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Auditing Standards
Established by the GAO
Their Meaning and
Significance for CPAs

A Report

American Institute of
Certified Public Accountants

AICPA

**Committee on Relations With
the GAO (1973-74)**

Gerald A. Polansky, *Chairman*

Donald E. Balderson

George L. Bernstein

Milton M. Broeker

William S. Kanaga

Anthony M. Mandolini

James E. Meredith, Jr.

Walter J. Oliphant

Haldon G. Robinson

Arthur B. Toan, Jr.

Thomas R. Hanley, *Director*,
Federal Government Division

Auditing Standards Established by the GAO –Their Meaning and Significance for CPAs

Prepared by the Committee on Relations With the
General Accounting Office of AICPA

American Institute of Certified Public Accountants

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666 Fifth Avenue, New York, New York 10019***

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Table of Contents

	<i>Page</i>
Preface	v
Introduction	1
GAO Definition of an Audit	2
Discussion of GAO Standards	3
Financial and Compliance	4
Independence	4
Reliance on Other Auditors	5
Reports on Compliance	5
Reporting on Financial Presentations	6
Efficiency and Economy	7
Professional Proficiency	8
Due Professional Care	8
Evidence	8
Reporting	8
Program Results	9
Conclusions and Recommendations	10
Appendix A	13
Excerpts from GAO's <i>Standards for Audit of Govern- mental Organizations, Programs, Activities & Functions</i> ..	13
Appendix B	21
GAO's Fourth Reporting Standard	21

Preface

The Committee on Relations With the General Accounting Office was organized in 1972 to represent the profession's viewpoint regarding matters of mutual concern and interest. The Committee is also responsible for advising the senior technical committees and members of the Institute on significant developments relating to activities of the General Accounting Office.

In August 1972, the GAO issued a publication entitled *Standards for Audit of Governmental Organizations, Programs, Activities & Functions*. The standards set forth therein correspond in important respects with the AICPA's generally accepted auditing standards; however, they address not only the traditional audits of financial presentations, but also compliance with applicable laws and regulations in financial and nonfinancial areas, efficiency and economy of operations, and program results (effectiveness). The standards apply to audits of governmental organizations, programs, activities, and functions and also to audits of contractors, grantees, and other such organizations performed by or for a governmental entity. They are intended to apply whether the audits are performed by auditors employed by federal, state, or local governments, by independent public accountants or by others qualified to perform parts of the audit work contemplated under the standards.

This report has been prepared to help independent public accountants understand the GAO standards, their effect on practice today, their relationship to the AICPA's "generally accepted auditing standards," and their application to the GAO's broadened definition of auditing.

*Committee on Relations With
the General Accounting Office*

Introduction

The United States General Accounting Office (GAO), created by the Budget and Accounting Act of 1921 as the national public auditing agency, is a nonpolitical, nonpartisan agency of the legislative branch of government acting on behalf of Congress. It examines the manner in which government agencies discharge their financial responsibilities with regard to public funds appropriated or otherwise made available to them by Congress and makes recommendations for economy and efficiency in public expenditures. Under the authority granted to it, GAO is not limited to examining financial statements of government agencies, but may investigate all matters relating to the receipt, disbursement, and application of public funds and may recommend measures that might lead to greater economy, efficiency, and effectiveness of public expenditures. The Budget and Accounting Procedures Act of 1950 permits and encourages GAO to make comprehensive audits that include studies of administrative practices, as well as audits of financial transactions.

In harmony with the provisions of the Budget and Accounting Procedures Act of 1950, Comptroller General Elmer B. Staats states, in his foreword to the GAO publication, *Standards for Audit of Governmental Organizations, Programs, Activities & Functions*, that

This demand for information has widened the scope of governmental auditing so that such auditing no longer is a function concerned primarily with financial operations. Instead, governmental auditing now is also concerned with whether governmental

organizations are achieving the purposes for which programs are authorized and funds are made available, are doing so economically and efficiently, and are complying with applicable laws and regulations.

The standards set forth in the text of the GAO publication apply to the evolutionary audit concepts necessary to meet the growing demand for independent evaluation of nonfinancial and financial information. Adoption of the GAO standards by various governmental agencies is required. The Office of Federal Management Policy of the General Services Administration, in its Federal Management Circular FMC 73-2, "Audit of Federal Operations and Programs by Executive Branch Agencies," has set forth the policies to be followed in the audit of federal operations and programs of executive departments and establishments. The definition of auditing contained in the circular conforms with the definition set forth in the GAO publication and requires that audit plans be tailored to each specific program according to the circumstances relating to the program, the management needs to be met, and the capacity of the audit facility. The circular also provides that the audit standards to be used in conducting audits of federal operations and programs are those issued by the GAO. State and local governmental units may be expected to adopt similar requirements. Impetus for adoption of the evolutionary audit concepts appears in recently promulgated regulations for revenue sharing, which provide that "recipient governments are encouraged to have such auditing performed to the extent they consider practical in accordance with the [GAO] standards."

Because the GAO standards may increasingly affect the work of the accounting profession, general understanding and agreement on interpretation and implementation of the standards are needed. This report is an initial attempt to interpret the standards and to explain their impact for independent public accountants.

GAO Definition of an Audit

In GAO's view, auditing is concerned not only with the financial aspects of an entity's operations, but also with the economy, efficiency, and effectiveness of the operations, and with whether

the entity complies with applicable laws and regulations. The GAO standards define the elements of an audit as follows:

1. *Financial and compliance*—determines (a) whether financial operations are properly conducted, (b) whether the financial reports of an audited entity are presented fairly, and (c) whether the entity has complied with applicable laws and regulations.
2. *Economy and efficiency*—determines whether the entity is managing or utilizing its resources (personnel, property, space, and so forth) in an economical and efficient manner and the causes of any inefficiencies or uneconomical practices, including inadequacies in management information systems, administrative procedures, or organizational structure.
3. *Program results*—determines whether the desired results or benefits are being achieved, whether the objectives established by the legislature or other authorizing body are being met, and whether the agency has considered alternatives which might yield desired results at a lower cost.

Although the GAO standards assume that an audit may have all three of the preceding elements, the GAO publication explicitly disclaims any intent to imply that every audit at present has all these elements or that such an extensive scope is always desirable. Nevertheless, the GAO's expansion of the definition of an audit accentuates the importance of having a clear understanding as to the scope of an engagement to which any of the GAO standards apply, and the importance of having an engagement letter as a medium for achieving this understanding. An audit of the broader scope will presumably require more time; it will provide greater service to the client but at additional cost.

Discussion of GAO Standards

A simple comparison of the GAO standards with the ten generally accepted auditing standards adopted by the membership of the AICPA and set forth in section 150 of Statement on Auditing Standards No. 1 does not disclose the impact of the GAO standards on auditing. Such a comparison shows a marked similar-

ity, but the GAO standards go further. The primary impact of the GAO standards is in the way the scope of auditing is expanded beyond examinations leading to the expression of opinions on the fairness of financial presentation to include audits for compliance, efficiency, economy, and effectiveness.

To emphasize the impact of the standards in broadening the definition of auditing, the discussion which follows is organized to conform to the three elements as defined by GAO:

- Financial and compliance.
- Efficiency and economy.
- Program results (effectiveness).

Financial and Compliance

GAO acknowledges the existence of AICPA standards early in its introduction:

The AICPA has adopted standards and procedures that are applicable to audits performed to express opinions on the fairness with which financial statements present the financial position and results of operations. These standards are generally accepted for such audits and have been incorporated into this statement.

Although it seems reasonably clear that the AICPA standards apply to examinations leading to the expression of an opinion on financial presentations, clarification of certain subjects may be helpful. These subjects are as follows:

1. Independence.
2. Reliance on other auditors.
3. Reports on compliance.
4. Reporting on financial presentations.

Independence. In connection with questions which may arise regarding independence, independent public accountants should refer to Rules 101 and 102 of the Rules of Conduct of the AICPA's Code of Professional Ethics and sections 220 and 517 of Statement on Auditing Standards No. 1. Compliance by independent public accountants with the Code and with auditing pronouncements of the AICPA should constitute compliance with the GAO standard on independence.

Reliance on Other Auditors. The GAO standards have as one basic premise that “auditors may rely upon the work of auditors at other levels of government if they satisfy themselves as to the other auditors’ capabilities by appropriate tests.” Independent public accountants should not confuse the basic premise of reliance as outlined by the GAO, with the AICPA auditing standard of reliance on other independent auditors, as expressed in section 543 of Statement on Auditing Standards No. 1. Rather, from the standpoint of independent public accountants, reliance under the GAO standard should perhaps be considered in the same manner as the work of internal auditors is considered, as stated in section 320.74 of Statement on Auditing Standards No. 1.

Reports on Compliance. Reviews of compliance with laws and regulations are not new to the accounting profession in that the independent accountant always has had to consider the financial effect of noncompliance on financial statements. Compliance reviews in nonfinancial areas will require extensive data gathering and may be time-consuming and expensive. However, a substantial part of this can be done by the organization requesting the audit, thus limiting the auditor’s involvement to the exercise of professional judgment in reviewing data accumulated. GAO states:

For many programs that are federally assisted, it would be neither practical nor economical to have every auditor at every level of government do his own background research on the laws, regulations, objectives, and goals of his segment of the program. Therefore, to provide the auditor with the necessary background information and to guide his judgment in the application of the accompanying standards, Federal or State agencies that request state, local, or other levels to make audits are expected to prepare broad, comprehensive audit instructions, tailored to particular programs or program areas.

The content of such audit guidance should include a digest of, or as a minimum, citations to applicable statutes, regulations, instructions, manuals, grant agreements, and other program documents; identification of specific audit objectives and reporting requirements in terms of matters of primary interest in such areas as program compliance, economy, and effectiveness; and other audit guidelines covering specific areas in which the auditor is expected to perform.

Several audit guides issued by governmental agencies currently require compliance reports in addition to reports on financial presentations. If the criteria for making such reviews have been incorporated in the audit guides, the report based upon such a review should conform to the recommendations contained in section 641 of Statement on Auditing Standards No. 1 and the related interpretation thereof. In the absence of established criteria, it will be extremely difficult for an independent public accountant to render a report on compliance which does not include a disclaimer concerning the entity's overall compliance with appropriate laws, rules, and regulations.

Reporting on Financial Presentations. The GAO standards for reporting on financial presentations generally parallel those of the AICPA, but there is an important difference. The GAO standards also call for the inclusion in the auditor's report of supplementary explanatory information which "may be necessary for full and informative disclosure about the financial operations" of the entity audited and of explanation of "violations of legal or other regulatory requirements."

As published, the GAO fourth reporting standard seems to require auditors to express two opinions (one concerning fairness of presentation, the other concerning conformity with generally accepted, or other, accounting principles and consistency of application) on financial presentations instead of the single opinion expressed in reports that comply with the AICPA's auditing standards. GAO has stated that this difference was not intended and that the GAO standards will be amended to eliminate it. The text of the pertinent sections of the GAO publication and a letter from GAO concerning this matter are presented as Appendix B.

The independent public accountant may encounter instances where financial reports are presented in conformity with specified accounting principles applicable to the organization, program, function, or activity which are at variance with generally accepted accounting principles. In such cases the independent public accountant should consider whether an adverse opinion, as discussed in section 544 of Statement on Auditing Standards No. 1, should be expressed with respect to generally accepted accounting principles.

Efficiency and Economy

The GAO standards recognize the difficulties associated with the evaluation of economy and efficiency in the following paragraph:

Efficiency and economy are both relative terms and it is virtually impossible to give an opinion as to whether an organization has reached the maximum practicable level of either. *Therefore, it is not contemplated in these standards that the auditor will be called upon to give such an opinion* [emphasis supplied].

Reviews for efficiency and economy ask whether the organization is getting the most it can for the money and other resources it spends or consumes. The auditor must be concerned with the way the management of an entity has chosen to organize and operate. For example, in such a review it is not sufficient to know that a part that was purchased was received and paid for at the billed price; the auditor must also consider whether the part was needed, whether it was actually used productively, and whether it could have been obtained at a lower price.

It is *critical* that, before the examination begins, the independent public accountant and his client have an understanding about which specific operating functions will be reviewed, e.g., purchasing, personnel, etc. For some federally assisted programs, the functions to be reviewed are identified in audit guidelines issued by the responsible federal agency.

All of the GAO standards (as reproduced in Appendix A) take on an added dimension when applied to engagements requiring a review of economy and efficiency. However, the application of certain of the standards will require special consideration. These standards are the following:

- The auditors assigned to perform the audit must collectively possess adequate professional proficiency for the tasks required.
- Due professional care is to be used in conducting the audit and in preparing related reports.
- Sufficient, competent, and relevant evidence is to be obtained to afford a reasonable basis for the auditor's opinions, judgments, conclusions, and recommendations.

Professional Proficiency. The GAO booklet identifies a basic knowledge of governmental organization and operation, acquired by either education or experience, as one measure of “adequate professional proficiency.”

Furthermore, the broader audit definition may require the use of specialized expertise. This necessary knowledge and expertise must be anticipated so that qualified personnel will be available to a public accounting firm doing an audit having this broadened scope.

Due Professional Care. Due professional care includes adequately defining the audit scope in cooperation with the audited entity and those authorizing the audit. If established criteria are vague or if the auditor must select his own measurement criteria, he should reach agreement with the interested parties on the appropriateness of these criteria.

Evidence. Because audits for efficiency and economy do not deal in absolutes, and because there can be differing views of an operation and its results, sufficiency of evidence cannot be clearly defined. In a financial audit, the fact that an item of inventory can be observed may be the only evidence the auditor requires of physical existence. In audits for efficiency and economy, criteria for evaluating evidence, for deciding what is to be measured, and for making the measurements will, for the most part, not have been specified. It is in the standardization and acceptance of new concepts of measurement that the GAO standards may be most challenging to auditors.

Reporting. The four reporting standards set by GAO will also require special consideration, particularly with respect to the wording of reports on compliance, efficiency, economy, and effectiveness. Reports containing an independent accountant’s observations and recommendations should identify in detail the specific functions that were reviewed. As to other aspects of the report, two things are evident from GAO’s statements:

1. The auditor is *not expected to give an opinion as to the economy and efficiency of an entity as a whole*, or to make judgments of the overall quality of operations.

2. The auditor is expected to focus his report on those specific areas of an operation wherein he believes improvements are possible, or wherein performance has been notably good. The reports should include enough facts and explanations so that an interested layman can understand the issues under discussion.

The foregoing indicates that each report will be tailored to the entity and subject under review and that uniformity in anything other than general format is not feasible. The independent public accountant's report should clearly set forth the scope of the review, including the criteria upon which any conclusions, comments, observations, and recommendations are based. Because it is virtually impossible to report on whether or not an organization has reached the maximum practical level of either efficiency or economy, the report should contain a clear statement to the effect that the independent public accountant is not offering any judgment about the overall efficiency and economy of operations. Failure to include such a statement may lead readers of the report to assume that negative assurance as to overall operations is being given tacitly.

Program Results

Reviewing and reporting on program results, or effectiveness, is on the leading edge of what has been done in auditing. The state of the art is such that little has been established for auditors in the way of precedent, evaluation guidelines, or measurement criteria although information developed in other disciplines may be useful.

The nature of an effectiveness audit can be seen more clearly by contrasting it with audits of other types already discussed. Thus, in audits for compliance, efficiency, or economy, the things an entity has chosen to do are measured more or less as if they were ends in themselves. In effectiveness auditing, those same things that the entity has chosen to do are weighed in a different balance. The questions to be asked are these: Has the entity chosen to do the right things for achieving its goals? Has it done them in a way that has enabled it to achieve the goals? To assess effectiveness an auditor must know what goals have been established for or by an entity and must be able to measure the results.

As in the case of audits for economy and efficiency, establishing measurement criteria is essential for audits of effectiveness. Obviously, goals or objectives will differ as will criteria. Additionally, the application of the standards discussed under the section on audits of efficiency and economy applies equally to audits of effectiveness.

GAO does not expect auditors to render an overall opinion on the effectiveness of a program or operation. Rather, GAO has expressed the view that reports on effectiveness are expected to contain observations and recommendations based on the auditors' review and should be similar in form to reports on economy and efficiency:

- The reports on effectiveness should contain a reference to the criteria upon which any conclusions, comments, observations, and recommendations are based.
- The reports should avoid positive assurance as to the overall evaluation of effectiveness because generally accepted criteria have not yet been established by which to measure the effectiveness of programs (operations) of this nature. Due to the lack of such generally accepted criteria, it is possible that others may have differing views as to the means by which effectiveness evaluations should be made.

Conclusions and Recommendations

Our review of the GAO standards has led us to the following conclusions and recommendations:

1. The GAO standards follow the same general organization as the generally accepted auditing standards of the AICPA, and the standards applicable to financial audits are intended to be identical. However, in GAO's definition, an audit may also be concerned with efficiency and economy of operations, compliance with both financial and nonfinancial laws and regulations, and with program effectiveness. This broader definition of an audit will require that agreement be reached as to criteria for evaluating economy, efficiency, and effectiveness.

2. Independent public accountants should be encouraged to participate in audits of the types contemplated by the GAO standards but should be cautioned to define carefully, in an engagement agreement, the scope of each engagement and the method of reporting. The profession should work to further define standards for performing such audits.

3. When the scope of an audit goes beyond examination of financial presentations, the auditor should ascertain whether criteria are available (in audit guides or other sources) for use in reviewing compliance with laws and regulations, and in evaluating efficiency and economy of operations and program effectiveness.

4. When nonaccounting expertise is needed, the independent auditor should determine in advance its availability and cost. He should further determine how his use of the work of nonaccounting experts will be made known in his report.

5. A CPA should recognize that the GAO standards do not contemplate that he will express an opinion as to the economy and efficiency of operations or as to program effectiveness. In reporting on reviews covering these matters, the auditor should limit his opinion to fairness of presentation of financial information in conformity with generally accepted accounting principles, or with other principles prescribed for the entity or program audited, and the consistency of application of such principles. This does not preclude an auditor from disclosing lack of compliance with laws and regulations. Also the auditor may identify areas in which improvements in methods or practices are possible and may make appropriate recommendations. He may also point out areas in which noteworthy accomplishments have occurred or in which further study may be required.

6. Audits concerned with economy, efficiency, and program effectiveness will presumably require more time than those covering only financial presentations. Care should be taken to provide for sufficient time to complete the engagement.

Audits of government activities provide both opportunities and challenges to the public accounting profession. Government agencies, CPAs, and others must deal with the need to develop techniques for measuring economy, efficiency, and effectiveness,

including techniques for measuring social considerations such as the success of an educational or environmental improvement program. Responding to this need will undoubtedly require much study and considerable time. The profession should be willing to work with government agencies and others toward developing measurement criteria and audit techniques.

The accounting profession should also consider developing professional study courses on the subject of auditing for efficiency, economy, and effectiveness and should consider whether standards are needed for reliance on nonaccounting experts. In this latter connection, the profession should not neglect to consider the extent to which reporting on efficiency, economy, and effectiveness falls within the area of expertise of CPAs.

The members of this Committee agree with the philosophy and objectives advocated by the GAO in its standards and believe that the GAO's broadened definition of auditing is a logical and worthwhile continuation of the evolution and growth of the auditing discipline.

Excerpts From GAO's "Standards for Audit of Governmental Organizations, Programs, Activities & Functions"

Part I—Introduction

Purpose

This statement contains a body of audit standards that are intended for application to audits of all government organizations, programs, activities, and functions—whether they are performed by auditors employed by Federal, State, or local Governments; independent public accountants; or others qualified to perform parts of the audit work contemplated under these standards. These standards are also intended to apply to both internal audits and audits of contractors, grantees, and other external organizations performed by or for a governmental entity. These audit standards relate to the scope and quality of audit effort and to the characteristics of a professional and meaningful audit report.

The American Institute of Certified Public Accountants (AICPA) has adopted standards and procedures that are applicable to audits performed to express opinions on the fairness with which financial statements present the financial position and results of operations.¹ These standards are generally accepted for such audits and have been incorporated into this statement. However, the interests of many users of reports on Government audits are broader than those that can be satisfied by audits performed to establish the credibility of financial reports. To provide for audits that will fulfill these broader interests, the standards in this statement include the essence of those prescribed by the American

¹The basic standards are included in "Statements on Auditing Procedure No. 33," issued by the Committee on Auditing Procedure of the American Institute of Certified Public Accountants.

Institute of Certified Public Accountants and additional standards for audits of a broader scope as will be explained subsequently.

Scope

A fundamental tenet of a democratic society holds that governments and agencies entrusted with public resources and the authority for applying them have a responsibility to render a full accounting of their activities. This accountability is inherent in the governmental process and is not always specifically identified by legislative provision. This governmental accountability should identify not only the objects for which the public resources have been devoted but also the manner and effect of their application.

This concept of accountability is woven into the basic premises supporting these standards. These standards provide for a scope of audit that includes not only financial and compliance auditing but also auditing for economy, efficiency, and achievement of desired results. Provision for such a scope of audit is not intended to imply that all audits are presently being conducted this way or that such an extensive scope is always desirable. However, an audit that would include provision for the interests of all potential users of government audits would ordinarily include provision for auditing all the above elements of the accountability of the responsible officials.

Definitions of the three elements of such an audit follow.

1. *Financial and compliance*—determines (a) whether financial operations are properly conducted, (b) whether the financial reports of an audited entity are presented fairly, and (c) whether the entity has complied with applicable laws and regulations.
2. *Economy and efficiency*—determines whether the entity is managing or utilizing its resources (personnel, property, space, and so forth) in an economical and efficient manner and the causes of any inefficiencies or uneconomical practices, including inadequacies in management information systems, administrative procedures, or organizational structure.
3. *Program results*—determines whether the desired results or benefits are being achieved, whether the objectives established by the legislature or other authorizing body are being

met, and whether the agency has considered alternatives which might yield desired results at a lower cost.

The audit standards are intended to be more than the mere codification of current practices, tailored to existing audit capabilities. Purposely forward-looking, these standards include some concepts and areas of audit coverage which are still evolving in practice but which are vital to the accountability objectives sought in the audit of governments and of intergovernmental programs. Therefore the audit standards have been structured so that each of the three elements of audit can be performed separately if this is deemed desirable.

It should be recognized that a concurrent audit of all three parts would probably be the most economical manner of audit, but often this may not be practical. Furthermore, it may not be practical or necessary to perform all three elements of the audit in particular circumstances. For most government programs or activities, however, the interests of many potential government users will not be satisfied unless all three elements are performed.

In memorandums of engagements between governments and independent public accountants or other audit organizations, the arrangements should specifically identify whether all, or specifically which, of the three elements of the audit are to be conducted. Such agreements are needed to ensure that the scope of audit to be made is understood by all concerned.

Basic Premises

The following certain basic premises underlie these standards and were considered in their development.

1. The term "audit" may be used to describe not only work done by accountants in examining financial reports but also work done in reviewing (a) compliance with applicable laws and regulations, (b) efficiency and economy of operations, and (c) effectiveness in achieving program results.
2. Public office carries with it the responsibility to apply resources in an efficient, economical, and effective manner to achieve the purposes for which the resources were furnished. This responsibility applies to all resources, whether entrusted to the public officials by their own constituency or by other levels of government.

3. A public official is accountable to those who provide the resources he uses to carry out governmental programs. He is accountable both to other levels of government for the resources such levels have provided and to the electorate, the ultimate source of all governmental funds. Consequently he should be providing appropriate reports to those to whom he is accountable. Unless legal restrictions or other valid reasons prevent him from doing so, the auditor should make the results of audits available to other levels of government that have supplied resources and to the electorate.
4. Auditing is an important part of the accountability process since it provides independent judgments of the credibility of public officials' statements about the manner in which they have carried out their responsibilities. Auditing also can help decisionmakers improve the efficiency, economy, and effectiveness of governmental operations by identifying where improvements are needed.
5. The interests of individual governments in many financially assisted programs often cannot be isolated because the resources applied have been commingled. Different levels of government share common interests in many programs. Therefore an audit should be designed to satisfy both the common and discrete accountability interests of each contributing government.
6. Cooperation by Federal, State, and local governments in auditing programs of common interest with a minimum of duplication is of mutual benefit to all concerned and is a practical method of auditing intergovernmental operations.
7. Auditors may rely upon the work of auditors at other levels of government if they satisfy themselves as to the other auditors' capabilities by appropriate tests of their work or by other acceptable methods.

An inherent assumption that underlies all the standards is that governments will cooperate in making audits in which they have mutual interests. For many programs that are federally assisted, it would be neither practical nor economical to have every auditor at every level of government do his own background research on the laws, regulations, objectives, and goals of his segment of the program. Therefore, to provide the auditor with the necessary

background information and to guide his judgment in the application of the accompanying standards, Federal or State agencies that request State, local, or other levels to make audits are expected to prepare broad, comprehensive audit instructions, tailored to particular programs or program areas.

The content of such audit guidance should include a digest of, or as a minimum, citations to applicable statutes, regulations, instructions, manuals, grant agreements, and other program documents; identification of specific audit objectives and reporting requirements in terms of matters of primary interest in such areas as program compliance, economy, and effectiveness; and other audit guidelines covering specific areas in which the auditor is expected to perform.

Part II—Summary

Part II is a summary of the standards. Parts III, IV, and V [not herein reproduced] explain the standards more fully.

General Standards

1. The full scope of an audit of a governmental program, function, activity, or organization should encompass:
 - a. An examination of financial transactions, accounts, and reports, including an evaluation of compliance with applicable laws and regulations.
 - b. A review of efficiency and economy in the use of resources.
 - c. A review to determine whether desired results are effectively achieved.

In determining the scope for a particular audit, responsible officials should give consideration to the needs of the potential users of the results of that audit.
2. The auditors assigned to perform the audit must collectively possess adequate professional proficiency for the tasks required.
3. In all matters relating to the audit work, the audit organization and the individual auditors shall maintain an independent attitude.

4. Due professional care is to be used in conducting the audit and in preparing related reports.

Examination and Evaluation Standards

1. Work is to be adequately planned.
2. Assistants are to be properly supervised.
3. A review is to be made of compliance with legal and regulatory requirements.
4. An evaluation is to be made of the system of internal control to assess the extent it can be relied upon to ensure accurate information, to ensure compliance with laws and regulations, and to provide for efficient and effective operations.
5. Sufficient, competent, and relevant evidence is to be obtained to afford a reasonable basis for the auditor's opinions, judgments, conclusions, and recommendations.

Reporting Standards

1. Written audit reports are to be submitted to the appropriate officials of the organizations requiring or arranging for the audits. Copies of the reports should be sent to other officials who may be responsible for taking action on audit findings and recommendations and to others responsible or authorized to receive such reports. Copies should also be made available for public inspection.
2. Reports are to be issued on or before the dates specified by law, regulation, or other arrangement and, in any event, as promptly as possible so as to make the information available for timely use by management and by legislative officials.
3. Each report shall:
 - a. Be as concise as possible but, at the same time, clear and complete enough to be understood by the users.
 - b. Present factual matter accurately, completely, and fairly.
 - c. Present findings and conclusions objectively and in language as clear and simple as the subject matter permits.
 - d. Include only factual information, findings, and conclusions that are adequately supported by enough evidence in the auditor's working papers to demonstrate or prove,

- when called upon, the bases for the matters reported and their correctness and reasonableness. Detailed supporting information should be included in the report to the extent necessary to make a convincing presentation.
- e. Include, when possible, the auditor's recommendations for actions to effect improvements in problem areas noted in his audit and to otherwise make improvements in operations. Information on underlying causes of problems reported should be included to assist in implementing or devising corrective actions.
 - f. Place primary emphasis on improvement rather than on criticism of the past; critical comments should be presented in balanced perspective, recognizing any unusual difficulties or circumstances faced by the operating officials concerned.
 - g. Identify and explain issues and questions needing further study and consideration by the auditor or others.
 - h. Include recognition of noteworthy accomplishments, particularly when management improvements in one program or activity may be applicable elsewhere.
 - i. Include recognition of the views of responsible officials of the organization, program, function, or activity audited on the auditor's findings, conclusions, and recommendations. Except where the possibility of fraud or other compelling reason may require different treatment, the auditor's tentative findings and conclusions should be reviewed with such officials. When possible, without undue delay, their views should be obtained in writing and objectively considered and presented in preparing the final report.
 - j. Clearly explain the scope and objectives of the audit.
 - k. State whether any significant pertinent information has been omitted because it is deemed privileged or confidential. The nature of such information should be described, and the law or other basis under which it is withheld should be stated.
4. Each audit report containing financial reports shall:
 - a. Contain an expression of the auditor's opinion on whether the information contained in the financial reports is pre-

*See Appendix B for agreed-upon revision of this standard.

sented fairly. If the auditor cannot express an opinion, reasons therefor should be stated in the audit report.

- b. State whether the financial reports have been prepared in accordance with generally accepted or prescribed accounting principles applicable to the organization, program, function, or activity audited and on a consistent basis from one period to the next. Material changes in accounting policies and procedures and their effect on the financial reports are to be explained in the audit report.
- c. Contain appropriate supplementary explanatory information about the contents of the financial reports as may be necessary for full and informative disclosure about the financial operations of the organization, program, function, or activity audited. Violations of legal or other regulatory requirements, including instances of noncompliance, shall be explained in the audit report.

GAO's Fourth Reporting Standard

As published, the GAO fourth reporting standard seems to require auditors to express two opinions (one concerning fairness of presentation, the other concerning conformity with generally accepted, or other, accounting principles and consistency of application) on financial presentations instead of the single opinion expressed in reports that comply with the AICPA's auditing standards.

The fourth reporting standard for governmental auditing set forth on page 49 of *Standards for Audit of Governmental Organizations, Programs, Activities & Functions* is as follows:

"Each audit report containing financial reports shall:

1. Contain an expression of the auditor's opinion on whether the information contained in the financial reports is presented fairly. If the auditor cannot express an opinion, the reasons therefor should be stated in the audit report.
2. State whether the financial reports have been prepared in accordance with generally accepted or prescribed accounting principles applicable to the organization, program, function, or activity audited and on a consistent basis from one period to the next. Material changes in accounting policies and procedures and their effect on the financial reports are to be explained in the audit report.
3. Contain appropriate supplementary explanatory information about the contents of the financial reports as may be necessary for full and informative disclosure about the financial operations of the organization, program, function, or activity audited. Violations of legal or other regulatory requirements, including instances of noncompliance, shall be explained in the audit report."

GAO has stated that this difference was not intended and that the GAO standards will be amended to eliminate it. A letter from GAO clarifying this matter is reproduced on the following page.



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

DIVISION OF FINANCIAL AND
GENERAL MANAGEMENT STUDIES

October 30, 1973

Mr. Gerald A. Polansky
Chairman, Committee on Relations with
the General Accounting Office
American Institute of Certified Public
Accountants
1620 I Street
Washington, D.C. 20006

Dear Mr. Polansky:

When we prepared the Standards for Audit of Governmental Organizations, Activities and Functions, we did not attach particular significance to the fact that "presented fairly" and "in accordance with GAAP" were included as separate items in Chapter 4 on financial reporting. The split was inadvertent and we did not intend any difference with the AICPA position on this point. Accordingly we would propose to make the following change at the next revision of the GAO standards:

The first sentence in item 2 would be dropped and the second sentence merged with what is now item 3.

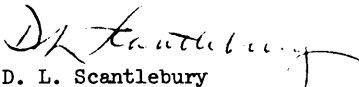
Item 1 and the lead-in would read as follows:

"Each audit report containing financial reports shall:

1. Contain an expression of the auditor's opinion as to whether the information in the financial reports is presented fairly in conformity with generally accepted accounting principles or with other specified accounting principles applicable to the organization, program, function or activity audited, applied on a basis consistent with that of the preceding reporting period. If the auditor cannot express such an opinion, the reasons should be stated in the audit report."

We trust that this will remove the problem you have had with the way in which we had stated this standard in our report and that this will bring our standards for financial statement presentation into substantial agreement with those of the Institute.

Sincerely yours,


D. L. Scantlebury
Director