is sufficient and appropriate for the purposes of the audit;
- h.** communications with management and others;
- i.** evidence of communications about deficiencies in internal control found during the audit;
- j.** evidence of communications to officials of the audited entity about instances of potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse;
- k.** the availability of the report for public inspection; and

¹¹¹ Auditors may meet this requirement by listing file numbers, case numbers, or other means of identifying specific documents they examined. They are not required to include copies of documents they examined as part of the audit documentation, nor are they required to list detailed information from those documents.

1. if the audit does not result in a report, a memorandum for the record that summarizes the results of the work and explains the reason the audit was terminated, and any communications regarding the termination of the audit.

7.78 Certain matters, such as auditor independence and staff training, that are not engagement specific, may be documented either centrally in the audit organization or in the documentation for the audit. Documentation of matters specific to a particular audit are included in the audit documentation file for the specific audit.

7.79 The form, content, and extent of audit documentation depend on the circumstances of the engagement and the audit methodology and tools used. Oral explanations on their own do not represent sufficient support for the work the auditor performed or conclusions the auditor reached but may be used by the auditor to clarify or explain information contained in the audit documentation. It is, however, neither necessary nor practicable to document every matter the auditor deals with during the audit.

7.80 The auditor should document significant findings or issues, actions taken to address them (including any additional evidence obtained), and the basis for the final conclusions reached. Judging the significance of a finding or issue requires an objective analysis of the facts and circumstances.

7.81 The auditor should document discussions of significant findings or issues with management and others, including the significant findings or issues discussed, and when and with whom the discussions took place.

7.82 If the auditor has identified information that contradicts or is inconsistent with the auditor's final conclusions regarding a significant finding or issue, the auditor should document how the contradiction or inconsistency was addressed in forming the conclusion.

7.83 In documenting the nature, timing, and extent of audit procedures performed, the auditor should record:

a. who performed the audit work and the date such work was completed, and

b. who reviewed specific audit documentation and the date of such review.

7.84 When documenting procedures performed, such as tests of specific transactions that involve inspection of documents, auditors should include the identifying characteristics of the specific items tested.

7.85 When the auditor does not comply with applicable unconditional or presumptively mandatory GAGAS requirements, the auditor should document the justification or reason for the departure, the impact of the departure, and whether alternative procedures performed in the circumstances were sufficient to achieve the objectives of the requirement. The auditor should also follow the requirements in paragraphs 1.13 through 1.15.

7.86 Underlying GAGAS audits is the premise that federal, state, and local government audit organizations and independent accounting firms engaged to perform performance audits in accordance with GAGAS cooperate in auditing programs of common interest so that the auditors may use others' work and avoid duplication of effort. Auditors should make appropriate audit staff and individuals, as well as audit documentation available, upon request, in a timely manner to other auditors or reviewers. It is also essential that contractual arrangements for GAGAS audits provide for full and timely access to audit staff and individuals, as well as audit documentation to facilitate reliance by other auditors or reviewers on the auditors' work.

7.87 Consistent with applicable laws and regulations, audit organizations should develop clearly defined policies and criteria to deal with situations where requests are made by outside parties to obtain access to audit documentation. Audit organizations

should develop clearly defined policies and criteria for responding to requests made by outside parties to obtain access indirectly through the auditor information that it is unable to obtain directly from the audited entity and how to respond to requests for access to audit documentation before the audit is complete. The audit organization should also include flexibility in its policies and procedures to consider the individual facts and circumstances surrounding a request, for instance, cases when granting access or providing certain information would serve to adversely affect the ability of the audit organization to successfully perform similar audits in the future.

7.88 The audit organization should adopt reasonable procedures to retain and access audit documentation for a period of time sufficient to meet the needs of the audit organization and to satisfy any applicable legal or regulatory requirements for records retention.

7.89 The auditor should complete the assembly of the final audit file on a timely basis, following the report release date (documentation completion date). Statutes, regulations, or the audit organization's quality control policies may state a specific time in which the assembly process should be completed.

7.90 At anytime prior to the documentation completion date, the auditor may make changes to the audit documentation to:

- a. complete the documentation and assembly of audit evidence that the auditor has obtained, discussed, and agreed with relevant members of the audit team prior to the date of the audit report,
- b. perform routine file-assembling procedures such as deleting or discarding superseded documentation and sorting, collating, and cross-referencing final audit documentation,
- c. sign-off on file completion checklists prior to completing and archiving the audit file, and

d. add information received after the date of the report, for example, an original document that was previously faxed.

7.91 After the documentation completion date, the auditors should not delete or discard audit documentation before the end of the specified retention period, as discussed above in paragraph 7.88. When the auditor finds it necessary to make an addition (including amendments) to audit documentation after the documentation completion date, the auditor should document the addition by including the following in the documentation:

a. when and by whom such additions were made and, where applicable, reviewed,

b. an audit trail that clearly shows the specific changes,

c. the specific reasons for the changes, and

d. the effect, if any, of the changes on the auditors' conclusions.

7.92 Whether audit documentation is in paper, electronic, or other media, the integrity, accessibility, and retrievability of the underlying data may be compromised if the documentation could be altered, added to, or deleted without the auditors' knowledge, or if the documentation could be permanently lost or damaged. Accordingly, auditors should apply appropriate controls to protect audit documentation from alteration, destruction, and unauthorized access.

Chapter 8
Reporting Standards for Performance Audits

Introduction

8.01 This chapter establishes reporting standards and provides guidance applicable to performance audits conducted in accordance with generally accepted government auditing standards (GAGAS). The reporting standards for performance audits relate to the form of the report, the report contents, and report issuance and distribution.

8.02 See paragraphs 1.16 through 1.17 and 1.20 for a discussion about the use of GAGAS with other standards.

Reporting

8.03 Auditors must prepare audit reports communicating the results of each audit.

8.04 Auditors should utilize a form of the audit report that is appropriate for its intended use, and should prepare reports in writing or in some other retrievable form. For example, audit reports also may be presented on electronic media that are retrievable by report users and the audit organization, such as video or compact disc formats. The users' needs, likely demand, and distribution will influence the form of the audit report used. In addition to a more traditional presentation of audit results, such as a chapter report or a letter report, briefing slides and/or other presentation materials that are complete and retrievable are considered to be audit reports. Regardless of form, auditors should comply with all applicable reporting standards.

8.05 The purpose of audit reports is to (1) communicate the results of audits to those charged with governance, the appropriate officials of the audited entity, and the appropriate oversight officials (2) make the results available to the public, and (3)

facilitate follow-up to determine whether appropriate corrective actions have been taken. The need to maintain public accountability for government programs demands that audit reports be retrievable.

8.06 If an audit is terminated before it is completed, auditors should notify those charged with governance, appropriate officials of the audited entity, and the entity requesting the audit, and other appropriate officials about the termination of the audit, preferably in writing.

Report Contents

8.07 Auditors should prepare audit reports which include (1) the objectives, scope, and methodology of the audit; (2) the audit results, including findings, conclusions, and recommendations, as appropriate; (3) a reference to compliance with generally accepted government auditing standards; (4) the views of responsible officials; and (5) if applicable, the nature of any privileged and confidential information omitted.

Objectives, Scope, and Methodology

8.08 Auditors should include in the report a description of the audit objectives and the scope and methodology used for achieving the audit objectives. This information is essential for report users to understand the purpose of the audit and the nature and extent of the audit work performed, context and perspective as to what is reported, and any significant limitations in audit objectives, scope, or methodology.

8.09 Audit objectives for performance audits may vary widely and may encompass a variety of objectives, as discussed in 1.34. Auditors should communicate audit objectives in the audit report in a clear, specific, neutral and unbiased manner that includes relevant assumptions, including why the audit organization undertook the assignment and state what the report is expected to accomplish. The reported audit objectives

provide more meaningful information to report users if they are measurable and feasible and are not presented in a broad or general manner. To reduce misunderstanding in cases where the objectives are particularly limited and broader objectives can be inferred, auditors may state objectives that were not part of the audit.

8.10 Auditors should clearly describe the scope of the work performed and any limitations; any applicable standards that were not followed, the reasons for not following the applicable standards, and how not following the applicable standards affected or could affect the results of the work. For example, if the auditors are unable to determine the appropriateness of evidence, and such evidence is critical to achieving the audit objectives, auditors should clearly state in the report the limitations associated with the evidence and refrain from making unwarranted findings, conclusions or recommendations. Auditors should address issues that a reasonable person would need to know to reasonably interpret the findings, conclusions and recommendations in the report and not be misled.

8.11 To report the methodology used, auditors should clearly explain the audit work completed to address the audit objectives, including the evidence gathering and analysis techniques used, in sufficient detail to allow knowledgeable users of their reports to understand how the auditors addressed the audit objectives. In situations when extensive and/or multiple sources of information are used by auditors, the auditors should consider whether to include a description of the procedures performed as part of the auditors' assessment of the appropriateness of information used as audit evidence. Auditors should identify any significant assumptions made in conducting the audit; describe any comparative techniques applied; describe the criteria used; and, when sampling significantly supports auditors' findings, conclusions or recommendations, describe the sample design and state why it was chosen, including whether the results can be projected to the intended population.

8.12 In describing the work conducted to accomplish the audit's objectives, auditors should, as applicable, explain the relationship between the population of items sampled

and what was audited; identify organizations, geographic locations, and the period covered; report the kinds and sources of evidence; and explain any significant limitations or uncertainties based on the auditors' overall assessment of the sufficiency and appropriateness of the evidence in the aggregate. Auditors should also report any significant constraints imposed on the audit approach by information limitations or scope impairments, including demands of access to certain records or individuals.

8.13 How the use of information of undetermined sufficiency and appropriateness affects the auditors' report depends on the significance of the information to the auditors' findings, conclusions, or recommendations in light of the audit objectives. For example, auditors may use such information to provide background information. In cases where auditors use information of undetermined sufficiency and appropriateness to support audit findings conclusions, or recommendations, auditors should fully disclose the fact that such information is being used, assess the impact of using such information, and use professional judgment to determine whether and to what extent to qualify the audit findings and conclusions. If the use of such information is significant to the auditors' findings and conclusions, auditors should determine the impact on the audit objectives and compliance with GAGAS. (See paragraphs 1.13 through 1.15.)

Findings

8.14 In the audit report, auditors should present sufficient, appropriate evidence to support the findings, conclusions and recommendations in relation to the audit objectives. Auditors should present findings in a manner to promote adequate understanding of the matters reported and to provide convincing but fair presentations in proper perspective that are compelling. Auditors consider the significance of evidence as they develop the report findings, conclusions and recommendations. In making judgments about significance, auditors consider whether the judgment of a reasonable person relying on the auditors' report would have been changed or influenced if the matter had been disclosed in the audit report. This includes the probability that the matter would change or influence the decisions of intended users of the auditors' report;

or, as another example, where the context is a judgment about whether to report a matter to those charged with governance, whether the matter would be regarded as important by those charged with governance in carrying out their duties. Auditors may provide selective background information to provide the context for the overall message and to help the reader understand the findings and significance of the issues discussed.¹¹²

8.15 If information necessary to achieve the audit objectives is not available or is determined to be not appropriate, auditors may report the issue as a finding and make related recommendations, if such information is significant to the performance of the program being audited. If the limitations of the information are partially or wholly a result of internal control deficiencies, auditors should recommend actions necessary to address the deficiencies.

8.16 As discussed in chapter 7, audit findings have often been regarded as containing the elements of criteria, condition, cause, and effect. (See 7.36 through 7.37 and 7.70 through 7.73). However, the elements needed for a finding depend on the audit objectives. For example, an audit objective may be limited to determining the current status or condition of implementing legislative requirements, and not the related cause or effect. Thus, a finding or set of findings is complete to the extent that the auditors achieve the audit objectives and the report clearly relates those objectives to the elements of the finding.

8.17 To the extent necessary to achieve the audit objectives, in presenting findings, auditors should develop the elements of criteria, condition, cause, and effect to assist management or oversight officials of the audited entity in understanding the need for taking corrective action. In addition, if auditors are able to sufficiently develop the elements of a finding, they should provide recommendations for corrective action if they

¹¹² Appropriate background information may include information on how programs and operations work; the significance of programs and operations (e.g., dollars, impact, purposes, and past audit work if relevant); a description of the audited entity's responsibilities; and explanation of terms, organizational structure, and the statutory basis for the program and operations.

are significant within the context of the audit objectives. Following is guidance for reporting on elements of findings:

a. Criteria: The required or desired state and/or what is expected from the program or operation. The criteria are easier to understand when stated objectively, explicitly, and completely and when the source of the criteria is identified in the audit report.¹¹³

b. Condition: What the auditors found regarding the actual situation. Reporting the scope or extent of the condition allows the report user to gain an accurate perspective.

c. Cause: Evidence on the factor or factors responsible for the difference between condition and criteria. In reporting the cause, auditors may consider whether the evidence provides a reasonable and convincing argument for why the stated cause is the key factor or factors contributing to the difference as opposed to other possible causes, such as poorly designed criteria or factors uncontrollable by program management. The auditors also may consider whether the identified cause could serve as a basis for the recommendations. Often the causes of deficiencies in internal control are complex and involve multiple factors. In some cases, it may not be practical for auditors to fully develop or identify all of the causes of deficiencies. However, analyzing and identifying root causes of internal control deficiencies are key to making recommendations for corrective action.

d. Effect or potential effect: A clear, logical link to establish the impact or potential impact of the difference between what the auditors found (condition) and the required or desired state (criteria). Effect is easier to understand when it is stated clearly, concisely,

¹¹³ Common sources for criteria include laws, regulations, policies, procedures, and best or standard practices. The *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: Nov. 1999) and *Internal Control—Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) are two sources of established criteria auditors can use to support their judgments and conclusions about internal control. The related *Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C.: Aug. 2001), based on the federal internal control standards, provides a systematic, organized, and structured approach to assessing internal control.

and, if possible, in quantifiable terms. The significance of the reported effect can be demonstrated through credible evidence.

8.18 Auditors should place their findings in perspective by describing the nature and extent of the issues being reported and the extent of the work performed that resulted in the finding. To give the reader a basis for judging the prevalence and consequences of these findings, auditors may relate the instances identified to the population or the number of cases examined and quantify the results in terms of dollar value, as appropriate. If the results cannot be projected, auditors should limit their conclusions appropriately.

8.19 Auditors should report deficiencies¹¹⁴ in internal control that are significant within the context of the objectives of the performance audit, all instances of potential fraud and illegal acts unless they are clearly inconsequential,¹¹⁵ significant violations of provisions of contracts or grant agreements, and significant abuse.

Reporting Deficiencies in Internal Control

8.20 Auditors should include in the audit report (1) the scope of their work on internal control and (2) deficiencies in internal control that are significant within the context of the audit objectives. When auditors detect deficiencies in internal control that are not significant to the objectives of the performance audit, they should communicate those deficiencies in a separate letter to officials of the audited entity unless the deficiencies are clearly inconsequential considering both qualitative and quantitative factors. If the auditors have communicated deficiencies to officials of the audited entity during the

¹¹⁴ As discussed in paragraph 7.23, in performance audits a deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect (1) misstatements in financial or performance information, (2) violations of laws and regulations, or (3) impairments of effectiveness or efficiency of operations, on a timely basis.

¹¹⁵ Whether a particular act is, in fact, illegal may have to await final determination by a court of law. Thus, when auditors disclose matters that have led them to conclude that an illegal act is likely to have occurred, they should take care not to unintentionally imply that a final determination of illegality has been made.

course of the audit, they should refer to that communication in the audit report. Whether or how to communicate deficiencies that are clearly inconsequential to officials of the audited entity is a matter of the auditors' professional judgment.

8.21 In a performance audit, auditors may conclude that identified deficiencies in internal control that are significant within the context of the audit objectives are the cause of the deficient performance. In reporting this type of finding, the internal control deficiency would be described as the cause.

Reporting Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse

8.22 When auditors conclude, based on evidence obtained, that potential fraud, illegal acts, significant violations of provisions of contracts or grant agreements, or significant abuse either has occurred or may have occurred, they should report the matter as a finding.¹¹⁶

8.23 When reporting instances of potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse, auditors should place the findings in perspective by describing the extent of work performed that resulted in the finding. To give the reader a basis for judging the prevalence and consequences of these findings, the auditors may relate the instances identified to the population or the number of cases examined and quantify the instances in terms of dollar value, as appropriate. If the results cannot be projected, auditors should limit their conclusions appropriately.

8.24 When auditors detect potential violations of provisions of contracts or grant agreements, or abuse that is not significant, they should communicate those findings in a separate letter to officials of the audited entity unless the findings are clearly inconsequential, considering both qualitative and quantitative factors. Auditors should

¹¹⁶ See paragraphs 8.26 through 8.28 for additional reporting considerations.

refer to that letter in the audit report. Whether or how to communicate potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse that are clearly inconsequential to officials of the audited entity is a matter of the auditors' professional judgment. Auditors should include in their audit documentation evidence of communications to officials of the audited entity about deficiencies in potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse.

8.25 When auditors conclude that potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse either have occurred or are likely to have occurred, they may consult with authorities and/or legal counsel about whether publicly reporting certain information about the potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse would compromise investigative or legal proceedings. Auditors should limit their public reporting to matters that would not compromise those proceedings, such as information that is already a part of the public record.

Direct Reporting of Potential Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, or Abuse

8.26 Auditors should report potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly to parties outside the audited entity in two circumstances, as discussed below.¹¹⁷ This reporting is in addition to any legal requirements for direct reporting of potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse. Auditors should follow these requirements even if they have resigned or been dismissed from the audit prior to its completion.

8.27 The audited entity may be required by law or regulation to report certain potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse to

¹¹⁷ Internal audit organizations do not have a duty to report outside the entity unless required by law, rule, regulation, or policy. See paragraph 3.19 for reporting requirements for internal audit organizations when reporting externally.

specified external parties, such as a federal inspector general or a state attorney general. When auditors have communicated such potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse to the audited entity and the audited entity fails to report them, then the auditors should communicate such an awareness to the governing body of the audited entity. When the audited entity does not make the required report as soon as possible after the auditors' communication with those charged with governance, then the auditors should report such potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly to the external party specified in the law or regulation.

8.28 When potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse involves awards received directly or indirectly from a government agency, auditors may have a duty to report directly if management fails to take remedial steps. When auditors conclude that such failure is likely to cause them to report such findings or resign from the audit, they should communicate that conclusion to those charged with governance of the audited entity. If the audited entity does not report the potential fraud, illegal act, violation of provisions of contracts or grant agreements, or abuse in a timely manner to the entity that provided the government assistance, the auditors should report the potential fraud, illegal act, violation of provisions of contracts or grant agreements, or abuse directly to that entity.

8.29 Auditors should obtain sufficient, appropriate evidence to corroborate assertions by management that it has reported potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse. When auditors are unable to do so, then they should report such potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse directly as discussed above.

Conclusions

8.30 Auditors should report conclusions related to the audit objectives and the audit findings and recommendations. Report conclusions are logical inferences about the

program based on the auditors' findings, not merely a summary of the findings. The strength of the auditors' conclusions depends on the sufficiency, and appropriateness of the evidence supporting the findings and the soundness of the logic used to formulate the conclusions. Conclusions are stronger if they lead to the auditors' recommendations and convince the knowledgeable user of the report that action is necessary.

Recommendations

8.31 Auditors should recommend actions to correct problems identified during the audit and to improve programs and operations when the potential for improvement in programs, operations, and performance is substantiated by the reported findings and conclusions. Auditors should make recommendations that logically flow from the findings and conclusions that clearly state the recommended actions.

8.32 Constructive recommendations can encourage improvements in the conduct of government programs and operations. For recommendations to be most constructive, auditors should make recommendations that are directed at resolving the cause of identified problems, action oriented and specific, and addressed to parties that have the authority to act.

Statement on Compliance with GAGAS

8.33 When auditors comply with all applicable GAGAS standards, they should include a statement in the audit report that they performed the audit in accordance with GAGAS and include the following language in the report:

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence

obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

8.34 The statement of compliance with GAGAS indicates that the auditors have complied with all applicable GAGAS general and auditing standards. When the auditors did not follow applicable standards, or were not able to follow applicable standards due to access problems or other scope limitations, they should follow the requirements in paragraphs 1.13 through 1.15.

Reporting Views of Responsible Officials

8.35 Auditors should obtain and report the views of responsible officials¹¹⁸ of the audited program concerning auditors' findings, conclusions, and recommendations, and planned corrective actions. Auditors should also include an evaluation of those views in the report.

8.36 One of the most effective ways to develop a report that is fair, complete, and objective is to provide a draft report for review and comment by responsible officials of the audited entity and others, as appropriate. Including the views of responsible officials results in a report that presents not only the auditors' findings, conclusions, and recommendations, but also the perspectives of the responsible officials of the audited entity and the corrective actions they plan to take. Auditors should include in their report a copy of the officials' written comments or a summary of the comments received along with the auditors' evaluation of the comments. In cases when the audited entity provides technical comments in addition to its written comments on the report, auditors should

¹¹⁸ Some audits may address audit objectives which cover cross-cutting issues that transcend specific government agencies. In these situations, auditors use professional judgment to identify appropriate officials for the issues addressed by the audit objectives and include the views of those officials in the audit report.

use professional judgment in determining whether to include such comments or disclose in the report that such comments were provided.

8.37 Auditors ordinarily request that the responsible officials submit in writing their views on the auditors' reported findings, conclusions, and recommendations, as well as management's planned corrective actions. However, oral comments are acceptable and, in some cases, may be the most expeditious way to obtain comments. Obtaining oral comments can be effective when, for example, there is a time-critical reporting date to meet a user's needs; auditors have worked closely with the responsible officials throughout the conduct of the work and the parties are familiar with the findings and issues addressed in the draft report; or the auditors do not expect major disagreements with the draft report's findings, conclusions, and recommendations, or perceive any major controversies with regard to the issues discussed in the draft report. If oral comments are provided by the responsible officials, auditors should prepare a summary of the oral comments and provide a copy of the summary to the responsible officials to verify that the comments are accurately stated prior to finalizing the report.

8.38 Auditors should fairly and objectively evaluate and recognize comments, as appropriate, in the final report. Auditors may note comments, such as a plan for corrective action, but should not accept them as justification for dropping a finding or a related recommendation without sufficient and appropriate evidence.

8.39 When the audited entity's comments are inconsistent or in conflict with the report's findings, conclusions, or recommendations and are not, in the auditors' opinion, valid, or when planned corrective actions do not adequately address the auditors' recommendations, the auditors should evaluate the validity of the audited entity's comments. If the auditors disagree with the comments, they should state in the report their reasons for disagreeing with the comments or planned corrective actions. Conversely, the auditors should modify their report as necessary if they find the officials' comments to be valid.

8.40 If the audited entity refuses to provide comments or is unable to provide comments within a reasonable period of time, auditors may need to issue the report without receiving comments from the audited entity. In such cases, auditors should describe in the report the reasons that comments from the audited entity are not included.

Reporting Privileged and Confidential Information

8.41 If information related to the audit objectives is prohibited from general disclosure, auditors should disclose in the report that certain information has been omitted and the requirement that makes the omission necessary.

8.42 Certain information may be classified or may be otherwise prohibited from general disclosure by federal, state, or local laws or regulations. In such circumstances, auditors may issue a separate, classified or limited-official-use report containing such information and distribute the report only to persons authorized by law or regulation to receive it. Additional circumstances associated with public safety and security concerns could also justify the exclusion of certain information in the report. For example, detailed information related to computer security for a particular program may be excluded from publicly available reports because of the potential damage that could be caused by the misuse of this information. In such circumstances, auditors may issue a limited-official-use report containing such information and distribute the report only to those parties responsible for acting on the auditors' recommendations. The auditors may consult with legal counsel regarding any requirements or other circumstances that may necessitate the omission of certain information.

8.43 Auditors consider the broader public interest in the program or activity under review when deciding whether to exclude certain information from publicly available reports. When circumstances call for omission of certain information, auditors should evaluate whether this omission could distort the audit results or conceal improper or unlawful practices.

Report Issuance and Distribution

8.44 Government auditors should submit audit reports to those charged with governance, to the appropriate officials of the audited entity and to the appropriate officials of the organizations requiring or arranging for the audits, including external funding organizations, such as legislative bodies, unless legal restrictions prevent it. Auditors should also send copies of the reports to other officials who have legal oversight authority or who may be responsible for acting on audit findings and recommendations, and to others authorized to receive such reports. Auditors should clarify whether the report will be made available for public distribution.

8.45 If the subject of the audit involves material that is classified for security purposes or is not releasable to particular parties or the public for other valid reasons, auditors may limit the report distribution.¹¹⁹ Auditors should document any limitation on report distribution.

8.46 When nongovernment auditors are engaged to perform the audit under GAGAS, they should clarify report distribution responsibilities with the engaging organization. If the nongovernment auditors are to make the distribution, they should reach agreement with the party contracting for the audit about which officials or organizations should receive the report and the steps being taken to make the report available to the public.

8.47 Internal auditors may follow the IIA standards for report distribution, which state internal auditors also follow any applicable statutory requirements for distribution. The head of the internal audit organization should disseminate results to the appropriate parties. The head of the internal audit organization is responsible for communicating the final results to parties who are in a position to take appropriate corrective actions. Distribution of reports outside the organization ordinarily is made only in accordance with applicable laws, rules, regulations, or policy.

¹¹⁹ See paragraphs 8.41 through 8.43 for additional guidance on limited report distribution.

Appendix

Introduction

A.01 The following sections provide supplemental guidance for auditors and the audited entities to assist in the implementation of GAGAS. The guidance is not intended to establish additional auditor requirements but instead is to facilitate auditor implementation of the standards contained in chapters 1 through 8. The supplemental guidance in the first section may be of assistance for all types of audits and engagements covered by GAGAS. Subsequent sections provide supplemental guidance for specific chapters of GAGAS, as indicated.

Overall Supplemental Guidance

A.02 Chapters 4 through 8 discuss the field work and reporting standards for financial audits, attestation engagements, and performance audits. The identification of significant deficiencies in internal control, significant abuse, fraud risks, and significant laws, regulations, or provisions of contract or grant agreements are important aspects of government auditing. The following discussion is provided to assist auditors with identifying significant deficiencies in internal control, abuse, and indicators of fraud risk and to assist auditors with determining whether laws, regulations, or provisions of contracts or grant agreements are significant to the audit objectives.

Examples of Significant Deficiencies in Internal Control

A.03 Auditor requirements for reporting significant deficiencies in internal control are discussed in paragraphs 5.13 through 5.18, 6.49 through 6.53, and 8.20 through 8.21. The following are examples of matters that may be significant deficiencies, including material weaknesses, depending on the facts and circumstances:

- a.** Ineffective oversight by those charged with governance of the entity's financial reporting, performance reporting, or internal control, or an ineffective overall governance structure.
- b.** Restatement of previously issued financial statements to reflect the correction of a material misstatement or significant corrections made to previously reported performance or operational results.
- c.** Identification by the auditor of a material misstatement in the financial statements for the period under audit that was not initially identified by the entity's internal control. This includes misstatements involving estimation and judgment for which the auditor identifies potential material adjustments and corrections of the recorded amounts. (This is a strong indicator of a material weakness even if management subsequently corrects the misstatement.)
- d.** An ineffective internal audit function or risk assessment function at an entity for which such functions are important to the monitoring or risk assessment component of internal control, such as for a very large or highly complex entity.
- e.** Identification of fraud of any magnitude on the part of senior management.
- f.** Failure by management or those charged with governance to assess the effect of a significant deficiency previously communicated to them and either correct it or conclude that it will not be corrected.
- g.** An ineffective control environment. Control deficiencies in various other components of internal control could lead the auditor to conclude that a significant deficiency or material weakness exists in the control environment.
- h.** Inadequate provisions for the safeguarding of assets.

i. Evidence of intentional override of internal control by those in authority to the detriment of the overall objectives of the system.

j. Deficiencies in the design or operation of internal control that could result in violations of laws, regulations, provisions of contracts or grant agreements; fraud; or abuse having a direct and material effect on the financial statements or the audit objective.

Examples of Abuse

A.04 [Placeholder for discussion of examples of abuse.]

Examples of Indicators of Fraud Risk

A.05 In some circumstances, conditions such as the following might indicate a heightened risk of fraud:

- a.** the entity's financial stability, viability, or budget is threatened by economic, programmatic, or entity operating conditions;
- b.** the nature of the audited entity's operations provide opportunities to engage in fraud;
- c.** inadequate monitoring by management for compliance with policies, laws, and regulations;
- d.** the organizational structure is unstable or unnecessarily complex;
- e.** lack of communication and/or support for ethical standards by management;

- f.** management has a willingness to accept unusually high levels of risk in making significant decisions;
- g.** a history of impropriety, such as previous issues with fraud, waste, abuse, or questionable practices, or past audits or investigations with findings of questionable or criminal activity;
- h.** operating policies and procedures have not been developed or are outdated;
- i.** key documentation is often lacking or does not exist;
- j.** lack of asset accountability or safeguarding procedures;
- k.** improper payments;
- l.** false or misleading information; or
- m.** a pattern of large procurements in any budget line with remaining funds at year end, in order to “use up all of the funds available.”

Determining Whether Laws, Regulations, or Provisions of Contracts or Grant Agreements Are Significant to Audit Objectives

A.06 Government programs are subject to many laws, regulations, and provisions of contracts or grant agreements. At the same time their significance to audit objectives vary widely, depending on the objectives of the audit. Auditors may find the following approach helpful in assessing whether laws, regulations, or provisions of contracts or grant agreements are significant to audit objectives:

a. Reduce each audit objective to questions about specific aspects of the program being audited (that is, purpose and goals, internal control, inputs, program operations, outputs, and outcomes).

b. Identify laws, regulations, and provisions of contracts or grant agreements that directly relate to specific aspects of the program included in questions that reflect the audit objectives.

c. Determine if the audit objectives or the auditors' conclusions could be significantly affected if violations of those laws, regulations, or provisions of contracts or grant agreements occurred. If the audit objectives or audit conclusions could be significantly affected, then those laws, regulations, and provisions of contracts or grant agreements are likely to be significant to the audit objectives.

A.07 Auditors may consult with legal counsel to (1) determine those laws and regulations that are significant to the audit objectives, (2) design tests of compliance with laws and regulations, or (3) evaluate the results of those tests. Auditors also may consult with legal counsel when audit objectives require testing compliance with provisions of contracts or grant agreements. Depending on the circumstances of the audit, auditors may consult with others, such as investigative staff, other audit organizations or government entities that provided assistance to the audited entity, or applicable law enforcement authorities, to obtain information on compliance matters.

Information to Accompany Chapter 1

A1.01 Chapter 1 discusses the use and application of GAGAS and the role of auditing in government accountability. Those charged with governance and management of audited organizations also have roles in government accountability. The discussion which follows is provided to assist auditors in understanding the roles of others in accountability. The following section also contains background information on the laws, regulations and guidelines which require the use of GAGAS. This information is

provided to place the requirements contained in GAGAS within the context of overall government accountability.

The Role of Those Charged with Governance in Accountability

A1.02 Those charged with governance are responsible for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process, subject matter, or program under audit including related internal controls. In certain entities covered by GAGAS, those charged with governance also may be part of the entity's management. In some audit entities, multiple parties may be charged with governance, including oversight bodies, members or staff of legislative committees, boards of directors, audit committees, or parties contracting for the audit.

Because the governance structures of government entities and organizations can vary widely, it may not always be clearly evident who is charged with key governance functions. In these situations, auditors evaluate the organizational structure for directing and controlling operations to achieve the entity's objectives. This evaluation also includes how the government entity delegates authority and establishes accountability for its management personnel.

Management's Role in Accountability

A1.03 Officials of the audited entity (for example, managers of a state or local governmental entity or a nonprofit entity that receives federal awards) are responsible for:

- a. using government resources efficiently, economically, effectively, equitably, and legally to achieve the purposes for which the resources were furnished or the program was established;¹²⁰
- b. complying with applicable laws and regulations, including identifying the requirements with which the entity and the official must comply and implementing systems designed to achieve that compliance;
- c. establishing and maintaining effective internal control to help ensure that appropriate goals and objectives are met; using resources efficiently, economically, effectively, and equitably, and safeguarding resources; following laws and regulations; and ensuring that management and financial information is reliable and properly reported;
- d. providing appropriate reports to those who oversee their actions and to the public in order to be accountable for the resources and authority used to carry out government programs and the results of these programs;
- e. addressing the findings and recommendations of auditors, and for establishing and maintaining a process to track the status of such findings and recommendations; and
- f. following sound procurement practices when contracting for audits and attestation engagements, including ensuring procedures are in place for monitoring contract performance.

A1.04 Management of the audited entity is responsible for resolving audit findings and recommendations and for having a process to track progress in resolving the findings and recommendations.

¹²⁰ This responsibility applies to all resources, both financial and physical, as well as informational resources, whether entrusted to public officials or others by their own constituencies or by other levels of government.

A1.05 Management of the audited entity is responsible for taking timely and appropriate steps to remedy fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse that auditors report to it.

Laws, Regulations, and Guidelines that Require Use of GAGAS

A1.06 The following are among the laws, regulations, and guidelines that require use of GAGAS:

a. The Inspector General Act of 1978, as amended, 5 U.S.C. App. (2000) requires that the statutorily appointed federal inspectors general comply with GAGAS for audits of federal establishments, organizations, programs, activities, and functions. The act further states that the inspectors general shall take appropriate steps to assure that any work performed by nonfederal auditors complies with GAGAS.

b. The Chief Financial Officers Act of 1990 (Public Law 101-576), as expanded by the Government Management Reform Act of 1994 (Public Law 103-356), requires that GAGAS be followed in audits of executive branch departments' and agencies' financial statements.

c. The Single Audit Act Amendments of 1996 (Public Law 104-156) require that GAGAS be followed in audits of state and local governments and nonprofit entities that receive federal awards.¹²¹ Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, which provides the governmentwide guidelines and policies on performing audits to comply with the Single Audit Act, also requires the use of GAGAS.

¹²¹ Under the Single Audit Act, as amended, federal awards include federal financial assistance (grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance) and cost-reimbursement contracts.

d. The Accountability of Tax Dollars Act of 2002 extends the requirement to prepare and submit audited financial statements to most executive agencies not subject to the Chief Financial Officers Act unless they are exempted by OMB. These covered agencies are required to follow GAGAS in their financial statement audits, but are not required to have systems that are compliant with FFMIA.

A1.07 Other laws, regulations, or other authoritative sources could require the use of GAGAS. For example, auditors at the state and local levels of government may be required by state and local laws and regulations to follow GAGAS. Also, auditors may be required by the terms of an agreement or contract to comply with GAGAS. Auditors may also be required by federal audit guidelines pertaining to program requirements, such as those issued for Housing and Urban Development programs and Student Financial Aid programs.

A1.08 Even if not required to do so, auditors may find it useful to follow GAGAS in performing audits of federal, state, and local government programs as well as in performing audits of government awards administered by contractors, nonprofit entities, and other nongovernment entities. Many audit organizations not formally required to do so, both in the United States of America and in other countries, voluntarily follow GAGAS.

Information to Accompany Chapters 3

A3.01 Chapter 3 discusses the general standards applicable when performing financial audits, attestation engagements, and performance audits under GAGAS. Auditors may also provide professional services, other than audits and attestation engagements which are sometimes referred to as consulting services. GAGAS do not cover nonaudit services since such services are not audits or attestation engagements. If an audit organization decides to perform nonaudit services, their independence for performing audits or attestation engagements may be impacted. Nonaudit services which may impair or do impair auditor independence are discussed in chapter 3. The following supplemental

guidance is provided to assist auditors and audited entities in identifying nonaudit services that are often provided by government audit organizations without impairing their independence with respect to entities for which they provide audit or attest services by providing examples of such services.

Nonaudit Services

A3.02 Government audit organizations frequently are requested to provide or are required to provide nonaudit services that differ from the traditional professional services provided to or for an audit/attest entity. These types of nonaudit services are often performed in response to a statutory requirement, under the authority of the audit organization, or for a legislative oversight body or an independent external organization and generally do not impair auditor independence. (The requirements for evaluating whether nonaudit services impair auditor independence are in chapter 3, paragraphs 3.24 through 3.35.)

A3.03 Examples of the types of services under this category include the following:

- a.** Providing information or data to a requesting party without auditor evaluation or verification of the information or data;
- b.** Developing standards, methodologies, audit guides, audit programs, or criteria for use throughout the government or for use in certain specified situations;
- c.** Collaborating with other professional organizations to advance auditing of government organizations;
- d.** Developing question and answer documents to promote understanding of technical issues or standards;

- e.** Providing assistance and technical expertise to legislative bodies or independent external organizations and assisting legislative bodies by developing questions for use at a hearing;
- f.** Providing training, speeches, and technical presentations;
- g.** Developing surveys, collecting responses on behalf of others, and reporting results as “an independent third party;”
- h.** Providing oversight assistance in reviewing budget submissions;
- i.** Contracting for audit services on behalf of an audited entity and overseeing the audit contract, as long as the overarching principles are not violated and the auditor under contract reports to the audit organization and not to management;
- j.** Assessing the advantages and disadvantages of legislative proposals;
- k.** Identifying best practices for users in evaluating program or management system approaches, including financial and information management systems; and
- l.** Audit, investigative, and oversight-related services that do not involve a full-scope GAGAS audit (but which could be performed as an audit, if the audit organization elects to do so), such as:
 - (1) Investigations of alleged fraud, violation of contract provisions or grant agreements, or abuse;
 - (2) Review-level work such as sales tax reviews that are designed to ensure the governmental entity receives from businesses, merchants and vendors all of the sales taxes to which it is entitled;

- (3) Periodic audit recommendation follow-up engagements and reports;
- (4) Identifying best practices or leading practices for use in advancing the practices of government organizations;
- (5) Analyzing cross-cutting and emerging issues; and
- (6) Providing forward-looking analysis involving programs.

Information to Accompany Chapter 7

A7.01 Chapter 7 discusses the field work standards for performance audits. An integral concept for performance auditing is the use of sufficient, appropriate evidence based on the audit objectives to support a sound basis for audit findings, conclusions, and recommendations. The following discussion is provided to assist auditors in identifying the various types of evidence and assessing the appropriateness of information or evidence in relation to the audit objectives.

Types of Evidence

A7.02 In terms of its form and how it is collected, evidence may be categorized as physical, documentary, or testimonial. Physical evidence is obtained by auditors' direct inspection or observation of people, property, or events. Such evidence may be documented in memoranda, photographs, videos, drawings, charts, maps, or physical samples. Documentary evidence is obtained in the form of already existing information such as letters, contracts, accounting records, invoices, spreadsheets, database extracts, electronically stored information, and management information on performance. Testimonial evidence is obtained through inquiries, interviews, focus groups, public forums, or questionnaires. Auditors frequently use analytical processes including computations, comparisons, separation of information into components, and rational

arguments to analyze any information gathered to determine whether it is sufficient and appropriate.¹²²

Appropriateness of Information in Relation to the Audit Objectives

A7.03 One of the primary factors influencing the assurance associated with a performance audit is the appropriateness of the information in relation to the audit objectives. For example:

a. The audit objectives might focus on verifying specific quantitative results presented by the audited entity. In these situations, the performance audit would likely provide reasonable assurance about the accuracy of the specific amounts in question. This work may include the possible use of statistical sampling.

b. The audit objectives might focus on the performance of a specific program or activity in the agency being audited. In this situation, the auditor may have to use specific information compiled by the agency being audited in order to answer the audit objectives. In this situation, the auditor may find it necessary to test the quality of the information, which includes both its validity and reliability.

c. The audit objectives might focus on information that is used for widely-accepted purposes and obtained from sources generally recognized as appropriate. For example, economic statistics issued by government agencies for purposes such as adjusting for inflation, or other such information issued by authoritative organizations, may be the best information available. In such cases, it may not be practical or necessary for auditors to conduct procedures to verify the information. These decisions call for professional judgment based on the nature of the information, its common usage or acceptance, and how it is being used in the audit. Paragraphs 7.56 through 7.62 in chapter 7 discuss the factors the auditor should consider.

¹²² See paragraphs 7.56 and 7.63 for definitions of appropriate and sufficient.

d. The audit objectives might focus on comparisons or benchmarking between various government functions or agencies. These types of audits are especially useful for analyzing the outcomes of various public policy decisions. In these cases, auditors may perform analyses, such as comparative statistics of different jurisdictions or changes in performance over time, where it would be cost prohibitive and/or impractical to do a verification of the detailed data underlying the statistics. Clear disclosure as to what extent the comparative information or statistics were evaluated or corroborated will place the information in proper context for report users.

e. The audit objectives might focus on trend information. In this situation, auditors may use overall analytical tests, combined with a knowledge and understanding of the systems or processes used for compiling information.

f. The audit objectives might focus on the auditor identifying emerging and cross-cutting issues using information compiled or self-reported by agencies. In such cases, it may be helpful for the auditor to consider the overall appropriateness of the compiled information with other information available about the program. Other sources of information, such as Inspector General reports or other external audits may provide the auditors with information regarding whether any unverified or self-reported information is consistent with or can be corroborated by these other external sources of information.

**Members of the Comptroller General's
Advisory Council on Government Auditing Standards**

Mr. Jack R. Miller, Chair
KMPG LLP (Retired)
(member 1997-1998; chair 2001-2008)

The Honorable Ernest A. Almonte
Office of the Auditor General
State of Rhode Island
(member 2001-2008)

Dr. Paul A. Copley
James Madison University
(member 2005-2008)

Mr. David Cotton
Cotton & Co. LLP
(member 2006-2009)

The Honorable Debra K. Davenport
Office of the Auditor General
State of Arizona
(member 2002-2005)

Ms. Kristine Devine
Deloitte & Touche, LLP
(member 2005-2008)

Dr. John H. Engstrom
Northern Illinois University
(member 2002-2005)

The Honorable Richard L. Fair
Office of the State Auditor
State of New Jersey
(member 2002-2005)

Dr. Ehsan Feroz
University of Minnesota Duluth
(member 2002-2009)

The Honorable Phyllis Fong
U.S. Department of Agriculture
(member 2004-2006)

Mr. Alex Fraser
Standard & Poor's
(member 2006-2009)

The Honorable Gregory H. Friedman
U.S. Department of Energy
(member 2002-2005)

Mr. Mark Funkhouser
Office of City Auditor
Kansas City, Missouri
(member 2005-2008)

Dr. Michael H. Granof
University of Texas at Austin
(member 2005-2008)

Mr. Jerome Heer
Office of the County Auditor
Milwaukee, Wisconsin
(member 2004-2006)

Ms. Marion Higa
Office of State Auditor
State of Hawaii
(member 2006-2009)

The Honorable John P. Higgins, Jr.
U.S. Department of Education
(member 2005-2008)

Mr. Russell Hinton
Office of the State Auditor
State of Georgia
(member 2004-2006)

Mr. Richard A. Leach
United States Navy
(member 2005-2008)

Mr. Patrick L. McNamee
PricewaterhouseCoopers, LLP
(member 2005-2008)

Mr. Rakesh Mohan
Office of Performance Evaluations
Idaho State Legislature
(member 2004-2006)

The Honorable Samuel Mok
U.S. Department of Labor
(member 2006-2009)

Mr. Harold L. Monk
Davis Monk & Company, CPAs
(member 2002-2009)

Mr. William Monroe
Office of Auditor General
State of Florida
(member 2004-2006)

Mr. Stephen L. Morgan
Office of the City Auditor
Austin, Texas
(member 2001-2008)

Mr. Robert M. Reardon, Jr.
State Farm Insurance Companies
(member 2002-2005)

Mr. Brian A. Schebler
McGladrey & Pullen, LLP
(member 2005-2008)

Mr. Gerald Silva
Office of the City Auditor
San Jose, California
(member 2002-2009)

Mr. Barry R. Snyder
Federal Reserve Board
(member 2001-2008)

Mr. James R. Speer
JP Associates, Inc.
(member 2004-2006)

Dr. Daniel Stufflebeam
Western Michigan University
(member 2002-2009)

The Honorable Nikki Tinsley
U. S. Environmental Protection Agency
(member 2002-2005)

Mr. George Willie
Bert Smith & Co.
(member 2004-2006)

GAO Project Team:

Jeffrey C. Steinhoff, Managing Director
Jeanette M. Franzel, Project Director
Marcia B. Buchanan, Assistant Director
Gail F. Vallieres, Assistant Director
Michael C. Hrapsky, Senior Project Manager
Heather I. Keister, Senior Auditor
Maxine L. Hattery, Communications Analyst
Jennifer V. Allison, Council Administrator

(194574)