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By the Comptroller General of the United States

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Government Auditing Standards

Amendment No. 3

Independence

GAO-02-388G

This third amendment to *Government Auditing Standards* (1994 revision), Amendment No. 3, *Independence*, substantially changes the previous standard to better serve the public interest and to maintain a high degree of integrity, objectivity, and independence for audits of government entities. While this new amendment deals with a range of auditor independence issues, the most significant change relates to the rules associated with nonaudit, or consulting services.

Auditors have the capability of performing a range of services for their clients. However, in some circumstances it is not appropriate for them to perform both audit and certain nonaudit services for the same client. In these circumstances, the auditor and/or their client will have to make a choice as to which of these services they will provide. The standard includes a principle-based approach to addressing this issue supplemented with certain safeguards. The standard for nonaudit services is based on two overarching principles:

- Auditors should not perform management functions or make management decisions; and
- Auditors should not audit their own work or provide nonaudit services in situations where the amounts or services involved are significant/material to the subject matter of the audit.

For nonaudit services that do not violate the above principles, certain supplemental safeguards would have to be met. For example, (1) personnel who perform nonaudit services would be precluded from performing any related audit work, (2) the auditor's work could not be reduced beyond the level that would be appropriate if the nonaudit work was performed by another unrelated party, and (3) certain documentation and quality assurance requirements must be met. The standard includes an express prohibition regarding auditors providing certain bookkeeping/recordkeeping services, and limits payroll processing and certain other services, all of which are presently permitted under the ethics rules of the American Institute of Certified Public Accountants (AICPA). At the same time, the standard recognizes that auditors can provide routine advice and answer technical questions without violating the two principles or having to comply with the supplemental safeguards. The standard also provides examples of how certain services would be treated under the new rules. We plan to issue further guidance in the form of questions and answers to assist in implementing the standard.

This standard also acknowledges the ways that government audit organizations can be free from organizational impairments to independence. First, the amendment expands the presumptive criteria by specifying additional ways for an organization to be free from organizational impairments to independence. If the audit organization meets any of the presumptive criteria listed in the standard, it can be considered organizationally independent to audit externally. Second, the standard recognizes that other organizational structures can provide sufficient safeguards to prevent the audited entity from interfering with the audit organization's ability to perform the work and report the results impartially. If the audit organization meets all the statutory protections listed in the amendment, it can be considered organizationally independent to report externally.

The revised standard also recognizes that internal auditors play a vital role in government auditing and can be free from organizational impairments to independence. However, since internal auditors are responsible to management while external auditors are responsible to third parties outside the audited entity, a fundamental difference exists between internal and external auditors. The amendment acknowledges this difference by retaining the sections on internal audit in the 1994 revision of *Government Auditing Standards* but refocusing the discussion to organizational impairment considerations when reporting internally to management.

Because of the breadth of changes in the amendment, they are applicable to all audits for periods beginning on or after October 1, 2002. However, early implementation is encouraged.

We have included as appendix I a version of the standard which shows the deletion of language appearing in the 1994 Yellow Book with a strikeout and presents the new or amended language with bold and italics. Appendix II contains a list of members of the Comptroller General's Advisory Council on Government Auditing Standardsand GAO staff working with the Council.

An electronic version of this standard can be accessed through the U.S. General Accounting Office's (GAO) Internet Home Page (**www.gao.gov**) from the GAO Policy and Guidance Materials or the Special Publications sections of the GAO site, or directly at **www.gao.gov/govaud/ybk01.htm.** This site also contains a new electronic version of *Government Auditing Standards*, which codifies the new standard by reflecting changes made resulting from the issuance of these amendments. Printed copies of this standard can be obtained from the U.S. Government Printing Office.

This amendment have gone through an extensive deliberative process including extensive public comments and input from the Comptroller General's Advisory Council on Government Auditing Standards. The Council includes 20 experts in financial and performance auditing and reporting drawn from all levels of government, academia, private enterprise, and public accounting, who advise the Comptroller General on Government Auditing Standards. The views of all parties that formally commented on the exposure draft of the standard were thoroughly considered by the Comptroller General in finalizing the standard. I thank those who commented and suggested improvements to the standard. I especially commend the Advisory Council on Government Auditing Standards and the project team for their efforts.

If you have questions regarding this amendment, please contact Jeffrey C. Steinhoff, Managing Director, Financial Management and Assurance , (202) 512-2600 or Marcia B. Buchanan, Assistant Director, Financial Management and Assurance, (202) 512-9321.

David M. Walker
Comptroller General
of the United States

Amendment No. 3

INDEPENDENCE

3.11 The second general standard is:

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

3.12 Auditors and audit organizations have a responsibility to maintain independence, so that opinions, conclusions, judgments, and recommendations will be impartial and will be viewed as impartial by knowledgeable third parties. An auditor should avoid situations that could lead reasonable third parties with knowledge of the relevant facts and circumstances to conclude that the auditor is not able to maintain independence and, thus, is not capable of exercising objective and impartial judgment on all issues associated with conducting and reporting on the work.

3.13 Auditors need to consider three general classes of impairments to independence—personal, external, and organizational.[1] If one or more of these impairments affects an auditor's capability to perform the work and report results impartially, that auditor should either decline to perform the work, or in those situations in which the government auditor because of a legislative requirement or for other reasons cannot decline to perform the work, the impairment(s) should be reported in the scope section of the audit report.

[1]Nongovernment auditors should also follow the AICPA code of professional conduct and the code of professional conduct of the state board with jurisdiction over the practice of the public accountant and the audit organization.

3.14 In using the work of a specialist,[2] auditors need to consider the specialist as a member of the audit team and, accordingly, assess the specialist's capability to perform the work and report results impartially. In conducting this assessment, auditors should provide the specialist with the GAGAS independence requirements and obtain representations from the specialist regarding their independence from the activity or program under audit. If the specialist has an impairment to independence, the auditor should not use the work of that specialist.

Personal Impairments

3.15 The audit organization should have an internal quality control system to help determine if auditors have any personal impairments to independence that could affect their impartiality or the appearance of impartiality. The audit organization needs to be alert for personal impairments to independence of its staff members. Personal impairments of staff members result from relationships and beliefs that might cause an auditor to limit the extent of the inquiry, limit disclosure, or weaken or slant audit findings in any way. Auditors are responsible for notifying the appropriate officials within their audit organizations if they have any personal impairments to independence. Examples of personal impairments of individual auditors include, but are not limited to, the following:

a. immediate family or close family member[3] who is a director or officer of the audited entity, or as an

[2]Specialists to whom this section applies include, but are not limited to, actuaries, appraisers, attorneys, engineers, environmental consultants, medical professionals, statisticians, and geologists. This section also applies to external consultants and firms performing work for the audit organization.

[3]Immediate family member is a spouse, spouse equivalent, or dependent (whether or not related). A close family member is a parent, sibling, or nondependent child.

employee of the audited entity, is in a position to exert direct and significant influence over the entity or the program under audit,

b. financial interest that is direct, or is significant/material though indirect, in the audited entity or program,

c. responsibility for managing an entity or decision-making that could affect operations of the entity or program being audited, for example as a director, officer, or other senior position of the entity, activity, or program being audited, or as a member of management in any decision-making, supervisory, or ongoing monitoring function for the entity, activity, or program under audit,[4] [5]

d. concurrent or subsequent performance of an audit by the same individual who maintained the official accounting records when such services involved preparing source documents or originating data, in electronic or other form; posting transactions (whether coded by management or not coded); authorizing, executing, or consummating transactions (for example, approving invoices, payrolls, claims, or other payments of the entity or program being audited), maintaining an entity's bank account or otherwise having custody of the

[4]If the auditor has performed nonaudit services for a client that affect information that is the subject of the audit and management is unable or unwilling to take responsibility for this information, the risk that the auditor may be perceived to have a personal impairment to independence is increased. See paragraphs 3.18 through 3.26 for additional guidance on impairments to independence associated with the scope of services that may be provided by audit organizations to entities they audit.

[5]The auditor needs to be free from this personal impairment for the period covered by the activity under audit, including any financial statements being audited, and for the period in which the audit is being performed and reported.

audited entity's funds; or otherwise exercising authority on behalf of the entity, or having authority to do so,[6]

e. preconceived ideas toward individuals, groups, organizations, or objectives of a particular program that could bias the audit,

f. biases, including those induced by political or social convictions, that result from employment in, or loyalty to, a particular group, organization, or level of government, and

g. seeking employment with an audited organization during the conduct of the audit.

3.16 Audit organizations and auditors may encounter many different circumstances or combination of circumstances that could create a personal impairment. Therefore, it is impossible to identify every situation that could result in a personal impairment. Accordingly, audit organizations should include as part of its internal quality control system requirements to identify personal impairments and determine compliance with GAGAS independence requirements. At a minimum, audit organizations should:

a. establish policies and procedures that will enable the identification of personal impairments to independence, including whether performing nonaudit services affects the subject matter of audits and applying safeguards to appropriately reduce that risk, (See paragraphs 3.20 through 3.26.)

b. communicate the audit organization's policies and procedures to all auditors in the organization and ensure understanding of requirements through training or other

[6]See footnote 5.

means such as auditors acknowledging their understanding periodically,

c. establish internal policies and procedures to monitor compliance with the audit organization's policies and procedures,

d. establish a disciplinary mechanism to promote compliance with the audit organization's policies and procedures, and

e. stress the importance of independence and the expectation that auditors will always act in the public interest.

3.17 When the audit organization identifies a personal impairment to independence, the impairment needs to be resolved in a timely manner. In situations where the personal impairment is applicable only to an individual auditor on a particular assignment, the audit organization may be able to mitigate the personal impairment by requiring the auditor to eliminate the personal impairment. For example, the auditor could sell a financial interest that created the personal impairment, or the audit organization could remove that auditor from any work on that audit assignment.[7] If the personal impairment cannot be mitigated through these means, the audit organization needs to withdraw from the audit. In situations in which government auditors cannot withdraw from the audit, they should follow the requirements in paragraph 3.13.

3.18 Audit organizations that provide other professional services (nonaudit services) should

[7]Auditors participating in the audit assignment, including those who perform review of the report, and all others within the audit organization who can directly influence the outcome of the audit, need to be free from personal impairments.

consider whether providing these services creates a personal impairment either in fact or appearance that adversely affects their independence for conducting audits.

3.19 Nonaudit services generally differ from financial audits, attestation engagements, and performance audits described in chapter 2 in that auditors may (1) perform tasks requested by management that directly support the entity's operations, such as developing or implementing accounting systems; determining account balances;[8] developing internal control systems; establishing capitalization criteria; processing payroll; posting of transactions; evaluating assets; designing or implementing information technology or other system; or performing actuarial studies, or (2) provide information or data to a requesting party without providing verification, analysis, or evaluation of the information or data, and therefore the work does not usually provide a basis for conclusions, recommendations, or opinions on the information or data. These other services may or may not result in a report. In the case of nongovernment auditors that perform audits of government entities under GAGAS, the term nonaudit services is synonymous with consulting services.

3.20 Audit organizations have the capability of performing a range of services for their clients. However, in certain circumstances, it is not appropriate for the audit organization to perform both audit and selected nonaudit services for the same client. In these circumstances, the auditor and/or the audited entity will have to make a choice as to which of these services the

[8]The determination of account balances is used by management to prepare financial statements, such as determining for management the accounts receivable or accounts payable balance or the value of inventory.

audit organization will provide. GAGAS recognize that nonaudit services are provided by audit organizations and that care needs to be taken to avoid situations that can impair auditor independence, either in fact or appearance, to provide financial audits, attestations engagements, or performance audits in accordance with GAGAS.

3.21 Before an audit organization agrees to perform nonaudit services, it should carefully consider the requirements of paragraph 3.12 that auditors should avoid situations that could lead reasonable third parties with knowledge of the relevant facts and circumstances to conclude that the auditor is not able to maintain independence in conducting audits. In conducting the assessment, there are two overarching principles: (1) audit organizations should not provide nonaudit services that involve performing management functions or making management decisions and (2) audit organizations should not audit their own work or provide nonaudit services in situations where the nonaudit services are significant/material to the subject matter of audits. If the audit organization makes the determination that the nonaudit service does not violate these principles, it should comply with all the safeguards stated in paragraph 3.25.

3.22 Audit organizations should not perform management functions or make management decisions. Performing management functions or making management decisions creates a situation that impairs the audit organization's independence, both in fact and in appearance, to perform audits of that subject matter and may affect the audit organization's independence to conduct audits of related subject matter. For example, auditors should not serve as members of an entity's management committee or board of directors, make policy decisions that affect future direction and operation of an entity's programs, supervise entity employees, develop programmatic policy, authorize an entity's transactions, or maintain custody of an entity's assets.[9]

3.23 Auditors may participate on committees or task forces in a purely advisory capacity to advise entity management on issues related to the knowledge and skills of the auditors without impairing their independence. However, auditors should not make management decisions or perform management functions. For an example, auditors can provide routine advice to the audited entity and management to assist them in activities such as establishing internal controls or implementing audit recommendations, can answer technical questions, and/or provide training. The decision to follow the auditor's advice remains with management of the audited entity. These types of interactions are normal between the auditor and the management of the audited entity given the auditor's technical expertise and the knowledge the auditor gains of the audited entity's operations. An auditor may also provide tools and methodologies, such as best practice guides, benchmarking studies, and internal control assessment methodologies that can be used by management. By their very nature, these are routine activities that would not require the audit organization to apply the safeguards described in paragraph 3.25.

3.24 Audit organizations should not audit their own work or provide nonaudit services if the services are significant/material to the subject matter of audits. In considering whether the nonaudit service can have a significant or material affect on the subject matter of audits, audit organizations should consider (1) ongoing audits, (2) planned audits, (3) requirements and commitments for providing audits, which includes laws,

[9]Entity assets are intended to include all of the entity's property including bank accounts, investment accounts, inventories, equipment or other assets owned, leased, or otherwise in the entity's possession.

regulations, rules, contracts and other agreements, and (4) policies placing responsibilities on the audit organization for providing audit services. Government auditors generally have broad audit responsibilities that may extend to a level of government or a particular entity within a level of government. Given their broad area of audit responsibility, government auditors need to be especially careful in providing nonaudit services to the entity so that their independence is not impaired to fulfill their full range of audit responsibilities. Nongovernment audit organizations may provide audit and nonaudit services under contractual commitments to an entity (commonly referred to as consulting) and need to consider whether nonaudit services they have provided or are committed to provide have a significant or material affect on the subject matter of audits.

3.25 Audit organizations may perform nonaudit services that do not violate the principles stated in paragraph 3.21 only if the audit organization and the audited entity complies with the following safeguards. These safeguards would not apply in connection with the type of routine activities described in paragraph 3.23. The intent in paragraph 3.25 is not for the audit organization to apply these safeguards to each and every interaction it has with management.

a. The audit organization should document its consideration of the nonaudit services as discussed in paragraph 3.21, including documentation for its rationale that providing the nonaudit services does not violate the two overarching principles.

b. Before performing nonaudit services, the audit organization should establish and document an understanding with the audited entity regarding the objectives, scope of work, and product or deliverables of the nonaudit service. The audit organization should also establish and document an understanding with management that management is responsible for the substantive outcomes of the work and, therefore, has a responsibility to be in a position in fact and appearance to make an informed judgment on the results of the nonaudit service and that the audited entity complies with the following:

1. Designates a management-level individual to be responsible and accountable for overseeing the nonaudit service.

2. Establishes and monitors the performance of the nonaudit service to ensure that it meets management's objectives.

3. Makes any decisions that involve management functions related to the nonaudit service and accepts full responsibility for such decisions.

4. Evaluates the adequacy of the services performed and any findings that result.

c. The audit organization should preclude personnel who provided the nonaudit services from planning, conducting, or reviewing audit work related to the nonaudit service under the overarching principle that auditors cannot audit their own work.[10]

d. The audit organization is precluded from reducing the scope and extent of the audit work beyond the level that would be appropriate if the nonaudit work was performed by another unrelated party.

[10]Personnel who provided the nonaudit service are permitted to convey the knowledge gained of the audited entity and its operations to the audit assignment team.

e. The audit organization's quality control systems for compliance with independence requirements should include policies and procedures to assure consideration of the effect on the ongoing, planned, and future audits when deciding whether to provide nonaudit services and a requirement to have the understanding with management of the audited entity documented. The understanding should be communicated to management in writing and can be included in the engagement letter. In addition, the documentation should specifically identify management's compliance with the elements discussed in paragraph 3.25b, including evidence of the management-level individual responsible for overseeing the nonaudit service's qualifications to conduct the required oversight, and that the tasks required of management were performed.

f. By their nature, certain nonaudit services impair the audit organization's ability to meet either or both of the overarching principles in paragraph 3.21 for certain types of audit work. In these cases, the audit organization should communicate to management of the audited entity that the audit organization would not be able to perform subsequent audit work related to the subject matter of the nonaudit service. It should be clear to management upfront that the audit organization would be in violation of the independence standard and that another audit organization that met the independence standard would have to be engaged to perform the audit. For example, if the audit organization has been responsible for designing, developing, and/or installing the entity's accounting system or is operating the system and then performed a financial statement audit of the entity, the audit organizations would clearly be in violation of the two overarching principles of the GAGAS independence standard. Likewise, if the audit organization developed an entity's performance measurement system, the audit organization would not be deemed independent if it was asked to conduct a performance audit to evaluate whether the system was adequate. In both of these examples, the audit organization could decide to perform the nonaudit service but would then not be permitted under GAGAS to perform the subsequent audit because it would be in violation of one or both of the two overarching principles. It becomes a matter of choice for the audit organization and the audited entity. But the audit organization cannot both provide the service and perform the audit if either of the two overarching principles is violated.

g. For individual audits selected in the peer review, all related nonaudit services should be identified to the audit organization's peer reviewer and the audit documentation required by paragraphs 3.25a through e are made available for inclusion in the audit organization's peer review.

3.26 Audit organizations and auditors may encounter many different circumstances or combinations of circumstances; therefore, it is impossible to define every situation that could result in an impairment, as discussed in paragraph 3.20. The following are examples of nonaudit services performed by an audit organization that typically would not create an impairment to the audit organization's independence as long as the auditor avoids situations that would conflict with the two overarching principles listed in paragraph 3.21 and the audit organization complies with the safeguards in paragraph 3.25.

a. Providing basic accounting assistance limited to services such as preparing draft financial statements that are based on management's chart of accounts and trial balance and any adjusting, correcting, and closing entries that have been approved by management; preparing draft notes to the financial statements based on information determined and approved by management; preparing a trial balance based on management's chart of accounts; maintaining depreciation schedules for which management has determined the method of depreciation, rate of depreciation, and salvage value of the asset. The audit organization, however, cannot maintain or prepare the audited entity's basic accounting records or maintain or take responsibility for basic financial or other records that the audit organization will audit.[11] As part of this prohibition, auditors should not post transactions (whether coded or not coded) to the entity's financial records or to other records that subsequently provide data to the entity's financial records.

b. Providing payroll services limited to services such as computing pay amounts for the entity's employees based on entity maintained and approved time records, salaries or pay rates, and deductions from pay; generating unsigned payroll checks; transmitting client approved payroll to a financial institution provided management has approved the transmission and limited the financial institution to make payments only to previously approved individuals. In cases, where the audit organization was processing the entity's entire payroll and payroll was a material amount to the subject matter of the audit, this would be a violation of one of the overarching principles in paragraph 3.21 and the auditor would not be deemed independent under GAGAS.

c. Providing appraisal or valuation services limited to services such as reviewing the work of the entity or a specialist employed by the entity where the entity or specialist provides the primary support for the balances

[11]Proposing adjusting and correcting entries that are identified during the audit are a routine byproduct of audit services that are always permissible so long as management makes the decision on accepting these entries.

recorded in financial statements or other information that will be audited; valuing an entity's pension, other post-employment benefit, or similar liabilities provided management has determined and taken responsibility for all significant assumptions and data.

d. Preparing an entity's indirect cost proposal[12] or cost allocation plan provided management has taken responsibility for all significant assumptions and data.

e. Providing advisory services on information technology limited to services such as advising on system design, system installation, and system security if management in addition to the safeguards in paragraph 3.25 acknowledges responsibility for the design, installation, and internal control over the entity's system and does not rely on the auditor's work as the primary basis for determining (1) whether to implement a new system, (2) the adequacy of the new system design, (3) the adequacy of major design changes to an existing system, and (4) the adequacy of the system to comply with regulatory or other requirements. However, the audit organization should not operate or supervise the operation of the entity's information technology system.

f. Providing human resource services to assist management in its evaluation of potential candidates that are limited to activities such as serving on an evaluation panel to review applications or interviewing candidates to provide input to management in arriving at a listing of best qualified applicants to be provided to management. The auditor should not recommend a single individual for a specific position nor should the

[12]The Office of Management and Budget prohibits an auditor who prepared the entity's indirect cost proposal from conducting the required audit when indirect costs recovered by the entity during the prior year exceeded $1 million.

auditor conduct an executive search or a recruiting program for the audited entity.

g. Preparing routine tax filings in accordance with federal tax laws and rules and regulations of the Internal Revenue Service and state and local tax authorities and any applicable laws.

h. Gathering and reporting unverified external or third-party data to aid legislative and administrative decision-making.

i. Advising an entity regarding its performance of internal control self-assessments.

j. Assisting a legislative body by developing questions for use at a hearing.

External Impairments

3.27 Factors external to the audit organization may restrict the work or interfere with an auditor's ability to form independent and objective opinions and conclusions. External impairments to independence occur when an auditor is deterred from acting objectively and exercising professional skepticism by pressures, actual or perceived, from management and employees of the audited entity or oversight organizations. For example, under the following conditions, an auditor may not have complete freedom to make an independent and objective judgment and an audit may be adversely affected:

a. external interference or influence that could improperly or imprudently limit or modify the scope of an audit or threaten to do so, including pressure to reduce inappropriately the extent of work performed in order to reduce costs or fees,

b. external interference with the selection or application of audit procedures or in the selection of transactions to be examined,

c. unreasonable restrictions on the time allowed to complete an audit or issue the report,

d. interference external to the audit organization in the assignment, appointment, and promotion of audit personnel,

e. restrictions on funds or other resources provided to the audit organization that adversely affect the audit organization's ability to carry out its responsibilities,

f. authority to overrule or to inappropriately influence the auditor's judgment as to the appropriate content of the report,

g. threat of replacement over a disagreement with the contents of an audit report, the auditor's conclusions or the application of an accounting principle or other criteria, and

h. influences that jeopardize the auditor's continued employment for reasons other than incompetence, misconduct, or the need for audit services.

3.28 An audit organization's internal quality control system for compliance with GAGAS independence requirements, as stated in paragraph 3.16, should include internal policies and procedures for reporting and resolving external impairments.

Organizational Impairments

3.29 In addition to the preceding paragraphs which address personal and external impairments, government audit organization's capability to perform the work and report the results impartially can be affected by their place within government and the structure of the government entity which the audit organization is assigned to audit. Whether performing work to report externally to third parties outside the audited entity or internally to top management within the audited entity, auditor organization need to be free from organizational impairments to independence.-

Organizational Impairment Considerations When Reporting Externally to Third Parties

3.30 Government auditors can be presumed to be free from organizational impairments to independence when reporting externally to third parties if their audit organization is organizationally independent from the audited entity. Government audit organizations can meet the requirement for organizational independence in a number of ways.

3.30.1 First, a government audit organization may be presumed to be free from organizational impairments to independence from the audited entity to report externally, if the audit organization is

a. assigned to a level of government other than the one to which the audited entity is assigned (federal, state, or local), for example, a federal auditor auditing a state government program, or

b. assigned to a different branch of government within the same level of government as the audited entity; for example, a legislative auditor auditing an executive branch program.

3.30.2 Second, a government audit organization may also be presumed to be free from organizational impairments for external reporting if the audit organization's head meets any of the following criteria:

a. is directly elected by voters of the jurisdiction being audited,

b. is elected or appointed by a legislative body subject to removal by a legislative body, and reports the results of audits to and is accountable to a legislative body,

c. is appointed by someone other than a legislative body, so long as the appointment is confirmed by a legislative body and removal from the position is subject to oversight or approval by a legislative body,[13] and reports the results of audits to and is accountable to a legislative body, or

d. is appointed by, accountable to, reports to, and can only be removed by a statutorily created governing body, the majority of whose members are independently elected or appointed and come from outside the organization being audited.

3.30.3 In addition to the presumptive criteria in paragraphs 3.30.1 and 3.30.2, GAGAS recognize that there may be other organizational structures under which a government audit organization could be considered to be free from organizational impairments, and thereby be considered organizationally independent to report externally. These other structures should provide sufficient safeguards to prevent the audited entity from interfering with the audit organization's ability to perform the work and report the results impartially. For an audit organization to be considered free from organizational impairments to report externally under a structure different from the ones

[13]Legislative bodies may exercise their confirmation powers through a variety of means as long as they are involved in the approval of the individual to head the audit office. This involvement can be demonstrated by approving the individual after the appointment or by initially selecting or nominating an individual or individuals for appointment by the appropriate authority.

listed in paragraphs 3.30.1 and 3.30.2, the audit organization should have all of the following safeguards:

a. statutory protections that prevent the abolishment of the audit organization by the audited entity,

b. statutory protections that require that if the head of the audit organization is removed from office, the head of the agency should report this fact and the reasons for the removal to the legislative body,

c. statutory protections that prevent the audited entity from interfering with the initiation, scope, timing, and completion of any audit,

d. statutory protections that prevent the audited entity from interfering with the reporting on any audit, including the findings, conclusions, and recommendations, or the manner, means, or timing of the audit organization's reports,

e. statutory protections that require the audit organization to report to a legislative body or other independent governing body on a recurring basis,

f. statutory protections that give the audit organization sole authority over the selection, retention, advancement, and dismissal of its staff, and

g. statutory access to records and documents that relate to the agency, program, or function being audited.[14]

3.30.4 If the head of the audit organization concludes that the organization meets all the safeguards listed in

[14]Statutory authority to issue a subpoena to obtain the needed records is one way to meet the requirement for access to records.

paragraph 3.30.3, the audit organization should be considered free from organizational impairments to independence when reporting the results of its audits externally to third parties. The audit organization should document the statutory provisions in place that allow it to meet these safeguards. Those provisions should be reviewed during the external quality assurance review to ensure that all the necessary safeguards have been met.

Organizational Impairment Considerations When Reporting Internally to Management

3.30.5 Certain federal, state, or local government audit organizations or audit organizations within other government entities, such as public colleges, universities, and hospitals, employ auditors to work for management of the audited entities. These auditors may be subject to administrative direction from persons involved in the government management process. Such audit organizations are internal audit organizations. A government internal audit organization can be presumed to be free from organizational impairments to independence when reporting internally to management if the head of the audit organization meets all of the following criteria:

a. is accountable to the head or deputy head of the government entity,

b. is required to report the results of the audit organization's work to the head or deputy head of the government entity, and

c. is located organizationally outside the staff or line management function of the unit under audit.

3.30.6 If the conditions of paragraph 3.30.5 are met, the audit organization should be considered free of organizational impairments to independence to audit internally and report objectively to the entity's management. Further distribution of reports outside the organization should only be made in accordance with applicable law, rule, regulation, or policy. In these situations, the fact that the auditors are auditing in their employing organizations should be clearly reflected in the auditors' reports.

3.30.7 Auditors need to be sufficiently removed from political pressures to ensure that they can conduct their audits objectively and can report their findings, opinions, and conclusions objectively without fear of political repercussions. Whenever feasible, auditors within internal audit organizations should be under a personnel system in which compensation, training, job tenure, and advancement are based on merit.

3.30.8 The audit organization's independence is enhanced when it also reports regularly to the entity's independent audit committee and/or the appropriate government oversight body.

3.30.9 When internal audit organizations that are free of organizational impairments to independence, under the criteria in paragraph 3.30.5, perform audits external to the government entities to which they are directly assigned, such as auditing contractors or outside party agreements, and no personal or external impairments exist, they may be considered independent of the audited entities and free to report objectively to the heads or deputy heads of the government entities to which they are assigned and to parties outside the organizations in accordance with applicable law, rule, regulation, or policy.

3.30.10 The audit organization should document the conditions in place that allow it to be considered free of organizational impairments to independence to report internally. Those conditions should be reviewed during the peer review to ensure that all the necessary safeguards have been met.

INDEPENDENCE

3.11 The second general standard is:

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

3.12 ~~This standard places~~ ***Auditors and audit organizations have a*** responsibility ~~on each auditor and the audit organization~~ to maintain independence, so that opinions, conclusions, judgments, and recommendations will be impartial and will be viewed as impartial by knowledgeable third parties. ~~3.13 Auditors should consider not only whether they are independent but also whether there is anything about their situations that might lead others to question their independence. All situations deserve consideration because it is essential not only that auditors are, in fact, independent and impartial, but also that knowledgeable third parties consider them so.~~ ***An auditor should avoid situations that could lead reasonable third parties with knowledge of the relevant facts and circumstances to conclude that the auditor is not able to maintain independence and, thus, is not capable of exercising objective and impartial judgment on all issues associated with conducting and reporting on the work***.

3.13 ~~Government a~~Auditors~~, including hired consultants and internal experts and specialists,~~ need to consider three general classes of impairments to independence—personal, external, and organizational.[1] If one or more of these impairments affects an auditor's

capability to ***perform*** ~~***do***~~ the work and report ~~***results findings***~~ impartially, that auditor should either decline to perform the work, or in those situations **in which the government** ~~***where that***~~ auditor ***because of a legislative requirement or for other reasons*** cannot decline to perform the *work* audit, the impairment(s) should be reported in the scope section of the audit report. ~~Also, when auditors are employees of the audited entity, that fact should be reflected in a prominent place in the audit report. 3.15 Nongovernment auditors also need to consider those personal and external impairments that might affect their ability to do their work and report their findings impartially. If their ability is adversely affected, they should decline to perform the audit.~~

3.14 In using the work of a specialist,*[2] *auditors need to consider the specialist as a member of the audit team and, accordingly, assess the specialist's capability to perform the work and report results impartially. In conducting this assessment, auditors should provide the specialist with the GAGAS independence requirements and obtain representations from the specialist regarding their independence from the activity or program under audit. If the specialist has an impairment to independence, the auditor should not use the work of that specialist.

[1]***Nongovernment auditors*** ~~Public accountants~~ should also follow the ~~American Institute of Certified Public Accountants (~~AICPA~~)~~ code of professional conduct and the code of professional conduct of the state board with jurisdiction over the practice of the public accountant and the audit organization~~, and the guidance on personal and external impairments in these standards~~.

[2]Specialists to whom this section applies include, but are not limited to, actuaries, appraisers, attorneys, engineers, environmental consultants, medical professionals, statisticians, and geologists. This section also applies to external consultants and firms performing work for the audit organization.

Personal Impairments

3.15 ~~*There are circumstances under which auditors may not be impartial, or may not be perceived as impartial.*~~ *The audit organization* ~~*is responsible for having policies and procedures in place*~~ ***should have an internal quality control system*** to help determine if auditors have any personal impairments ***to independence that could affect their impartiality or the appearance of impartiality***. ~~Managers and supervisors~~ ***The audit organization*** need***s*** to be alert for personal impairments ***to independence*** of ~~their~~ ***its*** staff members. ***Personal impairments of staff members result from relationships and beliefs that might cause an auditor to limit the extent of the inquiry, limit disclosure, or weaken or slant audit findings in any way.*** Auditors are responsible for notifying the appropriate officials within their audit organizations if they have any personal impairments ***to independence. Examples of*** ~~P~~***p***ersonal impairments ***of individual auditors*** ~~may~~ include, but are not limited to, the following:

~~a. official, professional, personal, or financial relationships that might cause an auditor to limit the extent of the inquiry , to limit disclosure, or to weaken or slant audit findings in any way;~~

a. immediate family or close family member[3] who is a director or officer of the audited entity, or as an employee of the audited entity, is in a position to exert direct and significant influence over the entity or the program under audit,

[3]Immediate family member is a spouse, spouse equivalent, or dependent (whether or not related). A close family member is a parent, sibling, or nondependent child.

b. *financial interest that is direct, or is ~~substantial~~* ***significant/material*** though indirect, in the audited entity or program,

c. ~~previous~~ responsibility for managing an entity or decision-making that ~~w~~***c***ould affect operations of the entity or program being audited,***for example as a director, officer, or other senior position of the entity, activity, or program being audited, or as a member of management in any decision-making, supervisory, or ongoing monitoring function for the entity, activity, or program under audit,***[4] [5]

d. concurrent or subsequent performance of an audit by the same individual who~~, for example, had~~ maintained the official accounting records ***when such services involved preparing source documents or originating data, in electronic or other form; posting transactions (whether coded by management or not coded); authorizing, executing, or consummating transactions (for example,*** ~~previously~~ approve~~ed~~***ing*** invoices, payrolls, claims, or other payments of the entity or program being audited***), maintaining an entity's bank account or otherwise having custody of the audited entity's funds; or otherwise exercising authority on behalf of the entity, or having authority to do so,*** [6]

[4]***If the auditor has performed nonaudit services for a client that affect information that is the subject of the audit and management is unable or unwilling to take responsibility for this information, the risk that the auditor may be perceived to have a personal impairment to independence is increased. See paragraphs 3.18 through 3.26 for additional guidance on impairments to independence associated with the scope of services that may be provided by audit organizations to entities they audit.***

[5]***The auditor needs to be free from this personal impairment for the period covered by the activity under audit, including any financial statements being audited, and for the period in which the audit is being performed and reported.***

e. preconceived ideas toward individuals, groups, organizations, or objectives of a particular program that could bias the audit,

f. biases, including those induced by political or social convictions, that result from employment in, or loyalty to, a particular group, organization, or level of government, and

g. ***seeking employment with an audited organization during the conduct of the audit.***

3.16 ***Audit organizations and auditors may encounter many different circumstances or combination of circumstances that could create a personal impairment. Therefore, it is impossible to identify every situation that could result in a personal impairment. Accordingly, audit organizations should include as part of its internal quality control system requirements to identify personal impairments and determine compliance with GAGAS independence requirements. At a minimum, audit organizations should:***

a. ***establish policies and procedures that will enable the identification of personal impairments to independence, including whether performing nonaudit services affects the subject matter of audits and applying safeguards to appropriately reduce that risk, (See paragraphs 3.20 through 3.26.)***

b. communicate the audit organization's policies and procedures to all auditors in the organization and ensure understanding of

[6]See footnote 5.

requirements through training or other means such as auditors acknowledging their understanding periodically,

c. establish internal policies and procedures to monitor compliance with the audit organization's policies and procedures,

d. establish a disciplinary mechanism to promote compliance with the audit organization's policies and procedures, and

e. stress the importance of independence and the expectation that auditors will always act in the public interest.

3.17 When the audit organization identifies a personal impairment to independence, the impairment needs to be resolved in a timely manner. In situations where the personal impairment is applicable only to an individual auditor on a particular assignment, the audit organization may be able to mitigate the personal impairment by requiring the auditor to eliminate the personal impairment. For example, the auditor could sell a financial interest that created the personal impairment, or the audit organization could remove that auditor from any work on that audit assignment.[7] *If the personal impairment cannot be mitigated through these means, the audit organization needs to withdraw from the audit. In situations in which government auditors cannot withdraw from the*

[7]*Auditors participating in the audit assignment, including those who perform review of the report, and all others within the audit organization who can directly influence the outcome of the audit, need to be free from personal impairments.*

audit, they should follow the requirements in paragraph 3.13.

3.18 Audit organizations that provide other professional services (nonaudit services) should consider whether providing these services creates a personal impairment either in fact or appearance that adversely affects their independence for conducting audits.

3.19 Nonaudit services generally differ from financial audits, attestation engagements, and performance audits described in chapter 2 in that auditors may (1) perform tasks requested by management that directly support the entity's operations, such as developing or implementing accounting systems; determining account balances;[8] developing internal control systems; establishing capitalization criteria; processing payroll; posting of transactions; evaluating assets; designing or implementing information technology or other system; or performing actuarial studies, or (2) provide information or data to a requesting party without providing verification, analysis, or evaluation of the information or data, and therefore the work does not usually provide a basis for conclusions, recommendations, or opinions on the information or data. These other services may or may not result in a report. In the case of nongovernment auditors that perform audits of government entities under GAGAS, the term nonaudit services is synonymous with consulting services.

[8]The determination of account balances is used by management to prepare financial statements, such as determining for management the accounts receivable or accounts payable balance or the value of inventory.

3.20 Audit organizations have the capability of performing a range of services for their clients. However, in certain circumstances, it is not appropriate for the audit organization to perform both audit and selected nonaudit services for the same client. In these circumstances, the auditor and/or the audited entity will have to make a choice as to which of these services the audit organization will provide. GAGAS recognize that nonaudit services are provided by audit organizations and that care needs to be taken to avoid situations that can impair auditor independence, either in fact or appearance, to provide financial audits, attestations engagements, or performance audits in accordance with GAGAS.

3.21 Before an audit organization agrees to perform nonaudit services, it should carefully consider the requirements of paragraph 3.12 that auditors should avoid situations that could lead reasonable third parties with knowledge of the relevant facts and circumstances to conclude that the auditor is not able to maintain independence in conducting audits. In conducting the assessment, there are two overarching principles: (1) audit organizations should not provide nonaudit services that involve performing management functions or making management decisions and (2) audit organizations should not audit their own work or provide nonaudit services in situations where the nonaudit services are significant/material to the subject matter of audits. If the audit organization makes the determination that the nonaudit service does not violate these principles, it should comply with all the safeguards stated in paragraph 3.25.

3.22 Audit organizations should not perform management functions or make management

decisions. Performing management functions or making management decisions creates a situation that impairs the audit organization's independence, both in fact and in appearance, to perform audits of that subject matter and may affect the audit organization's independence to conduct audits of related subject matter. For example, auditors should not serve as members of an entity's management committee or board of directors, make policy decisions that affect future direction and operation of an entity's programs, supervise entity employees, develop programmatic policy, authorize an entity's transactions, or maintain custody of an entity's assets.[9]

3.23 Auditors may participate on committees or task forces in a purely advisory capacity to advise entity management on issues related to the knowledge and skills of the auditors without impairing their independence. However, auditors should not make management decisions or perform management functions. For an example, auditors can provide routine advice to the audited entity and management to assist them in activities such as establishing internal controls or implementing audit recommendations, can answer technical questions, and/or provide training. The decision to follow the auditor's advice remains with management of the audited entity. These types of interactions are normal between the auditor and the management of the audited entity given the auditor's technical expertise and the knowledge the auditor gains of

[9]Entity assets are intended to include all of the entity's property including bank accounts, investment accounts, inventories, equipment or other assets owned, leased, or otherwise in the entity's possession.

the audited entity's operations. An auditor may also provide tools and methodologies, such as best practice guides, benchmarking studies, and internal control assessment methodologies that can be used by management. By their very nature, these are routine activities that would not require the audit organization to apply the safeguards described in paragraph 3.25.

3.24 Audit organizations should not audit their own work or provide nonaudit services if the services are significant/material to the subject matter of audits. In considering whether the nonaudit service can have a significant or material affect on the subject matter of audits, audit organizations should consider (1) ongoing audits, (2) planned audits, (3) requirements and commitments for providing audits, which includes laws, regulations, rules, contracts and other agreements, and (4) policies placing responsibilities on the audit organization for providing audit services. Government auditors generally have broad audit responsibilities that may extend to a level of government or a particular entity within a level of government. Given their broad area of audit responsibility, government auditors need to be especially careful in providing nonaudit services to the entity so that their independence is not impaired to fulfill their full range of audit responsibilities. Nongovernment audit organizations may provide audit and nonaudit services under contractual commitments to an entity (commonly referred to as consulting) and need to consider whether nonaudit services they have provided or are committed to provide have a significant or material affect on the subject matter of audits.

3.25 Audit organizations may perform nonaudit services that do not violate the principles stated

in paragraph 3.21 only if the audit organization and the audited entity complies with the following safeguards. These safeguards would not apply in connection with the type of routine activities described in paragraph 3.23. The intent in paragraph 3.25 is not for the audit organization to apply these safeguards to each and every interaction it has with management.

a. The audit organization should document its consideration of the nonaudit services as discussed in paragraph 3.21, including documentation for its rationale that providing the nonaudit services does not violate the two overarching principles.

b. Before performing nonaudit services, the audit organization should establish and document an understanding with the audited entity regarding the objectives, scope of work, and product or deliverables of the nonaudit service. The audit organization should also establish and document an understanding with management that management is responsible for the substantive outcomes of the work and, therefore, has a responsibility to be in a position in fact and appearance to make an informed judgment on the results of the nonaudit service and that the audited entity complies with the following:

1. Designates a management-level individual to be responsible and accountable for overseeing the nonaudit service.

2. Establishes and monitors the performance of the nonaudit service to ensure that it meets management's objectives.

3. Makes any decisions that involve management functions related to the nonaudit service and accepts full responsibility for such decisions.

4. Evaluates the adequacy of the services performed and any findings that result.

c. The audit organization should preclude personnel who provided the nonaudit services from planning, conducting, or reviewing audit work related to the nonaudit service under the overarching principle that auditors cannot audit their own work.[10]

d. The audit organization is precluded from reducing the scope and extent of the audit work beyond the level that would be appropriate if the nonaudit work was performed by another unrelated party.

e. The audit organization's quality control systems for compliance with independence requirements should include policies and procedures to assure consideration of the effect on the ongoing, planned, and future audits when deciding whether to provide nonaudit services and a requirement to have the understanding with management of the audited entity documented. The understanding should be communicated to management in writing and can be included in the engagement letter. In addition, the documentation should specifically identify management's compliance with the elements discussed in paragraph 3.25b, including evidence of the management-level individual responsible

[10]*Personnel who provided the nonaudit service are permitted to convey the knowledge gained of the audited entity and its operations to the audit assignment team.*

for overseeing the nonaudit service's qualifications to conduct the required oversight, and that the tasks required of management were performed.

f. By their nature, certain nonaudit services impair the audit organization's ability to meet either or both of the overarching principles in paragraph 3.21 for certain types of audit work. In these cases, the audit organization should communicate to management of the audited entity that the audit organization would not be able to perform subsequent audit work related to the subject matter of the nonaudit service. It should be clear to management upfront that the audit organization would be in violation of the independence standard and that another audit organization that met the independence standard would have to be engaged to perform the audit. For example, if the audit organization has been responsible for designing, developing, and/or installing the entity's accounting system or is operating the system and then performed a financial statement audit of the entity, the audit organizations would clearly be in violation of the two overarching principles of the GAGAS independence standard. Likewise, if the audit organization developed an entity's performance measurement system, the audit organization would not be deemed independent if it was asked to conduct a performance audit to evaluate whether the system was adequate. In both of these examples, the audit organization could decide to perform the nonaudit service but would then not be permitted under GAGAS to perform the subsequent audit because it would be in violation of one or both of the two overarching principles. It becomes a matter of choice for the audit organization and the audited entity. But the audit organization cannot both provide the

service and perform the audit if either of the two overarching principles is violated.

g. ***For individual audits selected in the peer review, all related nonaudit services should be identified to the audit organization's peer reviewer and the audit documentation required by paragraphs 3.25a through e are made available for inclusion in the audit organization's peer review.***

3.26 Audit organizations and auditors may encounter many different circumstances or combinations of circumstances; therefore, it is impossible to define every situation that could result in an impairment, as discussed in paragraph 3.20. The following are examples of nonaudit services performed by an audit organization that typically would not create an impairment to the audit organization's independence as long as the auditor avoids situations that would conflict with the two overarching principles listed in paragraph 3.21 and the audit organization complies with the safeguards in paragraph 3.25.

a. Providing basic accounting assistance limited to services such as preparing draft financial statements that are based on management's chart of accounts and trial balance and any adjusting, correcting, and closing entries that have been approved by management; preparing draft notes to the financial statements based on information determined and approved by management; preparing a trial balance based on management's chart of accounts; maintaining depreciation schedules for which management has determined the method of depreciation, rate of depreciation, and salvage value of the asset. The audit

organization, however, cannot maintain or prepare the audited entity's basic accounting records or maintain or take responsibility for basic financial or other records that the audit organization will audit.[11] ***As part of this prohibition, auditors should not post transactions (whether coded or not coded) to the entity's financial records or to other records that subsequently provide data to the entity's financial records.***

b. Providing payroll services limited to services such as computing pay amounts for the entity's employees based on entity maintained and approved time records, salaries or pay rates, and deductions from pay; generating unsigned payroll checks; transmitting client approved payroll to a financial institution provided management has approved the transmission and limited the financial institution to make payments only to previously approved individuals. In cases, where the audit organization was processing the entity's entire payroll and payroll was a material amount to the subject matter of the audit, this would be a violation of one of the overarching principles in paragraph 3.21 and the auditor would not be deemed independent under GAGAS.

c. Providing appraisal or valuation services limited to services such as reviewing the work of the entity or a specialist employed by the entity where the entity or specialist provides the primary support for the balances recorded in

[11]roposing adjusting and correcting entries that are identified during the audit are a routine byproduct of audit services that are always permissible so long as management makes the decision on accepting these entries.

financial statements or other information that will be audited; valuing an entity's pension, other post-employment benefit, or similar liabilities provided management has determined and taken responsibility for all significant assumptions and data.

d. Preparing an entity's indirect cost proposal[12] or cost allocation plan provided management has taken responsibility for all significant assumptions and data.

e. Providing advisory services on information technology limited to services such as advising on system design, system installation, and system security if management in addition to the safeguards in paragraph 3.25 acknowledges responsibility for the design, installation, and internal control over the entity's system and does not rely on the auditor's work as the primary basis for determining (1) whether to implement a new system, (2) the adequacy of the new system design, (3) the adequacy of major design changes to an existing system, and (4) the adequacy of the system to comply with regulatory or other requirements. However, the audit organization should not operate or supervise the operation of the entity's information technology system.

f. Providing human resource services to assist management in its evaluation of potential candidates that are limited to activities such as serving on an evaluation panel to review applications or interviewing candidates to

[12]he Office of Management and Budget prohibits an auditor who prepared the entity's indirect cost proposal from conducting the required audit when indirect costs recovered by the entity during the prior year exceeded $1 million.

provide input to management in arriving at a listing of best qualified applicants to be provided to management. The auditor should not recommend a single individual for a specific position nor should the auditor conduct an executive search or a recruiting program for the audited entity.

g. Preparing routine tax filings in accordance with federal tax laws and rules and regulations of the Internal Revenue Service and state and local tax authorities and any applicable laws.

h. Gathering and reporting unverified external or third-party data to aid legislative and administrative decision-making.

i. Advising an entity regarding its performance of internal control self-assessments.

j. Assisting a legislative body by developing questions for use at a hearing.

External Impairments

3.27 Factors external to the audit organization may restrict the work or interfere with an auditor's ability to form independent and objective opinions and conclusions. ***External impairments to independence occur when an auditor is deterred from acting objectively and exercising professional skepticism by pressures, actual or perceived, from management and employees of the audited entity or oversight organizations.*** For example, under the following conditions, an auditor may not have complete freedom to make an independent and objective judgment ***and an audit may be adversely affected:***

a. external interference or influence that ***could*** improperly or imprudently limit~~s~~ or modif***y***~~ies~~ the scope of an audit ***or threaten to do so, including pressure to reduce inappropriately the extent of work performed in order to reduce costs or fees,***

b. external interference with the selection or application of audit procedures or in the selection of transactions to be examined,

c. unreasonable restrictions on the time allowed to complete an audit ***or issue the report***,

d. interference external to the audit organization in the assignment, appointment, and promotion of audit personnel,

e. restrictions on funds or other resources provided to the audit organization that adversely affect the audit organization's ability to carry out its responsibilities,

f. authority to overrule or to ***inappropriately*** influence the auditor's judgment as to the appropriate content of the report,

g. threat of replacement over a disagreement with the contents of an audit report, the auditor's conclusions or the application of an accounting principle or other criteria, and

h. influences that jeopardize the auditor's continued employment for reasons other than ***in***competenc***e***~~y~~, ***misconduct,*** or the need for audit services.

3.28 An audit organization's internal quality control system for compliance with GAGAS independence requirements, as stated in paragraph 3.16, should include internal policies

and procedures for reporting and resolving external impairments.

Organizational Impairments

3.29 ***In addition to the preceding paragraphs which address personal and external impairments***, ~~G~~***g***overnment audit~~ors'~~ ***organization's capability to perform the work and report the results impartially*** ~~independence~~ can be affected by their place within ***government and*** the structure of the government entity ~~to~~ which ~~they are~~ ***the audit organization is*** assigned ***to audit*** ~~and also by whether they are auditing internally or auditing other entities.~~ ***Whether performing work to report externally to third parties outside the audited entity or internally to top management within the audited entity, auditor organization need to be free from organizational impairments to independence.***-

Organizational Impairment Considerations When Reporting Externally to Third Parties

3.30 Government auditors can be presumed to be ~~independent of the audited entity, assuming no personal or external impairments exist, if the entity is~~***free from organizational impairments to independence when reporting externally to third parties if their audit organization is organizationally independent from the audited entity. Government audit organizations can meet the requirement for organizational independence in a number of ways.***

3.30.1 First, a government audit organization may be presumed to be free from organizational impairments to independence from the audited entity to report externally, if the audit organization is

a. assigned to a level of government other than the one to which ~~they are~~ ***the audited entity is*** assigned (federal, state, or local),***for example, a federal auditor auditing a state government program***, or

b. ***assigned to*** a different branch of government within the *same* level of government ~~to which they~~ as the audited entity ~~(legislative, executive, or judicial)~~; ***for example, a legislative auditor auditing an executive branch program.***

3.30.2 Second, a g~~G~~overnment audit~~ors~~ ***organization*** may also be presumed to be ***free from organizational impairments for external reporting*** ~~independent, assuming no personal or external impairments exist,~~ if the audit organization's head ~~is~~ ***meets any of the following criteria:***

a. ***is directly*** elected by ~~the citizens~~ ***voters*** of the~~ir~~ jurisdiction ***being audited***,

b. ***is*** elected or appointed by a legislative body ~~of the level of government to which they are assigned~~ ***subject to removal by a legislative body***, and reports the results of audits to and ~~are~~ ***is*** accountable to ~~the~~ ***a*** legislative body,

c. ***is*** appointed by ~~the chief executive~~ ***someone other***than a legislative body, so long as the appoint***ment is*** ~~but~~ confirmed by~~,~~ ***a legislative body and*** removal from the position is subject to oversight ***or approval by a legislative body,***[13] and reports the results of

[13]Legislative bodies may exercise their confirmation powers through a variety of means as long as they are involved in the approval of the individual to head the audit office. This involvement can be demonstrated by approving the individual after the appointment or by initially selecting or nominating an individual or individuals for appointment by the appropriate authority.

audits to, and are is accountable to a legis lative body ~~of the level of government to which they are assigned, or~~

d. is appointed by, accountable to, reports to, and can only be removed by a statutorily created governing body, the majority of whose members are independently elected or appointed and come from outside the organization being audited.

3.30.3 In addition to the presumptive criteria in paragraphs 3.30.1 and 3.30.2, GAGAS recognize that there may be other organizational structures under which a government audit organization could be considered to be free from organizational impairments, and thereby be considered organizationally independent to report externally. These other structures should provide sufficient safeguards to prevent the audited entity from interfering with the audit organization's ability to perform the work and report the results impartially. For an audit organization to be considered free from organizational impairments to report externally under a structure different from the ones listed in paragraphs 3.30.1 and 3.30.2, the audit organization should have all of the following safeguards:

a. statutory protections that prevent the abolishment of the audit organization by the audited entity,

b. statutory protections that require that if the head of the audit organization is removed from office, the head of the agency should report this fact and the reasons for the removal to the legislative body,

c. statutory protections that prevent the audited entity from interfering with the initiation, scope, timing, and completion of any audit,

d. statutory protections that prevent the audited entity from interfering with the reporting on any audit, including the findings, conclusions, and recommendations, or the manner, means, or timing of the audit organization's reports,

e. statutory protections that require the audit organization to report to a legislative body or other independent governing body on a recurring basis,

f. statutory protections that give the audit organization sole authority over the selection, retention, advancement, and dismissal of its staff, and

g. statutory access to records and documents that relate to the agency, program, or function being audited.[14]

3.30.4 If the head of the audit organization concludes that the organization meets all the safeguards listed in paragraph 3.30.3, the audit organization should be considered free from organizational impairments to independence when reporting the results of its audits externally to third parties. The audit organization should document the statutory provisions in place that allow it to meet these safeguards. Those provisions should be reviewed during the external

[14]Statutory authority to issue a subpoena to obtain the needed records is one way to meet the requirement for access to records.

quality assurance review to ensure that all the necessary safeguards have been met.

Organizational Impairment Considerations When Reporting Internally to Management

3.30.5 Certain federal, state, or local government audit organizations or audit organizations within other government entities, such as public colleges, universities, and hospitals, employ auditors to work for management of the audited entities. These auditors may be subject to administrative direction from persons involved in the government management process. ***Such audit organizations are internal audit organizations.*** ~~To help achieve organizational independence, audit organizations should~~ ***A government internal audit organization can be presumed to be free from organizational impairments to independence when reporting internally to management if the head of the audit organization meets all of the following criteria:***

a. ~~be~~ ***is*** accountable to the head or deputy head of the government entity,

b. is required to report the results of ~~their audits~~ ***the audit organization's work*** to the head or deputy head of the government entity, and

c. ~~be~~ ***is*** located organizationally outside the staff or line management function of the unit under audit.

3.30.6 If the ~~above~~ conditions ***of paragraph 3.30.5*** are met, ~~and no personal or external impairments exist,~~ the audit ~~staff~~ ***organization*** should be considered ***free of*** organizational~~ly~~ ***impairments to*** independen~~t~~ce to audit internally and ~~free to~~ report objectively to ~~top~~ ***the entity's*** management. ***Further distribution of reports outside the organization should only be made in accordance with applicable law, rule, regulation, or policy. In these situations, the fact***

that the auditors are auditing in their employing organizations should be clearly reflected in the auditors' reports.

3.30.7 Auditors ***need*** ~~should also~~ ***to*** be sufficiently removed from political pressures to ensure that they can conduct their audits objectively and can report their findings, opinions, and conclusions objectively without fear of political repercussions. Whenever feasible, auditors within internal audit organizations should be under a personnel system in which compensation, training, job tenure, and advancement are based on merit.

3.30.8 The audit organization's independence is enhanced when it also reports regularly to the entity's independent audit committee and/or the appropriate government oversight body.

3.30.9 When ~~organizationally independent internal auditors~~ ***internal audit organizations that are free of organizational impairments to independence, under the criteria in paragraph 3.30.5,*** ~~conduct~~ ***perform*** audits external to the government entities to which they are directly assigned, ***such as auditing contractors or outside party agreements,*** and no personal or external impairments exist, they may be considered independent of the audited entities and free to report objectively to the heads or deputy heads of the government entities to which they are assigned ***and to parties outside the organizations in accordance with applicable law, rule, regulation, or policy***.

3.30.10 The audit organization should document the conditions in place that allow it to be considered free of organizational impairments to independence to report internally. Those conditions should be reviewed during the peer

review to ensure that all the necessary safeguards have been met.

Appendix I

Advisory Council on Government Auditing Standards

Advisory Council Members

Mr. Jack R. Miller, Chair
MPG Peat Marwick LLP
(member 1997-1998; chair 2001-2003)

Mr. Richard C. Tracy, Former Chair
Office of City Auditor
Portland, Oregon
(member 1997-1998; chair 1999-2000)

The Honorable James B. Thomas, Former Chair
Office of Chief Inspector General
State of Florida
(chair 1997-1998)

Mr. Ernest A. Almonte
Office of the Auditor General
State of Rhode Island
(member 2001-2003)

Mr. Robert H. Attmore
Office of the Comptroller
New York State
(member 1997-1999)

The Honorable Thomas R. Bloom
Defense Finance and Accounting Service
(member 1997-2000)

The Honorable June Gibbs Brown
U.S. Department of Health and Human Services
(member 1997-1999)

The Honorable Ralph Campbell, Jr.
Office of the State Auditor
State of North Carolina
(member 2000-2003)

Mr. Donald H. Chapin
Consultant
(member 1997-1998)

Ms. Patricia A. Dalton
U.S. Department of Labor
(member 1997-1999)

The Honorable Bert T. Edwards
U.S. Department of Interior
(member 2000-2002)

The Honorable Gaston L. Gianni, Jr.
Federal Deposit Insurance Corporation
(member 1999-2001)

Ms. Barbara J. Hinton
Office of the Legislative Post Auditor
State of Kansas
(member 1999-2001)

Mr. David G. Hitchcock
Standards & Poor's
(member 1999-2001)

Dr. Jesse W. Hughes
Consultant
(member 2000-2002)

Dr. Rhoda C. Icerman
Florida State University
(member 2001-2003)

Mr. Norwood J. Jackson, Jr.
U.S. Office of Management and Budget
(member 1997-2000)

Mr. Auston G. Johnson
Office of the State Auditor

State of Utah
(member 2000-2002)

The Honorable Margaret B. Kelly
Office of the State Auditor
State of Missouri
(member 1997-1998)

Dr. Daniel G. Kyle
Office of the Legislative Auditor
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