Auditor Independence

GAGAS Independence Standard Implementation Issues

Jeffrey C. Steinhoff
Managing Director
Financial Management and Assurance
U.S. General Accounting Office

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GAGAS Amendment 3: Independence

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

Overarching Principles for Nonaudit Services

- Auditors should not perform management functions or make management decisions

- Auditors should not audit their own work or provide nonaudit services in situations where the amounts or services involved are significant/material to the subject matter of the audit

Supplemental Safeguards

- Personnel who perform nonaudit services would be precluded from performing any related audit work
- The auditor's work could not be reduced beyond the level that would be appropriate if the nonaudit work was performed by another unrelated party
- Certain documentation and quality assurance requirements must be met

Affect on Auditors Required to Use GAGAS

- Sometimes not appropriate to perform both audit and nonaudit services for the same client
- May need to choose which of these services an audit organization will provide

Steps in Assessing Services

1. Does the service **violate** either of the **overarching principles**?

   - If yes, auditor cannot perform the service and the audit.
   - If no, continue to question 2.

Steps in Assessing Services (con't.)

2. Is the **nature** of the service **similar** to a performance audit or an attestation engagement?

- If yes, can be done as a attestation engagement or a performance audit.
  - Must follow the standards applicable to that type of audit.
- If no, or if choose to keep as a consulting activity, continue to question 3.

Steps in Assessing Services (con't.)

3. Can the supplemental **safeguards be applied**?

- If yes, auditor can perform the nonaudit service.
- If no, auditor cannot perform both the audit and the nonaudit service for that audited entity.

Frequent Questions on Implementation

- Routine Activities
- Effective Date and Grandfather Provisions
- De Minimis Criteria
- Safe Harbor Questions
- Mandates for Nonaudit and Audit Services

Routine Activities Based on Technical Expertise and Knowledge

Paragraph 3.23 allows certain routine activities without an independence impairment or applying safeguards

- Providing routine advice to assist in activities such as establishing internal controls or implementing audit recommendations
- Answering technical questions
- Providing training
- Participating on committees in an advisory capacity or as an observer or ex-officio member

Routine Activities (cont'd.)

- Developing best practice guides
- Developing internal control assessment methodologies
- Performing investigative services
- Developing professional standards
- Undertaking benchmarking studies
- Developing audit methodologies
- Providing legal/accounting opinions to legislative bodies
- Developing questions for hearings and draft legislation

Extending the Effective Date

Original effective date:

- Applicable to all audits for periods beginning on or after ***October 1, 2002***

Extended effective date:

- Applicable to all audits for periods beginning on or after ***January 1, 2003***

The Grandfather Provision

In cases where nonaudit services would not have violated pre-existing professional standards, exemptions are allowed for:

- Nonaudit services contracted for or *initiated by* June 30, 2002, if the nonaudit work is completed no later than June 30, 2003

De Minimis Criteria

- Personnel providing nonaudit services can perform related audit work if the nonaudit services total
  - ***40 hours*** or fewer

- The overarching principles must be complied with and the other safeguards would apply

Safe Harbor Questions

- Paragraph 3.26 is not a safe harbor
  - All nonaudit services need to be considered in light of overarching principles and substance over form doctrine.

Mandates for Both Audit and Nonaudit Services

Paragraph 3.13 states

"… in those situations in which the government auditor because of a legislative requirement or for other reasons cannot decline to perform the work, the impairment(s) should be reported in the scope section of the audit report."

Stopping Short of the Line

Avoid situations that could lead reasonable third parties with knowledge of the relevant facts and circumstances to conclude that the auditor is not able to maintain independence in conducting audits

A Final Note

Remember

The independence standard is ***principles-based*** and should be applied using a ***substance over form*** doctrine to the specific ***facts and circumstances*** so that you are independent to protect the public interest in ***fact and appearance***

Looking Ahead

Independence standard questions and answers document and other Yellow Book information is available through GAO's website:

www.gao.gov