

# **Government Auditing Standards and Professional Requirements**

**Presented by**

## **Tax CE Publishing**



**Publication Date: March 15<sup>th</sup>, 2022**

# Copyright Notice

Copyright 2022 by Tax CE Publishing.

All rights reserved. No part of this work may be used, reproduced, or transmitted in any form or by any means, electronic or mechanical, including photocopying, recording, or by any information storage and retrieval system, without prior agreement and written permission from Tax CE Publishing and Andrew Clark Enterprises.

The contents of this program are subject to revision without notice due to the continued evolution of the U.S. Tax Code.

This program is presented as is, without warranty of any kind, including but not limited to implied warranties of the workbook's quality, performance, merchantability, or fitness for any particular purpose. Tax CE Publishing shall not be liable to the purchaser or any other entity with respect to liability, loss, or damage caused directly or indirectly by using this program.

All brand names, trademarks, and registered trademarks are the property of their respective holders.

Tax CE Publishing  
1890 Junction Blvd.,  
Apt. 2515  
Roseville, CA 95747

## Introduction

The Generally Accepted Governmental Auditing Standards, also known as the Yellow Book, provides a comprehensive framework for conducting governmental audits with a focus on high quality, integrity, competence, independence, and objectivity. The Yellow Book is used by auditors of government organizations, entities that receive government awards, and any other audit organization performing Yellow Book audits. The Yellow Book outlines all requirements for governmental audit reports, professional qualifications for auditors, and audit organization quality control.

This course will describe when the Yellow Book standards must be applied. This course will identify the categories of requirements that GAGAS uses to describe the degree of responsibility imposed on auditors and audit organizations. This course will identify the ethical principles that guide the work of auditors who conduct engagements in accordance with GAGAS. Finally, this course will identify the individuals that have a role on an audit engagement.

**CPE Credit:** 3 CPE for CPAs

**Level:** Intermediate

**Instructional Method:** Self-Study

**NASBA Field of Study:** Auditing

**Program Prerequisites:** Basic understanding of the auditing process.

**Advanced Preparation:** None

## **2018 Yellow book Overview**

### **Objectives**

At the end of this chapter, the student will be able to:

- Recognize when the Yellow Book standards must be applied.
- Identify the new organization and format of the 2018 Yellow Book.
- Recognize the five areas that changed in the 2018 Yellow Book from the 2011 Yellow Book.

### **2018 Yellow Book Overview Introduction**

The 2018 Yellow Book Overview is a summary of the significant changes in the 2018 Yellow Book. This overview will provide some background information on Governmental Auditing Standards and the topics covered in the Yellow Book. The Yellow Book Overview will identify the effective dates for the 2018 revision of the Yellow Book. The 2018 Yellow Book Overview identifies the five key areas that changed from previous version of the Yellow Book including: the structure of the document, defining independence, peer review, defining waste and abuse, and performance audits.

### **Yellow Book**

Government Auditing Standards are published by the U.S. Government Accountability Office (known as the GAO). The U.S. Government Accountability Office (GAO), also known as the "Congressional Watchdog," is an independent, nonpartisan agency that helps Congress fulfill its constitutional duties. The General Attorneys at GAO work in the Office of the General Counsel and ensure that GAO's work for Congress is legally sound.

The GAO publishes a book called "Government Auditing Standards", which is commonly known as the Yellow Book. The GAO Yellow Book is a manual for auditors and auditing agencies. The professional standards and guidance contained in this document provide a framework for conducting high-quality engagements with competence, integrity, objectivity, and independence.

The Yellow Book is based on the concept of accountability for use of public resources. This concept of accountability also means that management and officials entrusted with public resources are responsible for carrying out public functions and providing service to the public effectively, efficiently, economically, and ethically within the context of the statutory boundaries of the specific government program. Government auditing is essential in providing accountability to legislators, oversight bodies, those charged with governance, and the public. GAGAS engagements provide an independent, objective, nonpartisan assessment of the stewardship, performance, or cost of government policies, programs, or operations, depending upon the type and scope of the engagement.

The 2018 revision of the Yellow Book is effective for financial audits, attestation engagements, and reviews of financial statements for periods ending on or after June 30, 2020, and for performance audits beginning on or after July 1, 2019. Early implementation is not permitted.

The Yellow Book standards are used by auditors who examine the federal government, including the Government Accountability Office, various offices of Inspectors General, and others. Many local government performance auditors also use the yellow book standards. In addition, CPA firms that perform local government financial audits that include an A-133 "single audit" must follow yellow book standards.

In addition to financial audits, the Yellow Book standards cover Performance Audits, which evaluate the performance of a program or project against defined objectives, such as objectives for efficiency and effectiveness.

The standards apply to both financial and performance audits of government agencies. Five general sections are included:

- Independence
- Due Care
- Continuing Professional Education (CPE)
- Supervision
- Quality Control

As you can see, auditing of governmental and not-for-profit entities and organizations is very similar to providing auditing services for private entities and organizations. The governmental auditor is responsible for to following:

- Making judgements about internal controls
- Selectively testing transactions

- Sending confirmations
- Assess the fairness of the entity's financial statements, and
- Issue an audit report

It is important to recognize that governmental auditing is requires to follow a set of defined guidelines, which are established the U.S. Government Accountability Office (known as the GAO).

## Engagement Team Definitions

The 2018 Yellow Book states in Paragraph 4.12 that the engagement team should determine that specialists assisting the engagement team on a GAGAS engagement are qualified and competent in their areas of specialization. As a result, the 2018 Yellow Book provides definitions for:

- Auditor
- Engagement Team
- Specialist

### **Auditor:**

An individual assigned to planning, directing, performing engagement procedures or reporting on GAGAS engagements (including work on audits, attestation engagements, and reviews of financial statements) regardless of job title. Therefore, individuals who may have the title auditor, information technology auditor, analyst, practitioner, evaluator, inspector, or other similar titles are considered auditors under GAGAS. (2018 Yellow Book paragraph 1.27(f))

### **Engagement team (or audit team):**

Auditors assigned to planning, directing, performing engagement procedures or reporting on GAGAS engagements. (2018 Yellow Book paragraph 1.27(i))

## **Specialist:**

An individual or organization possessing special skill or knowledge in a particular field other than accounting or auditing that assists auditors in conducting engagements. A specialist may be either an internal specialist or an external specialist. (2018 Yellow Book paragraph 1.27(p))

Some engagements may necessitate the use of specialized techniques or methods that call for the skills of specialists. Specialists do not include individuals with special skill or knowledge related to specialized areas within the field of accounting or auditing, such as income taxation and information technology. Such individuals are considered auditors. (2018 Yellow Book paragraph 4.13)

Internal specialists assisting on a GAGAS engagement who are not involved in planning, directing, performing engagement procedures, or reporting on a GAGAS engagement are not auditors subject to the GAGAS CPE requirements. (2018 Yellow Book paragraph 4.30)

Finally, the other changes worth noting are the minor wording changes throughout the document.

- The term “audit” was replaced with “engagement”
- The term “performance” was replaced with “conducting”

Finally, a Glossary added at end of 2018 Yellow Book.

## **Yellow Book Publications**

The GAO has been publishing this book of government auditing standards for more than four decades. The GAO first published the Yellow Book back in the 1970s as a guide for their own auditors. Auditing processes have essentially remained the same since the original versions of the Yellow Book. The primary evolution has been to address the complexities that have been added to the auditing environment. The Yellow Book has also evolved to address the use of new IT technologies, internal controls and/or revisions to internal controls. As a result, the revisions are published to try to keep up to date with those changes. The Yellow Book has also evolved over the years to stay aligned with the commercial auditing standards that are being used today. It is recognized that the Yellow Book document must be kept updated so it is appropriate in the governmental environment.

The most recent Yellow Book publications include:

- 2005 Yellow Book
- 2011 Yellow Book
- 2018 Yellow Book

## Purpose

The Yellow Book is used by auditors of government entities, entities that receive government awards, and other audit organizations performing Yellow Book audits. It outlines the requirements for audit reports, professional qualifications for auditors, and audit organization quality control. Auditors of federal, state, and local government programs use these standards to perform their audits and produce their reports.

Yellow Book guidelines must be applied to any entities and organizations that are required by law or regulation to follow the Yellow Book. Yellow Book guidelines must be applied to any entities and organizations that receive federal funds. This means that it must be applied to entities and organizations in the federal, state and local environments. It may also be required for a fair number of not-for-profit organizations that receive federal, state and local funds. Therefore, the Yellow Book is used not only by GAO auditors, but also by other federal, state and local government auditing agencies. Finally, it may also be a requirement for some overseas auditing agencies.

Yellow Book is a set of standards that define a set of guidelines. This document is not prescriptive in terms of how you must perform an audit. However, the application guidance defined in this document provides direction for the audit. The Yellow Book does not mandate a practitioner how to perform the audit, but instead, it defines the basic requirements of a yellow book audit and leaves how to do it up to the practitioner.

## When and Where to Apply Yellow Book

When required (for example, by law, regulation, contract, grant agreement, and policy), the Yellow Book guidelines must be used such as:

- Participation in federal programs (such as grants or loan programs) over a certain dollar threshold triggers a Yellow Book requirement (and related compliance audit)



Note - When not required, auditees may voluntarily engage auditors to apply the Yellow Book on the engagement.

Audit Requirement	GAGAS Applicable?
Single Audit	Yes
HUD Consolidated Audit Guide	Yes
F/S audit of GASB reporting entity	Maybe
Agreed-upon procedures engagement on grant compliance	Maybe

## Effective Date

The current version is the 2018 Yellow Book. This revised version of the Yellow Book updated the 2011 Yellow Book version. The 2018 Yellow Book supersedes the 2011 Yellow Book version. It also supersedes the 2014 GAO peer review ratings guidance and the 2005 GAO CPE guidance.

The new Yellow Book is effective for financial audits, attestation engagements, and reviews of financial statements. The new Yellow Book is effective for performance audits beginning on or after July 1, 2019. The new Yellow Book is effective for financial audits, attestation engagements, and reviews of financial statements for periods ending on or after June 30, 2020.

Early implementation is not permitted.

## Overview of the 2018 Yellow Book Changes

The revised Yellow Book changed in five key areas including:

1. Structure of the document
2. Defining independence
3. Peer Review
4. Defining waste and abuse
5. Performance audits

The first important change is in the structure of the document where the requirements are highlighted and separated from the application guidance. The application guidance provides information on how to meet the specified

requirements. The previous version (2011 version) was pure text. Now, it is text with a little more direction.

The second important change is in the area of independence. This version of the Yellow Book focuses on clarifying challenging independence issues, particularly when auditors also prepare the financial statements of their audit client.

The third important change is in the area of peer review. It defines when peer reviews are required by the audit organizations. As a result, the revised Yellow Book added clarification to the requirements for peer review and the audit organizations that we are accepting for peer review and their program.

The fourth important change is in the area of waste and abuse. In previous versions of the Yellow Book, waste was not defined. The revised Yellow Book provides guidance on waste, fraud, and abuse. The revised Yellow Book proceeded to define waste and it re-characterizes what the auditors' responsibilities are if waste is detected by the auditor. In addition, the revised Yellow Book looks at waste and abuse in terms of internal controls and how an auditor may report those for an organization that is being audited.

The fifth important change relates to performance audits. This version of the Yellow Book also focuses on internal controls when those internal controls are very important to the objectives of the financial or the performance audit.

Finally, most practitioners will find that the revised Yellow Book is current with both US Auditing Standards and International Auditing standards. The revised Yellow Book will provide a good set of guidelines and standards for practitioners in the governmental space.

## New Organization and Format

The 2018 Yellow Book has a new organization from the 2011 Yellow Book. In the 2018 Yellow Book, chapters are reorganized and realigned. Certain topic areas that had previously been combined are now separated out. These changes have resulted in 9 chapters.

The 2018 Yellow Book also uses a clarified format. This means that requirements appear in boxes and all application guidance appears after each boxed requirement. This is shown here.

## Relationship between GAGAS and Other Professional Standards

### Requirement: Relationship between GAGAS and Other Professional Standards

**2.11** When auditors cite compliance with both GAGAS and another set of standards, such as those listed in paragraphs 2.13, 2.15, 6.01, and 7.01, auditors should refer to paragraph 2.17 for the requirements for citing compliance with GAGAS. In addition to citing GAGAS, auditors may also cite the use of other standards in their reports when they have also met the requirements for citing compliance with the other standards. Auditors should refer to the other set of standards for the basis for citing compliance with those standards.

### Application Guidance: Relationship between GAGAS and Other Professional Standards

**2.12** Auditors may use GAGAS in conjunction with professional standards issued by other authoritative bodies.

**2.13** The relationship between GAGAS and other professional standards for financial audits, attestation engagements, and reviews of financial statements is as follows:

- a. The American Institute of Certified Public Accountants (AICPA) has established professional standards that apply to financial audits, attestation engagements, and reviews of financial statements for nonissuers (entities other than issuers under the Sarbanes-Oxley Act of 2002,<sup>14</sup> such as privately held companies,

<sup>14</sup>See the Sarbanes-Oxley Act of 2002 (Public Law 107-204) for a discussion of issuers (generally, publicly traded companies with a reporting obligation under the Securities Exchange Act of 1934).

Finally, supplemental guidance that was included in the appendices from the 2011 Yellow Book is either removed or incorporated into the 2018 Yellow Book.

The new format provides clearer guidance between requirements, presumptively mandatory requirements, and application guidance.

- Requirements – auditor “must” comply with where relevant; identified with use of “must”
- Presumptively mandatory requirements – auditor must comply with except in rare circumstances; identified with use of “should”
- If depart from, should perform alternative procedures and document justification
- Application guidance – provides further explanation of the requirements and guidance for applying them; identified with “may,” “might,” and “could.”

## Independence Changes

The most significant changes in the 2018 Yellow Book relate to the performance of non-audit services that include preparing accounting records and financial statements. The 2018 Yellow Book retains much of its other independence requirements and guidance.

Although the 2011 Yellow Book advised to consider these possibilities, the 2018 Yellow Book goes a step further and clarifies when independence is impaired. It outlines when preparing the financial statements in their entirety creates a significant threat to independence that should be reduced to an acceptable level by safeguards. A firm should also document the evaluation and how threats were effectively addressed.

Unless specifically prohibited under the 2018 Yellow Book, a firm preparing accounting records and financial statements for an audit client creates threats to independence that either will or may require the firm to apply safeguards to maintain its independence. Therefore, the 2018 Yellow Book indicates that non-audit services in this area fall into three categories:

1. Those that automatically impair independence
2. Those that are significant threats
3. Those that are threats

For other permissible services involving preparation of accounting records and financial statements, firms should document the evaluation of the threat(s) to determine significance. If significant, the documentation should include a description of the safeguards applied to reduce any significant threat(s) to an acceptable level.

Activities that impair independence when preparing accounting records and financial statements include the following:

- Determining or changing journal entries, account codes or classifications for transactions, or other accounting records for the entity without obtaining management's approval;
- Authorizing or approving the entity's transactions; and
- Preparing or making changes to source documents without management approval

Activities that are significant threats when preparing accounting records and financial statements include the following:

- Preparing financial statements in their entirety from the client-provided trial balance or underlying accounting records creates significant threats.

Activities that are threats when preparing accounting records and financial statements include the following:

- Performing any other services related to preparing accounting records and financial statements will create a threat whose evaluation for significance must be documented. Examples of these services are:
  - Recording transactions where management has determined or approved the appropriate account classification, or posting coded transactions to an audited entity's general ledger;
  - Preparing certain line items or sections of the financial statements based on information in the trial balance;
  - Posting entries that an audited entity's management has approved to the entity's trial balance; and
  - Preparing account reconciliations that identify reconciling items for the audited entity management's evaluation.

Clarifications to these points can be found in the 2018 Yellow Book. For example:

**Paragraph 3.88** states that when preparing a client's financial statements in their entirety from the client's trial balance or underlying accounting records, firms should conclude that *significant threats* to independence exist. Under the Yellow Book's conceptual framework approach (Paragraphs 3.26–3.63), when a firm encounters significant threats to independence, the firm should apply safeguards to eliminate or reduce the threats to an acceptable level.

Threats are at an acceptable level when a reasonable and informed third party would conclude that the firm could perform the audit without compromising its professional judgment. A firm that will apply effective safeguards should document the evaluation of threats to independence and describe the safeguards applied. Paragraph 3.69 provides examples of possible safeguards the firm could apply that could be effective for the potential threats that may exist:

- Separate personnel perform the audit and preparation of accounting records and financial statement services.
- An independent party (from inside or outside the firm) performs a second review of the preparation of accounting records and financial statement work.

A firm that cannot apply effective safeguards that reduce the threats to an acceptable level should not perform the preparation of accounting records and financial statement services during the period covered by the financial statements (or other subject matter of the engagement) and the period of professional engagement, as independence would be considered impaired.

**Paragraph 3.89** states that a firm providing other preparation of accounting records and financial statement services should document its evaluation of threats to independence — even if the firm concludes that the threats are not significant — for the following activities:

- Recording transactions for which management has determined or approved the appropriate account classification or posting coded transactions to a client's general ledger;
- Preparing certain line items or sections of the financial statements based on information in the client's trial balance;
- Posting entries that management has approved to the client's trial balance; and
- Preparing account reconciliations that identify reconciling items for management's evaluation.

When threats to independence exist, firms should determine whether they are significant, because *significant* threats require the firm to apply safeguards to eliminate or reduce the threat(s) to an acceptable level. Auditors may consider the following factors in determining whether threats are significant, including:

- The extent to which the outcome of the service could have a material effect on the financial statements;
- The degree of subjectivity involved in determining the appropriate amounts or treatment for those matters reflected in the financial statements; and
- The extent of management's involvement in determining significant matters of judgment.

Factors in evaluating significance of threats when preparing accounting records and Financial statements include the following:

- The extent that the outcome could have to material effect on the financial statements.
- The degree of subjectivity in determining the amounts or the treatment of items.
- The extent of an entity's involvement in determining significant matters of judgment.

Under the 2018 Yellow Book, you are required to document your evaluation of the significance of a threat created by preparing accounting records and financial statements.

## **Independence Compared to the AICPA Code of Professional Conduct**

GAS Paragraphs 3.88–3.89 are more restrictive than the AICPA *Code of Professional Conduct* (the AICPA Code) nonattest service provisions in ET Section 1.295.020. Except for certain services that are considered to impair independence (ET §1.295.120.03), the AICPA does not conclude that preparation of accounting records and financial statement services create threats or significant threats to independence requiring analysis and documentation. The AICPA Code generally considers the services described in Paragraphs 3.88–3.89 of the Yellow Book to be permissible without the application of additional safeguards provided the firm complies with ET Section 1.295 (including the general requirements in ET §1.295.040). If preparation of accounting records and financial statement services proposed by a firm are *not* addressed in the Code, the firm should evaluate threats to independence under the AICPA Conceptual Framework for Independence (ET §1.210.010).

## **Prohibited bookkeeping services**

Paragraph 3.87 outlines the types of bookkeeping services firms may not perform because they are management responsibilities that impair independence. This section is unchanged from the 2011 Yellow Book. The types of bookkeeping services firms may not perform because they are management responsibilities that impair independence include the following:

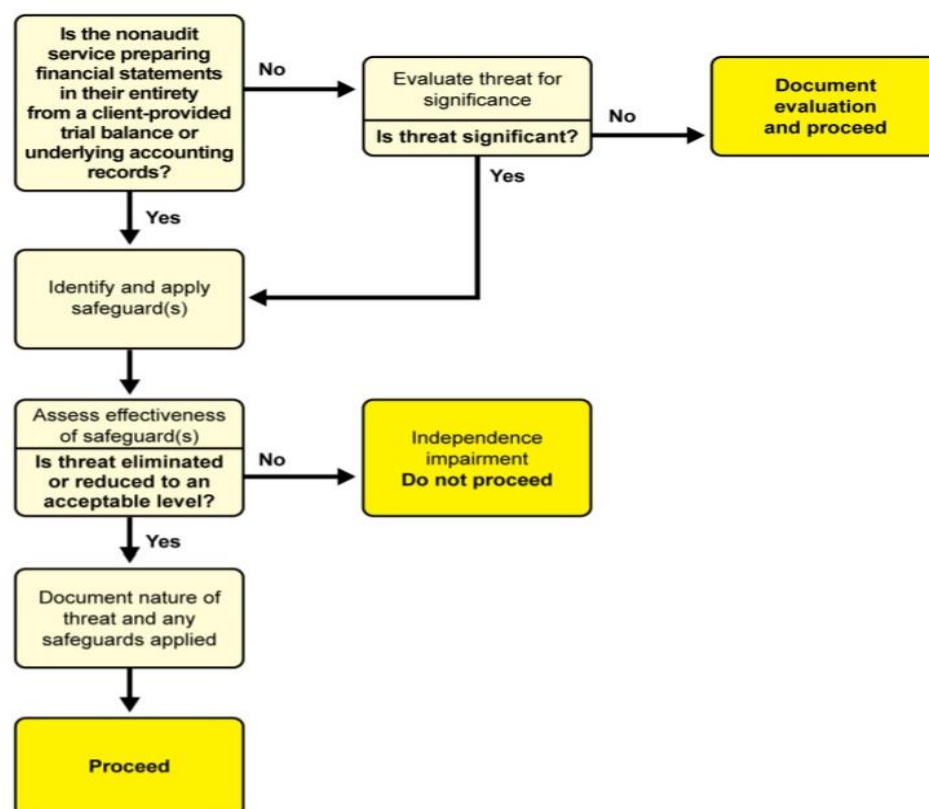
- Determine or change journal entries, account codes or classifications for transactions, or other accounting records for the client without obtaining management's approval;
- Authorize or approve the client's transactions; and
- Prepare or make changes to source documents without management's approval.

However, the 2018 Yellow Book provides new application guidance on clerical assistance. This is defined in paragraph 3.95. It states that providing clerical assistance, such as typing, formatting, printing, and binding financial statements, is unlikely to be a significant threat.

Independence must always be considered and evaluated. Per paragraph 3.20 in the 2018 Yellow Book, auditors and audit organizations should be

independent from an audited entity during any period of time that falls within the period covered by the financial statements or subject matter of the engagement and for the period of the professional engagement.

Chapter 3 provides a visual aid titled “Independence Considerations for Preparing Accounting Records and Financial Statements.” The revised evaluation process related to preparing accounting records and financial statements and shows the questions that must be asked in order to determine whether to proceed, document evaluation and proceed or to recognize the independence is impaired and not to proceed. This is shown in the following flowchart.



Source: GAO. | GAO-18-568G

## Skill, Knowledge and Expertise Guidance

The 2018 Yellow Book provides new application guidance on evaluating whether a client has sufficient skills, knowledge, or experience to oversee a non-audit service. This is defined in Paragraph 3.79 under Management



Responsibilities. This section states that Management not required to possess expertise needed to perform or re-perform the services. However, management is responsible for providing an individual that has sufficient skill, knowledge and expertise to oversee the non-audit service. If management lacks this ability, the firm should consider whether it can provide the non-audit service and remain compliant with the Yellow Book independence standards. If management believes they have the sufficient skills, knowledge, or experience to oversee a non-audit service, Paragraph 3.79 provides indicators of management's ability to effectively oversee the service. These indicators would include the ability to recognize a material error, omission, or misstatement in the results, or the reasonableness of the results of the non-audit service. Finally, the auditor should determine whether that the audited entity has designated an individual who possesses suitable skills, knowledge, or experience to oversee the service.

If a firm performs services involving preparation of accounting records and/or financial statements that involve straightforward calculations (not subject to significant judgment) where the results of the work would not be material to the financial statements, management is fully engaged in overseeing the services. However, management must supply an individual with appropriate skills, knowledge, and experience to oversee the service.

If the firm concludes the self-review threat is not significant, it still should document its evaluation, including the rationale for its conclusion. If threats are significant, and safeguards will be applied that effectively reduce threats to an acceptable level, then the documentation should include a description of the safeguards applied. A firm that cannot apply effective safeguards which reduce the threats to an acceptable level should not perform services that involve the preparation of accounting records and financial statements during the period covered by its audit (or other attest services) and the period of engagement, as independence would be considered impaired.

## Independence guidance for Government Audit Organizations

This provision recognizes that audit organizations in government entities frequently provide services that differ from the traditional professional services a firm provides. These types of services are often provided in the following situations:

- In response to a statutory requirement,
- At the discretion of the authority of the audit organization, or

- To an engaging party (such as a legislative oversight body or an independent external organization) rather than a responsible party.

Generally, all of these situations do not create a threat to independence. The 2018 Yellow Book paragraph 3.72 for the full list of examples of these situations that do not create a threat to independence including:

- providing information or data to a requesting party without auditor evaluation or verification of the information or data;
- developing standards, methodologies, audit guides, audit programs, or criteria for use throughout the government or for use in certain specified situations;
- collaborating with other professional organizations to advance auditing of government entities and programs;
- developing question and answer documents to promote understanding of technical issues or standards;
- Providing assistance and technical expertise to legislative bodies or independent external organizations;
- Assisting legislative bodies by developing questions for use at hearings;
- providing training, speeches, and technical presentations;
- Providing assistance in reviewing budget submissions;
- contracting for audit services on behalf of an audited entity and overseeing the audit contract, as long as the overarching principles are not violated and the auditor under contract reports to the audit organization and not to management; and
- Providing audit, investigative, and oversight-related services that do not involve a GAGAS engagement, such as:
  - Investigations of alleged fraud, or
  - Periodic audit recommendation follow-up engagements and reports

## Peer Review

The third important change is in the area of peer review. The peer review standard has been modified to require that audit organizations comply with their respective affiliated organization's peer review requirements and GAGAS peer review requirements. Additional requirements are provided for audit organizations not affiliated with recognized organizations. It also defines when peer reviews are required by the audit organizations. As a result, the revised Yellow Book added clarification to the baseline requirements for peer review.

The 2018 Yellow Book defines the requirements for audit organizations that are conducting engagements in accordance with GAGAS to obtain an external peer review from a recognized organization. These organizations are defined in section 5.61 and includes the following:

- American Institute of Certified Public Accountants
- Council of the Inspectors General on Integrity and Efficiency
- Association of Local Government Auditors
- International Organization of Supreme Audit Institutions
- National State Auditors Association

## Peer review requirements

2018 Yellow Book defines that 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.

The audit organization must be affiliated with a recognized peer review organization. This means that it must:

- Comply with the respective organization's peer review requirements
- Comply with all additional GAGAS peer review requirements in areas such as:
  - Selection of GAGAS engagements,
  - Peer review report ratings, and
  - Availability of peer review report to the public

In addition, 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. 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. The 2018 Yellow Book also provides examples of the factors that

may be considered when performing an assessment of risk for selecting engagements for peer review including the following:

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

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

- 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.
- 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.
- 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.

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.

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:

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

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:

- Explanation of the peer review process.
- Description of the audit organization's system of quality control.
- Explanation of the relationship of the peer review results to the audited organization's work.
- 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.

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.