United States General Accounting Office

GAO

By the Comptroller General of the United States

January 2002

Government Auditing Standards

2002 Revision

Exposure Draft

G A O

Accountability ★ Integrity ★ Reliability

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G A O
Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

January 2002

TO AUDIT OFFICIALS AND OTHERS INTERESTED IN
GOVERNMENT AUDITING STANDARDS

GAO invites your comments on the accompanying proposed changes to *Government Auditing Standards* (GAGAS), commonly known as the "yellow book." These changes propose revision throughout the entire set of standards except for the second general standard, independence, which is being revised separately. The proposed revisions fall into three categories: GAGAS framework, consistent application of the standards where applicable to the various types of audits, and strengthening or streamlining the standards. This letter describes the process followed in revising the standards, summarizes proposed major changes, outlines the format of this exposure draft, and requests comments from interested parties on these proposed revisions.

To help ensure that the standards continue to meet the needs of the audit community and the public it serves, the Comptroller General of the United States appointed the Advisory Council on Government Auditing Standards to review the standards and recommend necessary changes. The Advisory Council includes experts in financial and performance auditing drawn from all levels of government, private enterprise, public accounting, and academia. Public comment is requested on all draft revisions to the standards. This exposure draft reflects the Advisory Council's advice to the Comptroller General.

To assist you in developing your comments, this letter discusses the proposed GAGAS framework and encloses a listing of the proposed changes to GAGAS made for consistent application of the standards or for strengthening or streamlining the standards.

The types of audits and services and applicable standards are organized by separate chapters for financial audits, attestation engagements, and performance audits in order to make the standards user friendly. For example, the financial audit and attestation chapters are directed at auditors with a financial audit background and the required knowledge of the American Institute of Certified Public Accountants' (AICPA) Generally Accepted Auditing Standards (GAAS) and Attestation Standards. The performance audit chapters are written to avoid use of terminology drawn from financial audits.

The financial audit presentation proposes retaining the current format of separate chapters for field and reporting standards. The term financial audit is defined to include financial statement audits

and other services covered by GAAS and the AICPA's *Statements on Auditing Standards* (SASs), which interpret the standards. These other services are defined in the SASs and include areas such as special reports, reviews of interim financial information, letters to underwriters and certain other requesting parties, compliance auditing, and audits of service organizations.

Attestation engagements are defined as those services performed under the AICPA's Attestation Standards and the related *Statement on Standards for Attestation Engagements* (SSAEs), which interpret the standards. As the proposed additional GAGAS standards are fewer than for financial audits, the field and reporting standards are presented in a single chapter.

GAGAS proposes recognizing the overlap between attestation engagement objectives and performance audit objectives and allowing the services that overlap to be performed under either set of standards. Therefore, GAGAS simply proposes to recognize the reality of current practice. Namely, performance auditors provide these services using performance audit standards, and financial auditors are likely to provide these services using the attestation standards. We are not aware of any problems that have arisen as a result of this practice.

The presentation of the financial audit chapters proposes eliminating the term "financial related audits" by specifically recognizing the services in addition to financial statement audits that are covered by the AICPA's *Statements on Auditing Standards* in chapters 4 and 5 or by the *Statement on Standards for Attestation Engagements* in chapter 6. The term "financial related audits" was the source of considerable confusion to the users of GAGAS. By specifically recognizing the services covered by the AICPA's SASs and SSAEs, we have proposed clarifying what in fact was intended by this term, but not always understood by the users of GAGAS.

The proposed changes related to performance audits retain the current presentation of separate chapters for field and reporting standards. The Advisory Council has recognized that GAGAS applicable to the performance audit objectives of effectiveness, economy and efficiency, internal control, and compliance are also applicable to prospective analyses, guidance, or summary information. Therefore, we have proposed including that latter objective in the definition of performance audits, as discussed in chapter 2, and in the presentation of field work and reporting standards, in chapters 7 and 8, applicable to the various objectives of performance audits. We believe this is a more logical and user friendly presentation than having a separate chapter discussing the field work and reporting standards for these objectives that would only tell the auditor to follow the same standards applicable to other types of performance audit objectives.

Chapter 2 of this exposure draft discusses nonaudit services provided by audit organizations that are not covered by GAGAS. These services generally differ from financial audits, attestation engagements, and performance audits in that auditors may (1) provide information or data to a requesting party without providing verification, analysis, or evaluation of the information or data, and therefore the work does not usually provide a basis for conclusions, recommendations, or opinions on the information or data, or (2) perform tasks requested by management that directly support the entity's operations, such as asset evaluation, actuarial services, or information system design services. Audit organizations are encouraged to establish policies for maintaining the

quality of this type of work. This exposure draft does not discuss the impact of the provision of nonaudit services on auditor independence. That issue was addressed in the May 2001 exposure draft and comments are currently being considered.

As previously stated, we are enclosing a numbered listing of the more significant proposed changes made to the chapters for consistent application of GAGAS and the proposed changes made to strengthen or streamline GAGAS. The enclosure includes a reference to the applicable proposed revised paragraph(s) of GAGAS. The enclosure does not include the proposed reorganization of the order of presentation to provide a more logical grouping of the standards by function, such as planning, audit documentation, report content, and the audit process. This proposed type of change was primarily made to the presentation of the performance audit chapters.

Given the extensiveness of the proposed revisions, we plan to issue a new version of GAGAS that will incorporate existing amendments. We expect this revision of the standards to supersede the 1994 revision, including amendments 1 and 2. Thereafter, we intend to continue our policy of issuing amendments addressing specific issues as needed. We anticipate this revision of the standards, when finalized, will become effective for financial audits of periods ending on or after January 1, 2003, and for attestation engagements and performance audits beginning on or after January 1, 2003.

This draft is being sent to financial management and audit officials at all levels of government, the public accounting profession, academia, professional organizations, and public interest groups. We encourage you to send your comments, whether you wish to comment on the entire document or only a portion of it. It would be helpful to key your comments to the specific paragraph numbers, give your rationale for any proposed changes, and suggest revised language.

Additional copies of this exposure draft can be obtained from the U.S. General Accounting Office, Room 1100, 700 4th Street, NW, Washington, DC 20548 or by calling (202) 512-6000.

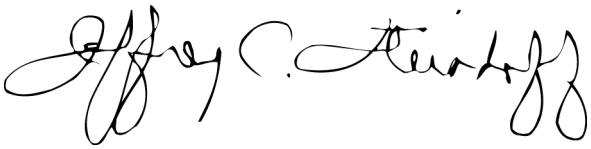
A marked version of the exposure draft is available on the Internet on GAO's Home Page (www.gao.gov/govaud/ybk01.htm). In the marked version, italicizing and bolding are used to identify potential added language and striking-out is used to identify potential deleted language from the 1994 revision of *Government Auditing Standards*, as currently amended.

Since GAO is still experiencing delays in mail delivery, it would be preferable if you sent your comments via e-mail to yellowbook@gao.gov. To ensure that your comments are considered by the Advisory Council in their deliberations, please submit them by April 30, 2002. If you need to use the mail, it would be helpful if you sent your comments both in writing and on diskette (in Word or ASCII format). Please send any mail to the following address:

Government Auditing Standards Comments
U.S. General Accounting Office
Room 5X16 (FMA)
441 G Street, NW
Washington, DC 20548

If you need additional information, please call Marcia Buchanan, Assistant Director, Financial Management and Assurance at (202) 512-9321 or Cheryl Clark, Assistant Director, Financial Management and Assurance at (202) 512-9377.

Sincerely yours,



Jeffrey C. Steinhoff
Managing Director
Financial Management and Assurance

Enclosures

Proposed changes made for consistent application of GAGAS where applicable:

1. For attestation engagements: require the additional GAGAS field work standards for auditor communication for all levels of work (par. 6.5-6.6); follow-up (par. 6.8-6.10); audit documentation (par. 6.11-6.17); internal control for examination level work (par. 6.18-6.19); and fraud, illegal acts, and other noncompliance for examination level work (par. 6.20-6.22)

2. For attestation engagements: require additional GAGAS reporting standards for reporting compliance with GAGAS (par. 6.25-6.27); reporting on internal control and on fraud, illegal acts, and other noncompliance when the work identifies deficiencies for all levels of attestation engagements (par. 6.28-6.31); views of responsible officials (par. 6.32-6.36); privileged and confidential information (par. 6.37-6.38); and report issuance and distribution (par. 6.39-6.43)

3. For performance audits: add a requirement that when using the work of a specialist, performance auditors be able to articulate the specialist's objectives, evaluate procedures used, and evaluate the results of the procedures or use another specialist for these purposes (par. 7.30-7.31)

4. For performance audits: add requirements consistent with Amendment No. 1, requiring documentation of decisions related to internal control over data significantly dependent on computerized information systems (par. 7.57), and Amendment No. 2, Auditor Communication (par. 7.32-7.33)

Proposed changes in requirements to strengthen/streamline GAGAS

5. Require, as part of the due care standard, that auditors exercise professional skepticism and perform their work with integrity (par. 3.6-3.7)

6. Require that audit organizations have an human capital management system (par. 3.10)

7. Require that auditors collectively possess the technical knowledge, skills, and experience necessary to be competent for the type of work being performed before beginning work on the assignment (par. 3.12)

8. Specifically state that auditors should have knowledge of GAGAS applicable to the work they are assigned (par. 3.12 a.) and knowledge of the specific environment in which the audited entity operates and the subject matter under review (par. 3.12b.)

9. Require that auditors be proficient in the AICPA *Statements on Standards for Attestation Engagements* when performing attestation engagements (par. 3.13 a) and that public auditors be licensed CPAs or work for a licensed CPA firm if engaged to perform an attestation engagement (par. 3.13b.)

10. Require that CPE directly contribute to the auditor's professional proficiency to perform work under GAGAS (par. 3.14)

11. Require external consultants/internal specialists that are responsible for following GAGAS in planning and directing an assignment, performing substantial portions of field work, or reporting on the assignment meet CPE requirements (par. 3.18)

12. Require that the internal quality control system include procedures for monitoring, on an ongoing basis, whether the policies and procedures related to the standards are suitably designed and are being effectively applied (par. 3.20)

13. Require that an audit organization prepare documentation to demonstrate compliance with its policies and procedures for its system of quality control (par. 3.21)

14. Specifically state that extensions of quality assurance review timeframes granted by other professional bodies are not recognized under GAGAS (par. 3.22, f/n. 7)

15. Require that organizations conducting external peer reviews to have received an unqualified opinion on the review of their organization's system of quality controls (par. 3.23b.)

16. Require that peer reviewers have knowledge and training on how to perform a peer review (par. 3.23c.)

17. Expand what is included in the peer review report (par. 3.23g.)

18. Require auditors to transmit their peer review reports to appropriate oversight bodies and provide a copy of their peer review report to auditors using their work (par. 3.25)

19. Specifically incorporate the AICPA's general standard on criteria for attestation engagements (par. 6.1)

20. Require that audit organizations establish policies and procedures for custody and retention of audit documentation (par. 4.24, 6.15, 7.67)

21. Require documentation when applicable standards are not followed (par. 4.22b, 6.16b, 7.68b)

22. Permit auditor judgment to exclude reporting certain information (par. 5.34, 6.38, 8.34) and to act with integrity in making this judgment (par. 8.35)

23. Revise the requirement for a written report to requiring a report that the auditor can make a judgment as the appropriate form (par. 8.3)

24. Require reporting whether the results from a sample can be projected to the intended population (par. 8.11)

25. Permit oral agency comments to be equally acceptable as written comments (par. 5.29, 6.34, 8.30)

26. Delete the specific statement that external quality control reviews conducted through or by other professional bodies meet GAGAS requirements

27. Delete the standard that requiring auditors to refer significant issues needing further study

28. Delete the requirement for auditors to report noteworthy accomplishments

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ABBREVIATIONS

AICPA	American Institute of Certified Public Accountants
CPA	certified public accountant
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAS	AICPA's generally accepted auditing standards
GAGAS	generally accepted government auditing standards
GASB	Governmental Accounting Standards Board
GAO	General Accounting Office
OMB	Office of Management and Budget
SASs	AICPA's statements on auditing standards
SSAEs	AICPA's statement on standards for attestation engagements

CHAPTER 1

INTRODUCTION

PURPOSE

1.1 The standards and guidance contained in this document, often referred to as generally accepted government auditing standards (GAGAS), are intended for use by government auditors[1] to ensure that they maintain integrity, objectivity, and independence in planning, conducting, and reporting their work, and are to be followed by auditors and audit organizations when required by law, regulation, contract, agreement, or policy.[2] The work performed in accordance with GAGAS is referred to as audits and attestation engagements. This work, which is described in this chapter and more fully in chapter 2, includes financial audits, attestation engagements, and performance audits. Users of government audits and attestation engagements that are performed in accordance with GAGAS should have confidence that the work is objective and credible.

1.2 The standards and guidance in this document are for audits and attestation engagements of government entities, programs,[3] activities, and services, and of government assistance administered by contractors, nonprofit entities, and other nongovernment entities. Adherence to GAGAS can help ensure that audits and attestation engagements provide credibility to the information reported by or obtained from management through objectively acquiring and evaluating evidence. When auditors

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[1]This document addresses the standards that should be used by the individuals conducting the broad array of work that is described more fully in chapter 2. Accordingly, the focus of this document is not on the wide variety of titles that are used by individuals conducting and reporting on this work, but instead the nature of the work that is being performed. The term "auditor" throughout this document includes individuals who may be titled auditor, analyst, evaluator, or a similar position description.

[2] Requirements in GAGAS are identified by statements that include the word "should." Auditors are expected to comply with these requirements if they apply to the type of work being performed. Auditors are strongly encouraged to comply with the guidance provided by GAGAS.

[3]Henceforth, the term "program" will be used in this document to include government entities, services, and activities.

perform their work in this manner and comply with GAGAS in reporting the results, their work can lead to improved government management, decision-making, and oversight, and can assist in fulfilling the government's duty to be accountable to the public. GAGAS pertain to auditors' professional qualifications and the quality of their work, the performance of field work, and the characteristics of meaningful audit reporting.

1.3 This chapter describes the applications of GAGAS by auditors and audit organizations. This chapter also describes the concept of accountability for public resources and discusses the responsibilities of managers of government programs, auditors, and audit organizations in the audit process.

APPLICABILITY

1.4 GAGAS are intended to be followed in performing audits and attestation engagements. A number of statutes and other mandates require that auditors follow GAGAS. Where a statute or other mandate does not exist, auditors will find it useful to use GAGAS in work regarding the use of government funds. If auditors hold themselves out as following GAGAS, regardless of whether they are required to follow such standards, they need to justify any departures from them.

1.5 The following laws, regulations, or guidelines require use of GAGAS:

a. The Inspector General Act of 1978, as amended, 5 U.S.C. App. (2000) requires that the statutorily-appointed federal inspectors general comply with GAGAS for audits of federal entities, programs, activities, and functions. The act further states that the inspectors general should take appropriate steps to ensure 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 federal departments' and agencies' financial statements.

c. The Single Audit Act Amendments of 1996 (Public Law 104-156) require that GAGAS be followed in audits of state and local governments and nonprofit entities that receive federal financial assistance. OMB Circular A-133, "Audits of States, Local Governments, and Non-profit Organizations," which provides the governmentwide guidelines and policies on performing audits to comply with the Single Audit Act, also requires the use of GAGAS.

1.6 Auditors need to be alert to other laws, regulations, or other authoritative sources that could require the use of GAGAS. For example, state and local laws and regulations may require auditors at the state and local levels of government to follow these standards. Also, the terms of an agreement or contract may require auditors to comply with GAGAS. Federal audit guidelines pertaining to program requirements, such as those issued for Housing and Urban Development and Student Financial Aid programs, may require that GAGAS be followed.

1.7 Even if not required to do so, auditors would find it useful to follow GAGAS in performing audits of federal, state, and local government programs as well as in performing audits of government assistance administered by contractors, nonprofit entities, and other nongovernment entities. Many audit organizations not formally required to do so, both in the United States and in other countries, voluntarily follow GAGAS.

1.8 Auditors may provide professional services, other than audits and attestation engagements, that consist solely of gathering, providing, and explaining information requested by decision-makers or by providing advice or assistance to management officials. GAGAS are not applicable to these other professional services, which are described more fully in chapter 2. However, providing other professional services may

affect an audit organization's independence to conduct audits, which is discussed in chapter 3.

Relationship between GAGAS and Other Professional Standards

1.9 GAGAS may be used in conjunction with professional standards issued by other authoritative bodies. For example, the American Institute of Certified Public Accountants (AICPA) has issued professional standards that apply in financial audits and attestation engagements. GAGAS incorporate the AICPA's field work and reporting standards and the related statements on the standards for financial audits unless specifically excluded, as discussed in chapters 4 and 5. GAGAS incorporates the AICPA's general standard on criteria, and the field work and reporting standards and the related statements on the standards for attestation engagements, unless specifically excluded, as discussed in chapter 6. To meet the needs of users of government audits and attestation engagements, GAGAS also prescribe additional requirements to those provided by the AICPA for these types of work.

1.10 Other professional standards which may be used by auditors are issued by such bodies as the Institute of Internal Auditors (Codification of the Standards for the Professional Practice of Internal Auditing, The Institute of Internal Auditors, Inc.), and the American Evaluation Association, which has developed guiding principles for evaluators (Guiding Principles for Evaluators, a report from the American Evaluation Association Task Force on Guiding Principles for Evaluators). These other professional standards are not incorporated into GAGAS, but can be used in conjunction with GAGAS.

ACCOUNTABILITY

1.11 The concept of accountability for public resources is inherent in our nation's governing processes. Legislators and other government officials, and the public want to

know whether (1) government resources are managed properly and used in compliance with laws and regulations, (2) government programs are achieving their objectives and desired outcomes, and (3) government programs are being provided efficiently, economically, and effectively. Managers of these programs are often asked to render an account of their activities and related results to legislative bodies and the public.

1.12 Financial audits contribute to making governments more accountable for the use of public resources. The auditor, in providing an independent report on whether an entity's financial information is presented fairly in accordance with recognized criteria, informs users whether they can rely on the information. Financial audits performed in accordance with GAGAS also provide information about internal control and compliance with laws and regulations as they relate to financial transactions, systems, and processes.

1.13 Attestation engagements also contribute to governments' accountability for the use of public resources and the delivery of services. In an attestation engagement, auditors issue an examination, a review, or an agreed-upon procedures report on the subject matter or on an assertion about the subject matter, based on or in conformity with criteria, that is the responsibility of another party. Attestation engagements can cover a broad range of financial or nonfinancial objectives and provide various levels of assurance about the subject matter or assertion dependent upon the user's needs.

1.14 Performance audits also contribute to governments' accountability for the use of public resources and for the delivery of services. The term performance audit is used to include a variety of objectives to meet users' needs. Performance audits provide an independent assessment of the performance and management of government programs against objective criteria or an assessment of best practices and other information. Performance audits provide information to improve program operations and facilitate decision-making by parties with responsibility to oversee or initiate corrective action, and improve public accountability. The term performance audit is used generically to include work classified by some audit organizations as program evaluations, program

effectiveness and results audits, economy and efficiency audits, operational audits, and value-for-money audits.

1.15 Given the importance and complexity of government programs in providing a variety of public services, auditors are increasingly being called on by legislative bodies and government agencies to expand the variety of performance audits to include work that has a prospective focus or provides guidance, best practice information, or information on issues that affect multiple programs or entities already studied or under study by an audit organization. This work may also include an assessment of policy alternatives, identification of risks and risk mitigation efforts, and a variety of analytical services to aid government officials in performing their responsibilities and stewardship of government resources. Such work, like other performance audits, involves a level of analysis, research, or evaluation; may provide conclusions and recommendations; and results in a report.

ROLES AND RESPONSIBILITIES

1.16 Management and auditors of government programs fulfill essential roles and responsibilities in ensuring that public resources are used efficiently, economically, effectively, and legally. Audit organizations also have the important responsibility for ensuring that auditors can meet their responsibilities. These unique roles involve sound management practices and professional audits and attestation engagements.

Management's Role

1.17 Management entrusted with handling public resources (for example, managers of a state or local governmental entity or a nonprofit entity that receives federal assistance) is responsible for applying those resources efficiently, economically, effectively, and legally to achieve the purposes for which the resources were furnished or the program was established. This responsibility applies to all resources, both financial and physical,

whether entrusted to public officials or others by their own constituencies or by other levels of government.

1.18 Management entrusted with public resources is responsible for complying with applicable laws and regulations. That responsibility encompasses identifying the requirements with which the entity and the official must comply and implementing systems designed to achieve that compliance.

1.19 Management entrusted with public resources is responsible for establishing and maintaining effective internal control to ensure that appropriate goals and objectives are met; resources are received, used efficiently and effectively, and safeguarded; laws and regulations are followed; and reliable data are obtained, maintained, and fairly disclosed. Management is responsible for providing appropriate reports to those who oversee their actions and to the public in order to be accountable for the resources used to carry out government programs and the results of these programs.

1.20 Management is responsible for addressing the findings and recommendations of auditors, and for establishing and maintaining a process to track the status of such findings and recommendations.

1.21 Management is responsible for following sound procurement practices when contracting for audits and attestation engagements, including procedures for monitoring contract performance, need to be in place. The objectives and scope of the assignment need to be made clear. In addition to price, other factors that may be considered in evaluating bid proposals include the responsiveness of the bidder to the request for proposal; the experience of the bidder; the availability of the bidder's staff who have the appropriate professional qualifications and technical abilities; and the results of the bidder's peer reviews.

Auditors' Responsibilities

1.22 Auditors in discharging their professional responsibilities need to observe the principles of serving the public interest and maintaining the highest sense of integrity, objectivity, and independence. These principles are fundamental to the responsibilities of auditors and the auditing profession.

1.23 Auditors are responsible to accept the obligation to act in a way that will serve the public interest, honor the public trust, and uphold their professionalism. A distinguishing mark of a profession is acceptance of its responsibility to the public. This responsibility is critical when auditing in the government environment. Because the concept of accountability underlies GAGAS, this need to serve the public interest is essential for all work done in accordance with GAGAS.

1.24 Auditors need to make decisions that are consistent with the public interest in the program or activity under audit. The public interest is defined as the collective well-being of the community of people and entities the auditor serves. In discharging their professional responsibilities, auditors may encounter conflicting pressures from management of the audited entity, various levels of government, employers, and others who rely on the objectivity and independence of the auditors. In resolving those conflicts, auditors are responsible to act with integrity, guided by the precept that when auditors fulfill their responsibilities to the public, these individuals' and organizations' interests are best served.

1.25 To maintain and broaden public confidence, auditors need to perform all professional responsibilities with the highest sense of integrity. Auditors are responsible to be honest and candid with the audited entity and users of the auditors' work in the conduct of their work, within the constraints of the audited entity's confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle. Integrity requires auditors to

observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment. Integrity also requires auditors to observe the principles of objectivity and independence.

1.26 Auditors are responsible to maintain objectivity and be free of conflicts of interest in discharging their professional responsibilities. Auditors are also responsible to be independent in fact and appearance when providing audit and attestation services. Objectivity is a state of mind that requires auditors to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may in fact or appearance impair an auditor's objectivity in performing the audit. The maintenance of objectivity and independence requires continuing assessment of relationships with the audited entities and public responsibility.

1.27 In applying GAGAS, auditors are responsible for using professional judgment when establishing scope and methodologies for their work, determining the tests and procedures to be performed, conducting the work, and reporting the results. Auditors need to maintain integrity and objectivity when doing their work to make decisions that are consistent with the broader public interest in the program or activity under review. When reporting on the results of their work, auditors are responsible for disclosing all material or significant facts known to them which, if not disclosed, could mislead knowledgeable users, misrepresent the results, or conceal improper or unlawful practices.

1.28 Auditors are responsible for helping management and other report users understand the auditors' responsibilities under GAGAS and other audit coverage required by law or regulation. To help managers and other report users understand an audit's objectives, time frames, and data needs, auditors need to communicate information concerning the planning, conduct, and reporting of the assignment to the parties involved.

Audit Organizations' Responsibilities

1.29 Audit organizations also have the responsibility for ensuring that (1) independence and objectivity are maintained in all phases of the assignment, (2) professional judgment is used in planning and performing the work and in reporting the results, (3) the work is performed by personnel who are professionally competent, and (4) their systems of quality control are periodically examined by independent peers to ensure that they have in place appropriately designed policies, procedures, and practices that are functioning effectively to meet professional standards.

1.30 While management is responsible for addressing audit and attestation engagement findings and recommendations and tracking their status of resolution, audit organizations are responsible for establishing policies and procedures for follow-up to determine whether previous findings and recommendations are addressed and are considered in planning future assignments.

CHAPTER 2

TYPES OF GOVERNMENT AUDITS AND ATTESTATION ENGAGEMENTS

INTRODUCTION

2.1 This chapter describes the types of audits and attestation engagements that audit organizations perform, or arrange to have performed, of government, programs,[1] and of government assistance administered by contractors, nonprofit entities, and other nongovernment entities. This description is not intended to limit or require the types of audits or attestation engagements that may be performed or arranged to be performed. In performing work described below in accordance with generally accepted government auditing standards (GAGAS), auditors should follow the applicable standards included and incorporated in chapters 3 through 8. This chapter also describes other professional services that audit organizations provide, although these services are not covered by GAGAS.

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

2.3 Assignments may have a combination of objectives that include more than one type of work described in this chapter or may have objectives limited to only some aspects of one type of work. Auditors should follow the standards that are applicable to the individual objectives of the audit or attestation engagement.

[1]The term "program" is used to include entities, services, and activities.

FINANCIAL AUDITS

2.4 Financial audits primarily concern providing reasonable assurance about whether financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP),[2] or with a comprehensive basis of accounting other than GAAP. Other objectives of financial audits may include

a. providing special reports for specified elements, accounts, or items of a financial statement;

b. reviewing interim financial information or segments of financial statements;

c. issuing letters for underwriters and certain other requesting parties;

d. reporting on the processing of transactions by service organizations; and

e. auditing compliance with regulations relating to governmental financial assistance.

2.5 Financial audits are performed under the American Institute of Certified Public Accountants' (AICPA) generally accepted auditing standards for field work and reporting, as well as the related AICPA Statements on Auditing Standards (SASs) which interpret the standards and provide guidance on conducting such work.[3] Accordingly, auditors performing financial audits need to be proficient in applying the AICPA standards and guidance contained in the SASs. GAGAS prescribe general standards and

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[2]Three authoritative bodies for generally accepted accounting principles (GAAP) are the Governmental Accounting Standards Board (GASB), the Financial Accounting Standards Board (FASB), and the Federal Accounting Standards Advisory Board (FASAB). GASB establishes accounting principles and financial reporting standards for state and local government entities. FASB establishes accounting principles and financial reporting standards for nongovernment entities. FASAB promulgates accounting principles and financial reporting standards for the federal government.

[3]GAGAS incorporate all AICPA field work and reporting auditing standards and the related SASs unless the Comptroller General of the United States excludes them by formal announcement. To date, the Comptroller General has not excluded any AICPA field work or reporting auditing standards or any SASs.

additional field work and reporting requirements beyond those provided by the AICPA when performing financial audits. (See chapters 3, 4, and 5 for standards and guidance for auditors performing a financial audit in accordance with GAGAS.)

ATTESTATION ENGAGEMENTS

2.6 Attestation engagements concern examining, reviewing, or performing agreed upon procedures on a subject matter or an assertion[4] about a subject matter and reporting on the results. The subject matter of an attestation engagement may take many forms, including historical or prospective performance or condition, physical characteristics, historical events, analyses, systems and processes, or behavior. Attestation engagements can cover a broad range of financial or nonfinancial objectives and can be part of a financial audit or other type of audit. Examples of objectives of attestation engagements include reporting on

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

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

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

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

e. prospective financial statements or pro forma financial information;

[4]An assertion is any declaration or set of declarations about whether the subject matter is based on or in conformity with the criteria selected.

f. the reliability of performance measures;

g. final contract cost; and

h. allowability and reasonableness of proposed contract amounts.[5]

2.7 Attestation engagements are performed under the AICPA's attestation standards, as well as the related AICPA Statements on Standards for Attestation Engagements (SSAEs) which interpret the standards and provide guidance on conducting such work.[6] Accordingly, auditors performing attestation engagements need to be proficient in applying the AICPA standards and guidance contained in the SSAEs. GAGAS prescribe general standards and additional field work and reporting requirements beyond those provided by the AICPA for attestation engagements. (See chapters 3 and 6 for standards and guidance for auditors performing an attestation engagement in accordance with GAGAS.)

PERFORMANCE AUDITS

2.8 A performance audit is an objective and systematic examination of evidence to provide an independent assessment of the performance and management of a program against objective criteria or an assessment of best practices and other information. Performance audits provide information to improve program operations and facilitate decisionmaking by parties with responsibility to oversee or initiate corrective action, and improve public accountability. Performance audits encompass a wide variety of

[5]Some of these examples of attestation engagement objectives are similar to some of the performance audit objectives listed in paragraphs 2.9 through 2.11. Depending on user needs and the auditor's qualifications, the auditor may choose to apply performance audit standards in chapters 7 and 8 to the objectives in paragraph 2.6 instead of following the attestation standards in chapter 6.

[6]GAGAS incorporate the AICPA's general attestation standard on criteria and all the AICPA's field work and reporting attestation standards and the related SSAEs unless the Comptroller General of the United States excludes them by formal announcement. To date, the Comptroller General has not excluded any AICPA field work or reporting attestation standards or SSAEs.

objectives including objectives related to assessing program effectiveness and results; economy and efficiency; internal control;[7] and compliance with legal or other requirements; and objectives related to providing prospective analyses, guidance, or summary information. Performance audits also may encompass a broad or narrow scope of work and a variety of methodologies; involve a level of analysis, research, or evaluation; generally provide conclusions and recommendations; and result in a report. (See chapters 3, 7, and 8 for standards and guidance for auditors performing a performance audit in accordance with GAGAS.)

2.9 Program effectiveness and results audit objectives address the effectiveness of a program and typically measure the extent to which a program is achieving its goals and objectives. Economy and efficiency audit objectives concern whether an entity is acquiring, protecting, and using its resources in the most productive manner to achieve program objectives. These audit objectives are often interrelated and may be concurrently addressed in a performance audit. Examples of program effectiveness and results and economy and efficiency audit objectives include assessing

a. the extent to which legislative, regulatory, or organizational goals and objectives are being achieved;

b. the relative utility of alternative approaches to yield better program performance or eliminate factors that inhibit program effectiveness;

c. the relative cost and benefits or cost effectiveness of program performance;[8]

d. whether a program produced intended results or produced effects that were not intended by the program's established or stated objectives;

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[7]The term internal control in this document is synonymous with the term management control and, unless otherwise stated, covers all aspects of an entity's operations (programmatic, financial, and compliance).
[8]These objectives focus on combining cost information with information about outputs or the benefit provided, and outcomes or the results achieved.

e. the extent to which programs duplicate, overlap, or conflict with other related programs;

f. whether the audited entity is following sound procurement practices;

g. the validity and reliability of performance measures concerning program effectiveness and results, or economy and efficiency; and

h. the financial information related to the performance of a program.

2.10 Internal control audit objectives relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations, and the system put in place for measuring, reporting, and monitoring program performance. Examples of audit objectives related to internal control include the extent that internal controls of a program provide reasonable assurance that

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

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

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

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

e. security over computerized information systems will prevent or detect unauthorized access; and

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

2.11 Compliance audit objectives relate to compliance criteria established by laws, regulations, contract provisions, grant agreements, and other requirements[9] that could affect the acquisition, protection, and use of the entity's resources, and the quantity, quality, timeliness, and cost of services the entity produces and delivers. Compliance objectives also concern the purpose of the program, the manner in which it is to be conducted and services delivered, and the population it serves.

2.12 Audit organizations are increasingly undertaking work that is similar to the traditional performance audit but may have a prospective focus or may provide guidance, best practice information, or information on cross-cutting issues already studied or under study by an audit organization. While this work generally does not involve assessing specific ongoing programs, it may use data from relevant audit work for comparative or baseline purposes. This performance-related work may encompass a broad or narrow range of objectives and scope of work; use a variety of methodologies; involve a level of analysis, research, or evaluation; generally provide conclusions and recommendations; and result in a report. It is also subject to the same standards as performance audits. Examples of objectives pertaining to this work include

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

b. assessing the advantages and disadvantages of legislative proposals;

c. conducting surveys to obtain and analyze views of stakeholders on policy proposals for decisionmakers;

[9] Compliance requirements can be either financial or nonfinancial in nature.

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

e. developing methods or approaches for use in evaluating new or proposed programs;

f. producing a high-level summary or a report that affects multiple programs or entities on issues studied or under study by the audit organization; and

g. developing guidance documents such as those based on best practices research and syntheses for management's use in evaluating program or management system approaches, including financial and information management systems.[10]

NONAUDIT SERVICES OF AUDIT ORGANIZATIONS

2.13 Audit organizations may also provide nonaudit services that are not covered by GAGAS. These nonaudit services consist of gathering, providing, or explaining information requested by decision makers or providing advice or assistance to management officials. Nonaudit services generally differ from financial audits, attestation engagements, and performance audits described above in that auditors provide information or data to a requesting party without providing verification, analysis, or evaluation of the information or data, and therefore the work does not usually provide a basis for conclusions, recommendations, or opinions on the information or data. These other services may or may not result in a report. Some examples of these other professional services include

a. assisting a legislative body by developing questions for use at a hearing;

b. gathering and reporting unverified external or third-party data to aid legislative and administrative decision making;

[10]These guidance documents may also be used by auditors in planning and performing their work.

c. compiling or reviewing financial statements or other information to assist entities and management officials;[11]

d. advising an entity regarding its performance of internal control self-assessments;

e. providing professional advice to entities and management officials to assist them in activities such as the design or installation of information systems and related internal control activities;

f. valuing an entity's pension, other postemployment benefit, or other similar liabilities;

g. preparing an entity's indirect cost proposal or cost allocation plan;

h. providing human resource services to assist management in its evaluation of potential candidates; and

i. development of audit methodologies, policies, and procedures.

2.14 GAGAS do not cover nonaudit services described in this chapter as such services are not audits or attestation engagements. Therefore, auditors should not report that such services were conducted in accordance with GAGAS. However, audit organizations are encouraged to establish policies for maintaining the quality of this type of work, and may wish to disclose in any product resulting from this work, any other professional standards followed and the quality control steps taken.

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[11]This type of work is covered under the AICPA's Statements on Standards for Accounting and Review Services (SSARS), which are not incorporated into GAGAS since the work covered by the SSARS are not considered audits.

CHAPTER 3

GENERAL STANDARDS

INTRODUCTION

3.1 This chapter prescribes general standards and provides guidance for performing financial audits, attestation engagements,[1] and performance audits. These general standards concern the fundamental requirements for ensuring the credibility of auditors' results. Credibility is essential to all audit organizations performing work that government leaders and other users rely on for making decisions, and is what the public expects of information provided by auditors. These general standards encompass the independence of the audit organization and its individual auditors; the exercise of professional judgment in the performance of work and the preparation of related reports; the competence of audit staff, including their continuing professional education; and the existence of quality control systems and external peer reviews.

3.2 These general standards provide the underlying framework that is critical in effectively applying the field work and reporting standards described in the following chapters, in performing the detailed work associated with the assignment, and in preparing related reports and other products. Therefore, these general standards are required to be followed by all auditors and audit organizations, both government and nongovernment, performing work under generally accepted government auditing standards (GAGAS).

[1]See chapter 6 for an additional general standard auditors should follow when performing an attestation engagement.

INDEPENDENCE

[Refer to Amendment No. 3, Independence. The following paragraph numbers will change accordingly.]

PROFESSIONAL JUDGMENT

3.3 The second general standard is:

Professional judgment should be used in planning and performing audits and attestation engagements, and in reporting the results.

3.4 This standard requires auditors to observe the principles of serving the public interest and maintaining the highest sense of integrity, objectivity, and independence in applying professional judgment[2] in all aspects of their work. This standard also imposes a responsibility upon each auditor within the audit organization to observe GAGAS. If auditors hold themselves out as following GAGAS, regardless of whether they are required to follow such standards, they need to justify any departures from them.

3.5 Auditors should use professional judgment in determining the type of assignment to be performed and the standards that apply to the work; establishing the scope of work; selecting the methodology; determining the type and amount of evidence to be gathered; and choosing the tests and procedures for their work. Professional judgment also should be applied in performing the tests and procedures and in evaluating and reporting the results of the work.

[2]Professional judgment is synonymous with due professional care as defined in the American Institute of Certified Public Accountants (AICPA) standards. While the principles of serving the public interest and maintaining the highest sense of integrity, objectivity, and independence are not explicitly stated in the AICPA's due professional care standard, these principles serve as the framework for all AICPA rules and standards.

3.6 Professional judgment requires auditors to exercise professional skepticism, which is an attitude that includes a questioning mind and a critical assessment of evidence. Auditors use the knowledge, skills, and experience called for by their profession to diligently perform, in good faith and with integrity, the gathering of evidence and objective evaluation of the competency and sufficiency of evidence. Since evidence is gathered and evaluated throughout the assignment, professional skepticism should be exercised throughout the assignment.

3.7 Auditors neither assume that management is dishonest nor assume unquestioned honesty. In exercising professional skepticism, auditors should not be satisfied with less than persuasive evidence because of a belief that management is honest.

3.8 The exercise of professional judgment allows the auditor to obtain reasonable assurance that material misstatements or significant inaccuracies in data will be detected if they exist. Absolute assurance is not attainable because of the nature of evidence and the characteristics of fraud. Therefore, an audit or attestation engagement conducted in accordance with GAGAS may not detect a material misstatement or significant inaccuracy, whether from error or fraud. Accordingly, while this standard places responsibility on each auditor and audit organization to exercise professional judgment in planning and performing an assignment, it does not imply unlimited responsibility, nor does it imply infallibility on the part of either the individual auditor or the audit organization.

COMPETENCE

3.9 The third general standard is:

The staff assigned to perform the assignment should collectively possess adequate professional competence for the tasks required.

3.10 This standard places responsibility on audit organizations to ensure that each assignment is performed by staff who collectively have the knowledge, skills, and experience necessary for that assignment. Audit organizations should have a process, such as a human capital system, for recruitment, hiring, continuous development, and evaluation of staff to assist the organization in maintaining a workforce that has adequate competence.

3.11 The competencies discussed below apply to the knowledge, skills, and experience of audit organizations as a whole and not necessarily to each individual auditor. An organization may need to employ individuals or hire subject matter experts who are knowledgeable, skilled, or experienced in such areas as accounting, statistics, law, engineering, audit design and methodology, information technology, public administration, economics, social sciences, or actuarial science.

Technical Knowledge and Competence

3.12 Staff members conducting audits and attestation engagements under GAGAS should collectively possess the technical knowledge, skills, and experience necessary to be competent for the type of work being performed before beginning work on an assignment. Auditors should possess

a. knowledge of government auditing standards applicable to the type of work they are assigned and the education, skills, and experience to apply such knowledge to the work being performed;

b. knowledge of the specific environment in which the audited entity operates and the subject matter under review;

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

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

(1) if the work requires use of statistical sampling, the staff or consultants to the staff should include persons with statistical sampling expertise;

(2) if the work requires extensive review of information systems, the staff or consultants to the staff should include persons with information technology expertise;

(3) if the work involves review of complex engineering data, the staff or consultants to the staff should include persons with engineering expertise; or

(4) if the work involves the use of specialized audit methodologies or analytical techniques, such as the use of complex survey instruments, actuarial-based estimates, or statistical analysis tests, the staff or consultants to the staff should include persons with expertise in those methodologies.

3.13 The following additional competencies are needed for financial audits.

a. Auditors should be knowledgeable in generally accepted accounting principles and the AICPA's generally accepted auditing standards for field work and reporting and the related statements on the standards (SASs) when performing a financial audit and should be competent in applying these standards and SASs to the task assigned. Similarly, when performing an attestation engagement, auditors should be knowledgeable in the AICPA's general attestation standard related to criteria, and the AICPA's attestation standards for field work and reporting and the related statements on the standards for attestation engagements (SSAEs), and should be competent in applying these standards and SSAEs to the task assigned.

b. Public accountants engaged to perform financial audits or attestation engagements should be (a) licensed certified public accountants or persons working for a licensed certified public accounting firm, or (b) public accountants licensed on or before

December 31, 1970, or persons working for a public accounting firm licensed on or before December 31, 1970.[3]

Continuing Professional Education

3.14 Auditors performing work under GAGAS need to maintain their professional competence through continuing professional education (CPE). Therefore, each auditor performing work under GAGAS should complete, every 2 years, at least 80 hours of CPE which directly contributes to the auditor's professional proficiency to perform such work. At least 20 hours should be completed in any 1 year of the 2-year period.

3.15 Continuing education may include such topics as developments in audit standards and methodology, accounting, assessment of internal control, principles of management or supervision, information systems management, statistical sampling, financial statement analysis, evaluation design, and data analysis. It may also include subjects related to specific fields of work, such as public administration, public policy and structure, industrial engineering, finance, economics, social sciences, and information technology.

3.16 In addition, auditors responsible for planning or directing an assignment, performing substantial portions of the field work,[4] or reporting on the assignment under GAGAS should complete at least 24 of the 80 hours of CPE in subjects directly related to the government environment and to government auditing. If the audited entity operates in a specific or unique environment, auditors should receive CPE that is related to that environment.

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[3]Accountants and accounting firms meeting these licensing requirements should also comply with the applicable provisions of the public accountancy law and rules of the jurisdiction(s) where the audit is being conducted and the jurisdiction(s) in which the accountants and their firms are licensed.

[4]Auditors are considered responsible for "conducting substantial portions of field work" when, in a given CPE year, time chargeable to audits and attestation engagements following GAGAS is 20 percent or more of their total chargeable time.

3.17 The audit organization is responsible for ensuring that auditors meet the continuing education requirements. The audit organization should maintain documentation of the CPE completed. GAO has developed guidance pertaining to CPE requirements to assist auditors and audit organizations in exercising professional judgment in complying with the CPE requirements.[5]

3.18 External consultants and internal experts and specialists should be qualified and maintain professional competence in their areas of expertise and/or specialization. However, they are not required to meet the above CPE requirements unless they are responsible for following GAGAS in planning or directing the assignment, performing substantial portions of field work, or reporting on the assignment.

QUALITY CONTROL AND ASSURANCE

3.19 The fourth general standard is:

Each audit organization performing assignments in accordance with GAGAS should have an appropriate internal quality control system in place and should undergo an external peer review.

3.20 The internal quality control system established by the audit organization should provide reasonable assurance that it is following (1) adequate quality control policies and procedures, and (2) applicable government auditing standards. The internal quality control system should include procedures for monitoring, on an ongoing basis, whether the policies and procedures related to the standards are suitably designed and are being effectively applied.

[5] Interpretation of Continuing Education and Training Requirements, April 1991, Government Printing Office stock number 020-000-00250-6.

3.21 The nature and extent of an audit organization's internal quality control system depends on a number of factors, such as its size, the degree of operating autonomy allowed its personnel and its audit offices, the nature of its work, its organizational structure, and appropriate cost-benefit considerations. Thus the systems established by individual organizations will vary as will the need for, and extent of, their documentation of the systems. However, each organization should prepare appropriate documentation to demonstrate compliance with its policies and procedures for its system of quality control.

3.22 Audit organizations performing assignments in accordance with GAGAS should have an external peer review conducted at least once every 3 years by reviewers independent of the organization being reviewed.[6] The external peer review should determine whether the organization's internal quality control system is in place and operating effectively to provide reasonable assurance that established policies and procedures and applicable government auditing standards are being followed.

3.23 An external peer review under this standard should meet the following requirements.

a. Individuals conducting peer reviews of an audit organization's system of quality control should have thorough knowledge of GAGAS and of the government environment relative to the work being reviewed.

b. Reviewers should be independent (as defined in GAGAS) of the audit organization being reviewed, its staff, and the assignments selected for review. An organization is not permitted to review the organization that conducted its most recent external peer review. Also, the employing organization of the peer reviewers should

[6]Audit organizations should have an external peer review conducted within 3 years from the date they start (that is, start of field work) their first assignment in accordance with GAGAS. Subsequent external peer reviews should be conducted every 3 years. Audit organizations should generally maintain their review year from review to review. Any extensions of these time frames to meet the external peer review requirements can only be granted by GAO and should only be requested for extraordinary circumstances.

have received an unqualified opinion on the review of their organization's system of quality controls.

c. Reviewers should have knowledge and training on how to perform a peer review and should use professional judgment in conducting and reporting the results of the review.

d. This review should include a review of the organization's internal quality control policies and procedures, reports, audit documentation, and other necessary documents (for example, independence statements, outside employment requests, financial disclosure reports, and CPE documentation). The review should also include contacts with various levels of the reviewed organization's professional staff to assess their understanding of and compliance with relevant quality control policies and procedures.

e. Reviewers should use one of the following approaches to selecting assignments for review: (1) select assignments that provide a reasonable cross section of the assignments performed by the reviewed organization in accordance with GAGAS or (2) select assignments that provide a reasonable cross section of the reviewed organization's work subject to quality control requirements, including one or more assignments performed in accordance with GAGAS.

f. The review should be sufficiently comprehensive to provide a reasonable basis for concluding whether the reviewed audit organization's system of quality control was complied with to provide the organization with reasonable assurance of conforming with professional standards in the conduct of its work. Reviewers may scale back the peer review procedures based on the reviewers' evaluation of the adequacy and results of the reviewed organization's monitoring efforts.

g. Reviewers should prepare a written report(s) communicating the results of the external peer review. The report should indicate the scope of the review, including

any limitations thereon, and should express an opinion on whether the system of quality control of the reviewed organization was in place and operating effectively to provide reasonable assurance that established policies and procedures and applicable government auditing standards are followed. The report should also describe the reason(s) for any modifications to the opinion. When there are matters that resulted in a modification to the standard report, reviewers should report a detailed description of the findings and recommendations to enable the reviewed organization to take appropriate actions. To help users of the peer review report understand the peer review process, each report should be accompanied by an attachment describing the process, including how peer reviews are planned and performed.

3.24 Audit organizations seeking to enter into a contract to perform an assignment in accordance with GAGAS should provide their most recent external peer review report[7] to the party contracting for the audit or attestation engagement. Information in the external peer review report often would be relevant to decisions on procuring audit or attestation engagement services.

3.25 Auditors who are relying on another audit organization's work should request a copy of the audit organization's peer review report, and the audit organization should provide the peer review report when requested. Audit organizations also should transmit their external peer review reports to appropriate oversight bodies. It is also recommended that the report be made available to the public in a timely manner.

[7]The term "report" does not include separate letters of comment.

CHAPTER 4

FIELD WORK STANDARDS FOR FINANCIAL AUDITS

INTRODUCTION

4.1 Generally accepted government auditing standards (GAGAS) incorporate the American Institute of Certified Public Accountants' (AICPA) generally accepted field work standards for audits and the related AICPA Statements on Auditing Standards (SASs) unless the Comptroller General of the United States excludes them by formal announcement.[1] This chapter identifies the AICPA field work standards and prescribes additional standards for applying the AICPA field work standards for financial audits performed in accordance with GAGAS. This chapter concludes with guidance that auditors should give consideration to when performing financial audits in accordance with GAGAS.

4.2 Financial audits consist of all work performed under the AICPA's generally accepted auditing standards and governed by the AICPA SASs, which interpret the standards. Such work performed in a government environment primarily includes audits of financial statements. The SASs also govern other types of services which may also be performed in a government environment, such as compliance auditing, issuing special reports,[3] audits of service organizations, reviews of interim

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[1]To date, the Comptroller General has not excluded any field work standards or statements on auditing standards.

[2]The term "financial statement" refers to a presentation of financial data, including accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in conformity with an identifiable framework, such as generally accepted accounting principles (GAAP) or an other comprehensive basis of accounting (OCBOA). Audits of financial statements include all services governed by the AICPA's SASs for which the auditors are engaged to provide a level of assurance on the fair presentation of financial statements in accordance with a stated criteria.

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

financial information, and issuing letters to underwriters and certain other requesting parties. These other services may be performed in conjunction with an audit of financial statements.

FIELD WORK STANDARDS

4.3 The three AICPA generally accepted standards of field work are as follows.

a. The work is to be adequately planned, and assistants, if any, are to be properly supervised.

b. A sufficient understanding of internal control is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed.

c. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit.

ADDITIONAL GAGAS FIELD
WORK STANDARDS

4.4 GAGAS prescribe additional standards for applying the AICPA three generally accepted AICPA field work standards which go beyond the requirements contained in the AICPA's SASs. Auditors must comply with these additional standards when citing GAGAS in their audit reports. The additional GAGAS relate to

a. auditor communication (see paragraphs 4.6 through 4.13),

b. considering the results of previous audits (see paragraphs 4.14 through 4.16),

c. noncompliance with provisions of contracts and grants (see paragraphs 4.17 through 4.19), and

d. audit documentation (see paragraphs 4.20 through 4.24).

4.5 This chapter concludes with guidance auditors should give consideration to when performing financial audits in accordance with GAGAS for the following areas:

a. audit risk and materiality (see paragraphs 4.26 and 4.27),

b. internal control over safeguarding of assets (see paragraphs 4.28 through 4.33),

c. internal control over compliance (see paragraphs 4.34 through 4.36), and

d. professional judgment concerning possible fraud and illegal acts (see paragraphs 4.37 through 4.39).

AUDITOR COMMUNICATION

4.6 An additional standard related to auditor communication for financial audits performed in accordance with GAGAS is:

Auditors should communicate information regarding the nature of services and level of assurance provided to not only officials of the audited entity, but also to the individuals contracting for or requesting the audit services, and the audit committee or other equivalent oversight body.

4.7 AICPA standards and GAGAS require auditors to establish an understanding with the client and to communicate with audit committees. GAGAS broaden the parties with whom auditors must communicate with during the planning stages of a financial audit to reduce the risk that the needs or

expectations of the parties involved may be misinterpreted. Auditors should use their professional judgment to determine the form, content, and frequency of the communication, although written communication is preferred, and should document the communication. Auditors may use an engagement letter, if appropriate, to communicate the information.

4.8 Auditors should communicate their responsibilities for the engagement to the appropriate officials of the audited entity, which may include

a. the head of the audited entity,

b. the audit committee or board of directors or other equivalent oversight body in the absence of an audit committee, and

c. the individual who possesses a sufficient level of authority and responsibility for the financial reporting process, such as the chief financial officer.

4.9 In situations where auditors are performing the audit under a contract with a party other than the officials of the audited entity, or pursuant to a third-party request, auditors should also communicate with the individuals contracting for or requesting the audit, such as contracting officials or legislative members or staff. When auditors are performing the audit pursuant to a law or regulation, auditors should communicate with the legislative members or staff who have oversight of the auditee.[4] Auditors should coordinate communications with the responsible government audit organization and/or management of the audited entity, and may use the engagement letter to keep interested parties informed.

4.10 In communicating the nature of services and level of assurance provided, auditors should specifically address their planned work related to testing compliance with laws and regulations and

[4]This requirement applies only to situations where the law or regulation specifically identifies the entity to be audited, such as an audit of a specific agency's financial statements required by the Chief Financial Officers Act, as expanded by the Government Management Reform Act of 1994. Situations where the audit of financial statements mandate applies to entities not specifically identified, such as audits required by the Single Audit Act Amendments of 1996, are excluded.

internal control over financial reporting. During the planning stages of an audit, auditors should communicate their responsibilities for testing and reporting on compliance with laws and regulations and internal control over financial reporting. Such communication should include the nature of any additional testing of compliance and internal control required by laws and regulations or otherwise requested, and whether the auditors are planning on providing opinions on compliance with laws and regulations and internal control over financial reporting.

4.11 To assist in understanding the limitations of auditors' responsibilities for testing and reporting on compliance and internal control over financial reporting, auditors may want to contrast those responsibilities with other audits of compliance and controls. The discussion in paragraphs 4.12 and 4.13 may be helpful to auditors in explaining their responsibilities for testing and reporting on compliance with laws and regulations and internal control over financial reporting to officials of the audited entity and other interested parties.

4.12 Tests of compliance with laws and regulations and internal control over financial reporting in a financial audit contribute to the evidence supporting the auditors' opinion on the financial statements or other conclusions regarding financial data. However, such tests generally are not sufficient in scope to opine on compliance or internal control over financial reporting. To meet certain audit report users' needs, laws and regulations sometimes prescribe testing and reporting on compliance and internal control over financial reporting to supplement coverage of these areas.[5]

4.13 Even after auditors perform and report the results of additional tests of compliance and internal control over financial reporting required by laws and regulations, some reasonable needs of report users still may be unmet. Auditors may meet these needs by performing further tests of compliance

[5]For example, when engaged to perform audits under the Single Audit Act Amendments of 1996 for state and local government entities and nonprofit entities that receive federal awards, auditors should be familiar with the Office of Management and Budget (OMB) Circular A-133 on single audits. The act and circular include specific audit requirements, mainly in the areas of compliance with laws and regulations and internal control, that exceed the minimum audit requirements in the standards in chapters 4 and 5 of this document. Audits conducted under the Chief Financial Officers Act of 1990, as expanded by the Government Management Reform Act of 1994, also have specific audit requirements prescribed by OMB in the areas of compliance and internal control. Many state and local governments have additional audit requirements.

and internal control in either of two ways:[6]

a. supplemental (or agreed-upon) procedures or

b. examination, resulting in an opinion.

CONSIDERING THE RESULTS
OF PREVIOUS AUDITS

4.14 An additional standard for financial audits performed in accordance with GAGAS is:

Auditors should consider the results of previous audits and follow up on known significant findings and recommendations, including those related to reportable conditions, identified in previous audits reports that relate to the objectives of the audit being undertaken.

4.15 Auditors should perform such follow-up to determine whether officials of the audited entity have taken appropriate corrective actions. In addition to following up on significant reported findings and recommendations[7] from previous financial audits, auditors should consider significant findings identified in attestation engagements, performance audits, or other studies if these findings could materially affect the results of the financial audit. For example, an audit report on an entity's computerized information systems may contain significant findings that could relate to the financial audit if the entity uses such systems to process its accounting information. In any event, auditors need to make judgments about the extent of follow-up needed and the appropriate disclosure of uncorrected significant findings and recommendations from prior audits that affect the audit objectives.

[6]Such work is generally performed under the AICPA's Statements on Standards for Attestation Engagements. See chapter 6 for a discussion of the standards used when performing attestation engagements.
[7]Significant findings and recommendations are those matters that, if not corrected, could affect the results of the auditors' work and users' conclusions about those results.

4.16 Providing continuing attention to significant findings and recommendations is important to ensure that the benefits of audit work are realized. Ultimately, the benefits of audit work occur when audit findings are resolved through meaningful and effective corrective action taken in response to the auditors' findings and recommendations. Officials of the audited entity are responsible for resolving audit findings and recommendations directed to them, and for having a process to track their status. If officials of the audited entity do not have such a process, auditors may wish to establish their own process.

NONCOMPLIANCE WITH PROVISIONS OF CONTRACTS AND GRANT AGREEMENTS

4.17 The additional standard related to compliance with provisions of contracts and grant agreements for financial audits performed in accordance with GAGAS is:

Auditors should design the audit to provide reasonable assurance of detecting material misstatements of financial statements or other financial data resulting from noncompliance with provisions of contracts or grant agreements that have a direct and material effect on the determination of financial statement amounts. If specific information comes to the auditors' attention that provides evidence concerning the existence of possible noncompliance that could affect financial data significant to the audit objectives or that could have a material indirect effect on the financial statements, auditors should apply audit procedures specifically directed to ascertaining whether noncompliance has occurred or is likely to have occurred.

4.18 AICPA standards and GAGAS require auditors to assess the risk of material misstatements of financial statements due to fraud and should consider that assessment in designing the audit procedures to be performed.[8] Auditors are also required to design the audit to provide reasonable assurance of detecting material misstatements resulting from direct and material illegal acts to be

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

aware of the possibility that indirect illegal acts may have occurred. Under GAGAS, the term noncompliance, however, has a broader meaning than fraud and illegal acts. Noncompliance includes not only fraud and illegal acts, but also violations of provisions of contracts or grant agreements.

4.19 Under GAGAS, auditors have the same responsibilities for detecting material misstatements arising from other types of noncompliance as they do for detecting those arising from fraud and illegal acts. Direct and material noncompliance is noncompliance having a direct and material effect on the determination of financial statement amounts or could have a significant effect on other financial data needed to achieve audit objectives. Auditors should design the audit to provide reasonable assurance of detecting material misstatements resulting from direct and material noncompliance with provisions of contracts or grant agreements. Indirect noncompliance is noncompliance having material but indirect effects on financial statements or other financial data needed to achieve audit objectives. If specific information comes to the auditors' attention that provides evidence concerning the existence of possible noncompliance that could have a material indirect effect on the financial statements or significant indirect effect on other financial data need to achieve audit objectives, auditors should apply audit procedures specifically directed to ascertaining whether that noncompliance has occurred or is likely to have occurred.

AUDIT DOCUMENTATION

4.20 An additional standard related to audit documentation for financial audits performed in accordance with GAGAS is:

Audit documentation should contain sufficient information to enable an experienced reviewer, who has had no previous connection with the audit, to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions. Audit documentation that supports significant findings, conclusions, and recommendations should be complete before auditors issue their report.

4.21 AICPA standards and GAGAS require auditors to prepare and maintain audit documentation. The form and content of audit documentation should be designed to meet the circumstances of the particular audit. The information contained in audit documentation constitutes the principal record of the work that the auditors have performed and the conclusions that the auditors have reached. The quantity, type, and content of audit documentation is a matter of the auditors' professional judgment. However, audits performed in accordance with GAGAS are subject to review by other reviewers and by oversight officials more frequently than audits done in accordance with AICPA standards. Thus, whereas AICPA standards cite two main purposes of audit documentation--providing the principal support for the audit report and aiding auditors in performing and supervising the audit--audit documentation serves an additional purpose in audits performed in accordance with GAGAS. Audit documentation allows for the review of audit quality by providing the reviewer documentation, either in written or electronic formats, of the evidence supporting the auditors' significant judgments and conclusions.

4.22 Audit documentation for financial audits performed under GAGAS should contain the following.

a. The objectives, scope, and methodology, including sampling and other selection criteria used.

b. Documentation of the auditor's determination that certain additional government auditing standards do not apply or that an applicable standard was not followed, the reasons therefore, and the known effect that not following the standard had, or could have, on the audit.

c. Documentation of the work performed to support significant judgments and conclusions, including descriptions of transactions and records examined that would enable an experienced reviewer to examine the same transactions and records.[9]

d. Auditors' basis for assessing control risk at the maximum level for assertions related to material

[9]Auditors may meet this requirement by listing voucher numbers, check numbers, or other means of identifying specific documents they examined. Auditors are not required to include copies of documents they examined as part of the audit documentation, nor are auditors required to list detailed information from those documents.

account balances, transaction classes, and disclosure components of financial statements when such assertions are significantly dependent upon computerized information systems by addressing (1) the ineffectiveness of the design and/or operation of the controls, or (2) the reasons why it would be inefficient to test the controls.

e. The consideration that the planned audit procedures are designed to achieve audit objectives when evidential matter obtained is highly dependent on computerized information systems and is material to the audit objective, and the auditors are not relying on the effectiveness of internal control over those computerized systems that produced the information. The audit documentation should specifically address (1) the rationale for determining the nature, timing, and extent of planned audit procedures; (2) the kinds and competence of available evidential matter produced outside a computerized information system; and (3) the effect on the audit report if evidential matter to be gathered does not afford a reasonable basis to achieve the audit objectives.[10]

f. Evidence of supervisory reviews of the work performed.

4.23 Underlying GAGAS audits is that federal, state, and local governments and other organizations cooperate in auditing programs of common interest so that auditors may use others' work and avoid duplicate audit efforts. In addition, audits performed in accordance with GAGAS are subject to quality control and assurance reviews. Auditors should make arrangements to make audit documentation available, upon request, in a timely manner to other auditors or reviewers. Contractual arrangements for GAGAS audits should provide for full and timely access to audit documentation to facilitate reliance by other auditors on the auditors' work, as well as reviews of audit quality control and assurance.

4.24 Audit organizations should establish reasonable policies and procedures for the safe custody and retention of audit documentation for a time sufficient to satisfy legal and administrative requirements. If audit documentation is only retained electronically, the audit organization should ensure that the electronic documentation is capable of being accessed throughout the specified

[10]This documentation requirement does not increase the auditors' responsibility for testing internal control but is intended to assist the auditor in ensuring that audit objectives are met and audit risk is reduced to an acceptable level.

retention period established for audit documentation and is safeguarded through sound computer security.

ADDITIONAL CONSIDERATIONS FOR FINANCIAL AUDITS PERFORMED IN ACCORDANCE WITH GAGAS

4.25 As discussed in chapter 1, financial audits contribute to making governments more accountable for the use of public resources and the delivery of services. Because of the increased accountability associated with government audits, auditors performing financial audits in accordance with GAGAS should consider the following guidance related to audit risk and materiality (see paragraphs 4.26 and 4.27), internal control over safeguarding of assets (see paragraphs 4.28 through 4.33), internal control over compliance (see paragraphs 4.34 through 4.36), and professional judgment concerning possible fraud and illegal acts (see paragraphs 4.37 and 4.39).

Audit Risk and Materiality

4.26 The AICPA standards and GAGAS require that the work is to be properly planned, and auditors should consider audit risk and materiality, among other matters, in determining the nature, timing, and extent of auditing procedures and in evaluating the results of those procedures. Auditors' consideration of audit risk and materiality is a matter of professional judgment and is influenced by their perception of the needs of a reasonable person who will rely on the financial statements. Materiality judgments are made in light of surrounding circumstances and necessarily involve both quantitative and qualitative considerations.

4.27 In an audit of a government entity or an entity that receives government assistance, auditors may need to set lower materiality levels than in audits in the private sector because of the public accountability of the audited entity, the various legal and regulatory requirements, and the visibility and sensitivity of government programs, activities, and functions.

Internal Control Over
Safeguarding of Assets

4.28 Safeguarding of assets is an internal control objective. that is especially important in performing financial audits of governmental entities or others receiving government funds.[11] Given the public accountability for stewardship of resources, safeguarding of assets permeates control objectives and components as defined by the AICPA standards and GAGAS.

4.29 As applied to financial audits, internal control over safeguarding of assets constitutes a process, effected by an entity's governing body, management, and other personnel designed to provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

4.30 Internal control over the safeguarding of assets relates to the prevention or timely detection of unauthorized transactions and unauthorized access to assets that could result in losses that are material to the financial statements, such as when unauthorized expenditures or investments are made, unauthorized liabilities are incurred, inventory is stolen, or assets are converted to personal use. Such controls are designed to help ensure the use of and access to assets are in accordance with management's authorization. Authorization includes approval of transactions in accordance with control activities established by management to safeguard assets, such as establishing and complying with requirements for extending and monitoring credit or making investment decisions, and related documentation. Control over safeguarding of assets is not designed to protect against loss of assets arising from inefficiency or from management's operating decisions, such as incurring expenditures for equipment or material that proves to be unnecessary or unsatisfactory.

4.31 AICPA standards and GAGAS require auditors to obtain a sufficient understanding of internal control to plan the audit. They also require auditors to plan the audit to provide reasonable assurance of detecting material fraud, including material misappropriation of assets. Because preventing or

[11]Auditors should apply the guidance contained in this section to other types of financial audits to the extent it is applicable to the nature of the engagement.

detecting material misappropriations is an objective of control over safeguarding of assets, understanding this type of control can be essential to planning the audit.

4.32 Control over safeguarding of assets is not limited to preventing or detecting misappropriations. It also helps prevent or detect other material losses that could result from unauthorized acquisition, use, or disposition of assets. Such controls include, for example, the process of assessing the risk of unauthorized acquisition, use, or disposition of assets and establishing control activities to help ensure that management directives to address the risk are carried out. Such control activities would include permitting acquisition, use, or disposition of assets only in accordance with management's general or specific authorization, including compliance with established control activities for such acquisition, use, or disposition. They would also include comparing existing assets with the related records at reasonable intervals and taking appropriate action with respect to any differences. Finally, controls over safeguarding of assets against unauthorized acquisition, use, or disposition also relate to making available to management information it needs to carry out its responsibilities related to prevention or timely detection of such unauthorized activities, as well as mechanisms to enable management to monitor the continued effective operation of such controls.

4.33 Understanding the control over safeguarding of assets can help auditors assess the risk that financial statements could be materially misstated. For example, an understanding of the audited entity's control over the safeguarding of assets can help auditors recognize risk factors such as

a. failure to adequately monitor decentralized operations;

b. lack of control over activities, such as lack of separation of duties or approval for major transactions;

c. lack of control over computerized information systems, such as a lack of control over access to applications that initiate or control the movement of assets;

d. failure to develop or communicate adequate control activities for security of data or assets, such as allowing unauthorized personnel to have ready access to data or assets; and

e. failure to investigate significant unreconciled differences between reconciliations of a control account and subsidiary records.

Internal Control Over Compliance

4.34 Governmental entities are subject to a variety of laws and regulations that affect their financial statements or other financial data, which is a major factor distinguishing governmental accounting from private-sector accounting. For example, such laws and regulations may address the required fund structure, procurement or debt limitations, or authority for transactions. Accordingly, compliance with such laws and regulations may have a direct and material effect on the determination of amounts in the financial statements of governmental entities. Likewise, entities that receive government assistance, such as contractors, nonprofit entities, and other nongovernmental entities, are also subject to regulations, contract provisions, or grant agreements that could have a direct and material effect on their financial statements. Management, of both governmental entities and others receiving governmental assistance, is responsible for ensuring that the entity complies with not only the laws and regulations but also contract provisions and grant agreements applicable to its activities. That responsibility encompasses the identification of applicable laws, regulations, contract provisions, and grant agreements, as well as the establishment of controls designed to provide reasonable assurance that the entity complies with those laws, regulations, contract provisions, and grant agreements.

4.35 AICPA standards and GAGAS require auditors to design the audit to provide reasonable assurance that the financial statements are free of material misstatements resulting from noncompliance that have a direct and material effect on the determination of financial statement amounts. To meet this requirement, auditors should have an understanding of internal control relevant to financial statement assertions affected by those laws, regulations, contract provisions, or grant agreements. Auditors may find it necessary to use the work of legal counsel in (1) determining

which laws and regulations might have a direct and material effect on the financial statements, (2) designing tests of compliance with laws and regulations, and (3) evaluating the results of those tests.[12] Auditors also may find it necessary to use the work of legal counsel when an audit requires testing compliance with provisions of contracts or grant agreements. Depending on the circumstances of the audit, auditors may find it necessary to obtain information on compliance matters from others, such as investigative staff, audit organizations, and officials of government entities that provided assistance to the audited entity, and/or the applicable law enforcement authority.

4.36 AICPA standards and GAGAS require that auditors use their understanding of internal control relevant to financial statement assertions affected by laws and regulations to identify types of potential misstatements, consider factors that affect the risk of material misstatement, and design substantive tests. GAGAS extends this requirement to include contract provisions and grant agreements. In applying this requirement, the following factors may influence the auditors' assessment of control risk:

a. management's awareness or lack of awareness of applicable laws, regulations, contract provisions, or grant agreements;

b. policy of the audited entity regarding such matters as acceptable operating practices and codes of conduct; and

c. assignment of responsibility and delegation of authority to deal with such matters as organizational goals and objectives, operating functions, and regulatory requirements.

[12]AICPA standards provide guidance for auditors who use the work of a specialist who is not a member of their staff.

Professional Judgment Concerning
Possible Fraud and Illegal Acts

4.37 Under AICPA standards and GAGAS, auditors are responsible for being aware of the characteristics and types of potentially material fraud that could be associated with the area being audited so that they can plan the audit to provide reasonable assurance of detecting material misstatements of the financial statements due to fraud.

4.38 Auditors should exercise professional judgment in pursuing indications of possible fraud and illegal acts so as not to interfere with potential future investigations, legal proceedings, or both. Under some circumstances, laws, regulations, or policies may require auditors to report indications of certain types of fraud or illegal acts to law enforcement or investigatory authorities before extending audit steps and procedures. Auditors may also be required to withdraw from or defer further work on the audit or a portion of the audit in order not to interfere with an investigation.

4.39 An audit made in accordance with GAGAS will not guarantee the discovery of fraud or illegal acts or contingent liabilities resulting from them. Nor does the subsequent discovery of illegal acts committed during the audit period mean that the auditors' performance was inadequate, provided the audit was made in accordance with GAGAS.

CHAPTER 5

REPORTING STANDARDS FOR FINANCIAL AUDITS

INTRODUCTION

5.1 This chapter presents reporting standards for financial audits, which include audits of financial statements and other work governed by the American Institute of Certified Public Accountants' (AICPA) generally accepted auditing standards and related Statements on Auditing Standards (SASs). Generally accepted government auditing standards (GAGAS) incorporate the AICPA field work and reporting standards and related SASs unless the Comptroller General of the United States excludes them by formal announcement.[1] This chapter identifies the AICPA generally accepted reporting standards and prescribes for financial audits conducted in accordance with GAGAS additional reporting standards on

a. reporting compliance with generally accepted government auditing standards (see paragraphs 5.3 through 5.6),

b. reporting on compliance with laws and regulations and on internal control over financial reporting (see paragraphs 5.7 through 5.10),

c. reporting deficiencies in internal control (see paragraphs 5.11 through 5.15),

d. reporting fraud, illegal acts, and other noncompliance (see paragraphs 5.16 through 5.26),

e. reporting views of responsible officials (see paragraph 5.27 through 5.31),

[1]To date, the Comptroller General has not excluded any field work or reporting standards or statements on auditing standards.

f. privileged and confidential information (see paragraphs 5.32 through 5.34), and

g. report issuance and distribution. (See paragraphs 5.35 through 5.38).

5.2 The four AICPA generally accepted standards of reporting are as follows.

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

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

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

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

REPORTING COMPLIANCE WITH GENERALLY
ACCEPTED GOVERNMENT AUDITING STANDARDS

5.3 An additional reporting standard for financial audits conducted in accordance with GAGAS is:

Audit reports should state that the audit was made in accordance with generally accepted government auditing standards.

5.4 The above statement refers to all the applicable standards that the auditors should have followed during their audit. The statement referencing compliance with generally accepted government auditing standards should be qualified in situations where the auditors did not follow an applicable standard. In these situations, the auditors should disclose in the scope section of the report the applicable standard that was not followed, the reasons therefore, and how not following the standard affected, or could have affected, the results of the audit.

5.5 When the report on the financial audit is submitted to comply with a legal, regulatory, or contractual requirement for a GAGAS audit, it should specifically cite GAGAS. The report on the financial audit may cite AICPA standards as well as GAGAS.

5.6 An audited entity receiving a GAGAS audit report may also need a financial audit report for purposes other than to comply with requirements calling for a GAGAS audit. For example, the audited entity may need audited financial statements to issue bonds or for other financing purposes. When a GAGAS audit is the basis for an auditor's subsequent report under the AICPA standards, it would be advantageous to users of the subsequent report for the auditor's report to include the information on compliance with laws and regulations and internal control that is required by GAGAS but not required by AICPA standards. To reissue essentially the same report omitting the information regarding compliance with laws and regulations and internal control is not in the public interest.

REPORTING ON COMPLIANCE WITH LAWS AND REGULATIONS AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING

5.7 An additional reporting standard for financial statement audits[2] conducted in accordance with GAGAS is:

When providing an opinion on financial statements, auditors should include in their report on the financial statements either a (1) description of the scope of the auditors' testing of compliance with laws and regulations and internal control over financial reporting and the results of those tests or an opinion, if sufficient work was performed; or (2) reference to the separate report(s) containing that information. In presenting the results of those tests, auditors should report fraud, illegal acts, other material noncompliance, and reportable conditions in internal control over financial reporting.

5.8 Auditors may report on compliance with laws and regulations and internal control over financial reporting in the report on the financial statements or in separate report(s). When auditors report on compliance and internal control over financial reporting as part of the report on the financial statements, auditors should include an introduction summarizing key findings in the audit of the financial statements and the related compliance and internal control work. Auditors should not issue this introduction as a stand-alone report.

5.9 When auditors report separately (including separate reports bound in the same document) on compliance with laws and regulations and internal control over financial reporting, the report on the financial statements should state that the auditors are issuing those additional reports. The report on the financial statements should also state that the reports on compliance with laws and regulations and internal control over financial reporting are an integral part of a GAGAS audit,

[2]Although the following standard on reporting on compliance with laws and regulations and on internal control over financial reporting is applicable to audits of financial statements, the requirement to report deficiencies in internal control (see paragraphs 5.11 through 5.15) and reporting fraud, illegal acts, and other noncompliance (see paragraphs 5.16 through 5.26) is applicable to all financial audits.

and, in considering the results of the audit, these reports should be read along with the auditors' report on the financial statements.

Scope of Compliance and Internal Control Work

5.10 Auditors should report the scope of their testing of compliance with laws and regulations and of internal control over financial reporting, including whether or not the tests they performed provided sufficient evidence to support an opinion on compliance with laws and regulations or internal control over financial reporting and whether the auditors are providing such opinions.[3]

REPORTING DEFICIENCIES IN
INTERNAL CONTROL

5.11 The additional reporting standard for financial audits conducted in accordance with GAGAS is:

Auditors should report significant deficiencies in internal control considered to be reportable conditions as defined in AICPA standards.

5.12 The following are examples of matters that may be reportable conditions:[4]

a. absence of appropriate segregation of duties consistent with appropriate control objectives;

b. absence of appropriate reviews and approvals of transactions, accounting entries, or systems output;

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[3]Auditors should follow the AICPA's Statements on Standards for Attestation Engagements when providing opinions on internal control over compliance with laws and regulations or on internal control over financial reporting. See chapter 6 for a discussion of the attestation standards.

[4]AICPA standards define reportable conditions as significant deficiencies in the design or operation of internal control which could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

c. inadequate provisions for the safeguarding of assets;

d. evidence of failure to safeguard assets from loss, damage, or misappropriation;

e. evidence that a system fails to provide complete and accurate output consistent with the control objectives of the audited entity because of the misapplication of control activities;

f. evidence of intentional override of internal control by those in authority to the detriment of the overall objectives of the system;

g. evidence of failure to perform tasks that are part of internal control, such as reconciliations not prepared or not timely prepared;

h. absence of a sufficient level of control consciousness within the organization;

i. significant deficiencies in the design or operation of internal control that could result in violations of laws and regulations having a direct and material effect on the financial statements; and

j. failure to follow up and correct previously identified deficiencies in internal control.

5.13 In reporting on deficiencies in internal control, auditors should identify those that are individually or in the aggregate considered to be material weaknesses.[5] Auditors should place their findings in proper perspective by providing a description of the objectives, scope, and methodology used to conduct the work. To give the reader a basis for judging the prevalence and

[5]The AICPA standards define a material weakness as a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

consequences of these findings, the instances identified should be related to the population or the number of cases examined and be quantified in terms of dollar value, if appropriate. Auditors may include such information in their audit report or may prepare a separate report. If auditors report separately, the audit report should contain a reference to the separate report containing this information[6] and state that the separate report is an integral part of the audit and should be considered in assessing the results of the audit.

5.14 To the extent possible, auditors should present findings to identify the elements of criteria, condition, and effect, as well as cause when problems are found. In addition, auditors should provide recommendations for corrective action if auditors are able to sufficiently develop the findings. However, the elements needed for a finding depend entirely on the scope and objectives of the financial audit, and, as a result, may not always have all of the elements fully developed. At a minimum, auditors should identify the condition, criteria, and possible effect to provide sufficient information to federal, state, and local officials to assist them in taking corrective action.

5.15 When auditors detect deficiencies in internal control that are not reportable conditions, they should communicate those deficiencies to officials of the audited entity, preferably in writing. If the auditors have communicated other deficiencies in internal control in a management letter to officials of the audited entity, auditors should refer to that management letter when they report on internal control. Auditors should include in their audit documentation evidence of all communications to officials of the audited entity about deficiencies in internal control.

REPORTING FRAUD, ILLEGAL ACTS, AND OTHER NONCOMPLIANCE

5.16 An additional reporting standard for financial audits conducted in accordance with GAGAS is:

[6]For audits of financial statements, such information is generally included in the reports on compliance and internal control over financial reporting.

Auditors should report fraud, illegal acts, or other material noncompliance. In some circumstances, auditors should report fraud and illegal acts directly to parties external to the audited entity.

5.17 AICPA standards and GAGAS require auditors to address the effect fraud or illegal acts may have on the audit report and to determine that the audit committee or others with equivalent authority and responsibility are adequately informed about the fraud or illegal acts. The additional GAGAS standard does not modify these responsibilities. However, AICPA standards do not require that this communication be written, nor do they address communication regarding other noncompliance (violations of other compliance requirements such as provisions of contracts or grant agreements).

5.18 When auditors conclude, on the basis of evidence obtained, that fraud or an illegal act either has occurred or is likely to have occurred,[7] they should report the relevant information. Auditors need not report information about fraud or an illegal act that is clearly inconsequential. Thus, auditors should include in their report the same information about fraud and illegal acts that they have informed the audit committees about under AICPA standards. Auditors should also report other noncompliance that is material to the audit.

5.19 In reporting material fraud, illegal acts, or other noncompliance, the auditors should place their findings in proper perspective by providing a description of the objectives, scope, and methodology used to conduct the work. To give the reader a basis for judging the prevalence and consequences of these findings, the instances identified should be related to the population or the number of cases examined and be quantified in terms of dollar value, if appropriate. Auditors may include such information in their audit report or may prepare a separate report. If auditors report separately, the audit report should contain a reference to the separate report containing this

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

information[8] and state that the report is an integral part of the audit and should be considered in assessing the results of the audit.

5.20 To the extent possible, auditors should present findings to identify the elements of criteria, condition, and effect, as well as cause when problems are found. In addition, auditors should provide recommendations for corrective action if auditors are able to sufficiently develop the findings. However, the elements needed for a finding depend entirely on the scope and objectives of the financial audit, and, as a result, may not always have all of the elements fully developed. At a minimum, auditors should identify the condition, criteria, and possible effect to provide sufficient information to federal, state, and local officials to assist them in taking corrective action. Auditors should also obtain the views of responsible officials of the audited entity regarding the findings and include this information in the report as appropriate.

5.21 When auditors detect fraud, illegal acts, or other noncompliance that do not meet criteria for reporting in paragraph 5.18, they should communicate those findings to officials of the audited entity, preferably in writing. If auditors have communicated those findings in a management letter to officials of the audited entity, auditors should refer to that management letter when they report on compliance. Auditors may provide less extensive disclosure of fraud and illegal acts that are not material in either a quantitative or qualitative sense.[9] Auditors should include in their audit documentation evidence of all communications to officials of the audited entity about fraud, illegal acts, and other noncompliance.

Direct Reporting of Fraud and Illegal Acts

5.22 GAGAS require auditors to report fraud or illegal acts directly to parties outside the audited entity in two circumstances, as discussed below. These requirements are in addition to any legal

[8]For audits of financial statements, such information is generally included in the reports on compliance with laws and regulations and internal control over financial reporting.

[9]Paragraphs 4.26 and 4.27 provide guidance on factors that may influence auditors' materiality judgments in audits of government entities or entities receiving government assistance. AICPA standards provide guidance on the interaction of quantitative and qualitative considerations in materiality judgments.

requirements for direct reporting of fraud or illegal acts. Auditors should meet these requirements even if they have resigned or been dismissed from the audit.[10]

5.23 Officials of the audited entity may be required by law or regulation to report certain fraud or illegal acts to specified external parties, such as a federal inspector general or a state attorney general. If auditors have communicated such fraud or illegal acts to officials of the audited entity and they fail to report them, then the auditors should communicate such an awareness to the governing body of the audited entity. If the officials of the audited entity do not make the required report as soon as practicable after the auditors' communication with the entity's governing body, then the auditors should report the fraud or illegal acts directly to the external party specified in the law or regulation.

5.24 Management of the audited entity is responsible for taking timely and appropriate steps to remedy fraud or illegal acts that auditors report to it. When fraud or an illegal act involves assistance received directly or indirectly from a government agency, auditors may have a duty to report directly if management fails to take remedial steps. If auditors conclude that such failure is likely to cause them to depart from the standard report on the financial statements or resign from the audit, then they should communicate that conclusion to the governing body of the audited entity. Then, if officials of the audited entity do not report the fraud or illegal act as soon as practicable to the entity that provided the government assistance, the auditors should report the fraud or illegal act directly to that entity.

5.25 In both of these situations, auditors should obtain sufficient, competent, and relevant evidence, such as confirmation with outside parties, to corroborate assertions by management that it has reported fraud or illegal acts. If they are unable to do so, then the auditors should report the fraud or illegal acts directly as discussed above.

5.26 Under some circumstances, laws, regulations, or policies may require auditors to report promptly indications of certain types of fraud or illegal acts to law enforcement or investigatory

[10]Internal audit organizations do not have a duty to report outside that entity unless required by law, rule, regulation, or policy.

authorities. When auditors conclude that this type of fraud or illegal act either has occurred or is likely to have occurred, they should ask those authorities and/or legal counsel if reporting certain information about that fraud or illegal act would compromise investigative or legal proceedings. Auditors should limit their reporting to matters that would not compromise those proceedings, such as information that is already a part of the public record.

VIEWS OF RESPONSIBLE OFFICIALS

5.27 An additional reporting standard for financial audits performed in accordance with GAGAS is:

If the auditors' report discloses significant deficiencies, auditors should report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as corrections planned.

5.28 One of the most effective ways to ensure that a report is fair, complete, and objective is to obtain advance review and comments by responsible officials of the audited entity and others, as may be appropriate. Including the views of responsible officials produces a report that shows not only what was found and what the auditors think about it but also what the responsible persons think about it and what they plan to do about it.

5.29 Auditors should normally request that the responsible officials' views on significant findings, conclusions, and recommendations be submitted in writing. Oral comments are acceptable as well, and, in some cases, may be the only or most expeditious way to obtain comments. Cases in which obtaining oral comments can be effective include when there is a time-critical need to meet a user's needs; the auditor has worked closely with the responsible officials throughout the conduct of the work and the parties are very familiar with the findings and issues addressed in the draft product; or the auditor does not expect major disagreements with the draft report's findings, conclusions, and recommendations, or perceive any major controversies with regard to the issued discussed in the draft report. Auditors should prepare a

summary of the officials' oral comments and provide a copy of the summary to management of the audited entity to verify that the comments are accurately stated.

5.30 Comments should be fairly and objectively evaluated and recognized, as appropriate, in the final report. Comments, such as a promise or plan for corrective action, should be noted but should not be accepted as justification for dropping a significant finding or a related recommendation.

5.31 When the comments oppose the report's findings, conclusions, or recommendations, and are not, in the auditors' opinion, valid, the auditors should state their reasons for disagreeing with the comments. The auditors' disagreement should be stated in a fair and objective manner. Conversely, the auditors should modify their report as necessary if they find the comments valid. Auditors may wish to attach the comment letter to the audit report to provide the reader with both points of view.

PRIVILEGED AND CONFIDENTIAL INFORMATION

5.32 An additional reporting standard for financial audits conducted in accordance with GAGAS is:

If certain pertinent information is prohibited from general disclosure, the audit report should state the nature of the information omitted and the requirement that makes the omission necessary.

5.33 Certain information may be prohibited from general disclosure by federal, state, or local laws or regulations. Such information may be provided on a need-to-know basis in a separate limited official-use report which is restricted to only persons authorized by law or regulation to

receive it. The auditors should, when appropriate, consult with legal counsel regarding any requirements or other circumstances that may necessitate the omission of certain information.

5.34 Additional circumstances associated with public safety and security concerns could also justify the exclusion of certain information in the report. For example, information related to computer security for a particular program should be excluded from publicly available reports because of the potential damage that could be caused by the misuse of this information. In such circumstances, auditors may issue a limited official-use report containing such information and distribute the report only to those parties responsible for acting on the auditors' recommendations. If auditors make the judgment that certain additional information should be excluded from a publicly available report, they should state the nature of the information omitted and the reasons that makes the omission necessary.

REPORT ISSUANCE AND DISTRIBUTION

5.35 An additional reporting standard for financial audits conducted in accordance with GAGAS is:

Auditors should submit written audit reports to the appropriate officials of the audited entity and to the appropriate officials of the organizations requiring or arranging for the audits, including external funding organizations such as legislative bodies, unless legal restrictions prevent it. Auditors should also send copies of the reports to other officials who have legal oversight authority or who may be responsible for acting on audit findings and recommendations and to others authorized to receive such reports. Unless the report is restricted by law or regulation, or contains privileged and confidential information, auditors should ensure that copies be made available for public inspection.

5.36 Audit reports should be distributed in a timely manner to officials interested in the results.[11] Such officials include those designated by law or regulation to receive such reports, those responsible for acting on the findings and recommendations, those of other levels of government that have provided assistance to the audited entity, and legislators. However, if the subject of the audit involves material that is classified for security purposes or not releasable to particular parties or the public for other valid reasons, auditors may limit the report distribution.

5.37 When public accountants are engaged, the engaging organization should ensure that the report is distributed appropriately. If the public accountants are to make the distribution, the engagement agreement should indicate which officials or organizations should receive the report.

5.38 Internal auditors should follow their entity's own arrangements and statutory requirements for distribution. Usually, they report to their entity's top managers, who are responsible for distribution of the report. Further distribution of reports outside the organization should be made in accordance with applicable laws, rules, regulations, or policy.

[11]See the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133 on single audits for the distribution of reports on single audits of state and local governmental entities and nonprofit organizations that receive federal awards.

CHAPTER 6

GENERAL, FIELD WORK, AND REPORTING STANDARDS FOR ATTESTATION ENGAGEMENTS

INTRODUCTION

6.1 In an attestation engagement, auditors issue an examination, a review, or an agreed-upon procedures report on subject matter, or on an assertion about the subject matter, that is the responsibility of another party. Attestation engagements can cover a broad range of financial or nonfinancial objectives[1] and can be part of a financial statement audit or other engagement. Attestation engagements are governed by the standards for attestation engagements issued by the American Institute of Certified Public Accountants (AICPA). Generally accepted government auditing standards (GAGAS) incorporate for attestation engagements the AICPA's general standard on criteria, its field work standards, and its reporting standards, as well as the AICPA Statements on Standards for Attestation Engagements (SSAEs), which interpret the attestation standards, unless the Comptroller General of the United States excludes them by formal announcement.[2] This chapter identifies the AICPA's general standard on criteria,[3] field work standards, and reporting standards and prescribes additional field work and reporting standards, as well as guidance, for attestation engagements performed in accordance with GAGAS.

[1] See chapter 2 for examples of objectives for attestation engagements.

[2] To date, the Comptroller General has not excluded any field work standards, reporting standards, or statements on standards for attestation engagements.

[3] GAGAS incorporate only one of the AICPA's general standards for attestation engagements. In addition to this general standard, auditors should follow the general standards for work performed under GAGAS, as discussed in chapter 3.

AICPA GENERAL AND FIELD WORK STANDARDS
FOR ATTESTATION ENGAGEMENTS

6.2 The AICPA's general standard related to criteria states the following.

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

6.3 The two AICPA field work standards for attestation engagements are as follows.

a. The work shall be adequately planned and assistants, if any, shall be properly supervised.

b. Sufficient evidence shall be obtained to provide a reasonable basis for the conclusion that is expressed in the report.

ADDITIONAL FIELD WORK STANDARDS
FOR ATTESTATION ENGAGEMENTS

6.4 GAGAS require additional field work standards for attestation engagements in the following areas:

a. auditor communication (see paragraphs 6.5 and 6.7),

b. considering the results of previous audits and attestation engagements (see paragraphs 6.8 through 6.10),

c. audit documentation (see paragraphs 6.11 through 6.17),

d. internal control (see paragraphs 6.18 and 6.19), and

e. fraud, illegal acts, and other noncompliance (see paragraphs 6.20 through 6.22).

Auditor Communication

6.5 An additional field work standard for attestation engagements performed in accordance with GAGAS is:

Auditors should communicate information to officials of the audited entity and the individual contracting for the audit services regarding the nature and extent of planned testing and reporting on the subject matter or assertion.

6.6 During the planning stages of an attestation engagement, auditors should communicate to officials of the audited entity and to individuals requesting or contracting for the services information regarding the nature and extent of testing and reporting, including any potential restriction of reports associated with the different levels of assurance services, to reduce the risk that the needs or expectations of the parties involved may be misinterpreted. For example, attestation standards provide for the following three levels of assurance.

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

b. Review: Auditors perform sufficient testing to express a conclusion whether any information came to the auditors' attention on the basis of the work performed that indicates the subject matter is not based on (or in conformity with) the criteria or the assertion is not presented (or fairly stated) in all material respects based on the criteria.[4]

[4] As stated in the AICPA's statements on standards for attestation engagements, auditors should not perform review-level work for reporting on internal control or compliance with laws and regulations.

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

6.7 Auditors should use their professional judgment to determine the form and content of the communication, although written communication is preferred. Auditors may use an engagement letter, if appropriate, to communicate the information. If the attestation engagement is part of a larger audit, this information may be communicated as part of that audit. Whatever the form of the communication, auditors should include audit documentation regarding the communication.

Considering the Results of Previous Audits
and Attestation Engagements

6.8 An additional field work standard for attestation engagements performed in accordance with GAGAS is:

Auditors should consider the results of previous audits and attestation engagements and follow up on known significant findings and recommendations that directly relate to the subject matter of the attestation engagement being undertaken.

6.9 Auditors should determine whether officials of the audited entity have taken appropriate corrective actions on known reported significant findings and recommendations.[5] In addition to following up on significant reported findings and recommendations from previous financial audits or attestation engagements, auditors should consider significant findings identified in performance audits and other studies if these findings relate to subject matter or assertions of the attestation engagement. For example, an audit report on an entity's computerized information systems may contain significant findings that could relate to the attestation engagement if the entity uses such systems to process information about the subject matter or contained in an assertion about the subject matter. Following up on known significant findings and

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

recommendations identified in previous audits, attestation engagements, or studies can help auditors evaluate the subject matter or the assertion associated with the attestation engagement.

6.10 Providing continuing attention to significant findings and recommendations is important to ensure the benefits of audit work are realized. Ultimately, the benefits of audit work occur when audit findings are resolved through meaningful and effective corrective action in response to the auditors' findings and recommendations. Officials of the audited organization are responsible for resolving audit findings and recommendations directed to them and for having a process to track their status. If officials of the audited organization do not have such a process, auditors may wish to establish their own process.

Audit Documentation

6.11 The additional field work standard related to audit documentation for attestation engagements performed in accordance with GAGAS is:

Audit documentation should contain sufficient information to enable an experienced reviewer, who has had no previous connection with the attestation engagement, to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions. Audit documentation that supports significant findings, conclusions, and recommendations should be complete before auditors issue their report.

6.12 AICPA standards and GAGAS require that auditors should prepare and maintain audit documentation. The form and content of audit documentation should be designed to meet the circumstances of the particular attestation engagement. The information contained in audit documentation constitutes the principal record of the work that the auditors have performed and the conclusions that the auditors have reached. The quantity, type, and content of audit documentation is a matter of the auditors' professional judgment.

6.13 GAGAS extend the level of required audit documentation to be sufficient for an experienced reviewer who has had no previous connection with the engagement to understand

the evidence that supports the auditors' significant judgments and conclusions. Further, such documentation must be complete before auditors issue their report.

6.14 Attestation engagements done in accordance with GAGAS are subject to review by other auditors and by oversight officials more frequently than audits done in accordance with AICPA standards. Thus, whereas AICPA standards cite two main purposes of audit documentation--providing the principal support for the audit report and aiding auditors in the conduct and supervision of the audit--audit documentation serves an additional purpose in attestation engagements performed in accordance with GAGAS. Audit documentation allows for the review of audit quality by providing the reviewer documentation, either in written or electronic formats, of the evidence supporting the auditors' significant judgments and conclusions.

6.15 Audit organizations should establish reasonable policies and procedures for the safe custody and retention of audit documentation for a time sufficient to satisfy legal and administrative requirements. If audit documentation is only retained electronically, the audit organization should ensure that the electronic documentation is capable of being accessed throughout the specified retention period established for audit documentation and is safeguarded through sound computer security.

6.16 Audit documentation for attestation engagements under GAGAS should contain the following.

a. The objectives, scope, and methodology, including any sampling criteria used.

b. Documentation of the auditor’s determination that certain additional government auditing standards do not apply or that an applicable standard was not followed, the reasons therefore, and the known effect that not following the standard had, or could have, on the attestation engagement.

c. Documentation of the work performed to support significant judgments and conclusions, including descriptions of transactions and records examined that would enable an experienced reviewer to examine the same transactions and records.[6]

d. The consideration that the planned procedures are designed to achieve objectives of the attestation engagement when evidential matter obtained is highly dependent on computerized information systems and is material to the objective of the engagement, and the auditors are not relying on the effectiveness of internal control over those computerized systems that produced the information. The audit documentation should specifically address (1) the rationale for determining the nature, timing, and extent of planned audit procedures; (2) the kinds and competence of available evidential matter produced outside a computerized information system; and (3) the effect on the attestation engagement report if evidential matter to be gathered does not afford a reasonable basis to achieve the objectives of the engagement.

e. Evidence of supervisory reviews of the work performed.

6.17 One factor underlying GAGAS audits is that federal, state, and local governments and other organizations cooperate in auditing programs of common interest so that auditors may use others' work and avoid duplicate audit efforts. In addition, attestation engagements performed in accordance with GAGAS are subject to quality control and assurance reviews. Auditors should make arrangements to make audit documentation available, upon request, in a timely manner to other auditors or reviewers. Contractual arrangements for attestation engagements performed in accordance with GAGAS should provide for full and timely access to audit documentation to facilitate reliance by other auditors on the auditors' work, as well as reviews of audit quality control and assurance.

[6] Auditors may meet this requirement by listing voucher numbers, check numbers, or other means of identifying specific documents they examined. Auditors are not required to include copies of documents they examined as part of the audit documentation, nor are auditors required to list detailed information from those documents.

Internal Control

6.18 An additional field work standard for attestation engagements performed in accordance with GAGAS is:

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

6.19 In planning the engagement, auditors should obtain an understanding of internal control[7] as it relates to the subject matter or assertion to which the auditors are attesting. The subject matter or assertion may be of a financial or nonfinancial nature, and internal control relevant to the subject matter or assertion the auditor is testing may relate to

a. effectiveness and efficiency of operations, including the use of an entity's resources;

b. reliability of financial reporting, including reports on budget execution and other reports for internal and external use;

c. compliance with applicable laws and regulations; and

d. safeguarding of assets.

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

Fraud, Illegal Acts, and Other Noncompliance

6.20 An additional field work standard for attestation engagements performed in accordance with GAGAS is:

In planning examination-level attestation engagements, auditors should design the engagement to provide reasonable assurance of detecting fraud, illegal acts, or other noncompliance that could have a material effect on the subject matter or assertion of the attestation engagement.

6.21 Auditors should exercise professional judgment in planning the engagement by obtaining an understanding of the possible effects of fraud, illegal acts, or other noncompliance on the subject matter or assertion of the attestation engagement and by identifying and assessing any associated risks that could have a material effect on the attestation engagement.[8] Auditors should include audit documentation on their assessment of risk, and, when risk factors are identified as being present, the documentation should include

a. those risk factors identified, and

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

6.22 In addition, if during the performance of the attestation engagement, risk factors or other conditions are identified that cause the auditors to believe that an additional response is required, such factors or other conditions, and any future response the auditors concluded was appropriate, should be documented.

[8] Although not applicable to attestation engagements, the AICPA statements on auditing standards may provide useful guidance related to fraud for auditors performing attestation engagements in accordance with GAGAS.

AICPA REPORTING STANDARDS
FOR ATTESTATION ENGAGEMENTS

6.23 The AICPA standards for attestation engagements provide for three levels of reporting based on the type of assurance the auditor is providing. (See paragraph 6.6.) The four AICPA reporting standards for attestation engagements are as follows.

a. The report shall identify the subject matter or the assertion being reported on and state the character of the engagement.

b. The report shall state the practitioner's [auditors'] conclusions about the subject matter or the assertion in relation to the criteria against which the subject matter was evaluated.

c. The report shall state all of the practitioner's [auditors'] significant reservations about the engagement, the subject matter, and, if applicable, the assertion related thereto.

d. The report shall state that the use of the report is restricted to specified parties under the following circumstances:[9] (1) When the criteria used to evaluate the subject matter are determined by the practitioner to be appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria. (2) When the criteria used to evaluate the subject matter are available only to specified parties. (3) When reporting on subject matter and a written assertion has not been provided by the responsible party. (4) When the report is on an attest engagement to apply agreed-upon procedures to the subject matter.

[9] Auditors should, however, follow the report distribution standard. (See paragraphs 6.39 through 6.43.)

ADDITIONAL REPORTING STANDARDS FOR ATTESTATION ENGAGEMENTS

6.24 GAGAS require additional reporting standards for attestation engagements in the following areas:

a. reporting compliance with generally accepted government auditing standards (see paragraphs 6.25 through 6.27);

b. reporting on internal control and on fraud, illegal acts, and other noncompliance (see paragraphs 6.28 through 6.31);

c. views of responsible officials (see paragraphs 6.32 through 6.36);

d. privileged and confidential information (see paragraphs 6.37 and 6.38); and

e. report issuance and distribution (see paragraphs 6.39 through 6.43).

Reporting Compliance With Generally Accepted Government Auditing Standards

6.25 An additional reporting standard for attestation engagements performed in accordance with GAGAS is:

Reports on attestation engagements should state that the engagement was made in accordance with generally accepted government auditing standards.

6.26 The above statement refers to all the applicable standards that the auditors should have followed during the attestation engagement. The statement should be qualified in situations where the auditors did not follow an applicable standard. In these situations, the auditors should disclose in the scope section of the report the applicable standard that was not followed, the

reasons therefore, and how not following the standard affected, or could have affected, the results of the attestation engagement.

6.27 When the report on the attestation engagement is submitted to comply with a legal, regulatory, or contractual requirement for a GAGAS audit, it should specifically cite GAGAS. An audited entity receiving a GAGAS attestation report may also need a report on the attestation engagement for purposes other than to comply with requirements calling for a GAGAS audit. When a GAGAS attestation engagement is the basis for an auditor's subsequent report under the AICPA standards, it would be advantageous to users of the subsequent report for the auditor's report to include the information on compliance with laws and regulations and internal control that is required by GAGAS but not required by AICPA standards. To reissue essentially the same report omitting the information regarding compliance with laws and regulations and internal control is not in the public interest.

Reporting on Internal Control and on Fraud,
Illegal Acts, and Other Noncompliance

6.28 An additional reporting standard for attestation engagements performed in accordance with GAGAS is:

The report on an attestation engagement should disclose deficiencies in internal control, including internal control over compliance with laws and regulations, that are material to the subject matter or assertion. Fraud, illegal acts, and other noncompliance often result from the lack, or circumvention, of internal control. Accordingly, auditors should also disclose in the report on the attestation engagement instances of fraud, illegal acts, or other noncompliance that are material to the subject matter or the assertion.

6.29 Auditors should place their findings in proper perspective by providing a description of the objectives, scope, and methodology used to conduct the work. To give the reader a basis for judging the prevalence and consequences of these findings, the instances identified should be related to the population or the number of cases examined and be quantified in terms of dollar

value, if appropriate. Auditors need not report information about fraud or an illegal act that is clearly inconsequential. However, these matters should be brought to the attention of management of the audited entity.

6.30 To the extent possible, auditors should present findings to identify the elements of criteria, condition, and effect, as well as cause when problems are found. In addition, auditors should provide recommendations for corrective action if auditors are able to sufficiently develop the findings. However, the elements needed for a finding depend entirely on the scope and objectives of the attestation engagement, and, as a result, may not always have all of the elements fully developed. At a minimum, auditors should identify the condition, criteria, and possible effect to provide sufficient information to federal, state, and local officials to assist them in taking corrective action.

6.31 When auditors detect deficiencies in internal control that are not material to the subject matter or assertion or conclude, on the basis of evidence obtained, that fraud, an illegal act, or other noncompliance either has occurred or is likely to have occurred,[10] they should communicate relevant information to officials of the audited entity, preferably in writing. Auditors should include in their audit documentation evidence of all communications to officials of the audited entity about deficiencies in internal control or indications of fraud, illegal acts, or other noncompliance.

Views of Responsible Officials

6.32 An additional reporting standard for attestation engagements performed in accordance with GAGAS is:

[10] Whether a particular act is, in fact, illegal may have to await final determination by a court of law. Thus, when auditors disclose matters that have led them to conclude that an illegal act is likely to have occurred, they should not imply that they have made a determination of illegality.

If the auditor's report discloses significant deficiencies, auditors should report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as corrections planned.

6.33 One of the most effective ways to ensure that a report is fair, complete, and objective is to obtain advance review and comments by responsible officials of the audited entity and others, as may be appropriate. Including the views of responsible officials produces a report that shows not only what was found and what the auditors think about it but also what the responsible persons think about it and what they plan to do about it.

6.34 Auditors should normally request that the responsible officials' views on significant findings, conclusions, and recommendations be submitted in writing. Oral comments are acceptable as well, and, in some cases, may be the only or most expeditious way to obtain comments. Cases in which obtaining oral comments can be effective include when there is a time-critical need to meet a user's needs; the auditors have worked closely with the responsible officials throughout the conduct of the work and the parties are very familiar with the findings and issues addressed in the draft product; or the auditor does not expect major disagreements with the draft report's findings, conclusions, and recommendations, or perceive any major controversies with regard to the issues discussed in the draft report. Auditors should prepare a summary of the officials' oral comments and provide a copy of the summary to management of the audited entity to verify that the comments are accurately stated.

6.35 Comments should be fairly and objectively evaluated and recognized, as appropriate, in the final report. Comments, such as a promise or plan for corrective action, should be noted but should not be accepted as justification for dropping a significant finding or a related recommendation.

6.36 When the comments oppose the report's findings, conclusions, or recommendations, and are not, in the auditors' opinion, valid, the auditors should state their reasons for disagreeing with the comments. The auditors' disagreement should be stated in a fair and objective manner. Conversely, the auditors should modify their report as necessary if they find the comments valid.

Auditors may wish to attach the comment letter to the audit report to provide the reader with both points of view.

Privileged and Confidential Information

6.37 An additional reporting standard for attestation engagements performed in accordance with GAGAS is:

If certain pertinent information is prohibited from general disclosure, the report on the attestation engagement should state the nature of the information omitted and the requirement that makes the omission necessary.

6.38 Certain information may be prohibited from general disclosure by federal, state, or local laws or regulations. Such information may be provided on a need-to-know basis only to persons authorized by law or regulation to receive it. Additional circumstances associated with public safety and security concerns could also justify the exclusion of certain information in the report. For example, information related to computer security for a particular program should be excluded from the report because of the potential damage that could be caused by the misuse of this information. In such circumstances, auditors may issue a limited official-use report containing such information and distribute the report only to those parties responsible for acting on the auditors' recommendations.

Report Issuance and Distribution

6.39 An additional reporting standard for attestation engagements performed in accordance with GAGAS is:

Auditors should submit written reports on the attestation engagement to the appropriate officials of the audited entity and to the appropriate officials of the organizations requiring or arranging for the engagement, including external funding organizations, unless legal restrictions prevent it. Auditors should also send copies of the reports to other officials

who have legal oversight authority or who may be responsible for acting on audit findings and recommendations and to others authorized to receive such reports. Unless the report is restricted by law or regulation, auditors should ensure that copies be made available for public inspection.

6.40 Reports should be distributed in a timely manner to officials interested in the results. Such officials include those designated by law or regulation to receive such reports, those responsible for acting on the findings and recommendations contained in the report, those of other levels of government that have provided assistance to the audited entity, and legislators.

6.41 If the subject of the attestation engagement involves material that is classified for security purposes or not releasable to particular parties or the public for other valid reasons, auditors may limit the report distribution. Although AICPA standards require that a report on an engagement to evaluate an assertion that has been prepared on agreed-upon criteria or on an engagement to apply agreed-upon procedures should contain a statement limiting its use to the parties who have agreed upon such criteria or procedures, such a statement does not require that the report distribution be limited.

6.42 When public accountants are engaged, the engaging organization should ensure that the report is distributed appropriately. If the public accountants are to make the distribution, the engagement agreement should indicate which officials or organizations should receive the report and other steps being taken to ensure the availability of the report for public inspection.

6.43 Internal auditors should follow their entity's own arrangements and statutory requirements for distribution. Usually, they report to their entity's top manager, who is responsible for distribution of the report. Further distribution of reports outside the organization should be made in accordance with applicable laws, rules, regulations, or policy.

CHAPTER 7

FIELD WORK STANDARDS FOR PERFORMANCE AUDITS

INTRODUCTION

7.1 This chapter prescribes field work standards and provides guidance to auditors conducting performance audits in accordance with generally accepted government auditing standards (GAGAS). The field work standards for performance audits relate to planning the audit, supervising staff, obtaining sufficient, competent, and relevant evidence, and preparing audit documentation.

PLANNING

7.2 The field work standard related to planning for performance audits conducted in accordance with GAGAS is:

Work is to be adequately planned.

7.3 In planning the audit, auditors should define the audit objectives, as well as the scope, and methodology to achieve those objectives. Audit objectives, scope, and methodologies are not determined in isolation. Auditors determine these three elements of the audit plan together, as the considerations in determining each often overlap. Planning is a continuous process throughout the audit. Therefore, auditors should consider the need to make adjustments to the audit objectives, scope, and methodology as work is being completed.

7.4 The objectives are what the audit is intended to accomplish. They identify the audit subjects and performance aspects to be included, as well as the potential finding and reporting elements

that the auditors expect to develop.[1] Audit objectives can be thought of as questions about the program[2] that auditors seek to answer. (See chapter 2.)

7.5 Scope is the boundary of the audit and should be directly tied to the audit objectives. For example, the scope defines parameters of the audit such as the period of time reviewed, the availability of necessary documentation or records, and the number of locations at which field work will be conducted.

7.6 The methodology comprises the work involved in gathering and analyzing data to achieve the objectives. Audit procedures are the specific steps and tests auditors will carry out to address the audit objectives. Auditors should design the methodology to provide sufficient, competent, and relevant evidence to achieve the objectives of the audit. Methodology includes both the types and extent of audit procedures used to achieve the audit objectives. Auditors may use different methodologies drawn from a wide variety of disciplines.[3]

7.7 Planning should be documented and should include

a. considering the significance of various programs and the needs of potential users of the audit report (see paragraphs 7.8 and 7.9);

b. obtaining an understanding of the program to be audited (see paragraph 7.10);

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[1]See discussion of the elements of a finding in paragraphs 7.45 through 7.48.

[2]This chapter uses only the term program; however, the concepts presented also apply to audits of organizations, activities, and services.

[3]If the auditor chooses to apply or use standards or methodologies developed by other professional organizations when performing work under GAGAS, the auditor should also apply the standards in this chapter as appropriate. Even if auditors do not follow such other standards and methodologies, they may still serve as a useful source of guidance to auditors in planning their work under GAGAS. However, if auditors decide to perform their work in accordance with the standards for attestation engagements issued by the AICPA, auditors should apply the additional GAGAS standards for attestation engagements contained in chapter 6.

c. obtaining an understanding of internal control as it relates to the specific objectives and scope of the audit, (see paragraphs 7 .11 through 7.16);

d. designing the audit methodology and procedures to test compliance with legal and regulatory requirements of the program to be audited that are significant to the specific objectives and scope of the audit (see paragraphs 7.17 through 7.20);

e. identifying the criteria needed to evaluate matters subject to audit (see paragraph 7.21);

f. considering the results of previous audits that could affect the current audit objectives (see paragraphs 7.22 and 7.23);

g. identifying potential sources of data that could be used as audit evidence (see paragraph 7.24);

h. considering whether the work of other auditors and experts may be used to satisfy some of the auditors' objectives (see paragraphs 7.25 and 7.27);

i. providing appropriate and sufficient staff and other resources to perform the audit (see paragraph 7.28-7.31);

j. communicating general information concerning the planning and conduct of the audit to management officials responsible for the program being audited, and others as applicable (see paragraphs 7.32 and 7.33); and

k. documenting planning decisions (see paragraphs 7.34 through 7.36).

Program Significance

7.8 The significance of a matter is its relative importance to the audit objectives and potential users of the audit report. Auditors should consider the significance of a program or program

component and the potential use that will be made of the audit results or report as they plan a performance audit. Indicators of significance and/or use to consider include

a. visibility and sensitivity of the program under audit,

b. newness of the program or changes in its conditions,

c. role of the audit in providing information that can improve public accountability and decisionmaking, and

d. level and extent of review or other forms of independent oversight.

7.9 One group of users of the auditors' report is government officials who may have authorized or requested the audit. Another important user of the auditors' report is the entity being audited, which is responsible for acting on the auditors' recommendations. Other potential users of the auditors' report include government legislators or officials (other than those who may have 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 understand why the program operates the way it does. This awareness can also help auditors judge whether possible findings could be significant to various possible users.

Understanding the Program

7.10 Auditors should obtain an understanding of the program to be audited to help assess, among other matters, the significance of possible audit objectives and the feasibility of achieving them. The auditors' understanding may come from knowledge they already have about the program or knowledge they gain from inquiries and observations they make in planning the audit. The extent and breadth of those inquiries and observations will vary among audits based on the audit

objectives, as will the need to understand individual aspects of the program, such as the following.

a. Laws and regulations: Government programs usually are created by law and are subject to more specific laws and regulations than the private sector. For example, laws and regulations usually set forth what is to be done, who is to do it, the purpose to be achieved, the population to be served, and how much can be spent on what. Thus, understanding the laws and the legislative history establishing a program can be essential to understanding the program itself. Obtaining that understanding is also a necessary step in identifying provisions of laws and regulations significant to audit objectives.

b. Purpose and goals: Purpose is the result or effect that is intended or desired from a program's operation. Legislatures usually establish the program purpose when they provide authority for the program. Entity officials may provide more detailed guidance on program purpose to supplement the authorizing legislation. Entity officials are sometimes asked to set goals for program performance and operations, including both outcome and output goals. Auditors may use the stated program purpose and goals as criteria for assessing program performance or may develop additional criteria or best practices to compare the program with.

c. Internal control: Internal control, often referred to as management controls, in the broadest sense includes the plan of organization, methods, and procedures adopted by management to meet its missions goals and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It includes the systems for measuring, reporting, and monitoring program performance. Internal control also serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. Paragraphs 7.11 through 7.16 contain guidance pertaining to internal control.

d. Efforts: Efforts are the amount of resources (in terms of money, material, personnel, and so forth) that are put into a program. These resources may come from within or outside the entity operating the program. Measures of efforts can have a number of dimensions, such as cost,

timing, and quality. Examples of measures of efforts are dollars, employee-hours, and square feet of building space.

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

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

g. Outcomes: Outcomes are accomplishments or results of programs. For example, an outcome measure for a job training program could be the percentage of trained persons obtaining a job and still in the work place after a specified period of time. Examples of outcome measures for an aviation safety inspection program could be the percentage reduction in significant safety problems found in subsequent inspections and/or the percentage of significant problems deemed corrected in follow-up inspections. Such outcome measures show progress in achieving the stated program purposes of helping unemployable citizens get and keep jobs and improving the safety of aviation operations. Auditors should be aware that outcomes may be influenced by cultural, economic, physical, or technological factors outside the program. Auditors may use approaches drawn from the field of program evaluation to try to isolate the effects of the program from these other influences.

Internal Control

7.11 Auditors should obtain an understanding of the internal control environment, as well as specific internal controls, that are significant to the audit objectives, including internal control over compliance with legal and regulatory requirements, and consider whether the internal controls have been placed in operation. Auditors also need to consider whether any reliance will be placed on internal controls in designing audit procedures. If so, auditors should include

specific tests of the effectiveness of internal control and consider the results in designing audit procedures.[4] Management is responsible for establishing effective internal control. The lack of administrative continuity in government units because of changes in elected legislative bodies and in administrative organizations increases the need for effective internal control.

7.12 The following classification of internal control is intended to help auditors better understand internal controls and determine their significance to the audit objectives.

a. Effectiveness and efficiency of program operations: Controls over program operations include policies and procedures that management has implemented to reasonably ensure that a program meets its objectives and that unintended actions do not result, such as improper payments. Understanding these controls can help auditors understand the program operations that convert efforts to outputs or outcomes.

b. Validity and reliability of data: Controls over the validity and reliability of data include policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports. These controls help assure management that it is getting valid and reliable information about whether programs are operating properly on an ongoing basis. Understanding these controls can help auditors (1) assess the risk that the data gathered by the entity may not be valid or reliable and (2) design appropriate tests of the data.

c. Compliance with applicable laws and regulations: Controls over compliance with applicable laws and regulations include policies and procedures that management has implemented to reasonably ensure that program implementation is consistent with laws and regulations.

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[4] Refer to internal control guidance developed for the private sector, *Internal Control – Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The publication, *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, November 1999), which incorporates the relevant guidance developed by COSO, provides definitions and fundamental concepts pertaining to internal control at the federal level and may be useful to other auditors at any level of government. The related *Internal Control Management and Evaluation Tool* (GAO-01-1008G, August 2001), based on the federal internal control standards, provides a systematic, organized, and structured approach to assessing the internal control structure.

Understanding the controls relevant to compliance with those laws and regulations that the auditors have determined are significant can help auditors assess the risk of illegal acts.

7.13 A subset of these categories of internal control is the safeguarding of resources. Controls over the safeguarding of resources include policies and procedures that management has implemented to reasonably prevent or promptly detect unauthorized acquisition, use, or disposition of resources.

7.14 Auditors can obtain an understanding of internal control through inquiries, observations, inspection of documents and records, or review of other auditors' reports. The procedures auditors perform to obtain an understanding of internal control will vary among audits. One factor influencing the extent of these procedures is the auditors' knowledge about internal control gained in prior audits. Also, the need to understand internal control will depend on the particular aspects of the program the auditors consider in setting objectives, scope, and methodology. The following are examples of how the auditors' understanding of internal control can influence the audit plan.

a. Audit objectives: Poorly controlled aspects of a program have a higher risk of failure, so they may be more significant than others in terms of where auditors would want to focus their efforts.

b. Audit scope: Knowledge of the internal control environment and the status of controls in a certain location may lead auditors to target their efforts there.

c. Audit methodology: Effective controls over collecting, summarizing, and reporting data may enable auditors to limit the extent of their direct testing of data validity and reliability. In contrast, evidence suggesting ineffective controls may lead auditors to perform more direct testing of the data, look for data from outside the entity, or develop their own data.

7.15 When internal controls are significant to the audit objectives, auditors should plan to obtain sufficient evidence to support their judgments about those controls.[5] The following are examples of circumstances where internal controls can be significant to audit objectives.

a. In determining the cause of unsatisfactory performance, that unsatisfactory performance could result from weaknesses in specific internal controls.

b. When assessing the validity and reliability of performance measures developed by the audited entity, effective internal control over collecting, summarizing, and reporting data will help ensure valid and reliable performance measures.

7.16 Internal auditing is an important part of internal control.[6] When an assessment of internal control is called for, the work of the internal auditors can be used to help provide reasonable assurance that internal controls are functioning properly and to prevent duplication of effort.

Considering Legal, Regulatory, and
Other Compliance Requirements

7.17 When laws, regulations, and other compliance requirements such as provisions of contracts or grant agreements are significant to the audit objectives, auditors should design the audit to provide reasonable assurance about compliance with them. This requires determining which laws, regulations, and other compliance requirements are significant to the audit objectives and assessing the risk that significant noncompliance could occur.[7] Based on that risk assessment, the auditors design and perform procedures to provide reasonable assurance of detecting

[5]The *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, November 1999) is one source of established criteria auditors can use to support their judgments and conclusions about internal control.

[6]Many government entities have these activities identified by other names, such as inspection, appraisal, investigation, organization and methods, or management analysis. These activities assist management by reviewing selected functions.

[7]The term noncompliance includes not only illegal acts resulting from violations of laws and regulations, but also violations of provisions of contracts or grant agreements.

significant instances of noncompliance. (See paragraphs 7.59 through 7.63 for a discussion of evidence indicative of fraud, illegal acts, or other noncompliance.)

7.18 Auditors may find it necessary to work with legal counsel to (1) determine those laws and regulations that are significant to the audit objectives, (2) design tests of compliance with laws and regulations, or (3) evaluate the results of those tests. Auditors also may find it necessary to rely on the work of legal counsel when audit objectives require testing compliance with provisions of contracts or grant agreements.[8] Depending on the circumstances of the audit, auditors may find it necessary to obtain information on compliance matters from others, such as investigative staff, other audit organizations or government entities that provided assistance to the audited entity, or the applicable law enforcement authority.

7.19 It is not practical to set precise standards for determining if laws, regulations, or other compliance requirements are significant to audit objectives because government programs are subject to many laws, regulations, and other compliance requirements, and audit objectives vary widely. However, auditors may find the following approach helpful in making that determination.

a. Reduce each audit objective to questions about specific aspects of the program being audited (that is, purpose and goals, internal control, efforts, program operations, outputs, and outcomes, as discussed in paragraph 7.10).

b. Identify laws, regulations, and other compliance requirements that directly relate to specific aspects of the program included in questions that reflect the audit objectives.

c. Determine if violations of those laws, regulations, or other compliance requirements could significantly affect the auditors' answers to the questions that relate to the audit objectives. If they could, then those laws, regulations, and other compliance requirements are likely to be significant to the audit objectives.

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[8] Paragraphs 7.25 through 7.27 discuss relying on the work of others.

7.20 In planning tests of compliance with significant laws, regulations, and other compliance requirements, auditors should assess the risk that noncompliance could occur. That risk may be affected by such factors as the complexity of the laws and regulations or their newness. The auditors' assessment of risk includes consideration of whether the entity has controls that are effective in preventing or detecting noncompliance. Management is responsible for establishing effective controls to ensure compliance with laws and regulations, as well as other compliance requirements such as provisions of contracts or grant agreements. If auditors obtain sufficient evidence of the effectiveness of these controls, they can reduce the extent of their tests of compliance.

Criteria

7.21 Criteria are the standards, measures, expectations of what should exist, best practices, or benchmarks against which performance is compared or evaluated. Criteria, one of the elements of a finding, provide a context for understanding the results of the audit. (See paragraphs 7.45 through 7.48 for a discussion on the other elements of a finding.) The audit plan, where possible, should state the criteria to be used. In selecting criteria, auditors have a responsibility to use criteria that are reasonable, attainable, and relevant to the objectives of the performance audit. The following are some examples of possible criteria:

a. purpose or goals prescribed by law or regulation or set by management,

b. policies and procedures established by management of the audited entity,

c. technically developed standards or norms,

d. expert opinions,

e. prior years' performance,

f. performance of similar entities,

g. performance in the private sector, or

h. best practices of leading organizations.

Considering the Results of Previous Audits

7.22 Auditors should consider the results of previous audits and follow-up on known significant findings and recommendations[9] that directly relate to the audit objectives of the performance audit. Auditors should also be alert to the status of relevant findings and recommendations identified in other available audits and studies by other organizations as well. For example, an audit report on an entity's computerized information systems may contain significant findings that could relate to the audit if the entity uses such systems to process its accounting or other information the auditors plan on using. In any event, auditors need to make judgments about the extent of follow-up needed and the appropriate disclosure of uncorrected significant findings and recommendations from prior audits that affect the audit objectives.

7.23 Providing continuing attention to significant findings and recommendations is important to ensure that the benefits of audit work are realized. Ultimately, the benefits of audit work occur when audit findings are resolved through meaningful and effective corrective action taken in response to the auditors' findings and recommendations. Officials of the audited entity are responsible for resolving audit findings and recommendations directed to them and for having a process to track their status. If officials of the audited entity do not have such a process, auditors may wish to establish their own process.

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

Identifying Sources of Audit Evidence

7.24 In identifying potential sources of data that could be used as audit evidence, auditors should consider the validity and reliability of these data, including data collected by the audited entity, data generated by the auditors, or data provided by third parties, as well as the sufficiency and relevance of the evidence. (See paragraphs 7.41 through 7.44 for guidance concerning evidence.)

Considering Work of Other Auditors

7.25 Auditors should determine if other auditors have previously done, or are doing, audits of the program or the entity that operates it. Whether other auditors have done performance audits, financial audits, or attestation engagements, the other auditors may be useful sources of information for planning and performing the audit. If other auditors have identified areas that warrant further study, their work may influence the auditors' selection of objectives. The availability of other auditors' work may also influence the selection of methodology, as the auditors may be able to rely on that work to limit the extent of their own testing.

7.26 If auditors intend to rely on the work of other auditors, they should perform procedures regarding the specific work to be relied on that provide a sufficient basis for that reliance. Auditors can obtain evidence concerning the other auditors' qualifications[10] and independence through prior experience, inquiry, and/or review of the other auditors' external quality control review report. Auditors can determine the sufficiency, relevance, and competence of other auditors' evidence by reviewing their report, audit program, or audit documentation, or by performing supplemental tests of the other auditors' work. The nature and extent of evidence needed will depend on the significance of the other auditors' work and on the extent to which the auditors will rely on that work.

[10] Auditors from another country engaged to conduct audits in their country should meet the professional qualifications to practice under that country's laws and regulations or other acceptable standards, such as those issued by the International Organization of Supreme Audit Institutions. Also see the International Federation of Accountants' *International Standards on Auditing*.

7.27 Auditors face similar considerations when using the work of nonauditors (consultants, experts, specialists, and so forth). In addition, auditors should obtain an understanding of the methods and significant assumptions used by the nonauditors. (See paragraph 3.xx for independence considerations when relying on the work of others.)

Staff and Other Resources

7.28 Staff planning should include, among other things,

a. assigning staff with the appropriate collective knowledge, skills, and experience for the job,

b. assigning an adequate number of staff and supervisors to the audit,

c. providing for on-the-job training of staff, and

d. engaging specialists when necessary.

7.29 The availability of staff and other resources and the need for specialized skills are important considerations in establishing the objectives, scope, and methodology. For example, limitations on travel funds may preclude auditors from visiting certain critical locations, or lack of expertise in a particular methodology or with computerized information systems may preclude auditors from undertaking certain objectives. Auditors may be able to overcome such limitations by using staff from any existing local field offices of the audit entity or by engaging consultants with the necessary expertise.

7.30 If the use of a specialist is planned, auditors should have sufficient knowledge to

a. articulate the objectives required of the specialist,

b. evaluate whether the specified procedures will meet auditors' objectives, and

c. evaluate the results of the procedures applied as they relate to other planned audit procedures.

7.31 Auditors without sufficient knowledge to perform the functions listed above may have to engage a consultant for quality control purposes for the areas related to the specialist's work.

Communicating With Management and Others

7.32 Auditors should communicate information about the specific nature of the audit, as well as general information concerning the planning and conduct of the performance audit, to the various parties involved in the audit to help them understand the objectives, time frames, and any data needs. Such parties may include

a. the head of the audited entity;

b. the audit committee or, in the absence of an audit committee, the board of directors or other equivalent oversight body;

c. the individual who possesses a sufficient level of authority and responsibility for the program or activity being audited; and

d. the individuals contracting for or requesting audit services, such as contracting officials or legislative members or staff, if applicable.

7.33 Auditors should use their professional judgment to determine the form, content, and frequency of the communication, although written communication is preferred, and should document the communication. Auditors may use an engagement letter, if appropriate, to communicate the information.

Documenting Planning Decisions

7.34 A written audit plan should be prepared for each audit. The form and content of the written audit plan will vary among audits but should include an audit program or project plan, a memorandum, or other appropriate documentation of key decisions about the audit objectives, scope, and methodology and of the auditors' basis for those decisions. It should be updated, as necessary, to reflect any significant changes to the plan made during the audit.

7.35 Documenting the audit plan is an opportunity for the auditors to review the work done in planning the audit to determine whether

a. the proposed audit objectives are likely to result in a useful report,

b. the proposed audit scope and methodology are adequate to satisfy the audit objectives, and

c. sufficient staff and other resources are available to perform the audit and to meet expected time frames for completing the work.

7.36 Written audit plans may include the following.

a. Information about the legal authority for the audited program, its history and current objectives, its principal locations, and other background that can help auditors understand and carry out the audit plan.

b. Information about the responsibilities of each member of the audit team (such as preparing audit programs, conducting audit work, supervising and reviewing audit work, drafting reports, handling comments from officials of the audited program, and processing the final report), which can help auditors when the work is conducted at several different locations. In these audits, use of comparable audit methods and procedures can help make the data obtained from participating locations comparable.

c. Audit programs describing procedures to accomplish the audit objectives and providing a systematic basis for assigning work to staff and for summarizing the work performed.

d. The general format of the audit report and the types of information to be included, which can help auditors focus their field work on the information to be reported.

SUPERVISION

7.37 The second field work standard for performance audits is:

Staff are to be properly supervised.

7.38 Supervision involves directing the efforts of staff assigned to the audit to ensure that the audit objectives are accomplished. Elements of supervision include providing sufficient guidance to staff members, keeping informed of significant problems encountered, reviewing the work performed, and providing effective on-the-job training.

7.39 Supervisors should satisfy themselves that staff members clearly understand what work they are to do, why the work is to be conducted, and what the work is expected to accomplish. With experienced staff, supervisors may outline the scope of the work and leave details to the staff. With a less experienced staff, supervisors may have to specify audit procedures to be performed as well as techniques for gathering and analyzing data.

7.40 The nature of the review of audit work may vary depending on the significance of the work or the experience of the staff. For example, it may be appropriate to have experienced staff review much of the work of other staff with similar experience.

EVIDENCE

7.41 The third field work standard for performance audits is:

Sufficient, competent, and relevant evidence is to be obtained to afford a reasonable basis for the auditors' findings and conclusions.

7.42 A large part of auditors' work on an audit concerns obtaining and evaluating evidence that ultimately supports their judgments and conclusions pertaining to the audit objectives. In evaluating evidence, auditors consider whether they have obtained the evidence necessary to achieve specific audit objectives. When internal control or compliance requirements are significant to the audit objectives, auditors should also collect and evaluate evidence relating to controls or compliance.

7.43 Evidence may be categorized as physical, documentary, testimonial, and analytical. Physical evidence is obtained by auditors' direct inspection or observation of people, property, or events. Such evidence may be documented in memoranda, photographs, drawings, charts, maps, or physical samples. Documentary evidence consists of created information such as letters, contracts, accounting records, invoices, and management information on performance. Testimonial evidence is obtained through inquiries, interviews, or questionnaires. Analytical evidence includes computations, comparisons, separation of information into components, and rational arguments.

7.44 The guidance in the following paragraphs is intended to help auditors judge the quality and quantity of evidence needed to satisfy audit objectives. Paragraphs 7.45 through 7.48 describe the elements of an audit finding. Paragraphs 7.49 through 7.58 provide guidance to help auditors determine what constitutes sufficient, competent, and relevant evidence to support their findings and conclusions.

Audit Findings

7.45 Audit findings often have been regarded as containing the elements of criteria, condition, and effect, plus cause when problems are found. However, the elements needed for a finding depend entirely on the objectives of the audit. Thus, a finding or set of findings is complete to the extent that the audit objectives are satisfied and the report clearly relates those objectives to the finding's elements. Criteria are discussed in paragraph 7.21, and the other elements of a finding--condition, effect, and cause--are discussed in the following paragraphs.

7.46 Condition: Condition is a situation that exists. It has been determined and documented during the audit.

7.47 Effect: Effect has two meanings, which depend on the audit objectives. When the auditors' objectives include identifying the actual or potential consequences of a condition that varies (either positively or negatively) from the criteria identified in the audit, "effect" is a measure of those consequences. Auditors often use effect in this sense to demonstrate the need for corrective action in response to identified problems. When the auditors' objectives include estimating the extent to which a program has caused changes in physical, social, or economic conditions, "effect" is a measure of the impact achieved by the program. Here, effect is the extent to which positive or negative changes in actual physical, social, or economic conditions can be identified and attributed to program operations.

7.48 Cause: Like effect, cause also has two meanings, which depend on the audit objectives. When the auditors' objectives include explaining why a particular type of positive or negative performance identified in the audit occurred, the reasons for that performance are referred to as "cause." Identifying the cause of problems can assist auditors in making constructive recommendations for correction. Because problems can result from a number of plausible factors or multiple causes, the recommendation can be more persuasive if auditors can clearly demonstrate and explain with evidence and reasoning the link between the problems and the factor or factors they identified as the underlying cause. When the auditors' objectives include

estimating the program's effect on changes in physical, social, or economic conditions, they seek evidence of the extent to which the program itself is the "cause" of those changes.

Tests of Evidence

7.49 Evidence should be sufficient, competent, and relevant to support a sound basis for audit findings, conclusions, and recommendations.

a. Evidence should be sufficient to support the auditors' findings. In determining the sufficiency of evidence, auditors should ensure that enough evidence exists to persuade a knowledgeable person of the validity of the findings. When appropriate, statistical methods may be used to establish sufficiency.

b. Evidence is competent if it is consistent with fact (that is, evidence is competent if it is valid and reliable). In assessing the competence of evidence, auditors should consider such factors as whether the evidence is accurate, authoritative, timely, and authentic. When appropriate, auditors may use statistical methods to derive competent evidence.

c. Evidence is relevant if it has a logical, sensible relationship to the issue being addressed.

7.50 The following presumptions are useful in judging the competence of evidence. However, these presumptions are not to be considered sufficient in themselves to determine competence. The amount and kinds of evidence required to support auditors' conclusions should be based on auditors' professional judgment.

a. Evidence obtained when internal controls are effective is more competent than evidence obtained when controls are weak or nonexistent. Auditors should therefore be particularly careful in cases where controls are weak or nonexistent.

b. Evidence obtained through the auditors' direct physical examination, observation, computation, and inspection is more competent than evidence obtained indirectly.

c. Original documents provide more competent evidence than do copies.

d. Testimonial evidence obtained under conditions where persons may speak freely is more competent than testimonial evidence obtained under compromising conditions (for example, where the persons may be intimidated).

e. Testimonial evidence obtained from an individual who is not biased or has complete knowledge about the area is more competent than testimonial evidence obtained from an individual who is biased or has only partial knowledge about the area.

f. Evidence obtained from a credible third party may in some cases be more competent than that secured from management or other officials of the audited entity.

7.51 Auditors may find it useful to obtain written representations concerning the competence of certain evidence from officials of the audited entity. Written representations ordinarily confirm oral representations given to auditors, indicate and document the continuing appropriateness of such representations, and reduce the possibility of misunderstanding concerning the matters that are the subject of the representations. Written representations can take several forms, including having entity management sign summary documents prepared by the auditors.

7.52 The auditors' approach to determining the sufficiency, competence, and relevance of evidence depends on the source of the information that constitutes the evidence. Information sources include original data gathered by auditors and existing data gathered by either management or a third party. Data from any of these sources may be obtained from computer-based systems.

7.53 Data gathered by auditors: Data gathered by auditors include the auditors' own observations and measurements. Among the methods for gathering this type of data are questionnaires, structured interviews, direct observations, and computations. The design of these methods and the skill of the auditors applying them are the keys to ensuring that these data constitute sufficient, competent, and relevant evidence. When these methods are applied to determine cause, auditors are concerned with eliminating rival explanations.

7.54 Data gathered by management: Auditors can use data gathered by management as part of their evidence. However, auditors should determine the validity and reliability of these data that are significant to the audit objectives and may do so by direct tests of the data. Auditors can reduce the direct tests of the data if they test the effectiveness of the entity's internal controls over the validity and reliability of the data, and these tests support the conclusion that the controls are effective. The nature and extent of testing of the data will depend on the significance of the data to support auditors' findings.

7.55 Data gathered by third parties: The auditors' evidence may also include data gathered by third parties. In some cases, these data may have been audited by others, or the auditors may be able to audit the data themselves. In other cases, however, it will not be practical to obtain evidence of the data's validity and reliability. How the use of unaudited third-party data affects the auditors' report depends on the data's significance to the auditors' findings. For example, in some circumstances, auditors may use unaudited data to provide background information; however, the use of such unaudited data would generally not be appropriate to support audit findings and conclusions.

7.56 Validity and reliability of data from computer-based systems: Auditors should obtain sufficient, competent, and relevant evidence that computer-processed data are valid and reliable when those data are significant to the auditors' findings. This work is necessary regardless of whether the data are provided to auditors or auditors independently extract them.[11] Auditors

[11] When computer-processed data are used by the auditor, or included in the report, for background or informational purposes and are not significant to the auditors' findings, citing the source of the data and stating that they were not verified will satisfy the reporting standards for accuracy and completeness set forth in this statement.

should determine if other auditors have worked to establish the validity and reliability of the data or the effectiveness of the controls over the system that produced the data. If the results of such work is current, auditors may be able to rely on that work. (See paragraphs 7.25 through 7.27 for requirements when relying on the work of others.) Auditors may also determine the validity and reliability of computer-processed data by direct tests of the data.

7.57 Auditors can reduce the direct tests of the data if they test the effectiveness of general and application controls over computer-processed data, and these tests support the conclusion that the controls are effective. If auditors determine that internal controls over data which are significantly dependent upon computerized information systems are not effective or if auditors do not plan to test the effectiveness of such controls, auditors should include audit documentation regarding the basis for that conclusion by addressing (1) the reasons why the design or operation of the controls is ineffective, or (2) the reasons why it is inefficient to test the controls. In such circumstances, auditors should also include audit documentation regarding their reasons for concluding that the planned audit procedures are effectively designed to achieve specific audit objectives. This documentation should address

a. the rationale for determining the types and extent of planned audit procedures;

b. the kinds and competence of available evidence produced outside a computerized information system; and

c. the effect on the audit report if the evidence gathered during the audit does not allow the auditors to achieve audit objectives.

7.58 When the auditors' tests of data disclose errors in the data, or when they are unable to obtain sufficient, competent, and relevant evidence about the validity and reliability of the data, they may find it necessary to

a. seek evidence from other sources,

b. redefine the audit's objectives to eliminate the need to use the data, or

c. use the data, but clearly indicate in their report the data's limitations and refrain from making unwarranted conclusions or recommendations.

Evidence Indicative of Fraud, Illegal Acts,
Or Other Noncompliance

7.59 Auditors should be alert to situations or transactions that could be indicative of fraud, illegal acts (violations of laws and regulations), or other noncompliance (violations of other compliance requirements such as provisions of contracts or grant agreements). When information comes to the auditors' attention (through audit procedures, allegations received through fraud hotlines, or other means) indicating that fraud, illegal acts, or other noncompliance may have occurred, auditors should consider whether the possible fraud, illegal acts, or other noncompliance could significantly affect the audit results. If they could, the auditors should extend the audit steps and procedures, as necessary, (1) to determine if fraud, illegal acts, or other noncompliance are likely to have occurred and (2) if so, to determine their effect on the audit results.

7.60 Auditors' training, experience, and understanding of the program being audited may provide a basis for recognizing that some acts coming to their attention may be indicative of fraud, illegal acts, or other noncompliance. Whether an act is, in fact, illegal is a determination to be made through the judicial or other adjudicative system and is beyond auditors' professional expertise and responsibility. However, auditors are responsible for being aware of vulnerabilities to fraud, illegal acts, or other noncompliance associated with the area being audited in order to be able to identify indications that fraud, illegal acts, or other noncompliance may have occurred. In some circumstances, conditions such as the following might indicate a heightened risk of fraud, illegal acts, or other noncompliance:

a. weak management which fails to enforce existing internal control or to provide adequate oversight over the control process;

b. inadequate separation of duties, especially those that relate to controlling and safeguarding resources;

c. transactions that are out of the ordinary and are not satisfactorily explained, such as unexplained adjustments in inventories or other resources;

d. instances when employees of the audited entity refuse to take vacations or accept promotions;

e. missing or altered documents, or unexplained delays in providing information;

f. false or misleading information; or

g. history of impropriety, such as past audits or investigations with findings of questionable or criminal activity.

7.61 Auditors should exercise professional judgment in pursuing indications of possible fraud, illegal acts, or other noncompliance so as not to interfere with potential investigations, legal proceedings, or both. Under some circumstances, laws, regulations, or policies require auditors to report indications of certain types of illegal acts to law enforcement or investigatory authorities before extending audit steps and procedures. Auditors may also be required to withdraw from or defer further work on the audit or a portion of the audit in order not to interfere with an investigation.

7.62 An audit made in accordance with these standards provides reasonable assurance of detecting fraud, illegal acts, or other noncompliance that could significantly affect the audit results; it does not guarantee the discovery of fraud, illegal acts, or other noncompliance. Nor

does the subsequent discovery of such acts committed during the audit period necessarily mean that the auditors' performance was inadequate, provided the audit was made in accordance with these standards.

7.63 Abuse is distinct from illegal acts and other noncompliance. When abuse occurs, no law, regulation, contract provision, or grant agreement is violated. Rather, the conduct of a government program falls far short of societal expectations for prudent program management. Auditors should be alert to situations or transactions that could be indicative of abuse. When information comes to the auditors' attention (through audit procedures, allegations received through a fraud hotline, or other means) indicating that abuse may have occurred, auditors should consider whether the possible abuse could significantly affect the audit results. If it could, the auditors should extend the audit steps and procedures, as necessary, (1) to determine if the abuse occurred and (2) if so, to determine its effect on the audit results. However, because the determination of abuse is so subjective, auditors are not expected to provide reasonable assurance of detecting it.

AUDIT DOCUMENTATION

7.64 The fourth field work standard for performance audits is:

Auditors should prepare and maintain audit documentation. Audit documentation should contain sufficient information to enable an experienced reviewer, who has had no previous connection with the audit, to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions. Audit documentation that supports significant findings, conclusions, and recommendations should be complete before auditors issue their report.

7.65 The form and content of audit documentation should be designed to meet the circumstances of the particular audit. The information contained in audit documentation constitutes the

principal record of the work that the auditors have performed and the conclusions that the auditors have reached. The quantity, type, and content of audit documentation is a matter of the auditors' professional judgment.

7.66 Audit documentation serves three main purposes: (1) to provide the principal support for the auditors' report, (2) to aid auditors in conducting and supervising the audit, and (3) to allow for the review of audit quality. This third purpose is important because audits done in accordance with GAGAS often are subject to review by other auditors and by oversight officials. Audit documentation allows for the review of audit quality by providing the reviewer documentation, either in written or electronic formats, of the evidence supporting the auditors' significant judgments and conclusions.

7.67 Audit organizations should establish reasonable policies and procedures for the safe custody and retention of audit documentation for a time sufficient to satisfy legal and administrative requirements. If audit documentation is only retained electronically, the audit organization should ensure that the electronic documentation is capable of being accessed throughout the specified retention period established for audit documentation and is safeguarded through sound computer security.

7.68 Audit documentation should contain

a. the objectives, scope, and methodology, including sampling and other selection criteria used;

b. documentation of the auditors' determination that certain standards do not apply or that an applicable standard was not followed, the reasons therefore, and the known effect that not following the standard had, or could have, on the audit;

c. documentation of the work performed to support significant judgments and conclusions, including descriptions of transactions and records examined that would enable an experienced reviewer to examine the same transactions and records;[12] and

d. evidence of supervisory review of the work performed.

7.69 Underlying GAGAS audits is that federal, state, and local governments and other organizations cooperate in auditing programs of common interest so that the auditors may use others' work and avoid duplicate audit efforts. In addition, audits performed in accordance with GAGAS are subject to quality control and assurance reviews. Auditors should make arrangements to make audit documentation available, upon request, in a timely manner to other auditors or reviewers. Contractual arrangements for GAGAS audits should provide for full and timely access to audit documentation to facilitate reliance by other auditors on the auditors' work, as well as reviews of audit quality control and assurance.

[12] The nature of this documentation will vary with the nature of the work performed. For example, when this work includes examination of management's records, the audit documentation should describe those records so that an experienced reviewer would be able to examine those same records. Auditors may meet this requirement by listing file numbers, case numbers, or other means of identifying specific documents they examined. They are not required to include in the audit documentation copies of documents they examined, nor are they required to list detailed information from those documents.

CHAPTER 8

REPORTING STANDARDS FOR PERFORMANCE AUDITS

INTRODUCTION

8.1 This chapter prescribes reporting standards and provides guidance to auditors reporting on performance audits in accordance with generally accepted government auditing standards (GAGAS). The reporting standards for performance audits relate to the form of the report, the report contents, report quality, and report issuance and distribution.

FORM

8.2 The first reporting standard for performance audits is:

Auditors should prepare audit reports communicating the results of each audit.

8.3 The form of the audit report should be appropriate for its intended use. Auditors should use their professional judgment including consideration of users' needs, likely demand, and distribution in determining the form of the audit report. In addition to a more formal presentation of audit results, such as a chapter report or a letter report, briefing slides may be considered audit reports. Audit reports also may be presented on electronic media that are retrievable by report users and the audit organization, such as video or compact disk formats. However, to comply with these standards, audit reports, regardless of form, should comply with all applicable reporting standards.

8.4 This standard is not intended to limit or prevent discussion of findings, judgments, conclusions, and recommendations with persons who have responsibilities involving the area being audited. On the contrary, such discussions are encouraged.

8.5 Audit reports (1) communicate the results of audits to officials at various levels of government, (2) make the results less susceptible to misunderstanding, (3) make the results available for public inspection, and (4) facilitate follow-up to determine whether appropriate corrective actions have been taken. The need to maintain public accountability for government program demands that audit reports be retrievable.

8.6 When an audit is terminated before it is completed, auditors should communicate that fact to management of the audited entity, the entity requesting the audit, and other appropriate officials, preferably in writing. In the absence of an audit report, auditors should also write a memorandum for the record that summarizes the results of the work to the date of termination and explains why the audit was terminated.

REPORT CONTENTS

8.7 The second reporting standard for performance audits is:

The audit report should include the objectives, scope, and methodology; the audit results, including findings, conclusions, and recommendations, as appropriate; a reference to compliance with generally accepted government auditing standards; the views of responsible officials; and, if applicable, the nature of any privileged and confidential information omitted.

Objectives, Scope, and Methodology

8.8 Auditors should include in the report the audit objectives and the scope and methodology used for achieving the audit objectives. This information is needed by report users to understand the purpose of the audit and the nature of the audit work performed, to provide perspective as to what is reported, and to understand any significant limitations in audit objectives, scope, or methodology. Auditors should also report the status of uncorrected significant findings and recommendations[1] from prior audits that affect the objectives of the current audit.

Objectives

8.9 Audit objectives should be communicated to knowledgeable users by reporting the questions that were to be answered in the audit in a clear, specific, and neutral manner that avoids unstated assumptions. In reporting the audit objectives, auditors should explain why the audit organization undertook the assignment and state what the report is to accomplish, and why the subject matter is important. Articulating what the report is to accomplish normally involves identifying the audit subject and the aspect of performance examined. The reported audit objectives provide more meaningful information to report users if they are measurable and feasible and avoid being presented in a broad or general manner. To reduce misunderstanding in cases where the objectives are particularly limited and broader objectives can be inferred, it may be necessary to state objectives that were not pursued.

Scope and Methodology

8.10 In reporting the scope of the audit, auditors should describe the depth and coverage of work conducted to accomplish the audit's objectives. Auditors should, as applicable, explain the relationship between the population of items sampled and what was audited; identify organizations, geographic locations, and the period covered; report the kinds and sources of evidence; and explain

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

any problems with the evidence. Auditors should also report significant constraints imposed on the audit approach by data limitations or scope impairments.

8.11 To report the methodology used, auditors should clearly explain how the audit objectives were accomplished including the evidence gathering and analysis techniques used in sufficient detail to allow knowledgeable users of their reports to understand the work. This explanation should identify any significant assumptions made in conducting the audit; describe any comparative techniques applied; describe the criteria used; and when sampling significantly supports auditors' findings, describe the sample design and state why it was chosen, including whether the results can be projected to the intended population.

8.12 Auditors should attempt to avoid misunderstanding by the report user concerning the work that was and was not done to achieve the audit objectives, particularly when the work was limited because of constraints on time or resources. The auditors' report should clearly describe the scope of the work performed and any limitations, the applicable standards that were not followed, and the reasons therefore, and how not following the applicable standards affected or could affect the results of the work. For example, if the auditors are unable to determine the reliability of information from an agency's database, and information from this database is critical to the audit findings, the report should clearly state the limitations associated with the information and refrain from making unwarranted conclusions or recommendations. In these situations, the audit report should also include the reasons the auditors were unable to perform this work and the potential impact on the findings if the information is not reliable.

Audit Results

8.13 Auditors should report significant findings by providing credible and convincing evidence that relates to the audit objectives. An audit report is improved when it provides sufficient contextual sophistication to reflect an understanding of the issues and an awareness of the external environment, including sensitivity to relevant trends. The report should provide selective background information

to provide the context for the overall message and to help the reader understand the significance of the issues discussed.[2] The report should also include all significant instances of fraud, illegal acts, or other noncompliance[3] and all significant instances of abuse that were found during or in connection with the audit and any significant weaknesses in internal control found during the audit, and where applicable, auditors' conclusions.[4]

Findings

8.14 Auditors should report the significant findings developed in response to each audit objective. These findings should be supported by sufficient, competent, and relevant evidence. They also should be presented in a manner to promote adequate understanding of the matters reported and to provide convincing but fair presentations in proper perspective.

8.15 As discussed in chapter 7, findings often have been regarded as containing the elements of criteria, condition, cause, and effect. However, the elements needed for a finding depend on the audit objectives. Thus, a finding or set of findings is complete to the extent that the audit objectives are satisfied and the report clearly relates those objectives to the elements of the finding.

8.16 Auditors should develop the elements of a finding in the audit report, as appropriate to satisfy the audit objectives. In reporting on elements of findings, auditors may find it useful to consider the following guidance on each finding element.

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[2]Appropriate background information may include information on how programs/operations work, the significance of programs/operations (i.e., dollars, impact, purposes, and past audit work if relevant), a description of the audited entity's responsibilities, and explanation of terms, organizational structure, and statutory basis for the program/operations.

[3]Whether a particular act is, in fact, illegal may have to await final determination by a court of law. Thus, when auditors disclose matters that have led them to conclude that an illegal act is likely to have occurred, they should take care not to imply that they have made a determination of illegality. See paragraph 8.17 for additional reporting considerations.

[4]Significant weaknesses in internal controls may be discussed in the report as an element of a finding. Many times these weaknesses will be described as the cause of the finding or in "a process finding" will be the condition element. Paragraphs 7.46 through 7.49 describe the elements of a finding.

a. Criteria: An audit report is improved when it provides information so that the report user will be able to determine what is the required or desired state or what is expected from the program or operation. The criteria are easier to understand when stated fairly, explicitly, and completely, and the source of the criteria are identified in the audit report.[5]

b. Condition: The audit report is improved when it provides evidence of what the auditors found regarding the actual situation. Reporting the scope or extent of the condition allows the report user to gain an accurate perspective.

c. Cause: The audit report is improved when it provides convincing evidence on the factor or factors responsible for the difference between condition and criteria. In reporting the cause, auditors may consider whether the evidence provides a reasonable and persuasive argument for why the stated cause is the key factor or factors contributing to the difference as opposed to other possible causes, such as poorly designed criteria or factors uncontrollable by program management. The auditors also may consider whether the identified cause serves as a basis for the recommendations.

d. Effect: The audit report is improved when it provides a clear, logical link to establish the impact of the difference between what the auditors found (condition) and what should be (criteria). Effect is easier to understand when it is stated clearly, concisely, and in concrete terms. The significance of the reported effect can be demonstrated through credible evidence.

8.17 When auditors conclude, based on evidence obtained, that significant fraud, illegal acts, or other noncompliance either has occurred or is likely to have occurred, they should include in their audit report the relevant information. The term "noncompliance" comprises illegal acts (violations of laws and regulations) and violations of provisions of contracts or grant agreements. When auditors conclude significant abuse has or is likely to have occurred, they should also include

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[5] Common sources for criteria are laws, regulations, policy, procedures, best or standard practice, or assertions. The *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, November 1999) and *Internal Control—Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO Report) are two sources of established criteria auditors can use to support their judgments and conclusions about internal control.

relevant information in the report. Abuse occurs when the conduct of a government organization, program, activity, or function falls short of societal expectations for prudent behavior.

8.18 In reporting significant instances of noncompliance, auditors should place their findings in perspective. To give the report user a basis for judging the prevalence and consequences of noncompliance, the instances of noncompliance should be related to the population or the number of cases examined and quantified in terms of dollar value, if appropriate. If the results cannot be projected, the conclusion should be limited to the items tested.

8.19 In reporting on internal control, auditors should describe the scope of internal control testing, and in presenting the results of those tests, report the significant weaknesses.[6] Auditors may identify significant weaknesses in internal control as the cause of deficient performance. In reporting this type of finding, the control weakness would be described as the "cause."

8.20 When auditors detect nonsignificant instances of fraud, illegal acts, or other noncompliance or nonsignificant instances of abuse or weaknesses in internal control, they should communicate them to the officials of the audited program, preferably in writing. Auditors should include in their audit documentation all communications to officials of the audited program about fraud, illegal acts, or other noncompliance and instances of abuse or internal control weaknesses. If the auditors have communicated such instances of fraud, illegal acts, or other noncompliance, abuse, and internal control weaknesses in a management letter to top management, auditors should refer to that management letter in the audit report.

[6]Significant weaknesses are matters coming to the auditors' attention that they believe should be reported to officials of the audited program because they could adversely affect the program under audit.

Direct Reporting of Fraud and Illegal Acts

8.21 Auditors are responsible for reporting certain fraud and illegal acts directly to parties outside the audited entity in certain circumstances, as discussed in the following paragraphs. Auditors should fulfill these responsibilities even if they have resigned or been dismissed from the audit.[7]

8.22 Officials of the audited entity may be required by law or regulation to report certain fraud and illegal acts to specified external parties such as a federal inspector general or a state attorney general. If auditors have communicated such fraud and illegal acts to officials of the audited entity, and the latter fail to report them, then the auditors should communicate their awareness of that failure to the audited entity's governing body. If officials of the audited entity do not make the required report as soon as practical after the auditors' communication with its governing body, then the auditors should report the fraud and illegal acts directly to the external party specified in the law or regulation.

8.23 Auditors should obtain sufficient, competent, and relevant evidence, such as confirmation with outside parties, to corroborate assertions by management that it has reported fraud or illegal acts. If they are unable to do so, then the auditors should report the fraud or illegal acts directly as discussed above.

8.24 Laws, regulations, or other authority may require auditors to report promptly indications of fraud or other illegal acts to law enforcement or investigatory authorities. In such circumstances, when auditors conclude that fraud or another illegal act either has or is likely to have occurred, they should refer it to law enforcement or investigatory authorities and ask those authorities or legal counsel if reporting certain information about the potential fraud or illegal act would compromise investigative or legal proceedings. Auditors should limit the extent of their reporting to matters that would not compromise those proceedings, such as information that is already a part of the public record.

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[7]Internal audit organizations do not have a duty to report outside that entity unless required by law, rule, regulation, or policy.

Conclusions

8.25 Auditors should report conclusions when called for by the audit objectives. Conclusions are logical inferences about the program based on the auditors' findings and should flow from the findings, instead of representing a summary of them. Conclusions should be clearly stated, not implied. The strength of the auditors' conclusions depends on the persuasiveness of the evidence supporting the findings and the soundness of the logic used to formulate the conclusions. Conclusions are stronger if they set up the report's recommendations and convince the knowledgeable user of the report that action is necessary.

Recommendations

8.26 If warranted, auditors should make recommendations for actions to improve programs and operations and to correct problem areas identified during the audit. Auditors should make recommendations when the potential for improvement in programs, operations, and performance is substantiated by the reported findings and conclusions. Recommendations should logically flow from the evidence and need to state clearly the actions to be taken. Recommendations to effect compliance with laws and regulations and improve internal control also should be made when significant instances of fraud, illegal acts, or other noncompliance are noted or significant abuse or weaknesses in controls are found.

8.27 Constructive recommendations can encourage improvements in the conduct of government programs and operations. For recommendations to be most constructive, they should be directed at resolving the cause of identified problems, action oriented and specific, addressed to parties that have the authority to act, practical, and, to the extent feasible, cost effective and measurable.

Statement on Compliance With
Generally Accepted Government Auditing Standards

8.28 Auditors should report that the audit was made in accordance with generally accepted government auditing standards. The statement of compliance with GAGAS refers to all the applicable standards that the auditors should have followed during the audit. The statement should be qualified in situations in which the auditors did not follow an applicable standard. In these situations, auditors should report in the scope section the applicable standard that was not followed, the reasons therefore, and how not following the standard affected the results of the audit.

Views of Responsible Officials

8.29 Auditors should report the views of responsible officials of the audited program concerning auditors' findings, conclusions, and recommendations. One of the most effective ways to ensure that a report is fair, complete, and objective is to obtain advance review and comments by responsible officials of the audited entity and others, as may be appropriate. Including the views of responsible officials produces a report that shows not only what was found, and what the auditors think about it, but also what the officials in the audited entity think about the report and what they plan to do about it.

8.30 Auditors should normally request that the responsible officials' views on significant findings, conclusions, and recommendations be submitted in writing. Oral comments are acceptable as well, and, in some cases, may be the only or most expeditious way to obtain comments. Cases in which obtaining oral comments can be effective include when there is a time-critical need to meet a user's needs; the auditor has worked closely with the responsible officials throughout the conduct of the work and the parties are very familiar with the findings and issues addressed in the draft product; or the auditor does not expect major disagreements with the draft report's findings, conclusions, and recommendations, or perceive any major controversies with regard to the issues discussed in the draft report. Auditors should prepare a summary of the officials' oral comments and provide a copy

of the summary to management of the audited entity to verify that the comments are accurately stated.

8.31 Comments should be fairly and objectively evaluated and recognized, as appropriate, in the final report. Comments, such as a promise or plan for corrective action, should be noted but should not be accepted as justification for dropping a significant finding or a related recommendation.

8.32 When the audited entity's comments state that the report's findings, conclusions, or recommendations are inaccurate or misleading and those comments are not, in the auditors' opinion, valid, the auditors should state their reasons for disagreeing with the comments. The auditors' disagreement should be stated in a fair and objective manner. Conversely, the auditors should modify their report as necessary if they find the comments valid. Auditors may wish to attach the comment letter to the audit report to provide the reader with both points of view.

Privileged and Confidential Information

8.33 If certain information is prohibited from general disclosure, auditors should report the nature of the information omitted and the requirement that makes the omission necessary. Certain information may be prohibited from general disclosure by federal, state, or local laws or regulations. In such circumstances, auditors may issue a separate limited official use report containing such information and distribute the report only to persons authorized by law or regulation to receive it. Auditors should, when appropriate, consult with legal counsel regarding any requirements or other circumstances that may necessitate the omission of certain information. If auditors make the judgment that certain pertinent information should be excluded from a publicly available report, they should state the nature of the information omitted and the reasons that make the omission necessary.

8.34 Additional circumstances associated with public safety and security concerns could also justify the exclusion of certain information in the report. For example, detailed information related to computer security for a particular program may be excluded from publicly available reports because

of the potential damage that could be caused by the misuse of this information. In such circumstances, auditors may issue a limited official use report containing such information and distribute the report only to those parties responsible for acting on the auditors' recommendations. If auditors make the judgment that certain additional information should be excluded from a publicly available report, they should state the nature of the information omitted and the reasons that makes the omission necessary.

8.35 Auditors are expected to act with integrity in judging whether any information should be excluded from publicly available reports. These judgments need to be made in a consistent manner with consideration of the broader public interest in the program or activity under review. Auditors need to weigh the need to reveal all significant facts known to them which, if not revealed, could either distort the results or conceal improper or unlawful practice against any requirements or other circumstances that may necessitate the omission of certain information.

REPORT QUALITY

8.36 The third reporting standard for performance audits is:

The reports should be timely, fact-based, accurate, objective, convincing, clear, and as concise as the subject permits.

Timely

8.37 To be of maximum use, the audit report needs to provide relevant information in time to respond to management, legislative officials, and other users' legitimate needs. Likewise, the information provided in the report needs to be current. Therefore, auditors should plan for the appropriate issuance of the report and conduct the audit with these goals in mind.

8.38 During the audit, the auditors should consider interim reporting of significant matters to appropriate entity officials. Such communication, which may be oral or written, is not a substitute for a final report, but it does alert officials to matters needing immediate attention and permits them to correct them before the final report is completed.

Fact-Based

8.39 Being fact-based requires that the report contains all evidence needed to satisfy the audit objectives and promotes an adequate and correct understanding of the matters reported. It also means the report states information and findings completely, including all necessary facts and explanations. Giving report users an adequate and correct understanding means providing perspective on the extent and significance of reported findings, such as the frequency of occurrence relative to the number of cases or transactions tested, and the relationship of the findings to the entity's operations.

8.40 In most cases, a single example of a deficiency is not sufficient to support a broad conclusion or a related recommendation. All that it supports is that a deviation, an error, or a weakness existed. Sufficient detailed supporting data should be included to make convincing presentations.

Accurate

8.41 Accuracy requires that the evidence presented be true and that findings be correctly portrayed. The need for accuracy is based on the need to assure report users that what is reported is credible and reliable. One inaccuracy in a report can cast doubt on the validity of an entire report and can divert attention from the substance of the report. Also, use of inaccurate evidence can damage the credibility of the issuing audit organization and reduce the effectiveness of its reports.

8.42 The report should include only information, findings, and conclusions that are supported by competent and relevant evidence in the audit documentation. If data are significant to the audit

findings and conclusions, but are not audited, the auditors should clearly indicate in their report the data's limitations and not make unwarranted conclusions or recommendations based on those data.

8.43 Reported evidence should demonstrate the correctness and reasonableness of the matters reported. Correct portrayal means describing accurately the audit scope and methodology, and presenting findings and conclusions in a manner consistent with the scope of audit work. The report should not have errors in logic and reasoning. One way to help ensure accuracy in the report is to use a quality control process such as referencing. Referencing is a process in which statements of facts, figures, and dates are traced back to the supporting working papers by an experienced auditor who is independent of the audit. This process is designed to ensure that sufficient credible evidence is present to support the report's conclusions and recommendations.

Objective

8.44 Objectivity requires that the presentation of the entire report be balanced in content and tone. A report's credibility is significantly enhanced when it presents evidence in an unbiased manner so that report users can be persuaded by the facts. The report should be fair and not misleading, and should place the audit results in perspective. This means presenting the audit results impartially and fairly. In describing shortcomings in performance, auditors should put findings in context. For example, the audited entity may have faced unusual difficulties or circumstances.

8.45 The tone of reports should encourage decision makers to act on the auditors' findings and recommendations. This tone should be balanced by requiring reports to present sound and logical evidence to support conclusions, while refraining from using adjectives or adverbs that characterize evidence in a way that implies criticism or conclusion by innuendo.

8.46 The report should also recognize the positive aspects of the program reviewed if applicable to the audit objectives. Inclusion of positive program aspects may lead to improved performance by other government organizations that read the report.

Convincing

8.47 Being convincing requires that the audit results be responsive to the audit objectives, the findings be presented persuasively, and the conclusions and recommendations follow logically from the facts presented. The information presented should be sufficient to convince the report users to recognize the validity of the findings, the reasonableness of the conclusions, and the benefit of implementing the recommendations. Reports designed in this way can help focus the attention of responsible officials on the matters that warrant attention and can help stimulate correction.

Clear

8.48 Clarity requires that the report be easy to read and understand. Reports should be prepared in language as clear and simple as the subject permits. Use of straightforward, nontechnical language is essential to simplicity of presentation. Whenever technical terms, abbreviations, and acronyms are used, they should be clearly defined.

8.49 Auditors may consider using a summary within the report to capture the report user's attention and highlight the overall message. If a summary is used, it generally should focus on the specific answers to the questions in the audit objectives, summarize the audit's most significant findings and the report's principal conclusions, and prepare users to anticipate the major recommendations.

8.50 Logical organization of material, and accuracy and precision in stating facts and in drawing conclusions, are essential to clarity and understanding. Effective use of titles and captions and topic sentences makes the report easier to read and understand. Visual aids (such as pictures, charts, graphs, and maps) should be used when appropriate to clarify and summarize complex material.

Concise

8.51 Being concise requires that the report be no longer than necessary to convey and support the message. Extraneous detail detracts from a report, may even conceal the real message, and may confuse or distract the users. Also, needless repetition should be avoided. Although room exists for considerable judgment in determining the content of reports, those that are fact-based, but still concise, are likely to achieve greater results.

REPORT ISSUANCE AND DISTRIBUTION

8.52 The fourth reporting standard for performance audits is:

Audit organizations should submit audit reports to the appropriate officials of the audited program and to the appropriate officials of the organizations requiring or arranging for the audits, including external funding organizations, unless legal restrictions prevent it. Copies of the reports should also be sent 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. Unless the report is restricted by law or regulation, copies should be made available for public inspection.

8.53 Audit reports should be distributed in a timely manner to officials interested in the results. Such officials include those designated by law or regulation to receive such reports, those responsible for acting on the findings and recommendations, those of other levels of government who have provided assistance to the audited entity, and legislators. However, if the subject of the audit involves material that is classified for security purposes or is not releasable to particular parties or the public for other valid reasons, auditors should limit the report distribution.

8.54 When nongovernment audit organizations are engaged, the engaging government organization should ensure that the report is distributed appropriately. If the nongovernment audit organization is to make the distribution, the engagement agreement should indicate which officials or organizations should receive the report.

8.55 Internal auditors should follow their entity's own arrangements and statutory requirements for distribution. Usually, they report to their entity's top managers, who are responsible for distribution of the report. Further distribution of reports outside the organization should be made in accordance with applicable law, rule, regulation, or policy.