

GAO AUDITING STANDARDS

What's New with Recent Changes...and How They Affect YOU!

By Rick Thomas, Vice President–Audit



Rick Thomas, CPA

Question: Why should I learn about auditing standards? My CPA should know the standards; that's his or her job. I have enough problems keeping up with federal and state regulations!

Answer: Because of several recent changes in government auditing standards, new rules could affect you directly. Definitely, these rules will affect your relationship with the CPA who performs your audits on financial and SFA programs.

First some background information on the changes.

Several years ago, the General Accounting Office (GAO), which oversees federal auditing rules, realized an unsettling trend in the relationships between independent CPAs and institutions that administer federal funds.

This trend showed that some CPAs, in addition to conducting audits, were offering extensive accounting, financial and consulting services to some of the institutions – services that could potentially adversely affect the auditors' independence.

Similar issues with independence relationships were also noted in the public arena, as seen in much-publicized financial debacles like Enron.

The GAO wanted the independence relationship between CPAs and their clients to be at the highest possible standards. Therefore, new regulations for CPAs performing government audits were issued during 2001 and 2002.

These new standards became effective in 2003 and affect the relationship between your company and your CPA with the following goal:

“The focus of the changes to auditor independence is to better serve the public interest and to maintain a high degree of integrity, objectivity and independence for audits of government entities.”

The new regulation, which is the



basis for all subsequent regulations, defines independence as follows:

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

Q. What does this mean to my institution?

A. As an owner or director, you should review your relationship with your independent CPA. If the relationship fails the independence test, your CPA must change his or her relationship with you. If the relationship does not change, audits performed by your CPA could be rejected.

The CPA could lose his or her license or be barred from performing audits for failure to follow auditing standards. Many of these standards relate to non-audit or consulting services.

Sometimes it is not appropriate for a CPA to perform both audit and non-audit services for the same client. Auditors may need to choose which of these services to provide.

SUBSTANCE OVER FORM

In using reasonable judgment, an auditor must consider the facts and circumstances of the audit as well as the nature of non-audit services and the totality of services provided to the audited company.

HOLISTIC APPROACH

Non-audit services provided by one office or unit of an audit firm affect the entire audit organization's independence as it relates to the audited entity:

“An auditor cannot ‘unbundle’ services to circumvent an independence impairment issue.”

Ask your auditor about the independence relationship question as well as other services he or she performs for you.

Q. I've developed a quality business relationship with my CPA. Can my CPA do anything other than the audit? And what are the activities that he or she can perform?

A. The rules allow certain routine activities without an independence impairment or without applying certain safeguards. For example, auditors can provide routine advice to assist in the following activities:

(Continued on reverse)



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Calendar
Career College Events

OCTOBER 2003

- 1-3 **CCST ANNUAL CONFERENCE**
Omni Mandalay Hotel, Irving, TX
- 6-10 **TASFEE ANNUAL CONFERENCE**
Wichita Falls, TX
- 15 **FINAL TAX FILING DEADLINES:**
 - Federal Individual Tax Return, Form 1040
 - Federal Partnership Tax Return, Form 1065
 - Federal Trust Tax Return, Form 1041

NOVEMBER 2003

- 2-5 **ED ELECTRONIC ACCESS CONFERENCE**
Manchester Grand Hyatt Hotel, San Diego, CA
- 4-6 **CAPPS 19th ANNUAL CONFERENCE**
Loews Coronado Hotel, San Diego, CA

- 4-7 **EDUCAUSE 2003 ANNUAL CONFERENCE**
Anaheim Convention Center, Anaheim, CA
Topic: Balancing Opportunities, Expectations & Resources
- 8-11 **AACS ANNUAL CONFERENCE**
Fontainebleau Hilton Hotel, Miami, FL
- 19-21 **7th ANNUAL TEXAS WORKFORCE CONFERENCE**
Westin Galleria Hotel, Houston, TX
- 19-21 **SWASFEE CONFERENCE**
Peabody Hotel, Little Rock, AR
Topic: Rollin', Rollin', Rollin' through Reauthorization

DECEMBER 2003

- 2-5 **ED 2003 ELECTRONIC ACCESS CONFERENCE**
Sheraton New Orleans Hotel, New Orleans

GAO STANDARDS
(continued from front)

- Preparing routine tax filings,
- Establishing internal controls or implementing audit recommendations,
- Answering technical questions,
- Providing training,
- Participating on committees in an advisory capacity or as an observer or ex-officio member,
- Developing best-practices guides,
- Developing internal control assessment methodologies,
- Developing professional standards,
- Undertaking benchmarking studies,
- Developing audit methodologies,
- Providing legal/accounting opinions to legislative bodies, and
- Developing questions for hearings and draft legislation.

TYPES OF SERVICES

BASIC ACCOUNTING:

An audit firm's independence to perform audits can be impaired if it maintains or prepares the audited company's basic accounting records.

Problems can arise from a CPA firm maintaining or taking responsibility for basic financial or other records that it will audit. Additional problems can occur by posting transactions to any of the company's records that provide data to the company's financial records.

INTERNAL AUDIT

External audit organizations would violate the overarching principles if they provide internal audit services, because these services are considered a management function.

TAX

Preparing tax returns or assisting with tax deposits are treated the same as routine advice and, therefore, would not violate the overarching principles.

Audit organizations may represent audited entities in IRS matters (under 5USC500) without independence impairment.

A CPA can prepare quarterly and annual payroll tax reports.

An independence relationship problem could arise from tax consulting, if it is material and non-routine.

INFORMATION TECHNOLOGY

In the area of information technology, auditors should limit advice to systems design, installation and security.

Also, auditors should not manage or supervise the operation of the company's

information technology system or install software.

HUMAN RESOURCES

With regard to human resources, auditors should limit services to activities such as serving on an evaluation panel to review applications – or to counsel management on how to choose the best-qualified applicants.

An auditor's independence would be impaired by recommending a single individual for a specific position or by conducting a recruiting program for the audited company.

STOPPING SHORT OF THE LINE

Your auditor should avoid situations that could lead third parties, with knowledge of the relevant facts, to think the auditor is not able to maintain independence in conducting audits.

A FINAL NOTE

Independence is principle-based and should be applied using a substance-over-form doctrine to identify the specific circumstances of each case. Every auditing firm must be independent in order to protect the public interest.

For more information, please contact Rick Thomas at **SalmonBeach**, rthomas@salmonbeach.com, or call 972.392.1143 or 888.332.4829. ■