Government Auditing Standards – 2018 Revision

Compiled by Ray B. Bartholomew, CPA – Squire & Company, PC

Effective for financial audits and attestation engagements for periods beginning on or after July 1, 2019. Early implementation is not permitted.

Excerpt from the Comptroller General of the United States:

> *The independence standard is expanded to state that preparing financial statements from a client-provided trial balance or underlying accounting records generally creates significant threats to auditors' independence, and auditors should document the threats and safeguards applied to eliminate and reduce threats to an acceptable level or decline to perform the service.*

Auditors must be independent from an audited entity. Management is responsible for the preparation and fair presentation of the financial statements, even if the auditor assisted in drafting those financial statements.

Opinions, findings, conclusions, judgments, and recommendations are to be impartial.

Categories to help identify treats to independence (with examples):

Self-interest threats
- The auditor has undue dependence on income from the client
- A member of the audit team has entered employment negotiations with the client
- The auditor discovers a significant error in work provided in a previous audit

Self-review threats
- The auditor helped design or implement the accounting system
- The auditor prepared the original data used by the client
- A member of the audit team is or was employed by the client

Bias threats
- The auditor has preconceptions about a program under audit that affect the auditor's objectivity

Familiarity threats
- A member of the engagement team is related to management
- An auditor accepting gifts or preferential treatment from a client
- Key audit personnel have a long association with the client

Influence threats
- The client exerts pressure to modify the extent of work performed (to reduce costs or limit access to information)
- Unreasonable restrictions on the time allowed to complete the audit
- Threat of replacing the auditor based on a disagreement

Management participation threats
- An auditor serving as a voting member of the client's management committee or board of directors
- An auditor recommending or ranking a candidate for a client position
- An auditor preparing management's corrective action plan to deal with deficiencies detected in the audit engagement

Structural threats
- Placement of the audit function within the reporting line of the areas under audit

Threats are to be evaluated from the view of a third party by a hypothetical person. This evaluation entails weighing all the relevant facts and circumstances including any safeguards applied.

Safeguards are actions that auditors take that effectively eliminate threats to independence or reduce them to an acceptable level. Examples of safeguards include

1. Consulting an independent third party (AICPA, GASB, or another auditor)
2. Involving another auditor to perform part of the engagement
3. Having an auditor who was not a member of the engagement team review the work performed
4. Removing an auditor from the engagement team

When independence is considered impaired (no safeguards have been effectively applied to eliminate an unacceptable threat or reduce it to an acceptable level), auditors should decline to accept an engagement or should terminate an engagement in progress.

Providing **nonaudit services** to audited entities may create threats to independence. Safeguards the auditor could use to address threats to independence related to nonaudit services include

1. Not including individuals who provided the nonaudit service as audit engagement team members
2. Having another auditor, not associated with the engagement, review the engagement and nonaudit work
3. Engaging another audit organization to evaluate the results of the nonaudit service (or re-perform the nonaudit service)

Routine activities, such as providing advice and responding to questions as part of an engagement, are not considered nonaudit services. Routine activities include providing information that is readily available such as best practices and benchmarking studies.

Before providing nonaudit services, the client should designate an individual (who possesses suitable skill, knowledge, or experience) to oversee them. This understanding is normally documented in the engagement letter between the client and the auditor.

Preparation of Accounting Records and Financial Statements

Three nonaudit services that always *impair* auditor independence:

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

The following is classified as a *significant threat* to auditor independence:

4. Preparing financial statements in their entirety from a client-provided trial balance or underlying accounting records

   (Providing clerical assistance, such as typing, formatting, printing, and binding financial statements, is unlikely to be a significant threat)

The following are classified as *threats* to auditor independence:

5. Recording transactions for which management has determined or approved the appropriate account classification, or posting coded transactions to an audited entity's general ledger
6. Preparing certain line items or sections of the financial statements based on information in the trial balance
7. Posting entries that an audited entity's management has approved to the entity's trial balance
8. Preparing account reconciliations that identify reconciling items for the audited entity management's evaluation

Nonaudit Service	Audit Team Member Responsible	Auditor Safeguard	Individual at Client Overseeing	Date Approved
Financial statement preparation				
Account classification and grouping				
Cash to accrual conversions				
Liquidity and short-term portions				
Reconciliations from funds to GWFS				
Supplementary information				
MD&A condensed data				
Capital asset schedules				
Long-term liability schedules				
Notes to the basic financial statements				
Eliminations				
Component units				
Classifications, estimates, or calculations				
Net investment in capital assets				
Restricted net position				
Fund balance classifications				
Major fund determination				
Depreciation methods and asset lives				
Deferred bond refunding costs				
General or program revenue				
Program revenue by function				
Depreciation expense by function				
Employee benefit obligations by fund and function				
Fair values				
Claims and other estimates				
Recommending audit adjustments				
Completion of GAAP disclosure checklist and application of GAAP				
Tax positions and preparation of Form 990 for Foundation				