



United States Government Accountability Office

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By the Comptroller General of the  
United States

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January 2023

# GOVERNMENT AUDITING STANDARDS

## 2023 Exposure Draft

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### Abbreviations

AICPA	American Institute of Certified Public Accountants
ASB	Auditing Standards Board
AU-C	<i>AICPA Codification of Statements on Auditing Standards</i>
CPE	continuing professional education
GAGAS	generally accepted government auditing standards
GAO	Government Accountability Office
IAASB	International Auditing and Assurance Standards Board
INTOSAI	International Organization of Supreme Audit Institutions
ISQM	International Standards on Quality Management
ISSAI	International Standards of Supreme Audit Institutions
PCAOB	Public Company Accounting Oversight Board
SQMS	Statement on Quality Management Standards

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January 30, 2023

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

GAO invites your comments on the proposed revisions to *Government Auditing Standards*, commonly known as the Yellow Book. This letter describes GAO's process for revising the Yellow Book and provides instructions for submitting comments on the proposed standards.

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

GAO first issued *Government Auditing Standards* in 1972 and has made several updates. The most recent revision occurred in July 2018 with a technical update issued in April 2021. The proposed revisions in the 2023 exposure draft update the Yellow Book to reflect major developments in the auditing and accountability professions and emphasize specific considerations applicable to the government environment. Enclosure I to this letter contains a discussion of the major proposed changes.

When issued in final form, this revision will supersede the April 2021 Technical Update to the 2018 revision of the standards. The effective date for this revision, as well as application guidance to help officials and auditors implement the revised standards, will be included when the Yellow Book is issued in final form.

We are requesting comments on this draft from federal, state, and local government officials; managers and auditors at all levels of government; the public accounting profession; academia; professional organizations; public interest groups; and other interested parties. To assist you in developing your comments, specific questions are presented in enclosure II to this letter. All comments received from the public will be considered a matter of public record and will be posted on the GAO website.

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Please send your comment letters to our Yellow Book Comments inbox, [YellowBookComments@gao.gov](mailto:YellowBookComments@gao.gov), no later than April 28, 2023. If you need additional information, please contact James R. Dalkin, Director, Financial Management and Assurance, at (202) 512-9535 or [YellowBookComments@gao.gov](mailto:YellowBookComments@gao.gov).

A handwritten signature in black ink that reads "Gene L. Dodaro". The signature is fluid and cursive, with a long horizontal stroke extending to the right from the end of the name.

Gene L. Dodaro  
Comptroller General of the United States

Enclosures – 2

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# Enclosure I: Overview of Major Changes in Proposed *Government Auditing Standards* 2023 Revision

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The proposed *Government Auditing Standards* 2023 revision reflects enhancements that strengthen an audit organization's framework for conducting high-quality government audits through its quality management system. An effective system of quality management provides the audit organization with reasonable assurance that the audit organization and its personnel fulfill their responsibilities in accordance with professional standards and applicable laws and regulations, and perform and report on engagements in accordance with such standards and requirements.

The proposed standard emphasizes the responsibility of the audit organization's leadership for proactively managing quality on its engagements and requires a risk-based approach to design, implement, and operate a system of quality management. The proposed standard also takes into account that the nature, extent, and formality of an audit organization's quality management system will vary based on an audit organization's circumstances, such as size, number of offices and geographic dispersion, knowledge and experience of its personnel, nature and complexity of its engagement work, and cost-benefit considerations. The discussion that follows provides an overview of major changes proposed to generally accepted government auditing standards (GAGAS).

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## Background

The proposed standard has been influenced by the audit community's concerns about audit quality and the scalability of quality management standards for audit organizations that vary in size, number of offices and geographic dispersion, personnel knowledge and experience, and nature and complexity of engagement work. Both the International Auditing and Assurance Standards Board (IAASB) and the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) have updated their quality management standards to address such concerns. The proposed *Government Auditing Standards* 2023 revision largely harmonizes with the IAASB and ASB standards while taking into account the potential impact on governmental audit organizations and GAGAS engagements, including performance audits.<sup>1</sup> The Public Company Accounting Oversight Board (PCAOB) recently issued an exposure draft on its new quality control standard and the International

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<sup>1</sup>GAGAS incorporates by reference the ASB's Statements on Auditing Standards and Statements on Standards for Attestation Engagements. It does not incorporate by reference the ASB's quality management standards.

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Organization of Supreme Audit Institutions (INTOSAI) is undertaking work to update its quality standards.<sup>2</sup>

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## Major Changes in the Government Auditing Standards 2023 Revision

The proposed *Government Auditing Standards* 2023 revision would replace extant *Government Auditing Standards* 2018 revision, 2021 Technical Update, chapter 5, “Quality Control and Peer Review,” paragraphs 5.01 through 5.59. The proposed revision would also add to extant chapter 6, “Standards for Financial Audits, Application Guidance: Reporting the Auditors’ Compliance,” paragraphs 6.37 through 6.38, additional application guidance in paragraph 6.39. This additional guidance is for auditors engaged to report on key audit matters in financial audits. A discussion of the major changes in the proposed revision follows.

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### Provides Flexibility for Audit Organizations Subject to Other Quality Management Standards

Designing, implementing, monitoring, and evaluating a system of quality management requires an audit organization to devote resources to these tasks. GAO believes that there is substantial harmonization between proposed GAGAS and the quality management requirements that the IAASB and ASB issued. To permit audit organizations that are subject to those organizations’ quality management standards to avoid the potential burden of designing and maintaining separate systems of quality management, paragraph 5.07 of the proposed *Government Auditing Standards* 2023 revision directs those audit organizations to comply with the IAASB or ASB quality management standards and specific additional GAGAS requirements.

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### Emphasizes the Responsibility of Leadership for Quality Management

The leadership of an audit organization is of paramount importance to engagement quality because it establishes the audit organization’s culture and ethics and serves as the framework for how decisions are made. Paragraphs 5.13 through 5.15 of the proposed *Government Auditing Standards* 2023 revision require senior leadership within the audit organization to assume responsibility for and take an active role in the system of quality management.

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<sup>2</sup>The IAASB issued its updated standards titled International Standards on Quality Management (ISQM), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (ISQM 1) and *Engagement Quality Reviews* (ISQM 2) in December 2020. The ASB issued its updated standards titled Statement on Quality Management Standards (SQMS), *A Firm’s System of Quality Management* (SQMS 1) and *Engagement Quality Reviews* (SQMS 2) in June 2022. The PCAOB issued its exposure draft titled *A Firms’ System of Quality Control* in November 2022. INTOSAI has undertaken work to update its International Standards of Supreme Audit Institutions (ISSAI) 140, *Quality Control for Supreme Audit Institutions*.

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## Adds Risk Assessment Process and Information and Communication Components

The proposed system of quality management consists of the following eight components:

- Quality management risk assessment process
- Governance and leadership
- Independence, legal, and ethical requirements
- Initiation, acceptance, and continuance of engagements
- Engagement performance
- Resources
- Information and communication
- Monitoring and remediation process

The quality management risk assessment process component and the information and communication component have been added to the framework for the system of quality management in the proposed standard. The remaining six items are largely included in extant GAGAS. The quality management risk assessment process (paras. 5.19–5.42) establishes a risk-based approach to designing, implementing, and operating the system of quality management in an interconnected and coordinated manner. This risk-based approach involves establishing desired outcomes referred to as quality objectives of the components of the system of quality management; identifying and assessing risks to achieve the objectives; and designing and implementing responses to address these risks to the system of quality management.

The information and communication component emphasizes the importance of a continuous flow of information and communication. Paragraph 5.78 of the proposed *Government Auditing Standards 2023* revision requires that an audit organization establish an information system that identifies, captures, processes, and maintains relevant and reliable information. Application guidance acknowledges that smaller or less-complex audit organizations may achieve the related quality objectives with less formal policies and procedures. The standard discusses both internal and external communication and reinforces the need for robust two-way communication throughout the audit organization.

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Emphasizes Monitoring of  
the Entire System of  
Quality Management

The proposed *Government Auditing Standards* 2023 revision emphasizes monitoring of the entire system of quality management. The requirements and application guidance (paras. 5.84–5.125) promote proactive and effective monitoring activities and increase the emphasis on tailoring the monitoring activities to provide a sufficient basis for the audit organization to evaluate the system of quality management. The proposed revision includes a new requirement to investigate the underlying causes of identified quality management deficiencies.

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Promotes Scalability for  
Use by Audit  
Organizations Differing in  
Size and Complexity

A quality management approach drives an audit organization to think about the audit organization’s nature and circumstances and the engagements it performs when designing, implementing, and operating its system of quality management. The proposed approach focuses on achieving quality objectives that are outcome based. Although this approach is expected to generate multiple benefits for engagement quality, one of the most important benefits is a tailored system of quality management that is suitable for the nature and circumstances of the audit organization and the engagements it performs. Thus, the proposed approach promotes scalability of the standard for audit organizations of different sizes and complexity (paras. 5.11–5.12).

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Provides for the Use of  
Engagement Quality  
Reviews

An engagement quality review is an objective evaluation of the engagement team’s significant judgments and the conclusions reached thereon. While not required in the proposed revision, an audit organization may determine that an engagement quality review is an appropriate response to address quality risks. The proposed revision requires audit organizations to develop policies and procedures for determining if an engagement quality review is an appropriate response to address one or more quality risks and, if so, developing policies and procedures for performing the engagement quality review (paras. 5.53e–5.53f).

The proposed revision establishes engagement quality review requirements for audit organizations that determine that engagement quality reviews are an appropriate response to address one of more quality risks (paras. 5.137–5.150). An engagement quality review may be a response to quality risks for any type of engagement, not only financial audits. Also, an audit organization may determine that engagement quality reviews apply to all GAGAS engagements, specific types of GAGAS engagements, specifically identified GAGAS engagements, or to no GAGAS engagements at all.

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**Enclosure I: Overview of Major Changes in  
Proposed Government Auditing Standards  
2023 Revision**

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**Includes Application  
Guidance for Key Audit  
Matters**

The ASB has updated its financial audit reporting standards that are incorporated by reference into GAGAS. The ASB's standards address the auditor's responsibility to communicate key audit matters when the auditor is engaged to do so. The proposed revision adds application guidance (para. 6.39) to provide clarity as to when this might apply for financial audits of government entities and entities that receive government financial assistance.

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**Permits Early Adoption of  
Proposed Standard**

The proposed revision's effective date requires quality management systems to be designed and implemented within 2 years from issuance of *Government Auditing Standards* 2023 revision. The evaluation of the system of quality management is required within 1 additional year (3 years from the issuance of the final revision). Early adoption of the proposed revision is permitted.

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# Enclosure II: Questions for Commenters

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The following questions are provided to guide users in commenting on the proposed *Government Auditing Standards 2023* revision. We encourage you to comment on these issues and any additional issues that you note.

Please associate your comments with specific references to question numbers, paragraph numbers, or both in the proposed standard and provide the rationale for any modifications, along with suggested revised language.

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## Discussion Questions for Responses

### **Audit Organizations Subject to Other Quality Management Standards**

1. The proposed standard (para. 5.07) permits audit organizations subject to the quality management standards of either the International Auditing and Assurance Standards Board or the Auditing Standards Board of the American Institute of Certified Public Accountants to comply with those standards and specific additional generally accepted government auditing standards (GAGAS) requirements to avoid having to maintain and document two systems of quality management.

Is it appropriate to permit this flexibility to audit organizations? Why or why not?

### **Quality Management Risk Assessment Process**

2. A system of quality management depends on an appropriately designed and implemented quality management risk assessment process (paras. 5.19–5.42).

Is the quality management risk assessment process in the proposed standard sufficiently clear and understandable?

### **Monitoring and Remediation Process**

3. The proposed standard includes new and revised requirements and application guidance for monitoring and remediation activities to assist audit organizations in identifying and remediating deficiencies in the system of quality management (paras. 5.84–5.125).

Are these requirements sufficiently clear and understandable?

**Scalability Approach for Audit Organizations Differing in Size and Complexity**

4. The proposed revision intends to promote scalability to enable each audit organization, based on its size and complexity, to design, implement, and maintain a tailored system of quality management that responds to the circumstances of the audit organization and the engagements that it conducts (paras. 5.11–5.12).

Does the proposed revision promote sufficient scalability?

**Engagement Quality Reviews**

5. The proposed standard includes a section (paras. 5.137–5.150) on performing engagement quality reviews that applies when an audit organization determines that such a response is appropriate to address one or more quality risks.

Are the requirements and application guidance relating to engagement quality reviews sufficiently clear and understandable?

**Application Guidance for Key Audit Matters**

6. The proposed standard adds application guidance (para. 6.39) stating that communicating key audit matters is permitted in GAGAS financial audits if the auditors are engaged to do so or required to do so by law or regulation as discussed in AU-C section 701, Communicating Key Audit Matters in the Independent Auditor’s Report.

Is the application guidance sufficiently clear and understandable?

**Early Adoption of Proposed Revision**

7. Audit organizations would be required to design and implement systems of quality management that comply with GAGAS within 2 years from the issuance of the final standard. The required evaluation of the system of quality management would be required within 1 additional year (3 years from the issuance of the final revision).

Should audit organizations be permitted to adopt the standard early?

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# Chapter 5: Quality Management and Peer Review

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**5.01** This chapter addresses the audit organization’s responsibilities for designing, implementing, and operating a system of quality management for engagements conducted in accordance with generally accepted government auditing standards (GAGAS). It includes requirements and application guidance for engagement quality reviews that the audit organization may use as a response to one or more quality risks relating to quality management. Finally, the chapter also addresses the audit organization’s responsibilities for administering, planning, performing, and reporting on peer reviews of audit organizations that conduct engagements in accordance with GAGAS. The requirements of this chapter are intended to be followed in conjunction with all other applicable GAGAS requirements.

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## System of Quality Management

**5.02** The objective of a system of quality management for engagements performed in accordance with GAGAS is to provide the audit organization with reasonable assurance that the audit organization and its personnel

- a. fulfill their responsibilities in accordance with professional standards and applicable laws and regulations and
- b. perform and report on engagements in accordance with such standards and requirements.

**5.03** In GAGAS, a system of quality management consists of the following components: governance and leadership; independence, legal, and ethical requirements; initiation, acceptance, and continuance of engagements; engagement performance; resources; and information and communication. It also includes two components that are processes: assessing and responding to risks to achieving the quality objectives and monitoring the system of quality management.

**5.04** GAGAS establishes a risk-based approach to designing, implementing, and operating the system of quality management in an interconnected and coordinated manner. This risk-based approach involves the following:

- a. Establishing the desired outcomes relative to the components of the system of quality management (referred to as quality objectives).
- b. Identifying and assessing risks to achieving the quality objectives (referred to as quality risks).

- c. Designing and implementing responses to address quality risks.

**Requirements: System of Quality Management**

**5.05** An audit organization conducting engagements in accordance with GAGAS must design, implement, and operate a system of quality management that provides it with reasonable assurance that the audit organization and its personnel

- a. fulfill their responsibilities in accordance with professional standards and applicable laws and regulations and
- b. perform and report on engagements in accordance with such standards and requirements.

**5.06** The audit organization should exercise professional judgment in designing, implementing, and operating a system of quality management, taking into account the nature and circumstances of the audit organization and its engagements.

**5.07** An audit organization subject to the quality management standards of one of the following organizations should comply with the respective organization's quality management requirements and the requirements of paragraphs 5.53a, 5.53b, 5.53d, and 5.72c:

- a. American Institute of Certified Public Accountants
- b. International Auditing and Assurance Standards Board

**5.08** An audit organization not subject to the quality management standards of one of the recognized organizations in paragraph 5.07 should meet the GAGAS quality management requirements in paragraphs 5.05 through 5.150 unless a requirement or an aspect thereof is not relevant to the audit organization because of its nature and circumstances or its engagements.

**Application Guidance: System of Quality Management**

**5.09** The public interest is served by the consistent performance of quality engagements.<sup>1</sup> The design, implementation, and operation of the system

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<sup>1</sup>See paras. 3.07 and 3.08 for additional guidance on the public interest.

of quality management enables the consistent performance of quality engagements by providing the audit organization with reasonable assurance that the objective of the system of quality management, stated in paragraph 5.02, is achieved. An audit organization obtains reasonable assurance when the system of quality management reduces to an acceptably low level the risk that the objective stated in paragraph 5.02 is not achieved.

**5.10** Quality management is not a separate function of the audit organization; it is the integration of a culture that demonstrates a commitment to quality with the audit organization's strategy, operational activities, and business processes. Designing the system of quality management and the audit organization's operational activities and business processes in an integrated manner promotes a harmonious approach to managing the audit organization and enhances the effectiveness of quality management.

*Scalability Considerations*

**5.11** The design of the audit organization's system of quality management, and in particular the complexity and formality of the system, will vary based on the audit organization's circumstances, such as size, number of offices and geographic dispersion, knowledge and experience of its personnel, nature and complexity of its engagement work, and cost-benefit considerations. For example, an audit organization that performs different types of engagements for a wide variety of entities, such as audits of specialized industries or group audits, may need to have a more complex and formalized system of quality management and supporting documentation than one that performs only reviews of financial statements or agreed-upon procedures engagements. Similarly, a large audit organization with multiple divisions and offices may need to have a more complex and formal system of quality management than a small audit organization with a few auditors at a single location.

**5.12** An example of when a requirement of this chapter may not be relevant to an audit organization includes when the audit organization consists of a single auditor. In such a situation, the requirements addressing the organizational structure and assigning roles, responsibilities, and authority within the audit organization; direction, supervision, and review; and differences of opinion may not be relevant.

Responsibility for the System of Quality Management

**Requirements: Responsibility for the System of Quality Management**

**5.13** The audit organization should assign

- a. responsibility and accountability for the system of quality management to a senior-level official within the audit organization and
- b. operational responsibility for the system of quality management or specific aspects of the system of quality management to a specific individual or individuals.

**5.14** The audit organization should determine that the individual or individuals in paragraph 5.13

- a. possess the appropriate experience, knowledge, influence, and authority within the audit organization;
- b. have sufficient time to fulfill the assigned responsibility;
- c. have a sufficient understanding of this chapter and other applicable GAGAS requirements, as well as application guidance and other explanatory material, to understand the objectives of the system of quality management and to apply the related requirements properly; and
- d. understand the assigned roles and are held accountable for fulfilling them.

**5.15** The audit organization should determine that those assigned operational responsibility for the system of quality management or aspects of the system of quality management are in direct communication with the senior-level official assigned responsibility and accountability for the system of quality management.

**Application Guidance: Responsibility for the System of Quality Management**

**5.16** Notwithstanding the assignment of responsibilities related to the system of quality management in accordance with paragraph 5.13, the audit organization remains ultimately responsible for the system of quality management and for holding individuals responsible and accountable for

their assigned roles. Further, the audit organization is responsible for its system of quality management even when it uses resources from a service provider as part of its system of quality management.

**5.17** The manner in which audit organizations assign and describe roles, responsibilities, and authority may vary. Laws and regulations may impose requirements for an audit organization that may affect the structure of leadership and management and their assigned responsibilities. As such, professional judgment assists an audit organization in identifying the appropriate individual or individuals to whom to assign the responsibilities described in paragraph 5.13.

**5.18** Delegating operational responsibility for the system of quality management or aspects of the system of quality management may depend on the size and complexity of the audit organization. For small or less complex audit organizations, an individual may be assigned operational responsibility for the system of quality management. For large or more complex audit organizations, more than one person may be assigned operational responsibility for the system of quality management or aspects of the system of quality management. For example, operational responsibility for aspects of a system of quality management that could be delegated include

- a. compliance with independence requirements,
- b. compliance with continuing professional education requirements,
- c. compliance with professional standards, and
- d. the monitoring and remediation process.

## Quality Management Risk Assessment Process

### Requirements: Quality Management Risk Assessment Process

**5.19** The audit organization should design and implement a risk assessment process that establishes quality objectives, identifies and assesses quality risks, and designs and implements responses to address the quality risks.

**5.20** The audit organization should establish the quality objectives specified by this chapter and any additional quality objectives that the audit organization considers necessary to achieve the objective of the system of quality management.

**5.21** The audit organization should identify and assess quality risks. To identify and assess quality risks, the audit organization should

- a. obtain an understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives and
- b. take into account how, and the degree to which, events, circumstances, actions, or inactions may adversely affect the achievement of the quality objectives.

**5.22** The audit organization should design and implement responses to address the quality risks in a manner that is based on, and responsive to, quality management risk assessments.

**5.23** The audit organization should identify, analyze, and respond to changes in the nature and circumstances of the audit organization or its engagements that could impact the quality objectives, quality risks, or responses to address quality risks.

### Application Guidance: Quality Management Risk Assessment Process

**5.24** The process of establishing quality objectives, identifying and assessing quality risks, and designing and implementing responses is iterative.

**5.25** Appropriate responses to changes in the nature and circumstances of the audit organization or its engagements could include modification or

establishment of additional quality objectives, quality risks, or responses to address quality risks, or a determination that no changes are needed.

*Quality Objectives*

**5.26** Quality objectives are the desired outcomes to be achieved by the audit organization in relation to the components of the system of quality management.

**5.27** The quality objectives specified by this chapter relate to the following components:

- a. Governance and Leadership (5.43)
- b. Independence, Legal, and Ethical Requirements (5.45)
- c. Initiation, Acceptance, and Continuance of Engagements (5.49)
- d. Engagement Performance (5.52)
- e. Resources (5.72)
- f. Information and Communication (5.78)

**5.28** There are no quality objectives for the quality management risk assessment process and the monitoring and remediation process because these components are processes.

**5.29** The audit organization may determine that a quality objective specified by this chapter, or an aspect thereof, is not relevant because of the nature and circumstances of the audit organization or its engagements.

**5.30** The audit organization may identify additional quality objectives beyond those specified by this chapter that it determines are necessary to achieve the objective of the system of quality management. For instance, laws, regulations, contracts, grant agreements, or professional standards may establish requirements that give rise to additional quality objectives. The audit organization may also determine that additional quality objectives previously established are no longer necessary or need to be modified.

**5.31** The need to establish additional quality objectives is not expected to be common. Therefore, not all audit organizations will find it necessary to establish quality objectives beyond those specified in this chapter.

*Quality Risks*

**5.32** Quality risks are risks that have a reasonable possibility of

- a. occurring and
- b. adversely affecting the achievement of one or more quality objectives individually, or in combination with other risks.

**5.33** A risk arises from how, and the degree to which, a condition, event, circumstance, action, or inaction may adversely affect the achievement of a quality objective. Not all risks to achieving a quality objective meet the definition of a quality risk. Professional judgment assists the audit organization in determining whether a risk is a quality risk, which is based on whether the audit organization considers that there is a reasonable possibility of the risk occurring and, individually or in combination with other risks, adversely affecting the achievement of one or more quality objectives.

**5.34** Conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives may be related to the nature and circumstances of the audit organization, and may include

- a. the complexity and operating characteristics of the audit organization;
- b. the strategic and operational decisions and actions of the audit organization;
- c. the characteristics and management style of leadership;
- d. the resources of the audit organization, including the resources provided by service providers; and
- e. law, regulation, professional standards, and the environment in which the audit organization operates.

**5.35** Conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives may be related to the nature and circumstances of the engagements performed by the audit organization, and may include

- a. the types of engagements performed by the audit organization and the reports to be issued and
- b. the types of entities for which and upon which such engagements are undertaken.

**5.36** The degree to which a risk, individually or in combination with other risks, may adversely affect the achievement of one or more quality objectives may vary based on the conditions, events, circumstances, actions, or inactions giving rise to the risk, taking matters such as the following into account:

- a. how the condition, event, circumstance, action, or inaction would affect the achievement of the quality objective(s);
- b. how frequently the condition, event, circumstance, action, or inaction is expected to occur;
- c. how long it would take after the condition, event, circumstance, action, or inaction occurred for it to have an effect, and whether in that time the audit organization would have an opportunity to respond to mitigate its effect; and
- d. how long the condition, event, circumstance, action, or inaction would affect the achievement of the quality objective(s) once it has occurred.

**5.37** The assessment of quality risks may include formal ratings or scores, although audit organizations are not required to use them.

### *Responses*

**5.38** Responses are the policies and procedures that the audit organization designs and implements to address one or more quality risks.

**5.39** The audit organization is not required to design and implement a response for a specific quality objective unless there is a risk that rises to the level of a quality risk.

**5.40** The nature, timing, and extent of the responses to address quality risks are based on the assessments of those risks, that is, the conclusions from the consideration of how, and the degree to which, conditions, events, circumstances, actions, or inactions may adversely affect the achievement of one or more quality objectives.

**5.41** Given the evolving nature of the system of quality management, the responses that the audit organization designs and implements may give rise to conditions, events, circumstances, actions, or inactions that result in further quality risks.

**5.42** The responses that the audit organization designs and operates may operate at the audit organization level or engagement level, or there may be a combination of responsibilities for actions to be taken at both levels.

## Governance and Leadership

### **Requirement: Governance and Leadership**

**5.43** The audit organization should establish quality objectives that address its governance and leadership as follows:

- a. The audit organization demonstrates a commitment to quality through a culture that exists throughout the audit organization.
- b. Leadership is responsible and accountable for quality.
- c. Leadership demonstrates a commitment to quality through its actions and behaviors.
- d. The organizational structure and assignment of roles, responsibilities, and authority is appropriate to enable the design, implementation, and operation of the audit organization's system of quality management.
- e. Resource needs are planned for, obtained, allocated, and assigned in a manner consistent with the audit organization's commitment to quality.

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**Application Guidance: Governance and Leadership**

**5.44** Demonstrating a commitment to quality through a culture that exists throughout the audit organization may include recognizing and reinforcing the following:

- a. the audit organization's role in serving the public interest by consistently performing quality engagements;
- b. the importance of professional ethics, values, and attitudes;
- c. the responsibility of all personnel for quality in performing engagements or activities within the system of quality management and their expected behavior; and
- d. the importance of quality in the audit organization's strategic decisions and actions.

## Independence, Legal, and Ethical Requirements

### Requirements: Independence, Legal, and Ethical Requirements

**5.45** The audit organization should establish a quality objective that addresses fulfilling independence and applicable legal and ethical requirements as follows:

The audit organization and its personnel understand and fulfill their responsibilities in relation to the independence and applicable legal and ethical requirements to which the audit organization and its personnel are subject.<sup>2</sup>

**5.46** As part of designing and implementing responses to address quality risks that adversely affect the achievement of the quality objective in paragraph 5.45, the audit organization should

- a. establish policies and procedures for identifying, evaluating, and addressing threats to compliance with independence requirements and applicable legal and ethical requirements and appropriately responding to the causes and consequences of any breaches of these requirements and
- b. at least annually, obtain written affirmation of compliance with its policies and procedures on independence from all of its personnel required to be independent.

### Application Guidance: Independence, Legal, and Ethical Requirements

**5.47** Policies and procedures pertaining to independence requirements and applicable legal and ethical requirements assist the audit organization in

- a. communicating its independence requirements to its personnel and
- b. identifying and evaluating circumstances and relationships that create threats to independence and taking appropriate action to eliminate those threats or reduce them to an acceptable level by

<sup>2</sup>See paras. 3.02 through 3.16 for a discussion of ethical principles and paras. 3.18 through 3.108 for independence requirements and guidance.

applying safeguards or, if considered appropriate, withdrawing from the engagement where withdrawal is not prohibited by law or regulation.

**5.48** Written affirmation of compliance with its policies and procedures on independence from all audit organization personnel required to be independent may be in paper or electronic form. By obtaining affirmation of retrospective compliance with the audit organization’s policies and procedures on independence during a specified period and taking appropriate action on information indicating noncompliance, or potential noncompliance, the organization demonstrates the importance that it attaches to independence and keeps the issue current for, and visible to, its personnel. An audit organization may obtain affirmation of required personnel’s compliance with policies and procedures on independence more frequently than once per year. For example, affirmation may be obtained on a per-engagement basis when such engagements last less than 1 year.

Acceptance, Initiation, and Continuance of Engagements

**Requirement: Acceptance, Initiation, and Continuance of Engagements**

**5.49** The audit organization should establish a quality objective that addresses the acceptance, initiation, and continuance of engagements as follows:

The audit organization accepts, initiates, and continues engagements only if it

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

**Application Guidance: Acceptance, Initiation, and Continuance of Engagements**

**5.50** Government audit organizations may initiate engagements as a result of (1) legal mandates, (2) requests from legislative bodies or oversight bodies, and (3) audit organization discretion. In the case of legal

mandates and requests, a government audit organization may be required to conduct the engagement and may not be permitted to make decisions about acceptance or continuance or to resign or withdraw from the engagement.

**5.51** Audit organizations may operate with limited resources. An audit organization may consider its workload in determining whether it has the resources to perform quality engagements over the range of work. To achieve this, an audit organization may develop systems to prioritize its work in a way that takes into account the need to maintain quality.

## Engagement Performance

### Requirements: Engagement Performance

**5.52** The audit organization should establish quality objectives that address the performance of engagements as follows:

- a. Engagement teams understand and fulfill their responsibilities in connection to engagements, including the overall responsibility of an engagement partner or director for
  - (1) managing and achieving quality on the engagement and
  - (2) being sufficiently and appropriately involved throughout the engagement.
- b. The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is appropriate based on the nature and circumstances of the engagements and the resources assigned or made available to the engagement team.
- c. Engagement teams exercise appropriate professional judgment, which includes exercising reasonable care and professional skepticism.<sup>3</sup>
- d. Consultation on significant matters is undertaken, especially for difficult or contentious matters, and the conclusions agreed to are implemented and, as appropriate, documented.
- e. Differences of opinion within the engagement team, or between the engagement team and individuals performing activities within the audit organization's system of quality management, are brought to the attention of officials at the appropriate level of the

<sup>3</sup>See paras. 3.109 through 3.117 for a discussion of professional judgment.

audit organization and resolved.

- f. Engagement documentation is assembled on a timely basis and is appropriately maintained and retained to meet the needs of the audit organization and comply with professional standards; independence requirements; and applicable legal and ethical requirements.

**5.53** As part of designing and implementing responses to address quality risks that adversely affect the achievement of the quality objectives in paragraph 5.52, the audit organization should establish policies and procedures for

- a. communicating the identity and role of the engagement partner or director to management and those charged with governance of the audited entity;
- b. if auditors change the engagement objectives during the engagement, documenting the revised engagement objectives and the reasons for the changes;
- c. requiring that engagement team members with appropriate levels of skill and proficiency supervise engagements and review work that other engagement team members perform;
- d. if an engagement is terminated before it is completed and an audit report is not issued, documenting the results of the work to the date of termination and why the engagement was terminated;
- e. determining if an engagement quality review is an appropriate response to address one or more quality risks; and
- f. performing an engagement quality review, if an engagement quality review is determined to be an appropriate response to address one or more quality risks.<sup>4</sup>

<sup>4</sup>See paras. 5.137 through 5.150 for requirements and application guidance on performing engagement quality reviews.

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**Application Guidance: Engagement Performance**

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

**5.55** Examples of engagement supervision include the following:

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

**5.56** A review of the work performed may include determining whether

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

- g. the objectives of the engagement procedures have been achieved.

**5.57** In the case of an audit organization consisting of a single auditor, the requirement for an engagement team member to review work performed by other team members may be achieved through alternative procedures.

**5.58** Consultation involves a discussion at the appropriate professional level with individuals within or outside the audit organization who have specialized expertise.

**5.59** Consultation uses appropriate research resources, as well as the collective experience and technical expertise of the audit organization. Consultation helps promote quality and improves the application of professional judgment.

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

- a. those consulted are given all the relevant facts that will enable them to provide informed advice;
- b. those consulted have appropriate knowledge, authority, and experience; and
- c. conclusions resulting from consultations are appropriately documented and implemented.

**5.61** Difficult or contentious matters on which consultation is needed may be specified by the audit organization, or the engagement team may identify matters that require consultation. The audit organization may also specify how conclusions should be agreed upon and implemented.

**5.62** The audit organization may encourage identifying differences of opinion at an early stage and may specify the steps to be taken in raising and dealing with them, including how the matter is to be resolved and how the related conclusions should be implemented and documented.

**5.63** The appropriate level of official to whom differences of opinion are raised may vary. For example, a partner or director may be an appropriate level of official to resolve differences of opinion in the engagement team. The senior-level official assigned accountability and

responsibility for the system of quality management may be an appropriate level of official to resolve differences of opinion between the engagement team and individuals performing activities within the audit organization's system of quality management.

**5.64** Law, regulation, or professional standards may prescribe the timeframes in which the assembly of final engagement files for specific types of engagements is to be completed.

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

**5.66** Law, regulation, or professional standards may prescribe the retention periods for engagement documentation. If the retention periods are not prescribed, the audit organization may consider the nature of the engagements that it performs and its circumstances.

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

**5.68** An engagement quality review is an objective evaluation of the engagement team's significant judgments and the conclusions reached thereon that the engagement quality reviewer performs and completes on or before the date of the audit report.

**5.69** Determining that an engagement quality review is an appropriate response to address one or more quality risks may apply to all GAGAS engagements, specific types of GAGAS engagements, or specifically identified GAGAS engagements.

**5.70** Criteria that an audit organization establishes to determine if an engagement quality review is an appropriate response for one or more quality risks may relate to the types of engagements that the audit organization performs and the types of entities for which it undertakes engagements. Examples of conditions, events, circumstances, actions, or

inactions that could create quality risks for which an engagement quality review may be an appropriate response include

- a. engagements that involve a high level of complexity or judgment, such as financial audits for entities with significant accounting estimates with a high degree of estimation uncertainty;
- b. engagements on which issues have been encountered, such as recurring inspection findings;
- c. entities that hold a significant amount of assets in a fiduciary capacity for a large number of stakeholders;
- d. audited entities with deficiencies in internal control that are significant within the context of the audit objectives; and
- e. for financial audits, audited entities with material restatements in their financial statements.

**5.71** The audit organization's responses to address quality risks may include other forms of engagement reviews that are not engagement quality reviews. The audit organization may determine that engagement quality reviews are not necessary to address quality risks.

Resources

**Requirement: Resources**

**5.72** The audit organization should establish quality objectives that address appropriately obtaining, developing, using, maintaining, allocating, and assigning resources in a timely manner to enable the design, implementation, and operation of a system of quality management as follows:

- a. Personnel are hired, developed, and retained who have the competence and capabilities to consistently perform quality engagements and carry out responsibilities related to the operation of the audit organization’s system of quality management.
- b. Personnel develop and maintain the appropriate competence to perform their roles and are held accountable or recognized for doing so through timely evaluations, compensation, promotion, and other incentives.
- c. Auditors who are performing work in accordance with GAGAS meet the continuing professional education (CPE) requirements.
- d. The audit organization has sufficient resources to perform quality engagements consistently and enable the operation of the audit organization’s system of quality management.
- e. Individuals assigned to engagements or to perform activities within the system of quality management have appropriate competence and capabilities, including sufficient time, to perform their duties.
- f. Appropriate technological and intellectual resources are obtained or developed, implemented, maintained, and used to enable the operation of the audit organization’s system of quality management and the performance of engagements.
- g. Human, technological, or intellectual resources from service providers are appropriate for use in the audit organization’s system of quality management and in performing engagements.

### Application Guidance: Resources

**5.73** The policies and procedures designed and implemented relating to hiring, developing, and retaining personnel may address issues such as the following:

- a. recruiting individuals who have, or are able to develop, appropriate competence;
- b. training programs focused on developing personnel's competence and continuing professional development;
- c. evaluation mechanisms that are undertaken at appropriate intervals and include competency areas and other performance measures; and
- d. compensation, promotion, and other incentives for all personnel, including engagement partners or directors and those assigned roles and responsibilities related to the audit organization's system of quality management.

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

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

**5.75** The size and circumstances of the audit organization are important considerations in determining the structure of the audit organization's performance evaluation process. A smaller audit organization, in

particular, may employ less formal methods of evaluating the performance of its personnel.

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

**5.77** Intellectual resources include the information that the audit organization uses to enable the operation of the system of quality management and promote consistency in performing engagements. Examples of intellectual resources include written policies and procedures, methodologies, guides, standardized documentation, and access to information sources such as subscription-based databases.

## Information and Communication

### **Requirement: Information and Communication**

**5.78** The audit organization should establish quality objectives that address obtaining, generating, or using information regarding the system of quality management and communicating information to enable the design, implementation, and operation of the system of quality management as follows:

- a. The audit organization's information system identifies, captures, processes, and maintains relevant and reliable information that supports the system of quality management.
- b. Relevant and reliable information is communicated to personnel and engagement teams to enable them to understand and carry out their responsibilities within the system of quality management or engagements.
- c. Personnel and engagement teams communicate to the audit organization when performing activities within the system of quality management or engagements.
- d. Relevant and reliable information is communicated to external parties.

### **Application Guidance: Information and Communication**

**5.79** Obtaining, generating, or communicating information is generally an ongoing process that involves all personnel and encompasses

disseminating information within the audit organization and externally. Information and communication are part of all components of the system of quality management.

**5.80** Relevant and reliable information includes information that is accurate, complete, timely, and valid to enable the proper functioning of the system of quality management and to support decisions regarding the system of quality management.

**5.81** The audit organization may recognize and reinforce the responsibility of personnel and engagement teams to exchange information with the audit organization and one another by establishing communication channels to facilitate communication across the audit organization.

**5.82** Laws, regulations, and professional standards may require information to be communicated externally, particularly to support external parties' understanding of the system of quality management.

*Scalability Considerations*

**5.83** The complexity and formality of an audit organization's mechanisms for communicating with personnel or engagement teams information relevant to the system of quality management will vary. For example, a smaller or less complex audit organization may find informal staff meetings effective for communicating with personnel or engagement teams. A larger or more complex audit organization may need formal mechanisms, such as written reports, intranet portals, or periodic official meetings, for communicating such information.

**Monitoring and Remediation Process**

**Requirement: Monitoring and Remediation Process**

**5.84** The audit organization should establish a process to monitor the design, implementation, and operation of the system of quality management to provide a basis for identifying deficiencies and remediating them on a timely basis.

**Application Guidance: Monitoring and Remediation Process**

**5.85** Monitoring of quality is a process comprising ongoing consideration and evaluation of the audit organization's system of quality management,

including inspection of engagement documentation and reports for a selection of completed engagements. The purpose of monitoring is to provide management of the audit organization with reasonable assurance that (1) the policies and procedures related to the system of quality management are suitably designed and operating effectively in practice, (2) auditors have fulfilled their responsibilities in accordance with professional standards and applicable laws and regulations, and (3) auditors have performed and reported on engagements in accordance with such standards and requirements.

**5.86** In addition to enabling the evaluation of the system of quality management, the monitoring and remediation process facilitates the proactive and continual improvement of engagement quality and the system of quality management.

**Requirements: Designing and Performing Monitoring Activities**

**5.87** The audit organization should design and perform monitoring and remediation activities to

- a. provide relevant, reliable, and timely information about the design, implementation, and operation of the system of quality management;
- b. take appropriate actions to respond to identified deficiencies such that they are remediated on a timely basis; and
- c. enable it to assess compliance with professional standards and with policies and procedures it has established to address quality risks.

**5.88** The audit organization should establish policies and procedures that require the individuals performing the monitoring activities to be objective and have sufficient competence, authority, and time to perform these activities.

**Application Guidance: Designing and Performing Monitoring Activities**

**5.89** Monitoring is most effective when performed by persons who do not have responsibility for the specific activity being monitored.

**5.90** Monitoring activities will vary based on the audit organization's facts and circumstances.

**5.91** In determining the nature, timing, and extent of the monitoring activities, the audit organization may take the following into account:

- a. Quality management risk assessments
- b. The design of the responses to address quality risks
- c. The design of the audit organization's quality management risk assessment process and monitoring and remediation process
- d. Changes in the system of quality management
- e. The results of previous monitoring activities, including whether
  - (1) previous monitoring activities continue to be relevant in evaluating the audit organization's system of quality management and
  - (2) remedial actions to address previously identified deficiencies were effective
- f. Other relevant information, including
  - (1) complaints and allegations about
    - a. failures to perform work in accordance with professional standards and applicable laws and regulations or
    - b. noncompliance with the audit organization's policies and procedures related to the system of quality management and
  - (2) information from inspections

**5.92** The audit organization's monitoring activities may comprise a combination of ongoing monitoring activities and periodic monitoring activities. Ongoing monitoring activities are generally routine activities built into the audit organization's processes and performed on a real-time

basis. Periodic monitoring activities are conducted at certain intervals by the audit organization.

**5.93** Reviews of engagement team members' work prior to the date of the report are not monitoring procedures.

**5.94** When performing monitoring activities, the audit organization may determine that changes to the nature, timing, and extent of the monitoring activities are needed, such as when findings concerning the system of quality management indicate the need for more extensive monitoring activities.

**5.95** How the audit organization's quality management risk assessment process is designed (for example, a centralized or decentralized process, or the frequency of review) may affect the nature, timing, and extent of the monitoring activities, including monitoring activities over the audit organization's quality management risk assessment process.

**5.96** Changes in the system of quality management may include

- a. changes to address an identified deficiency in the system of quality management and
- b. changes to the quality objectives, quality risks, or responses to address the quality risks resulting from changes in the nature and circumstances of the audit organization and its engagements.

**5.97** When changes in the system of quality management occur, the audit organization's previous monitoring activities may no longer provide it with information to support the evaluation of the system of quality management. Therefore, the audit organization's monitoring activities may include monitoring of those changes.

**5.98** Inspection is a retrospective evaluation of the adequacy of the audit organization's quality management policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the audit organization's compliance with them. The extent and nature of inspection procedures vary based on the audit organization's quality management policies and procedures and on the existence, effectiveness, and results of other monitoring activities.

**5.99** The manner in which the inspection is organized depends on many factors, such as the following:

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

**5.100** Inspection procedures may include the review of completed engagements to determine if responses to address quality risks at the engagement level have been implemented as designed and are operating effectively. The matters considered during an inspection of an individual engagement depend on how the inspection will be used to monitor the system of quality management.

**5.101** The results of inspection procedures or other relevant information may indicate that previous monitoring activities that the audit organization undertook failed to identify a deficiency in the system of quality management. This information may affect the audit organization's consideration of the nature, timing, and extent of the monitoring activities.

**5.102** A peer review is not a substitute for all monitoring procedures. However, because the objective of a peer review is similar to that of inspection procedures, an audit organization may decide that a peer review conducted under standards established in this chapter may be a substitute for inspection procedures.

**5.103** The audit organization may consider threats to objectivity when designing the policies and procedures addressing the objectivity of the individuals performing the monitoring activities. Examples of threats to objectivity include when

- a. an individual who performs an inspection of an engagement was an engagement team member or the engagement quality reviewer for that engagement and

- b. an individual who performs another type of monitoring activity participated in designing, executing, or operating the response being monitored.

**5.104** Individuals are not precluded from performing monitoring activities, including inspections, of their own compliance with a system of quality management. However, such self-inspections may be less effective than compliance inspections by another qualified individual. When individuals inspect their own compliance with an audit organization's policies and procedures, the audit organization has a higher risk that noncompliance will not be detected or reported through monitoring activities. To effectively self-monitor for compliance, it is necessary that individuals be able to critically review their own performance, assess their own strengths and weaknesses, and maintain attitudes of continual improvement.

**Requirement: Evaluating Quality Management Findings and Identifying Deficiencies**

**5.105** The audit organization should evaluate findings concerning the system of quality management to determine whether deficiencies exist.

**Application Guidance: Evaluating Quality Management Findings and Identifying Deficiencies**

**5.106** A finding in relation to a system of quality management is information about the design, implementation, and operation of the system of quality management that has been accumulated through the performance of monitoring activities and from other relevant sources, which indicates that one or more deficiencies may exist.

**5.107** The audit organization accumulates findings from monitoring activities, inspections, and other relevant sources. Information that the audit organization accumulates from the monitoring activities, inspections, and other relevant sources may lead to observations about the audit organization's system of quality management, such as

- a. actions, behaviors, or conditions that have given rise to positive outcomes in the context of quality or the effectiveness of the system of quality management or

- b. similar circumstances in which no findings were noted (for example, engagements in which no findings were noted but the engagements have a similar nature to the engagements in which findings were noted).

**5.108** The information that the audit organization accumulates from the monitoring activities and other relevant sources may also lead to other observations that may be useful to the audit organization. Such information may assist the audit organization in investigating the underlying causes of identified deficiencies, indicate practices that it can support or apply more extensively (for example, across all engagements), or highlight opportunities for it to enhance its system of quality management. The results of the monitoring and remediation process provide information about the operation of the system of quality management that is relevant to the audit organization's quality management risk assessment process.

**5.109** A deficiency in the audit organization's system of quality management exists when

- a. a quality objective required to achieve the objective of the system of quality management is not established;
- b. a quality risk, or combination of quality risks, is not identified or properly assessed;
- c. a response, or combination of responses, does not reduce to an acceptably low level the likelihood of a related quality risk occurring because the responses are not properly designed, implemented, or operating effectively; or
- d. another aspect of the system of quality management is absent, or not properly designed, implemented, or operating effectively, such that a requirement of this chapter has not been addressed.

**5.110** The audit organization exercises professional judgment in determining whether findings, individually or in combination with other findings, give rise to a deficiency in the system of quality management. In making the judgment, the audit organization may take into account the relative importance of the findings in the context of the quality objectives, quality risks, responses, or other aspects of the system of quality management to which they relate. The audit organization's judgments may be affected by quantitative and qualitative factors relevant to the

findings. In some circumstances, the audit organization may deem it appropriate to obtain more information about the findings in order to determine whether a deficiency exists. Not all findings, including findings about specific engagements, will be a deficiency.

**5.111** Evaluating findings and identifying deficiencies and evaluating the severity and pervasiveness of identified deficiencies, including investigating the underlying causes of identified deficiencies, are part of an iterative process.

**Requirement: Evaluating Identified Quality Management Deficiencies**

**5.112** The audit organization should evaluate the severity and pervasiveness of identified deficiencies in the system of quality management by investigating their underlying causes and evaluating their effect, both individually and in the aggregate, on the system of quality management.

**Application Guidance: Evaluating Identified Quality Management Deficiencies**

**5.113** Factors the audit organization may consider in evaluating the severity and pervasiveness of an identified deficiency include the following:

- a. the nature of the identified deficiency, including the aspect of the audit organization's system of quality management to which the deficiency relates, and whether the deficiency is in the design, implementation, or operation of the system of quality management
- b. in the case of an identified deficiency related to a response, whether there are compensating responses to address the quality risk to which the response relates
- c. the underlying causes of the identified deficiency
- d. the frequency with which the matter giving rise to the identified deficiency occurred

- e. the magnitude of the identified deficiency, how quickly it occurred, and its duration and effect on the system of quality management

**5.114** The severity and pervasiveness of identified deficiencies affect the evaluation of the system of quality management that the senior-level official assigned responsibility and accountability for the system of quality management undertakes.

**5.115** The nature, timing, and extent of the procedures undertaken to understand the underlying causes of an identified deficiency may also be affected by the nature and circumstances of the audit organization, such as the following:

- a. The complexity and operating characteristics of the audit organization
- b. The size of the audit organization
- c. The geographical dispersion of the audit organization
- d. How the audit organization is structured or the extent to which the audit organization concentrates or centralizes its processes or activities

**Requirements: Responding to Identified Quality Management Deficiencies**

**5.116** The audit organization should design and implement remedial actions that respond to the results of the analysis of underlying causes to address identified deficiencies in the system of quality management.

**5.117** The audit organization should evaluate the remedial actions to determine whether they are effective in addressing the identified quality management deficiencies and their related underlying causes.

**5.118** If the audit organization's evaluation indicates that the remedial actions are not effective in addressing the quality management deficiencies, the audit organization should modify the remedial actions such that identified deficiencies and their related underlying causes are addressed.

*Quality Management Findings About a Particular Engagement*

**5.119** The audit organization should respond to circumstances when quality management findings indicate that there is an engagement for which

- a. required procedures were omitted during the performance of the engagement or
- b. the report issued may not comply with professional standards and applicable laws and regulations.

**Application Guidance: Responding to Identified Quality Management Deficiencies**

**5.120** The nature, timing, and extent of remedial actions may depend on a variety of factors, including

- a. the underlying causes;
- b. the severity and pervasiveness of the identified deficiency and therefore the urgency with which it needs to be addressed; and
- c. the effectiveness of the remedial actions in addressing the underlying causes, such as whether the audit organization needs

to implement more than one remedial action to effectively address the underlying causes, or needs to implement remedial actions as interim measures until it is able to implement more effective remedial actions.

**5.121** In some circumstances, the remedial action may include establishing additional quality objectives, or adding or modifying quality risks or responses, to address identified deficiencies.

*Quality Management Findings About a Particular Engagement*

**5.122** When quality management findings indicate that required procedures were omitted during the performance of an engagement or that the report may not comply with professional standards and laws and regulations, the audit organization could

- a. take action to comply with relevant professional standards and applicable laws and regulations or
- b. when the report may not comply with professional standards and applicable laws and regulations, take appropriate action, including considering whether to obtain legal advice.

**Requirements: Ongoing Communication Related to Monitoring and Remediation**

**5.123** The audit organization should communicate to appropriate personnel, including the senior-level official assigned responsibility and accountability for the system of quality management, and relevant engagement partner(s) or director(s), the following:

- a. a description of the monitoring activities performed;
- b. the identified deficiencies, along with information about their severity and pervasiveness; and
- c. the remedial actions to address identified deficiencies.

**5.124** The audit organization should communicate the matters described in paragraph 5.123 to engagement teams and others within the system of quality management to enable the audit organization and appropriate personnel to take prompt remedial action related to deficiencies in accordance with their responsibilities.

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**Application Guidance: Ongoing Communication Related to Monitoring and Remediation**

**5.125** Communications about the monitoring and remediation to the senior-level official assigned responsibility and accountability for the system of quality management may be ongoing or periodic.

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**Evaluating the System of Quality Management**

**Requirements: Evaluating the System of Quality Management**

**5.126** The senior-level official assigned responsibility and accountability for the audit organization’s system of quality management should evaluate the system of quality management at least annually.

**5.127** Based on the evaluation in paragraph 5.126, the senior-level official assigned responsibility and accountability for the audit organization’s system of quality management should conclude one of the following:

- a. The system of quality management provides the audit organization with reasonable assurance that the objective of the system of quality management is being achieved.
- b. Except for matters related to identified deficiencies that have a severe but not pervasive effect on its design, implementation, and operation, the system of quality management provides the audit organization with reasonable assurance that the objective of the system of quality management is being achieved.
- c. The system of quality management does not provide the audit organization with reasonable assurance that the objective of the system of quality management is being achieved.

**Application Guidance: Evaluating the System of Quality Management**

**5.128** In concluding on the system of quality management, the senior-level official assigned responsibility and accountability for the system of quality management may consider

- a. the audit organization’s quality management risk assessment process, including its quality objectives, quality risks, and a

description of the responses and the extent to which the audit organization's responses address the quality risks and

- b. the results of the monitoring and remediation process, including
  - (1) the severity and pervasiveness of identified deficiencies and the effect on the achievement of the objective of the system of quality management;
  - (2) whether remedial actions have been designed and implemented by the audit organization and whether the remedial actions taken up to the time of the evaluation are effective; and
  - (3) whether the effect of identified deficiencies on the system of quality management have been appropriately corrected, such as whether further actions have been taken in accordance with paragraph 5.119.

**5.129** There may be circumstances when identified deficiencies that are severe (including those that are severe and pervasive) have been appropriately remediated and their effect corrected at the point in time of the evaluation. In such cases, the senior-level official assigned responsibility and accountability for the system of quality management may conclude that the system of quality management provides the audit organization with reasonable assurance that the objective of the system of quality management is being achieved.

Documentation

**Requirements: Documentation**

**5.130** The audit organization should document its system of quality management and communicate this information to its personnel in a manner sufficient to

- a. support personnel’s consistent understanding of the system of quality management, including an understanding of their roles and responsibilities with respect to the system of quality management and performing engagements;
- b. support the consistent implementation and operation of the responses to address quality risks; and
- c. provide evidence of the design, implementation, and operation of the responses to address quality risks to support the evaluation of the system of quality management by the senior-level official assigned responsibility and accountability for it.

**5.131** The audit organization should include the following in its documentation of its system of quality management:

- a. Identification of the
  - (1) senior-level official assigned responsibility and accountability for the system of quality management, as discussed in paragraph 5.13a, and
  - (2) individual or individuals assigned operational responsibility for the system of quality management, as discussed in paragraph 5.13b.
- b. The audit organization’s quality management risk assessment, including its quality objectives, quality risks, and a description of the responses and how the audit organization’s responses address the quality risks, as discussed in paragraphs 5.19 through 5.23.
- c. Regarding the monitoring and remediation process,
  - (1) evidence of the monitoring activities performed, as discussed in paragraph 5.87;
  - (2) the evaluation of findings, and identified deficiencies and their related underlying causes, as discussed in paragraphs 5.105 and 5.112;
  - (3) remedial actions to address identified deficiencies and

the evaluation of the design and implementation of such remedial actions, as discussed in paragraphs 5.116 and 5.117; and

(4) communications about monitoring and remediation, as discussed in paragraphs 5.123 and 5.124.

d. The basis for the conclusion reached pursuant to paragraph 5.127.

**5.132** The audit organization should establish a period of time for document retention for the system of quality management that is sufficient to enable the audit organization and its peer reviewer to monitor the design, implementation, and operation of the system of quality management or for a longer period if required by law or regulation.

### Application Guidance: Documentation

**5.133** An audit organization's judgments about the form, content, and extent of documentation may be affected by factors related to the nature and complexity of the audit organization and engagements performed. Areas of greater quality risk, matters involving more complex judgments, and changes to aspects of the system of quality management may have a greater effect on the form, content, and extent of documentation.

**5.134** In some instances, an external oversight authority may establish additional documentation requirements, either formally or informally, as a result of inspection findings or external peer review results or for reasons that the external oversight authority deems necessary.

**5.135** The audit organization is not required to document the consideration of every condition, event, circumstance, action, or inaction for each quality objective or each risk that may give rise to a quality risk.

**5.136** In documenting the quality risks and how its responses address the quality risks, the audit organization may document the assessments given to each quality risk (that is, the considered occurrence and effect on the achievement of one or more quality objectives) to support the consistent implementation and operation of the responses.

## Engagement Quality Reviews

**5.137** This section establishes requirements for audit organizations that elect to conduct engagement quality reviews as a response to address quality risks. An engagement quality review is an objective evaluation of the engagement team's significant judgments and the conclusions reached thereon.

**5.138** The audit organization may determine that an engagement quality review is an appropriate response to address one or more quality risks applicable to all GAGAS engagements, specific types of GAGAS engagements, or specifically identified GAGAS engagements. The audit organization may determine that engagement quality reviews are not necessary to address quality risks.

### **Requirement: Eligibility to Serve as an Engagement Quality Reviewer**

**5.139** An audit organization using engagement quality reviews should establish policies and procedures that set forth the eligibility criteria to be appointed as an engagement quality reviewer or an assistant to an engagement quality reviewer. The policies and procedures should require that any engagement quality reviewer and any assistants to an engagement quality reviewer not be members of the engagement team and

- a. have the competence and capabilities, including sufficient time, and the appropriate authority to perform the engagement quality review and
- b. comply with applicable legal and ethical requirements, including those addressing threats to the objectivity of the engagement quality reviewer.

### **Application Guidance: Eligibility to Serve as an Engagement Quality Reviewer**

**5.140** The audit organization may consider threats to objectivity created by an individual being appointed as the engagement quality reviewer after having been previously assigned to the engagement. In recurring engagements, the matters on which significant judgments are made often do not vary. Significant judgments made in prior engagements may continue to affect the engagement team's judgments in subsequent engagements. Therefore, the ability of an engagement quality reviewer to

perform an objective evaluation of significant judgments may be affected when the individual was previously involved with those judgments. In such circumstances, it is important that appropriate safeguards are put in place to reduce threats to objectivity to an acceptable level.

**Requirement: Impairment of Engagement Quality Reviewer's Eligibility to Perform the Engagement Quality Review**

**5.141** An audit organization using engagement quality reviews should establish policies and procedures that address circumstances in which the engagement quality reviewer's eligibility to perform the engagement quality review is impaired and the appropriate actions to be taken by the audit organization. The audit organization should include in such policies and procedures notification to appropriate individuals within the audit organization if the engagement quality reviewer becomes aware of circumstances that impair the engagement quality reviewer's eligibility.

**Requirements: Performance of the Engagement Quality Review**

**5.142** An audit organization using engagement quality reviews should establish policies and procedures regarding the performance of the engagement quality review that address the following:

- a. The engagement quality reviewer's responsibilities to perform procedures at appropriate points in time during the engagement to provide an appropriate basis for an objective evaluation of the engagement team's significant judgments and the conclusions reached thereon.
- b. The responsibilities of the engagement partner or director in relation to the engagement quality review, including that
  - (1) the engagement partner or director is precluded from releasing the audit report until after having received notification from the engagement quality reviewer that the engagement quality review is complete and
  - (2) documentation is provided to the engagement quality reviewer to permit completion of the engagement quality review.
- c. Circumstances when the nature and extent of engagement team discussions with the engagement quality reviewer about a

significant judgment give rise to a threat to the engagement quality reviewer's objectivity and appropriate actions to take in these circumstances.

**5.143** In performing an engagement quality review, the engagement quality reviewer should do the following:

- a. Read and obtain an understanding about information communicated to the engagement quality reviewer by the
  - (1) engagement team regarding the nature and circumstances of the engagement and the entity and
  - (2) audit organization related to the organization's monitoring and remediation process, in particular, identified deficiencies that may relate to, or affect, the areas involving significant judgments made by the engagement team.
- b. Discuss with the engagement partner or director and, if applicable, other members of the engagement team, significant matters and significant judgments made in planning, performing, and reporting on the engagement.
- c. Based on the information obtained in paragraph 5.143 (a) and (b), review selected engagement documentation relating to the engagement team's significant judgments and evaluate the following:
  - (1) The basis for making those significant judgments, including, when applicable to the type of engagement, the engagement team's exercise of professional skepticism
  - (2) Whether the engagement documentation supports the conclusions reached
  - (3) Whether the conclusions reached are appropriate.
- d. Evaluate whether appropriate consultation has taken place on difficult or contentious matters or matters involving differences of opinion and the conclusions arising from those consultations.
- e. For audits of financial statements, evaluate the basis for:
  - (1) the engagement partner's or director's determination that the engagement partner's or director's involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner or

director has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement and

- (2) the engagement partner's or director's determination that independence and ethical requirements have been fulfilled.

f. Review

- (1) for audits of financial statements, the financial statements and the auditor's report thereon, including, if applicable, the description of the key audit matters;
- (2) for reviews of financial statements or financial information, the financial statements or financial information and the audit report thereon; or
- (3) for other engagements, the audit report, and when applicable, the subject matter information.

**5.144** If an engagement quality reviewer has concerns that the engagement team's significant judgments or conclusions are not appropriate, the engagement quality reviewer should notify the engagement partner or director. If such concerns are not resolved to the engagement quality reviewer's satisfaction, the engagement quality reviewer should notify appropriate individuals in the audit organization that the engagement quality review cannot be completed.

**Application Guidance: Performance of the Engagement Quality Review**

**5.145** Frequent communication between the engagement team and engagement quality reviewer throughout the engagement may facilitate an effective and timely engagement quality review. However, a threat to the objectivity of the engagement quality reviewer may be created if the engagement quality reviewer is, or may be perceived to be, making decisions on behalf of the engagement team.

**5.146** The audit organization's policies and procedures may specify the nature, timing, and extent of the procedures that the engagement quality reviewer performs and also may emphasize the importance of the

engagement quality reviewer exercising professional judgment in performing the review.

**5.147** The audit organization's policies and procedures may specify the individual or individuals in the audit organization to be notified if the engagement quality reviewer has unresolved concerns that the engagement team's significant judgments or conclusions are not appropriate. With respect to such unresolved concerns, the audit organization's policies and procedures may also require consultation within or outside the audit organization.

**Requirement: Completion of the Engagement Quality Review**

**5.148** When an engagement quality review is performed, the engagement quality reviewer should notify the engagement partner or director when the engagement quality review is complete.

**Requirement: Engagement Quality Review Documentation**

**5.149** When an engagement quality review is performed, the engagement quality reviewer should document

- a. the names of the engagement quality reviewer and individuals who assisted with the engagement quality review;
- b. that the procedures required by the audit organization's policies on engagement quality reviews have been performed;
- c. that the engagement quality reviewer is not aware of any unresolved matters that would cause the engagement quality reviewer to believe that the significant judgments that the engagement team made and the conclusions it reached were not appropriate;
- d. the notifications required in accordance with paragraphs 5.144 and 5.148; and
- e. the date of completion of the engagement quality review.

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**Application Guidance: Engagement Quality Review Documentation**

**5.150** The form, content, and extent of the documentation of the engagement quality review may vary based on factors such as

- a. the nature and complexity of the engagement;
- b. the nature of the entity;
- c. the nature and complexity of the matters subject to the engagement quality review; or
- d. the extent of the engagement documentation reviewed.

Note: No changes to the External Peer Review section are proposed and therefore that section is removed from the exposure draft. The final revision of *Government Auditing Standards* will include conforming amendments to change references to “quality control” to “quality management” and to update affected cross-references.

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# Chapter 6: Standards for Financial Audits

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## Additional GAGAS Requirements for Reporting on Financial Audits

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### Reporting the Auditor's Compliance with GAGAS

**Requirement: Reporting the Auditors' Compliance with GAGAS**

**6.36** When auditors comply with all applicable GAGAS requirements, they should include a statement in the audit report that they conducted the audit in accordance with GAGAS.<sup>1</sup>

**Application Guidance: Reporting the Auditors' Compliance with GAGAS**

**6.37** Because GAGAS incorporates by reference the AICPA's financial audit standards, GAGAS does not require auditors to cite compliance with AICPA standards when citing compliance with GAGAS. GAGAS does not prohibit auditors from issuing a separate report conforming only to the requirements of the AICPA or other standards.<sup>2</sup>

**6.38** When disclaiming an opinion on a financial audit, auditors may revise the statement that the auditor was engaged to audit the financial statements.<sup>3</sup> For example, auditors may state that they were engaged to conduct the audit in accordance with GAGAS or that the auditors' work was conducted in accordance with GAGAS, depending on whether the use of GAGAS is required or voluntary. Determining how to revise this statement is a matter of professional judgment.

**6.39** *Although there is no requirement to communicate key audit matters, auditors may be required to communicate key audit matters for audits of*

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<sup>1</sup>See paras. 2.16 through 2.19 for information on the GAGAS compliance statement.

<sup>2</sup>See AU-C section 700, *Forming an Opinion and Reporting on Financial Statements* (AICPA, Professional Standards).

<sup>3</sup>See AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report* (AICPA, Professional Standards).

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*government entities and entities that receive government financial assistance if (1) engaged to do so by management or those charged with governance, or (2) required by law or regulation.<sup>4, 5</sup>*

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<sup>4</sup>See AU-C section 701, *Communicating Key Audit Matters in the Independent Auditor's Report* (AICPA, *Professional Standards*).

<sup>5</sup>See para. 1.04 for additional information on those charged with governance.

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# Acknowledgments

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## Comptroller General's Advisory Council on Government Auditing Standards (2022- 2026)

Erica Forhan, Chair  
Moss Adams LLP

David Berry  
National Labor Relations Board, Office of the Inspector General

Irving L. Dennis  
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Penn State Harrisburg

Nick Hart  
Data Foundation

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Smithsonian Institution, Office of the Inspector General

Lindsey D. Oakley  
FORVIS, LLP

Timothy M. O'Brien  
City and County of Denver

Kerrey M. Olden  
KPMG LLP

April Renfro  
State of Idaho, Legislative Services Office

Doug A. Ringler  
Michigan Office of the Auditor General

Brianna Schletz  
U.S. Election Assistance Commission, Office of the Inspector General

Corrie Stokes  
City of Austin

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**Acknowledgments**

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Lorin Venable  
U.S. Department of Defense, Office of the Inspector General

Theresa Watson  
City of Houston

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**GAO Project Team**

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**Staff  
Acknowledgments**

In addition to the project team named above, also contributing were  
Matthew Gardner, Joanne Howard, Jason Kirwan, Kristen Kociolek, Tuan  
Lam, Jean Mathew, Brian Paige, and Kimberly Y. Young.

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