

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

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

5.57 Reporting of identified deficiencies to individuals other than the relevant engagement partner or director need not include identifying the specific engagements concerned, unless such identification is necessary for individuals other than the engagement partner or director to properly discharge their responsibilities.

5.58 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.

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

- a. monitoring procedures, including the procedure for selecting completed engagements to be inspected;
- b. a record of the evaluation of the following:

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

External Peer Review

Requirements: General

5.60 Each audit organization conducting engagements in accordance with GAGAS must obtain an external peer review conducted by reviewers independent of the audit organization being reviewed. The peer review should be sufficient in scope to provide a reasonable basis for determining whether, for the period under review, (1) the reviewed audit organization's system of quality control was suitably designed and (2) the organization is complying with its quality control system so that it has reasonable assurance that it is performing and reporting in conformity with professional standards and applicable legal and regulatory requirements in all material respects.

5.61 Audit organizations affiliated with one of the following recognized organizations should comply with the respective organization's peer review requirements and the requirements listed throughout paragraphs 5.66 through 5.80.

- a. American Institute of Certified Public Accountants

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

5.62 Any audit organization not affiliated with an organization listed in paragraph 5.61 should meet the minimum GAGAS peer review requirements throughout paragraphs 5.66 through 5.94.

Application Guidance: General

5.63 Each audit organization has discretion in selecting and accepting its peer review teams. Auditors in governments or jurisdictions without access to established peer review programs may engage other auditors, including public accounting firms, to conduct their peer reviews. If access to an established peer review program is not available, auditors may organize regional programs with other auditors.

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

5.65 Some audit organizations may be subject to or required to follow a peer review program of a recognized organization. Other audit organizations may follow a specific peer review program voluntarily. In instances where the audit organization follows a recognized organization's peer review program voluntarily, the use of such a peer review program means compliance with the recognized organization's entire peer review process, including, where applicable, standards for administering, performing, and reporting on peer reviews, oversight procedures, training, and related guidance materials.

Requirements: Assessment of Peer Review Risk

5.66 The peer review team should perform an assessment of peer review risk to help determine the number and types of engagements to

select for review.

5.67 Based on the risk assessment, the peer review team should select engagements that provide a reasonable cross section of all types of work subject to the reviewed audit organization's quality control system, including one or more engagements conducted in accordance with GAGAS.

Application Guidance: Assessment of Peer Review Risk

5.68 Peer review risk is the risk that the review team

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

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

5.70 A peer review is designed to test significant risk areas where it is possible that engagements are not being conducted, reported on, or both in conformity with professional standards and applicable legal and regulatory requirements in all material respects. A peer review is not designed to test every engagement, compliance with every professional

standard, or every detailed component of the audit organization's system of quality control.

5.71 Examples of the factors that may be considered when performing an assessment of risk for selecting engagements for peer review include

- a. scope of the engagements, including size of the audited entity or engagements covering multiple locations;
- b. functional area or type of government program;
- c. types of engagements conducted, including the extent of nonaudit services provided to audited entities;
- d. personnel (including use of new personnel or personnel not routinely assigned the types of engagements conducted);
- e. initial engagements;
- f. familiarity resulting from a long-standing relationship with the audited entity;
- g. political sensitivity of the engagements;
- h. budget constraints faced by the audit organization that could negatively affect engagement quality;
- i. results of the peer review team's review of the design of system of quality control;
- j. results of the audit organization's monitoring process; and
- k. overall risk tolerance within the audit organization that could negatively affect engagement quality.

Requirements: Peer Review Report Ratings

5.72 The peer review team should use professional judgment in deciding on the type of peer review rating to issue; the ratings are as follows:

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

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

5.74 The peer review team should aggregate and systematically evaluate any observed matters (circumstances that warrant further consideration by the peer review team) and document its evaluation.³⁷ The peer review team should perform its evaluation and issue report

³⁷See fig. 3 for a flowchart on developing peer review communications for observed matters in accordance with GAGAS.

ratings as follows:

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

Application Guidance: Peer Review Report Ratings

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

5.76 Significant deficiencies are one or more deficiencies that the peer review team concludes result from a condition in the audit organization's system of quality control or compliance with that system such that the system taken as a whole does not provide reasonable assurance of performing, reporting, or both in conformity with professional standards and applicable legal and regulatory requirements.

Requirements: Availability of the Peer Review Report to the Public

5.77 An external audit organization should make its most recent peer

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

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

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

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

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

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

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

- a. Explanation of the peer review process.
- b. Description of the audit organization's system of quality control.

- c. Explanation of the relationship of the peer review results to the audited organization's work.
- d. If a peer review report is issued with a rating of pass with deficiencies or fail, explanation of the reviewed audit organization's plan for improving quality controls and the status of the improvements.

Additional Requirements for Audit Organizations Not Affiliated with Recognized Organizations

Requirement: Peer Review Scope

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

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

Application Guidance: Peer Review Scope

5.83 Review of documentation related to terminated engagements can provide information on the audit organization's response to threats to

independence. For example, the documentation may include information on whether an engagement was terminated as a result of an undue influence from outside the audit organization.

Requirement: Peer Review Intervals

5.84 An audit organization not already subject to a peer review requirement should obtain an external peer review at least once every 3 years. The audit organization should obtain its first peer review covering a review period ending no later than 3 years from the date an audit organization begins its first engagement in accordance with GAGAS.

Application Guidance: Peer Review Intervals

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

Requirement: Written Agreement for Peer Review

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

Application Guidance: Written Agreement for Peer Review

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

- a. scope of the peer review;
- b. staffing and time frame;
- c. compensation for conducting the peer review, if applicable;

- d. preliminary findings, if applicable;
- e. reporting results;
- f. administrative matters; and
- g. access to audit documentation.

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

Requirement: Peer Review Team

5.89 The peer review team should meet the following criteria:

- a. The review team collectively has adequate professional competence and knowledge of GAGAS and government auditing.
- b. The organization conducting the peer review and individual review team members are independent (as defined in GAGAS) of the audit organization being reviewed, its personnel, and the engagements selected for the peer review.³⁸
- c. The review team collectively has sufficient knowledge to conduct a peer review.

Application Guidance: Peer Review Team

5.90 Peer review knowledge and professional competence may be obtained from on-the-job training, training courses, or a combination of both. Having individuals on the peer review team with prior experience on a peer review or internal inspection team is desirable.

Requirement: Report Content

³⁸See paras. 3.18 through 3.108 for discussion of independence.

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

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

Application Guidance: Report Content

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

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

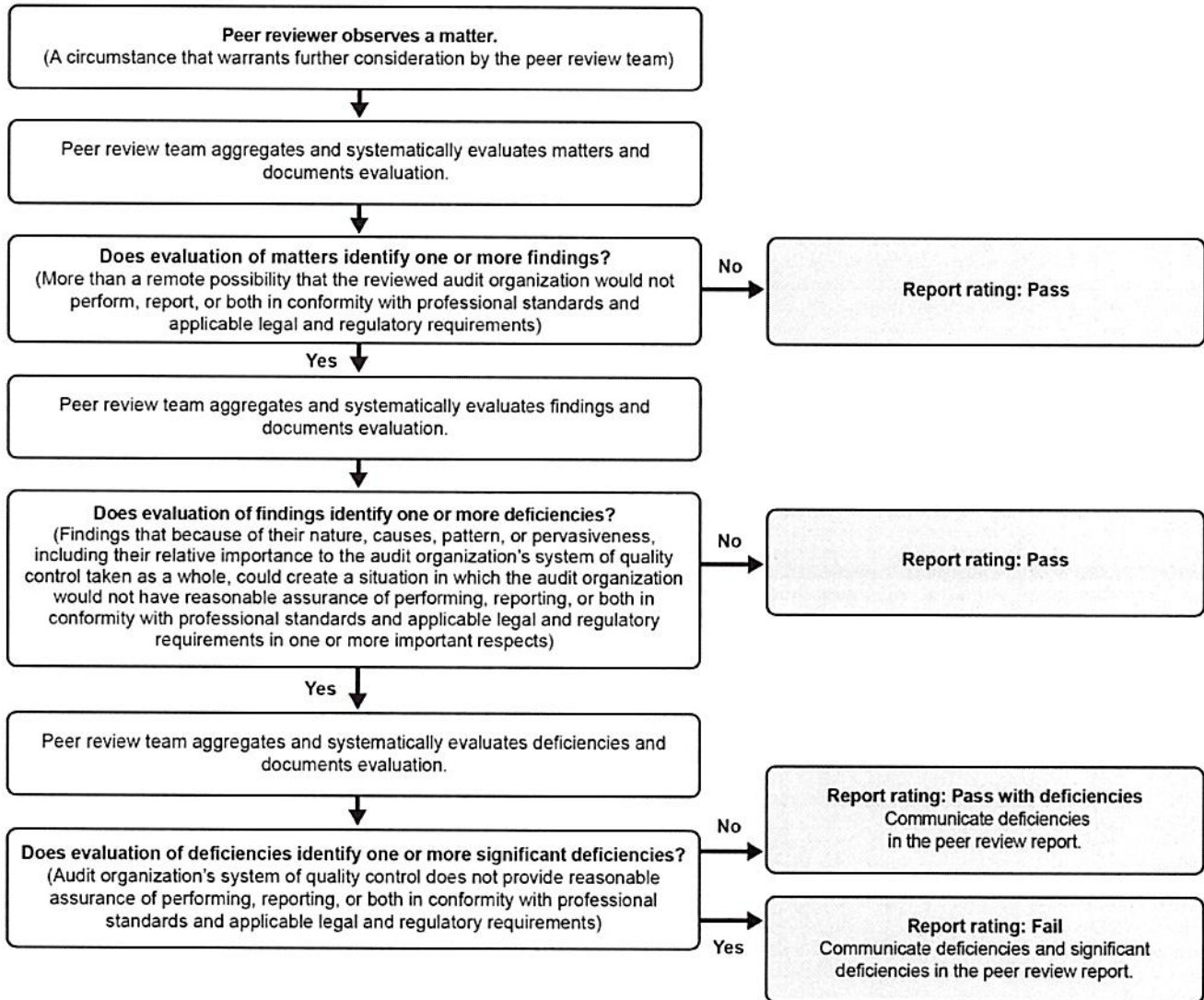
5.93 If the reviewed audit organization receives a report with a peer review rating of pass with deficiencies or fail, the reviewed audit organization should respond in writing to the deficiencies or significant deficiencies and related recommendations identified in the report.

5.94 With respect to each deficiency or significant deficiency in the report, the reviewed audit organization should describe in its letter of response the corrective actions already taken, target dates for planned corrective actions, or both.

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

5.95 When an audit organization receives a peer review rating of pass with deficiencies or fail that relates to its GAGAS engagements, critical evaluation of the design and implementation of the system of quality control is a factor in determining the audit organization's ability to accept and perform future GAGAS engagements.

Figure 3: Developing Peer Review Communications for Observed Matters in Accordance with Generally Accepted Government Auditing Standards



Source: GAO. | GAO-21-368G

Text of Figure 3: Developing Peer Review Communications for Observed Matters in Accordance with Generally Accepted Government Auditing Standards

Steps for evaluating Developing Peer Review Communications for Observed Matters in Accordance with Generally Accepted Government Auditing Standards

- 1) Peer reviewer observes a matter. (A circumstance that warrants further consideration by the peer review team)
- 2) Peer review team aggregates and systematically evaluates matters and documents evaluation.
- 3) Does evaluation of matters identify one or more findings? (More than a remote possibility that the reviewed audit organization would not perform, report, or both in conformity with professional standards and applicable legal and regulatory requirements)
 - a) No – **Report rating: Pass**
- 4) Yes – Peer review team aggregates and systematically evaluates findings and documents evaluation.
- 5) Does evaluation of finding identify one or more deficiencies? (Findings that because of their nature, causes, pattern, or pervasiveness, including their relative importance to the audit organization's system of quality control taken as a whole, could create a situation in which the audit organization would not have reasonable assurance of performing, reporting, or both in conformity with professional standards and applicable legal and regulatory requirements in one or more important respects)
 - a) No – **Report rating: Pass**
- 6) Yes – Peer review team aggregates and systemically evaluates deficiencies and documents evaluation
- 7) Does evaluation of deficiencies identify one or more significant deficiencies? (Audit organization's system of quality control does not provided reasonable assurance of performing, reporting, or both in conformity with professional standards and applicable legal and regulatory requirements)
 - a) No – **Report rating: Pass with deficiencies. Communicate deficiencies in the peer review report.**

Yes – Report rating: Fail. Communicate deficiencies and significant deficiencies in the peer review report

Chapter 6: Standards for Financial Audits

6.01 This chapter contains requirements and guidance for conducting and reporting on financial audits conducted in accordance with generally accepted government auditing standards (GAGAS). GAGAS incorporates by reference the American Institute of Certified Public Accountants' (AICPA) Statements on Auditing Standards (SAS).³⁹ All sections of the SAS are incorporated, including the introduction, objectives, definitions, requirements, and application material. GAGAS does not incorporate the AICPA Code of Professional Conduct by reference but recognizes that certain certified public accountants (CPA) may use or may be required to use the code in conjunction with GAGAS.⁴⁰ For financial audits conducted in accordance with GAGAS, the requirements and guidance in the incorporated SAS and this chapter apply. The requirements and guidance contained in chapters 1 through 5 also apply.

Additional GAGAS Requirements for Conducting Financial Audits

Compliance with Standards

Requirement: Compliance with Standards

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

³⁹See para. 2.13 and the AICPA *Codification of Statements on Auditing Standards (AU-C)* for additional discussion of the relationship between GAGAS and other professional standards.

⁴⁰See para. 2.14 for a discussion of the AICPA Code of Professional Conduct.

Application Guidance: Compliance with Standards

6.03 Standards used in conjunction with GAGAS require the auditors to apply the concept of materiality appropriately in planning and performing the audit.⁴¹ Additional considerations may apply to GAGAS engagements that concern government entities or entities that receive government awards. For example, for engagements conducted in accordance with GAGAS, auditors may find it appropriate to use lower materiality levels than those used in non-GAGAS audits because of the public accountability of government entities and entities receiving government funding, various legal and regulatory requirements, and the visibility and sensitivity of government programs.

Licensing and Certification

Requirements: Licensing and Certification

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

6.05 Auditors engaged to conduct financial audits of entities operating outside of the United States who do not work for a government audit organization should meet the qualifications indicated in paragraph 6.04, have certifications that meet all applicable national and international standards and serve in their respective countries as the functional equivalent of CPAs in the United States, or work for nongovernment audit organizations that are the functional equivalent of licensed certified public accounting firms in the United States.

⁴¹See AU-C section 320, *Materiality in Planning and Performing an Audit* (AICPA, *Professional Standards*).

Auditor Communication

Requirements: Auditor Communication

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

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

Application Guidance: Auditor Communication

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

6.09 For some matters, early communication to management or those charged with governance may be important because of the relative significance and the urgency for corrective follow-up action.⁴² Further, early communication is important to allow management to take prompt corrective action to prevent further occurrences when a control deficiency results in identified or suspected noncompliance with provisions of laws, regulations, contracts, and grant agreements or identified or suspected instances of fraud. When a deficiency is communicated early, the reporting requirements and application guidance in paragraphs 6.39 through 6.49 still apply.

6.10 Because the governance structures of government entities and organizations can vary widely, it may not always be clearly evident who is charged with key governance functions. The process for identifying those charged with governance includes evaluating the organizational structure

⁴²See AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*).

for directing and controlling operations to achieve the audited entity's objectives and how the audited entity delegates authority and establishes accountability for management.

Results of Previous Engagements

Requirement: Results of Previous Engagements

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

Investigations or Legal Proceedings

Requirement: Investigations or Legal Proceedings

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

Application Guidance: Investigations or Legal Proceedings

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

6.14 Avoiding interference with investigations or legal proceedings is important in pursuing indications of fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements. In some

cases, it may be appropriate for the auditors to work with investigators or legal authorities or to withdraw from or defer further work on the engagement or a portion of the engagement to avoid interfering with an ongoing investigation or legal proceeding.

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

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

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

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

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

⁴³See AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* (AICPA, *Professional Standards*).

Findings

Requirements: Findings

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

6.18 Auditors should consider internal control deficiencies in their evaluation of identified findings when developing the cause element of the identified findings.

Application Guidance: Findings

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

6.20 Given the concept of accountability for use of public resources and government authority, evaluating internal control in a government environment may also include considering internal control deficiencies that result in waste or abuse. Because the determination of waste and abuse is subjective, auditors are not required to perform specific procedures to detect waste or abuse in financial audits. However, auditors may consider whether and how to communicate such matters if they become aware of them. Auditors may also discover that waste or abuse are indicative of fraud or noncompliance with provisions of laws, regulations, contracts, and grant agreements.

6.21 Waste is the act of using or expending resources carelessly, extravagantly, or to no purpose. Importantly, waste can include activities that do not include abuse and does not necessarily involve a violation of law. Rather, waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight.

6.22 The following are examples of waste, depending on the facts and circumstances:

- a. Making travel choices that are contrary to existing travel policies or are unnecessarily extravagant or expensive.

- b. Making procurement or vendor selections that are contrary to existing policies or are unnecessarily extravagant or expensive.

6.23 Abuse is behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances, but excludes fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate.

6.24 The following are examples of abuse, depending on the facts and circumstances:

- a. Creating unneeded overtime.
- b. Requesting staff to perform personal errands or work tasks for a supervisor or manager.
- c. Misusing the official's position for personal gain (including actions that could be perceived by an objective third party with knowledge of the relevant information as improperly benefiting an official's personal financial interests or those of an immediate or close family member; a general partner; an organization for which the official serves as an officer, director, trustee, or employee; or an organization with which the official is negotiating concerning future employment).

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

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

6.27 Cause: The cause is the factor or factors responsible for the difference between the condition and the criteria, and may also serve as a

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

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

6.29 Regardless of the type of finding identified, the cause of a finding may relate to one or more underlying internal control deficiencies. Depending on the magnitude of impact, likelihood of occurrence, and nature of the deficiency, the deficiency could be a significant deficiency or material weakness in a financial audit.⁴⁴

6.30 Considering internal control in the context of a comprehensive internal control framework, such as *Standards for Internal Control in the Federal Government* or *Internal Control—Integrated Framework*,⁴⁵ can help auditors to determine whether underlying internal control deficiencies exist as the root cause of findings. Identifying these deficiencies can help provide the basis for developing meaningful recommendations for corrective actions.

⁴⁴See AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*).

⁴⁵Para. .A16 of AU-C section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements* (AICPA, *Professional Standards*) indicates that the Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control—Integrated Framework* and *Standards for Internal Control in the Federal Government* (GAO-14-704G) provide suitable and available criteria against which management may evaluate and report on the effectiveness of the entity's internal control over financial reporting. *Standards for Internal Control in the Federal Government* may be adopted by entities beyond those federal entities for which it is legally required, such as state, local, and quasi-governmental entities, as well as other federal entities and not-for-profit organizations, as a framework for an internal control system.

Audit Documentation

Requirements: Audit Documentation

6.31 Auditors should document supervisory review, before the report release date, of the evidence that supports the findings and conclusions contained in the audit report.

6.32 Auditors should document any departures from the GAGAS requirements and the effect on the audit and on the auditors' conclusions when the audit is not in compliance with applicable GAGAS requirements because of law, regulation, scope limitations, restrictions on access to records, or other issues affecting the audit.

Application Guidance: Audit Documentation

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

Availability of Individuals and Documentation

Requirement: Availability of Individuals and Documentation

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

Application Guidance: Availability of Individuals and Documentation

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

Additional GAGAS Requirements for Reporting on Financial Audits

Reporting the Auditors' 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.⁴⁶

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 the AICPA standards when citing compliance with GAGAS. GAGAS does not prohibit auditors from issuing a separate report conforming only to the requirements of the AICPA or other standards.⁴⁷

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.⁴⁸ 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.

⁴⁶See paras. 2.16 through 2.19 for information on the GAGAS compliance statement.

⁴⁷See AU-C section 700, *Forming an Opinion and Reporting on Financial Statements* (AICPA, *Professional Standards*).

⁴⁸See AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report* (AICPA, *Professional Standards*).

Reporting on Internal Control; Compliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements; and Instances of Fraud

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

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

6.40 When providing an opinion or a disclaimer on financial statements, auditors should report as findings any significant deficiencies or material weaknesses in internal control over financial reporting that the auditors identified based on the engagement work performed.

6.41 Auditors should include in their report on internal control or compliance the relevant information about noncompliance and fraud when auditors, based on sufficient, appropriate evidence, identify or suspect

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

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

laws, regulations, contracts, and grant agreements.

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

6.44 Auditors should communicate in writing to audited entity officials when

- a. identified or suspected noncompliance with provisions of laws, regulations, contracts, or grant agreements comes to the auditor's attention during the course of an audit that has an effect on the financial statements or other financial data significant to the audit objectives that is less than material but warrants the attention of those charged with governance or
- b. the auditor has obtained evidence of identified or suspected instances of fraud that have an effect on the financial statements or other financial data significant to the audit objectives that are less than material but warrant the attention of those charged with governance.

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

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

significant deficiencies and material weaknesses to users of financial statements other than those charged with governance.

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

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

6.48 When identified or suspected noncompliance with provisions of laws, regulations, contracts, or grant agreements that does not warrant the attention of those charged with governance comes to the auditor's attention during the course of the audit, the auditors' determination of how to communicate such instances to audited entity officials is a matter of professional judgment. When identified or suspected noncompliance with provisions of laws, regulations, contracts, or grant agreements is clearly inconsequential, the auditors' determination of whether and how to communicate such instances to audited entity officials is a matter of professional judgment.

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

Presenting Findings in the Audit Report

Requirements: Presenting Findings in the Audit Report
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6.50 When presenting findings, auditors should develop the elements
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of the findings to the extent necessary to assist management or oversight officials of the audited entity in understanding the need for corrective action.

6.51 Auditors should place their findings in perspective by describing the nature and extent of the issues being reported and the extent of the work performed that resulted in the finding. To give the reader a basis for judging the prevalence and consequences of these findings, auditors should, as appropriate, relate the instances identified to the population or the number of cases examined and quantify the results in terms of dollar value or other measures. If the results cannot be projected, auditors should limit their conclusions appropriately.

Application Guidance: Presenting Findings in the Audit Report

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

Reporting Findings Directly to Parties outside the Audited Entity

Requirements: Reporting Findings Directly to Parties outside the Audited Entity

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

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

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

6.54 Auditors should comply with the requirements in paragraph 6.53 even if they have resigned or been dismissed from the audit prior to its completion.

6.55 Auditors should obtain sufficient, appropriate evidence, such as confirmation from outside parties, to corroborate representations by management of the audited entity that it has reported audit findings in accordance with provisions of laws, regulations, or funding agreements. When auditors are unable to do so, they should report such information directly as discussed in paragraphs 6.53 and 6.54.

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

6.56 The reporting in paragraph 6.53 is in addition to any legal requirements to report such information directly to parties outside the audited entity.

Obtaining and Reporting the Views of Responsible Officials

Requirements: Obtaining and Reporting the Views of Responsible Officials

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

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

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

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

Application Guidance: Obtaining and Reporting the Views of Responsible Officials

6.61 Providing a draft report with findings for review and comment by responsible officials of the audited entity and others helps the auditors develop a report that is fair, complete, and objective. Including the views of responsible officials results in a report that presents not only the auditors' findings, conclusions, and recommendations but also the perspectives of the audited entity's responsible officials and the corrective actions they plan to take. Obtaining the comments in writing is preferred, but oral comments are acceptable. In cases in which the audited entity provides technical comments in addition to its written or oral comments on the report, auditors may disclose in the report that such comments were received. Technical comments address points of fact or are editorial in nature and do not address substantive issues, such as methodology, findings, conclusions, or recommendations.

6.62 Obtaining oral comments may be appropriate when, for example, there is a reporting date critical to meeting a user's needs; auditors have worked closely with the responsible officials throughout the engagement,

and the parties are familiar with the findings and issues addressed in the draft report; or the auditors do not expect major disagreements with findings, conclusions, or recommendations in the draft report or major controversies with regard to the issues discussed in the draft report.

Reporting Confidential or Sensitive Information

Requirements: Reporting Confidential or Sensitive Information

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

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

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

Application Guidance: Reporting Confidential or Sensitive Information

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

6.67 Certain information may be classified or may otherwise be prohibited from general disclosure by federal, state, or local laws or regulations. In such circumstances, auditors may issue a separate, classified, or limited

use report containing such information and distribute the report only to persons authorized by law or regulation to receive it.

6.68 Additional circumstances associated with public safety, privacy, or security concerns could also justify the exclusion of certain information from a publicly available or widely distributed report. For example, detailed information related to computer security for a particular program may be excluded from publicly available reports because of the potential damage that misuse of this information could cause. In such circumstances, auditors may issue a limited use report containing such information and distribute the report only to those parties responsible for acting on the auditors' recommendations. In some instances, it may be appropriate to issue both a publicly available report with the sensitive information excluded and a limited use report. The auditors may consult with legal counsel regarding any requirements or other circumstances that may necessitate omitting certain information. Considering the broad public interest in the program or activity under audit assists auditors when deciding whether to exclude certain information from publicly available reports.

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

Distributing Reports

Requirement: Distributing Reports

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

- a. An audit organization in a government entity should distribute audit reports to those charged with governance, to the appropriate audited entity officials, and to the appropriate oversight bodies or organizations requiring or arranging for the audits. As appropriate, auditors should also distribute copies of the reports to other officials who have legal oversight authority or who may be responsible for acting on audit findings and

recommendations and to others authorized to receive such reports.

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

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

7.01 This chapter contains requirements and guidance for conducting and reporting on attestation engagements and reviews of financial statements conducted in accordance with generally accepted government auditing standards (GAGAS). For attestation engagements, GAGAS incorporates by reference the American Institute of Certified Public Accountants' (AICPA) Statements on Standards for Attestation Engagements (SSAE). For reviews of financial statements, GAGAS incorporates by reference AICPA's AR-C section 90, *Review of Financial Statements*.⁴⁹ All sections of the cited standards are incorporated, including the introduction, objectives, definitions, requirements, and application and other explanatory material. GAGAS does not incorporate the AICPA Code of Professional Conduct by reference but recognizes that certain certified public accountants (CPA) may use or may be required to use the code in conjunction with GAGAS.⁵⁰ For attestation engagements and reviews of financial statements conducted in accordance with GAGAS, the requirements and guidance in the respective incorporated standards and this chapter apply. The requirements and guidance contained in chapters 1 through 5 also apply.

7.02 An attestation engagement can provide one of three levels of service as defined by the AICPA: an examination engagement, a review engagement, or an agreed-upon procedures engagement.

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

⁴⁹AICPA, *Professional Standards*.

⁵⁰See para. 2.14 for a discussion of the AICPA Code of Professional Conduct.

of the engagement, responsibilities of audited entity management, responsibilities of auditors, and limitations of the engagement.⁵¹

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

Examination Engagements

Compliance with Standards

Requirement: Compliance with Standards

7.05 GAGAS establishes requirements for examination engagements in addition to the requirements for examinations contained in the AICPA's SSAEs. Auditors should comply with these additional requirements, along with the AICPA requirements for examination engagements, when citing GAGAS in their examination engagement reports.

⁵¹See para. .08 of AT-C section 205, para. .09 of AT-C section 210, and para. .14 of AT-C section 215; and para. .11 of AR-C section 90 (AICPA, *Professional Standards*).

Application Guidance: Compliance with Standards

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

Licensing and Certification

Requirements: Licensing and Certification

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

7.08 Auditors engaged to conduct examination engagements of entities operating outside of the United States who do not work for a government audit organization should meet the qualifications indicated in paragraph 7.07, have certifications that meet all applicable national and international standards and serve in their respective countries as the functional equivalent of CPAs in the United States, or work for nongovernment audit organizations that are the functional equivalent of licensed certified public accounting firms in the United States.

Auditor Communication

Requirements: Auditor Communication

7.09 If the law or regulation requiring an examination engagement specifically identifies the entities to be examined, auditors should communicate pertinent information that in the auditors' professional

judgment needs to be communicated both to individuals contracting for or requesting the examination and to those legislative committees, if any, that have ongoing oversight responsibilities for the audited entity.

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

Application Guidance: Auditor Communication

7.11 For some matters, early communication to those charged with governance or management may be important because of the relative significance and the urgency for corrective follow-up action. Further, early communication is important to allow management to take prompt corrective action to prevent further occurrences when a control deficiency results in identified or suspected noncompliance with provisions of laws, regulations, contracts, and grant agreements or identified or suspected fraud. When a deficiency is communicated early, the reporting requirements and application guidance in paragraphs 7.39 through 7.47 still apply.

7.12 Because the governance structures of government entities and organizations can vary widely, it may not always be clearly evident who is charged with key governance functions. The process for identifying those charged with governance includes evaluating the organizational structure for directing and controlling operations to achieve the audited entity's objectives and how the audited entity delegates authority and establishes accountability for management.

Results of Previous Engagements

Requirement: Results of Previous Engagements

7.13 When planning a GAGAS examination engagement, auditors should ask management of the audited entity to identify previous audits, attestation engagements, and other studies that directly relate to the subject matter or an assertion about the subject matter of the examination engagement, including whether related recommendations have been implemented. Auditors should evaluate whether the audited

entity has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a significant effect on the subject matter or an assertion about the subject matter. Auditors should use this information in assessing risk and determining the nature, timing, and extent of current work and determining the extent to which testing the implementation of the corrective actions is applicable to the current examination engagement objectives.

Investigations or Legal Proceedings

Requirement: Investigations or Legal Proceedings

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

Application Guidance: Investigations or Legal Proceedings

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

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

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

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

7.17 Auditors should extend the AICPA requirements concerning consideration of noncompliance with laws and regulations to include consideration of noncompliance with provisions of contracts and grant agreements.⁵²

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

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

Findings

Requirements: Findings

7.19 When auditors identify findings, they should plan and perform procedures to develop the criteria, condition, cause, and effect of the findings to the extent that these elements are relevant and necessary

⁵²See paras. .32 and .33 of AT-C section 205 (AICPA, *Professional Standards*).

to achieve the examination objectives.

7.20 Auditors should consider internal control deficiencies in their evaluation of identified findings when developing the cause element of the identified findings.

Application Guidance: Findings

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

7.22 Given the concept of accountability for use of public resources and government authority, evaluating internal control in a government environment may also include considering internal control deficiencies that result in waste or abuse. Because the determination of waste and abuse is subjective, auditors are not required to perform specific procedures to detect waste or abuse in examinations. However, auditors may consider whether and how to communicate such matters if they become aware of them. Auditors may also discover that waste or abuse are indicative of fraud or noncompliance with provisions of laws, regulations, contracts, and grant agreements.

7.23 Waste is the act of using or expending resources carelessly, extravagantly, or to no purpose. Importantly, waste can include activities that do not include abuse and does not necessarily involve a violation of law. Rather, waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight.

7.24 The following are examples of waste, depending on the facts and circumstances:

- a. Making travel choices that are contrary to existing travel policies or are unnecessarily extravagant or expensive.
- b. Making procurement or vendor selections that are contrary to existing policies or are unnecessarily extravagant or expensive.

7.25 Abuse is behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances, but excludes fraud and noncompliance with provisions of laws, regulations, contracts, and

grant agreements. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate.

7.26 The following are examples of abuse, depending on the facts and circumstances:

- a. Creating unneeded overtime.
- b. Requesting staff to perform personal errands or work tasks for a supervisor or manager.
- c. Misusing the official's position for personal gain (including actions that could be perceived by an objective third party with knowledge of the relevant information as improperly benefiting an official's personal financial interests or those of an immediate or close family member; a general partner; an organization for which the official serves as an officer, director, trustee, or employee; or an organization with which the official is negotiating concerning future employment).

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

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

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

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

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

7.32 Considering internal control in the context of a comprehensive internal control framework, such as *Standards for Internal Control in the Federal Government* or *Internal Control—Integrated Framework*,⁵³ can help auditors to determine whether underlying internal control deficiencies exist as the root cause of findings. Identifying these deficiencies can help provide the basis for developing meaningful recommendations for corrective actions.

Examination Engagement Documentation

Requirements: Examination Engagement Documentation

7.33 Auditors should comply with the following documentation requirements.

- a. Before the date of the examination report, document supervisory review of the evidence that supports the findings, -

⁵³The Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control—Integrated Framework* and *Standards for Internal Control in the Federal Government* (GAO-14-704G) provide suitable and available criteria against which management may evaluate and report on the effectiveness of the entity's internal control. *Standards for Internal Control in the Federal Government* may be adopted by entities beyond those federal entities for which it is legally required, such as state, local, and quasi-governmental entities, as well as other federal entities and not-for-profit organizations, as a framework for an internal control system.

conclusions, and recommendations contained in the examination report.

- b. Document any departures from the GAGAS requirements and the effect on the examination engagement and on the auditors' conclusions when the examination engagement does not comply with applicable GAGAS requirements because of law, regulation, scope limitations, restrictions on access to records, or other issues affecting the examination engagement.

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

Application Guidance: Examination Engagement Documentation

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

7.36 An experienced auditor is an individual who possesses the competencies and skills to be able to conduct the examination engagement. These competencies and skills include an understanding of (1) examination engagement processes and related examination standards, (2) GAGAS and applicable legal and regulatory requirements, (3) the subject matter on which the auditors are engaged to report, (4) the suitability and availability of criteria, and (5) issues related to the audited entity's environment.

Availability of Individuals and Documentation

Requirement: Availability of Individuals and Documentation

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

Application Guidance: Availability of Individuals and Documentation

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

Reporting the Auditors' Compliance with GAGAS

Requirements: Reporting the Auditors' Compliance with GAGAS

7.39 When auditors comply with all applicable GAGAS requirements, they should include a statement in the report that they conducted the examination in accordance with GAGAS.⁵⁴

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

⁵⁴See paras. 2.16 through 2.19 for information on the GAGAS compliance statement.

Application Guidance: Reporting the Auditors' Compliance with GAGAS

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

Reporting Deficiencies in Internal Control

Requirement: Reporting Deficiencies in Internal Control

7.42 Auditors should include in the examination report all internal control deficiencies, even those communicated early, that are considered to be significant deficiencies or material weaknesses that the auditors identified based on the engagement work performed.⁵⁵

Application Guidance: Reporting Deficiencies in Internal Control

7.43 Determining whether and how to communicate to officials of the audited entity internal control deficiencies that are not considered significant deficiencies or material weaknesses is a matter of professional judgment.

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

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

7.44 Auditors should include in their examination report the relevant information about noncompliance and fraud when auditors, based on

⁵⁵GAGAS's use of internal control terminology is consistent with the definitions contained in AU-C section 265 (AICPA, *Professional Standards*).

sufficient, appropriate evidence, identify or suspect

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

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

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

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

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

Presenting Findings in the Report

Requirements: Presenting Findings in the Report

7.48 When presenting findings, auditors should develop the elements

of the findings to the extent necessary to assist management or oversight officials of the audited entity in understanding the need for taking corrective action.

7.49 Auditors should place their findings in perspective by describing the nature and extent of the issues being reported and the extent of the work performed that resulted in the findings. To give the reader a basis for judging the prevalence and consequences of the findings, auditors should, as appropriate, relate the instances identified to the population or the number of cases examined and quantify the results in terms of dollar value or other measures. If the results cannot be projected, auditors should limit their conclusions appropriately.

Application Guidance: Presenting Findings in the Report

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

Reporting Findings Directly to Parties outside the Audited Entity

Requirements: Reporting Findings Directly to Parties outside the Audited Entity

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

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

information directly to the specified external parties.

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

7.52 Auditors should comply with the requirements in paragraph 7.51 even if they have resigned or been dismissed from the engagement prior to its completion.

7.53 Auditors should obtain sufficient, appropriate evidence, such as confirmation from outside parties, to corroborate representations by management of the audited entity that it has reported engagement findings in accordance with laws, regulations, or funding agreements. When auditors are unable to do so, they should report such information directly, as discussed in paragraphs 7.51 and 7.52.

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

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

Obtaining and Reporting the Views of Responsible Officials

Requirements: Obtaining and Reporting the Views of Responsible Officials