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Comptroller General  
of the United States

United States General Accounting Office  
Washington, DC 20548

May 20, 2003

Mr. Urton Anderson  
Chairman, Internal Auditing Standards Board  
The Institute of Internal Auditors  
Global Practices Center, Technical Services ED-03S1  
247 Maitland Avenue  
Altamonte Springs, Fl 32701-4201

Subject: *Exposure Draft of Proposed New and Amended Standards for the Professional Practice of Internal Auditing*

Dear Mr. Anderson:

This letter provides the U.S. General Accounting Office's (GAO) input on the Institute of Internal Auditors' (IIA) January 15, 2003, exposure draft containing proposed new and amended standards for internal auditors. We compliment the IIA's efforts to enhance the guidance and clarity of the professional standards, and we believe that the IIA proposals to strengthen the standards in the areas of information technology and governance are especially important.

GAO also supports the IIA's efforts to more clearly distinguish assurance services from consulting services. At the same, we believe that the use of the term "consulting" services to cover internal audit work other than assurance services is problematic. The term "consulting" provides a connotation that the internal auditor may not be independent. We recommend that IIA consider using other terminology such as performance audits or "constructive engagements" to describe the work that it now labels as consulting to more accurately depict the nature of this work. We realize that this is a significant recommendation and that the IIA may need to consider this as a separate proposal, but we urge the IIA to consider such changes.

As a result of recent, high profile breakdowns in auditing and corporate governance, there has been widespread realization that, in many cases, it is not appropriate for an auditor to provide both audit and certain non-audit (consulting) services for the same client. Prior to the recent, high profile problems in the profession, GAO had begun work in this area and issued its revised independence standards in January 2002. GAO's standards emphasize overarching principles and safeguards that auditors should follow related to nonaudit, or consulting services, in order to maintain independence to provide audit services.<sup>1</sup>

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<sup>1</sup>*Government Auditing Standards: Amendment No. 3, Independence.* (GAO-02-388G, January 2002).

The term “consulting,” as used in the IIA’s standards, is currently causing confusion among IIA members and in the external auditing profession. We recently held discussions with representatives from the IIA at their request to determine whether there was a conflict between GAO’s independence standards and the IIA’s standards for consulting, as they apply to government auditors who follow the Yellow Book.<sup>2</sup> As a result of those discussions, we concluded that the vast majority of services provided by internal auditors that fall under the IIA’s consulting definition and standards are, in fact, assurance services or “constructive engagements,” whereby the internal auditor maintains independence as defined by the IIA standards.

In a recent American Institute of Certified Public Accountants (AICPA) proposed attestation standard on external auditor reporting on internal controls, the work of internal auditors was generally considered to be equivalent to the work of other consultants hired to do work for management. The exposure draft also cautioned that “the practitioner should recognize that a potential impairment of objectivity may exist when internal auditors perform a monitoring function within the entity’s internal control.”<sup>3</sup> GAO comments on that AICPA proposal emphasized the unique position of internal auditors in evaluating the effectiveness of internal control within an organization, and the steps that external auditors can take to utilize the work of internal auditors.<sup>4</sup>

We believe that emphasizing the independence and objectivity of internal auditors by removing the word “consulting” from the IIA’s standards and definitions will help dispel confusion and questions about the role of internal auditors and their independence and objectivity within their organizations. Such changes should also serve to emphasize the unique position of internal auditors in an organization’s system of governance.

We believe that the term “constructive engagement” should be used in the IIA standards rather than “consulting” to describe those services performed by internal auditors that facilitate management improvements on a real-time basis without compromising the independence and objectivity of the internal auditor, such as providing technical advice and training.

GAO uses “constructive engagement” as an approach in certain situations to achieve reform in a significant area through cooperative arrangements with affected agencies, while still maintaining independence according to our standards. This approach allows us to utilize our skills, knowledge, and experience in working cooperatively to improve government operations. Constructive engagements, where appropriate, can facilitate management improvements on a real-time basis without compromising our independence and objectivity.

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<sup>2</sup>*Government Auditing Standards, 1994 Revision*, plus subsequent amendments.

<sup>3</sup>March 18, 2003 AICPA Exposure Draft of Proposed Statements on Auditing and Attestation Standards, related to auditing and reporting on an entity’s internal control over financial reporting. Proposed SSAE, paragraphs 51 and 74-76.

<sup>4</sup>GAO letter dated May, 20, 2003, to Mr. James Gerson, Chair of the Auditing Standards Board, and Mr. Charles Landes, Director of Audit and Attest Services, AICPA, regarding the AICPA’s March 18, 2003, Exposure Draft.

Consulting services, as defined in the IIA's Text of the Proposed Introduction to the Standards (page 9 of the Exposure Draft), can easily be recharacterized as constructive engagements, as follows:

**Constructive engagements consulting services** are advisory **services** and other non-assurance activities delivered by the internal auditor generally **in cooperation with at the specific request** of an engagement client, while **maintaining independence and objectivity and** not assuming management responsibility for the engagement results. **Constructive engagements Consulting services** involve two parties, the auditor and the client. Unlike assurance services engagements where the internal auditor determines the nature and scope, in **constructive engagements, consulting** the nature and scope are **generally cooperative in nature and** subject to agreement with the client. **Constructive engagements Consulting services**, like assurances services, are intended to add value and improve the organization's governance, risk management, and control processes, **while maintaining auditor independence and objectivity.**

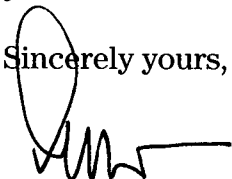
In addition, we would suggest replacing the definition of "consulting services" in the standards' glossary with the above, and removing "process design" from the definition.

Finally, we recommend that the standards adopt the principles-based approach used in Government Auditing Standards with respect to non-audit services. Those overarching principles state

- Auditors should not perform management functions or make management decisions; and
- Auditors should not audit their own work or provide nonaudit services in situations where the amounts or services involved are significant/material to the subject matter of the audit.<sup>5</sup>

We realize that the above changes would also require changes throughout the IIA standards, and that this is a significant recommendation. At the same time, we believe that these changes will clarify the role of the internal auditor and emphasize internal auditors' independence and objectivity within their organization. We thank you for considering our comments on this very important issue.

Sincerely yours,



David M. Walker  
Comptroller General  
of the United States

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<sup>5</sup> *Government Auditing Standards: Amendment No. 3, Independence.* (GAO-02-388G, January 2002) pg.1.