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By the Comptroller General of the
United States

GOVERNMENT AUDITING STANDARDS

2017 EXPOSURE DRAFT

Accessible Version

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Washington, DC 20548

Comptroller General
of the United States

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To Federal Officials and Others Interested in *Government Auditing Standards*

GAO invites your comments on the accompanying proposed changes to *Government Auditing Standards*, commonly known as the Yellow Book. This letter describes the process used by GAO for revising the Yellow Book, summarizes the proposed major changes, discusses proposed effective dates, and provides instructions for submitting comments on the proposed standards.

Process for Revising the Yellow Book

To help ensure that the standards continue to meet the needs of the federal, state, and local government communities and the public these bodies serve, the Comptroller General of the United States appointed the Advisory Council on Government Auditing Standards to review GAO's proposed revisions of the standards and consider any other necessary changes. The advisory council includes experts from federal, state, and local government; the private sector; and academia. This exposure draft includes the advisory council's input regarding the proposed changes. We are currently requesting public comments on the proposed revisions in the exposure draft.

Summary of Major Changes

GAO first issued the standards in 1972. The proposed changes contained in the 2017 exposure draft update the Yellow Book to reflect major developments in the auditing, accountability, and financial management professions and emphasize specific considerations applicable to the government environment.

Enclosure I to this letter contains a discussion of the major proposed changes.

Effective Dates

When issued in final form, this revision will supersede the December 2011 revision of the standards. The effective date for this revision, as well as transition guidance to help officials and auditors implement the revised standards, will be included when the Yellow Book is issued in final form.

Instructions for Commenting

The draft of the proposed changes to *Government Auditing Standards*, 2017 Exposure Draft, is only available in electronic format and can be downloaded from GAO's Yellow Book web page at <http://www.gao.gov/yellowbook>.

We are requesting comments on this draft from federal, state, and local government officials; managers and auditors 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 questions are presented in enclosure II to this letter. We encourage you to respond to these questions and comment on any additional issues that you note. Please associate your comments with specific references to question numbers in the enclosure, paragraph numbers in the proposed standards, or both and provide your rationale for any suggested changes, along with suggested revised language. All comments received from the public will be considered a matter of public record and will ultimately be posted on the GAO website.

Please send your comment letters to our Yellow Book Comments inbox, YellowBookComments@gao.gov, no later than July 6, 2017.

If you need additional information, please contact James Dalkin, Director, Financial Management and Assurance, at (202) 512-9535 or YellowBookComments@gao.gov.

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Comptroller General
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Enclosure I: Summary of Major Changes

The 2017 revision of the *Government Auditing Standards* represents a modernized version of the standards that takes into account developments in the accounting and auditing professions. The proposed standards contain the major changes from the 2011 revision outlined below. These changes are intended to reinforce the principles of transparency and accountability and provide the framework for high-quality government audits. The list of changes does not include minor editorial changes in the 2017 revision but instead focuses on those changes that may meaningfully affect generally accepted government auditing standards (GAGAS).

Change to Guidance for Government Auditing Standards

The guidance provided in *Government Auditing Standards: Guidance on GAGAS Requirements for Continuing Professional Education* (GAO-05-568G) will be superseded by the revised GAGAS standards when they become effective.

Overall Changes

All chapters are presented in a revised format that differentiates requirements and application guidance related to those requirements.

Chapters are reorganized and realigned. Chapter 1 addresses the types of GAGAS engagements. Chapter 2 contains general requirements for complying with GAGAS. Ethical principles and independence requirements are combined into a single chapter (ch. 3), as are competence and continuing professional education requirements (ch. 4). Chapter 5 consists of quality control and peer review requirements.

Supplemental guidance from the appendix of the 2011 revision is either removed or incorporated into the individual chapters.

Chapter 1 – Government Auditing: Foundation and Principles for the Use and Application of Generally Accepted Government Auditing Standards

Examples of types of GAGAS users are addressed. (para. 1.12)

Integrated audit is added to the types of financial audits. (para. 1.17.b)

Descriptions of attestation engagements, reviews of financial statements, and performance audits are expanded. (paras. 1.18 through 1.21)

Definitions of common terms used in GAGAS are expanded. Definitions for terms such as engaging party, audited entity, responsible party, and specialist are added. (para. 1.23)

Chapter 2 - General Requirements for Complying with *Government Auditing Standards*

Guidance is expanded to explain that for financial audits, attestation engagements, and reviews of financial statements, GAGAS does not incorporate the American Institute of

Certified Public Accountants Code of Conduct by reference but recognizes that certain certified public accountants (CPA) may use or may be required to use the code in conjunction with GAGAS. (para. 2.13)

Chapter 3 – Ethics, Independence, and Professional Judgment

The independence requirements of the auditor when the engaging party differs from the responsible party are further explained and examples of when this could occur are provided. (para. 3.24)

Guidance is added to address situations in which government auditors work in conditions that do not permit independence. A modified GAGAS compliance statement may be applicable in such cases. (para. 3.25)

Standard is expanded to require that, as part of applying the conceptual framework, auditors reevaluate threats to independence whenever the audit organization becomes aware of new information or changes in facts and circumstances. (para. 3.29)

Guidance related to professional services in government is further explained and examples of when this could occur are provided. (para. 3.80)

Standard is expanded to state that any services performed by auditors related to preparing accounting records and financial statements, other than those defined as impairments to independence in paragraph 3.88, create significant threats to auditors' independence, and auditors should document the threats and safeguards applied to eliminate and reduce threats to an acceptable level or decline to perform the service. (para. 3.89)

Chapter 4 – Competence and Continuing Professional Education

Standard is revised to require that management assign auditors to conduct an engagement who possess the competence needed for their assigned roles at the time of their assignment. (para. 4.03)

The concept of competence is discussed further in application guidance, including the following:

- The levels of GAGAS proficiency expected for different roles on an engagement. (paras. 4.09 through 4.10)
- The competence of specialists. (paras. 4.12 through 4.14)

The requirements for continuing professional education (CPE) are revised to promote greater proficiency in GAGAS. This includes the following:

- Introducing a new 4-hour requirement in GAGAS topics, to be required each time a new version of GAGAS is issued. (paras. 4.15 through 4.17)
- Providing application guidance concerning the topics required by the 80-hour GAGAS CPE requirements. (paras. 4.21 through 4.25)
- Detailing exemptions that may be granted to auditors in certain circumstances. (paras. 4.26 through 4.30)

Elements of the GAGAS guidance on CPE are incorporated into the exposure draft in order to address common questions on CPE. (various paragraphs from paras. 4.26 through 4.50)

Chapter 5: Quality Control and Peer Review

Standard is modified to require that audit organizations at least annually obtain written affirmation of compliance with policies and procedures on independence from all audit organization personnel required to be independent. (para. 5.09)

Standard is expanded to require that audit organizations establish policies and procedures designed to provide reasonable assurance that the audit organization undertake engagements only if it has the capabilities to do so. (para. 5.12)

Requirements are added and guidance is provided for engagement performance, documentation, and reporting, including requirements for policies and procedures pertaining to the review and supervision of engagement work performed by the engagement team. (paras. 5.20 through 5.41)

In particular, the following are discussed:

- The policies and procedures should require that experienced engagement team members review the work of less experienced engagement team members.
- The audit organization should assign responsibility for each engagement to an engagement team partner or director with authority to assume that responsibility.
- The audit organization should establish policies and procedures requiring the audit organization to communicate the identity and role of the engagement partner or director to management and those charged with governance of the audited entity.
- The audit organization should establish policies and procedures requiring the audit organization to clearly define the responsibilities of the engagement partner or director and communicate them to that individual.
- The audit organization should establish policies and procedures designed to provide reasonable assurance that appropriate consultation takes place on contentious issues, sufficient resources are available to enable appropriate consultation, the nature and scope of such consultations are documented and agreed upon, and the conclusions resulting from such consultations are documented and implemented.
- For terminated engagements, auditors should document the results of the work to the date of termination and why the engagement was terminated if an engagement is terminated before it is completed and an audit report is not issued.

Standard is modified to require that audit organizations affiliated with a recognized organization comply with the respective organization's peer review requirements and additional GAGAS peer review requirements. (para. 5.64)

Standard is modified for audit organizations not affiliated with recognized organizations (para. 5.65) as follows:

- Peer review scope is expanded to include review of documentation of terminated engagements, if a terminated engagement is selected from the universe of engagements used for the peer review sample. (para. 5.80)

- Peer review scope is expanded to include a review of prior peer review reports, if applicable. (para. 5.80)
- For subsequent peer reviews, the audit organization should obtain a peer review report dated not later than 3 years and 6 months from the year-end of the previous peer review. (para. 5.82)
- Peer reviews should include a written agreement between the peer review team and the reviewed audit organization to avoid potential misunderstandings. (para. 5.84)
- Peer review team leadership should possess sufficient expertise and position within the reviewing audit organization that ensures the team’s independence and objectivity; and leadership also ensures the proper supervision of the peer review team. (para. 5.87)
- Peer review teams should assess the effectiveness of the corrective actions implemented by the reviewed audit organization in response to any prior peer review recommendations linked to a deficiency. (para. 5.91)
- Peer review reports should include a statement that the peer review was conducted in accordance with GAGAS peer review requirements. (para. 5.103)
- Audit organizations that receive peer reviews ratings of “Pass with Deficiencies” or “Fail” should respond in writing to the deficiencies or significant deficiencies and related recommendations of the peer review team. In particular, with respect to each deficiency or significant deficiency in the report, the reviewed audit organization’s letter of response should describe (1) the corrective actions already taken, target dates for planned corrective actions, or both, or (2) why corrective action is not considered necessary. (paras. 5.106 through 5.107)

Standard is modified for both audit organizations affiliated with a recognized organization and audit organizations not affiliated with recognized organizations to require as follows:

- The peer review team should determine the type of peer review rating to issue based on the observed matters’ importance to the audit organization’s system of quality control as a whole and the nature, causes, patterns, and pervasiveness of those matters. The matters should be assessed both alone and in aggregate. (paras. 5.71 and 5.99)
- The peer review team should aggregate and systematically evaluate any observed matters (circumstances that warrant further consideration by the peer review team) and document their evaluation. (paras. 5.72 and 5.100)

Chapter 6: Standards for Financial Audits

Qualification requirements for auditors engaged to conduct financial audits of entities operating outside of the United States are further explained. (para. 6.05) Auditors engaged to conduct financial audits of entities operating outside of the United States should meet the qualifications indicated in paragraph 6.04 or

- have certifications that meet all applicable national and international standards and serve in their respective countries as the functional equivalent of CPAs in the United States,
- work for nongovernment audit organizations that meet the requirements of paragraph 6.04, or

- work for government audit organizations.

Standard is expanded to require that auditors perform audit procedures to ascertain the potential effect on the audit objectives if they become aware of waste that could be quantitatively or qualitatively significant to the audit objectives. (para. 6.16)

Standard is expanded to require auditors to consider potential internal control deficiencies in their evaluation of the cause of identified findings when internal control is significant to the audit objectives. (para. 6.20)

Standard is expanded to require that auditors report findings of waste when they conclude based on sufficient, appropriate evidence that instances of waste have occurred that have a material effect, either quantitatively or qualitatively, on the financial statements. (para. 6.35)

Standard is modified to require auditors, when reporting separately from a financial audit, to make available to users the reports on internal control over financial reporting and compliance with provisions of laws, regulations, contracts, and grant agreements in the same manner as the financial audit reports to which they relate, when integrated audits are conducted. (para. 6.38)

Standard is expanded to require that auditors communicate findings of waste in writing to audited entity officials when the auditors detect potential instances that do not have a material effect on the financial statements but warrant the attention of those charged with governance. (para. 6.39)

Guidance is provided to further explain that reporting on internal control and compliance with provisions of laws, regulations, contracts, and grant agreements relates only to the most recent reporting period included, when comparative financial statements are presented. (para. 6.41)

Chapter 7: Standards for Attestation Engagements and Reviews of Financial Statements

Statement on Standards for Attestation Engagements No. 18, *Attestation Standards: Clarification and Recodification*, is incorporated into this chapter by reference for auditors conducting attestation engagements in accordance with GAGAS. (para. 7.01)

Statement on Standards for Accounting and Review Services No. 21, section 90 (*Review of Financial Statements*) is incorporated into GAGAS for auditors conducting reviews of financial statements in accordance with GAGAS. (para. 7.01)

Qualification requirements for auditors engaged to conduct attestation engagements and reviews of financial statements engagements of organizations operating outside of the United States are further explained. (paras. 7.08, 7.70, and 7.83) Auditors engaged to conduct attestation engagements and reviews of financial statements of entities operating outside of the United States should meet the qualifications indicated in paragraph 7.07, 7.69, and 7.82 or

- have certifications that meet all applicable national and international standards and serve in their respective countries as the functional equivalent of CPAs in the United States;
- work for nongovernment audit organizations that meet the requirements of paragraphs 7.07, 7.69, and 7.82; or

- work for government audit organizations.

Standard for examination engagements is expanded to require that auditors perform audit procedures to ascertain the potential effect on the audit objectives if they become aware of waste that could be quantitatively or qualitatively significant to the audit objectives. (para. 7.18)

Standard for examination engagements is expanded to require that auditors consider potential internal control deficiencies in their evaluation of the cause of identified findings when internal control is significant to the engagement objectives. (para. 7.22)

Standard for examination engagements is expanded to require that auditors report findings of waste when they conclude based on sufficient, appropriate evidence that instances of waste have occurred that are material, either quantitatively or qualitatively, and are significant to the audit objectives. (para. 7.41)

Standard for examination engagements is expanded to require that auditors communicate findings of waste in writing to audited entity officials when the auditors detect potential instances that are not significant within the context of the audit objectives but warrant the attention of those charged with governance. (para. 7.42)

Standard for review and agreed-upon procedures engagements is expanded to require that auditors communicate to those charged with governance and audited entity officials as appropriate instances of waste that come to their attention that warrant the attention of those charged with governance. (paras. 7.73 and 7.84)

Chapter 8: Fieldwork Standards for Performance Audits

Guidance is revised to further explain that management assertions are not required when conducting a performance audit in accordance with GAGAS. (para. 8.14)

Discussion of suitable criteria, including attributes and examples, is provided. (paras. 8.17 through 8.19)

Internal control requirements and guidance are updated to align with the revised *Standards for Internal Control in the Federal Government* and *Internal Control – Integrated Framework*. (paras. 8.37 through 8.65)

Standard is expanded to require that auditors perform audit procedures to ascertain the potential effect on the audit objectives if they become aware of waste that could be quantitatively or qualitatively significant to the audit objectives. (para. 8.69)

Standard is expanded to require that auditors consider potential internal control deficiencies in their evaluation of identified findings when developing the cause element of the identified findings. (para. 8.115)

Chapter 9: Reporting Standards for Performance Audits

Standard is revised to require that audit organizations that meet the independence requirements for internal auditors include in the GAGAS compliance statement, where applicable, a statement that they are independent per the GAGAS requirements for internal auditors. (para. 9.03)

Standard is expanded to require that when internal control is significant within the context of the audit objectives, auditors include in the audit report discussion of how the auditors considered the concept of accountability for use of public resources and government authority while assessing audit risk associated with internal control. (para. 9.24)

Standard is expanded to require that auditors indicate in their report that the audit did not consider all internal control components if internal control that is significant to the audit objectives does not include all internal control components and underlying principles. (para. 9.25)

Standard is expanded to require that auditors report findings of waste when they conclude based on sufficient, appropriate evidence that instances of waste have occurred that are material, either quantitatively or qualitatively, and are significant to the audit objectives. (para. 9.32)

Standard is expanded to require that auditors communicate findings of waste in writing to audited entity officials when the auditors detect potential instances that are not significant within the context of the audit objectives but warrant the attention of those charged with governance. (para. 9.33)

Enclosure II: Questions for Commenters

The following questions are provided to guide users in commenting on the 2017 exposure draft. We encourage you to comment on these issues and any additional issues that you note. Please associate your comments with specific references to question numbers, paragraph numbers, or both in the proposed standards and provide your rationale for any proposed changes, along with suggested revised language.

Discussion Items

1. Generally accepted government auditing standards (GAGAS) is presented in a revised format. This is intended to allow auditors to quickly identify requirements and application guidance related to those requirements. In addition, certain topics are regrouped within the chapters.
Please comment on how the revised format of GAGAS affects the organization and readability of the standards.
2. In chapter 3 (“Ethics, Independence, and Professional Judgment”), additional requirements and guidance are provided concerning the provision of nonaudit services to audited entities, including further explanation of the responsibility to ensure that management of the audited entity possesses the appropriate skills, knowledge, and experience to oversee the nonaudit service and expanding discussion of nonaudit services that should be considered threats or impairments to an external auditor’s independence. (various paras. 3.67 through 3.101)
Please comment on whether the revisions related to nonaudit services sufficiently and clearly explain what is required and prohibited under GAGAS.
3. In chapter 4 (“Competence and Continuing Professional Education”), GAGAS discusses the levels of proficiency required for the roles on an engagement as well as a description of the tasks generally expected to be performed by auditors in these roles. (paras. 4.09 through 4.10)
Do these roles and descriptions clarify the competence required of auditors conducting engagements in accordance with GAGAS? Is the level of proficiency expected for each of these roles clear?
4. Chapter 4 (“Competence and Continuing Professional Education”) includes a requirement for auditors to complete at least 4 hours of continuing professional education (CPE) in GAGAS topics (“GAGAS Qualification”). This 4-hour requirement is a subset of the 24-hour CPE requirement and needs to be completed each time a GAGAS revision is issued. Application guidance provides examples of the types of topics that would qualify as GAGAS topics. (paras. 4.15 and 4.23)
Please comment on any additional topics that could be included in the 4-hour GAGAS CPE requirement or other requirements that would enhance auditor proficiency in GAGAS.
5. The content from the GAGAS guidance document on CPE (GAO-05-568G) is largely incorporated into chapter 4. We plan to retire the guidance document when the new GAGAS is issued. (paras. 4.26 through 4.50)
Is there any additional application guidance that should be included in the GAGAS

revision to enable auditors and audit organizations to effectively implement the CPE requirements given the planned retirement of the CPE guidance document?

6. In chapter 5 (“Quality Control and Peer Review”), the sections on quality control and external peer review are expanded to harmonize with other standards and promote consistency in practice across the range of GAGAS auditors.
Are the changes to the quality control and external peer review sections appropriate and reasonable?
7. In chapter 5 (“Quality Control and Peer Review”), peer review requirements are categorized by requirements for (1) audit organizations affiliated with recognized organizations and (2) other audit organizations. (paras. 5.63 through 5.113)
Are the peer review requirements for each category of audit organization clear?
8. Chapter 7 (“Standards for Attestation Engagements and Reviews of Financial Statements”) is expanded to incorporate by reference Statement on Standards for Accounting and Review Services No. 21, section 90, *Review of Financial Statements*, and includes additional requirements and guidance for reviews of financial statements conducted in accordance with GAGAS. (paras. 7.68 through 7.80)
Please comment on the expanded requirements and application guidance.
9. In chapter 8 (“Fieldwork Standards for Performance Audits”), internal control considerations are expanded to reference the 2014 *Standards for Internal Control in the Federal Government* and *Internal Control – Integrated Framework*. (paras. 8.37 through 8.65)
Do these sections clearly describe ways auditors assess internal control on performance audits?

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Abbreviations

AICPA	American Institute of Certified Public Accountants
AT-C	AICPA Codification of Statements on Standards for Attestation Engagements
AU-C	AICPA Codification of Statements on Auditing Standards
CPA	certified public accountant
CPE	continuing professional education
GAGAS	generally accepted government auditing standards
GAO	Government Accountability Office
IAASB	International Auditing and Assurance Standards Board
IT	information technology
OMB	Office of Management and Budget
PCAOB	Public Company Accounting Oversight Board
SAS	Statements on Auditing Standards
SSAE	Statements on Standards for Attestation Engagements
SSARS	Statements on Standards for Accounting and Review Services

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Chapter 1: Government Auditing: Foundation and Principles for the Use and Application of Generally Accepted Government Auditing Standards

- 1.01** This chapter provides guidance for engagements conducted in accordance with generally accepted government auditing standards (GAGAS). This chapter also
- a. explains the types of auditors and audit organizations that may employ GAGAS to conduct their work,
 - b. identifies the types of engagements that may be conducted in accordance with GAGAS, and
 - c. explains terminology that is commonly used in GAGAS.

Introduction

1.02 The concept of accountability for use of public resources and government authority is key to our nation's governing processes. Management and officials entrusted with public resources are responsible for carrying out public functions and providing service to the public effectively, efficiently, economically, ethically, and equitably within the context of the statutory boundaries of the specific government program.

1.03 As reflected in applicable laws, regulations, agreements, and standards, management and officials of government programs are responsible for providing reliable, useful, and timely information for transparency and accountability of these programs and their operations. Legislators, oversight bodies, those charged with governance, and the public need to know whether (1) management and officials manage government resources and use their authority properly and in compliance with laws and regulations; (2) government programs are achieving their objectives and desired outcomes; and (3) government services are provided effectively, efficiently, economically, ethically, and equitably.

1.04 Those charged with governance refers to the individuals 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. Those charged with governance may also be part of the entity's management. In some audited 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 engagement.

1.05 Government auditing is essential in providing accountability to legislators, oversight bodies, those charged with governance, and the public. GAGAS engagements provide an independent, objective, nonpartisan assessment of the stewardship, performance, or cost of government policies, programs, or operations, depending upon the type and scope of the engagement.

1.06 The professional standards and guidance contained in this document provide a framework for conducting high-quality engagements with competence, integrity, objectivity, and independence. Auditors of government entities, entities that receive government awards, and

other entities as required by law or regulation or as they elect may use these standards. Overall, GAGAS contains standards for engagements comprising individual requirements that are identified by terminology as discussed in paragraphs 2.02 through 2.09. GAGAS contains requirements and guidance dealing with ethics, independence, auditors' professional judgment and competence, quality control, peer review, performance of the engagement, and reporting.

1.07 Engagements conducted in accordance with GAGAS provide information used for oversight, accountability, transparency, and improvements of government programs and operations. GAGAS contains requirements and guidance to assist auditors in objectively acquiring and evaluating sufficient, appropriate evidence and reporting the results. When auditors conduct their work in this manner and comply with GAGAS in reporting the results, their work can lead to improved government management, better decision making and oversight, effective and efficient operations, and accountability and transparency for resources and results.

1.08 Laws, regulations, contracts, grant agreements, and policies frequently require that engagements be conducted in accordance with GAGAS. In addition, many auditors and audit organizations voluntarily choose to conduct their work in accordance with GAGAS. The requirements and guidance in GAGAS in totality apply to engagements pertaining to government entities, programs, activities, and functions, and to government assistance administered by contractors, nonprofit entities, and other nongovernmental entities when the use of GAGAS is required or voluntary.

1.09 The following are some of the laws, regulations, and other authoritative sources that require the use of GAGAS:

- a. The Inspector General Act of 1978, as amended, 5 U.S.C. App., 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 major executive branch departments' and agencies' financial statements. The Accountability of Tax Dollars Act of 2002 (Public Law 107-289) generally extended this requirement to most executive agencies not subject to the Chief Financial Officers Act unless they are exempted for a given year by the Office of Management and Budget (OMB).
- c. The Single Audit Act Amendments of 1996 (Public Law 104-156) requires that GAGAS be followed in audits of state and local governments and nonprofit entities that receive federal awards. OMB's *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, subpart F, which provides the government-wide guidelines and policies on conducting audits to comply with the Single Audit Act, reiterates this requirement to use GAGAS.

1.10 Other laws, regulations, or authoritative sources may require the use of GAGAS. For example, auditors at the state and local government levels 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 follow GAGAS. Auditors may also be required to follow GAGAS by federal audit guidelines pertaining to program requirements. Being aware of such other laws, regulations, or authoritative sources may assist auditors in performing their work in accordance with the required standards.

1.11 Even if not required to do so, auditors may find it useful to follow GAGAS in conducting engagements pertaining to federal, state, and local government programs as well as engagements pertaining to government awards administered by contractors, nonprofit entities, and other nongovernmental entities. Many audit organizations not formally required to do so, both in the United States and in other countries, voluntarily follow GAGAS.

Types of GAGAS Users

1.12 GAGAS provides standards that are used by a wide range of auditors and audit organizations that audit government entities, entities that receive government awards, and other entities. These auditors and audit organizations may also be subject to additional requirements unique to their environments. Examples of the various types of users who may be required or may elect to use GAGAS include the following:

- a. Contract auditors: audit organizations that specialize in conducting engagements pertaining to government acquisitions and contract administration
- b. Certified public accounting firms: public accounting organizations in the private sector that provide audit, attestation, or review services under contract to government entities or recipients of government funds
- c. Federal inspectors general: government audit organizations within federal agencies that conduct audits and investigations relating to the programs and operations of their agencies and issue reports both to agency management and to third parties external to the audited entity
- d. Federal agency internal auditors: internal government audit organizations associated with federal agencies that conduct audits and investigations relating to the programs and operations of their agencies
- e. Municipal auditors: elected or appointed officials in government audit organizations in the United States at the city, county, and other local government levels
- f. State auditors: elected or appointed officials in audit organizations in the governments of the 50 states, the District of Columbia, and the U.S. territories
- g. Supreme audit institutions: national government audit organizations, in the United States or elsewhere, typically headed by a comptroller general or auditor general

Types of GAGAS Engagements

1.13 This section describes the types of engagements that audit organizations may conduct in accordance with GAGAS. This description is not intended to limit or require the types of engagements that may be conducted in accordance with GAGAS.

1.14 All GAGAS engagements begin with objectives, and those objectives determine the type of engagement to be conducted and the applicable standards to be followed. This document classifies financial audits, attestation engagements, reviews of financial statements, and performance audits, as defined by their objectives, as the types of engagements that are covered by GAGAS.

1.15 In some GAGAS engagements, the standards applicable to the specific objective will be apparent. For example, if the objective is to express an opinion on financial statements, the standards for financial audits apply. However, some engagements may have objectives that could be met using more than one approach. For example, if the objective is to determine the reliability of performance measures, auditors can perform this work in accordance with either the standards for attestation engagements or performance audits.

1.16 GAGAS requirements and guidance apply to the types of engagements that auditors may conduct in accordance with GAGAS as follows:

- a. Financial audits: the requirements and guidance in chapters 1 through 6 apply.
- b. Attestation-level examination, review, and agreed-upon procedures engagements and reviews of financial statements: the requirements and guidance in chapters 1 through 5 and 7 apply.
- c. Performance audits: the requirements and guidance in chapters 1 through 5, 8, and 9 apply.

Financial Audits

1.17 Financial audits provide an independent assessment of whether an entity's reported financial information (e.g., financial condition, results, and use of resources) is presented fairly in accordance with recognized criteria. Financial audits conducted in accordance with GAGAS include financial statement audits and other related financial audits.

- a. Financial statement audits: The primary purpose of a financial statement audit is to provide an opinion about whether an entity's financial statements are presented fairly in all material respects in accordance with an applicable financial reporting framework. Reporting on financial statement audits conducted in accordance with GAGAS also includes reports on internal control over financial reporting and on compliance with provisions of laws, regulations, contracts, and grant agreements that have a material effect on the financial statements.
- b. Other types of financial audits: Other types of financial audits conducted in accordance with GAGAS entail various scopes of work, including
 - (1) obtaining sufficient, appropriate evidence to form an opinion on a single financial statement or specified elements, accounts, or line items of a financial statement;¹
 - (2) issuing letters (commonly referred to as comfort letters) for underwriters and certain other requesting parties;²
 - (3) auditing applicable compliance and internal control requirements relating to one or more government programs;³ and

¹See American Institute of Certified Public Accountants (AICPA) *Codification of Statements on Auditing Standards (AU-C) sec. 805, Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*.

²See AICPA AU-C sec. 920, *Letters for Underwriters and Certain Other Requesting Parties*.

³See AICPA AU-C sec. 935, *Compliance Audits*.

- (4) conducting an audit of internal control over financial reporting that is integrated with an audit of financial statements (integrated audit).⁴

Attestation Engagements and Reviews of Financial Statements

1.18 Attestation engagements can cover a broad range of financial or nonfinancial objectives about the subject matter or assertion depending on the users' needs. In an attestation engagement, a party other than the auditors measures or evaluates the subject matter against criteria. The auditors' conclusion addresses whether the results of that measurement or evaluation are free from material misstatement. The three types of attestation engagements are as follows:

- a. Examination: Consists of obtaining sufficient, appropriate evidence to express an opinion on whether the subject matter is based on (or in accordance with) the criteria in all material respects or the assertion is presented (or fairly presented), in all material respects, based on the criteria.
- b. Review: Consists of sufficient testing to express a conclusion about whether the auditors are aware of any material modifications that need to be made to the subject matter in order for it to be in accordance with (or based on) the criteria or the responsible party's assertion in order for it to be fairly presented. Review-level work does not include reporting on internal control or compliance with provisions of laws, regulations, contracts, and grant agreements.
- c. Agreed-upon procedures engagement: Consists of auditors performing specific procedures on the subject matter and issuing a report of findings based on the agreed-upon procedures. In an agreed-upon procedures engagement, the auditors do not express an opinion or conclusion, but only report on agreed-upon procedures in the form of procedures and findings related to the specific procedures applied.

1.19 A review of financial statements consists of sufficient testing as a basis for reporting whether the auditors are aware of any material modifications that should be made to financial statements in order for the financial statements to be in accordance with the applicable financial reporting framework. A review of financial statements does not include obtaining an understanding of the entity's internal control, assessing fraud risk, or some other procedures ordinarily performed in an audit.

Performance Audits

1.20 Performance audits provide objective analysis to assist management and those charged with governance and oversight in using findings and conclusions to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability. In a performance audit, the auditors measure or evaluate the subject matter of the audit and present the resulting information as part of, or accompanying, the audit report.

1.21 Performance audit objectives vary widely and include assessments of program effectiveness, economy, and efficiency; internal control; compliance; and prospective analyses.

⁴See AICPA AU-C sec. 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*.

Audit objectives may also pertain to the current status or condition of a program. These overall objectives are not mutually exclusive. For example, a performance audit with an objective of determining or evaluating program effectiveness may also involve an additional objective of evaluating the program's internal controls. Key categories of performance audit objectives include the following:

- a. Program effectiveness and results audit objectives. These are frequently interrelated with economy and efficiency objectives. Audit objectives that focus on program effectiveness and results 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.
- b. Internal control audit objectives. These relate to an assessment of one or more aspects of an entity's system of internal control that is designed to provide reasonable assurance of achieving effective and efficient operations, reliability of reporting for internal and external use, or compliance with provisions of applicable laws and regulations. Internal control objectives also may be relevant when determining the cause of unsatisfactory program performance. Internal control is a process effected by an entity's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved. Internal control comprises the plans, methods, policies, and procedures used to fulfill the mission, strategic plan, goals, and objectives of the entity.
- c. Compliance audit objectives. These relate to an assessment of compliance with criteria established by provisions of laws, regulations, contracts, and grant agreements, or other requirements that could affect the acquisition, protection, use, and disposition of the entity's resources and the quantity, quality, timeliness, and cost of services the entity produces and delivers. Compliance requirements can be either financial or nonfinancial.

Nonaudit Services Provided by Audit Organizations and Other Professional Services Provided by Auditors in Government

1.22 GAGAS does not cover nonaudit services, which are defined as professional services provided on behalf of management at audited entities. Therefore, auditors do not report that the nonaudit services were provided in accordance with GAGAS. Chapter 3 includes requirements for providing nonaudit services for an entity for which the audit organization conducts a GAGAS engagement. GAGAS also does not cover three-party or two-party professional services arrangements provided by auditors in government.⁵

Terms Used in GAGAS

1.23 This paragraph describes the use of the following terms in GAGAS.

- a. Attestation engagement – An examination, review, or agreed-upon procedures engagement conducted under the GAGAS attestation standards related to subject matter or an assertion that is the responsibility of another party.

⁵See para. 3.80 for a discussion of three-party and two-party professional services provided by auditors in government.

- b. Audit – Either a financial audit or performance audit conducted in accordance with GAGAS.
- c. Audit organization – A government audit entity or a public accounting or other audit entity that performs GAGAS engagements.
- d. Audited entity – The entity that is subject to a GAGAS engagement, whether that engagement is a financial audit, attestation engagement, review of financial statements, or performance audit.
- e. Auditor – An individual performing work in accordance with GAGAS (including work on audits, attestation engagements, and reviews of financial statements) regardless of job title. Therefore, individuals who may have the title auditor, information technology auditor, analyst, practitioner, evaluator, inspector, or other similar titles are considered auditors in GAGAS.
- f. Control objective – The aim or purpose of specified controls; control objectives address the risks related to achieving an entity’s objectives.
- g. Engagement – A financial audit, attestation engagement, review of financial statements, or performance audit conducted in accordance with GAGAS.
- h. Engagement team (or audit team) – Professional staff members assigned to planning, directing, performing fieldwork, or reporting on GAGAS engagements.
- i. Engaging party – The party requesting or requiring a GAGAS engagement.
- j. Entity objective – What an entity wants to achieve; entity objectives are intended to meet the entity’s mission, strategic plan, and goals and requirements of applicable laws and regulations.
- k. External audit organization – An audit organization that issues reports to third parties external to the audited entity.
- l. Internal audit organization – An audit organization that is accountable to senior management and those charged with governance of the audited entity and that does not generally issue reports to third parties external to the audited entity.
- m. Responsible party – The party responsible for a GAGAS engagement’s subject matter.
- n. Review of financial statements – An engagement conducted under GAGAS for review of financial statements.
- o. Specialist – An individual or organization possessing expertise in a field other than auditing that assists auditors in conducting engagements.

The GAGAS Format

1.24 GAGAS uses a revised format designed to allow auditors to quickly identify requirements and application guidance related to those requirements. GAGAS requirements are differentiated from application guidance by borders surrounding the text. The requirements within the borders are followed immediately by application guidance that relates directly to the preceding requirements. While the application guidance does not contain requirements, it provides information that is critical to understanding and implementing the requirements that precede them.

Chapter 1: Government Auditing: Foundation and Principles for the Use and Application of Generally Accepted Government Auditing Standards

Chapter 2: General Requirements for Complying with *Government Auditing Standards*

2.01 This chapter establishes general requirements for complying with generally accepted government auditing standards that are applicable to all GAGAS engagements. The information it contains relates to how auditors conducting GAGAS engagements identify and apply the requirements contained in GAGAS. The chapter also contains requirements for using other audit standards in conjunction with GAGAS and for reporting compliance with GAGAS in the audit report.

Complying with GAGAS

Requirements: Complying with GAGAS

2.02 GAGAS uses two categories of requirements, identified by specific terms, to describe the degree of responsibility they impose on auditors and audit organizations:

- a. Unconditional requirements: Auditors and audit organizations must comply with an unconditional requirement in all cases where such requirement is relevant. GAGAS uses *must* to indicate an unconditional requirement.
- b. Presumptively mandatory requirements: Auditors and audit organizations must comply with a presumptively mandatory requirement in all cases where such a requirement is relevant except in rare circumstances discussed in paragraphs 2.03, 2.04, and 2.08. GAGAS uses *should* to indicate a presumptively mandatory requirement.

2.03 In rare circumstances, auditors and audit organizations may determine it necessary to depart from a relevant presumptively mandatory requirement. In such rare circumstances, auditors should perform alternative procedures to achieve the intent of that requirement.

2.04 If, in rare circumstances, auditors judge it necessary to depart from a relevant presumptively mandatory requirement, they must document their justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement.

2.05 In addition to requirements as identified in paragraph 2.02, GAGAS contains related explanatory material in the form of application guidance. Auditors should have an understanding of the application guidance.

2.06 Auditors should also have an understanding of interpretations that are issued by GAO in planning and conducting GAGAS engagements. These interpretations have the same level of authority as application guidance in GAGAS.⁶

⁶See <http://www.gao.gov/yellowbook> for a listing of related GAGAS interpretations.

Application Guidance: Complying with GAGAS

2.07 GAGAS contains requirements together with related explanatory material in the form of application guidance. Auditors have a responsibility to consider the entire text of GAGAS in carrying out their work and in understanding and applying the requirements in GAGAS. Not every paragraph of GAGAS carries a requirement. Rather, GAGAS identifies the requirements through use of specific language.

2.08 The need for auditors to depart from a relevant presumptively mandatory requirement is expected to arise only when the requirement is for a specific procedure to be performed and, in the specific circumstances of the engagement, that procedure would be ineffective in achieving the intent of the requirement.

2.09 The application guidance provides further explanation of the requirements and guidance for applying them. In particular, it may explain more precisely what a requirement means or is intended to address or include examples of procedures that may be appropriate in the circumstances. Although such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements. The application guidance may also provide background information on matters addressed in GAGAS.

Relationship between GAGAS and Other Professional Standards

Requirement: Relationship between GAGAS and Other Professional Standards

2.10 When auditors cite compliance with both GAGAS and another set of standards, such as those listed in paragraphs 2.12, 2.14, 6.01, and 7.01, auditors should refer to paragraph 2.16 for the requirements for citing compliance with GAGAS. In addition to citing GAGAS, auditors may also cite the use of other standards in their reports when they have also met the requirements for citing compliance with the other standards. Auditors should refer to the other set of standards for the basis for citing compliance with those standards.

Application Guidance: Relationship between GAGAS and Other Professional Standards

2.11 Auditors may use GAGAS in conjunction with professional standards issued by other authoritative bodies.

2.12 The relationship between GAGAS and other professional standards for financial audits, attestation engagements, and reviews of financial statements is as follows:

- a. The American Institute of Certified Public Accountants (AICPA) has established professional standards that apply to financial audits, attestation engagements, and reviews of financial statements for nonissuers (entities other than issuers under the Sarbanes-Oxley Act of 2002,⁷ such as privately held companies, nonprofit entities, and

⁷See the Sarbanes-Oxley Act of 2002 (Pub. L. No. 107-204) for a discussion of issuers (generally, publicly traded companies with a reporting obligation under the Securities Exchange Act of 1934).

government entities) conducted by certified public accountants (CPA). For financial audits and attestation engagements, GAGAS incorporates by reference AICPA Statements on Auditing Standards and Statements on Standards for Attestation Engagements. For reviews of financial statements, GAGAS incorporates by reference Statement on Standards for Accounting and Review Services No. 21, section 90.

- b. The International Auditing and Assurance Standards Board (IAASB) has established professional standards that apply to financial audits and assurance engagements. Auditors may elect to use the IAASB standards and the related International Standards on Auditing and International Standards on Assurance Engagements in conjunction with GAGAS.
- c. The Public Company Accounting Oversight Board (PCAOB) has established professional standards that apply to financial audits and attestation engagements for issuers. Auditors may elect to use the PCAOB standards in conjunction with GAGAS.

2.13 For financial audits, attestation engagements, and reviews of financial statements, GAGAS does not incorporate the AICPA Code of Conduct by reference, but recognizes that certain CPAs may use or may be required to use the code in conjunction with GAGAS.

2.14 For performance audits, GAGAS does not incorporate other standards by reference, but recognizes that auditors may use or may be required to use other professional standards in conjunction with GAGAS, such as the following:

- a. *International Standards for the Professional Practice of Internal Auditing*, Institute of Internal Auditors, Inc.;
- b. *Guiding Principles for Evaluators*, American Evaluation Association;
- c. *The Program Evaluation Standards*, Joint Committee on Standards for Education Evaluation;
- d. *Standards for Educational and Psychological Testing*, American Psychological Association; and
- e. *IT Standards, Guidelines, and Tools and Techniques for Audit and Assurance and Control Professionals*, Information Systems Audit and Control Association.

Stating Compliance with GAGAS in the Audit Report

Requirements: Stating Compliance with GAGAS in the Audit Report

2.15 When auditors are required to conduct an engagement in accordance with GAGAS or are representing to others that they did so, they should cite compliance with GAGAS in the audit report as set forth in paragraphs 2.16 through 2.17.

2.16 Auditors should include one of the following types of GAGAS compliance statements in reports on GAGAS engagements, as appropriate.

- a. Unmodified GAGAS compliance statement: Stating that the auditors conducted the engagement in accordance with GAGAS. Auditors should include an unmodified GAGAS compliance statement in the audit report when they have (1) followed unconditional and applicable presumptively mandatory GAGAS requirements or (2) followed unconditional requirements, documented justification for any departures from applicable presumptively

mandatory requirements, and achieved the objectives of those requirements through other means.

- b. Modified GAGAS compliance statement: Stating either that (1) the auditors conducted the engagement in accordance with GAGAS, except for specific applicable requirements that were not followed, or (2) because of the significance of the departure(s) from the requirements, the auditors were unable to and did not conduct the engagement in accordance with GAGAS. When auditors use a modified GAGAS statement, they should disclose in the report the applicable requirement(s) not followed, the reasons for not following the requirement(s), and how not following the requirement(s) affected or could have affected the engagement and the assurance provided.

2.17 When auditors do not comply with applicable requirement(s), they should (1) assess the significance of the noncompliance to the engagement objectives; (2) document the assessment, along with their reasons for not following the requirement(s); and (3) determine the type of GAGAS compliance statement.

Application Guidance: Stating Compliance with GAGAS in the Audit Report

2.18 Auditors use modified compliance statements in situations that include scope limitations, such as restrictions on access to records, government officials, or other individuals needed to conduct the engagement.

2.19 The auditors' determination of noncompliance with applicable requirements is a matter of professional judgment, which is affected by the significance of the requirement(s) not followed in relation to the engagement objectives.

2.20 Auditors consider the individual and aggregate effect of exceptions to GAGAS requirements to determine whether an unmodified or modified GAGAS compliance statement is appropriate. Factors that the auditor may consider include

- a. the pervasiveness of the exception(s);
- b. the potential effect of the exception(s) on the sufficiency and appropriateness of evidence supporting the audit findings, conclusions, and recommendations; and
- c. whether report users might misunderstand the implications of a modified or unmodified GAGAS compliance statement.

Chapter 3: Ethics, Independence, and Professional Judgment

3.01 The first section of this chapter sets forth fundamental ethical principles for auditors in the government environment. Requirements and application guidance for auditor independence and professional judgment follow the ethical principles section. The second section establishes independence standards and provides guidance on this topic for auditors conducting financial audits, attestation engagements, reviews of financial statements, and performance audits under GAGAS. This section emphasizes the importance of independence of the audit organization and its individual auditors. The requirements of this chapter are intended to be followed in conjunction with all other applicable GAGAS requirements.

Ethical Principles

3.02 The ethical principles presented in this section provide the foundation, discipline, and structure, as well as the environment, that influence the application of GAGAS.⁸

3.03 Because auditing is essential to government accountability to the public, the public expects audit organizations and auditors who perform their work in accordance with GAGAS to follow 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 an environment that reinforces and encourages ethical behavior throughout all levels of the organization. The ethical tone maintained and demonstrated by management and staff is an essential element of a positive ethical environment for the audit organization.

3.04 Performing audit work in accordance with ethical principles is a matter of personal and organizational responsibility. Ethical principles apply in preserving auditor independence,⁹ taking on only work that the audit organization is competent to perform,¹⁰ performing high-quality work, and following the applicable standards cited in the audit report. Integrity and objectivity are maintained when auditors perform their work and make decisions that are consistent with the broader interest of those relying on the audit report, including the public.

3.05 Other ethical requirements or codes of professional conduct may also be applicable to auditors who conduct engagements in accordance with GAGAS. For example, 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 employed by government entities may also be subject to government ethics laws and regulations.

3.06 The ethical principles that guide the work of auditors who conduct engagements in accordance with GAGAS are

⁸See para. 5.08 for a discussion of ethical requirements in an audit organization's system of quality control.

⁹See paras. 3.18 through 3.103 for requirements and guidance related to independence.

¹⁰See paras. 4.02 through 4.14 for additional information on competence.

- a. the public interest;
- b. integrity;
- c. objectivity;
- d. proper use of government information, resources, and positions; and
- e. professional behavior.

3.07 All fundamental ethical principles apply to the relationship between the auditors and the engaging party, even if that party is not the responsible party.

The Public Interest

3.08 The public interest is defined as the collective well-being of the community of people and entities that the auditors serve. Observing integrity, objectivity, and independence in discharging their professional responsibilities helps auditors serve the public interest and honor the public trust. The principle of the public interest is fundamental to the responsibilities of auditors and critical in the government environment.

3.09 A distinguishing mark of an auditor is acceptance of responsibility to serve the public interest. This responsibility is critical when auditing in the government environment. GAGAS embodies the concept of accountability for public resources, which is fundamental to serving the public interest.

Integrity

3.10 Public confidence in government is maintained and strengthened by auditors performing their professional responsibilities with integrity. Integrity includes auditors performing their work with an attitude that is objective, fact-based, nonpartisan, and nonideological with regard to audited entities and users of the audit reports. Within the constraints of applicable confidentiality laws, regulations, or policies, communications with the audited entity, those charged with governance, and the individuals contracting for or requesting the engagement are expected to be honest, candid, and constructive.

3.11 Making decisions consistent with the public interest of the program or activity under audit is an important part of the principle of integrity. In discharging their professional responsibilities, auditors may encounter conflicting pressures from management of the audited entity, various levels of government, and other likely users. Auditors may also encounter pressures to inappropriately achieve personal or organizational gain. In resolving those conflicts and pressures, acting with integrity means that auditors place priority on their responsibilities to the public interest.

Objectivity

3.12 Auditors' objectivity in discharging their professional responsibilities is the basis for the credibility of auditing in the government sector. Objectivity includes independence of mind and appearance when conducting engagements, maintaining an attitude of impartiality, having intellectual honesty, and being free of conflicts of interest. Maintaining objectivity includes a continuing assessment of relationships with audited entities and other stakeholders in the

context of the auditors' responsibility to the public. The concepts of objectivity and independence are closely related. Independence impairments affect auditors' objectivity.¹¹

Proper Use of Government Information, Resources, and Positions

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

3.14 In the government environment, the public's right to the transparency of government information has to be balanced with the proper use of that information. In addition, many government programs are subject to laws and regulations dealing with the disclosure of information. To accomplish this balance, exercising discretion in the use of information acquired in the course of auditors' duties is an important part in achieving this goal. Improperly disclosing any such information to third parties is not an acceptable practice.

3.15 Accountability to the public for the proper use and prudent management of government resources is an essential part of auditors' responsibilities. Protecting and conserving government resources and using them appropriately for authorized activities are important elements of the public's expectations for auditors.

3.16 Misusing the auditor position for financial gain or other benefits violates an auditor's fundamental responsibilities. An auditor's credibility can be damaged by actions that could be perceived by an objective third party with knowledge of the relevant information as improperly benefiting an auditor's personal financial interests or those of an immediate or close family member; a general partner; an entity for which the auditor serves as an officer, director, trustee, or employee; or an entity with which the auditor is negotiating concerning future employment.

Professional Behavior

3.17 High expectations for the auditing profession include complying with all relevant legal, regulatory, and professional obligations and avoiding any conduct that could bring discredit to auditors' work, including actions that would cause an objective third party with knowledge of the relevant information to conclude that the auditors' work was professionally deficient. Professional behavior includes auditors putting forth an honest effort in performing their duties in accordance with the relevant technical and professional standards.

Independence

Requirements: General

3.18 In all matters relating to the audit work, the individual auditors and audit organizations must be independent.

¹¹See paras. 3.18 through 3.103 for independence requirements and guidance.

3.19 Auditors should avoid situations that could lead reasonable and informed third parties to conclude that the auditors are not independent and thus are not capable of exercising objective and impartial judgment on all issues associated with conducting the engagement and reporting on the work.

3.20 Except under the limited circumstances discussed in paragraph 3.79, auditors should be independent from an audited entity during

- a. any period of time that falls within the period covered by the financial statements or subject matter of the engagement and
- b. the period of professional engagement.

Application Guidance: General

3.21 Independence comprises the following:

- a. Independence of Mind

The state of mind that permits the conduct of an engagement without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

- b. Independence in Appearance

The absence of circumstances that would cause a reasonable and informed third party, having knowledge of the relevant information, including any safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of an audit organization or member of the engagement team had been compromised.

3.22 It is important for auditors and audit organizations to maintain their independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial and reasonable and informed third parties will view them as impartial.

3.23 The period of professional engagement begins when the auditors either sign an initial engagement letter or other agreement to conduct an engagement or begin to conduct an engagement, whichever is earlier. The period lasts for the duration of the professional relationship—which, for recurring engagements, could cover many periods—and ends with the formal or informal notification, either by the auditors or the audited entity, of the termination of the professional relationship or with the issuance of a report, whichever is later. Accordingly, the period of professional engagement does not necessarily end with the issuance of a report and recommence with the beginning of the following year's engagement or a subsequent engagement with a similar objective.

3.24 Under some conditions, the party requesting or requiring an engagement, referred to as the engaging party, will differ from the party responsible for the engagement's subject matter, referred to as the responsible party. Under such conditions, the GAGAS independence requirements apply to the relationship between the auditors and the responsible party, not the relationship between the auditors and the engaging party. The following are examples of conditions under which the party requesting an engagement may differ from the party responsible for the engagement's subject matter.

- a. A legislative body requires that auditors conduct, on the legislative body's behalf, a performance audit of program operations that are the responsibility of an executive agency. GAGAS requires that the auditors be independent of the executive agency.
- b. A state agency engages an independent public accountant to conduct an examination-level attestation engagement to assess the validity of certain information provided to the state agency by a local government. GAGAS requires that the independent public accountant be independent of the local government.
- c. A government department works with a government agency that conducts examination-level attestation engagements of contractor compliance with the terms and conditions of agreements between the department and the contractor. GAGAS requires that the auditors be independent of the contractors.

3.25 Auditors in government sometimes work under conditions that do not permit independence in accordance with this section. Examples of such circumstances include statutory requirements for auditors to serve in official roles that conflict with the independence requirements of this section and civil service statutes that permit staff members to seek employment with audited entities. Auditors who experience such conflicts and are unable to mitigate the resulting independence impairments in accordance with this section may refer to the GAGAS provision for modified GAGAS compliance statements in paragraph 2.16 for guidance.

3.26 GAGAS's practical consideration of independence consists of four interrelated sections, providing

- a. a conceptual framework for making independence determinations based on facts and circumstances that are often unique to specific environments;
- b. requirements for and guidance on independence for audit organizations that are structurally located within the entities they audit;
- c. requirements for and guidance on independence for auditors providing nonaudit services, including identification of specific nonaudit services that always impair independence and others that would not normally impair independence; and
- d. requirements for and guidance on documentation necessary to support adequate consideration of auditor independence.

GAGAS Conceptual Framework Approach to Independence

3.27 Many different circumstances, or combinations of circumstances, are relevant in evaluating threats to independence. Therefore, GAGAS establishes a conceptual framework that auditors use to identify, evaluate, and apply safeguards to address threats to independence. The conceptual framework assists auditors in maintaining both independence of mind and independence in appearance. It can be applied to many variations in circumstances that create threats to independence and allows auditors to address threats to independence that result from activities that are not specifically prohibited by GAGAS.

Requirements: GAGAS Conceptual Framework Approach to Independence

3.28 Auditors should apply the conceptual framework¹² at the audit organization, engagement, and individual auditor levels to

- a. identify threats to independence;
- b. evaluate the significance of the threats identified, both individually and in the aggregate; and
- c. apply safeguards as necessary to eliminate the threats or reduce them to an acceptable level.

3.29 Auditors should reevaluate threats to independence, including any safeguards applied, whenever the audit organization becomes aware of new information or changes in facts and circumstances that could affect whether a threat has been eliminated or reduced to an acceptable level.

3.30 If the engagement team intends to use the work of specialists, it should assess the independence of the specialists.¹³

3.31 Auditors should conclude that independence is impaired if no safeguards have been effectively applied to eliminate an unacceptable threat or reduce it to an acceptable level.

3.32 When auditors conclude that independence is impaired under paragraph 3.31, auditors should decline to conduct a prospective engagement or should terminate an engagement in progress (except in circumstances discussed in para. 3.25).

3.33 Auditors should evaluate the following broad categories of threats to independence when applying the GAGAS conceptual framework:

- a. Self-interest threat – the threat that a financial or other interest will inappropriately influence an auditor’s judgment or behavior.
- b. Self-review threat – the threat that an auditor or audit organization that has provided nonaudit services will not appropriately evaluate the results of previous judgments made or services provided as part of the nonaudit services when forming a judgment significant to a GAGAS engagement.
- c. Bias threat – the threat that an auditor will, as a result of political, ideological, social, or other convictions, take a position that is not objective.
- d. Familiarity threat – the threat that aspects of a relationship with management or personnel of an audited entity, such as a close or long relationship, or that of an immediate or close family member, will lead an auditor to take a position that is not objective.
- e. Undue influence threat – the threat that influences or pressures from sources external to the audit organization will affect an auditor’s ability to make objective judgments.
- f. Management participation threat – the threat that results from an auditor’s taking on the role of management or otherwise performing management functions on behalf of the audited entity, which will lead an auditor to take a position that is not objective.

¹²See the flowchart at the end of ch. 3 on applying the conceptual framework in accordance with GAGAS.

¹³See para. 1.23.o for the definition of specialists.

- g.** Structural threat – the threat that an audit organization’s placement within a government entity, in combination with the structure of the government entity being audited, will affect the audit organization’s ability to perform work and report results objectively.

3.34 Using professional judgment, auditors should evaluate threats to independence under the conceptual framework when the facts and circumstances under which the work is performed may create or augment threats. This includes instances in which relevant new information about a threat comes to the attention of the auditors during the engagement. Auditors should evaluate threats to independence both individually and in the aggregate because threats can have a cumulative effect on auditors’ independence.

3.35 Auditors should determine whether identified threats to independence are at an acceptable level or have been eliminated or reduced to an acceptable level, considering both qualitative and quantitative factors to determine the significance of a threat.

3.36 When auditors determine that threats to independence are not at an acceptable level, the auditors should determine whether appropriate safeguards can be applied to eliminate the threats or reduce them to an acceptable level.

3.37 In cases where auditors determine that threats to independence require the application of safeguards, auditors should document the threats identified and the safeguards applied to eliminate or reduce the threats to an acceptable level.

3.38 If auditors initially identify a threat to independence after the audit report is issued, auditors should evaluate the threat’s effect on the engagement and on GAGAS compliance. If the auditors determine that the newly identified threat’s effect on the engagement would have resulted in the audit report being different from the report issued had the auditors been aware of it, they should communicate in the same manner as that used to originally distribute the report to those charged with governance, the appropriate officials of the audited entity, the appropriate officials of the audit organizations requiring or arranging for the engagements, and other known users, so that they do not continue to rely on findings or conclusions that were affected by the threat to independence. If auditors previously posted the report to their publicly accessible website, they should remove the report and post a public notification that the report was removed. The auditors should then determine whether to perform the additional audit work necessary to reissue the report, including any revised findings or conclusions, or to repost the original report if the additional audit work does not result in a change in findings or conclusions.

Application Guidance: GAGAS Conceptual Framework Approach to Independence

3.39 The GAGAS section on nonaudit services in paragraphs 3.67 through 3.101 provides requirements and guidance on evaluating threats to independence related to nonaudit services provided by auditors to audited entities. That section also enumerates specific nonaudit services that always impair auditor independence with respect to audited entities and that auditors are prohibited from providing to audited entities. Further, this section includes requirements for consideration of management’s ability to effectively oversee the nonaudit service to be provided, as discussed in paragraphs 3.67, 3.68, 3.81, and 3.83. If management is not able to effectively oversee the nonaudit service provided, the auditor’s independence is impaired and the GAGAS independence requirements cannot be met.

3.40 When evaluating threats to independence, an acceptable level is a level at which a reasonable and informed third party would likely conclude that an audit organization or auditor is

independent. The concept of a reasonable and informed third party is a test that involves an evaluation by a hypothetical person. Such a person possesses skills, knowledge, and experience to objectively evaluate the appropriateness of the auditor's judgments and conclusions. This evaluation entails weighing all the relevant facts and circumstances that the auditor knows, or could reasonably be expected to know, at the time that the evaluation is made.

3.41 Because independence is an aspect of ethics, a threat to the auditor's independence that cannot be addressed through the application of safeguards is considered a form of ethical conflict.

3.42 For consideration of auditor independence, offices or units of an audit organization, or related or affiliated entities under common control, are not differentiated from one another. Consequently, for the purposes of independence evaluation using the conceptual framework, an audit organization that includes multiple offices or units, or includes multiple entities related or affiliated through common control, is considered to be one audit organization. Common ownership may also affect independence in appearance regardless of the level of control.

3.43 Auditors' assessment of the independence of specialists who perform audit work includes identifying threats and applying any necessary safeguards in the same manner as they would for auditors performing work on those engagements.

3.44 Whether independence is impaired depends on the nature of the threat, whether the threat is of such significance that it would compromise an auditor's professional judgment or create the appearance that the auditor's professional judgment may be compromised, and the specific safeguards applied to eliminate the threat or reduce it to an acceptable level.

3.45 Threats to independence may be created by a wide range of relationships and circumstances. Circumstances that result in a threat to independence in one of the categories may result in other threats as well.

3.46 Examples of circumstances that create self-interest threats for an auditor include the following:

- a. An audit organization having undue dependence on income from a particular audited entity.
- b. A member of the audit team entering into employment negotiations with an audited entity.
- c. An auditor discovering a significant error when evaluating the results of a previous professional service provided by a member of the auditor's audit organization.
- d. A member of the audit team having a direct financial interest in the audited entity. However, this would not preclude auditors from auditing pension plans that they participate in if (1) the auditors have no control over the investment strategy, benefits, or other management issues associated with the pension plan and (2) the auditors belong to such pension plan as part of their employment with the audit organization, provided that the plan is normally offered to all employees in equivalent employment positions.

3.47 Examples of circumstances that create self-review threats for an auditor follow:

- a. An audit organization issuing a report on the effectiveness of the operation of financial or performance management systems after designing or implementing the systems.

- b. An audit organization having prepared the original data used to generate records that are the subject matter of the engagement.
- c. An audit organization providing a service for an audited entity that directly affects the subject matter information of the engagement.
- d. A member of the engagement team being, or having recently been, employed by the audited entity in a position to exert significant influence over the subject matter of the engagement.

3.48 Examples of circumstances that create bias threats for an auditor follow:

- a. A member of the engagement team having preconceptions about the objectives of a program under audit that are strong enough to affect the auditor's objectivity.
- b. A member of the engagement team having biases associated with political, ideological, or social convictions that result from membership or employment in, or loyalty to, a particular type of policy, group, entity, or level of government that could affect the auditor's objectivity.

3.49 Examples of circumstances that create familiarity threats for an auditor follow:

- a. A member of the engagement team having a close or immediate family member who is a principal or senior manager of the audited entity.
- b. A member of the engagement team having a close or immediate family member who is an employee of the audited entity and is in a position to exert significant influence over the subject matter of the engagement.
- c. A principal or employee of the audited entity having recently served on the engagement team in a position to exert significant influence over the subject matter of the engagement.
- d. An auditor accepting gifts or preferential treatment from an audited entity, unless the value is trivial or inconsequential.
- e. Senior audit personnel having a long association with the audited entity.

3.50 Examples of circumstances that create undue influence threats for an auditor or audit organization include existence of the following:

- a. External interference or influence that could improperly limit or modify the scope of an engagement or threaten to do so, including exerting pressure to inappropriately reduce 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 engagement or issue the report.
- d. External interference over the assignment, appointment, compensation, and promotion of audit personnel.
- e. Restrictions on funds or other resources provided to the audit organization that adversely affect the audit organization's ability to carry out its responsibilities.

- f. Authority to overrule or to inappropriately influence the auditors' judgment as to the appropriate content of the report.
- g. Threat of replacing the auditors over a disagreement with the contents of an audit report, the auditors' conclusions, or the application of an accounting principle or other criteria.
- h. Influences that jeopardize the auditors' continued employment for reasons other than incompetence, misconduct, or the audited entity's need for GAGAS engagements.

3.51 Examples of circumstances that create management participation threats for an auditor follow:

- a. A member of the engagement team being, or having recently been, a principal or senior manager of the audited entity.
- b. An audit organization principal or employee serving as a voting member 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 or approving programmatic policy, authorizing an entity's transactions, or maintaining custody of an entity's assets.
- c. An audit organization principal or employee 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.
- d. An auditor preparing management's corrective action plan to deal with deficiencies detected in the engagement.

3.52 Examples of circumstances that create structural threats for an auditor follow:

- a. For both external and internal audit organizations, structural placement of the audit function within the reporting line of the areas under audit.
- b. For internal audit organizations, administrative direction from the audited entity's management.

3.53 The ability of audit organizations that are structurally located in government entities to perform work and report the results objectively can be affected by their placement within the government entity and the structure of the government entity being audited. The independence standard applies to auditors in government entities whether they report to third parties externally (external auditors), to senior management within the audited entity (internal auditors), or to both. Such audit organizations are often subject to constitutional or statutory safeguards that mitigate the effects of structural threats to independence.

3.54 External audit organizations that are structurally located within governments may be subject to one or more of the following three categories of safeguards to mitigate structural independence threats:

Category I

3.55 The government audit organization is

- a. at a level of government other than the one of which the audited entity is part (federal, state, or local), for example, federal auditors auditing a state government program, or
- b. placed within a different branch of government from that of the audited entity, for example, legislative auditors auditing an executive branch program.

Category II

3.56 The head of a government audit organization meets any of the following criteria in accordance with constitutional or statutory requirements:

- 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 engagements 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, and reports the results of engagements to and is accountable to a legislative body; or
- d. appointed by, accountable to, reports to, and can only be removed by a constitutionally or statutorily created governing body, the majority of whose members are independently elected or appointed and are outside the entity being audited.

Category III

3.57 The government audit organization is subject to all of the following constitutional or statutory provisions:

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

3.58 Government internal auditors who work under the direction of the audited entity's management are considered structurally independent for the purposes of reporting internally, if the head of the audit organization meets all of the following criteria:

- a. is accountable to the head or deputy head of the government entity or to those charged with governance;
- b. reports the engagement results both to the head or deputy head of the government entity and to those charged with governance;

- c. is located organizationally outside the staff or line-management function of the unit under audit;
- d. has access to those charged with governance; and
- e. is sufficiently removed from pressures to conduct engagements and report findings, opinions, and conclusions objectively without fear of reprisal.

3.59 Certain entities employ auditors to work for entity management. These auditors may be subject to administrative direction from persons involved in the entity management process. Such audit organizations are internal audit functions and are encouraged to use the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*,¹⁴ in conjunction with GAGAS.

3.60 When an internal audit organization conducts engagements pertaining to external parties, such as contractors or entities subject to other outside agreements, and no impairments to independence exist, the audit organization can be considered independent as an external audit organization of those external parties.

3.61 A threat to independence is not at an acceptable level if it either

- a. could affect the auditors' ability to conduct an engagement without being affected by influences that compromise professional judgment or
- b. could expose the auditors or audit organization to circumstances that would cause a reasonable and informed third party to conclude that the integrity, objectivity, or professional skepticism of the audit organization, or a member of the engagement team, had been compromised.

3.62 Safeguards are actions, individually or in combination, that auditors and audit organizations take that effectively eliminate threats to independence or reduce them to an acceptable level.

3.63 The list of safeguards in paragraph 3.77 provides examples that may be effective under certain circumstances. The list cannot provide safeguards for all circumstances. It may, however, provide a starting point for auditors who have identified threats to independence and are considering what safeguards could eliminate those threats or reduce them to an acceptable level. In some cases, multiple safeguards may be necessary to address a threat. Some other examples include consulting an independent third party, such as a professional organization, a professional regulatory body, or another auditor, or removing an individual from an audit team when that individual's financial or other interests or relationships pose a threat to independence.

3.64 In addition to the safeguards applied by auditors, there may be controls in place within the audited entity that serve to mitigate threats to auditor independence. Examples of factors that mitigate independence threats within the audited entity's systems and procedures include

- a. an entity requirement that persons other than management ratify or approve the appointment of an audit organization to conduct a GAGAS engagement,
- b. internal procedures at the entity that help ensure objective choices in commissioning nonaudit services, and

¹⁴Institute of Internal Auditors, *International Standards for the Professional Practice of Internal Auditing* (Lake Mary, Fla.: 2016).

- c. a governance structure at the entity that provides appropriate oversight and communications regarding the audit organization's services.

3.65 Depending on the nature of the engagement, auditors may be able to place limited reliance on safeguards that the audited entity has implemented. It is not possible to rely solely on such safeguards to eliminate threats or reduce them to an acceptable level.

3.66 Facts and circumstances that create threats to independence can result from events such as the start of a new engagement, assignment of new staff to an ongoing engagement, and acceptance of a nonaudit service at an audited entity.

Provision of Nonaudit Services to Audited Entities

Requirements: Identifying Prohibited Nonaudit Services

3.67 Before auditors agree to provide a nonaudit service to an audited entity, they should determine whether providing such a service would create a threat to independence, either by itself or in aggregate with other nonaudit services provided, with respect to any GAGAS engagement they conduct. Before auditors agree to provide nonaudit services on behalf of the audited entity, auditors should determine that the audited entity has designated an individual who possesses suitable skill, knowledge, or experience, and that the individual understands the services to be provided sufficiently to oversee them and be capable of detecting a material error, omission, or misstatement. Auditors should document consideration of management's ability to effectively oversee nonaudit services to be provided.

3.68 In cases where the audited entity is unable or unwilling to assume these responsibilities (for example, the audited entity does not have an individual with suitable skill, knowledge, or experience to oversee the nonaudit services provided, or is unwilling to perform such functions because of lack of time or desire), auditors should conclude that the provision of these services is an impairment to independence.

3.69 Auditors should conclude that management responsibilities performed by the auditors for an audited entity are impairments to independence. If the auditors were to assume management responsibilities for an audited entity, the management participation threats created would be so significant that no safeguards could reduce them to an acceptable level.

Application Guidance: Identifying Prohibited Nonaudit Services

3.70 Auditors have traditionally provided a range of nonaudit services that are consistent with their skills and expertise to entities at which they conduct engagements. Providing such nonaudit services may create threats to auditors' independence.

3.71 A critical component of determining whether a threat to independence exists is consideration of management's ability to effectively oversee the nonaudit service to be provided. Although the responsible individual in management is required to have sufficient expertise to oversee the nonaudit services and to be capable of detecting a material error, omission, or misstatement, management is not required to possess the expertise to perform or re-perform the services.

3.72 Management responsibilities involve leading and directing an entity, including making decisions regarding the acquisition, deployment, and control of human, financial, physical, and intangible resources.

3.73 The following activities are considered management responsibilities:

- a. setting policies and strategic direction for the audited entity;
- b. directing and accepting responsibility for the actions of the audited entity's employees in the performance of their routine, recurring activities;
- c. having custody of an audited entity's assets;
- d. reporting to those charged with governance on behalf of management;
- e. deciding which of the audit organization's or outside third party's recommendations to implement;
- f. accepting responsibility for the management of an audited entity's project;
- g. accepting responsibility for designing, implementing, or maintaining internal control;
- h. providing services that are intended to be used as management's primary basis for making decisions that are significant to the subject matter of the engagement;
- i. developing an audited entity's performance measurement system when that system is material or significant to the subject matter of the engagement; and
- j. serving as a voting member of an audited entity's management committee or board of directors.

3.74 Whether an activity is a management responsibility as identified in paragraph 3.73 or otherwise depends on the facts and circumstances.

3.75 Routine activities performed by auditors that relate directly to the performance of an engagement, such as providing advice and responding to questions as part of an audit, are not considered nonaudit services under GAGAS. Such routine activities generally involve providing advice or assistance to the audited entity on an informal basis as part of an audit. Routine activities typically are insignificant in terms of time incurred or resources expended and generally do not result in a specific project or engagement or in the auditors producing a formal report or other formal work product. However, activities such as financial statement preparation, cash-to-accrual conversions, and reconciliations are considered nonaudit services under GAGAS, not routine activities related to the performance of an engagement, and are evaluated using the conceptual framework as discussed in paragraph 3.87.

3.76 Routine activities directly related to an audit may include the following:

- a. providing advice to the audited entity on an accounting matter as an ancillary part of the overall financial audit;
- b. providing advice to the audited entity on routine business matters;
- c. educating the audited entity on matters within the technical expertise of the auditors; and
- d. providing information to the audited entity that is readily available to the auditors, such as best practices and benchmarking studies.

3.77 Safeguards vary depending on the facts and circumstances. The following are examples of actions that in certain circumstances could be safeguards in addressing threats to independence related to nonaudit services:

- a. not including individuals who provided the nonaudit service as engagement team members,
- b. having another auditor review the audit and nonaudit work as appropriate,
- c. engaging another audit organization to evaluate the results of the nonaudit service, or
- d. having another audit organization re-perform the nonaudit service to the extent necessary to enable that other audit organization to take responsibility for the service.

3.78 Nonaudit services provided by auditors can affect independence of mind and in appearance in periods after the nonaudit service was provided. For example, if auditors have designed and implemented an accounting and financial reporting system that is expected to be in place for many years, a threat to independence in appearance may exist in subsequent periods for future engagements conducted by those auditors. For recurring engagements, having another independent audit organization conduct an audit of the areas affected by the nonaudit service may provide a safeguard that allows the audit organization that provided the nonaudit service to mitigate the threat to its independence.

3.79 For performance audits and agreed-upon procedures engagements, nonaudit services that are otherwise prohibited by GAGAS may be provided when such services do not relate to the specific subject matter of the engagement. For financial statement audits and examination or review engagements, a nonaudit service otherwise prohibited by GAGAS and provided during the period covered by the financial statements may not threaten auditors' independence with respect to those financial statements provided that the following conditions exist:

- a. the nonaudit service was provided prior to the period of professional engagement;
- b. the nonaudit service related only to periods prior to the period covered by the financial statements; and
- c. the financial statements for the period to which the nonaudit service did relate were audited by other auditors (or in the case of an examination or review engagement, examined, reviewed, or audited by other auditors as appropriate).

Additional Guidance for Auditors in Government

3.80 Auditors in government sometimes provide professional services in the context of a three-party arrangement where auditors act for an engaging party (such as the governing body) to evaluate actions or information of a responsible party (i.e., management). Objectives of such services may include investigating possible fraud, reducing the risk of management override of controls, or improving governance. Provided auditors do not set direction or accept responsibility for key processes or controls, these services do not pose management participation threats. The auditors' role is to review the responsible party's activities on behalf of the engaging party. Similarly, auditors may provide services that represent a two-party relationship between the auditors and the public or governing body, such as estimating the fiscal

impact of proposed legislation or preparing questions for hearings. There are no GAGAS requirements related to these three-party or two-party professional services arrangements.

Requirements: Providing Nonaudit Services

3.81 Auditors providing nonaudit services on behalf of entities for which they conduct GAGAS engagements should obtain assurance from audited entity management that audited entity management performs the following functions in connection with the nonaudit services:

- a. assumes all management responsibilities;
- b. oversees the services, by designating an individual, preferably within senior management, who possesses suitable skill, knowledge, or experience;
- c. evaluates the adequacy and results of the services provided; and
- d. accepts responsibility for the results of the services.

3.82 In connection with nonaudit services, auditors should establish and document their understanding with the audited entity's management or those charged with governance, as appropriate, regarding the following:

- a. objectives of the nonaudit service,
- b. services to be provided,
- c. audited entity's acceptance of its responsibilities as discussed in paragraph 3.81,
- d. the auditors' responsibilities, and
- e. any limitations on the provision of nonaudit services.

3.83 Auditors who previously provided nonaudit services for an entity that is a prospective subject of an audit should evaluate the effect of those nonaudit services on independence before agreeing to conduct a GAGAS engagement. If auditors provided a nonaudit service in the period to be covered by the audit, they should (1) determine if GAGAS expressly prohibits the nonaudit service; (2) determine whether the skills, knowledge, and experience of the individual responsible for overseeing the nonaudit service are sufficient; and (3) determine whether a threat to independence exists and address any threats noted in accordance with the conceptual framework.

3.84 Auditors should use professional judgment to determine whether the safeguards adequately mitigate the threats to independence.

3.85 Auditors in a government entity may be required to provide a nonaudit service that impairs the auditors' independence with respect to a required audit. If, because of constitutional or statutory requirements over which they have no control, the auditors cannot implement safeguards to reduce the resulting threat to an acceptable level, or decline to provide or terminate a nonaudit service that is incompatible with audit responsibilities, auditors should disclose the nature of the threat that could not be eliminated or reduced to an acceptable level and modify the GAGAS compliance statement accordingly.

Application Guidance: Providing Nonaudit Services

3.86 By their nature, certain nonaudit services directly support an entity's operations and, if provided to an audited entity, create a threat to the auditors' ability to maintain independence in mind and appearance. Some aspects of these services will impair auditors' ability to conduct GAGAS engagements for the entities for which the services are provided.

3.87 Auditors may be able to provide nonaudit services in the broad areas indicated in paragraphs 3.88 through 3.101 without impairing independence if (1) the nonaudit services are not expressly prohibited by GAGAS requirements, (2) the auditors have determined that the requirements for providing nonaudit services in paragraphs 3.67 and 3.81 through 3.85 have been met and the application guidance in paragraphs 3.70 through 3.79 and 3.86 has been considered, and (3) any significant threats to independence have been eliminated or reduced to an acceptable level through the application of safeguards. The conceptual framework enables auditors to evaluate independence given the facts and circumstances of individual services that are not specifically prohibited.

Requirements: Preparing Accounting Records and Financial Statements

3.88 Auditors should conclude that the following services involving preparation of accounting records impair independence with respect to an audited entity:

- a. determining or changing journal entries, account codes or classifications for transactions, or other accounting records for the entity without obtaining management's approval;
- b. authorizing or approving the entity's transactions; and
- c. preparing or making changes to source documents without management approval.

3.89 Auditors should conclude that any services related to preparing accounting records and financial statements, other than those defined as impairments to independence in paragraph 3.88, create significant threats to auditors' independence, and should document the threats and safeguards applied to eliminate and reduce threats to an acceptable level or decline to perform the services. These services include

- a. recording transactions for which management has determined or approved the appropriate account classification, or posting coded transactions to an audited entity's general ledger;
- b. preparing financial statements based on information in the trial balance;
- c. posting entries that have been approved by an audited entity's management to the entity's trial balance; and
- d. preparing account reconciliations that identify reconciling items for the audited entity management's evaluation.

Application Guidance: Preparing Accounting Records and Financial Statements

3.90 Management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, even if the auditor

assisted in drafting those financial statements. Consequently, an auditor's acceptance of responsibility for the preparation and fair presentation of financial statements that the auditor will subsequently audit would impair the auditor's independence.

3.91 Source documents include those providing evidence that transactions have occurred (for example, purchase orders, payroll time records, customer orders, and contracts). Such records also include an audited entity's general ledger and subsidiary records or equivalent.

Requirements: Internal Audit Assistance Services Provided by External Auditors

3.92 Internal audit assistance services involve assisting an entity in the performance of its internal audit activities. Auditors should conclude that the following internal audit assistance activities impair an external auditor's independence with respect to an audited entity:

- a. setting internal audit policies or the strategic direction of internal audit activities;
- b. performing procedures that form part of the internal control, such as reviewing and approving changes to employee data access privileges; and
- c. determining the scope of the internal audit function and resulting work.

Requirements: Internal Control Evaluation as a Nonaudit Service

3.93 Auditors should conclude that providing or supervising ongoing monitoring procedures over an entity's system of internal controls impairs independence because the management participation threat created is so significant that no safeguards could reduce the threat to an acceptable level.

3.94 Separate evaluations are sometimes provided as nonaudit services by individuals who are not directly involved in the operation of the controls being monitored. As such, it is possible for an auditor to provide an objective analysis of control effectiveness by performing separate evaluations without creating a management participation threat that would impair independence. However, in all such cases, auditors should evaluate the significance of the threat created by performing separate evaluations and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level. Auditors should assess the frequency of the separate evaluations as well as the scope or extent of the controls (in relation to the scope of the audit conducted) being tested when evaluating the significance of the threat.

Application Guidance: Internal Control Evaluation as a Nonaudit Service

3.95 An evaluation prepared as a nonaudit service is not a substitute for engagement procedures in a GAGAS audit.

3.96 Accepting responsibility for designing, implementing, or maintaining internal control includes accepting responsibility for designing, implementing, or maintaining monitoring procedures. Monitoring involves the use of either ongoing monitoring procedures or separate evaluations to gather and analyze persuasive information supporting conclusions about the effectiveness of the internal control system. Ongoing monitoring procedures performed on behalf of management are built into the routine, recurring operating activities of an entity.

Requirement: Information Technology Services

3.97 Auditors should conclude that providing information technology (IT) services to an audited entity that relate to the period under audit impairs independence if those services include

- a. designing or developing an audited entity's financial information system or other IT system that will play a significant role in the management of an area of operations that is or will be the subject matter of an audit;
- b. making other than insignificant modifications to source code underlying an audited entity's existing financial information system or other IT system that will play a significant role in the management of an area of operations that is or will be the subject matter of an audit;
- c. supervising audited entity personnel in the daily operation of an audited entity's information system; or
- d. operating an audited entity's network, financial information system, or other IT system that will play a significant role in the management of an area of operations that is or will be the subject matter of an audit.

Application Guidance: Information Technology Services

3.98 Services related to IT systems include the design or implementation of hardware or software systems. The systems may aggregate source data, form part of the internal control over the subject matter of the engagement, or generate information that affects the subject matter of the engagement.

Requirement: Appraisal, Valuation, and Actuarial Services

3.99 Auditors should conclude that independence is impaired if an audit organization provides appraisal, valuation, or actuarial services to an audited entity when (1) the services involve a significant degree of subjectivity and (2) the results of the service, individually or when combined with other valuation, appraisal, or actuarial services, are material to the audited entity's financial statements.

Application Guidance: Appraisal, Valuation, and Actuarial Services

3.100 A valuation comprises the making of assumptions with regard to future developments; the application of appropriate methodologies and techniques; and the combination of both to compute a certain value, or range of values, for an asset, a liability, or an entity as a whole.

Requirement: Other Nonaudit Services

3.101 Auditors should conclude that provision of certain other nonaudit services impair an external auditor's independence with respect to an audited entity. These activities include the following:

- a. Advisory service
 - (1) Assuming any management responsibilities

- b. Benefit plan administration
 - (1) Making policy decisions on behalf of management
 - (2) Interpreting the provisions in a plan document for a plan participant on behalf of management without first obtaining management's concurrence
 - (3) Making disbursements on behalf of the plan
 - (4) Having custody of the plan's assets
 - (5) Serving in a fiduciary capacity, as defined under the Employee Retirement Income Security Act of 1974¹⁵
- c. Business risk consulting
 - (1) Making or approving business risk decisions
 - (2) Presenting business risk considerations to those charged with governance on behalf of management
- d. Executive or employee recruiting
 - (1) Committing the audited entity to employee compensation or benefit arrangements
 - (2) Hiring or terminating the audited entity's employees
- e. Investment advisory or management
 - (1) Making investment decisions on behalf of management or otherwise having discretionary authority over an audited entity's investments
 - (2) Executing a transaction to buy or sell an audited entity's investments
 - (3) Having custody of an audited entity's assets, such as taking temporary possession of securities

Documentation

Requirement: Documentation

3.102 While insufficient documentation of an auditor's compliance with the independence standard does not impair independence, auditors should prepare appropriate documentation under the GAGAS quality control and assurance requirements. The independence standard includes the following documentation requirements, where applicable:

- a. document threats to independence that require the application of safeguards, along with safeguards applied, in accordance with the conceptual framework for independence as required by paragraph 3.37;
- b. document the safeguards in paragraphs 3.53 through 3.58 if an audit organization is structurally located within a government entity and is considered independent based on those safeguards;

¹⁵See Section 2510.3-21 of Title 29, *Code of Federal Regulations*.

- c. document consideration of audited entity management’s ability to effectively oversee a nonaudit service to be provided by the auditor as indicated in paragraph 3.67; and
- d. document the auditor’s understanding with an audited entity for which the auditor will provide a nonaudit service as indicated in paragraph 3.82.

Application Guidance: Documentation

3.103 Documentation of independence considerations provides evidence of the auditor’s judgments in forming conclusions regarding compliance with independence requirements.

Professional Judgment

Requirement: Professional Judgment

3.104 Auditors must use professional judgment in planning and conducting the engagement and in reporting the results.

Application Guidance: Professional Judgment

3.105 Professional judgment includes exercising reasonable care and professional skepticism. Reasonable care includes acting diligently in accordance with applicable professional standards and ethical principles. Attributes of professional skepticism include a questioning mind, awareness of conditions that may indicate possible misstatement owing to error or fraud, and a critical assessment of evidence. Professional skepticism includes being alert to, for example, evidence that contradicts other evidence obtained, or information that brings into question the reliability of documents or responses to inquiries to be used as evidence. Further, it includes a mindset in which auditors assume that management is neither dishonest nor of unquestioned honesty. Auditors may accept records and documents as genuine unless they have reason to believe the contrary. Auditors may consider documenting procedures undertaken to support their application of professional skepticism in highly judgmental or subjective areas under audit.

3.106 Using the auditor’s professional knowledge, skills, and experience, in good faith and with integrity, to diligently gather information and objectively evaluate the sufficiency and appropriateness of evidence is a critical component of GAGAS engagements. Professional judgment and competence are interrelated because judgments made depend upon the auditor’s competence, as discussed in chapter 4.

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

3.108 Using professional judgment is important to auditors in carrying out all aspects of their professional responsibilities, including following the independence standards and related conceptual framework; maintaining objectivity and credibility; assigning competent staff to the engagement; defining the scope of work; evaluating, documenting, and reporting the results of the work; and maintaining appropriate quality control over the engagement process.

3.109 Using professional judgment is important to auditors in applying the conceptual framework to determine independence in a given situation. This includes considering any

threats to the auditor's independence and related safeguards that may mitigate the identified threats. Auditors use professional judgment in identifying and evaluating any threats to independence, including threats to the appearance of independence.¹⁶

3.110 Using professional judgment is important to auditors in determining the necessary level of understanding of the engagement subject matter and related circumstances. This includes consideration about whether the audit team's collective experience, training, knowledge, skills, abilities, and overall understanding are sufficient to assess the risks that the subject matter of the engagement may contain a significant inaccuracy or could be misinterpreted.¹⁷

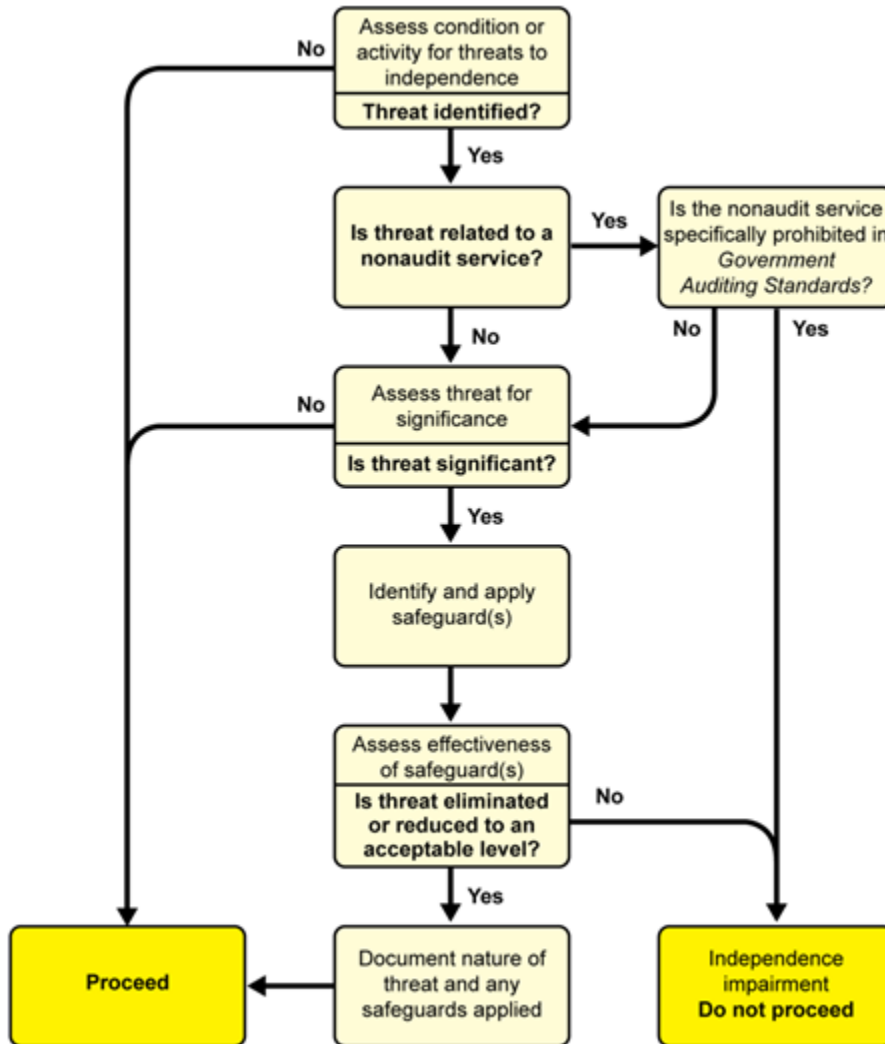
3.111 An auditor's consideration of the risk level of each engagement, including the risk of arriving at improper conclusions, is also important. Within the context of audit risk, exercising professional judgment in determining the sufficiency and appropriateness of evidence to be used to support the findings and conclusions based on the engagement objectives and any recommendations reported is integral to the engagement process.

3.112 While this requirement places responsibility on each auditor and audit organization to exercise professional judgment in planning and conducting an engagement, 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 factors such as the nature of evidence and characteristics of fraud. Professional judgment does not mean eliminating all possible limitations or weaknesses associated with a specific engagement, but rather identifying, assessing, mitigating, and concluding on them.

¹⁶See para. 3.21.b for a description of independence in appearance.

¹⁷See paras. 4.02 through 4.14 for a discussion of competence.

Figure 1: GAGAS Conceptual Framework for Independence



Chapter 4: Competence and Continuing Professional Education

4.01 This chapter establishes the GAGAS requirements for competence and continuing professional education (CPE). Competence includes being knowledgeable about the specific GAGAS requirements and having the skills and abilities to proficiently apply that knowledge on GAGAS engagements. CPE contributes to auditors' competence. The requirements of this chapter are intended to be followed in conjunction with all other applicable GAGAS requirements.

Competence

Requirements: General

4.02 The audit organization's management must assign auditors to conduct the engagement who at the time of the assignment collectively possess the competence needed to address the engagement objectives and perform their work in accordance with GAGAS.

4.03 The audit organization's management must assign auditors who at the time of assignment possess the competence needed for their assigned roles.

4.04 Audit organizations should have a process for recruitment, hiring, continuous development, assignment, and evaluation of staff so that the workforce has the essential knowledge, skills, and abilities necessary to conduct the engagement. The nature, extent, and formality of the process will depend on various factors, such as the size of the audit organization, its structure, and its work.

Requirements: Specialists

4.05 The engagement team should determine that specialists consulting on a GAGAS engagement are qualified and competent in their areas of specialization.

Application Guidance: General

4.06 Competence is the knowledge, skills, and abilities, obtained from education and experience, necessary to conduct the GAGAS engagement. Competence enables auditors to make sound professional judgments. Competence includes possessing the technical knowledge and skills necessary for the assigned role and the type of work being done. This includes possessing specific knowledge about GAGAS.

4.07 Competence is derived from a combination of education and experience. Education is a structured and systematic process aimed at developing knowledge, skills, and other abilities; it is a process that is typically but not exclusively conducted in academic environments. Experience refers to workplace activities that are relevant to developing professional proficiency. Competence is not necessarily measured by years of auditing experience because such a quantitative measurement may not accurately reflect the kinds of experiences gained by auditors in any given time period. Maintaining competence through a commitment to learning and development throughout auditors' professional lives is an important element for auditors.

Application Guidance: Indicators of Competence

Technical Knowledge and Skills

4.08 The knowledge, skills, and abilities needed when conducting an engagement in accordance with GAGAS include the understanding necessary to proficiently apply

- a. GAGAS;
- b. standards, statutory requirements, regulations, criteria, and guidance applicable to auditing or the objectives for the engagement(s) being conducted; and
- c. techniques, tools, and guidance related to professional expertise applicable to the work being performed.

Auditors successfully achieving proficiency in these areas helps ensure that engagements are conducted in accordance with GAGAS.

Competence for Assigned Roles

4.09 Audit organizations and engagement teams may consider the levels of proficiency needed for each role on the engagement when assigning auditors to the engagement.

4.10 Roles on the engagement include the following:

- a. **Entry level:** Auditors in entry-level roles plan or perform engagement procedures on engagements. Work situations for these auditors are characterized by low levels of ambiguity, complexity, and uncertainty. The entry-level role necessitates at least a basic level of proficiency.
- b. **Supervisory:** Auditors in supervisory roles plan engagements, perform engagement procedures, or direct engagements. Work situations for these auditors are characterized by moderate levels of ambiguity, complexity, and uncertainty. The supervisory role necessitates at least an intermediate level of proficiency.
- c. **Partners and directors:** Auditors in these roles plan engagements, perform engagement procedures, or direct or report on engagements. They are also responsible for reviewing engagement quality prior to issuing the report, for signing the report, or both. Work situations for these auditors are characterized by high levels of ambiguity, complexity, and uncertainty. Partners and directors need at least an advanced level of proficiency.

4.11 Definitions of key terms follow:

- a. **Planning:** Determining engagement objectives, scope, and methodology; establishing criteria to evaluate matters subject to audit; or coordinating the work of other audit organizations. This definition excludes auditors whose role is limited solely to gathering information used in planning the engagement.
- b. **Directing:** Supervising the efforts of others who are involved in accomplishing the objectives of the engagement or reviewing engagement work to determine whether those objectives have been accomplished.
- c. **Performing engagement procedures:** Performing tests and procedures necessary to accomplish the engagement objectives in accordance with GAGAS.
- d. **Reporting:** Determining the report content and substance or reviewing reports to determine whether the engagement objectives have been accomplished and the evidence supports the report's technical content and substance prior to issuance. This includes reviewing engagement quality prior to issuing the report and signing the report.

Application Guidance: Specialists

4.12 Some engagements may necessitate the use of specialized techniques or methods that call for the skills of specialists. Specialists to whom this section applies include, but are not limited to, actuaries, appraisers, attorneys, engineers, environmental consultants, medical professionals, statisticians, geologists, and information technology experts.

4.13 The competence and qualifications of specialists significantly affect whether their work will be adequate for the engagement team's purposes and will meet GAGAS requirements. Competence relates to the nature and level of expertise of specialists. Qualifications of specialists relate to their professional certifications, reputations, and previous work in the subject matter. Other relevant factors include the ability of specialists to exercise competence in the circumstances of the engagement and the effects that bias, conflict of interest, or the influence of others may have on the specialists' professional judgment.

4.14 Sources that may inform the auditors' assessment of the competence and professional qualifications of a specialist include the following:

- 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;
- c. the specialist's experience and previous work in the subject matter;
- d. the auditors' prior experience in using the specialist's work;
- e. the knowledge of any technical performance standards or other professional or industry requirements in the specialist's field (for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation);
- f. the competence of the specialist with respect to relevant auditing standards; and
- g. the assessment of unexpected events, changes in conditions, or the evidence obtained from the results of engagement procedures that indicate it may be necessary to reconsider the initial evaluation of the competence and qualifications of a specialist as the engagement progresses.

Continuing Professional Education

Requirements: GAGAS Qualification

4.15 Auditors who plan, direct, perform engagement procedures for, or report on an engagement conducted in accordance with GAGAS should complete the GAGAS Qualification requirements as part of developing and maintaining their professional competence. GAGAS Qualification requires auditors to complete at least 4 hours of CPE in GAGAS topics. Auditors assigned to supervisory or partner and director roles should obtain GAGAS Qualification before completing work on their first GAGAS engagement. Entry-level staff should obtain GAGAS Qualification by the end of their first full 2-year CPE period.¹⁸

¹⁸See para. 4.10 for a discussion of the various roles on the engagement.

4.16 For CPE to fulfill the GAGAS Qualification requirement, the CPE provider should include in the course content the relevant GAGAS topics listed in paragraph 4.23 and include in the course description wording that indicates that its purpose is to fulfill the GAGAS Qualification CPE requirement.

Requirements: Updating GAGAS Qualification and Maintaining Professional Competence

4.17 To update their GAGAS Qualification, auditors should complete at least 4 hours of CPE in GAGAS topics each time the Comptroller General issues a revision of GAGAS. These CPE hours should be completed by the end of each auditor's next full 2-year CPE period after the GAGAS revision is issued. The audit organization should maintain documentation of each auditor's CPE.¹⁹

4.18 Auditors should maintain their professional competence and GAGAS Qualification by completing at least 80 hours of CPE in every 2-year period as follows:

CPE hours	Subject matter categories of CPE
24 hours	Standards, statutory requirements, regulations, criteria, and guidance applicable to auditing or the objectives for the GAGAS engagement(s) being conducted (includes the 4 hours of GAGAS topics for GAGAS Qualification when applicable)
56 hours	Subject matter or topics that directly enhance auditors' professional expertise to conduct GAGAS engagements ²⁰

4.19 Auditors should complete at least 20 hours of CPE in each year of the 2-year periods.

Application Guidance: General

4.20 The continuing competence of the audit organization's personnel depends, in part, on an appropriate level of CPE so that auditors maintain the knowledge, skills, and abilities necessary to conduct the GAGAS engagement.

Application Guidance: Subject Matter Categories of CPE

4.21 Determining what subjects are appropriate for individual auditors to satisfy the CPE requirements is a matter of professional judgment to be exercised by auditors in consultation with appropriate officials in their audit organizations. When determining what specific subjects qualify for the CPE requirement, the auditors may consider the types of knowledge, skills, and abilities, and the level of proficiency necessary, in order to be competent for their assigned roles. Auditors may consider probable future engagements to which they may be assigned when selecting specific CPE subjects to satisfy the 24-hour and the 56-hour

¹⁹See paras. 4.48 and 5.23 for a discussion of CPE documentation.

²⁰ The 56 hours may include CPE hours in a subject matter category that would otherwise qualify toward the 4- or 24-hour requirements, provided those requirements have already been met.

CPE requirements. When an auditor takes the 4 hours in GAGAS topics—either because it is an auditor's first GAGAS engagement or because GAO has issued a new revision of GAGAS—these hours count toward the 24-hour requirement for that reporting cycle. The subject matter categories for the 4-hour and 24-hour requirements may also be used to satisfy the 56-hour CPE requirement.

4.22 Examples of CPE subjects that may qualify for each of the categories are listed below.

GAGAS Topics for GAGAS Qualification (4-Hour Requirement)

4.23 GAGAS topics include the following:

- a. standards for ethics, independence, professional judgment, competence and CPE, quality control, and peer review as established in GAGAS;
- b. the types of GAGAS engagements;
- c. the relationship between GAGAS and other standards;
- d. stating compliance with GAGAS in the auditor's report;
- e. additive GAGAS requirements for financial audits and examination engagements;
- f. additive GAGAS requirements for review and agreed-upon procedures engagements;
- g. GAGAS fieldwork standards for performance audits;
- h. GAGAS reporting standards for performance audits; and
- i. internal control as addressed in GAGAS.

Standards, Statutory Requirements, Regulations, Criteria, and Guidance Applicable to Auditing or the Objectives for the GAGAS Engagement(s) Being Conducted (24-Hour Requirement)

4.24 Standards, statutory requirements, regulations, criteria, and guidance applicable to auditing or to the engagement objectives may include, but are not limited to, the following:

- a. GAGAS topics listed in paragraph 4.23;
- b. U.S. generally accepted accounting principles, or the applicable financial reporting framework being used, and the American Institute of Certified Public Accountants' (AICPA) Statements on Auditing Standards;²¹
- c. the AICPA general attestation standard related to criteria, the AICPA attestation standards for fieldwork and reporting, and the related Statements on Standards for Attestation Engagements and Statements on Standards for Accounting and Review Services;²²
- d. *Standards for Internal Control in the Federal Government*;²³
- e. *Internal Control—Integrated Framework*;²⁴

²¹See para. 6.01 for a discussion of the AICPA standards incorporated into GAGAS for financial audits.

²²See para. 7.01 for a discussion of the AICPA standards incorporated into GAGAS for attestation engagements and reviews of financial statements.

²³GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C.: September 2014).

- f. requirements for Single Audits, such as the *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*;²⁵
- g. requirements for federal program audits;
- h. relevant or applicable audit standards or guides;
- i. regulations, statutory requirements, criteria, or guidance relevant to the specific and unique environment in which the audited entity operates;
- j. regulations, statutory requirements, criteria, or guidance relevant to the subject matter of the engagement, such as scientific, medical, environmental, educational, or any other specialized subject matter;
- k. specialized audit methodologies or analytical techniques, such as the use of complex survey instruments, actuarial estimates, statistical analysis tests, or statistical or nonstatistical sampling, as applicable;
- l. performance auditing topics, such as obtaining evidence, professional skepticism, and other applicable audit skills;²⁶ and
- m. general ethics and independence.

Subject Matter or Topics That Directly Enhance Auditors' Professional Expertise to Conduct GAGAS Engagements (56-Hour Requirement)

4.25 Subject matter or topics that directly enhance auditors' professional expertise to conduct engagements may include, but are not limited to, the following:

- a. GAGAS topics listed in paragraph 4.23;
- b. subject matter categories for the 24-hour requirement listed in paragraph 4.24;
- c. communicating clearly and effectively, both orally and in writing;
- d. managing time and resources;
- e. information technology; and
- f. economics, human capital management, social and political sciences, and other academic disciplines, as applicable.

Application Guidance: Exemptions and Exceptions

4.26 Auditors may be exempted from the 56-hour CPE requirement by the audit organization, but not the 24-hour and 4-hour GAGAS Qualification requirements, if they

- a. charge less than 20 percent of their time annually to engagements conducted in accordance with GAGAS and
- b. are only involved in performing engagement procedures, but not involved in planning, directing, or reporting on the engagement.

²⁴Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control - Integrated Framework* (New York: American Institute of Certified Public Accountants, 2013).

²⁵See Part 200, Subpart F, of Title 2, *Code of Federal Regulations*.

²⁶See chs. 8 and 9 for performance audit topics that may be included.

4.27 Entry-level auditors who charge less than 40 hours of their time annually to engagements conducted in accordance with GAGAS may be exempted from all CPE requirements.

4.28 Auditors hired or initially assigned to GAGAS engagements after the beginning of the audit organization's 2-year CPE period may prorate the 56-hour and the 24-hour CPE requirements, but not the 4-hour GAGAS Qualification requirement.

4.29 The audit organization may exempt from the CPE requirements college and university students employed on a temporary basis for a limited period of time (for example, an internship of limited duration) or enrolled in a formal program sponsored by the college or university for a specific period of employment, such as a term or semester.

4.30 The audit organization, at its discretion, may grant exemptions from a portion of the CPE requirement in the event of extended absences or other extenuating circumstances if situations such as the following prevent auditors from fulfilling those requirements and conducting engagements:

- a. ill health,
- b. maternity or paternity leave,
- c. extended family leave,
- d. sabbaticals,
- e. leave without pay absences,
- f. foreign residency,
- g. military service, or
- h. disasters.

The audit organization may not grant exceptions for reasons such as workload, budget, or travel constraints.

Application Guidance: Programs and Activities That Qualify for CPE

4.31 CPE programs are structured educational activities or programs with learning objectives designed to maintain or enhance the auditors' competence to address engagement objectives and perform work in accordance with GAGAS.

4.32 The following are examples of structured educational programs and activities:

- a. internal training programs (e.g., courses, seminars, and workshops);
- b. education and development programs presented at conferences, conventions, meetings, and seminars and meetings or workshops of professional organizations;
- c. training programs presented by other audit organizations, educational organizations, foundations, and associations;
- d. web-based seminars and individual-study programs;
- e. audio conferences;
- f. accredited university and college courses (credit and noncredit);
- g. standard-setting organization, professional organization, or audit organization staff meetings when a structured educational program with learning objectives is presented

(e.g., the portion of the meeting that is a structured educational program with learning objectives designed to maintain or enhance auditors' competence);

- h. correspondence courses, individual-study guides, and workbooks;
- i. serving as a speaker, panelist, instructor, or discussion leader at programs that qualify for CPE hours;
- j. developing courses or the course materials for programs that qualify for CPE hours; or
- k. publishing articles and books that contribute directly to the author's professional proficiency to conduct engagements.

Application Guidance: Measurement of CPE

4.33 A CPE hour may be granted for each 50 minutes of participation in group programs and activities that qualify. One-half CPE hour increments (equal to 25 minutes) may also be granted after the first CPE hour has been earned in a given program or activity.

4.34 For university or college credit courses, each unit of college credit under a semester system equals 15 CPE hours, and each unit of college credit under a quarter system equals 10 CPE hours. For university or college noncredit courses, CPE hours may be granted only for the actual classroom time.

4.35 For individual-study programs where successful completion is measured by a summary examination, CPE credit may be granted if auditors complete the examination with a passing grade. Auditors in other individual-study programs may earn CPE hours when they satisfactorily complete the requirements of the self-study program. The number of hours granted may be based on the CPE provider's recommended number of CPE hours for the program.

4.36 Speakers, instructors, and discussion leaders at programs that qualify for CPE, and auditors who develop or write the course material may receive CPE hours for preparation and presentation time to the extent the subject matter contributes to auditors' competence. One CPE hour may be granted for each 50 minutes of presentation time. Up to 2 CPE hours may be granted for the developing, writing, or advance preparation for each 50 minutes of the presentation. Auditors may not receive CPE hours for either preparation or presentation time for repeated presentations that they make within the 2-year period, unless the subject matter involved was changed significantly for each presentation. The maximum number of CPE hours that may be granted to an auditor as a speaker, instructor, discussion leader, or preparer of course materials may not exceed 40 hours for any 2-year period.

4.37 Articles, books, or materials written by auditors and published on subjects and topics that contribute directly to professional proficiency to conduct engagements qualify for CPE hours in the year they are published. One CPE hour may be granted for each hour devoted to writing articles, books, or materials that are published. However, CPE hours for published writings may not exceed 20 hours for any 2-year period.

4.38 Auditors hired or assigned to a GAGAS engagement after the beginning of an audit organization's 2-year CPE period may complete a prorated number of CPE hours.²⁷ An audit

²⁷When auditors are newly hired or newly assigned to GAGAS engagements and have had some previous CPE, the audit organization has flexibility and may choose between using a pro rata approach or evaluating whether and to what extent any CPE already taken in that period would satisfy GAGAS CPE requirements.

organization may define a prorated number of hours based on the number of full 6-month intervals remaining in the CPE period. For example, an audit organization has a 2-year CPE period running from January 1, 2015, through December 31, 2016. The audit organization assigns a new staff member to a GAGAS engagement in May 2015. The audit organization may calculate the prorated CPE requirement for the staff member as follows:

- a. Number of full 6-month intervals remaining in the CPE period: 3
- b. Number of 6-month intervals in the full 2-year period: 4
- c. Newly assigned auditor's CPE requirement: $\frac{3}{4} \times 80 \text{ hours} = 60 \text{ hours}$

4.39 For newly assigned auditors who are subject to the 24-hour requirement, the number of prorated hours may be calculated in a similar manner: $\frac{3}{4} \times 24 \text{ hours} = 18 \text{ hours}$, in this example. The prorated amount of hours would be the total requirement over the partial period. The 20-hour minimum for each CPE year would not apply when the prorated number of hours is being used to cover a partial 2-year CPE period.

4.40 At their discretion, audit organizations may give auditors who have not completed the 80-hour CPE requirement for any 2-year period up to 2 months immediately following the 2-year period to make up the deficiency. Audit organizations may also give auditors who have not completed the 20 hours of CPE in a 1-year period up to 2 months immediately following the 1-year period to make up the deficiency. Any CPE hours completed toward a deficiency in one period may be documented in the CPE records and may not be counted toward the requirements for the next period. Audit organizations that grant the 2-month grace period may not allow auditors who have not satisfied the CPE requirements after the grace period to participate in GAGAS engagements until those requirements are satisfied.

4.41 To determine whether auditors charged less than 20 percent of their time annually to engagements conducted in accordance with GAGAS, the audit organization may base the 20 percent on total historical or estimated charges in a year, provided that the audit organization has a basis for this determination and monitors actual time. For auditors who change status such that they are charging more than 20 percent of their time annually to engagements under GAGAS, the audit organization may follow the guidance for prorating required CPE hours when auditors are assigned to GAGAS engagements after the beginning of a 2-year CPE measurement period.

4.42 If an audit organization discontinues conducting GAGAS engagements or reassigns auditors to non-GAGAS assignments before auditors complete the CPE requirements, the auditors are not required to complete the number of hours to satisfy the CPE requirements. However, the audit organization may wish to have its auditors complete those requirements if it is foreseeable that the auditors will conduct GAGAS engagements in the future.

4.43 Examples of programs and activities that do not qualify for CPE hours under GAGAS include, but are not limited to, the following:

- a. on-the-job training;
- b. basic or elementary courses in subjects and topics in which auditors already have the knowledge and skills being taught;
- c. programs that are designed for general personal development, such as résumé writing, improving parent-child relations, personal investments and money management, and retirement planning;

- d. programs that demonstrate office equipment or software that is not used in conducting engagements;
- e. programs that provide training on the audit organization's administrative operations;
- f. business sessions at professional organization conferences, conventions, and meetings that do not have a structured educational program with learning objectives;
- g. conducting external quality control reviews; and
- h. sitting for professional certification examinations.

4.44 Auditors who complete a professional certification review course may receive CPE hours only for those segments of the review course that are relevant to the standards, statutory requirements, regulations, criteria, and guidance applicable to auditing or to the audit objectives being performed, or subject matter or topics that directly enhance auditors' professional expertise to conduct engagements.

4.45 To simplify administration of the CPE requirements, an audit organization may establish a standard 2-year period for all of its auditors, which can be on either a fixed-year or rolling-year basis. A fixed-year measurement period, for example, would be the 2-year periods 2016–2017, 2018–2019, and so forth, while a rolling-year measurement period would be 2016–2017, 2017–2018, 2018–2019, and so forth.

4.46 An audit organization may use a measurement date other than the date it started its first GAGAS engagement, or the audit organization may choose to change its measurement date to coincide with a fiscal year or another reporting requirement, such as one established by a state licensing body or professional organization. For example, if an audit organization changes the end date of the measurement period from December 31 to June 30, during the audit organization's transition period (January 1 to June 30), its auditors may complete at least a prorated number of CPE hours for the 6-month transition period. The number of prorated hours required may be calculated using the method illustrated in paragraphs 4.38 and 4.39.

4.47 The audit organization's policies and procedures for CPE may address the following:

- a. identifying all auditors required to meet the CPE requirements;
- b. providing auditors with the opportunity to attend internal CPE programs, external CPE programs, or both;
- c. assisting auditors in determining which programs, activities, and subjects qualify for CPE;
- d. documenting the number of CPE hours completed by each auditor; and
- e. monitoring auditor compliance with the CPE requirements to ensure that auditors complete sufficient CPE in qualifying programs and subjects.

4.48 Policies and procedures for documentation may address maintaining documentation of the CPE hours completed by each auditor subject to the CPE requirements for an appropriate period of time to satisfy any legal and administrative requirements, including peer review. The audit organization may maintain documentation of CPE or may delegate the responsibility to the auditor and put in place adequate procedures to ensure that its records of CPE hours earned by auditors are supported by the documentation maintained by auditors. Documentation may include the following information:

- a. the name of the organization providing the CPE;

- b. the title of the training program, including the subject matter or field of study;
- c. the dates attended for group programs or dates completed for individual study programs;
- d. the number of CPE hours earned toward the 56-hour, 24-hour, and 4-hour requirements;
- e. any reasons for specific exceptions granted to the CPE requirement; and
- f. evidence of completion of CPE, such as a certificate or other evidence of completion from the CPE provider for group and individual-study programs, if provided; documentation of CPE courses presented or copies of course materials developed by or for speakers, instructors, or discussion leaders, along with a written statement supporting the number of CPE hours claimed; or a copy of the published book, article, or other material that name the writer as author or contributor, or a written statement from the writer supporting the number of CPE hours claimed.

4.49 The audit organization may monitor CPE compliance through its internal inspections, or other quality assurance monitoring activities, and the audit organization's normal peer review process.

4.50 Audit organizations are not required to prepare reports on CPE. However, audit organizations may consider preparing a periodic CPE report for distribution to the auditors or maintaining or accessing training data online to monitor their staff members' progress toward meeting the CPE requirements.

Chapter 5: Quality Control and Peer Review

5.01 This chapter establishes the GAGAS requirements and guidance for quality control and assurance, and for administering, planning, performing, and reporting on peer reviews of audit organizations that conduct engagements in accordance with GAGAS. The requirements of this chapter are intended to be followed in conjunction with those of all other applicable GAGAS requirements.

Quality Control and Assurance

Requirement: Quality Control and Assurance

5.02 An audit organization conducting engagements in accordance with GAGAS must establish and maintain a system of quality control that is designed to provide the audit organization with reasonable assurance that the organization and its personnel comply with applicable professional standards and legal and regulatory requirements, and that the reports issued by the audit organization are appropriate in the circumstances.

Application Guidance: Quality Control and Assurance

5.03 An audit organization's system of quality control encompasses the audit organization's leadership, emphasis on performing high-quality work, and policies and procedures designed to provide reasonable assurance of complying with applicable professional standards and legal and regulatory requirements. The nature, extent, and formality of an audit organization's quality control system will vary based on the audit organization's circumstances, such as size, number of offices and geographic dispersion, knowledge and experience of its personnel, nature and complexity of its audit work, and cost-benefit considerations.

System of Quality Control

Requirement: System of Quality Control

5.04 An audit organization should document its quality control policies and procedures and communicate those policies and procedures to its personnel. The audit organization should document compliance with its quality control policies and procedures and maintain such documentation 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 its quality control policies and procedures.

Requirements: Leadership Responsibilities for Quality within the Audit Organization

5.05 Audit organizations should establish policies and procedures on leadership responsibilities for quality within the audit organization that include the designation of responsibility for quality of engagements conducted in accordance with GAGAS and communication of policies and procedures relating to quality.

5.06 Audit organizations should establish policies and procedures designed to provide reasonable assurance that those assigned operational responsibility for the audit organization's system of quality control have sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility.

Application Guidance: Leadership Responsibilities for Quality within the Audit Organization

5.07 Appropriate policies and communications encourage a culture that recognizes that quality is essential in conducting GAGAS engagements and that leadership of the audit organization is ultimately responsible for the system of quality control.

Requirements: Independence, Legal, and Ethical Requirements

5.08 Audit organizations should establish policies and procedures on independence and legal and ethical requirements that are designed to provide reasonable assurance that the audit organization and its personnel maintain independence and comply with applicable legal and ethical requirements.²⁸

5.09 At least annually, the audit organization should obtain written affirmation of compliance with its policies and procedures on independence from all audit organization personnel required to be independent.

Application Guidance: Independence, Legal, and Ethical Requirements

5.10 Policies and procedures pertaining to independence and legal and ethical requirements assist the audit organization in

- a. communicating its independence requirements to its personnel and
- b. identifying and evaluating circumstances and relationships that create threats to independence, and taking appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards or, if considered appropriate, withdrawing from the engagement where withdrawal is not prohibited by law or regulation.

5.11 Written affirmation of compliance with its policies and procedures on independence from all audit organization personnel required to be independent may be in paper or electronic form. By obtaining affirmation and taking appropriate action on information indicating noncompliance, or potential noncompliance, the audit organization demonstrates the importance that it attaches to independence and keeps the issue current for, and visible to, its personnel.

Requirement: Initiation, Acceptance, and Continuance of Audits

5.12 Audit organizations should establish policies and procedures for the initiation, acceptance, and continuance of engagements that are designed to provide reasonable assurance that the audit organization will undertake engagements only if the organization

²⁸See paras. 3.02 through 3.17 for a discussion of ethical principles.

- a. complies with applicable professional standards, legal requirements, and ethical principles;
- b. acts within its legal mandate or authority; and
- c. has the capabilities, including time and resources, to do so.

Application Guidance: Initiation, Acceptance, and Continuance of Audits

5.13 Audit organizations may operate with limited resources. Audit organizations may consider their workloads in determining whether they have the resources to deliver the range of work to the desired level of quality. To achieve this, audit organizations may develop systems to prioritize their work in a way that takes into account the need to maintain quality.

Requirement: Human Resources

5.14 Audit organizations should establish policies and procedures for human resources that are designed to provide them with reasonable assurance that they have personnel with the competence to conduct GAGAS engagements in accordance with applicable professional standards and legal requirements.

Application Guidance: Human Resources

5.15 Effective recruitment processes and procedures help the audit organization select individuals of integrity who have the capacity to develop the competence and capabilities necessary to perform the audit organization's work and possess the appropriate characteristics to enable them to perform competently. Examples of such characteristics include meeting minimum academic requirements established by the audit organization and leadership traits.

5.16 The audit organization may use a suitably qualified external person to conduct engagement work when internal resources, for example, particular areas of technical expertise, are unavailable.

5.17 Effective performance evaluation, compensation, and advancement procedures give due recognition and reward to the development and maintenance of competent personnel. Steps that an audit organization may take in developing and maintaining competent personnel include the following:

- a. making personnel aware of the audit organization's expectations regarding performance and ethical principles;
- b. providing personnel with an evaluation of, and counseling on, performance, progress, and career development; and
- c. helping personnel understand that compensation and advancement to positions of greater responsibility depend on, among other things, performance quality, and that failure to comply with the audit organization's policies and procedures may result in disciplinary action.

5.18 The size and circumstances of the audit organization are important considerations in determining the structure of the audit organization's performance evaluation process. Smaller audit organizations, in particular, may employ less formal methods of evaluating the performance of their personnel.

5.19 Objectives of the audit organization's human resources policies and procedures include

- a. promoting learning and training for all staff to encourage their professional development and to help ensure that personnel are trained in current developments in the profession; and
- b. helping ensure that personnel and any parties contracted to carry out work for the audit organization have an appropriate understanding of the environment(s) in which the audit organization operates and a good understanding of the work they are required to carry out.

Requirements: Audit Performance, Documentation, and Reporting

5.20 Audit organizations should establish policies and procedures for audit performance, documentation, and reporting that are designed to provide the audit organization with reasonable assurance that engagements are conducted and reports are issued in accordance with applicable professional standards and legal and regulatory requirements.

5.21 The audit organization should establish policies and procedures pertaining to review of audit work performed and related audit documentation that require experienced engagement team members to review the work of less experienced engagement team members.

5.22 The audit organization should assign responsibility for each engagement to an engagement partner or director with authority designated by the audit organization to assume that responsibility and should establish policies and procedures requiring

- a. the audit organization to communicate the identity and role of the engagement partner or director to management and those charged with governance of the audited entity and
- b. the audit organization to clearly define the responsibilities of the engagement partner or director and communicate them to that individual.

5.23 The audit organization should establish quality control procedures to help ensure that auditors who are performing work in accordance with GAGAS meet the continuing professional education (CPE) requirements, including maintaining documentation of the CPE completed, the determination of how a subject qualified for CPE, and any exemptions granted.

5.24 The audit organization should establish policies and procedures designed to provide it with reasonable assurance that

- a. appropriate consultation takes place on difficult or contentious issues;
- b. sufficient resources are available to enable appropriate consultation to take place;
- c. both the individual seeking consultation and the individual consulted document and agree upon the nature and scope of such consultations; and
- d. the conclusions resulting from consultations are documented, understood by both the individual seeking consultation and the individual consulted, and implemented.

5.25 If an engagement is terminated before it is completed and an audit report is not issued, auditors should document the results of the work to the date of termination and why the engagement was terminated.

5.26 If auditors change the audit objectives during the engagement, they should document the revised audit objectives and the reasons for the changes.

Application Guidance: Audit Performance, Documentation, and Reporting

5.27 The audit organization’s policies and procedures may address consistency in the quality of engagement performance. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Matters addressed may include the following:

- a. how engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work;
- b. processes for complying with applicable engagement standards;
- c. processes of engagement supervision, staff training, and mentoring;
- d. methods of reviewing the work performed, the significant judgments made, and the type of report being issued;
- e. appropriate documentation of the work performed and of the timing and extent of the review; and
- f. processes to keep all policies and procedures current.

5.28 The form and content of the documentation of the audit organization’s policies and procedures, as well as its compliance with those policies and procedures, are a matter of professional judgment and will vary based on the audit organization’s circumstances.

5.29 Documentation of policies and procedures, as well as compliance with those policies and procedures, may be either electronic or manual. For example, large audit organizations may use electronic databases to document matters such as independence confirmations, performance evaluations, and the results of monitoring. Smaller audit organizations may use more informal methods in the documentation of their systems of quality control, such as manual notes, checklists, and forms.

5.30 Examples of subjects covered by documented policies and procedures include the following:

- a. communicating to help staff sufficiently understand the objectives of their work and applicable professional standards;
- b. planning and supervising the engagement;
- c. appropriately documenting the work performed;
- d. reviewing the work performed, the significant judgments made, and the resulting audit documentation and report;
- e. reviewing the independence and qualifications of any specialists and the scope and quality of their work;
- f. resolving difficult or contentious issues or disagreements among team members, including specialists;
- g. obtaining and addressing comments from the audited entity on draft reports; and
- h. reporting findings and conclusions supported by the evidence obtained and in accordance with applicable professional standards and legal and regulatory requirements.

5.31 Whether audit documentation is in paper, electronic, or other form, the integrity, accessibility, and retrievability of the underlying information could be compromised if the documentation is altered, added to, or deleted without the auditors' knowledge or if the documentation is lost or damaged.

5.32 Appropriate teamwork and training help less experienced members of the engagement team to clearly understand the objectives of the assigned work.

5.33 Engagement supervision includes the following:

- a. tracking the progress of the engagement;
- b. considering the competence of individual members of the engagement team, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the engagement;
- c. addressing significant findings and issues arising during the engagement, considering their significance, and modifying the planned approach appropriately; and
- d. identifying matters for consultation or consideration by more experienced engagement team members, specialists, or both during the engagement.

5.34 A review of the audit work performed consists of consideration of whether

- a. the work has been performed in accordance with applicable professional standards and legal and regulatory requirements;
- b. significant findings and issues have been raised for further consideration;
- c. appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- d. the nature, timing, and extent of the work performed is appropriate and without need for revision;
- e. the work performed supports the conclusions reached and is appropriately documented;
- f. the evidence obtained is sufficient and appropriate to support the report; and
- g. the objectives of the engagement procedures have been achieved.

5.35 Consultation includes discussion at the appropriate professional level with individuals within or outside the audit organization who have relevant specialized expertise.

5.36 Consultation uses appropriate research resources, as well as the collective experience and technical expertise of the audit organization. Consultation helps promote quality and improves the application of professional judgment. Appropriate recognition of consultation in the audit organization's policies and procedures helps promote a culture in which consultation is recognized as a strength and personnel are encouraged to consult on difficult or contentious issues.

5.37 Effective consultation on significant technical, ethical, and other matters within the audit organization or, when applicable, outside the audit organization can be achieved when

- a. those consulted are given all the relevant facts that will enable them to provide informed advice;
- b. those consulted have appropriate knowledge, authority, and experience; and

- c. conclusions resulting from consultations are appropriately documented and implemented.

5.38 Detailed documentation of consultations with other professionals that involve difficult or contentious matters contributes to an understanding of

- a. the issue on which consultation was sought and
- b. the results of the consultation, including any decisions made, the basis for those decisions, and how they were implemented.

5.39 An audit organization needing to consult externally may take advantage of advisory services provided by the following:

- a. other audit organizations,
- b. professional and regulatory bodies, and
- c. commercial organizations that provide relevant quality control services.

5.40 Before contracting for such services, consideration of the competence and capabilities of the external provider helps the audit organization determine whether the external provider is suitably qualified for that purpose.

5.41 Determining whether and how to communicate the reason for terminating an engagement or changing the audit objectives to those charged with governance, appropriate officials of the audited entity, the entity contracting for or requesting the engagement, and other appropriate officials will depend on the facts and circumstances and therefore is a matter of professional judgment.

Monitoring of Quality

Requirements: Monitoring of Quality

5.42 The audit organization should establish policies and procedures for monitoring its system of quality control.

5.43 The audit organization should perform monitoring procedures that enable it to assess compliance with applicable professional standards and quality control policies and procedures for GAGAS engagements. Individuals performing monitoring should collectively have sufficient expertise and authority.

5.44 The audit organization should analyze and summarize the results of its monitoring process at least annually, with identification of any systemic or repetitive issues needing improvement, along with recommendations for corrective action. The audit organization should communicate to the relevant engagement supervisor, and other appropriate personnel, any deficiencies noted during the monitoring process and make recommendations for appropriate remedial action. This communication should be sufficient to enable the audit organization and appropriate personnel to take prompt corrective action related to deficiencies, when necessary, in accordance with their defined roles and responsibilities. Information communicated should include the following:

- a. a description of the monitoring procedures performed;
- b. the conclusions reached from the monitoring procedures; and

- c. when relevant, a description of systemic, repetitive, or other deficiencies and of the actions taken to resolve those deficiencies.

5.45 The audit organization should evaluate the effects of deficiencies noted during monitoring of the audit organization's system of quality control to determine and implement appropriate actions to address the deficiencies. This evaluation should include assessments to determine if the deficiencies noted indicate that the audit organization's system of quality control is sufficient to provide it with reasonable assurance that it complies with applicable professional standards and legal and regulatory requirements, and that the reports issued by the audit organization are appropriate in the circumstances.

5.46 The audit organization should establish policies and procedures that require retention of engagement documentation for a period of time sufficient to permit those performing monitoring procedures and peer review of the audit organization to evaluate its compliance with its system of quality control or for a longer period if required by law or regulation.

Application Guidance: Monitoring of Quality

5.47 Monitoring of quality is a periodic assessment of work completed on engagements designed to provide management of the audit organization with reasonable assurance that the policies and procedures related to the system of quality control are suitably designed and operating effectively in practice.

5.48 The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of whether the

- a. applicable professional standards and legal and regulatory requirements have been followed,
- b. quality control system has been appropriately designed, and
- c. quality control policies and procedures are operating effectively and are complied with in practice.

5.49 Monitoring procedures will vary based on the audit organization's facts and circumstances.

5.50 Periodic consideration and evaluation of the audit organization's system of quality control may identify circumstances that necessitate changes to, or improve compliance with, the audit organization's policies and procedures to provide the audit organization with reasonable assurance that its system of quality control is effective.

5.51 Periodic consideration and evaluation of the system of quality control may include matters such as the following:

- a. review of selected administrative and personnel records pertaining to the quality control elements;
- b. review of engagement documentation and reports;
- c. discussions with the audit organization's personnel;
- d. determination of corrective actions to be taken and improvements to be made in the system, including providing feedback on the audit organization's policies and procedures relating to education and training;

- e. communication to appropriate audit organization personnel of weaknesses identified in the system, in the level of understanding of the system, or compliance with the system; and
- f. follow-up by appropriate audit organization personnel so that necessary modifications are promptly made to the quality control policies and procedures.

5.52 Monitoring procedures may also include an assessment of the following:

- a. the appropriateness of the audit organization's guidance materials and any practice aids;
- b. new developments in applicable professional standards and legal and regulatory requirements and how they are reflected in the audit organization's policies and procedures, when appropriate;
- c. the effectiveness of staff training;
- d. decisions related to acceptance and continuance of relationships with audited entities and specific engagements; and
- e. audit organization personnel's understanding of the audit organization's quality control policies and procedures and implementation thereof.

5.53 Reviews of the work by engagement team members prior to the date of the report, such as second partner reviews, are not monitoring procedures because it is expected that quality issues identified during such reviews will be addressed prior to the date of the report. Monitoring procedures, by contrast, are performed on completed engagements.

5.54 The need for, and the extent of, inspection procedures depends, in part, on the existence and effectiveness of the other monitoring procedures. The nature of inspection procedures varies based on the audit organization's quality control policies and procedures and the effectiveness and results of other monitoring procedures.

5.55 The inspection of a selection of completed engagements may be performed on a cyclical basis. The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, such as the following:

- a. the size of the audit organization;
- b. the number and geographical location of offices;
- c. the results of previous monitoring procedures;
- d. the degree of authority of both personnel and office (for example, whether individual offices are authorized to conduct their own inspections or whether only the head office may conduct them);
- e. the nature and complexity of the audit organization's practice and structure; and
- f. the risks associated with entities audited by the audit organization and specific engagements.

5.56 The inspection process involves the selection of individual engagements, some of which may be selected without prior notification to the engagement team. In determining the scope of the inspections, the audit organization may take into account the scope or conclusions of a peer review or regulatory inspections.

5.57 Reporting of identified deficiencies to individuals other than the relevant engagement partner or director need not include identifying the specific engagements concerned, unless

such identification is necessary for individuals other than the engagement partner or director to properly discharge their responsibilities.

5.58 Complaints and allegations of noncompliance with the audit organization's system of quality control (which do not include those that are clearly frivolous) may originate from within or outside the audit organization. They may be made by audit organization personnel, audited entities, state boards of accountancy, other regulators, or other third parties. They may be received by engagement team members or other audit organization personnel.

5.59 Policies and procedures established for investigating complaints and allegations may include, for example, that the engagement partner or director supervising the investigation

- a. has sufficient and appropriate experience,
- b. has authority within the audit organization, and
- c. is otherwise not involved in the engagement.

5.60 The engagement partner or director supervising the investigation may involve legal counsel as necessary.

5.61 In the case of audit organizations with few engagement partners or directors, it may not be practicable for the engagement partner or director supervising the investigation not to be involved in the engagement. These small audit organizations and sole practitioners may use the services of a suitably qualified external person or another audit organization to carry out investigations into complaints and allegations.

5.62 Appropriate documentation relating to monitoring may include, for example, the following:

- a. monitoring procedures, including the procedure for selecting completed engagements to be inspected;
- b. a record of the evaluation of the following:
 - (1) adherence to applicable professional standards and legal and regulatory requirements,
 - (2) whether the system of quality control has been appropriately designed and is effectively implemented and operating, and
 - (3) whether the audit organization quality control policies and procedures have been appropriately applied so that the reports that are issued by the audit organization are appropriate in the circumstances; and
- c. identification of the deficiencies noted, an evaluation of their effect, and the basis for determining whether and what further action is necessary.

External Peer Review

General Requirements

Requirements: General Requirements

5.63 Each audit organization conducting engagements in accordance with GAGAS must obtain an external peer review conducted by reviewers independent of the audit organization being reviewed. The peer review should be sufficient in scope to provide a reasonable basis for

determining whether, for the period under review, (1) the reviewed audit organization's system of quality control was suitably designed and (2) the organization is complying with its quality control system so that it has reasonable assurance that it is performing and reporting in conformity with professional standards and applicable legal and regulatory requirements in all material respects.

5.64 Audit organizations affiliated with one of the following recognized organizations should comply with the respective organization's peer review requirements and the requirements listed in the "Additional Requirements for Audit Organizations Affiliated with Recognized Organizations" section (paras. 5.68 through 5.79).

- a. American Institute of Certified Public Accountants
- b. Council of the Inspectors General on Integrity and Efficiency
- c. Association of Local Government Auditors
- d. International Organization of Supreme Audit Institutions
- e. National State Auditors Association

5.65 Any audit organization not affiliated with an organization listed in paragraph 5.64 should meet the minimum GAGAS peer review requirements that follow in the "Requirements for Audit Organizations Not Affiliated with Recognized Organizations" section (paras. 5.80 through 5.113).

Application Guidance: General Requirements

5.66 Audit organizations have discretion in selecting and accepting their peer review teams. Auditors in governments or jurisdictions without access to established peer review programs may engage other auditors, including public accounting firms, to conduct their peer reviews. If access to an established peer review program is not available, auditors may organize regional programs with other auditors.

5.67 In cases of unusual difficulty or hardship, extensions of the deadlines for submitting peer review reports exceeding 3 months beyond the due date may be granted by the entity that administers the peer review program with the concurrence of GAO.

Additional Requirements for Audit Organizations Affiliated with Recognized Organizations

Requirements: Selection of GAGAS Engagements

5.68 The peer review team should select one or more engagements that provide a reasonable cross section of the GAGAS audits performed by the reviewed audit organization.

Application Guidance: Selection of GAGAS Engagements

5.69 A selection approach that provides a cross section of all types of work is generally applicable to audit organizations that conduct a small number of GAGAS engagements in relation to other types of engagements. In these cases, one or more GAGAS engagements may represent more than what would be selected when looking at a cross section of the audit organization's work as a whole. Some audit organizations conduct audit and attestation work in a number of functional areas. For example, an organization may conduct financial audits, attestation engagements, reviews of financial statements, and performance audits. The peer review team may consider reviewing engagements sampled from the major functional areas included within the scope of the review.

Requirements: Peer Review Report Ratings

5.70 The peer review team should use professional judgment in deciding the type of peer review rating to issue. The following are the types of peer review ratings.

- a. Peer review rating of Pass: A conclusion that the audit organization's system of quality control has been suitably designed and complied with to provide the audit organization with reasonable assurance of performing and reporting in conformity with professional standards and applicable legal and regulatory requirements in all material respects.
- b. Peer review rating of Pass with Deficiencies: A conclusion that the audit organization's system of quality control has been suitably designed and complied with to provide the audit organization with reasonable assurance of performing and reporting in conformity with professional standards and applicable legal and regulatory requirements in all material respects with the exception of a certain deficiency or deficiencies described in the report.
- c. Peer review rating of Fail: A conclusion, based on the significant deficiencies described in the report, that the audit organization's system of quality control is not suitably designed to provide the audit organization with reasonable assurance of performing and reporting in conformity with professional standards and applicable legal and regulatory requirements in all material respects, or that the audit organization has not complied with its system of quality control to provide the audit organization with reasonable assurance of performing and reporting in conformity with professional standards and applicable legal and regulatory requirements in all material respects.

5.71 The peer review team should determine the type of peer review rating to issue based on the observed matters' importance to the audit organization's system of quality control as a whole and the nature, causes, patterns, and pervasiveness of those matters. The matters should be assessed both alone and in aggregate.

5.72 The peer review team should aggregate and systematically evaluate any observed matters (circumstances that warrant further consideration by the peer review team) and document their evaluation.²⁹ The peer review team should perform their evaluation and issue report ratings as follows:

²⁹See the flowchart at the end of ch. 5 on developing peer review communications for observed matters in accordance with GAGAS.

- a. If the peer review team’s evaluation of matters does not identify any findings (more than a remote possibility that the reviewed audit organization would not perform, report, or both in conformity with applicable standards), or identifies findings that are not considered to be deficiencies, the peer review team issues a Pass rating.
- b. If the peer review team’s evaluation of findings identified deficiencies but did not identify any significant deficiencies, the peer review team issues a Pass with Deficiencies rating and communicates the deficiencies in its report.
- c. If the peer review team’s evaluation of deficiencies identified significant deficiencies, the peer review team issues a Fail rating and communicates the deficiencies and significant deficiencies in its report.

Application Guidance: Peer Review Report Ratings

5.73 Deficiencies are findings that because of their nature, causes, pattern, or pervasiveness, including their relative importance to the audit organization’s system of quality control taken as a whole, could create a situation in which the audit organization would not have reasonable assurance of performing, reporting, or both in conformity with standards in one or more important respects.

5.74 Significant deficiencies are one or more deficiencies that the peer reviewer concludes result from a condition in the audit organization’s system of quality control or compliance with that system such that the system taken as a whole does not provide reasonable assurance of performing, reporting, or both in conformity with standards.

Requirements: Availability of the Peer Review Report to the Public

5.75 An external audit organization should make its most recent peer review report publicly available. If a separate communication detailing findings, conclusions, and recommendations is issued, the external audit organization is not required to make that communication publicly available. An internal audit organization that reports internally to management and those charged with governance should provide a copy of its peer review report to those charged with governance.

5.76 An audit organization should satisfy the publication requirement for its peer review report by posting the report on a publicly available website or to a publicly available file. Alternatively, if neither of these options is available, then the audit organization should use the same mechanism it uses to make other reports or documents public.

5.77 Because information in peer review reports may be relevant to decisions on procuring audit services, an audit organization seeking to enter into a contract to conduct a performance audit in accordance with GAGAS should provide the following to the party contracting for such services when requested:

- a. the audit organization’s most recent peer review report and
- b. any subsequent peer review reports received during the period of the contract.

5.78 Auditors who are using another audit organization's work should request a copy of that organization's most recent peer review report, and the organization should provide this document when it is requested.

Application Guidance: Availability of the Peer Review Report to the Public

5.79 To help the public understand the peer review reports, an audit organization may include a description of the peer review process and how it applies to its organization. Examples of additional information that audit organizations may include to help users understand the meaning of the peer review report follow:

- a. Explanation of the peer review process.
- b. Description of the audit organization's system of quality control.
- c. Explanation of the relationship of the peer review results to the audited organization's work.
- d. If a peer review report is issued with a rating of Pass with Deficiencies or Fail, explanation of the reviewed audit organization's plan for improving quality controls and the status of the improvements.

Requirements for Audit Organizations Not Affiliated with Recognized Organizations

Requirement: Peer Review Scope

5.80 The peer review team should include the following elements in the scope of the peer review:

- a. review of the audit organization's design of, and compliance with, quality control and related policies and procedures;
- b. consideration of the adequacy and results of the audit organization's internal monitoring procedures;
- c. review of selected audit reports and related documentation and, if applicable, documentation related to selected terminated engagements prepared in accordance with paragraph 5.25, if any terminated engagements are selected from the universe of engagements used for the peer review sample;
- d. review of prior peer review reports, if applicable;
- e. review of other documents necessary for assessing compliance with standards, for example, independence documentation, CPE records, and relevant human resource management files; and
- f. interviews with selected members of the audit organization's staff in various roles to assess their understanding of and compliance with relevant quality control policies and procedures.

Application Guidance: Peer Review Scope

5.81 Review of documentation related to terminated engagements can provide information on the audit organization's response to threats to independence. For example, the documentation may include information on whether an engagement was terminated as a result of an undue influence from outside the audit organization.

Requirements: Peer Review Intervals

5.82 An audit organization not already subject to a peer review requirement should obtain its first peer review covering a review period ending no later than 3 years from the date an audit organization begins its first engagement in accordance with GAGAS. For subsequent peer reviews, the audit organization should obtain a peer review report dated not later than 3 years and 6 months from the year-end of the previous peer review.

Application Guidance: Peer Review Intervals

5.83 The period under review in a peer review generally covers 1 year.

Requirement: Written Agreement for Peer Review

5.84 The peer review team and the reviewed audit organization should incorporate their basic agreement on the peer review into a written agreement. The written agreement should be drafted by the peer review team, reviewed by the reviewed audit organization to ensure that it accurately describes the agreement between the parties, and signed by the authorized representatives of both the peer review team and the reviewed audit organization prior to the initiation of work under the agreement. The written agreement should state that the peer review will be conducted in accordance with GAGAS.

Application Guidance: Written Agreement for Peer Review

5.85 The written agreement is meant to ensure mutual consent on the fundamental aspects of the peer review and to avoid any potential misunderstandings. The written agreement may address the following:

- a. scope of the peer review;
- b. staffing and time frame;
- c. compensation for conducting the peer review, if applicable;
- d. preliminary findings, if applicable;
- e. reporting results;
- f. administrative matters; and
- g. access to audit documentation.

5.86 The peer review team is responsible for ensuring that the peer review is conducted in accordance with GAGAS peer review requirements.

Requirement: Peer Review Team

5.87 The peer review team should meet the following criteria:

- a. The review team collectively has adequate professional competence and knowledge of GAGAS and government auditing.
- b. Team leadership possesses sufficient expertise and reports to an individual whose position in the reviewing audit organization will ensure the team's independence and objectivity in conducting the peer review. Team leadership also ensures the proper supervision of the peer review team members.
- c. The organization conducting the peer review and individual review team members are independent (as defined in GAGAS) of the audit organization being reviewed, its staff, and the engagements selected for the peer review.
- d. The review team collectively has sufficient knowledge of how to perform a peer review.
- e. The peer review team is adequately staffed to complete the review within the time frame specified in the written agreement.

Application Guidance: Peer Review Team

5.88 Peer review knowledge and professional competence 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.

5.89 The number of staff assigned to the peer review team depends on several factors, including the size and geographic dispersion of the reviewed audit organization and the nature and extent of its engagements.

5.90 Other factors that may be considered in selecting peer review team members include the types and complexity of GAGAS engagements selected for review and any specialized skills or experience that may be needed. Examples of team members with such skills or experience may include

- a. information technology specialists,
- b. statisticians,
- c. auditors with experience auditing entities similar to those audited by the audit organization under review, and
- d. individuals with specialized knowledge of government programs or policy.

Requirement: Follow-up on Prior Peer Review

5.91 The peer review team should follow up on the status of any prior peer review recommendations linked to a deficiency and assess the effectiveness of corrective actions implemented by the reviewed audit organization in response to the prior peer review recommendations.

Requirements: Assessment of Peer Review Risk

5.92 The peer review team should perform an assessment of peer review risk to help determine the number and types of engagements to select for review.

5.93 Based on the risk assessment, the peer review team should select engagements that provide a reasonable cross section of all types of work subject to the reviewed audit organization's quality control system, including one or more engagements conducted in accordance with GAGAS. In using this approach, the peer review team should select engagements for review with emphasis on those with higher assessed levels of peer review risk.

Application Guidance: Assessment of Peer Review Risk

5.94 Peer review risk is the risk that the review team

- a. fails to identify significant weaknesses in the reviewed audit organization's system of quality control for its auditing practice, its lack of compliance with that system, or a combination thereof;
- b. issues an inappropriate opinion on the reviewed audit organization's system of quality control for its auditing practice, its compliance with that system, or a combination thereof; or
- c. makes an inappropriate decision about the matters to be included in, or excluded from, the peer review report.

5.95 A selection approach that provides a cross section of all types of work is generally applicable to audit organizations that conduct a small number of GAGAS engagements in relation to other types of engagements. In these cases, one or more GAGAS engagements may represent more than what would be selected when looking at a cross section of the audit organization's work as a whole. Some audit organizations conduct audit and attestation work in a number of functional areas. For example, an organization may conduct financial audits, attestation engagements, reviews of financial statements, and performance audits. The peer review team may consider reviewing a sample of engagements from each of the major functional areas included within the scope of the review.

5.96 A peer review is designed to test a reasonable cross section of an audit organization's engagements focusing on those engagements with higher assessed levels of peer review risk. In addition, a peer review is designed to test significant risk areas where it is possible that engagements are not being conducted, reported on, or both in conformity with professional standards and applicable legal and regulatory requirements in all material respects. A peer review is not designed to test every engagement, compliance with every professional standard, or every detailed component of the audit organization's system of quality control.

5.97 Examples of the factors to consider when performing an assessment of peer review risk for selecting engagements for peer review include

- a. scope of the engagements, including size of the audited entity or engagements covering multiple locations;
- b. functional area or type of government program;
- c. types of engagements provided, including the extent of nonaudit services provided to audited entities;

- d. personnel (including use of new personnel or personnel not routinely assigned the types of engagements provided);
- e. initial engagements;
- f. familiarity resulting from a long-standing relationship with the audited entity;
- g. political sensitivity of the engagements;
- h. budget constraints faced by the audit organization that could negatively affect audit quality;
- i. results of the peer review team's review of the design of system of quality control;
- j. results of the audit organization's monitoring process; and
- k. overall risk tolerance within the audit organization that could negatively affect audit quality.

Requirements: Peer Review Report Ratings

5.98 The peer review team should use professional judgment in deciding the type of peer review rating to issue. The following are the types of peer review ratings.

- a. Peer review rating of Pass: A conclusion that the audit organization's system of quality control has been suitably designed and complied with to provide the audit organization with reasonable assurance of performing and reporting in conformity with professional standards and applicable legal and regulatory requirements in all material respects.
- b. Peer review rating of Pass with Deficiencies: A conclusion that the audit organization's system of quality control has been suitably designed and complied with to provide the audit organization with reasonable assurance of performing and reporting in conformity with professional standards and applicable legal and regulatory requirements in all material respects with the exception of a certain deficiency or deficiencies described in the report.
- c. Peer review rating of Fail: A conclusion, based on the significant deficiencies described in the report, that the audit organization's system of quality control is not suitably designed to provide the audit organization with reasonable assurance of performing and reporting in conformity with professional standards and applicable legal and regulatory requirements in all material respects, or that the audit organization has not complied with its system of quality control to provide the audit organization with reasonable assurance of performing and reporting in conformity with professional standards and applicable legal and regulatory requirements in all material respects.

5.99 The peer review team should determine the type of peer review rating to issue based on the observed matters' importance to the audit organization's system of quality control as a whole and the nature, causes, patterns, and pervasiveness of those matters. The matters should be assessed both alone and in aggregate.

5.100 The peer review team should aggregate and systematically evaluate any observed matters (circumstances that warrant further consideration by the peer review team) and

document their evaluation.³⁰ The peer review team should perform their evaluation and issue report ratings as follows:

- a. If the peer review team's evaluation of matters does not identify any findings (more than a remote possibility that the reviewed audit organization would not perform, report, or both in conformity with applicable standards), or identifies findings that are not considered to be deficiencies, the peer review team issues a Pass rating.
- b. If the peer review team's evaluation of findings identified deficiencies but did not identify any significant deficiencies, the peer review team issues a Pass with Deficiencies rating and communicates the deficiencies in its report.
- c. If the peer review team's evaluation of deficiencies identified significant deficiencies, the peer review team issues a Fail rating and communicates the deficiencies and significant deficiencies in its report.

Application Guidance: Peer Review Report Ratings

5.101 Deficiencies are findings that because of their nature, causes, pattern, or pervasiveness, including their relative importance to the audit organization's system of quality control taken as a whole, could create a situation in which the audit organization would not have reasonable assurance of performing, reporting, or both in conformity with standards in one or more important respects.

5.102 Significant deficiencies are one or more deficiencies that the peer reviewer concludes result from a condition in the audit organization's system of quality control or compliance with that system such that the system taken as a whole does not provide reasonable assurance of performing, reporting, or both in conformity with standards.

Requirement: Report Content

5.103 The peer review team should prepare one or more written reports communicating the results of the peer review, which collectively include the following elements:

- a. a description of the scope of the peer review, including any limitations;
- b. a rating concluding on whether the system of quality control of the reviewed audit organization was adequately designed and complied with during the period reviewed and would provide the audit organization with reasonable assurance that it conformed to professional standards and applicable legal and regulatory requirements;
- c. specification of the professional standards and applicable legal and regulatory requirements to which the reviewed audit organization is being held;
- d. reference to a separate written communication, if issued under the peer review program;
- e. a statement that the peer review was conducted in accordance with GAGAS peer review requirements; and

³⁰See the flowchart at the end of ch. 5 on developing peer review communications for observed matters in accordance with GAGAS.

- f. a detailed description of the findings, conclusions, and recommendations related to any deficiencies or significant deficiencies identified in the review.

Application Guidance: Report Content

5.104 When the scope of the peer review is limited by conditions that preclude the application of one or more peer review procedures considered necessary in the circumstances and the peer review team cannot accomplish the objectives of those procedures through alternative procedures, the report can be modified by including a statement in the report's scope paragraph, body, and opinion paragraph. The statement describes the relationship of the excluded engagement(s) or functional area(s) to the reviewed audit organization's full scope of practice as a whole and system of quality control and the effects of the exclusion on the scope and results of the review.

5.105 An example of a possible scope limitation is the reviewed audit organization's loss of audit documentation for a significant number of its engagements completed during the review period caused by a natural disaster or other event.

Requirements: Audit Organization's Response to the Peer Review Report

5.106 If the reviewed audit organization receives a report with a peer review rating of Pass with Deficiencies or Fail, the reviewed audit organization should respond in writing to the deficiencies or significant deficiencies and related recommendations identified in the report.

5.107 With respect to each deficiency or significant deficiency in the report, the reviewed audit organization should describe in its letter of response the corrective actions already taken, target dates for planned corrective actions, or both, or why the organization does not believe corrective action is necessary.

Application Guidance: Audit Organization's Response to the Peer Review Report

5.108 If the reviewed audit organization receives a report with a peer review rating of Pass, a letter of response is not applicable.

Requirements: Availability of the Peer Review Report to the Public

5.109 An external audit organization should make its most recent peer review report publicly available. If a separate communication detailing findings, conclusions, and recommendations is issued, the external audit organization is not required to make that communication publicly available. An internal audit organization that reports internally to management and those charged with governance should provide a copy of its peer review report to those charged with governance.

5.110 An audit organization should satisfy the publication requirement for its peer review report by posting the report on a publicly available website or to a publicly available file. Alternatively, if neither of these options is available, then the audit organization should use the same mechanism it uses to make other reports or documents public.

5.111 Because information in peer review reports may be relevant to decisions on procuring audit services, an audit organization seeking to enter into a contract to conduct a performance audit in accordance with GAGAS should provide the following to the party contracting for such services when requested:

- a. the audit organization's most recent peer review report and
- b. any subsequent peer review reports received during the period of the contract.

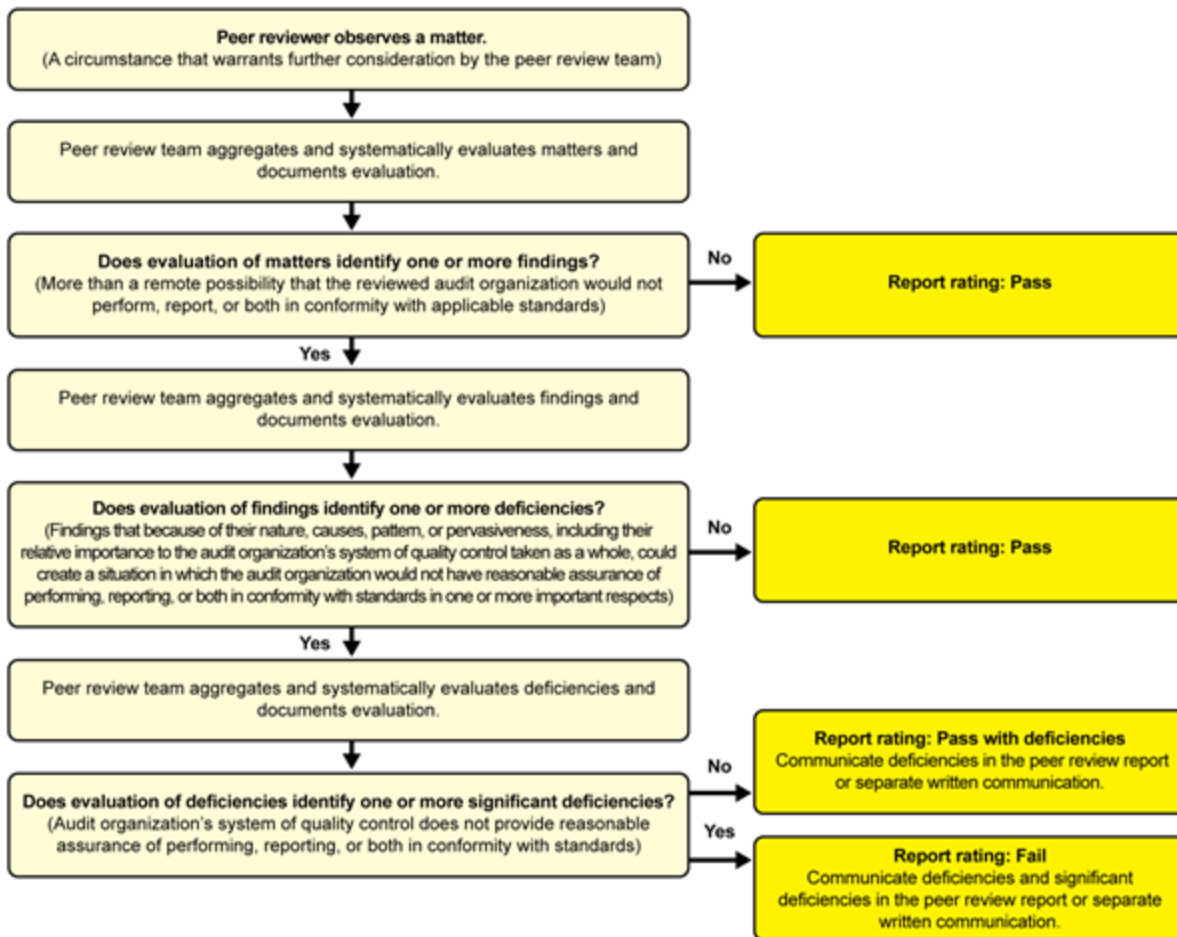
5.112 Auditors who are using another audit organization's work should request a copy of that organization's most recent peer review report, and the organization should provide this document when it is requested.

Application Guidance: Availability of the Peer Review Report to the Public

5.113 To help the public understand the peer review reports, an audit organization may include a description of the peer review process and how it applies to its organization. Examples of additional information that audit organizations may include to help users understand the meaning of the peer review report follow:

- a. Explanation of the peer review process.
- b. Description of the audit organization's system of quality control.
- c. Explanation of the relationship of the peer review results to the audited organization's work.
- d. If a peer review report is issued with a rating of Pass with Deficiencies or Fail, explanation of the reviewed audit organization's plan for improving quality controls and the status of the improvements.

Figure 2: Developing Peer Review Communications for Observed Matters in Accordance with Generally Accepted Government Auditing Standards



Chapter 6: Standards for Financial Audits

6.01 This chapter contains requirements and guidance for performing and reporting on financial audits conducted in accordance with GAGAS. GAGAS incorporates by reference the American Institute of Certified Public Accountants' (AICPA) Statements on Auditing Standards (SAS).³¹ All sections of the SAS are incorporated, including the introduction, objectives, definitions, requirements, and application material. However, GAGAS does not incorporate the AICPA Code of Conduct by reference, but recognizes that certain certified public accountants (CPA) may use or may be required to use the code in conjunction with GAGAS.³² For financial audits conducted in accordance with GAGAS, the requirements and guidance in the incorporated SAS and this chapter apply. The requirements and guidance contained in chapters 1 through 5 also apply.

Additional GAGAS Requirements for Conducting Financial Audits

Requirement: Compliance with Standards

6.02 GAGAS establishes requirements for financial audits in addition to the requirements in the AICPA SAS. Auditors should comply with these additional requirements, along with the AICPA requirements for financial audits, when citing GAGAS in financial audit reports.

Application Guidance: Compliance with Standards

6.03 Standards used in conjunction with GAGAS require the auditors to apply the concept of materiality appropriately in planning and conducting the audit. Additional considerations may apply to GAGAS engagements that concern government entities or entities that receive government awards. For example, for engagements conducted in accordance with GAGAS, auditors may find it appropriate to use lower materiality levels than those used in non-GAGAS audits because of the public accountability of government entities and entities receiving government funding, various legal and regulatory requirements, and the visibility and sensitivity of government programs.

Requirements: Licensing and Certification

6.04 Auditors engaged to conduct financial audits in the United States who do not work for a government audit organization should be licensed CPAs, persons working for a licensed certified public accounting firm, or licensed accountants in states that have multiclass licensing systems that recognize licensed accountants other than CPAs.

6.05 Auditors engaged to conduct financial audits of entities operating outside of the United States should meet the qualifications indicated in the previous paragraph or

³¹ See para. 2.12 and the AICPA *Codification of Statements on Auditing Standards (AU-C)* for additional discussion of the relationship between GAGAS and other professional standards.

³² See para. 2.13 for a discussion of the AICPA Code of Conduct.

- a. have certifications that meet all applicable national and international standards and serve in their respective countries as the functional equivalent of CPAs in the United States,
- b. work for a nongovernment audit organization that meets the organizational requirements of paragraph 6.04, or
- c. work for a government audit organization.

Requirements: Auditor Communication

6.06 If the law or regulation requiring an audit specifically identifies the entities to be audited, auditors should communicate pertinent information that in the auditors' professional judgment needs to be communicated both to individuals contracting for or requesting the audit and to those legislative committees, if any, that have ongoing oversight responsibilities for the audited entity.

6.07 If the identity of those charged with governance is not clearly evident, auditors should document the process followed and conclusions reached in identifying the appropriate individuals to receive the required auditor communications.

Application Guidance: Auditor Communication

6.08 One example of a law or regulation requiring an audit that does not specifically identify the entities to be audited is the Single Audit Act Amendments of 1996.

6.09 For some matters, early communication to management or those charged with governance may be important because of the relative significance and the urgency for corrective follow-up action. Further, early communication is important to allow management to take prompt corrective action when a control deficiency results in potential instances of the following: noncompliance with provisions of laws, regulations, contracts, and grant agreements or fraud, waste, or abuse. When a deficiency is communicated early, the reporting requirements and application guidance in paragraphs 6.34 through 6.44 still apply.

Requirement: Results of Previous Audits

6.10 When planning the audit, auditors should ask management of the audited entity to identify previous audits, attestation engagements, and other studies that directly relate to the objectives of the audit, including whether related recommendations have been implemented. Auditors should evaluate whether the audited entity has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a significant effect on the subject matter. Auditors should use this information in assessing risk and determining the nature, timing, and extent of current audit work and determining the extent to which testing the implementation of the corrective actions is applicable to the current audit objectives.

Requirement: Investigations or Legal Proceedings

6.11 Auditors should inquire of management of the audited entity whether any investigations or legal proceedings have been initiated or are in process with respect to the period under audit, and should evaluate the effect of initiated or in-process investigations or legal proceedings on the current audit.

Application Guidance: Investigations or Legal Proceedings

6.12 Laws, regulations, or policies may require auditors to report indications of certain types of fraud; noncompliance with provisions of laws, regulations, contracts, and grant agreements; or waste or abuse to law enforcement or investigatory authorities before performing additional audit procedures.

6.13 Avoiding interference with investigations or legal proceedings is important in pursuing indications of fraud; noncompliance with provisions of laws, regulations, contracts, and grant agreements; or waste or abuse. In some cases, it may be appropriate for the auditors to work with investigators or legal authorities, or withdraw from or defer further work on the engagement or a portion of the engagement to avoid interfering with an ongoing investigation or legal proceeding.

Requirement: Noncompliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements

6.14 Auditors should extend the AICPA requirements concerning consideration of noncompliance with laws and regulations to include consideration of noncompliance with provisions of contracts and grant agreements.³³

Application Guidance: Noncompliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements

6.15 Government programs are subject to provisions of many laws, regulations, contracts, and grant agreements. At the same time, these provisions' significance within the context of the audit objectives varies widely, depending on the objectives of the audit. Auditors may consult with their own 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, and (3) evaluate the results of those tests. Auditors also may consult with their own 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 professional services to the audited entity, or applicable law enforcement authorities, to obtain information on compliance matters.

Requirement: Waste and Abuse

6.16 As part of a GAGAS audit, if auditors become aware of waste or abuse that could be quantitatively or qualitatively material to the financial statements or other financial data significant to the audit objectives, auditors should perform audit procedures to ascertain the potential effect on the financial statements or other financial data significant to the audit objectives. Also, if auditors become aware of waste or abuse that could be significant to the entity's operations, they should consider the potential effect on the entity's operations.

³³See AICPA AU-C sec. 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.

Application Guidance: Waste and Abuse

6.17 Waste is the act of using or expending resources carelessly, extravagantly, or to no purpose. Waste involves the taxpayers not receiving reasonable value for money in connection with any government-funded activities because of an inappropriate act or omission by parties with control over or access to government resources. Importantly, waste can include activities that do not include abuse and does not necessarily involve a violation of law. Rather, waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight.

6.18 Abuse is 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, but excludes fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Because the determination of abuse is subjective, auditors are not required to perform procedures to detect abuse in financial audits. Auditors may discover that abuse is indicative of fraud or noncompliance with provisions of laws, regulations, contracts, and grant agreements.

Requirements: Findings

6.19 When auditors identify findings, auditors should plan and perform procedures to develop the criteria, condition, cause, and effect of the findings to the extent that these elements are relevant and necessary to achieve the audit objectives.

6.20 Auditors should consider potential internal control deficiencies in their evaluation of identified findings when developing the cause element of the identified findings when significant to the audit objectives.

Application Guidance: Findings

6.21 Findings may involve deficiencies in internal control; noncompliance with provisions of laws, regulations, contracts, and grant agreements; or instances of fraud, waste, or abuse.

6.22 Criteria: For inclusion in findings, criteria may include the laws, regulations, contracts, grant agreements, standards, measures, expected performance, defined business practices, and benchmarks against which performance is compared or evaluated. Criteria identify the required or desired state or expectation with respect to the program or operation. Criteria provide a context for evaluating evidence and understanding the findings. In a financial audit, the applicable financial reporting framework, such as generally accepted accounting principles, represents one set of criteria.

6.23 Condition: Condition is a situation that exists. The condition is determined and documented during the audit.

6.24 Cause: The cause is the factor or factors responsible for the difference between the condition and the criteria, which may also serve as a basis for recommendations for corrective actions. Common factors include poorly designed policies, procedures, or criteria; inconsistent, incomplete, or incorrect implementation; or factors beyond the control of program management. Auditors may assess whether the evidence provides a reasonable and convincing argument for

why the stated cause is the key factor contributing to the difference between the condition and the criteria.

6.25 Effect or potential effect: The effect or potential effect is the outcome or consequence resulting from the difference between the condition and the criteria. When the audit 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. Effect or potential effect may be used to demonstrate the need for corrective action in response to identified problems or relevant risks.

6.26 Regardless of the type of finding identified, the cause of a finding may relate to an underlying internal control deficiency. Depending on the magnitude of impact, likelihood of occurrence, and nature of the deficiency, the deficiency could be a significant deficiency or material weakness in a financial audit.³⁴

6.27 Considering internal control in the context of a comprehensive internal control framework, such as *Standards for Internal Control in the Federal Government* or *Internal Control—Integrated Framework*,³⁵ can help auditors to determine whether potential underlying internal control deficiencies exist as the root cause of findings. Identifying these deficiencies can help provide the basis for developing meaningful recommendations for corrective actions.

Requirement: Audit Documentation

6.28 Auditors should comply with the following requirements when conducting a GAGAS audit.

- a. Document supervisory review, before the report release date, of the evidence that supports the findings, conclusions, and recommendations contained in the audit report.
- b. Document any departures from the GAGAS requirements and the effect on the audit and on the auditors' conclusions when the audit is not in compliance with applicable GAGAS requirements because of law, regulation, scope limitations, restrictions on access to records, or other issues affecting the audit.

Application Guidance: Audit Documentation

6.29 When documenting departures from the GAGAS requirements, the audit documentation requirements apply to departures from unconditional requirements and from presumptively mandatory requirements when alternative procedures performed in the circumstances were not sufficient to achieve the objectives of the requirements.

³⁴See AICPA AU-C sec. 265, *Communicating Internal Control Related Matters Identified in an Audit*.

³⁵SAS 130 para. A16 indicates that the Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control—Integrated Framework* and *Standards for Internal Control in the Federal Government* (GAO-14-704G) provide suitable and available criteria against which management may evaluate and report on the effectiveness of the entity's internal control over financial reporting. *Standards for Internal Control in the Federal Government* may be adopted by entities beyond those federal entities for which it is legally required, such as state, local, and quasi-governmental entities, as well as other federal entities and not-for-profit organizations, as a framework for an internal control system.

Requirement: Availability of Individuals and Documentation

6.30 Subject to applicable provisions of laws and regulations, auditors should make appropriate individuals, as well as audit documentation, available upon request and in a timely manner to other auditors or reviewers.

Application Guidance: Availability of Individuals and Documentation

6.31 Underlying GAGAS audits is the premise that audit organizations in federal, state, and local governments and public accounting firms engaged to conduct financial audits in accordance with GAGAS cooperate in auditing programs of common interest so that auditors may use others' work and avoid duplication of efforts. The use of auditors' work by other auditors may be facilitated by contractual arrangements for GAGAS audits that provide for full and timely access to appropriate individuals and to audit documentation.

Additional GAGAS Requirements for Reporting on Financial Audits

Requirement: Reporting the Auditors' Compliance with GAGAS

6.32 When auditors comply with all applicable GAGAS requirements, they should include a statement in the audit report that they conducted the audit in accordance with GAGAS.

Application Guidance: Reporting the Auditors' Compliance with GAGAS

6.33 Because GAGAS incorporates by reference the AICPA's financial audit standards, GAGAS does not require auditors to cite compliance with the AICPA standards when citing compliance with GAGAS. GAGAS does not prohibit auditors from issuing a separate report conforming only to the requirements of the AICPA or other standards.

Requirements: Reporting on Internal Control; Compliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements; and Instances of Fraud, Waste, or Abuse

6.34 When providing an opinion or a disclaimer on financial statements, auditors should also report as findings any significant deficiencies or material weaknesses in internal control over financial reporting.

6.35 When auditors are conducting a GAGAS financial audit and conclude, based on sufficient, appropriate evidence, that any of the following has occurred, they should include in their report on internal control or compliance the relevant information about

- a. noncompliance with provisions of laws, regulations, contracts, or grant agreements that has a material effect on the financial statements or other financial data significant to the audit objectives;
- b. fraud that is material, either quantitatively or qualitatively, to the financial statements or other financial data significant to the audit objectives; or

- c. waste or abuse that is material, either quantitatively or qualitatively, to the financial statements or to other financial data that are significant to the audit objectives or to the entity's operations.

6.36 Auditors should report on internal control and compliance with provisions of laws, regulations, contracts, or grant agreements regardless of whether they identify internal control deficiencies or instances of noncompliance.

6.37 Auditors should include either in the same or in separate report(s) a description of the scope of the auditors' testing of internal control over financial reporting and of compliance with provisions of laws, regulations, contracts, and grant agreements. Auditors should also state in the report(s) whether the tests they performed provided sufficient, appropriate evidence to support opinions on the effectiveness of internal control and on compliance with provisions of laws, regulations, contracts, and grant agreements.

6.38 If auditors report separately (including separate reports bound in the same document) on internal control over financial reporting and on compliance with provisions of laws, regulations, contracts, and grant agreements, they should include a reference in the audit report on the financial statements to those additional reports. They should also state in the audit report that the reports on internal control over financial reporting and on compliance with provisions of laws, regulations, contracts, and grant agreements are an integral part of a GAGAS audit in considering the audited entity's internal control over financial reporting and compliance. If separate reports are used, the auditors should make the report on internal control and compliance available to users in the same manner as the financial audit report to which it relates.

6.39 Auditors should communicate findings in writing to audited entity officials when they detect potential instances of noncompliance with provisions of laws, regulations, contracts, or grant agreements or fraud, waste, or abuse that have an effect on the financial statements or other financial data significant to the audit objectives that are less than material but warrant the attention of those charged with governance.

Application Guidance: Reporting on Internal Control; Compliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements; and Instances of Fraud, Waste, or Abuse

6.40 Internal control plays an expanded role in the government sector. Given the government's accountability for public resources, assessing internal control in a government environment may involve consideration of controls that would not be required in the private sector. In the government sector, evaluating controls that are relevant to the audit involves understanding significant controls that the audited entity designed, implemented, and operated as part of its responsibility for oversight of public resources.

6.41 The audit report on internal control and compliance with provisions of laws, regulations, contracts, and grant agreements relates only to the most recent reporting period included, when comparative financial statements are presented.

6.42 The GAGAS requirement to report on internal control over financial reporting is based on the AICPA requirements to communicate in writing to those charged with governance significant deficiencies and material weaknesses in internal control over financial reporting identified during an audit. The objective of the GAGAS internal control reporting requirement for financial audits

is to increase the availability of information on significant deficiencies and material weaknesses to users of financial statements other than those charged with governance.

6.43 When auditors detect any potential instances of noncompliance with provisions of laws, regulations, contracts, or grant agreements or fraud, waste, or abuse that do not warrant the attention of those charged with governance, the auditors' determination of whether and how to communicate such instances to audited entity officials is a matter of professional judgment.

6.44 When noncompliance with provisions of laws, regulations, contracts, or grant agreements or instances of fraud, waste, or abuse have occurred, auditors may consult with authorities or legal counsel about whether publicly reporting such information would compromise investigative or legal proceedings. Auditors may limit their public reporting to matters that would not compromise those proceedings and, for example, report only on information that is already a part of the public record.

Requirements: Presenting Findings in the Audit Report

6.45 When presenting findings, auditors should develop the elements of the findings to the extent necessary to assist management or oversight officials of the audited entity in understanding the need for corrective action.

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

Application Guidance: Presenting Findings in the Audit Report

6.47 Along with assisting management or oversight officials of the audited entity in understanding the need for corrective action, clearly developed findings assist auditors in making recommendations for corrective action. If auditors sufficiently develop the elements of a finding, they may provide recommendations for corrective action.

Requirements: Reporting Findings Directly to Parties outside the Audited Entity

6.48 Auditors should report noncompliance with provisions of laws, regulations, contracts, and grant agreements and instances of fraud, waste, or abuse directly to parties outside the audited entity in the following two circumstances.

- a. When audited entity management fails to satisfy legal or regulatory requirements to report such information to external parties specified in law or regulation, auditors should first communicate the failure to report such information to those charged with governance. If the audited entity still does not report this information to the specified external parties as soon as practicable after the auditors' communication with those charged with governance, then the auditors should report the information directly to the specified external parties.

- b.** When audited entity management fails to take timely and appropriate steps to respond to fraud; noncompliance with provisions of laws, regulations, contracts, and grant agreements; or instances of waste or abuse that (1) are likely to have a material effect on the subject matter and (2) involve funding received directly or indirectly from a government agency, auditors should first report management's failure to take timely and appropriate steps to those charged with governance. If the audited entity still does not take timely and appropriate steps as soon as practicable after the auditors' communication with those charged with governance, then the auditors should report the audited entity's failure to take timely and appropriate steps directly to the funding agency.

6.49 Auditors should comply with the requirements in paragraph 6.48 even if they have resigned or been dismissed from the audit prior to its completion.

6.50 Auditors should obtain sufficient, appropriate evidence, such as confirmation from outside parties, to corroborate representations by management of the audited entity that it has reported audit findings in accordance with provisions of laws, regulations, or funding agreements. When auditors are unable to do so, they should report such information directly as discussed in paragraphs 6.48 and 6.49.

Application Guidance: Reporting to Findings Directly to Parties outside the Entity

6.51 The reporting in paragraph 6.48 is in addition to any legal requirements to report such information directly to parties outside the audited entity.

Requirements: Obtaining and Reporting the Views of Responsible Officials

6.52 Auditors should obtain and report the views of responsible officials of the audited entity concerning the findings, conclusions, and recommendations included in the audit report, as well as any planned corrective actions.

6.53 When auditors receive written comments from the responsible officials, they should include in their report a copy of the officials' written comments or a summary of the comments received. When the responsible officials provide oral comments only, auditors should prepare a summary of the oral comments, provide a copy of the summary to the responsible officials to verify that the comments are accurately represented, and include the summary in their report.

6.54 Auditors should include in the report an evaluation of the comments, as appropriate.

6.55 When the audited entity's comments are inconsistent or in conflict with the findings, conclusions, or recommendations in the draft report, 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 explain in the report their reasons for disagreement. Conversely, the auditors should modify their report as necessary if they find the comments valid and supported by sufficient, appropriate evidence.

6.56 If the audited entity refuses to provide comments or is unable to provide comments within a reasonable period of time, the auditors should issue the report without receiving comments from the audited entity. In such cases, the auditors should indicate in the report that the audited entity did not provide comments.

Application Guidance: Obtaining and Reporting the Views of Responsible Officials

6.57 Providing a draft report with findings for review and comment by responsible officials of the audited entity and others helps the auditors develop a report that is fair, complete, and objective. 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. Obtaining the comments in writing is preferred, but oral comments are acceptable. In cases in which the audited entity provides technical comments in addition to its written or oral comments on the report, auditors may disclose in the report that such comments were received.

6.58 Obtaining oral comments may be appropriate when, for example, there is a reporting date critical to meeting a user's needs; auditors have worked closely with the responsible officials throughout 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 findings, conclusions, or recommendations in the draft report or major controversies with regard to the issues discussed in the draft report.

Requirements: Reporting Confidential or Sensitive Information

6.59 If certain information is prohibited from public disclosure or is excluded from a report because of its confidential or sensitive nature, auditors should disclose in the report that certain information has been omitted and the circumstances that make the omission necessary.

6.60 When circumstances call for omission of certain information from the report, auditors should evaluate whether this omission could distort the audit results or conceal improper or illegal practices and revise the report language as necessary to minimize the risk that report users will draw inappropriate conclusions from the information presented.

6.61 When audit organizations are subject to public records laws, auditors should determine whether public records laws could affect the availability of classified or limited use reports and determine whether other means of communicating with management and those charged with governance would be more appropriate. Auditors use judgment to determine the appropriate means to communicate the omitted information to management and those charged with governance considering, among other things, whether public records laws could affect the availability of classified or limited use reports.

Application Guidance: Reporting Confidential or Sensitive Information

6.62 If the report refers to the omitted information, the reference may be general and not specific. If the omitted information is not necessary to meet the audit objectives, the report need not refer to its omission.

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

6.64 Additional circumstances associated with public safety, privacy, or security concerns could also justify the exclusion of certain information from a publicly available or widely distributed

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 misuse of this information could cause. In such circumstances, auditors may issue a limited use report containing such information and distribute the report only to those parties responsible for acting on the auditors' recommendations. In some instances, it may be appropriate to issue both a publicly available report with the sensitive information excluded and a limited use report. The auditors may consult with legal counsel regarding any requirements or other circumstances that may necessitate omitting certain information. Considering the broad public interest in the program or activity under audit assists auditors when deciding whether to exclude certain information from publicly available reports.

6.65 In cases described in paragraph 6.61, the auditors may communicate general information in a written report and communicate detailed information orally. The auditors may consult with legal counsel regarding applicable public records laws.

Requirements: Distributing Reports

6.66 Distribution of reports completed in accordance with GAGAS depends on the auditors' relationship with the audited entity and the nature of the information contained in the reports. Auditors should document any limitation on report distribution.

- a.** Audit organizations in government entities should distribute audit reports to those charged with governance, to the appropriate audited entity officials, and to the appropriate oversight bodies or organizations requiring or arranging for the audits. As appropriate, auditors should also distribute 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.
- b.** A public accounting firm contracted to conduct an audit in accordance with GAGAS should clarify report distribution responsibilities with the engaging party. If the contracting firm is responsible for the distribution, it should reach agreement with the party contracting for the audit about which officials or organizations will receive the report and the steps being taken to make the report available to the public.

Chapter 7: Standards for Attestation Engagements and Reviews of Financial Statements

7.01 This chapter contains requirements and guidance for performing and reporting on attestation engagements and reviews of financial statements conducted in accordance with GAGAS. GAGAS incorporates by reference the American Institute of Certified Public Accountants' (AICPA) Statement on Standards for Attestation Engagements (SSAE) No. 18, *Attestation Standards: Clarification and Recodification*. For reviews of financial statements, GAGAS incorporates by reference Statement on Standards for Accounting and Review Services (SSARS) No. 21, section 90, *Review of Financial Statements*. All sections of the cited standards are incorporated, including the introduction, objectives, definitions, requirements, and application and other explanatory material. However, GAGAS does not incorporate the AICPA Code of Conduct by reference, but recognizes that certain certified public accountants (CPA) may use or may be required to use the code in conjunction with GAGAS.³⁶ For attestation engagements and reviews of financial statements conducted in accordance with GAGAS, the requirements and guidance in the respective incorporated standards and this chapter apply. The requirements and guidance contained in chapters 1 through 5 also apply.

7.02 An attestation engagement can provide one of three levels of service as defined by the AICPA: an examination engagement, a review-level attestation engagement, or an agreed-upon procedures engagement.³⁷ The "Review Engagements" section can be used for either review-level attestation engagements or reviews of financial statements, as applicable.

7.03 The AICPA standards used in conjunction with GAGAS require auditors to establish an understanding with the audited entity regarding the services to be performed for each attestation engagement or review of financial statements. Such an understanding reduces the risk that either the auditors or the audited entity may misinterpret the needs or expectations of the other party. The understanding includes the objectives of the engagement, responsibilities of audited entity management, responsibilities of auditors, and limitations of the engagement.³⁸

7.04 Auditors often conduct GAGAS engagements under a contract with a party other than the officials of the audited entity or pursuant to a third-party request. In such cases, auditors may also find it appropriate to communicate information regarding the services to be performed to the individuals contracting for or requesting the engagement. Such an understanding can help auditors avoid any misunderstandings regarding the nature of the review or agreed-upon procedures engagement. For example, review engagements only provide limited assurance, and as a result, auditors do not perform sufficient work to be able to develop elements of a finding or provide recommendations that are common in other types of GAGAS engagements. Agreed-upon procedures engagements do not provide an opinion or conclusion, and as a result, auditors do not perform sufficient work to be able to develop elements of a finding or provide

³⁶See para. 2.13 for a discussion of the AICPA Code of Conduct.

³⁷See para. 1.18 and the AICPA's *Codification of Statements on Standards for Attestation Engagements* (AT-C), sec. 105.10. Hereinafter, all references to this document will be to AICPA AT-C.

³⁸AICPA AT-C secs. 205.08, 210.09, and 215.14, and SSARS No. 21, sec. 90.11.

recommendations that are common in other types of GAGAS engagements. Consequently, requesting parties may find that a different type of attestation engagement or a performance audit may provide the appropriate level of assurance to meet their needs.

Examination Engagements

Additional GAGAS Requirements for Conducting Examination Engagements

Requirement: Compliance with Standards

7.05 GAGAS establishes requirements for examination engagements in addition to the requirements for examinations contained in the AICPA's SSAE No. 18, *Attestation Standards: Clarification and Recodification*. Auditors should comply with these additional requirements, along with the AICPA requirements for examination engagements, when citing GAGAS in their examination engagement reports.

Application Guidance: Compliance with Standards

7.06 The AICPA standards applicable to examinations require the auditors to apply the concept of materiality appropriately in planning and performing the examination. Additional considerations may apply to GAGAS engagements that concern government entities or entities that receive government awards. For example, for engagements conducted in accordance with GAGAS, auditors may find it appropriate to use lower materiality levels than those used in non-GAGAS engagements because of the public accountability of government entities and entities receiving government funding, various legal and regulatory requirements, and the visibility and sensitivity of government programs.

Requirements: Licensing and Certification

7.07 Auditors engaged to conduct examination engagements in the United States who do not work for a government audit organization should be licensed CPAs, persons working for a licensed certified public accounting firm, or licensed accountants in states that have multiclass licensing systems that recognize licensed accountants other than CPAs.

7.08 Auditors engaged to conduct examination engagements of entities operating outside of the United States should meet the qualifications indicated in the previous paragraph or

- a. have certifications that meet all applicable national and international standards and serve in their respective countries as the functional equivalent of CPAs in the United States,
- b. work for a nongovernment audit organization that meets the organizational requirements of paragraph 7.07, or
- c. work for a government audit organization.

Requirements: Auditor Communication

7.09 If the law or regulation requiring an examination engagement specifically identifies the entities to be examined, auditors should communicate pertinent information that in the auditors' professional judgment needs to be communicated both to individuals contracting for or requesting the examination and to those legislative committees, if any, that have ongoing oversight responsibilities for the audited entity.

7.10 If the identity of those charged with governance is not clearly evident, auditors should document the process followed and conclusions reached in identifying the appropriate individuals to receive the required communications.

Application Guidance: Auditor Communication

7.11 For some matters, early communication to those charged with governance or management may be important because of the relative significance and the urgency for corrective follow-up action. Further, early communication is important to allow management to take prompt corrective action to prevent further occurrences when a control deficiency results in potential instances of noncompliance with provisions of laws, regulations, contracts, and grant agreements or fraud, waste, or abuse. When a deficiency is communicated early, the reporting requirements and application guidance in paragraphs 7.37 through 7.44 still apply.

Requirement: Results of Previous Engagements

7.12 When planning a GAGAS examination engagement, auditors should ask management of the audited entity to identify previous audits, attestation engagements, and other studies that directly relate to the subject matter or an assertion about the subject matter of the examination engagement, including whether related recommendations have been implemented. Auditors should evaluate whether the audited entity has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a significant effect on the subject matter or an assertion about the subject matter. Auditors should use this information in assessing risk and determining the nature, timing, and extent of current work and determining the extent to which testing the implementation of the corrective actions is applicable to the current examination engagement objectives.

Requirement: Investigations or Legal Proceedings

7.13 Auditors should inquire of management of the audited entity whether any investigations or legal proceedings significant to the engagement objectives have been initiated or are in process with respect to the period under examination, and should evaluate the effect of initiated or in-process investigations or legal proceedings on the current examination engagement.

Application Guidance: Investigations or Legal Proceedings

7.14 Laws, regulations, or policies may require auditors to report indications of certain types of fraud; noncompliance with provisions of laws, regulations, contracts, and grant agreements; or waste or abuse to law enforcement or investigatory authorities before performing additional examination procedures.

7.15 Avoiding interference with investigations or legal proceedings is important in pursuing indications of fraud; noncompliance with provisions of laws, regulations, contracts, and grant agreements; or waste or abuse. In some cases, it may be appropriate for the auditors to work with investigators or legal authorities, or withdraw from or defer further work on the attestation engagement or a portion of the engagement to avoid interfering with an ongoing investigation or legal proceeding.

Requirement: Noncompliance with Provisions of Contracts and Grant Agreements

7.16 Auditors should extend the AICPA requirements concerning consideration of noncompliance with laws and regulations to include consideration of noncompliance with provisions of contracts and grant agreements.³⁹

Application Guidance: Noncompliance with Provisions of Contracts and Grant Agreements

7.17 Government programs are subject to provisions of many laws, regulations, contracts, and grant agreements. At the same time, these provisions' significance within the context of the engagement objectives varies widely, depending on the objectives of the engagement. Auditors may consult with their own 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, and (3) evaluate the results of those tests. Auditors also may consult with their own legal counsel when engagement objectives require testing compliance with provisions of contracts or grant agreements. Depending on the circumstances of the engagement, auditors may consult with others—such as investigative staff, other audit organizations or government entities that provided professional services to the audited entity, or applicable law enforcement authorities—to obtain information on compliance matters.

Requirement: Waste and Abuse

7.18 As part of a GAGAS engagement, if auditors become aware of waste or abuse that could be quantitatively or qualitatively material to the subject matter or to an assertion about the subject matter that is significant to the engagement objectives, auditors should perform procedures to ascertain the potential effect on the subject matter or assertion. Also, if auditors become aware of waste or abuse that could be significant to the entity's operations, they should consider the potential effect on the entity's operations.

Application Guidance: Waste and Abuse

7.19 Waste is the act of using or expending resources carelessly, extravagantly, or to no purpose. Waste involves the taxpayers not receiving reasonable value for money in connection with any government-funded activities because of an inappropriate act or omission by parties with control over or access to government resources. Importantly, waste can include activities

³⁹See AICPA AT-C sec. 205, paras. 32 and 33.

that do not include abuse and does not necessarily involve a violation of law. Rather, waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight.

7.20 Abuse is 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, but excludes fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Because the determination of abuse is subjective, auditors are not required to perform procedures to detect abuse in examination engagements. Auditors may discover that abuse is indicative of fraud or noncompliance with provisions of laws, regulations, contracts, and grant agreements.

Requirements: Findings

7.21 When auditors identify findings, auditors should plan and perform procedures to develop the criteria, condition, cause, and effect of the findings to the extent that these elements are relevant and necessary to achieve the examination objectives.

7.22 Auditors should consider potential internal control deficiencies in their evaluation of identified findings when developing the cause element of the identified findings when significant to the examination objectives.

Application Guidance: Findings

7.23 Findings may involve deficiencies in internal control; noncompliance with provisions of laws, regulations, contracts, and grant agreements; or instances of fraud, waste, or abuse.

7.24 Criteria: For inclusion in findings, criteria may include the laws, regulations, contracts, grant agreements, standards, measures, expected performance, defined business practices, and benchmarks against which performance is compared or evaluated. Criteria identify the required or desired state or expectation with respect to the program or operation. Criteria provide a context for evaluating evidence and understanding the findings.

7.25 Condition: Condition is a situation that exists. The condition is determined and documented during the attestation engagement.

7.26 Cause: The cause is the factor or factors responsible for the difference between the condition and the criteria, which may also serve as a basis for recommendations for corrective actions. Common factors include poorly designed policies, procedures, or criteria; inconsistent, incomplete, or incorrect implementation; or factors beyond the control of program management. Auditors may assess whether the evidence provides a reasonable and convincing argument for why the stated cause is the key factor contributing to the difference between the condition and the criteria.

7.27 Effect or potential effect: The effect or potential effect is the outcome or consequence resulting from the difference between the condition and the criteria. When the engagement objectives include identifying the actual or potential consequences of a condition that varies (either positively or negatively) from the criteria identified in the engagement, “effect” is a measure of those consequences. Effect or potential effect may be used to demonstrate the need for corrective action in response to identified problems or relevant risks.

7.28 Regardless of the type of finding identified, the cause of a finding may relate to an underlying internal control deficiency. Depending on the magnitude of impact, likelihood of occurrence, and nature of the deficiency, this deficiency could be a significant deficiency or a material weakness.⁴⁰

7.29 Considering internal control in the context of a comprehensive internal control framework, such as *Standards for Internal Control in the Federal Government* or *Internal Control—Integrated Framework*,⁴¹ can help auditors to determine whether potential underlying internal control deficiencies exist as the root cause of findings. Identifying these deficiencies can help provide the basis for developing meaningful recommendations for corrective actions.

Requirements: Examination Engagement Documentation

7.30 Auditors should comply with the following documentation requirements.

- a. Before the date of the examination report, document supervisory review of the evidence that supports the findings, conclusions, and recommendations contained in the audit report.
- b. Document any departures from the GAGAS requirements and the effect on the examination engagement and on the auditors' conclusions when the examination engagement does not comply with applicable GAGAS requirements because of law, regulation, scope limitations, restrictions on access to records, or other issues affecting the examination engagement.

7.31 In addition to the requirements of the examination engagement standards used in conjunction with GAGAS, auditors should prepare attest documentation in sufficient detail to enable an experienced auditor, having no previous connection to the examination engagement, to understand from the documentation the nature, timing, extent, and results of procedures performed and the evidence obtained and its source and the conclusions reached, including evidence that supports the auditors' significant judgments and conclusions.

Application Guidance: Examination Engagement Documentation

7.32 When documenting departures from the GAGAS requirements where alternative procedures performed were not sufficient to achieve the objectives of the requirements, the examination engagement documentation requirements apply to departures from unconditional requirements and presumptively mandatory requirements.

7.33 An experienced auditor is an individual who possesses the competencies and skills to be able to conduct the examination engagement. These competencies and skills include an

⁴⁰GAGAS's use of internal control terminology is consistent with the definitions contained in the AICPA *Codification of Statements on Auditing Standards* (AU-C) sec. 265. Hereinafter, all references to this document will be to AICPA AU-C.

⁴¹The Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control—Integrated Framework* and *Standards for Internal Control in the Federal Government* (GAO-14-704G) provide suitable and available criteria against which management may evaluate and report on the effectiveness of the entity's internal control. *Standards for Internal Control in the Federal Government* may be adopted by entities beyond those federal entities for which it is legally required, such as state, local, and quasi-governmental entities, as well as other federal entities and not-for-profit organizations, as a framework for an internal control system.

understanding of (1) examination engagement processes and related examination standards, (2) GAGAS and applicable legal and regulatory requirements, (3) the subject matter that the auditors are engaged to report on, (4) the suitability and availability of criteria, and (5) issues related to the audited entity's environment.

Requirement: Availability of Individuals and Documentation

7.34 Subject to applicable provisions of laws and regulations, auditors should make appropriate individuals, as well as examination engagement documentation, available upon request and in a timely manner to other auditors or reviewers.

Application Guidance: Availability of Individuals and Documentation

7.35 Underlying GAGAS examination engagements is the premise that audit organizations in federal, state, and local governments and public accounting firms engaged to conduct an examination engagement in accordance with GAGAS cooperate in evaluating programs of common interest so that auditors may use others' work and avoid duplication of efforts. The use of auditors' work by other auditors may be facilitated by contractual arrangements for GAGAS engagements that provide for full and timely access to appropriate individuals and to engagement documentation.

Additional GAGAS Requirements for Reporting on Examination Engagements

Requirements: Reporting the Auditors' Compliance with GAGAS

7.36 When auditors comply with all applicable GAGAS requirements, they should include a statement in the audit report that they conducted the examination in accordance with GAGAS.

7.37 If auditors report separately on deficiencies in internal control; noncompliance with provisions of laws, regulations, contracts, and grant agreements; or instances of fraud, waste, or abuse (including separate reports bound in the same document), they should state in the examination report that they are issuing those additional reports. They should include a reference to the separate reports and also state that the reports are an integral part of a GAGAS examination engagement.

Application Guidance: Reporting the Auditor's Compliance with GAGAS

7.38 Because GAGAS incorporates by reference the AICPA's attestation standards, GAGAS does not require auditors to cite compliance with the AICPA standards when citing compliance with GAGAS. GAGAS does not prohibit auditors from issuing a separate report conforming only to the requirements of the AICPA or other standards.

Requirement: Reporting Deficiencies in Internal Control

7.39 Auditors should include in the examination report all identified internal control deficiencies, even those communicated early, that are considered to be significant deficiencies or material weaknesses.⁴²

Application Guidance: Reporting Deficiencies in Internal Control

7.40 Determining whether and how to communicate to officials of the audited entity internal control deficiencies that warrant the attention of those charged with governance, but are not considered significant deficiencies or material weaknesses, is a matter of professional judgment.

Requirements: Reporting on Noncompliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements or Instances of Fraud, Waste, or Abuse

7.41 When auditors conclude, based on sufficient, appropriate evidence, that any of the following has occurred, they should include in their examination report the relevant information about

- a. noncompliance with provisions of laws, regulations, contracts, or grant agreements that has a material effect on the subject matter or an assertion about the subject matter;
- b. fraud that is material, either quantitatively or qualitatively, to the subject matter or an assertion about the subject matter that is significant to the engagement objectives; or
- c. waste or abuse that is material, either quantitatively or qualitatively, to the subject matter or an assertion about the subject matter that is significant to the engagement objectives or the entity's operations.

7.42 When auditors detect potential instances of noncompliance with provisions of laws, regulations, contracts, or grant agreements or fraud, waste, or abuse that have an effect on the subject matter or an assertion about the subject matter that are less than material but warrant the attention of those charged with governance, they should communicate those findings in writing to audited entity officials.

Application Guidance: Reporting on Noncompliance with Provisions of Laws, Regulations, Contracts, or Grant Agreements or Instances of Fraud, Waste, or Abuse

7.43 When auditors detect any potential instances of noncompliance with provisions of laws, regulations, contracts, or grant agreements or fraud, waste, or abuse that do not warrant the attention of those charged with governance, the auditors' determination of whether and how to communicate such instances to audited entity officials is a matter of professional judgment.

⁴²GAGAS's use of internal control terminology is consistent with the definitions contained in AICPA AU-C sec. 265.

7.44 When noncompliance with provisions of laws, regulations, contracts, or grant agreements or instances of fraud, waste, or abuse have occurred, auditors may consult with authorities or legal counsel about whether publicly reporting such information would compromise investigative or legal proceedings. Auditors may limit their public reporting to matters that would not compromise those proceedings and, for example, report only on information that is already a part of the public record.

Requirements: Presenting Findings in the Audit Report

7.45 When presenting findings, auditors should develop the elements of the findings to the extent necessary to assist management or oversight officials of the audited entity in understanding the need for taking corrective action.

7.46 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 findings. To give the reader a basis for judging the prevalence and consequences of the findings, auditors should, as appropriate, relate the instances identified to the population or the number of cases examined and quantify the results in terms of dollar value or other measures. If the results cannot be projected, auditors should limit their conclusions appropriately.

Application Guidance: Presenting Findings in the Audit Report

7.47 Along with assisting management or oversight officials of the audited entity in understanding the need for taking corrective action, clearly developed findings assist auditors in making recommendations for corrective action. If auditors sufficiently develop the elements of a finding, they may provide recommendations for corrective action.

Requirements: Reporting Findings Directly to Parties outside the Audited Entity

7.48 Auditors should report noncompliance with provisions of laws, regulations, contracts, and grant agreements and instances of fraud, waste, or abuse directly to parties outside the audited entity in the following two circumstances.

- a. When audited entity management fails to satisfy legal or regulatory requirements to report such information to external parties specified in law or regulation, auditors should first communicate the failure to report such information to those charged with governance. If the audited entity still does not report this information to the specified external parties as soon as practicable after the auditors' communication with those charged with governance, then the auditors should report the information directly to the specified external parties.
- b. When audited entity management fails to take timely and appropriate steps to respond to fraud; noncompliance with provisions of laws, regulations, contracts, and grant agreements; or instances of waste or abuse that (1) are likely to have a material effect on the subject matter and (2) involve funding received directly or indirectly from a government agency, auditors should first report management's failure to take timely and appropriate steps to those charged with governance. If the audited entity still does not take timely and appropriate steps as soon as practicable after the auditors' communication with those charged with governance, then the auditors should report the

audited entity's failure to take timely and appropriate steps directly to the funding agency.

7.49 Auditors should comply with the requirements in paragraph 7.48 even if they have resigned or been dismissed from the engagement prior to its completion.

7.50 Auditors should obtain sufficient, appropriate evidence, such as confirmation from outside parties, to corroborate representations by management of the audited entity that it has reported engagement findings in accordance with laws, regulations, or funding agreements. When auditors are unable to do so, they should report such information directly, as discussed in paragraphs 7.48 and 7.49.

Application Guidance: Reporting Findings Directly to Parties outside the Audited Entity

7.51 The reporting in paragraph 7.48 is in addition to any legal requirements to report such information directly to parties outside the audited entity.

Requirements: Obtaining and Reporting the Views of Responsible Officials

7.52 Auditors should obtain and report the views of responsible officials of the audited entity concerning the findings, conclusions, and recommendations included in the audit report, as well as any planned corrective actions.

7.53 When auditors receive written comments from the responsible officials, they should include in their report a copy of the officials' written comments or a summary of the comments received. When the responsible officials provide oral comments only, auditors should prepare a summary of the oral comments, provide a copy of the summary to the responsible officials to verify that the comments are accurately represented, and include the summary in their report.

7.54 Auditors should include in the report an evaluation of the comments, as appropriate.

7.55 When the audited entity's comments are inconsistent or in conflict with the findings, conclusions, or recommendations in the draft report, 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 explain in the report their reasons for disagreement. Conversely, the auditors should modify their report as necessary if they find the comments valid and supported by sufficient, appropriate evidence.

7.56 If the audited entity refuses to provide comments or is unable to provide comments within a reasonable period of time, the auditors should issue the report without receiving comments from the audited entity. In such cases, the auditors should indicate in the report that the audited entity did not provide comments.

Application Guidance: Obtaining and Reporting the Views of Responsible Officials

7.57 Providing a draft report with findings for review and comment by responsible officials of the audited entity and others helps the auditors develop a report that is fair, complete, and objective. 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. Obtaining

the comments in writing is preferred, but oral comments are acceptable. When the audited entity provides technical comments in addition to its written or oral comments on the report, auditors may disclose in the report that such comments were received.

7.58 Obtaining oral comments may be appropriate when, for example, there is a reporting date critical to meeting a user's needs; auditors have worked closely with the responsible officials throughout 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 findings, conclusions, or recommendations in the draft report or major controversies with regard to the issues discussed in the draft report.

Requirements: Reporting Confidential or Sensitive Information

7.59 If certain information is prohibited from public disclosure or is excluded from a report because of its confidential or sensitive nature, auditors should disclose in the report that certain information has been omitted and the circumstances that make the omission necessary.

7.60 When circumstances call for omission of certain information, auditors should evaluate whether the omission could distort the examination engagement results or conceal improper or illegal practices and revise the report language as necessary to minimize the risk that report users will draw inappropriate conclusions from the information presented.

7.61 When audit organizations are subject to public records laws, auditors should determine whether public records laws could affect the availability of classified or limited use reports and determine whether other means of communicating with management and those charged with governance would be more appropriate. Auditors use judgment to determine the appropriate means to communicate the omitted information to management and those charged with governance considering, among other things, whether public records laws could affect the availability of classified or limited use reports.

Application Guidance: Reporting Confidential or Sensitive Information

7.62 If the report refers to the omitted information, the reference may be general and not specific. If the omitted information is not necessary to meet the engagement objectives, the report need not refer to its omission.

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

7.64 Additional circumstances associated with public safety, privacy, or security concerns could also justify the exclusion of certain information from a publicly available or widely distributed 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 misuse of this information could cause. In such circumstances, auditors may issue a limited use report containing such information and distribute the report only to those parties responsible for acting on the auditors' recommendations. In some instances, it may be appropriate to issue both a publicly available report with the sensitive information excluded and a limited use report. The auditors may consult with legal counsel regarding any requirements or other circumstances that may necessitate omitting certain information.

7.65 Considering the broad public interest in the program or activity under review assists auditors when deciding whether to exclude certain information from publicly available reports.

7.66 In cases described in paragraph 7.61, the auditors may communicate general information in a written report and communicate detailed information orally. The auditors may consult with legal counsel regarding applicable public records laws.

Requirement: Distributing Reports

7.67 Distribution of reports completed in accordance with GAGAS depends on the auditors' relationship with the audited organization and the nature of the information contained in the reports. Auditors should document any limitation on report distribution.

- a. Audit organizations in government entities should distribute audit reports to those charged with governance, to the appropriate audited entity officials, and to the appropriate oversight bodies or organizations requiring or arranging for the examination engagements. As appropriate, auditors should also distribute copies of the reports to other officials who have legal oversight authority or who may be responsible for acting on engagement findings and recommendations and to others authorized to receive such reports.
- b. A public accounting firm contracted to conduct an examination engagement in accordance with GAGAS should clarify report distribution responsibilities with the engaging party. If the contracting firm is responsible for the distribution, it should reach agreement with the party contracting for the examination engagement about which officials or organizations will receive the report and the steps being taken to make the report available to the public.

Review Attestation Engagements and Reviews of Financial Statements

Requirement: Compliance with Standards

7.68 GAGAS establishes requirements for review engagements in addition to the requirements for reviews contained in the AICPA's SSAE No. 18, *Attestation Standards: Clarification and Recodification*, and SSARS No. 21 section 90, *Review of Financial Statements*. Auditors should comply with the additional GAGAS requirements, along with the applicable AICPA requirements, when citing GAGAS in their review engagement reports.

Requirements: Licensing and Certification

7.69 Auditors engaged to conduct review attestation engagements and reviews of financial statements in the United States who do not work for a government audit organization should be licensed CPAs, persons working for a licensed certified public accounting firm, or licensed accountants in states that have multiclass licensing systems that recognize licensed accountants other than CPAs.

7.70 Auditors engaged to conduct review attestation engagements and reviews of financial statements of entities operating outside of the United States should meet the qualifications indicated in the previous paragraph or

- a. have certifications that meet all applicable national and international standards and serve in their respective countries as the functional equivalent of CPAs in the United States,
- b. work for a nongovernment audit organization that meets the organizational requirements of paragraph 7.69, or
- c. work for a government audit organization.

Requirement: Noncompliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements

7.71 Auditors should extend the AICPA requirements concerning consideration of noncompliance with laws and regulations to include consideration of noncompliance with provisions of contracts and grant agreements.⁴³

Application Guidance: Noncompliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements

7.72 Government programs are subject to many laws, regulations, contracts, and grant agreements. At the same time, their significance within the context of the engagement objectives varies widely, depending on the objectives of the engagement. Auditors may consult with their own legal counsel to (1) determine those laws and regulations that are significant to the engagement objectives, (2) design tests of compliance with provisions of laws and regulations, and (3) evaluate the results of those tests. Auditors also may consult with their own legal counsel when engagement objectives require testing compliance with provisions of contracts or grant agreements. Depending on the circumstances of the engagement, auditors may consult with others, such as investigative staff, other audit organizations or government entities that provided professional services to the audited entity, or applicable law enforcement authorities, to obtain information on compliance matters.

Requirement: Communicating Fraud; Significant Deficiencies or Material Weaknesses in Internal Control; Noncompliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements; or Instances of Waste or Abuse

7.73 If, on the basis of conducting the procedures necessary to conduct a review, significant deficiencies or material weaknesses in internal control;⁴⁴ potential instances of noncompliance with provisions of laws, regulations, contracts, and grant agreements; or fraud, waste, or abuse come to the auditors' attention that warrant the attention of those charged with governance, auditors should communicate such matters to those charged with governance and audited entity officials. Additionally, auditors should determine whether the existence of such matters affects the auditors' ability to conduct or report on the review.

⁴³See AICPA AT-C sec. 210, paras. 23 and 24, and SSARS No. 21 sec. 90, para. 34.

⁴⁴GAGAS's use of internal control terminology is consistent with the definitions contained in AICPA AU-C sec. 265.

Application Guidance: Communicating Fraud; Significant Deficiencies or Material Weaknesses in Internal Control; Noncompliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements; or Instances of Waste or Abuse

7.74 When auditors detect any potential instances of noncompliance with provisions of laws, regulations, contracts, and grant agreements or fraud, waste, or abuse that do not warrant the attention of those charged with governance, the auditors' determination of whether and how to communicate such instances to audited entity officials is a matter of professional judgment.

7.75 Waste is the act of using or expending resources carelessly, extravagantly, or to no purpose. Waste involves the taxpayers not receiving reasonable value for money in connection with any government-funded activities because of an inappropriate act or omission by parties with control over or access to government resources. Importantly, waste can include activities that do not include abuse and does not necessarily involve a violation of law. Rather, waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight.

7.76 Abuse is 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, but excludes fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Because the determination of abuse is subjective, auditors are not required to perform procedures to detect abuse in examination engagements. Auditors may discover that abuse is indicative of fraud or noncompliance with provisions of laws, regulations, contracts, and grant agreements.

Requirement: Reporting Auditors' Compliance with GAGAS

7.77 When auditors comply with all applicable requirements for a review engagement conducted in accordance with GAGAS, they should include a statement in the review report that they conducted the engagement in accordance with GAGAS.

Application Guidance: Reporting Auditors' Compliance with GAGAS

7.78 Because GAGAS incorporates by reference the AICPA's attestation standards, GAGAS does not require auditors to cite compliance with the AICPA standards when they cite compliance with GAGAS. GAGAS does not prohibit auditors from issuing a separate report conforming only to the requirements of the AICPA or other standards setters.

7.79 Because review engagements are substantially less in scope than audits and examination engagements, it is important to include all required reporting elements contained in the standards used in conjunction with GAGAS. For example, a required element of the review report under SSAE No. 18 is a statement that a review is substantially less in scope than an examination, the objective of which is an expression of opinion on the subject matter, and accordingly, no such opinion is expressed.⁴⁵ Similarly, a required element of the review of

⁴⁵AICPA AT-C sec. 210.46(f)(iii).

financial statements under SSARS No. 21, section 90, includes a statement that a review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole, and that accordingly the accountant does not express such an opinion.⁴⁶ Including only those elements that the reporting standards for review engagements require or permit helps ensure that auditors comply with the standards and that users of GAGAS reports have an understanding of the nature of the work performed and the results of the review engagement.

Requirement: Distributing Reports

7.80 Distribution of reports completed in accordance with GAGAS depends on the auditors' relationship with the audited organization and the nature of the information contained in the reports. If the subject matter or the assertion involves material that is classified or contains confidential or sensitive information, auditors should limit report distribution. Auditors should document any limitation on report distribution.

- a. Audit organizations in government entities should distribute reports to those charged with governance, to the appropriate audited entity officials, and to the appropriate oversight bodies or organizations requiring or arranging for the engagements. As appropriate, auditors should also distribute copies of the reports to other officials who have legal oversight authority and to others authorized to receive such reports.
- b. A public accounting firm contracted to conduct a review engagement in accordance with GAGAS should clarify report distribution responsibilities with the engaging party. If the contracting firm is responsible for the distribution, it should reach agreement with the party contracting for the engagement about which officials or organizations will receive the report and the steps being taken to make the report available to the public.

Agreed-Upon Procedures Engagements

Requirement: Compliance with Standards

7.81 GAGAS establishes requirements for agreed-upon procedures engagements in addition to the requirements for agreed-upon procedures engagements contained in the AICPA's SSAE No. 18, *Attestation Standards: Clarification and Recodification*. Auditors should comply with the additional GAGAS requirements, along with the applicable AICPA requirements, when citing GAGAS in their agreed-upon procedures engagement reports.

Requirements: Licensing and Certification

7.82 Auditors engaged to conduct agreed-upon procedures engagements in the United States who do not work for a government audit organization should be licensed CPAs, persons working for a licensed certified public accounting firm, or licensed accountants in states that have multiclass licensing systems that recognize licensed accountants other than CPAs.

⁴⁶SSARS No. 21 sec. 90.39(c)(vi).

7.83 Auditors engaged to conduct agreed-upon procedures engagements of entities operating outside of the United States should meet the qualifications indicated in the previous paragraph or

- a. have certifications that meet all applicable national and international standards and serve in their respective countries as the functional equivalent of CPAs in the United States,
- b. work for a nongovernment audit organization that meets the organizational requirements of paragraph 7.82, or
- c. work for a government audit organization.

Requirement: Communicating Fraud; Significant Deficiencies or Material Weaknesses in Internal Control; Noncompliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements; or Instances of Waste or Abuse

7.84 If, on the basis of performing the procedures necessary to conduct an agreed-upon procedures engagement, significant deficiencies or material weaknesses in internal control;⁴⁷ potential instances of noncompliance with provisions of laws, regulations, contracts, and grant agreements; or fraud, waste, or abuse come to the auditors' attention that warrant the attention of those charged with governance, auditors should communicate such matters to those charged with governance and audited entity officials. Additionally, auditors should determine whether the existence of such matters affects the auditors' ability to conduct or report on the agreed-upon procedures engagement.

Application Guidance: Communicating Fraud; Significant Deficiencies or Material Weaknesses in Internal Control; Noncompliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements; or Instances of Waste or Abuse

7.85 When auditors detect any potential instances of noncompliance with provisions of laws, regulations, contracts, and grant agreements or fraud, waste, or abuse that do not warrant the attention of those charged with governance, the auditors' determination of whether and how to communicate such instances to audited entity officials is a matter of professional judgment.

7.86 Waste is the act of using or expending resources carelessly, extravagantly, or to no purpose. Waste involves the taxpayers not receiving reasonable value for money in connection with any government-funded activities because of an inappropriate act or omission by parties with control over or access to government resources. Importantly, waste can include activities that do not include abuse and does not necessarily involve a violation of law. Rather, waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight.

7.87 Abuse is 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, but excludes fraud and noncompliance with provisions of laws, regulations,

⁴⁷GAGAS's use of internal control terminology is consistent with the definitions contained in AICPA AU-C sec. 265.

contracts, and grant agreements. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Because the determination of abuse is subjective, auditors are not required to perform procedures to detect abuse in examination engagements. Auditors may discover that abuse is indicative of fraud or noncompliance with provisions of laws, regulations, contracts, and grant agreements.

Requirement: Reporting Auditors' Compliance with GAGAS

7.88 When auditors comply with all applicable GAGAS requirements for agreed-upon procedures engagements, they should include a statement in the agreed-upon procedures engagement report that they conducted the engagement in accordance with GAGAS.

Application Guidance: Reporting Auditors' Compliance with GAGAS

7.89 Because GAGAS incorporates by reference the AICPA's attestation standards, GAGAS does not require auditors to cite compliance with the AICPA standards when citing compliance with GAGAS. GAGAS does not prohibit auditors from issuing a separate report conforming only to the requirements of the AICPA or other standards.

7.90 Because agreed-upon procedures engagements are substantially less in scope than audits and examination engagements, it is important not to deviate from the required reporting elements contained in SSAE No. 18, other than including the reference to GAGAS. For example, a required element of the report on agreed-upon procedures is a statement that the auditors were not engaged to and did not conduct an examination or a review of the subject matter, the objective of which would be the expression of an opinion or a conclusion, respectively, and that had the auditors performed additional procedures, other matters may have come to their attention that would have been reported.⁴⁸ Another required element is a statement that the sufficiency of the procedures is solely the responsibility of the parties specified in the report and a disclaimer of responsibility for sufficiency of those procedures.⁴⁹ Including only those elements that the AICPA reporting standards for agreed-upon procedures engagements require or permit helps ensure that auditors comply with the AICPA standards and that users of GAGAS reports understand the nature of the work performed and the results of the agreed-upon procedures engagement.

Requirement: Distributing Reports

7.91 Distribution of reports completed in accordance with GAGAS depends on the auditors' relationship with the audited organization and the nature of the information contained in the reports. If the subject matter or the assertion involves material that is classified or contains confidential or sensitive information, auditors should limit the report distribution. Auditors should document any limitation on report distribution.

- a. Audit organizations in government entities should distribute reports to those charged with governance, to the appropriate audited entity officials, and to the appropriate

⁴⁸AICPA AT-C sec. 215.35(j).

⁴⁹AICPA AT-C sec. 215.35(g).

oversight bodies or organizations requiring or arranging for the engagements. As appropriate, auditors should also distribute copies of the reports to other officials who have legal oversight authority and to others authorized to receive such reports.

- b.** A public accounting firm contracted to conduct an agreed-upon procedures engagement in accordance with GAGAS should clarify report distribution responsibilities with the engaging party. If the contracting firm is responsible for the distribution, it should reach agreement with the party contracting for the engagement about which officials or organizations will receive the report and the steps being taken to make the report available to the public.

Chapter 8: Fieldwork Standards for Performance Audits

8.01 This chapter contains fieldwork requirements and guidance for performance audits conducted in accordance with GAGAS. Fieldwork requirements establish an overall approach for auditors to apply in planning and performing an audit to obtain sufficient, appropriate evidence that provides a reasonable basis for findings and conclusions based on the audit objectives. For performance audits conducted in accordance with GAGAS, the requirements and guidance in chapters 1 through 5 and chapter 9 also apply.

8.02 The fieldwork requirements for performance audits relate to planning the audit; supervising staff; obtaining sufficient, appropriate evidence; and preparing audit documentation. The concepts of evidence, significance, and audit risk form a framework for applying these requirements and are included throughout the discussion of performance audits.

Planning

Requirements: General

8.03 Auditors must adequately plan the work necessary to address the audit objectives. Auditors must document the audit plan.

8.04 Auditors must plan the audit to reduce audit risk to an appropriate level for the auditors to obtain reasonable assurance to support their findings and conclusions.

8.05 In planning the audit, auditors should assess significance and audit risk. Auditors should apply these assessments to establish the scope and methodology for addressing the audit objectives. Planning is a continuous process throughout the audit.

8.06 Auditors should design the methodology to obtain sufficient, appropriate evidence that provides a reasonable basis for findings and conclusions based on the audit objectives and to reduce audit risk to an acceptable level.

8.07 Auditors should identify and use suitable criteria based on the audit objectives.

Application Guidance: General

8.08 The audit objectives are what the audit is intended to accomplish. They identify the audit subject matter and performance aspects to be included, and may also include the potential findings and reporting elements that the auditors expect to develop. Audit objectives can be thought of as questions about the program that the auditors seek to answer based on evidence obtained and assessed against criteria. Audit objectives may also pertain to the current status or condition of a program. The term program is used in GAGAS to include processes, projects, studies, policies, operations, activities, entities, and functions. Audit objectives may become more refined as the audit work is performed.

8.09 Auditors may need to adjust the audit objectives, scope, and methodology as work is performed. However, in situations where the audit objectives are established by statute or legislative oversight, auditors may not have latitude to define or adjust the audit objectives or scope.

8.10 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 necessary documents or records, the period of time reviewed, and the locations that will be included.

8.11 The methodology describes the nature and extent of audit procedures for gathering and analyzing evidence to address the audit objectives. Audit procedures are the specific steps and tests auditors perform to address the audit objectives.

8.12 In performance audits that comply with GAGAS, auditors obtain reasonable assurance that their findings and conclusions are valid, accurate, appropriate, and complete with respect to the audit objectives. Sufficient, appropriate evidence provides the basis for this assurance.

8.13 The sufficiency and appropriateness of evidence needed and tests of evidence are determined by the auditors based on the audit objectives, findings, and conclusions. Objectives for performance audits range from narrow to broad and involve varying types and quality of evidence. In some engagements, sufficient, appropriate evidence is available, but in others, information may have limitations. Professional judgment assists auditors in determining the audit scope and methodology needed to address the audit objectives and in evaluating whether sufficient, appropriate evidence has been obtained to address the audit objectives.

8.14 In performance audits that comply with GAGAS, auditors measure or evaluate the subject matter of the engagement and present the resulting information as part of, or accompanying, the audit report. Assertions by audited entity management with respect to the subject matter of the engagement do not affect the auditors' conclusions on that subject matter because the auditors are responsible for measuring or evaluating the subject matter. GAGAS does not require auditors to obtain management assertions with respect to the subject matter when conducting a performance audit.

8.15 The concept of significance assists auditors throughout a performance audit, including when deciding the type and extent of audit work to perform, when evaluating results of audit work, and when developing the report and related findings and conclusions. 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 the magnitude of the matter in relation to the subject matter of the audit, the nature and effect of the matter, the relevance of the matter, the needs and interests of an objective third party with knowledge of the relevant information, and the matter's effect on the audited program or activity. Professional judgment assists auditors when evaluating the significance of matters within the context of the audit objectives. In the performance audit requirements, the term significant is comparable to the term material as used in the context of financial statement engagements.

8.16 Audit risk is the possibility that the auditors' findings, conclusions, recommendations, or assurance may be improper or incomplete as a result of factors such as evidence that is not sufficient or appropriate, an inadequate audit process, or intentional omissions or misleading information because of misrepresentation or fraud. The assessment of audit risk involves both qualitative and quantitative considerations. Factors affecting audit risk include the time frames, complexity, or sensitivity of the work; size of the program in terms of dollar amounts and number of citizens served; adequacy of the audited entity's systems and processes to detect inconsistencies, significant errors, or potential fraud; and auditors' access to records. Audit risk includes the risk that auditors will not detect a mistake, inconsistency, significant error, or fraud in the evidence supporting the audit. Audit risk can be reduced by taking actions such as increasing the scope of work; adding specialists, additional reviewers, and other resources to conduct the audit; changing the methodology to obtain additional evidence, higher-quality

evidence, or alternative forms of corroborating evidence; or aligning the findings and conclusions to reflect the evidence obtained.

8.17 Criteria identify the required or desired state or expectation with respect to the program or operation. Criteria provide a context for evaluating evidence and understanding the findings, conclusions, and recommendations in the report. Suitable criteria are relevant, reliable, objective, and understandable and do not result in the omission of significant information, as applicable, within the context of the audit objectives. The relative importance of each of these characteristics to a particular engagement is a matter of professional judgment. In instances where such things as laws, regulations, and policies prescribe the criteria to be used for the engagement, such criteria are presumed to be suitable in the absence of indications to the contrary.

8.18 Examples of criteria include

- a. laws and regulations applicable to the operation of the audited entity;
- b. goals, policies, and procedures established by officials of the audited entity;
- c. technically developed standards or norms;
- d. expert opinions;
- e. prior periods' performance;
- f. defined business practices;
- g. contracts or grant agreements; and
- h. benchmarks against which performance is compared, including performance of other entities or sectors.

8.19 For audit objectives that pertain to the current status or condition of a program, sufficient, appropriate evidence is gathered to provide reasonable assurance that the description is accurate and reliable and does not omit significant information relevant to the audit objectives. Information addressing the audit objectives is to be provided in an objective, understandable manner. The relative importance of each of the characteristics of the information to a particular engagement is a matter of professional judgment. The term program includes processes, projects, studies, policies, operations, activities, entities, and functions.

Requirements: Auditor Communication

8.20 Auditors should communicate an overview of the objectives, scope, and methodology and the timing of the performance audit and planned reporting (including any potential restrictions on the report), unless doing so could significantly impair the auditors' ability to obtain sufficient, appropriate evidence to address the audit objectives. Auditors should communicate such information with the following parties, as applicable:

- a. management of the audited entity, including those with sufficient authority and responsibility to implement corrective action in the program or activity being audited;
- b. those charged with governance;
- c. the individuals contracting for or requesting audit services, such as contracting officials or grantees; and
- d. the cognizant legislative committee, when auditors conduct the audit pursuant to a law or regulation, or they conduct the work for the legislative committee that has oversight of the audited entity.

8.21 In situations where the parties required to receive communications, as described in paragraph 8.20, are not clearly evident, auditors should document the process followed and conclusions reached in identifying the appropriate individuals to receive the required auditor communications.

8.22 Auditors should retain written communication with the parties identified in paragraph 8.20 as audit documentation.

Application Guidance: Auditor Communication

8.23 Determining the form, content, and frequency of the communication with management or those charged with governance is a matter of professional judgment, although written communication is preferred. Auditors may use an engagement letter to communicate key information early in the engagement.

8.24 Examples of communications regarding the objectives, scope, methodology, and timing that could impair the auditor's ability to obtain sufficient, appropriate evidence include situations in which the auditors plan to perform unannounced cash counts or perform procedures related to indications of fraud.

8.25 Reporting to those charged with governance or management may include reporting potential deficiencies in internal control; fraud; noncompliance with provisions of laws, regulations, contracts, and grant agreements; waste; or abuse. Early communication of these matters may be important because of their relative significance and the urgency for corrective follow-up action. Further, early communication is important to allow management to take prompt corrective action to prevent further noncompliance when a control deficiency results in potential instances of the following: noncompliance with provisions of laws, regulations, contracts, and grant agreements or fraud, waste, or abuse. When a deficiency is communicated early, the reporting requirements and application guidance in paragraphs 9.24 through 9.35 still apply.

Requirement: Investigations or Legal Proceedings

8.26 Auditors should inquire of management of the audited entity whether any investigations or legal proceedings significant to the audit objectives have been initiated or are in process with respect to the period under audit, and should evaluate the effect of initiated or in-process investigations or legal proceedings on the current audit.

Application Guidance: Investigations or Legal Proceedings

8.27 Laws, regulations, or policies may require auditors to report indications of the following to law enforcement or investigatory authorities before performing additional audit procedures: certain types of fraud; noncompliance with provisions of laws, regulations, contracts, and grant agreements; waste; or abuse.

8.28 Avoiding interference with investigations or legal proceedings is important in pursuing indications of fraud; noncompliance with provisions of laws, regulations, contracts, and grant agreements; waste; or abuse. In some cases, it may be appropriate for the auditors to work with investigators or legal authorities or withdraw from or defer further work on the engagement or a portion of the engagement to avoid interfering with an ongoing investigation or legal proceeding.

Requirements: Assigning Staff

8.29 Audit management should assign sufficient staff with adequate collective professional competence, as described in paragraphs 4.02 through 4.14, to conduct the audit. Staffing an audit includes, among other things,

- a. assigning staff with the collective knowledge, skills, and experience appropriate for the audit;
- b. assigning a sufficient number of staff to the audit;
- c. providing for on-the-job training of staff; and
- d. engaging specialists when necessary.

8.30 If planning to use the work of specialists, auditors should document the nature and scope of the work to be performed by the specialists, including

- a. the objectives and scope of the specialists' work,
- b. the intended use of the specialists' work to support the audit objectives,
- c. the specialists' procedures and findings so they can be evaluated and related to other planned audit procedures, and
- d. the assumptions and methods used by the specialists.

Requirements: Preparing a Written Audit Plan

8.31 Auditors must prepare a written audit plan for each audit. Auditors should update the plan, as necessary, to reflect any significant changes to the plan made during the audit.

Application Guidance: Preparing a Written Audit Plan

8.32 The form and content of the written audit plan may vary among audits and may include an audit strategy, audit program, project plan, audit planning paper, or other appropriate documentation of key decisions about the audit objectives, scope, and methodology and the auditors' basis for those decisions.

8.33 A written audit plan provides an opportunity for 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 address the audit objectives;
- d. available evidence is likely to be sufficient and appropriate for purposes of the audit; and
- e. sufficient staff, supervisors, and specialists with adequate collective professional competence and other resources are available to conduct the audit and to meet expected time frames for completing the work.

Conducting the Engagement

Requirement: Nature and Profile of the Program and User Needs

8.34 Auditors should obtain an understanding of the nature 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 relevant risks associated with the program under audit;
- b. age of the program or changes in its conditions;
- c. the size of the program in terms of total dollars, number of citizens affected, or other measures;
- d. level and extent of review or other forms of independent oversight;
- e. the program's strategic plan and objectives; and
- f. external factors or conditions that could directly affect the program.

Application Guidance: Nature and Profile of the Program and User Needs

8.35 One group of users of the audit report is government officials who have authorized or requested the audit. Other important users of the audit report are the audited entity, those responsible for acting on the auditors' recommendations, oversight organizations, and legislative bodies. Other potential users of the audit report include legislators or government officials (other than those who authorized or requested the audit), the media, interest groups, and individual citizens. In addition to an interest in the program, potential users may have an ability to influence the conduct of the program. An awareness of these potential users' interests and influence can help auditors judge whether possible findings could be significant to relevant users.

8.36 Obtaining an understanding of the program under audit helps auditors to assess the relevant risks associated with the program and the effect of the risks 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, observations, and reviewing documents while 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. Provisions of laws, regulations, contracts, and grant agreements: Government programs are usually created by law and are subject to specific laws and regulations. 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 contracts or grant agreements. Thus, understanding the laws and legislative history establishing a program and the provisions of contracts or grant agreements is essential to understanding the program itself. Obtaining that understanding is also a necessary step in identifying the provisions of laws, regulations, contracts, and 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's purpose when they provide authority for the program. Audited entity officials may provide more detailed information on the program's purpose to supplement the authorizing legislation. Audited 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 to use when assessing performance.
- c.** Internal control: Internal control is a process effected by an entity's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved. Internal control comprises the plans, methods, policies, and procedures used to fulfill the mission, strategic plan, goals, and objectives of the entity.
- d.** Inputs: Inputs are the amount of resources (in terms of, for example, money, material, or personnel) that are put into a program. These resources may come from within or outside the entity operating the program. Measures of inputs can have a number of dimensions, such as cost, timing, and quality. Examples of measures of inputs are dollars spent, employee hours expended, and square feet of building space used.
- e.** Program operations: Program operations are the strategies, processes, and activities management uses to convert inputs into outputs. Program operations may be 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 a program. For example, an outcome measure for a job training program could be the percentage of trained persons obtaining a job and still in the workplace after a specified period. An example of an outcome measure for an aviation safety inspection program could be the percentage reduction in safety problems found in subsequent inspections or the percentage of problems deemed corrected in follow-up inspections. Such outcome measures show the progress made in achieving the stated program purposes of helping unemployed citizens obtain and retain jobs and improving the safety of aviation operations, respectively. 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. Outcomes also include unexpected effects, unintentional effects, or both of a program, both positive and negative.

Requirement: Internal Control Significance Considerations

8.37 Auditors should document the significance of internal control to the audit objectives.

Application Guidance: Internal Control Significance Considerations

8.38 Consideration of internal control in a performance audit begins with assessing the significance of internal control to the audit objectives and documenting that assessment. Some

factors that may be considered when assessing the significance of internal control to the audit objectives include

- a. the subject matter under audit, such as the program or program component under audit, including the audited entity's objectives for the program and associated inherent risks;
- b. the nature of findings and conclusions expected to be reported, based on the needs and interests of audit report users;
- c. the three categories of entity objectives; and
- d. the five components of internal control and the integration of the components.

8.39 The significance of internal control may be assessed at various levels. When internal control is significant to an audit, all components of internal control are generally relevant, but not all components may be significant to the audit. Significance is first assessed for the audit objectives overall. If internal control is significant to the audit objectives overall, significance is then assessed for the five components of internal control to identify which components are significant to the audit objectives. Obtaining a broad understanding of the five components of internal control at the entity level, as discussed in paragraph 8.45, can assist auditors in performing this assessment. The assessment can also identify other areas of internal control, such as programs or processes that are significant to the audit objectives. Determining which internal controls are significant to the audit is a matter of professional judgment.

8.40 Assessing the significance of internal control may be an iterative process. As discussed in paragraphs 8.08 and 8.09, the audit objectives can evolve and become more refined throughout the audit. When this occurs, the significance of internal control is assessed for the new or revised objectives.

8.41 The assessment of the significance of internal control may be documented in formats such as narratives or tables. The documentation includes the conclusions on whether internal control is significant to the overall audit objectives, and if so, which components of internal control are significant to the audit objectives. The documentation may also include the factors considered and steps taken to perform the assessment.

8.42 The assessment of the significance of internal control affects the audit planning required in paragraphs 8.03 through 8.07. Specifically, it enables auditors to determine whether to assess internal control as part of the audit and, if they do, to identify criteria for the assessment and plan the appropriate scope, methodology, and extent of internal control assessments to perform.

Requirement: Obtaining an Understanding of Internal Control Considerations

8.43 Auditors should obtain and document an understanding of internal control that is significant to the audit objectives.

Application Guidance: Obtaining an Understanding of Internal Control Considerations

8.44 The process for assessing internal control begins with obtaining and documenting an understanding of internal control that is significant to the audit. This generally occurs during the planning phase of an engagement, but the auditors' understanding is continually updated throughout the audit. The nature and extent of procedures auditors perform to obtain and

document an understanding of internal control is a matter of professional judgment and may vary among audits based on audit objectives, audit risk, known or potential internal control deficiencies, and the auditors' knowledge about internal control gained in prior audits. The understanding of internal control builds on the understanding of the program required in paragraph 8.34. The auditors' understanding of internal control may be obtained through procedures such as inquiries, observations, inspection of documents and records, review of other audit reports, or direct tests. The auditors' understanding of internal control may be documented in formats such as narratives, tables, or flowcharts.

8.45 Approaches for obtaining an understanding of internal control may vary and may include consideration of entity-level controls, transaction-level controls, or both. However, even when assessing only transaction-level controls, it may be beneficial to gain an understanding of entity-level controls that may affect transaction-level controls by obtaining a broad understanding of the five components of internal control at the entity level. This involves considering the relationships between the components, which work together in an integrated manner in an effective internal control system, and the principles of internal control that support each component. In addition to obtaining a broad understanding of internal control at the entity level, auditors may also obtain an understanding of internal control at the transaction level for the specific programs and processes under audit.

8.46 Obtaining an understanding of internal control assists auditors in identifying an audited entity's key controls. Identifying key controls involves considering the entity's objectives that are relevant to the audit and whether the entity has controls in place to achieve those objectives and address associated risks. Collectively, key controls are those controls necessary to achieve the entity's control objectives and provide reasonable assurance of achieving the entity's objectives. Key controls often have one or both of the following characteristics:

- a. Their failure may significantly affect the achievement of the entity's objectives, yet not reasonably be detected in a timely manner by other controls.
- b. Their operation may prevent other control failures or detect such failures before they have an opportunity to become significant to the achievement of the entity's objectives.

Requirement: Assessing Internal Control

8.47 To the extent that internal control is significant to the audit objectives, auditors should assess and document the design, implementation, and operating effectiveness of internal control.

Application Guidance: Assessing Internal Control

8.48 The auditors' understanding of internal control provides a basis for determining the nature, timing, and extent of procedures for assessing the effectiveness of internal control, if such an assessment will be performed. Assessing the effectiveness of internal control in a performance audit involves assessing the design; the design and implementation; or the design, implementation, and operating effectiveness of controls that are significant to the audit objectives.

8.49 Assessing the effectiveness of internal control involves designing and performing procedures to obtain sufficient, appropriate evidence, as required in paragraphs 8.88 through 8.92, to support and document the auditors' findings and conclusions on the effectiveness of controls that are significant to the audit objectives. The controls being assessed are generally

the key controls identified during the planning phase of the engagement, which may include controls at both the entity and transaction levels. Changes may be made to the initial determination of key controls based on additional information gathered during the course of fieldwork.

8.50 The design of internal control is assessed by determining whether controls individually and in combination are capable of achieving an objective and addressing the related risk. The implementation of internal control is assessed by determining if the control exists and has been placed into operation. The operating effectiveness of internal control is assessed by determining whether controls were applied at relevant times during the period under evaluation, the consistency with which they were applied, and by whom or by what means they were applied. A control cannot be effectively implemented if it was not effectively designed. A control cannot be operating effectively if it was not effectively designed and implemented.

8.51 During the assessment of the effectiveness of each control, deficiencies in internal control may be identified. A deficiency in internal control exists when the design, implementation, or operation of a control does not allow management or personnel to achieve control objectives and address related risks.⁵⁰ A deficiency in design exists when a necessary control is missing or is not properly designed so that even if the control operates as designed, the control objective would not be met. A deficiency in implementation exists when a control is properly designed but not implemented correctly in the internal control system. A deficiency in operating effectiveness exists when a properly designed control does not operate as designed or the person performing the control does not have the necessary competence or authority to perform the control effectively.

Requirement: Internal Control Deficiencies Considerations

8.52 Auditors should evaluate and document the significance of identified internal control deficiencies to the audit objectives.

Application Guidance: Internal Control Deficiencies Considerations

8.53 The internal control deficiencies identified when auditors assess the effectiveness of internal control are evaluated for significance to the audit objectives and the evaluation is documented.

8.54 Significance refers to the relative importance of a deficiency to achieving an entity's objective. Evaluating the significance of a deficiency involves consideration of the following factors:

- a. **Magnitude of impact:** Magnitude of impact refers to the likely effect that the deficiency could have on the entity achieving its objectives and is affected by factors such as the size, pace, and duration of the deficiency's impact. A deficiency may be more significant to one objective than another.
- b. **Likelihood of occurrence:** Likelihood of occurrence refers to the possibility of a deficiency impacting an entity's ability to achieve its objectives.

⁵⁰See paras. 1.23.f and 1.23.j for definitions of control objective and entity objective.

- c. Nature of the deficiency: The nature of the deficiency involves factors such as the degree of subjectivity involved with the deficiency and whether the deficiency arises from potential fraud or misconduct.

8.55 Internal control deficiencies are evaluated for significance to both the audited entity's objectives and the auditors' audit objectives. Deficiencies are evaluated both on an individual basis and in the aggregate. Consideration is given to the correlation among deficiencies. This evaluation and the audit work performed form the basis of the auditors' determination whether, individually or in combination, the deficiencies are significant enough to be included in the audit report.⁵¹ Determining whether deficiencies are significant enough to be included in the audit report involves evaluating factors such as the following:

- a. Likelihood that reporting or not reporting the deficiencies would affect the audit report conclusions and viewpoints of users of the audit report.
- b. Magnitude of impact of reporting or not reporting the deficiencies on the audit report's conclusions and the viewpoints of users of the audit report, both quantitatively and qualitatively.

8.56 Internal control deficiencies are a type of finding, and the requirements related to developing the four elements of a finding in paragraph 8.114 apply. When determining the cause of internal control deficiencies, it may be helpful for auditors to perform an analysis to identify the root cause of the deficiency. Identifying the root causes of internal control deficiencies may strengthen the quality of auditors' recommendations for corrective actions.

Requirements: Information Systems Controls Considerations

8.57 The effectiveness of significant internal controls frequently depends on the effectiveness of information systems controls. Thus, when obtaining an understanding of internal control significant to the audit objectives, auditors should also determine whether it is necessary to evaluate information systems controls.

8.58 When information systems controls are determined to be significant to the audit objectives or when the effectiveness of significant controls depends on the effectiveness of information systems controls, auditors should then evaluate the design, implementation, and operating effectiveness of such controls. This evaluation includes other information systems controls that affect the effectiveness of the significant controls or the reliability of information used in performing the significant controls. Auditors should obtain a sufficient understanding of information systems controls necessary to assess audit risk and plan the audit within the context of the audit objectives.

8.59 Auditors should determine which audit procedures related to information systems controls are needed to obtain sufficient, appropriate evidence to support the audit findings and conclusions.

8.60 When evaluating information systems controls is an audit objective, auditors should test information systems controls to the extent necessary to address the audit objective.

⁵¹See paras. 9.24 through 9.25 for a discussion of reporting internal control deficiencies.

Application Guidance: Information Systems Controls Considerations

8.61 Understanding information systems controls is important when information systems are used extensively throughout the program under audit and the fundamental business processes related to the audit objectives rely on information systems. Information systems controls consist of those internal controls that depend on information systems processing and include general controls, application controls, and user controls.

- a.** Information systems general controls (entity-wide, system, and application levels) are the policies and procedures that apply to all or a large segment of an entity's information systems. General controls help ensure the proper operation of information systems by creating the environment for proper operation of application controls. General controls include security management, logical and physical access, configuration management, segregation of duties, and contingency planning.
- b.** Application controls, sometimes referred to as business process controls, are those controls that are incorporated directly into computer applications to help ensure the validity, completeness, accuracy, and confidentiality of transactions and data during application processing. Application controls include controls over input, processing, output, master file, interface, and the data management system.
- c.** User controls are portions of controls that are performed by people interacting with information system controls. A user control is an information system control if its effectiveness depends on information systems processing or the reliability (accuracy, completeness, and validity) of information processed by information systems.

8.62 An entity's use of information systems controls may be extensive; however, auditors are primarily interested in those information systems controls that are significant to the audit objectives. Information systems controls are significant to the audit objectives if auditors determine that it is necessary to evaluate the effectiveness of information systems controls in order to obtain sufficient, appropriate evidence. For example, an audit objective may involve evaluating the effectiveness of information systems controls related to certain systems, facilities, or entities.

8.63 Audit procedures to evaluate the effectiveness of significant information systems controls include (1) gaining an understanding of the system as it relates to the information and (2) identifying and evaluating the general, application, and user controls that are critical to providing assurance over the reliability of the information required for the audit.

8.64 The evaluation of information systems controls may be done in conjunction with the auditors' consideration of internal control within the context of the audit objectives or as a separate audit objective or audit procedure, depending on the objectives 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 related to information systems controls are affected by the hardware and software used, the configuration of the entity's systems and networks, and the entity's information systems strategy.

8.65 The following factors may assist auditors in determining the significance of information system controls to the audit objectives:

- a.** The extent to which internal controls that are significant to the audit depend on the reliability of information processed or generated by information systems.

- b. The availability of evidence outside the information system to support the findings and conclusions: It may not be possible for auditors to obtain sufficient, appropriate evidence without evaluating the effectiveness of relevant information systems controls. For example, if information supporting the findings and conclusions is generated by information systems or its reliability depends 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: To obtain evidence about the reliability of computer-generated information, auditors may decide to evaluate the effectiveness of information systems controls as part of obtaining evidence about the reliability of the data. If the auditor concludes that information systems controls are effective, the auditor may reduce the direct testing of data.

Requirement: Provisions of Laws, Regulations, Contracts, and Grant Agreements

8.66 Auditors should identify any provisions of laws, regulations, contracts, and grant agreements that are significant within the context of the audit objectives and assess the risk that noncompliance with provisions of laws, regulations, contracts, and grant agreements could occur. Based on that risk assessment, the auditors should design and perform procedures to obtain reasonable assurance of detecting instances of noncompliance with provisions of laws, regulations, contracts, and grant agreements that are significant within the context of the audit objectives.

Application Guidance: Provisions of Laws, Regulations, Contracts, and Grant Agreements

8.67 Government programs are subject to many provisions of laws, regulations, contracts, and grant agreements. At the same time, these provisions' significance within the context of the audit objectives varies widely, depending on the objectives of the audit. Auditors may consult with their own legal counsel to (1) determine those laws and regulations that are significant to the audit objectives, (2) design tests of compliance with provisions of laws and regulations, and (3) evaluate the results of those tests. Auditors also may consult with their own 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 professional services to the audited entity, or applicable law enforcement authorities, to obtain information on compliance matters.

8.68 The auditors' assessment of audit risk may be affected by such factors as the complexity or recent establishment of the laws, regulations, contracts, and grant agreements. The auditors' assessment of audit risk also may be affected by whether the audited entity has controls that are effective in preventing or detecting noncompliance with provisions of laws, regulations, contracts, and grant agreements. If auditors obtain sufficient, appropriate evidence of the effectiveness of these controls, they can reduce their tests of compliance.

Requirements: Fraud, Waste, and Abuse

8.69 As part of a performance audit, if auditors become aware of potential fraud, waste, or abuse that could be quantitatively or qualitatively significant to the audit objectives, auditors should perform audit procedures to ascertain the potential effect on the audit objectives.

8.70 Auditors should assess risks of fraud occurring that are significant within the context of the audit objectives. Audit team members should discuss among the team fraud risks, including factors such as individuals' incentives or pressures to commit fraud, the opportunity for fraud to occur, and rationalizations or attitudes that could increase the risk of fraud. Auditors should gather and assess information to identify risks of fraud that are significant within the scope of the audit objectives or that could affect the findings and conclusions.

8.71 Assessing the risk of fraud is an ongoing process throughout the audit. When information comes to the auditors' attention indicating that potential fraud, significant within the context of the audit objectives, may have occurred, auditors should extend the audit steps and procedures, as necessary, to (1) determine whether fraud has likely occurred and (2) if so, determine its effect on the audit findings.

Application Guidance: Fraud, Waste, and Abuse

8.72 Fraud involves obtaining something of value through willful misrepresentation. Whether an act is, in fact, fraud is determined through the judicial or other adjudicative system and is beyond auditors' professional responsibility.

8.73 Auditors may obtain information through discussion with officials of the audited entity or through other means to determine the susceptibility of a program to fraud, the extent to which the audited entity has implemented leading practices to manage fraud risks, the status of internal controls the audited entity has established to prevent and detect fraud, or the risk that officials of the audited entity could override internal control. An attitude of professional skepticism in assessing the risk of fraud assists auditors in assessing which factors or risks could significantly affect the audit objectives.

8.74 If fraud that may have occurred is not significant within the context of the audit objectives, the auditors may perform additional audit work as a separate engagement or refer the matter to other parties with oversight responsibility or jurisdiction.

8.75 Waste is the act of using or expending resources carelessly, extravagantly, or to no purpose. Waste involves the taxpayers not receiving reasonable value for money in connection with any government-funded activities because of an inappropriate act or omission by parties with control over or access to government resources. Importantly, waste can include activities that do not include fraud and abuse and does not necessarily involve a violation of law. Rather, waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight.

8.76 Abuse is 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, but excludes fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Because the determination of abuse is subjective, auditors are not required to perform procedures to detect abuse in performance audits. Auditors may discover that the

abuse is indicative of potential fraud or noncompliance with provisions of laws, regulations, contracts, and grant agreements.

Requirements: Identifying Sources of Evidence and the Amount and Type of Evidence Required

8.77 Auditors should identify potential sources of information that could be used as evidence. Auditors should determine the amount and type of evidence needed to obtain sufficient, appropriate evidence to address the audit objectives and adequately plan audit work.

8.78 Auditors should also evaluate whether the lack of sufficient, appropriate evidence is caused by internal control deficiencies or other program weaknesses, and whether the lack of sufficient, appropriate evidence could be the basis for audit findings.

Application Guidance: Identifying Sources of Evidence and the Amount and Type of Evidence Required

8.79 If auditors believe that it is likely that sufficient, appropriate evidence will not be available, they may revise the audit objectives or modify the scope and methodology and determine alternative procedures to obtain additional evidence or other forms of evidence to address the current audit objectives.

Requirements: Using the Work of Others

8.80 Auditors should determine whether other auditors have conducted, or are conducting, audits that could be relevant to the current audit objectives.

8.81 If auditors use the work of other auditors, they should perform procedures that provide a sufficient basis for using that work. Auditors should obtain evidence concerning the other auditors' qualifications and independence and should determine whether the scope, quality, and timing of the audit work performed by the other auditors can be relied on in the context of the current audit objectives.

Application Guidance: Using the Work of Others

8.82 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 objectives, scope, and methodology.

8.83 Internal auditing is an important part of overall governance, accountability, and internal control. A key role of many internal audit organizations is to provide assurance that internal controls are in place to adequately mitigate risks and achieve program goals and objectives. Auditors may determine that it is appropriate to use the work of the internal auditors in assessing the effectiveness of design or operation of internal controls that are significant within the context of the audit objectives.

8.84 If other auditors have completed audit work related to the objectives of the current audit, the current auditors may be able to use the work of the other auditors to support findings or conclusions for the current audit and thereby avoid duplication of effort. Procedures that

auditors may perform in making this determination include reviewing the other audit report, audit plan, or audit documentation; performing tests of the other auditors' work; or a combination of these. The nature and extent of evidence needed will depend on the significance of the other auditors' work to the current audit objectives and the extent to which the auditors will use that work.

Supervision

Requirement: Supervision

8.85 Auditors in supervisory roles must properly supervise audit staff.

Application Guidance: Supervision

8.86 Audit supervision involves providing sufficient guidance and direction to staff assigned to the audit to address the audit objectives and follow applicable requirements, while staying informed about significant problems encountered, reviewing the work performed, and providing effective on-the-job training.

8.87 The nature and extent of the supervision of staff and 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.

Evidence

Requirements: Evidence

8.88 Auditors must obtain sufficient, appropriate evidence to provide a reasonable basis for addressing the audit objectives and supporting their findings and conclusions.

8.89 In assessing the appropriateness of evidence, auditors should assess whether the evidence is relevant, valid, and reliable.

8.90 In determining the sufficiency of evidence, auditors should determine whether enough appropriate evidence exists to address the audit objectives and support the findings and conclusions to the extent that would persuade a knowledgeable person that the findings are reasonable.

8.91 When auditors use information provided by officials of the audited entity as part of their evidence, they should determine what the officials of the audited entity or other auditors did to obtain assurance over the reliability of the information.

8.92 Auditors should evaluate the objectivity, credibility, and reliability of testimonial evidence.

Application Guidance: Evidence

8.93 Audit objectives may vary widely, as may the level of work necessary to assess the sufficiency and appropriateness of evidence to address the objectives. The concepts of audit risk and significance assist auditors in evaluating the audit evidence. Professional judgment assists auditors in determining the sufficiency and appropriateness of evidence taken as a

whole. Interpreting, summarizing, or analyzing evidence is typically used in determining the sufficiency and appropriateness of evidence and in reporting the results of the audit work.

8.94 When auditors use information provided by officials of the audited entity as part of their evidence, auditors may find it necessary to test management's procedures to obtain assurance, perform direct testing of the information, or obtain additional corroborating evidence. The nature, timing, and extent of the auditors' procedures will depend on the significance of the information to the audit objectives and the nature of the information being used. Using a risk-based approach, auditors may consider additional procedures if they become aware of evidence that conflicts with that provided by management. In their overall assessment, auditors may document how they resolved situations involving conflicting evidence.⁵²

8.95 Auditors may request that management provide written representations as to the accuracy and completeness of information provided. However, this step is not a requirement for GAGAS performance audits.

8.96 The nature, timing, and extent of audit procedures to assess sufficiency and appropriateness are affected by the effectiveness of the audited entity's internal controls over the information, including information systems controls, and the significance of the information and the level of detail presented in the auditors' findings and conclusions in light of the audit objectives. The sufficiency and appropriateness of computer-processed information is assessed regardless of whether this information is provided to auditors or auditors independently extract it. The assessment of the sufficiency and appropriateness of computer-processed information includes considering the completeness and accuracy of the data for the intended purposes.

Sufficiency

8.97 Sufficiency is a measure of the quantity of evidence used to support the findings and conclusions related to the audit objectives.

8.98 When appropriate, auditors may use statistical methods to analyze and interpret evidence to assess its sufficiency.

8.99 The following presumptions are useful in judging the sufficiency of evidence. The sufficiency of evidence required to support the auditors' findings and conclusions is a matter of the auditors' professional judgment.

- a. The greater the audit risk, the greater the quantity and quality of evidence required.
- b. Stronger evidence may allow less evidence to be used.

Appropriateness

8.100 Appropriateness is the measure of the quality of evidence that encompasses the relevance, validity, and reliability of evidence used for addressing the audit objectives and supporting findings and conclusions.

- a. Relevance refers to the extent to which evidence has a logical relationship with, and importance to, the issue being addressed.

⁵²See para. 8.103 for a discussion of the relationship between testimonial and documentary evidence.

- b. Validity refers to the extent to which evidence is a meaningful or reasonable basis for measuring what is being evaluated. In other words, validity refers to the extent to which evidence represents what it is purported to represent.
- c. Reliability refers to the consistency of results when information is measured or tested and includes the concepts of being verifiable or supported. For example, in establishing the appropriateness of evidence, auditors may test its reliability by obtaining supporting evidence, using statistical testing, or obtaining corroborating evidence.
- d. Having a large volume of evidence does not compensate for a lack of relevance, validity, or reliability.

8.101 The degree of assurance associated with a performance audit is strongly associated with the appropriateness of evidence in relation to the audit objectives. Examples follow.

- a. The audit objectives might focus on verifying specific quantitative results presented by the audited entity. In these situations, the audit procedures would likely focus on obtaining evidence about the accuracy of the specific amounts in question. This work may include the use of statistical sampling.
- b. The audit objectives might focus on the performance of a specific program or activity in the audited entity. In these situations, the auditors may be provided information compiled by the audited entity in order to satisfy the audit objectives. The auditors 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 perform procedures to verify the information. These decisions call for use of professional judgment based on the nature of the information, its common usage or acceptance, and how it is being used in the audit.
- 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 impractical to verify the detailed data underlying the statistics. Clear disclosure of the extent to which comparative information or statistics were evaluated or corroborated will likely be necessary to place the evidence in context for report users.
- e. The audit objectives might focus on trend information based on data provided by the audited entity. In this situation, auditors may assess the evidence by using overall analytical tests of underlying data, combined with knowledge and understanding of the systems or processes used for compiling information.
- f. The audit objectives might focus on identifying emerging and crosscutting issues using information compiled or self-reported by audited entities. In such cases, it may be helpful for the auditors to consider the overall appropriateness of the compiled information along 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.

8.102 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 summary memos, photographs, videos, drawings, charts, maps, or physical samples. Documentary evidence is 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 evidence gathered to determine whether it is sufficient and appropriate. Evidence may be obtained by observation, inquiry, or inspection. Each type of evidence has its own strengths and weaknesses. The following contrasts are useful in judging the appropriateness of evidence. However, these contrasts are not adequate in themselves to determine appropriateness. The nature and types of evidence to support auditors' findings and conclusions are matters of the auditors' professional judgment based on the audit objectives and audit risk.

- a. Evidence obtained when internal control is effective is generally more reliable than evidence obtained when internal control is weak or nonexistent.⁵³
- b. Evidence obtained through the auditors' direct physical examination, observation, computation, and inspection is generally more reliable than evidence obtained indirectly.
- c. Examination of original documents is generally more reliable than examination of copies.
- d. Testimonial evidence obtained under conditions in which persons may speak freely is generally more reliable than evidence obtained under circumstances in which the persons may be intimidated.
- e. Testimonial evidence obtained from an individual who is not biased and has direct knowledge about the area is generally more reliable than testimonial evidence obtained from an individual who is biased or has indirect or partial knowledge about the area.
- f. Evidence obtained from a knowledgeable, credible, and unbiased third party is generally more reliable than evidence obtained from management of the audited entity or others who have a direct interest in the audited entity.

8.103 Testimonial evidence may be useful in interpreting or corroborating documentary or physical information. Documentary evidence may be used to help verify, support, or challenge testimonial evidence.

8.104 Surveys generally provide self-reported information about existing conditions or programs. Evaluation of the survey design and administration assists auditors in evaluating the objectivity, credibility, and reliability of the self-reported information.

8.105 When sampling is used, the appropriate selection method will depend on the audit objectives. When a representative sample is needed, the use of statistical sampling approaches generally results in stronger evidence than that obtained from nonstatistical techniques. When a

⁵³See paras. 8.37 through 8.65 for a discussion of internal control.

representative sample is not needed, a targeted selection may be effective if the auditors have isolated risk factors or other criteria to target the selection.

Requirements: Overall Assessment of Evidence

8.106 Auditors should perform and document an overall assessment of the collective evidence used to support findings and conclusions, including the results of any specific assessments performed to conclude on the validity and reliability of specific evidence.

8.107 When assessing the overall sufficiency and appropriateness of evidence, auditors should evaluate the expected significance of evidence to the audit objectives, findings, and conclusions; available corroborating evidence; and the level of audit risk. If auditors conclude that evidence is not sufficient or appropriate, they should not use such evidence as support for findings and conclusions.

8.108 When the auditors identify limitations or uncertainties in evidence that is significant to the audit findings and conclusions, they should perform additional procedures, as appropriate.

Application Guidance: Overall Assessment of Evidence

8.109 Professional judgments about the sufficiency and appropriateness of evidence are closely interrelated, as auditors interpret the results of audit testing and evaluate whether the nature and extent of the evidence obtained is sufficient and appropriate.

8.110 Sufficiency and appropriateness of evidence are relative concepts, which may be thought of as a continuum rather than as absolutes. Sufficiency and appropriateness are evaluated in the context of the related findings and conclusions. For example, even though the auditors may identify some limitations or uncertainties about the sufficiency or appropriateness of some of the evidence, they may nonetheless determine that in total there is sufficient, appropriate evidence to support the findings and conclusions.

8.111 The steps to assess evidence may depend on the nature of the evidence, how the evidence is used in the audit or report, and the audit objectives.

- a. Evidence is sufficient and appropriate when it provides a reasonable basis for supporting the findings or conclusions within the context of the audit objectives.
- b. Evidence is not sufficient or not appropriate when (1) using the evidence carries an unacceptably high risk that it could lead auditors to reach an incorrect or improper conclusion; (2) the evidence has significant limitations, given the audit objectives and intended use of the evidence; or (3) the evidence does not provide an adequate basis for addressing the audit objectives or supporting the findings and conclusions.

8.112 Evidence has limitations or uncertainties when the validity or reliability of the evidence has not been assessed or cannot be assessed, given the audit objectives and the intended use of the evidence. Limitations also include errors identified by the auditors in their testing.

8.113 Additional procedures that could address limitations or uncertainties in evidence that is significant to the audit findings and conclusions include

- a. seeking independent, corroborating evidence from other sources;
- b. redefining the audit objectives or limiting the audit scope to eliminate the need to use the evidence;

- c. presenting the findings and conclusions so that the supporting evidence is sufficient and appropriate and describing in the report the limitations or uncertainties with the validity or reliability of the evidence, if such disclosure is necessary to avoid misleading the report users about the findings or conclusions; and
- d. determining whether to report the limitations or uncertainties as a finding, including any related, significant internal control deficiencies.

Requirements: Findings

8.114 As part of a performance audit, when auditors identify findings, auditors should plan and perform procedures to develop the criteria, condition, cause, and effect of the findings to the extent that these elements are relevant and necessary to achieve the audit objectives.

8.115 Auditors should consider potential internal control deficiencies in their evaluation of identified findings when developing the cause element of the identified findings.

Application Guidance: Findings

8.116 Findings may involve deficiencies in internal control; noncompliance with provisions of laws, regulations, contracts, and grant agreements; or instances of fraud, waste, or abuse.

8.117 Criteria: For inclusion in findings, criteria may include the laws, regulations, contracts, grant agreements, standards, measures, expected performance, defined business practices, and benchmarks against which performance is compared or evaluated. Criteria identify the required or desired state or expectation with respect to the program or operation. For audit objectives that pertain to the current status or condition of a program, sufficient, appropriate evidence is gathered to provide reasonable assurance that the description is accurate and reliable and does not omit significant information relevant to the audit objectives. Information addressing the audit objectives is to be provided in an objective, understandable manner. The relative importance of each of the characteristics of the information to a particular engagement is a matter of professional judgment. The term program includes processes, projects, studies, policies, operations, activities, entities, and functions. Criteria provide a context for evaluating evidence and understanding the findings, conclusions, and recommendations included in the report.

8.118 Condition: Condition is a situation that exists. The condition is determined and documented during the audit.

8.119 Cause: The cause is the factor or factors responsible for the difference between the condition and the criteria, which may also serve as a basis for recommendations for corrective actions. Common factors include poorly designed policies, procedures, or criteria; inconsistent, incomplete, or incorrect implementation; or factors beyond the control of program management. Auditors may assess whether the evidence provides a reasonable and convincing argument for why the stated cause is the key factor contributing to the difference between the condition and the criteria.

8.120 Effect or potential effect: The effect or potential effect is the outcome or consequence resulting from the difference between the condition and the criteria. When the audit 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. Effect or potential effect may be used to demonstrate the need for corrective action in response to identified problems or relevant risks.

8.121 The elements needed for a finding are related to the objectives of the audit. Thus, a finding or set of findings is complete to the extent that the audit objectives are addressed and the report clearly relates those objectives to the elements of a finding. For example, an audit objective may be to determine the current status or condition of program operations or progress in implementing legislative requirements, and not the related cause or effect. In this situation, developing the condition would address the audit objective, and developing the other elements of a finding would not be necessary.

8.122 The cause of a finding may relate to an underlying internal control deficiency. For example, auditors performing a compliance audit may find that an audited entity has not complied with certain legislation. Upon further evaluation, the auditors may find the root cause of the finding to be that one of the entity's control activities was not properly designed. In this case, the finding would be an instance of noncompliance, but the cause of the finding would be an internal control deficiency.

8.123 Considering internal control in the context of a comprehensive internal control framework, such as *Standards for Internal Control in the Federal Government* or *Internal Control—Integrated Framework*,⁵⁴ can help auditors to determine whether potential underlying internal control deficiencies exist as the root cause of findings. When the audit objectives include explaining why a particular type of positive or negative program performance, output, or outcome identified in the audit occurred, the underlying deficiencies are referred to as cause. Identifying the cause of problems may assist auditors in making constructive recommendations for correction. Auditors may identify deficiencies in program design or structure as the cause of deficient performance. Auditors may also identify deficiencies in internal control that are significant to the subject matter of the performance audit as the cause of deficient performance. In developing these types of findings, the deficiencies in program design or internal control would be described as the cause. Often the causes of deficient program performance are complex and involve multiple factors, including fundamental, systemic root causes.

8.124 When the audit objectives include estimating the extent to which a program has caused changes in physical, social, or economic conditions, “effect” is a measure of the program's impact. 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 the program.

Audit Documentation

Requirements: Audit Documentation

8.125 Auditors must prepare audit documentation related to planning, conducting, and reporting for each audit. Auditors should prepare audit documentation in sufficient detail to enable an experienced auditor, having no previous connection to the audit, to understand from the audit

⁵⁴The Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control—Integrated Framework* and *Standards for Internal Control in the Federal Government* (GAO-14-704G) provide suitable and available criteria against which management may evaluate and report on the effectiveness of the entity's internal control. *Standards for Internal Control in the Federal Government* may be adopted by entities beyond those federal entities for which it is legally required, such as state, local, and quasi-governmental entities, as well as other federal entities and not-for-profit organizations, as a framework for an internal control system.

documentation the nature, timing, extent, and results of audit procedures performed; the evidence obtained; and its source and the conclusions reached, including evidence that supports the auditors' significant judgments and conclusions.

8.126 Auditors should prepare audit documentation that contains evidence that supports the findings, conclusions, and recommendations before they issue their report.

8.127 Auditors should design the form and content of audit documentation to meet the circumstances of the particular audit. The audit documentation constitutes the principal record of the work that the auditors have performed in accordance with standards and the conclusions that the auditors have reached. The quantity, type, and content of audit documentation are a matter of the auditors' professional judgment.

8.128 Auditors should document the following:

- a. the objectives, scope, and methodology of the audit;
- b. the work performed and evidence obtained to support expectations in analytical procedures and significant judgments and conclusions, including descriptions of transactions and records examined (for example, by listing file numbers, case numbers, or other means of identifying specific documents examined, though copies of documents examined or detailed listings of information from those documents are not required); and
- c. supervisory review, before the audit report is issued, of the evidence that supports the findings, conclusions, and recommendations contained in the audit report.

8.129 When auditors do not comply with applicable GAGAS requirements because of law, regulation, scope limitations, restrictions on access to records, or other issues affecting the audit, the auditors should document the departure from the GAGAS requirements and the impact on the audit and on the auditors' conclusions.

Application Guidance: Audit Documentation

8.130 Audit documentation is an essential element of audit quality. The process of preparing and reviewing audit documentation contributes to the quality of an audit. Audit documentation serves to (1) provide the principal support for the audit report, (2) aid auditors in conducting and supervising the audit, and (3) allow for the review of audit quality.

8.131 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 conduct the performance audit. These competencies and skills include an understanding of (1) the performance audit processes, (2) GAGAS and applicable legal and regulatory requirements, (3) the subject matter associated with achieving the audit objectives, and (4) issues related to the audited entity's environment.

8.132 When documenting departures from the GAGAS requirements, the audit documentation requirements apply to departures from unconditional requirements and from presumptively mandatory requirements when alternative procedures performed in the circumstances were not sufficient to achieve the objectives of the requirements.

Requirement: Availability of Individuals and Documentation

8.133 Subject to applicable provisions of laws and regulations, auditors should make appropriate individuals, as well as audit documentation, available upon request and in a timely manner to other auditors or reviewers.

Application Guidance: Availability of Individuals and Documentation

8.134 Underlying GAGAS audits is the premise that audit organizations in federal, state, and local governments and public accounting firms engaged to conduct audits in accordance with GAGAS cooperate in auditing programs of common interest so that auditors may use others' work and avoid duplication of efforts. The use of auditors' work by other auditors may be facilitated by contractual arrangements for GAGAS audits that provide for full and timely access to appropriate individuals and to audit documentation.

Chapter 9: Reporting Standards for Performance Audits

9.01 This chapter contains reporting requirements and guidance for performance audits conducted in accordance with GAGAS. Reporting requirements establish the auditors' overall approach for communicating the results of the performance audit. The reporting requirements for performance audits relate to the form of the report, the report contents, and report issuance and distribution. For performance audits conducted in accordance with GAGAS, the requirements and guidance in chapters 1 through 5 and chapter 8 also apply.

GAGAS Requirements for Reporting on Performance Audits

Requirements: Reporting Auditors' Compliance with GAGAS

9.02 When auditors comply with all applicable GAGAS requirements, they should use the following language, which represents an unmodified GAGAS compliance statement, in the audit report to indicate that they conducted the audit in accordance with GAGAS:

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 to provide 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.

9.03 Audit organizations that meet the independence requirements for internal auditors, but not those for external auditors, should include in the GAGAS compliance statement, where applicable, a statement that they are independent per the GAGAS requirements for internal auditors.

9.04 When auditors do not comply with all applicable GAGAS requirements, they should include a modified GAGAS compliance statement in the audit report. For performance audits, auditors should use a statement that includes either (1) the language in paragraph 9.02, modified to indicate the requirements that were not followed, or (2) language indicating that the auditors did not follow GAGAS.

Report Format

Requirements: Report Format

9.05 Auditors should issue audit reports communicating the results of each completed performance audit.

9.06 Auditors should issue the audit report in a form that is appropriate for its intended use, either in writing or in some other retrievable form.⁵⁵

Application Guidance: Report Format

9.07 The purposes of audit reports are to (1) clearly communicate the results of audits to those charged with governance, the appropriate officials of the audited entity, and the appropriate oversight officials and (2) facilitate follow-up to determine whether appropriate corrective actions have been taken.

9.08 Auditors may present audit reports using electronic media that are retrievable by report users and the audit organization. The users' needs will influence the form of the audit report. Different forms of audit reports include written reports, letters, briefing slides, or other presentation materials.

Report Content

Requirements: Report Content, Including Objectives, Scope, and Methodology

9.09 Auditors should prepare audit reports that contain (1) the objectives, scope, and methodology of the audit; (2) the audit results, including findings, conclusions, and recommendations, as appropriate; (3) a summary of the views of responsible officials; and (4) if applicable, the nature of any confidential or sensitive information omitted.

9.10 Auditors should communicate audit objectives in the audit report in a clear, specific, neutral, and unbiased manner that includes relevant assumptions. In order to avoid potential misunderstanding, when audit objectives are limited but broader objectives could be inferred by users, auditors should state in the audit report that certain issues were outside the scope of the audit.

9.11 Auditors should describe the scope of the work performed and any limitations, including issues that would be relevant to likely users, so that report users can reasonably interpret the findings, conclusions, and recommendations in the report without being misled. Auditors should also report any significant constraints imposed on the audit approach by information limitations or scope impairments, including denials of, or excessive delays in, access to certain records or individuals.

⁵⁵See paras. 9.53 through 9.64 for a discussion of report distribution and reporting confidential or sensitive information.

9.12 In describing the work performed to address the audit objectives and support the reported findings and conclusions, auditors should, as applicable, explain the relationship between the population and the items tested; identify entities, 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.

9.13 In reporting audit methodology, auditors should explain how the completed audit work supports the audit objectives, including the evidence-gathering and evidence-analysis techniques, in sufficient detail to allow knowledgeable users of their reports to understand how the auditors addressed the audit objectives. Auditors should identify significant assumptions made in conducting the audit; describe comparative techniques applied; describe the criteria used; and, when the results of sample testing significantly support the auditors' findings, conclusions, or recommendations, describe the sample design and state why the design was chosen, including whether the results can be projected to the intended population.

Application Guidance: Report Content, Including Objectives, Scope, and Methodology

9.14 Report users need information regarding the audit objectives, scope, and methodology to understand the purpose of the audit; the nature and extent of the audit work performed; the context and perspective regarding what is reported; and any significant limitations in the audit objectives, scope, or methodology.

9.15 In reporting audit methodology, auditors may include a description of the procedures performed as part of their assessment of the sufficiency and appropriateness of information used as audit evidence.

Requirements: Reporting Findings

9.16 In the audit report, auditors should present sufficient, appropriate evidence to support the findings and conclusions in relation to the audit objectives. Auditors should provide recommendations for corrective action if findings are significant within the context of the audit objectives.

9.17 Auditors should describe in their report limitations or uncertainties with the reliability or validity of evidence if (1) the evidence is significant to the findings and conclusions within the context of the audit objectives and (2) such disclosure is necessary to avoid misleading the report users about the findings and conclusions. Auditors should describe the limitations or uncertainties regarding evidence in conjunction with the findings and conclusions, in addition to describing those limitations or uncertainties as part of the objectives, scope, and methodology.

9.18 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 findings. To give the reader a basis for judging the prevalence and consequences of these findings, auditors should, as appropriate, relate the instances identified to the population or the number of cases examined and quantify the results in terms of dollar value or other measures. If the results cannot be projected, auditors should limit their conclusions appropriately.

9.19 When reporting on the results of their work, auditors should disclose significant facts relevant to the objectives of their work and known to them that if not disclosed, could mislead

knowledgeable users, misrepresent the results, or conceal significant improper or illegal practices.

9.20 Auditors should report deficiencies in internal control; noncompliance with provisions of laws, regulations, contracts, and grant agreements; and instances of fraud, waste, or abuse that have occurred and are significant within the context of the audit objectives.⁵⁶

Application Guidance: Reporting Findings

9.21 The extent to which the elements for a finding are developed depends on the audit objectives. Clearly developed findings assist management and oversight officials of the audited entity in understanding the need for taking corrective action. Recommendations can be developed from, at a minimum, the criteria and condition elements of a finding.

9.22 As discussed in paragraphs 8.106 through 8.113, even though the auditors may have some uncertainty about the sufficiency or appropriateness of some of the evidence, they may nonetheless determine that in total there is sufficient, appropriate evidence given the findings and conclusions. Describing limitations provides report users with a clear understanding regarding how much responsibility the auditors are taking for the information.

9.23 Auditors may provide background information to establish the context for the overall message and to help the reader understand the findings and significance of the issues discussed. Appropriate background information may include information on how programs and operations work; the significance of programs and operations (e.g., dollars, effect, 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.

Requirement: Reporting on Internal Control

9.24 When internal control is significant within the context of the audit objectives, auditors should include in the audit report (1) the scope of their work on internal control, including how the auditors considered the concept of accountability for use of public resources and government authority while assessing audit risk associated with internal control, and (2) any deficiencies in internal control that are significant within the context of the audit objectives and based upon the audit work performed. When auditors detect deficiencies in internal control that are not significant to the objectives of the audit but warrant the attention of those charged with governance, they should include those deficiencies either in the report or communicate those deficiencies in writing to audited entity officials. If the written communication is separate from the audit report, auditors should refer to that written communication in the audit report.

9.25 If internal control that is significant to the audit objectives does not include all internal control components and underlying principles, the auditors should indicate in their report that the audit did not consider all internal control components, and that if it had, deficiencies may have been identified that could impair the effectiveness of the controls evaluated as part of the audit. This could occur, for example, in an audit where only the control activities component of internal control or only certain control activities are significant to the audit objectives, and

⁵⁶See para. 8.15 for a discussion of significance.

deficiencies in the other components or controls that are not significant to the audit objectives could impair the effectiveness of the control activities.

Application Guidance: Reporting on Internal Control

9.26 When auditors detect deficiencies in internal control that do not warrant the attention of those charged with governance, determining whether and how to communicate such deficiencies to audited entity officials is a matter of professional judgment.

Requirements: Reporting on Noncompliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements

9.27 Auditors should report a matter as a finding when they conclude, based on sufficient, appropriate evidence—which may include a legal determination or adjudication by a court—that noncompliance with provisions of laws, regulations, contracts, and grant agreements has occurred that is significant within the context of the audit objectives.

9.28 Auditors should communicate findings in writing to audited entity officials when the auditors detect potential instances of noncompliance with provisions of laws, regulations, contracts, and grant agreements that are not significant within the context of the audit objectives but warrant the attention of those charged with governance.

Application Guidance: Reporting on Noncompliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements

9.29 Whether a particular act is, in fact, noncompliance with provisions of laws, regulations, contracts, and grant agreements may have to await final determination by a court of law or other adjudicative body.⁵⁷

9.30 When auditors detect potential instances of noncompliance with provisions of laws, regulations, contracts, and grant agreements that do not warrant the attention of those charged with governance, the auditors' determination of whether and how to communicate such instances to audited entity officials is a matter of professional judgment.

9.31 When noncompliance with provisions of laws, regulations, contracts, and grant agreements has occurred, auditors may consult with authorities or legal counsel about whether publicly reporting such information would compromise investigative or legal proceedings. Auditors may limit their public reporting to matters that would not compromise those proceedings and, for example, report only on information that is already a part of the public record.

Requirements: Reporting on Instances of Fraud, Waste, or Abuse

9.32 Auditors should report a matter as a finding when they conclude, based on sufficient, appropriate evidence—which may include a legal determination or adjudication by a court—that instances of fraud, waste, or abuse have occurred that are material, either quantitatively or qualitatively, and are significant to the audit objectives.

⁵⁷See paras.8.26 through 8.28 for a discussion of investigations or legal proceedings.

9.33 Auditors should communicate findings in writing to audited entity officials when the auditors detect potential instances of fraud, waste, or abuse that are not significant within the context of the audit objectives but warrant the attention of those charged with governance.

Application Guidance: Reporting on Instances of Fraud, Waste, or Abuse

9.34 Whether a particular act is, in fact, fraud, waste, or abuse may have to await final determination by a court of law or other adjudicative body.⁵⁸

9.35 When auditors detect potential instances of fraud, waste, or abuse that do not warrant the attention of those charged with governance, the auditors' determination of whether and how to communicate such instances to audited entity officials is a matter of professional judgment.

9.36 When fraud, waste, or abuse have occurred, auditors may consult with authorities or legal counsel about whether publicly reporting such information would compromise investigative or legal proceedings. Auditors may limit their public reporting to matters that would not compromise those proceedings and, for example, report only on information that is already a part of the public record.

Requirements: Reporting Findings Directly to Parties outside the Audited Entity

9.37 Auditors should report noncompliance with provisions of laws, regulations, contracts, and grant agreements and instances of fraud, waste, or abuse directly to parties outside the audited entity in the following two circumstances.

- a. When audited entity management fails to satisfy legal or regulatory requirements to report such information to external parties specified in law or regulation, auditors should first communicate the failure to report such information to those charged with governance. If the audited entity still does not report this information to the specified external parties as soon as practicable after the auditors' communication with those charged with governance, then the auditors should report the information directly to the specified external parties.
- b. When audited entity management fails to take timely and appropriate steps to respond to noncompliance with provisions of laws, regulations, contracts, and grant agreements or instances of fraud, waste, or abuse that (1) are likely to have a material effect on the subject matter and (2) involve funding received directly or indirectly from a government agency, auditors should first report management's failure to take timely and appropriate steps to those charged with governance. If the audited entity still does not take timely and appropriate steps as soon as practicable after the auditors' communication with those charged with governance, then the auditors should report the audited entity's failure to take timely and appropriate steps directly to the funding agency.

9.38 Auditors should comply with the requirements in paragraph 9.37 even if they have resigned or been dismissed from the audit prior to its completion.

9.39 Auditors should obtain sufficient, appropriate evidence, such as confirmation from outside parties, to corroborate representations by audited entity management that it has reported audit

⁵⁸See paras.8.26 through 8.28 for a discussion of investigations or legal proceedings.

findings in accordance with provisions of laws, regulations, or funding agreements. When auditors are unable to do so, they should report such information directly, as discussed in paragraphs 9.37 and 9.38.

Application Guidance: Reporting Findings Directly to Parties outside the Audited Entity

9.40 The reporting in paragraph 9.37 is in addition to any legal requirements to report such information directly to parties outside the audited entity.

9.41 Internal audit organizations do not have a duty to report outside the audited entity unless required by law, rule, regulation, or policy.

Requirements: Obtaining the Views of Responsible Officials

9.42 Auditors should obtain and report the views of responsible officials of the audited entity concerning the findings, conclusions, and recommendations included in the audit report, as well as any planned corrective actions.

9.43 When auditors receive written comments from the responsible officials, they should include in their report a copy of the officials' written comments, or a summary of the comments received. When the responsible officials provide oral comments only, auditors should prepare a summary of the oral comments, provide a copy of the summary to the responsible officials to verify that the comments are accurately represented, and include the summary in their report.

9.44 Auditors should include in the report an evaluation of the comments from responsible officials, as appropriate.

9.45 When the audited entity's comments are inconsistent or in conflict with the findings, conclusions, or recommendations in the draft report, 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 explain in the report their reasons for disagreement. Conversely, the auditors should modify their report as necessary if they find the comments valid and supported by sufficient, appropriate evidence.

9.46 If the audited entity refuses to provide comments or is unable to provide comments within a reasonable period of time, the auditors may issue the report without receiving comments from the audited entity. In such cases, the auditors should indicate in the report that the audited entity did not provide comments.

Application Guidance: Obtaining the Views of Responsible Officials

9.47 Providing a draft report with findings for review and comment by responsible officials of the audited entity and others helps the auditors develop a report that is fair, complete, and objective. 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. Obtaining the comments in writing is preferred, but oral comments are acceptable. In cases in which the audited entity provides technical comments in addition to its written or oral comments on the report, auditors may disclose in the report that such comments were received.

9.48 Obtaining oral comments may be appropriate when, for example, there is a reporting date critical to meeting a user's needs; auditors have worked closely with the responsible officials

throughout 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 findings, conclusions, or recommendations in the draft report, or major controversies with regard to the issues discussed in the draft report.

Requirement: Conclusions

9.49 Auditors should report conclusions based on the audit objectives and the audit findings.

Application Guidance: Conclusions

9.50 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 more compelling if they lead to the auditors' recommendations and convince a knowledgeable user of the report that action is necessary.

Requirement: Recommendations

9.51 When feasible, auditors should recommend actions to correct deficiencies and other findings 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 flow logically from the findings and conclusions, are directed at resolving the cause of identified deficiencies and findings, and clearly state the actions recommended.

Application Guidance: Recommendations

9.52 Effective recommendations encourage improvements in the conduct of government programs and operations. Recommendations are effective when they are addressed to parties with the authority to act and when the recommended actions are specific, practical, cost-effective, and measurable.

Requirements: Report Distribution

9.53 Distribution of reports completed in accordance with GAGAS depends on the auditors' relationship with the audited organization and the nature of the information contained in the reports. Auditors should document any limitation on report distribution. Auditors should make audit reports available to the public, unless distribution is specifically limited by the terms of the engagement, law, or regulation.

Report Distribution for Internal Auditors

9.54 If an internal audit organization in government entities follows the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing* as well as GAGAS, the head of the internal audit organization should communicate results to the parties who can ensure that the results are given due consideration. If not otherwise mandated by statutory or regulatory requirements, prior to releasing results to parties outside the

organization, the head of the internal audit organization should (1) assess the potential risk to the organization, (2) consult with senior management or legal counsel as appropriate, and (3) control dissemination by indicating the intended users in the report.

Report Distribution for External Auditors

9.55 Audit organizations in government entities should distribute audit reports to those charged with governance, to the appropriate audited entity officials, and to the appropriate oversight bodies or organizations requiring or arranging for the audits. As appropriate, auditors should also distribute 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.

9.56 A public accounting firm contracted to perform an audit in accordance with GAGAS should clarify report distribution responsibilities with the engaging party. If the contracting firm is responsible for the distribution, it should reach agreement with the party contracting for the audit about which officials or organizations will receive the report and the steps being taken to make the report available to the public.

Application Guidance: Report Distribution for External Auditors

9.57 Making an audit report available to the public can involve auditors posting the audit report to their publicly accessible websites or verifying that the audited entity has posted the audit report to its publicly accessible website.

Requirements: Reporting Confidential or Sensitive Information

9.58 If certain information is prohibited from public disclosure or is excluded from a report because of its confidential or sensitive nature, auditors should disclose in the report that certain information has been omitted and the circumstances that make the omission necessary.

9.59 When circumstances call for omission of certain information, auditors should evaluate whether this omission could distort the audit results or conceal improper or illegal practices and revise the report language as necessary to minimize the risk that report users will draw inappropriate conclusions from the information presented.

9.60 When audit organizations are subject to public records laws, auditors should determine whether public records laws could affect the availability of classified or limited use reports and determine whether other means of communicating with management and those charged with governance would be more appropriate. Auditors use judgment to determine the appropriate means to communicate the omitted information to management and those charged with governance considering, among other things, whether public records laws could affect the availability of classified or limited use reports.

Application Guidance: Reporting Confidential or Sensitive Information

9.61 If the report refers to the omitted information, the reference may be general and not specific. If the omitted information is not necessary to meet the audit objectives, the report need not refer to its omission.

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

9.63 Additional circumstances associated with public safety, privacy, or security concerns could justify the exclusion of certain information from a publicly available or widely distributed 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 misuse of this information could cause. In such circumstances, auditors may issue a limited use report containing such information and distribute the report only to those parties responsible for acting on the auditors' recommendations. In some instances, it may be appropriate to issue both a publicly available report with the sensitive information excluded and a limited use report. The auditors may consult with legal counsel regarding any requirements or other circumstances that may necessitate omitting certain information. Considering the broad public interest in the program or activity under audit assists auditors when deciding whether to exclude certain information from publicly available reports.

9.64 In cases described in paragraph 9.60, auditors may communicate general information in a written report and communicate detailed information orally. Auditors may consult with legal counsel regarding applicable public records laws.

Discovery of Insufficient Evidence after Report Release

Requirement: Discovery of Insufficient Evidence after Report Release

9.65 If, after the report is issued, the auditors discover that they did not have sufficient, appropriate evidence to support the reported findings or conclusions, they should communicate in the same manner as that used to originally distribute the report to those charged with governance, the appropriate officials of the audited entity, the appropriate officials of the entities requiring or arranging for the audits, and other known users, so that they do not continue to rely on the findings or conclusions that were not supported. If the report was previously posted to the auditors' publicly accessible website, the auditors should remove the report and post a public notification that the report was removed. The auditors should then determine whether to perform the additional audit work necessary to either reissue the report, including any revised findings or conclusions, or repost the original report if the additional audit work does not result in a change in findings or conclusions.

Appendix I: Acknowledgments

Comptroller General's Advisory Council on Government Auditing Standards (2016-2020)

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