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## Report of the Task Force on the Quality of Audits of Governmental Units : March 1987

Task Force on the Quality of Audits of Governmental Units; American Institute of Certified Public Accountants

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# Report of the Task Force on the Quality of Audits of Governmental Units

MARCH 1987

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AICPA 100  
A CENTURY OF PROGRESS  
IN ACCOUNTING  
1887 1987

American Institute of Certified Public Accountants

## **NOTICE TO READERS**

This report has been prepared by the Task Force on the Quality of Audits of Governmental Units. The conclusions and recommendations presented are those of the task force members and have not been approved, disapproved, or otherwise acted on by the governing body of the American Institute of Certified Public Accountants. Therefore, this report is not an official pronouncement of the Institute.

# Report of the Task Force on the Quality of Audits of Governmental Units

MARCH 1987

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# Preface

The federal government provides state and local governments with more than \$100 billion per year in financial assistance. Federal officials rely heavily on CPAs' audits of these funds to help assure accountability in their use.

To determine how well those audits are conducted, and whether this reliance is appropriate, Congressman Jack Brooks (D-Texas), chairman of the U.S. House of Representatives Committee on Government Operations, requested the General Accounting Office (GAO) to conduct a review of the quality of CPA audits of federal financial assistance. After examining 120 randomly selected audits, the GAO concluded that 34 percent of these audits did not satisfactorily comply with applicable auditing standards. On November 13, 1985, and March 19, 1986, the Legislation and National Security Subcommittee of the House Committee on Government Operations held hearings to review the GAO reports on the quality of audits of federal financial assistance.

The AICPA is concerned about the findings of substandard work by CPAs in the conduct of these audits. Accordingly, the chairman of the AICPA Federal Government Executive Committee appointed the Task Force on the Quality of Audits of Governmental Units. The primary objective of the task force was to develop a comprehensive action plan designed to improve the quality of audits of governmental units. This booklet contains the final report and recommendations of the task force.

Audits of governmental units differ from audits of nongovernmental units, primarily in the areas of testing and reporting on internal controls and compliance with applicable laws and regulations. Accordingly, the recommendations of the task force are directed toward that unique area of audit practice and may not necessarily be applicable to nongovernmental audits. Moreover, the recommendations of the task force are divided into five areas. They have been labeled the five "E's": education, engagement, evaluation, enforcement, and exchange.

The task force recognizes that an auditor who undertakes an engagement has the ultimate responsibility for conducting that engagement in accordance with applicable professional standards. However, others also have a responsibility. The changes recommended in this report must be implemented by the three major participants in the governmental audit process: the auditors, the auditees, and the organizations that oversee the auditors and the auditees. Some of the recommendations can be implemented entirely by one group. Others, however, will require a joint effort of two, or perhaps all three, groups working together. As stated in the report, if the many participants fulfill their responsibilities, the five E's can be brought together into the sixth and most important E – excellence.

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## **Acknowledgments**

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## Acronyms and Abbreviations

<b>AGA</b>	Association of Government Accountants
<b>AICPA</b>	American Institute of Certified Public Accountants
<b>ASB</b>	Auditing Standards Board
<b>CPE</b>	Continuing Professional Education
<b>GAAP</b>	Generally accepted accounting principles
<b>GAAS</b>	Generally accepted auditing standards
<b>GAO</b>	General Accounting Office
<b>GFOA</b>	Government Finance Officers Association
<b>IGs</b>	Inspectors General
<b>ILAO</b>	Independent Local Auditor Organization
<b>JEEP</b>	Joint Ethics Enforcement Program
<b>NSAA</b>	National State Auditors Association
<b>NASBA</b>	National Association of State Boards of Accountancy
<b>NIAF</b>	National Intergovernmental Audit Forum
<b>OMB</b>	Office of Management and Budget
<b>PCIE</b>	President's Council on Integrity and Efficiency
<b>RFP</b>	Request for Proposal
<b>RIAF</b>	Regional Intergovernmental Audit Forums
<b>RIGs</b>	Regional Inspectors General
<b>SAO</b>	State Audit Organizations
<b>SAS</b>	Statement on Auditing Standards
<b>SBOA</b>	State Boards of Accountancy
<b>SSOC</b>	State Societies of CPAs
<b>USDA</b>	USDA Graduate Inter-Agency Auditor Training Programs

## CHAPTER 1

# Introduction

Several factors have caused a significant increase in recent years in the number of state and local governments that have engaged independent auditors to perform audits of their financial statements. The fiscal crisis in some American cities made governments recognize the importance of publishing audited financial statements. The Government Finance Officers Association (GFOA) and other organizations of government officials have urged their members to prepare financial statements in accordance with generally accepted accounting principles (GAAP) and subject the financial statements to an audit performed in accordance with generally accepted auditing standards (GAAS). The federal government, through the Revenue Sharing Act, the Single Audit Act of 1984, and various regulations, required governments receiving federal financial assistance to obtain audits of their financial statements.

In many instances, the scope of audits of governmental units extends beyond requiring the auditor to express an opinion on the financial statements. *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions* issued by the Comptroller General of the United States (frequently referred to as the "Yellow Book" and hereafter referred to as "Standards for Audit issued by the GAO"); the Single Audit Act; and Office of Management and Budget (OMB) Circular A-128, "Audits of State and Local Governments," establish requirements for studying, evaluating, and reporting on internal control that exceed the requirements of GAAS. Also, the auditor is often required to review and report on the entity's compliance with specific statutes, regulations, and contract and grant agreements beyond what is required for determining whether there are contingent liabilities relating to such contracts and grants that may affect the financial statements.

Confidence in the reliability of a government's financial statements, systems, and reported compliance depends, in part, on the belief that the audits of that government have been adequately and properly conducted in accordance with applicable standards. However, as described herein, substantial evidence exists that audits of governmental units have not always been conducted in accordance with such standards.

At the request of the chairman of the Legislation and National Security Subcommittee of the Committee on Government Operations, U.S. House of Representatives, the General Accounting Office (GAO) conducted a comprehensive study of the quality of audits of governmental funds by nonfederal auditors. The GAO issued two reports. In December 1985, it reported that during the year ended September 30, 1984, 25 percent of the

audit reports that were desk reviewed (that is, a review of only the reports) by federal Inspectors General required correction by the auditor.<sup>1</sup> It also reported that 45 percent of the audits that received more extensive reviews (that is, a review of the auditor's working papers) by the federal Inspectors General were deficient in such aspects as the following:

- Absence of adequate planning and supervision
- Little or no testing of compliance with laws and regulations
- Inadequate or no evidence of a study and evaluation of internal controls
- Insufficient documentation of work performed or conclusions reached

A subsequent GAO report, released in March 1986, sustained the earlier findings.<sup>2</sup> Based on reviews of auditors' working papers, the GAO found that 34 percent of a sample of 120 audits did not satisfactorily comply with GAAS or the Standards for Audit issued by the GAO.

The AICPA is concerned about these findings and is committed to developing a comprehensive action plan that will improve the quality of audit performance and enhance the confidence of all parties in the reliability of audits of governmental units. To help the AICPA develop a plan of action that deals with all aspects of this multifaceted problem, the chairman of the AICPA Federal Government Executive Committee established the Task Force on the Quality of Audits of Governmental Units in July 1985.

## **The Task Force's Charge**

The charge to the task force is—

1. Determine the factors that adversely affect the quality of nonfederal auditors' financial and compliance audits of governmental units and funds, and recommend ways to correct these conditions.
2. Identify programs to improve government officials' understanding of the factors necessary to obtain quality audits of governmental units and funds.

Although the GAO study focused on audits of federal grants performed by CPAs in public practice, the task force members recognized,

1. Comptroller General of the United States, U.S. General Accounting Office, Report to the Chairman, Legislation and National Security Subcommittee, House Committee on Government Operations, *CPA Audit Quality—Inspectors General Find Significant Problems* (Washington, D.C.), December 1985. GAO/AFMD 86-20.

2. Comptroller General of the United States, U.S. General Accounting Office, Report to the Chairman, Legislation and National Security Subcommittee, Committee on Government Operations, House of Representatives, *CPA Audit Quality—Many Governmental Audits Do Not Comply With Professional Standards* (Washington, D.C.), March 1986. GAO/AFMD 86-33.

from experience, that CPAs typically perform the audit of federal funds as an integral part of the audit of the entire governmental unit. Hence, the task force concluded that the concern about the quality of audits of federal funds should be extended to audits of all governmental funds. It also recognized that the auditors of governmental funds may be either CPAs in public practice or employed by state or local governments. Accordingly, the study and its recommendations address audits performed by *all* auditors for *all* governmental units and funds.

## Background

Deficiency in the quality of the audits performed for governmental units is not a new concern for the accounting profession. The demand for independent audits of governmental units began to increase substantially in the 1970s. Recognizing the importance of improving the quality of these audits, the AICPA and the GAO jointly sponsored a colloquium in Cherry Hill, New Jersey, in 1980 to consider ways to improve the quality of audits of governmental organizations and programs.

The purpose of the Cherry Hill colloquium was to obtain the views of CPAs and government officials on ways to improve their communications and develop recommendations that would improve the quality of governmental audits. Approximately seventy people participated in the colloquium, including CPAs from firms of all sizes and representatives from all levels of government.

The colloquium report contained recommendations in two areas: procurement and education.<sup>3</sup> In addition, a plan was formulated for implementing the recommendations. However, for a variety of reasons, the plan was not fully implemented. Nonetheless, several of the recommendations and concerns identified at the colloquium were implemented and addressed. A summary of the specific recommendations and the actions taken is presented in exhibit 1.

Furthermore, in recent years, the AICPA has taken various steps to improve the quality of governmental audits. Specifically, it has issued the following guidance:

- Interpretation of Statement on Auditing Standards No. 22, *Planning and Supervision*, which provides specific guidance on planning audits of federal assistance programs (April 1981)
- Ethics Division interpretation to Rule 501-3, entitled "Failure to Follow Standards and/or Procedures or Other Requirements in Governmental Audits," which states that a member who accepts an engagement

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3. General Accounting Office, *Procurement and Performance of Audits of Government Organizations and Programs* (Washington, D.C.), November 1980.

and undertakes an obligation to follow specified government audit standards, guides, and requirements is obligated to do so; and that the failure to do so is an act discreditable to the profession, unless the fact that the requirements were not followed and the reasons therefore are disclosed in the auditor's report (August 1981)

- Interpretation of AU sec. 642, "Reporting on Internal Accounting Control," which provides specific guidance on preparing the internal accounting control reports required by the Standards for Audit issued by the GAO (issued April 1982, modified December 1983)
- Statement on Auditing Standards No. 41, *Working Papers*, which clarifies the auditor's responsibility for preparing and maintaining working papers (April 1982)
- Audit and Accounting Guide *Audits of State and Local Governmental Units*, which contains four chapters relating to auditing federal financial assistance programs (January 1986)

The AICPA also increased its emphasis on continuing professional education (CPE). Since 1982, the AICPA has offered, directly and through the state societies of CPAs, 234 sessions of twelve different conferences and group study programs and almost 3,000 copies of eight different self-study written and video training programs that pertain to accounting and auditing for governmental units. A list of these programs and the enrollments or sales of each is presented in exhibit 2.

In 1981, the AICPA's Professional Ethics Division undertook a program in response to a GAO report and in cooperation with federal agencies to review selected audits conducted by CPAs in public practice. The purpose of the reviews was to identify problem areas and determine possible solutions. Federal agencies submitted 199 audit reports for review. Of these, 116 cases warranted further investigation, 106 of which involved AICPA members. The disposition of these investigations was as follows:

- Reviews that found prima facie evidence of violation of AICPA technical standards:
 

Received administrative reprimands	23	
Referred to the Trial Board	<u>4</u>	
		27
- Reviews that found no prima facie evidence of violations of AICPA technical standards:
 

Received constructive comments	64	
No action taken	<u>13</u>	
		77
- Action deferred because the respondents were involved in litigation
 

		<u>2</u>
		<u>106</u>

The Professional Ethics Division issued status reports in February 1982 and October 1984 noting that the reports submitted for review were not selected randomly, and thus cautioning against using the findings to reach a conclusion about the extent of violation of technical standards. However, the results of the review were used to develop the previously described auditing interpretation on planning and supervision and the Professional Ethics Division interpretation to Rule 501-3. In addition, the AICPA requested the Inspectors General to continue to submit alleged substandard audit work to the Professional Ethics Division.

The federal government and others also have taken several steps to improve the quality of governmental audits, including the following:

- The OMB issued Attachment P to Circular A-102, "Uniform Requirements for Assistance to State and Local Governments," to replace the grant-by-grant audit approach with a single audit of the entire entity administering federal assistance programs (October 1979).
- The GAO substantially revised *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions*, the standards that must be followed when auditing federal assistance programs (February 1981).
- Congress enacted the Single Audit Act, providing a statutory base for the single audit approach (October 1984).
- The OMB issued Circular A-128, "Audits of State and Local Governments" (which superseded Attachment P to Circular A-102), to implement the Single Audit Act (April 1985).
- The OMB designated cognizant agencies to provide a federal liaison for the audits of state governments and agencies and large local governments (October 1980; revised January 1986).
- The Joint Financial Management Improvement Program and the President's Council on Integrity and Efficiency (PCIE) published guidelines to define the federal cognizant agency's participation (October 1981; revised October 1985).
- The OMB issued and then updated a *Compliance Supplement for Single Audits of State and Local Governments (Compliance Supplement)* to identify the major compliance requirements for the major federal assistance programs and to suggest audit procedures (August 1980; revised December 1982 and April 1985).

Other organizations have also taken various steps to improve the quality of government audits. For example, the National State Auditors Association (NSAA) established the State Auditor Training Program to help state auditors enhance their professional proficiency and skills. NSAA also assumed responsibility for the peer review program for state auditor organizations that was initiated by the National Intergovernmental Audit Forum (NIAF). Since that time, thirteen state auditor organizations have under-



gone one or more peer reviews. The Association of Governmental Accountants (AGA), GFOA, and other organizations of state and local government officials have also provided numerous training programs in governmental accounting and auditing.

The Western Intergovernmental Audit Forum issued a model request for audit proposals that governments could use when procuring audit services. The Mid-America Intergovernmental Audit Forum published the *Single Audit Desk Review Guide*. The AGA published *A Common Body of Knowledge* for governmental accountants as suggested during the Cherry Hill colloquium.

The National Association of State Boards of Accountancy (NASBA) published *A Positive Enforcement Program for State Boards of Accountancy*, which recommends monitoring practitioner performance, particularly in the areas of governmental auditing, and responding to complaints. It then approved a policy statement calling for a formalized program of positive enforcement to be adopted in all jurisdictions (1982); published and distributed a *Positive Enforcement Manual for State Boards of Accountancy* (1984); and exposed for discussion and adoption a revised *Model Positive Enforcement Program for State Boards of Accountancy* (1986). A chronology of the foregoing and other significant events is included in exhibit 3.

In summary, there have been numerous activities by several organizations that contributed to improving the quality of governmental audits. Nonetheless, a problem still exists and additional action is therefore required.

## **The Task Force's Scope and Approach**

The requirements for conducting a governmental audit are generally broader and more varied than those for conducting a nongovernmental audit. When the auditor, who can be a practitioner in public practice or a state or local government employee, undertakes the audit, he or she may be engaged by a government for whom the audit is still evolving as a management tool or one that considers an audit an unnecessary intrusion forced upon it by others. Furthermore, in conducting the audit, the auditor must adhere not only to the professional audit standards with which he or she usually works, but also to various additional requirements established by one or more governmental organizations.

To provide a full understanding of these various aspects, members of the task force include representatives of large and small certified public accounting firms; two state auditors, one representing a major portion of the governmental audit community that is engaged in other than public practice and the other as a representative of a state oversight agency that

reviews and accepts or rejects auditor performance; and a representative of the federal Inspectors General, since they provide guidance to the auditors and have a responsibility to review and evaluate the audits. Considerable input was also provided by representatives of the GAO and NASBA.

The task force considered the following six areas.

1. Previous studies and programs involving the quality of audits of governmental units and the perceptions and expectations of those concerned with such audits
2. The standards and guidelines needed to achieve quality performance
3. The role of educational programs in the quality of governmental audits
4. The impact that the process for procuring audits has on the quality of the audits
5. The role of government's and the profession's quality control and enforcement procedures
6. The opportunities to increase the dialogue among the various individuals and organizations that are interested in or that affect the quality of audits of governmental units

Several methods were used to gain insight into the problem and to seek opportunities for improvement, including interviewing knowledgeable persons; questioning CPAs who specialize in governmental auditing, state auditors, state CPA societies, state boards of accountancy, federal Inspectors General, and other federal officials; reviewing existing standards and other guidance; reviewing the contents of and attendance at educational programs; and tapping the personal knowledge and experiences of the task force members and staff.

## **Summary of Conclusions and Recommendations**

The recommendations of the task force are divided into five areas, each of which is addressed in a subsequent chapter. They have been labeled the five "E's."

1. *Education.* There are elements in the audits of governmental units that do not exist in other audits. The major education-related conclusions of the task force are that training in governmental accounting and auditing should be mandatory for persons who perform governmental audits, and the courses and instructors should be of the highest quality. A statement on auditing standards (SAS) should be issued addressing auditing for compliance with laws and regulations. The AICPA Technical Information Division, the regional offices of Inspectors General, and state and local audit oversight organizations should take several steps to improve and standardize the quality of guidance

provided. Finally, the OMB *Compliance Supplement* should be expanded and updated annually.

2. *Engagement.* An auditor who undertakes an engagement has the ultimate responsibility for conducting that engagement in accordance with applicable professional standards. However, to assist him or her in fulfilling that responsibility, the process by which auditors are engaged to perform an audit must be improved to ensure that the auditor has sufficient knowledge of what is expected and necessary *before* proposing to undertake the audit, and to ensure sufficient time to develop a sound audit plan. Also, the process for the selection of the auditor should consider factors that will ensure a quality audit. Accordingly, the task force believes that the study being conducted by the GAO at the request of the Chairman of the House of Representatives' Legislation and National Security Subcommittee, Committee on Government Operations, to determine how the audit procurement practice affects the quality of government audits will result in suggested improvements in the process. The task force also supports the National Intergovernmental Audit Forum's (NIAF) development of a "Model Request for Proposal" that defines the desired practices for selecting an auditor and sets forth the minimum qualifications the auditor must meet. Finally, the federal government's numerous rules that govern the conduct of single audits should be consolidated into a single rule, and policies and requirements for all government audits should be established and monitored by an Office of Inspector General or state or local audit oversight organization.
3. *Evaluation.* Feedback on how auditors are performing audits of governmental units will enable them to correct substandard performance. It can also help the profession identify common problems and actions necessary to prevent those problems from continuing. Hence, the task force is urging a comprehensive program to maximize the audit evaluation process. The program would have the Inspectors General and others with similar responsibilities conduct the initial reviews and, in so doing, accumulate and provide data identifying frequently occurring problems so that solutions can be developed to correct those problems. The program would seek the initiation of a positive enforcement program in each state and require participation in a peer review program for auditors who perform governmental audits.
4. *Enforcement.* Government personnel have been reluctant to refer audits they believe are substandard to the profession's disciplinary mechanism, including the state boards of accountancy, because they have found the process too complex and time-consuming. Also, they have had difficulty obtaining information on the results of the referrals. Accordingly, the task force is recommending the development of a simpler, more efficient, more effective, and less time-consuming proc-

ess. It is also recommending the explanation of this process to government officials and the development and distribution of guidelines that will assist in the use of the process. Finally, the task force is recommending that the AICPA, state societies, and state boards of accountancy report to the referring government and other appropriate officials the status and disposition of referrals of alleged substandard work. Auditors would be expected to waive their right to confidentiality, if necessary, in order to permit this feedback.

5. *Exchange of Information.* CPAs and others involved in audits of governmental units need to maintain a regular dialogue to air and share their problems, ideas, and possible solutions. Such a dialogue can contribute significantly toward motivating and reinforcing a sense of professionalism and improving audit quality. To achieve this continuing dialogue, the task force recommends broadening the memberships of the National and Regional Intergovernmental Audit Forums to include CPAs in public practice, the AICPA's governing bodies and committees to include individuals from the government audit community, and the governing bodies and committees of government auditors' and financial officers' associations to include CPAs in public practice. The task force also recommends greater involvement of federal, state, and local auditors as teachers and students in the AICPA's governmental accounting and auditing training programs.

## **Implementation**

As stated, an auditor who undertakes an engagement has the ultimate responsibility for conducting that engagement in accordance with applicable professional standards. However, the audited governmental unit and the various oversight organizations also have a responsibility. They must provide clear and unequivocal standards. They must use the standards to measure the auditor's performance and seek corrections when appropriate.

Accordingly, the changes recommended in this report must be implemented by the three major participants in the governmental audit process: the auditors, the auditees, and the organizations that oversee the auditors and auditees. Some of the recommendations can be implemented entirely by one or another of the groups. Other recommendations, however, will require a joint effort of two, or perhaps all three, groups working together. Furthermore, the implementation of these recommendations should be monitored by a steering committee consisting of representatives of these groups.

The task force is pleased that some of its recommendations have been or are in the process of being implemented, even before the final report is

issued. For example, the AICPA has formed a task force to develop an SAS on auditing and reporting on compliance with laws and regulations. It has also changed its procedures to permit the Professional Ethics Division to report the status and disposition of referrals of alleged substandard governmental audits. The GAO is conducting a study of the process for procuring audits, and the NIAF is developing a Model Request for Proposal. NASBA and the Southeastern Intergovernmental Audit Forum jointly sponsored an audit quality conference in Atlanta, Georgia.

This need for a continuing joint implementation effort is displayed at the end of each of the ensuing chapters in a chart that depicts the responsibility for implementing each recommendation discussed in the chapter. It is also depicted in a slightly different format in the final chapter. If each group accepts its responsibility for addressing and implementing the recommendations listed for it under the five E's—education, engagement, evaluation, enforcement, and exchange—the auditing profession can achieve the sixth and most important E; excellence.

## CHAPTER 2

# Education

Auditing a nongovernmental entity typically entails examining the entity's basic financial statements in accordance with GAAS to determine whether those statements are fairly presented in accordance with GAAP. Governmental audits conducted in accordance with the Standards for Audit issued by the GAO are different from audits of nongovernmental entities. Governmental audits include an auditor's report on the financial statements, but, in addition, require the auditor to issue a report on the entity's internal control system and to test and report on the entity's compliance with applicable laws and regulations.

Auditors' lack of knowledge about the additional requirements for conducting a governmental audit and their lack of training in conducting such audits are directly responsible for many of the deficiencies in the quality of audits of governmental units noted by the GAO and the federal Inspectors General. CPAs' formal education and subsequent continuing professional education (CPE) programs generally address nongovernmental audits. The authoritative auditing literature that is the basis for those educational programs is also aimed primarily at nongovernmental audits.

Hence, better education and training of auditors and additional guidance in the unique aspects of governmental audits are essential to improve the quality of such audits. Three major elements must be addressed:

1. Complete and timely guidance must be available.
2. Training programs and instructors must be of the highest quality and readily available.
3. Auditors must avail themselves of the training programs.

### ***Recommendation No. 1—Require Auditors of Governmental Units to Complete Relevant Continuing Professional Education Programs***

**Auditors of governmental organizations, programs, activities, and functions should be required to complete continuing professional education courses in the unique aspects of governmental accounting and governmental auditing.**

CPE programs that cover the unique requirements of governmental accounting and governmental auditing have been and are available from the AICPA, Association of Government Accountants (AGA), GFOA, public accounting firms, and many other organizations.<sup>1</sup> However, some auditors

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1. Courses offered by the AICPA are listed in exhibit 2. Details about other courses are available from the sponsoring organizations.

who perform governmental audits do not take the time or make an effort to acquire the knowledge necessary to perform such audits in accordance with applicable standards.

The task force believes that the most effective method of assuring that auditors who perform governmental audits are familiar with the unique requirements of governmental accounting and governmental auditing is to require them to complete CPE programs specifically designed to meet that need before undertaking such engagements.

Careful consideration was given to which participants in the audit should be subject to the CPE requirement and how much CPE should be required. Recognizing that any conclusion is judgmental, the task force decided that the best way of assuring quality audits is to require that the individuals who are responsible for planning and directing the audit and signing the auditors' report, and individuals who perform substantial portions of the fieldwork, be subject to the CPE requirements. Furthermore, the CPE should be no less than sixteen hours in governmental accounting and governmental auditing, including the requirements for auditing compliance with applicable laws and regulations, and should be completed within three years before commencing the audit.

Although the AICPA can recommend mandatory CPE in governmental accounting and governmental auditing for those performing governmental audits, it cannot impose the requirement on the governments requesting the audits or on auditors who are not members of the AICPA. However, there are at least three ways to implement the recommendation on a wide scale.

The first is to include the requirement in the forthcoming revision of the *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions* issued by the Comptroller General of the United States. Since an auditor reporting on a governmental audit is required to state that the audit was performed in accordance with those standards, including mandatory CPE in governmental accounting and governmental auditing, those standards should assure that the auditor performing the audit had completed the required CPE. In fact, stating the requirements explicitly would be a minor revision because CPE is already referred to in the qualifications standard.

The second way is to include the requirement in a revision to OMB Circular A-128, "Audits of State and Local Governments." This would affect the single audits of governmental units because auditors are required to perform such audits in accordance with the requirements of that circular. Furthermore, the OMB can affect the audits of other than governmental units by considering a similar requirement in other circulars that govern audits of federal assistance (for example, OMB Circular A-110, "Grants and Agreements of Higher Education, Hospitals, and Other Nonprofit Organizations").

A third way is to include wording, such as the following, in the Model Request for Proposal recommended in chapter 3 of this report. If this occurs, the requirement is likely to be adopted by governments using the model.

The individual assigned to the audit engagement who will be responsible for planning and directing the audit and signing the auditor's report, and the person(s) who perform substantial portions of the fieldwork must have completed, within three years prior to commencing work on the engagement, at least sixteen hours of continuing professional education in governmental accounting and governmental auditing. The nature, timing, and extent of such training should be disclosed in the auditor's proposal or otherwise furnished to the government.

***Recommendation No. 2—Ensure Quality of Continuing Professional Education Courses in Governmental Accounting and Governmental Auditing***

**All new governmental accounting and governmental auditing courses offered by the AICPA, including the self-study programs discussed in Recommendation No. 4, should be reviewed before presentation by the AICPA's State and Local Government Committee. They should be reviewed annually and updated for continued relevance as necessary.**

The effectiveness of a training program depends partly on the quality of the courses. (It also depends on the quality of the instructors, which is the subject of the next recommendation.) In many instances, it is the task force's understanding that courses have been developed by the AICPA's CPE Division with minimal input from AICPA technical committees. This practice can result in courses that contain outdated, incomplete, or inaccurate information—especially where courses in governmental accounting and governmental auditing are concerned because the requirements and practices are changing rapidly.

The task force recommends that all governmental accounting and auditing courses, including the self-study programs developed by the AICPA's CPE Division, be reviewed by a technical committee at the key stages of the process. For example, the technical committee should be involved in selecting the authors and reviewing the contents. It should also provide editorial review, establish the methodology for evaluating the course and the instructors, and review the evaluations. Furthermore, the courses should be reviewed annually and updated as necessary to reflect—

- Changes in requirements, practices, and so forth, that occurred during the year.



- Practice deficiencies identified by the GAO, the Inspectors General, and others.
- Findings from the AICPA Professional Ethics Division investigations.
- Participants' evaluations.

The courses should then be reviewed by the technical committee to assure continuing relevance.

The AICPA State and Local Government Committee is the appropriate committee to conduct these reviews. Accordingly, the CPE Division should work with that committee to develop procedures and timetables that provide sufficient time for meaningful reviews and still permit the programs to be provided on a timely basis.

**Recommendation No. 3—Ensure Quality Instructors for Courses in Governmental Accounting and Governmental Auditing**

**Steps should be taken to ensure that instructors of the AICPA governmental accounting and governmental auditing courses are properly qualified and adequately trained to teach the courses.**

As stated, the effectiveness of a training program also depends on the quality of the instructors. Both the "AICPA Policies and Standards on CPE" and the "Principles of Good Practice in Continuing Education," issued by the Council on the Continuing Education Unit, identify the requisites for qualified instructors. The former states that the instructors should be "qualified both as to program content and teaching methods used" (Standard No. 2 for CPE Program Presentation). The latter states that the competence in the subject matter should be "based on work experience, formal education or training, publications, recognition by peers, or professional credentials" (Principle 3.4.2).

The AICPA courses are frequently sponsored by the state societies, which also select the instructors. In the past, the instructors of governmental accounting and governmental auditing courses sponsored by the AICPA, state societies, and others have not always had the qualifications mentioned above. Nor have the instructors always had sufficient practical experience in governmental accounting and governmental auditing.

The task force has concluded that instructors in governmental accounting and governmental auditing courses should have completed CPE courses in governmental accounting and governmental auditing, should be involved in performing governmental audits, and should be thoroughly familiar with the course content. Also, they should be skilled classroom instructors.

Finally, the course participants should complete a written evaluation of the instructors' knowledge of the subject matter and ability to deliver it

effectively. The evaluation results should be given to the instructors in order for them to improve their knowledge and modify the presentation. The evaluations should also be used by the sponsor of the course when considering the reappointment of instructors.

#### **Recommendation No. 4—Increase Marketing of Self-Study Programs**

**Self-study programs in governmental accounting and governmental auditing, including video programs, should be marketed actively, particularly in geographic areas where it would be difficult for auditors to participate in a group study program.**

Requiring auditors of governmental units to obtain continuing professional education in governmental accounting and governmental auditing prior to undertaking those audits will significantly increase the number of auditors who will need to take such courses. In certain geographic areas, the number of persons who would take a course in a classroom setting may not be enough to justify holding the course. In other instances, courses may be scheduled, but not until after an audit must be conducted. In these situations, CPAs may have to obtain the CPE by other than classroom training—even though self-study programs frequently are not as effective as those held in a classroom setting. Group study sessions should be taken whenever possible.

The AICPA already has self-study programs, including video programs, in governmental accounting and governmental auditing that could be used to fulfill the CPE requirement (see exhibit 2 for the names of these courses and sales of each since 1982). The task force believes the AICPA should initiate a program to publicize the availability of these self-study programs to both members and nonmembers. The marketing effort should focus on states where classroom or group study courses have not been conducted or scheduled. Other organizations with self-study programs in governmental accounting and governmental auditing should consider similar marketing efforts.

#### **Recommendation No. 5—Work Together to Maximize the Quality of Courses Offered by All Organizations**

**The AICPA should work with other organizations that offer governmental accounting and governmental auditing courses to receive or provide information that would improve the quality of such courses.**

As stated, several organizations in addition to the AICPA provide courses in governmental accounting and governmental auditing. For instance, courses in governmental accounting and governmental auditing

were given during the past year by the Association of Government Accountants, National State Auditors Association, USDA Graduate School Interagency Auditor Training Program, and Government Finance Officers Association. Auditors have taken those courses to fulfill their CPE requirements and to obtain knowledge in governmental accounting and governmental auditing.

All training courses should be at the same high-quality level. Furthermore, the courses should be up to date and relevant, incorporating the frequent and continuing changes in governmental accounting and governmental auditing. This could be achieved if the organizations that offer these courses exchange information and advice. For example, the AICPA could offer to provide through its technical committees, and particularly the State and Local Government Committee, the same initial and annual reviews that it provides for its own programs.

Obviously, the organizations offering the courses should not construe or publicize this cooperative service as an endorsement of the particular courses by the reviewing organization.

### ***Recommendation No. 6—Develop a Statement on Auditing Standards on Compliance With Applicable Laws and Regulations***

**A statement on auditing standards relating to auditing for and reporting on compliance with applicable laws and regulations should be developed and issued.**

The scope of a governmental audit usually includes a requirement for testing and reporting on the entity's compliance with applicable laws and regulations. Since this requirement does not exist with most nongovernmental audits, standards have not been developed that address this aspect of auditing. As stated, it was one of the major problem areas discussed by the GAO in its December 1985 and March 1986 reports.

The task force believes that an SAS dealing with auditing for compliance with laws and regulations will provide the guidance auditors need in this area. It would also reduce the uncertainty about such matters as the auditor's responsibility for identifying the compliance requirements, determining a representative number of items to test, and reporting instances of noncompliance.

Therefore, an SAS addressing auditing for compliance with applicable laws and regulations should be developed and issued. The following should be considered for inclusion in the statement:

- A definition of auditing for compliance with applicable laws and regulations
- Identifying the compliance requirements for consideration in the audit

- The role of internal control in assuring and determining compliance with laws and regulations
- Appropriate audit procedures
- Adequate documentation of work performed and conclusions reached
- The use of sampling
- Reporting, particularly in relation to both materiality considerations and the need to fulfill the user's expectations
- Definitions of such terms as unallowed costs, unallowable costs, questioned costs, and recommended for disallowance, and an identification of the appropriate uses for each term
- Disposition of prior audit findings
- The auditor's responsibilities to the organization that contracts for the audit and to others that will rely on the results of the audit

The implementation of this recommendation is under way. It was discussed with the Auditing Standards Board (ASB) Planning Subcommittee. A task force of qualified and knowledgeable individuals has been appointed by the ASB to consider and, if appropriate, develop a proposed statement on auditing standards addressing auditing for compliance with applicable laws and regulations.

**Recommendation No. 7—Strengthen the Capability of the AICPA to Provide Timely Technical Advice**

**The AICPA Technical Information Division's capacity to provide a timely response to questions relating to governmental accounting and governmental auditing should be strengthened and maintained.**

CPAs conducting governmental audits need a source within the profession that can provide timely answers and guidance for questions and problems that might arise while the audits are being conducted. Many firms have internal technical information functions within the firm that provide such assistance. However, most firms do not have such resources.

Furthermore, the growing volume of reference materials relating to the audits of governmental units makes it difficult for CPAs to be continuously aware of current developments. For example, the following are some of the widely publicized documents relating to conducting audits in accordance with the Single Audit Act and OMB Circular A-128.

1. The AICPA Audit and Accounting Guide *Audits of State and Local Governmental Units*
2. The GAO's *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions*

3. The OMB's *Compliance Supplement for Single Audits of State and Local Governments*
4. The publication issued by the President's Council on Integrity and Efficiency (PCIE) Single Audit Committee, *Federal Cognizant Agency Audit Organization Guidelines*

However, there are other reference materials developed by individual departments and commercial services that are not as widely known, such as the following:

1. Several federal departments have prepared compliance requirements and suggested audit procedures for federal programs not contained in the OMB's *Compliance Supplement*.
2. Several subscription services obtain and disseminate audit guidance regarding the single audit. However, confusion can arise about how materials contained in these services apply to specific situations.

One way to assure that all auditors can obtain reliable, timely advice about governmental auditing is to assure that the AICPA's Technical Information Division can respond quickly and accurately to questions from members performing governmental audits. Consequently, the staff of the Technical Information Division should become familiar with the reference materials listed above and others as they are issued. Copies of the materials should be readily available to the staff.

Furthermore, it is important that the advice be consistent and correct. Thus, the Technical Information Division should establish a process whereby the questions raised and the responses provided are documented and provided to others within the AICPA who work full-time in governmental accounting and governmental auditing—for example, members of the State and Local Government Committee. Finally, the questions and responses should be shared with others such as the AICPA Federal Government and CPE Divisions. In this way, they can be considered for the development or revision of training programs and other guidance to practitioners. The Technical Information Division should publish periodically the questions and answers for use by auditors of governmental units.

***Recommendation No. 8—Strengthen the Capability of Government Officials to Provide Timely Technical Advice***

**The capacity of the regional offices of Inspectors General and other governmental organizations to provide timely and proper guidance to recipients of federal financial assistance and their independent auditors should be strengthened and maintained.**

The federal government is also a source of technical assistance for auditors performing audits of governmental units. Indeed, OMB Circular

A-128 states that cognizant agencies are responsible for providing technical assistance and liaison to recipients and their auditors. In many agencies, the Inspector General and specifically the regional Offices of Inspectors General perform this function.

In 1983, PCIE, a federal government group composed primarily of the Inspectors General in the federal departments and major agencies, formed two teams, each headed by an Inspector General, to provide training to all regional Inspector General personnel involved with single audits performed in accordance with OMB Circular A-102, Attachment P. The objective of the training was to assure that the Inspector General community would provide uniform and reliable interpretations of the provisions of OMB Circular A-102, Attachment P, and thereby overcome reports that regional Offices of Inspectors General were providing guidance that was not in conformance with the requirements of Attachment P or that was inconsistent with advice provided by other regional Offices of Inspectors General in the same department or other Inspectors General in the same region.

This approach worked well. However, since 1983, the Single Audit Act has been enacted, Attachment P has been superseded by OMB Circular A-128, and considerable other guidance has been issued. Also, in many regional Inspectors General offices, the personnel providing the single audit advice has changed. It is thus desirable that the Inspectors General undertake another effort to strengthen the capacity of the regional offices to provide timely and proper guidance that is consistent among all departments and all parts of the country.

Ideally, the effort should be similar to the 1983 program, with teams headed by Inspectors General personally presenting training in the regional cities. If this is not feasible because of budget constraints or other reasons, alternative methods for training regional personnel should be considered. One alternative is for the PCIE to present a training session to the National Single Audit Coordinators Committee, which has a representative from each department and major agency involved in single audits. The session could be videotaped and circulated to the regional Offices of Inspectors General. Another alternative is for committee members to provide the training to their respective regional staffs through teleconferencing.

Also, the regional Offices of Inspectors General should adopt the same program for documenting inquiries and responses that is recommended for the AICPA Technical Information Division. This would provide another means for determining where additional guidance is needed.

Many states and some local audit and audit oversight organizations also provide technical guidance to auditors of governmental units in their respective states or governmental units. Programs similar to those recommended for the AICPA Technical Information Division and the federal Inspectors General would also be appropriate for those organizations. Fur-

thermore, NSAA or the GAO should develop and distribute an addendum to the GAO directory of state audit organizations that identifies the organization within each state that will provide technical guidance to independent auditors in public practice.

***Recommendation No. 9—Review the Compliance Supplement Annually and Update if Necessary***

**The Compliance Supplement for Single Audits of State and Local Governments, published by the Office of Management and Budget, should be reviewed annually, and updated as necessary.**

The OMB has published and periodically updated *The Compliance Supplement for Single Audits of State and Local Governments*. The *Compliance Supplement's* purpose is to identify the compliance requirements for the most significant laws and regulations applicable to all federal assistance programs and the major compliance requirements for sixty-two federal assistance programs that account for approximately 90 percent of the federal financial assistance provided to state and local governments. It also suggests audit procedures for testing for compliance with the compliance requirements. The *Compliance Supplement* was last updated in April 1985.

Since laws are enacted and regulations issued each year that can affect the audit requirements and suggested audit procedures, it is likely that auditors are working with outdated requirements and guidance. Accordingly, the OMB should review and update the *Compliance Supplement* annually, if necessary, to reflect changes in the statutes or regulations pertaining to the compliance requirements and procedures for the programs now included in the document and to include the requirements and suggested procedures for additional federal programs for which substantial aid is likely to be awarded. In addition to considering revisions to the *Compliance Supplement* necessitated by changes in laws and regulations, OMB should also consider revisions based on the experiences auditors have had using the *Compliance Supplement*.

***Recommendation No. 10—Develop Compliance Requirements and Suggested Audit Procedures for Programs Not Included in the Compliance Supplement***

**The compliance requirements and suggested audit procedures for federal financial assistance programs not included in the *Compliance Supplement* should be developed by the respective agencies and made available to auditors.**

As stated, the OMB has issued the *Compliance Supplement* containing the compliance requirements and suggested audit procedures for sixty-two of the largest federal assistance programs. This document is extremely helpful to auditors. However, when an auditor is planning or conducting an audit that includes federal programs other than those in the *Compliance Supplement*, he or she must expend considerable time researching laws and regulations to determine the requirements that should be tested and developing the audit procedures for the testing. Even then, it is possible that the cognizant agency or a representative of the program believes the requirements or procedures, or both, should be different.

To overcome this problem, some agencies have defined the compliance requirements and suggested audit procedures for grant programs not included in the OMB's *Compliance Supplement*. These materials are available to auditors.

The task force believes that all federal departments and agencies should identify the compliance requirements and suggested audit procedures for those programs not in the *Compliance Supplement* that are likely to be major programs for some recipients. The OMB should monitor the agencies' development of these compliance requirements and suggested audit procedures to assure that they are in the same format and depth as the requirements and procedures in the original supplement. The departments and agencies should then announce their availability to the governments operating those programs and their auditors through such means as commercial subscription services, professional organizations, and the *Federal Register*. Furthermore, auditors should ask the cognizant agency for copies of the compliance requirements and suggested audit procedures for programs not included in the *Compliance Supplement*.

States with extensive compliance requirements should consider developing their own compliance supplements to assure that the requirements are fully understood and appropriate audit procedures performed.

**Recommendation No. 11—Update the OMB's Questions and Answers Booklet**

**Questions and Answers on the Single Audit Provisions of OMB Circular A-102 "Uniform Requirements for Grants to State and Local Governments," published by the Office of Management and Budget, should be updated to reflect the issuance of Circular A-128.**

An essential element in the quality of government audit work is clear and consistent guidance. Statutes, regulations, and audit guides can provide some of this guidance. However, there are always inconsistencies,



uncertainties, and areas in which additional guidance would be helpful. Thus, the OMB issued a document in 1981, entitled *Questions and Answers on the Single Audit Provisions of OMB Circular A-102 "Uniform Requirements for Grants to State and Local Governments"* (*Questions and Answers—The Single Audit Process*) to eliminate the inconsistencies and uncertainties.

Since 1981, the Single Audit Act has been enacted and the OMB has issued Circular A-128, both of which greatly expand the requirements of a governmental audit. The task force believes that an update of *Questions and Answers—The Single Audit Process* reflecting these changes would be very helpful in defining what the federal government is seeking in governmental audits, and thus would contribute to audit quality. The task force recommends that OMB publish such an update.

## **Additional Recommendations by the General Accounting Office**

The GAO, in its March 1986 report, made two additional recommendations relating to education.

1. Place greater emphasis on governmental accounting and governmental auditing in the Uniform CPA Examination.
2. Seek an expansion of college curriculum to include greater attention to the nature and performance of governmental accounting and governmental auditing.

The recommendation to place greater emphasis on governmental accounting and governmental auditing in the Uniform CPA Examination was discussed at the meetings of the following Examinations Division committees:

1. The Auditing Subcommittee, which is responsible for the preparation of the auditing section of the Uniform CPA Examination (May 14–16, 1986 meeting)
2. The Task Force on Content Validity, which is studying the format and structure of the Uniform CPA Examination (June 6, and September 6–7, 1986 meetings)
3. The Board of Examiners, which oversees the preparation of the Uniform CPA Examination (June 12–13, 1986 meeting)

Before the issuance of the March 1986 GAO report, the Task Force on Content Validity had decided that the portions of the Accounting Practice and Accounting Theory sections of the Uniform CPA Examination relating

to not-for-profit and governmental accounting should be increased from 10 percent of each section to 25 percent of the proposed new accounting practice and theory sections. After reading and discussing the GAO report, it recommended that the *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions* issued by the Comptroller General be added to the list of publications candidates should study for the auditing section of the CPA examination, and that "Professional Responsibilities—Responsibilities in Governmental Auditing and Reporting—GAO Standards for Governmental Audits" should be added to the auditing section's content specification outline. These recommendations were made to the Board of Examiners in October 1986, and are included in an exposure draft of proposed changes to the Uniform CPA Examination issued by the AICPA Examinations Division in March 1987.

The task force concurs with these recommendations. It also suggests that the auditing section of future CPA examinations include questions on the unique aspects of the Standards for Audit issued by the GAO.

The expansion of college curriculum to encompass more attention on governmental accounting and governmental auditing may have already occurred. Exhibit 1 of this report cites a recent survey that discusses the increases in the number of institutions offering public sector accounting courses. It also reports on a substantial increase in college and university usage of governmental accounting texts.

Furthermore, achieving increases in government auditing education should be viewed within two contexts. First, there would need to be an increase in auditing education in general, beyond the minimal amounts currently provided. Second, government and other public sector employers would have to expand their college recruiting activities as a way of convincing students and faculty of the opportunities in public sector auditing, and thus the relevance of public sector auditing courses.

## **Implementation**

The quality of governmental audits is the concern of many persons and groups, including the individual auditor. As indicated, it is also affected by the actions of these same persons and groups as well as of the auditor. Accordingly, implementation of the recommendations contained herein must be addressed by the many individuals and groups involved in the process.

The task force designed the following chart to identify which groups would be the most likely to bring about quick and effective implementation of each of the education recommendations. Similar charts appear at the end of each of the four subsequent chapters.

<u>Recommendation No.</u>	<u>Auditor</u>	<u>Auditee</u>	<u>Audit Oversight Organization</u>
1. Auditors of governmental organizations, programs, activities, and functions should be required to complete continuing professional education courses in the unique aspects of governmental accounting and governmental auditing.	Auditor (S)	Governmental Unit (S)	GAO (P), OMB (S)
2. All new governmental accounting and governmental auditing courses offered by the AICPA, including the self-study programs discussed in Recommendation No. 4, should be reviewed before presentation by the AICPA's State and Local Government Committee. They should be reviewed annually and updated for continued relevance as necessary.	AICPA (P)		
3. Steps should be taken to ensure that instructors of the AICPA governmental accounting and governmental auditing courses are properly qualified and adequately trained to teach the courses.	AICPA (P), SSOC (P)		
4. Self-study programs in governmental accounting and governmental auditing, including video programs, should be marketed actively, particularly in geographic areas where it would be difficult for auditors to participate in a group study program.	AICPA (P)		

<u>Recommendation No.</u>	<u>Auditor</u>	<u>Auditee</u>	<u>Audit Oversight Organization</u>
5. The AICPA should work with other organizations that offer governmental accounting and governmental auditing courses to receive or provide information that would improve the quality of such courses.	AICPA (P)		
6. A statement on auditing standards relating to auditing for and reporting on compliance with applicable laws and regulations should be developed and issued.	AICPA (P)		
7. The AICPA Technical Information Division's capacity to provide a timely response to questions relating to governmental accounting and governmental auditing should be strengthened and maintained.	AICPA (P)		
8. The capacity of the regional offices of Inspectors General and other governmental organizations to provide timely and proper guidance to recipients of federal financial assistance and their independent auditors should be strengthened and maintained.			IGs (P), SAO (P)
9. The <i>Compliance Supplement for Single Audits of State and Local Governments</i> , published by the Office of Management and Budget, should be reviewed annually, and updated as necessary.			OMB (P)

<u>Recommendation No.</u>	<u>Auditor</u>	<u>Auditee</u>	<u>Audit Oversight Organization</u>
10. The compliance requirements and suggested audit procedures for federal financial assistance programs not included in the <i>Compliance Supplement</i> should be developed by the respective agencies and made available to auditors.			IGs (P)
11. <i>Questions and Answers on the Single Audit Provisions of OMB Circular A-102 "Uniform Requirements for Grants to State and Local Governments,"</i> published by the Office of Management and Budget, should be updated to reflect the issuance of Circular A-128.			OMB (P)

P = primary role; S = secondary role; AICPA = American Institute of Certified Public Accountants; GAO = General Accounting Office; IGs = federal Inspectors General; OMB = Office of Management and Budget; SAO = state audit organizations; SSOC = state societies of CPAs.

## CHAPTER 3

# Engagement

Governmental units obtaining audits can take several steps to help improve the quality of those audits. Chief among them is the manner in which the governmental units contract for the audit and the subsequent communication and oversight the entity provides the auditors as the work progresses.

Discussions with members of the accounting profession, government procurement officials, and program managers who rely on audit reports to improve the administration of their programs disclosed several problems with the current procurement process that have an effect on audit quality. These problems relate to the adequacy of the information disseminated to or obtained by auditors who propose to perform the audits, the manner in which auditors are expected to submit proposals, the procedures for evaluating audit proposals, and the support the governmental unit provides during the audit. Indeed, the following problems are often cited by those who contract with governmental units to perform audit services:

1. Contracting entities do not provide potential bidders with adequate information with which to prepare a thorough audit proposal.
2. Contracting entities do not provide potential bidders with sufficient time to prepare and submit comprehensive proposals.
3. Estimates of starting dates are often inaccurate, necessitating audit organizations to use alternate staff rather than those originally assigned to the audit.
4. Contracting entities sometimes emphasize inappropriate evaluation factors in selecting an audit firm, for example, location of firm, number of hours to be provided, political support, cost only.
5. Governmental entities often request, and sometimes require, auditors to issue reports that are not permitted by authoritative auditing literature. For example, the illustrative auditor's report in federal regulations sometimes includes language that conflicts with generally accepted auditing standards.

The task force recognizes that specific requirements, motivations, or limitations may influence the manner in which governmental units procure audit services. Moreover, the ultimate responsibility for performing a quality audit rests with the auditor; the contracting entity can only assist the auditor in meeting his or her professional responsibility. Nonetheless, it is incumbent on all participants in a governmental audit to understand that good procurement practices and procedures may indeed influence the quality of the audit.

**Recommendation No. 12—Undertake a Study of the Audit Procurement Process**

**A comprehensive study should be undertaken of the procurement of audit services and the way in which that process influences audit quality.**

The previously noted problems in the governmental audit procurement process are only some of those that can impair audit quality; there are probably others. Hence, the federal, state, and local governments will benefit from a comprehensive study of the process used by governments to procure audit services. Such a study could determine any effect the current process has on audit quality and could develop recommendations to improve audit quality by the factors that can impair audit quality. The study also could aid in developing a handbook that identifies and discusses the attributes of a procurement process that contributes to audit quality.

To be meaningful, the study should encompass the contracting process for all governmental audits. It should examine the total procurement process from beginning to end; review the role of the contracting officials, if any, and how that role relates to the role of the officials responsible for obtaining the audit; identify existing rules and guidance for contracting officials; evaluate contracting officials' understanding of governmental auditing standards; and determine the relationship between the procurement process and audit quality. Views should be obtained from auditors in public practice, persons requiring or desiring the audits, contracting officials, Inspectors General, and others whose views would contribute to the comprehensiveness and objectives of the study.

The chairman of the Legislation and National Security Subcommittee of the Committee on Government Operations, House of Representatives, has requested that the GAO conduct a study of the process state and local governments use to procure financial and compliance audits. The task force believes that the GAO is in the best position to obtain the needed information from the numerous affected parties, particularly the independent auditors and the finance directors that engage the auditors; develop recommendations that would be accepted as devoid of self-interest; and work for their implementation at all levels. The task force supports this request and is pleased that the study is already in process.

Although the scope of the study does not include the process with which the federal government procures audit services, the task force believes that the information and recommendations developed during the study should be used to develop guidance for the federal government on how it should procure audit services. Finally, the findings and recommendations of the study should be widely publicized and distributed to the contracting officials at all levels of government.

***Recommendation No. 13—Develop and Distribute a Model Request for Proposal***

**A Model Request for Proposal for audit services should be developed and widely distributed.**

A comprehensive request for proposal (RFP) and a thorough, objective process for obtaining proposals can contribute significantly to the effectiveness of the audit procurement process and the quality of the audit.

In 1981, the Western Intergovernmental Audit Forum developed a model audit RFP. It has been used by many governmental entities as a guide for preparing comprehensive RFPs and conducting an effective audit procurement process. However, the absence of input from many interested groups during its development, and the lack of an endorsement from a national organization, precluded it from receiving as widespread a use as it could have.

The Western Forum has drafted an updated version of the model RFP. The National Intergovernmental Audit Forum is obtaining and will incorporate the views of the other regional forums, other potential users of the model RFP, and others interested in the audit procurement process, and will publish the results. This approach will secure a broader endorsement for the document and will assure a wider use.

The task force concurs with this project and is participating with the National Forum and other interested organizations in the development of the updated model RFP. The task force suggests that the publication and dissemination of the final document be a joint effort of the NIAF, GFOA, NSAA, and other groups that represent the purchasers of audit services.

***Recommendation No. 14—Standardize Agency Implementation Regulations for the Single Audit***

**The federal government's numerous rules that govern the conduct of a single audit should be consolidated into a single rule. The rules should be expanded to incorporate certain applicable recommendations discussed in this report.**

The Single Audit Act requires that federal regulations be written to define the audit requirements for state and local governments that receive federal financial assistance. Thus, following enactment of the Act, the OMB issued Circular A-128, "Audits of State and Local Government." Unfortunately, at least thirteen federal agencies then issued their own versions of a single audit regulation, some of which differ from Circular A-128 (see exhibit 4).

Therefore, an auditor conducting a single audit of governmental funds must read the regulations of each agency that has provided a grant to the



auditee. Obviously, considerable time could be saved if there were only one regulation to read. Moreover, since some of the regulations are slightly different from one another, the auditor not only expends his or her time unnecessarily, but must also decide how to follow both the cognizant agency's and the granting agencies' regulations.

The task force recommends that OMB Circular A-128 be established as the implementing regulation for single audits of federal financial assistance expended by state and local governments. Agencies should either adopt Circular A-128 as is or state that their regulation is Circular A-128.

In making this change, the OMB should consider some of the other recommendations contained in this and other reports. These are the recommendations that could improve the quality of audits by establishing additional requirements for auditors of governmental funds or affect the way payments are made for audits of governmental funds.

Specifically, a revised Circular A-128 should—

- Require that an auditor conducting an audit as required by the circular has completed continuing professional education courses in the unique aspects of governmental accounting and auditing before undertaking the audit.
- Require that an auditor conducting an audit as required by the circular participate in a peer review program that includes reviews of audits of governmental entities.
- Require that an auditor conducting an audit as required by the circular waive his or her right to confidentiality in the event the audit is referred to a licensing body or professional association for review or investigation.

Finally, the revised circular A-128 should state that the required audits be conducted in accordance with the guidelines established in the AICPA audit and accounting guide, *Audits of State and Local Governmental Units*.

***Recommendation No. 15—Place All Audit Quality Activities Under the Responsibility of Knowledgeable Officials***

**Compliance with the requirements for audits conducted for or on behalf of governments should be monitored by an Office of Inspector General at the federal level, the respective state auditor's office at the state level, or the independent local auditor's office at the local level, if one exists.**

The Inspector General Act of 1978 centralized all audit activities in each federal department in which an Office of Inspector General was established in that office. The expectation was that the quality and usefulness of audits would be improved by placing audit activities in the office of a person who understood and appreciated the audit process and its limita-

tions and who would monitor the performance of audits. By and large, this approach has been effective.

However, there are still instances in federal departments and agencies of audits being required and performed without Inspector General review, input, or involvement. Indications are that those audits may be of poorer quality than those in which the Office of Inspector General is involved. Indeed, the GAO is currently studying the performance of audits in which there is no Inspector General involvement.

The same situation exists at the state and local level. Audits of state units or certain types of local governments (for example, school districts) are conducted without input from a state or independent local audit organization whose primary expertise is auditing.

The task force believes that the quality of governmental audits could be improved if a federal Inspector General, a state auditor, or an independent local auditor, if one exists, has some involvement in all such audits. This involvement can be provided for in any of several ways. The responsibility for obtaining and monitoring the audits (and the personnel necessary to discharge the responsibility) can be legislatively or administratively transferred to the Inspector General's or to state or independent local auditors' offices. If a transfer is not appropriate, the Inspector General or state or independent local auditors should have a role in providing policy guidance for the audits, establishing requirements, and monitoring performance. At the very least, the Inspector General and state or independent local auditors should review the reports, on at least a sample basis, for adherence to standards and take steps to determine the reasons for substandard performance and eliminate such reasons.

## Implementation

The following chart identifies the groups that can bring about the quickest and most effective implementation of the engagement recommendations.

<u>Recommendation No.</u>	<u>Auditor</u>	<u>Auditee</u>	<u>Audit Oversight Organization</u>
12. A comprehensive study should be undertaken of the procurement of audit services and the way in which that process influences audit quality.			GAO(P)
13. A model request for proposal for audit services should be developed and widely distributed.	AICPA(S)	NIAF(P) GFOA(S) NSAA(S)	GAO(S)

<u>Recommendation No.</u>	<u>Auditor</u>	<u>Auditee</u>	<u>Audit Oversight Organization</u>
14. The federal government's numerous rules that govern the conduct of a single audit should be consolidated into a single rule. The rules should be expanded to incorporate certain applicable recommendations discussed in this report.			OMB(P)
15. Compliance with the requirements for audits conducted for or on the behalf of governments should be monitored by an Office of Inspector General at the federal level, the respective state auditor's office at the state level, or independent local auditors at the local level, if one exists.			IGs(P) SAO(P) ILAO(P)

P = primary role; S = secondary role; AICPA = American Institute of Certified Public Accountants; GAO = General Accounting Office; GFOA = Government Finance Officers Association; IGs = federal Inspectors General; ILAO = independent local auditor organizations. NIAF = National Intergovernmental Audit Forum; NSAA = National State Auditors Association; SAO = state audit organizations.

## CHAPTER 4

# Evaluation

Evaluating individual audit reports and working papers is an important part of improving audit quality. It is particularly important for governmental audits because of the additional scope associated with these audits.

An effective audit evaluation process should have three objectives.

1. Determine if a specific audit is acceptable or needs correction, and in the event of the latter, provide feedback to the auditor to help correct or improve his or her performance.
2. Identify recurring problems and provide information that may help or eliminate the problems.
3. Determine if referral to a professional or licensing organization for disciplinary action is warranted.

Statistics developed for recent evaluation programs support the value of this approach. For instance, of approximately 2,300 peer reviews conducted in the AICPA's peer review program, 270 firms were required to take some form of corrective action, such as another review sooner than would otherwise occur, a revisit by the peer reviewer, or another type of action responsive to the noted deficiencies. Moreover, an analysis of the results of the GAO study revealed that although 51 percent of the audits reviewed by GAO were conducted by firms that are members of the AICPA Division for CPA Firms and subject to peer reviews, only 2 percent of those audits had severe violations.

Governmental audits may be subject to evaluation in three different ways. First, the governmental audit oversight organizations, such as Inspectors General or state auditors, conduct reviews. Indeed, the former have a statutory requirement to assure the quality of audits by nonfederal auditors. They fulfill this mandate by conducting reviews of the audit reports they receive to determine if the reports are presented in accordance with appropriate professional standards and by conducting reviews and evaluations of the auditors' working papers to determine if the audits were conducted in accordance with appropriate professional standards.

Second, state boards of accountancy and state CPA societies conduct reviews primarily as a result of complaints or referrals. Several state accountancy boards also conduct a positive enforcement or quality assurance program whereby they select for review reports filed with governmental organizations or a sample report submitted by a licensee in order to have a license renewed. Also, some state CPA societies offer a voluntary quality review service for member firms.

Finally, some CPA firms participate in a peer review program that evaluates the adequacy of a firm's quality control standards, whether the standards are appropriately documented and communicated, and whether the standards are complied with in individual audits. This evaluation is performed by an independent review team.

Although this continuum of evaluation processes is in place, it must be strengthened. A survey of state accountancy boards, state CPA societies, and state audit agencies conducted by the task force disclosed that 44 percent of the respondents considered the quality of governmental audits to be lower than that of commercial audits. Over 50 percent believed working paper reviews should be mandatory, and over 85 percent of the respondents believed that greater disclosure of substandard work would reduce its frequency.

**Recommendation No. 16—Expand Guidelines for PCIE Audit Report and Working Paper Reviews**

**The guidelines for conducting audit report and working paper reviews included in the *Federal Cognizant Agency Audit Organization Guidelines* should be expanded to assure comprehensive, consistent quality control reviews.**

As stated, the Inspectors General are required by law to review non-federal auditors' audits of federal funds to assure they were performed in accordance with the Standards for Audit issued by the GAO. They discharge this responsibility by reviewing audit reports and working papers. The PCIE, whose members are the Inspectors General of the departments and major agencies, has developed guidelines for these reviews that describe in broad terms the general areas that should be covered. The guidelines are contained in a PCIE publication entitled *Federal Cognizant Agency Audit Organization Guidelines*.

The regional offices of Inspector General, and in some instances the departmental Inspectors General, develop more detailed guidelines or checklists for the reviews they conduct. With a detailed standardized checklist, the Inspector General reviews are more likely to be consistent and thorough.

The PCIE could address this issue by replacing the broad guidelines in the *Federal Cognizant Agency Audit Organization Guidelines* with more detailed audit report and working paper review checklists that include the minimum requirements for such reviews. For example, the current guidelines for quality control reviews include a requirement that the working papers be reviewed to determine if they show that the auditor's review of the system of internal control over federal assistance programs satisfies the requirement of OMB Circular A-128. A detailed checklist would specify

that the reviewer should determine whether (1) a full study and evaluation was performed where required, (2) the study and evaluation covered all significant control cycles, (3) at least a preliminary review was performed for programs not requiring a full study and evaluation, (4) the extent of testing was sufficient, (5) all material weaknesses found were reported, and (6) the work was adequately documented. Furthermore, the detailed checklist should be distributed to auditors and auditees so that they know what is expected of them.

### **Recommendation No. 17—Use Data Obtained From Audit Report and Working Paper Reviews**

**The audit deficiency data collected during audit report and working paper reviews should be categorized by type of deficiency and solutions sought for recurring and systemic problems.**

Inspectors General frequently have used the results of audit report and working paper reviews only to correct the individual audits reviewed. They have not compiled and analyzed the data to determine the types and patterns of deficiencies, even though such an approach would provide an opportunity to seek corrections of the problems in a broader and more systematic manner. For instance, properly accumulated data could reveal frequently recurring problems with a particular financial audit procedure, specific compliance audit requirement, or audits performed in a particular state or region.

The task force recommends that the PCIE, in cooperation with the AICPA and other professional organizations, define categories for the deficiencies the Inspector General reviews disclose. The PCIE should also develop and implement a process for accumulating the data concerning deficiencies, classified by type of deficiency. This information should be shared with the appropriate committees of the AICPA and other organizations for analysis and possible action.

For example, the information could be—

- Reported to auditors who perform governmental audits so they can assess their own performance and avoid making the same mistakes.
- Reported to specific state societies of CPAs and state boards of accountancy with a suggestion that the overall performance in that state *bear improvement*.
- Used to identify recurring and systemic problems for which additional authoritative guidance is needed.
- Used to identify the subjects for which existing training programs need to provide more emphasis, or new specialized training programs should be developed.

### **Recommendation No. 18—Institute Positive Enforcement Programs**

#### **A positive enforcement program that includes reviews of audits of governmental units should be instituted in each state.**

In several states, the state board of accountancy, the state CPA society, or both operate a positive enforcement or quality review program that entails a review of audit reports to determine compliance with professional standards. In some states, the review entails only publicly available reports; in others it is a sample of all reports, but with identifying information deleted. Also, in some states the program includes all licensed practitioners and is used as a determining factor for renewing a license to practice.

As of January 1986, such programs, in one form or another, existed or were getting under way in fourteen states (Oregon, Louisiana, Ohio, Kentucky, Missouri, South Dakota, Arizona, California, Florida, Idaho, Iowa, Nebraska, South Carolina, and Washington). A recent NASBA survey indicates that at least twenty-two additional state boards are interested in implementing some form of positive enforcement program and are seeking the necessary statutory authority and resources.

Hence, NASBA has developed a model positive enforcement program, patterned after programs implemented successfully in several states. The program provides guidance on organizational structure; selection, training, and supervision of reviewers; selection of reports for review; classification of findings; communications with practitioners; confidentiality; procedures for follow-up and working paper review when such additional work is deemed necessary; rehabilitative and disciplinary sanctions; and reports on findings. NASBA is aggressively encouraging and assisting state boards to implement such programs to improve the quality of audits nationwide.

The task force recommends that a positive enforcement program be established in each state and that, at a minimum, it include a periodic review of governmental audits conducted by all licensed practitioners. This would provide the second point in the continuum of evaluations. Furthermore, persons in the governmental auditing community in each state should work with the state board and the state society to assure an effective program. Specifically, it is important that the reviewers be properly motivated, qualified, and experienced. Standardized review procedures and checklists should be developed. The reviewers should be trained in conducting the reviews and using the checklists.

### **Recommendation No. 19—Require Participation in Peer Reviews**

#### **Auditors and audit organizations performing audits of governmental funds should be required to participate in a peer review program that includes reviews of the governmental audits.**

A peer review evaluates the adequacy of an audit organization's quality control policies and procedures and the degree to which these policies

and procedures are adhered to on individual audits. Since peer reviews are widely recognized as upgrading the quality of audits in accordance with established professional standards and since the costs are usually not overly burdensome, even for small firms, they can and should be the third point in the evaluation continuum. Exhibit 6 presents the cost of recent peer reviews by size of firm.

Members of the AICPA Division for CPA Firms are required to have a peer review performed at least once every three years. Furthermore, at the suggestion of the task force and the GAO, the AICPA's peer review procedures were modified recently to provide that the review of firms that perform audits pursuant to the Single Audit Act of 1984 must include at least one such audit in the test sample. However, not all individuals, firms, or organizations performing audits of governmental units belong to or participate in the AICPA or other peer review programs such as that operated by NSAA.

The task force believes that all auditors who perform audits of governmental funds should participate in a peer review program that includes reviews of the governmental audits. Moreover, the reviewers should be knowledgeable and experienced in governmental accounting and governmental auditing. They should use a peer review checklist that is designed for governmental audits and that has appropriate supplements applicable to the unique requirements of the state in which the audit is conducted.

This recommendation should be implemented in the same way as the recommendation for continuing professional education in governmental accounting and governmental auditing. Specifically—

- The requirement should be included as a qualifications standard in the forthcoming revision of the Comptroller General's *Standards for Audit of Governmental Organizations, Programs, Activities and Functions*.
- The requirement should be included in the proposed single rule pertaining to single audits of federal financial assistance (see Recommendation 14 in chapter 3).
- Appropriate wording should be included in the proposed model request for proposal (see Recommendation 13 in chapter 3).

Assurance about the reviewers' knowledge and experience can be enhanced by considering the amount of continuing professional education in governmental accounting and governmental auditing each reviewer has had, the governmental audits he or she performs, and the results of peer reviews or positive enforcement reviews made of the reviewer's firm.

Finally, the AICPA Peer Review Program has developed a checklist for reviewing the working papers and audit report for an audit of a governmental unit's financial statements prepared in accordance with GAAP. This document could serve as the basic peer review guide. The supplements that provide for reviewing the audit and reporting associated with the unique compliance and reporting requirements in a particular state could



be developed by the state society of CPAs, the state board of accountancy, or the state auditor of governmental audit oversight organization.

## Implementation

The following chart identifies the groups that can bring about the quickest and most effective implementation of the evaluation recommendations.

<u>Recommendation No.</u>	<u>Auditor</u>	<u>Auditee</u>	<u>Audit Oversight Organization</u>
16. The guidelines for conducting audit report and working paper reviews included in the <i>Federal Cognizant Agency Audit Organization Guidelines</i> should be expanded in order to assure comprehensive, consistent quality control reviews.			PCIE(P)
17. The audit deficiency data collected during audit report and working paper reviews should be categorized by type of deficiency and solutions sought for recurring and systemic problems.	AICPA(S)		PCIE(P)
18. A positive enforcement program that includes reviews of audits of governmental units should be instituted in each state.	SSOC(S)		NASBA(P), SBOA(P)
19. Auditors and audit organizations performing audits of governmental funds should be required to participate in a peer review program that includes reviews of the governmental audits.	Auditor(S)	Governmental Unit(S)	GAO(P), OMB(S)

P = primary role; S = secondary role; AICPA = American Institute of Certified Public Accountants; GAO = General Accounting Office; NASBA = National Association of State Boards of Accountancy; OMB = Office of Management and Budget; PCIE = President's Council on Integrity and Efficiency; SBOA = state boards of accountancy; SSOC = state societies of CPAs.

## Enforcement

Audit deficiencies identified in the evaluation process are usually corrected by the auditor. However, in some instances either an auditor refuses to make the correction, the deficiencies are egregious, or a specific auditor is repeatedly deficient. At that point, an enforcement process is needed to impose discipline on the individual, including restricting or revoking his or her right to practice, and thereby assure compliance with established professional standards.

There are two types of enforcement processes. At the organizational level, the AICPA and the state CPA societies have adopted codes of professional ethics. They have also established a Joint Ethics Enforcement Program under which complaints against members are investigated and, if warranted, referred to a Trial Board. As a result, a member may be censured, reprimanded, suspended, or expelled from the AICPA and the state CPA societies. In addition, the AICPA's Division for CPA Firms has provisions for investigating allegations of substandard work and taking disciplinary action against member firms.

At the governmental level, a state board of accountancy is established by statute in each state and given the authority and responsibility for regulating the practice of public accountancy within its jurisdiction, including examining and licensing CPAs. The state boards have also adopted rules of professional conduct. More important, they have the power to conduct investigations, issue subpoenas, hold hearings, and take disciplinary actions against licensees. This includes the authority to revoke, suspend, or otherwise impair a CPA's license to practice.

Despite their existence, these two enforcement mechanisms have not been extensively used for governmental audits. Government officials have claimed that the procedures to make a referral are difficult and complex: excessive time is required to complete the investigation, the disciplinary action is minimal, and determining the status and disposition of a referral is either difficult or impossible.

### ***Recommendation No. 20—Improve the System for Referring Substandard Audits***

**The system for referring allegedly substandard audits to licensing authorities and professional organizations should be modified to lessen the paperwork required to initiate a referral, enable the investigation to be completed in less time, and provide feedback to the referring and other appropriate officials.**

The referral process starts with an Inspector General, the GAO, another government official, or an individual submitting a complaint of a deficient audit. The complaint, which is often accompanied by very detailed and thorough reports of the allegedly substandard performance, is submitted to a state board of accountancy, the AICPA Professional Ethics Division, or both. The AICPA generally defers action if the complaint is filed with both organizations and the respondent so requests since the boards have jurisdiction over all CPAs they license, and the AICPA only has jurisdiction over its members.

The state boards or the AICPA then take the following steps:

1. Conduct an initial review and determination of possible violations.
2. Decide whether to dismiss the complaint or initiate an investigation.
3. Conduct an investigation.
4. Hold a hearing.
5. Present information to the Ethics Task Force for decision (AICPA only).
6. Refer the case to the Trial Board, if appropriate, but only after obtaining the concurrence of the Professional Ethics Executive Committee and appropriate state society (AICPA only).
7. Determine rehabilitative or disciplinary action.

The AICPA process generally takes 160 to 180 days if the case is not referred to the Trial Board, and 60 days longer if it is. The process takes such a long time because due process is required, portions of the process are conducted by volunteers, and the auditors have a continuing business to operate. During this entire period, the person making the referral cannot determine the status of the investigation. Also, he or she cannot determine its disposition unless disciplinary action is taken, and then only by reading an announcement that is generally available to CPAs only.

The task force believes the referral process should be simplified and shortened so that it can be used more frequently. Since the AICPA changed its procedures in June 1986 and will now inform the GAO and Inspectors General about the status and disposition of an investigation triggered by a GAO or Inspectors General complaint, one feasible approach is for government officials to file all complaints with the AICPA. The AICPA is committed to expediting the investigations of reported deficient government audits and is allocating the necessary resources to fulfill this commitment. Hence, the AICPA will advise the government official immediately if the auditor is not a member so that the complaint can be filed directly with a state board. Moreover, the GAO or Inspectors General can consider the results of the investigation and the proposed disciplinary action, if any, and decide whether referral to a state board of accountancy for additional disciplinary action is desirable. An alternative approach is for the GAO and the Inspectors General to send all referrals to state boards of

accountancy, particularly if the alleged violation is egregious or if experience shows the state board can provide a quick review. A third option is to send only those alleged violations that are egregious to the state board and the others to the AICPA.

The shortening of the time can be accomplished in two ways. First, the government officials need not take the time to prepare a detailed analysis; a copy of the report and a simple statement of the alleged deficiency generally will suffice. If, however, the referring official has already conducted a detailed analysis to determine whether a referral is justified, he or she can submit the analysis with the statement of the alleged deficiency. The materials may then be used by the investigating organization, which might shorten the process.

Second, the times allotted to each stage of the enforcement process should be reduced. For instance, the AICPA thirty-day response times could be reduced to twenty days, with extensions available in cases of hardship. Although this would not significantly reduce the length of the entire process, it would help emphasize the importance of timely resolution of complaints. Hearings could be scheduled on a timely basis rather than on the basis of an accumulation of a predetermined volume of work. This may cause certain inconveniences, but it will underscore the overall importance of the enforcement process to the profession.

The absence of feedback can be corrected in three ways, two of which are already in progress. First, as stated, the AICPA has already changed its procedures and will provide feedback to the GAO or the Inspectors General who make a referral. Second, auditors conducting a governmental audit should be required to waive their right to confidentiality for investigations conducted by state boards or societies and permit a reporting of the status and disposition of the investigation to the referring official and the audited government. This expectation could be established as a requirement in the government's request for proposal (and thus should be included in the model RFP). The willingness to waive confidentiality could also be included in the revised Standards for Audit issued by the GAO and the proposed single rule governing single audits.

Third, NASBA has appointed a Special Committee on Relations with Government Agencies, which is serving as a coordinating body to facilitate and expedite the process of handling referrals to state boards of accountancy from the GAO and the Inspectors General. The Committee is developing the necessary follow-up procedures to assure that action is taken and the results communicated to the appropriate parties.

The modification of the referral procedures is the responsibility of the AICPA, NASBA, and the state boards of accountancy. However, the PCIE is considering studying the audit referral process and, in particular, the feasibility of having the process standardized throughout the country. The results of this study, if conducted, should be considered in the proposed modifications.

***Recommendation No. 21—Inform Government Oversight Officials  
About the Improved Referral System***

**Guidelines should be developed and distributed to explain the referral process to organizations that would have a need to make referrals.**

The task force believes that the complexity and slowness of the referral process is not the only reason it has not been widely used for governmental audits. It also appears that most potential users do not understand how the process works and thus how to use it effectively. Accordingly, once a simpler, more timely system is in place, a program to explain its functioning and limitations should be undertaken. Such a program would (1) increase use of the process and thus serve as an effective deterrent to substandard audits, and (2) improve the communications and understanding between the participating organizations.

Several communication methods are suggested for the program, beginning with a brochure explaining the system. The AICPA and NASBA could develop the brochure jointly, announce its publication to practitioners, and distribute it to Inspectors General, state auditors, and other state audit oversight organizations and state boards.

The brochure would discuss the following topics:

- The overall investigation process and its role in assuring audit quality
- Due process considerations
- Procedures for requesting an investigation
- Use of Inspector General or similar reviews in the investigation process
- Hearings and other submissions of relevant information
- Possible disciplinary actions and their significance
- The successor auditor's responsibility to refer substandard work in a prior audit
- Obtaining of information concerning the status and disposition of an investigation
- How the final actions are disclosed to other individuals and organizations

Subsequent to the brochure's publication, the AICPA, NASBA, and the regional intergovernmental audit forums should hold educational seminars to discuss the brochure's contents and further enhance understanding of the process. These seminars could also be used to refine the process in each state, begin establishment of liaison relationships, and exchange information of continuing or broad significance. Finally, representatives of the AICPA, NASBA, Inspectors General, and state audit organizations should meet periodically to review the operation of the process and determine whether refinements are needed.

## Implementation

The following chart identifies the groups that can bring about the quickest and most effective implementation of the enforcement recommendations.

<u>Recommendation No.</u>	<u>Auditor</u>	<u>Auditee</u>	<u>Audit Oversight Organization</u>
20. The system for referring allegedly substandard audits to licensing authorities and professional organizations should be modified to lessen the paperwork required to initiate a referral, enable the investigation to be completed in less time, and provide feedback to the referring and other appropriate officials.	AICPA(P)		NASBA(S), SBOA(P), PCIE(S)
21. Guidelines should be developed and distributed to explain the referral process to organizations that would have a need to make referrals.	AICPA(P)		NASBA(S), SBOA(S)

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P=primary role; S=secondary role; AICPA=American Institute of Certified Public Accountants; NASBA=National Association of State Boards of Accountancy; PCIE = President's Council on Integrity and Efficiency; SBOA = state boards of accountancy.

# Exchange

Exchanging information is important for improving the relationships between CPAs in public practice, other nonfederal auditors, and those responsible for procuring and overseeing governmental audits, and thus contributes to improving the quality of audits of governmental units. Dialogue, or the exchange of information, enables problems, ideas, and possible solutions to be aired and shared; it helps educate; it motivates; and it reinforces a sense of professionalism in the practitioner.

The task force's survey on the image of the profession, which included responses from state auditors, federal and regional Inspectors General, and members of relevant AICPA committees, uncovered differing perceptions of auditor performance between government officials and CPAs in public practice. It also revealed a need for a better exchange of information. For example, government officials commented: "The profession needs to understand governmental audits are not low-risk audits." "There seems to be an attitude that a CPA not working in public practice is somehow inferior." "There is a perception that the CPAs consider government clients secondary to the private sector." On the other hand, the CPAs' viewpoint was characterized by such comments as "Federal auditors think CPAs are not competent" and "Educate government managers and federal officials as to the objectives of an audit, the resultant approach, and output."

All groups share the responsibility for removing these perceptions and improving the relationships. Unfortunately, however, although improved communication could foster the necessary trust and understanding, governmental auditors often meet with their own counterparts and have little interaction with CPAs in public practice. The opposite is also true. CPAs in public practice generally meet among themselves and have limited involvement with the governmental audit community.

This communication gap must be bridged. All segments of the profession and all organizations concerned with audits of governmental units, from the national level to the local level, need to exchange information.

### ***Recommendation No. 22—Open Membership in the Intergovernmental Audit Forums to CPAs in Public Practice***

#### **Membership in the National and regional Intergovernmental Audit Forums should be opened to CPAs in public practice.**

The National Intergovernmental Audit Forum and the regional intergovernmental audit forums were established to promote dialogue and

cooperation among federal, state, and local auditors. They have been very successful in meeting their objectives. However, participation in the forums by CPAs in public practice has been limited, often because of restrictions on membership eligibility. Therefore, governmental auditors are exchanging information and ideas within their community, and sometimes the information and ideas are slow to reach the CPAs in public practice. Furthermore, the lack of participation by CPAs in public practice prevents the government members from hearing about the problems those CPAs are having applying the government's laws and regulations.

The NIAF's recent establishment of a committee to address problems arising in the implementation of the Single Audit Act is a good example of the weaknesses in the current approach. Specifically, the majority of single audits will be performed by CPAs in public practice and many of the problems will occur as a result of requirements or actions of the federal Inspectors General and the state and local auditors. CPAs in public practice are needed on the committee in order to assure that all the problems are identified. CPAs in public practice also need to be part of the discussion in order to assure that the proposed solutions are feasible for their segment of the audit community.

However, the NIAF consists of representatives of only the GAO, the OMB, federal Inspectors General, and state and local auditors. While the NIAF has several official observers from various organizations, including the AICPA, which is represented by the Director of the Federal Government Division, the observers are not invited to actively participate in all the meetings.

At the regional level, there are ten forums that meet in different locations within the respective regions, two to three times a year. The members discuss issues of concern to that region and provide updates on professional developments. Although many of the audits of governmental units are conducted by CPAs in public practice, their participation varies from region to region. In fact, only three regional forums include CPAs in public practice as voting members. Exhibit 5 summarizes the participation by CPAs in public practice in the regional forums.

Participation in the NIAF should be expanded to include CPAs in public practice. One way this could be accomplished is to amend the charter of the NIAF to permit membership by CPAs in public practice, and appoint no more than one CPA in public practice from each region to be a member of the NIAF. In addition, NASBA should be invited to become an official observer to the NIAF, so that it can obtain an additional firsthand appreciation for the issues that could affect audit quality.

To fully inform their members about the NIAF's deliberations, the AICPA's official observers to the NIAF should distribute copies of the minutes of the NIAF meetings to the Auditing Standards Board, the State and Local Government Committee, Federal Government Accounting and Auditing Committee, and Members in Government Committee.



At the regional level, the charters of the regional forums should be amended, if necessary, to permit membership by CPAs in public practice, as is currently provided for in the New York/New Jersey, Mid-America, and Pacific Northwest Intergovernmental Audit Forums. Each regional forum could then offer membership to a CPA in public practice in each state of that region. The individuals should be active in performing governmental audits and active in their state societies, such as chairing the Local Government Accounting and Auditing Committee or the Committee on Cooperation with Government Agencies.

The CPAs in public practice should be appointed for three-year terms. They should be advised that they are responsible for apprising members of their state society about significant matters that arise from the forum. Alternatively, the Executive Director of each regional forum should prepare an article about each meeting and submit it to each state society in the region for publication in its newsletter. Finally, representatives of state boards of accountancy should also be invited to serve as observers at regional forum meetings.

### **Recommendation No. 23—Expand the Dialogue and Exchange of Information**

**The dialogue and exchange of information among the various individuals involved in governmental auditing should be expanded.**

Auditors of governmental units, including CPAs in public practice, and government financial managers' professional associations are typically very active organizations that have numerous meetings. These organizations provide an excellent opportunity for expanding the dialogue and exchange of information between CPAs in public practice and the governmental auditor and financial manager community. Moreover, since different organizations often have different perspectives on an issue, when the members get together, a useful exchange of views usually occurs.

For example, the National Association of State Boards of Accountancy and the Southeastern Intergovernmental Audit Forum jointly sponsored an audit quality conference in Atlanta, Georgia, in October 1986. Another example is a recent meeting between several federal Inspectors General and representatives of twenty CPA firms that have multiple offices. At that meeting, they discussed the need for a mechanism to notify a firm's executive office of substandard work performed by an operating office, and defined a suitable approach. The group also agreed to continue the dialogue and meet from time to time.

The AICPA and the other organizations involved in governmental auditing should seek opportunities for joint meetings at which common concerns could be discussed. One group can update the other on hap-

penings that affect both. New programs of interest to the two (or more) groups can be presented.

There are various ways a meeting can be conducted jointly. One group can sponsor the meeting and invite members of other groups. Or, a group can publicize other groups' meetings in publications sent to members. Perhaps the most effective way to conduct a joint meeting is to have the two groups sponsor the meeting, plan the program, and mail the announcements to members of both groups.

Another mechanism for exchanging information from meetings is to make transcripts or tapes of meetings available to other organizations. The latter could then notify their memberships that the transcripts or tapes are available. Thus, the information would reach more than just the members attending the meeting.

A program to seek more joint meetings should not be limited to national organizations, particularly since high travel costs often limit participation in national conferences. Jointly sponsored regional and local conferences involving state CPA societies, regional intergovernmental audit forums, and state and local chapters of the GFOA and the AGA, and patterned after jointly sponsored national conferences, would promote the exchange of information among more people. These meetings can be facilitated by the national organizations providing publicity, program, and other materials useful for joint meetings to their state and local affiliates.

Finally, the state societies, through their state and local government committees, should periodically meet with representatives of the regional Inspectors General and state audit organizations to discuss issues relating to governmental auditing. Such communication may help ensure that CPAs in public practice performing these audits are aware of new developments in governmental auditing, and that the regional Inspectors General and state audit organizations are aware of problems encountered.

### **Recommendation No. 24—Increase Participation in Governing Bodies and Committees**

**The governing bodies and committees of the AICPA should include individuals from the governmental audit community, and the governing bodies and committees of the government auditor and financial management associations should include CPAs in public practice.**

The AICPA has taken several steps to ensure that it understands how its activities affect governmental accounting and governmental auditing and how governments' actions can affect auditors performing government audits. For example, at the urging of the Members in Government Committee, members in government have been appointed to several AICPA committees. These include the Auditing Standards Board, the Special

Committee on Standards of Professional Conduct for CPAs, the Federal Government Executive Committee, the Centennial Steering Committee, the State Legislation Area Planning Subcommittees, the Federal Government Accounting and Auditing Committee, the Taxation of Special Entities and Industries Subcommittee, and the State and Local Government Committee. In addition, several members in government have been appointed to Council, although a member in government has not been on the AICPA Board of Directors.

Governmental representation on the committees and governing bodies of the AICPA facilitates recognition of this segment of the profession and promotes mutual respect. It also enables the problems and possible solutions to be considered by the AICPA on a timely basis.

This exchange of information is a two-way process. It is just as important for CPAs in public practice to be represented on the committees and governing bodies of governmental audit and financial management organizations. Examples are the NSAA, whose by-laws permit other than state audit personnel to be members, but which has only one such person as a member; the GFOA, which has CPAs in public practice on its committees, but whose by-laws prohibit executive board membership; and the AGA, which opens its governing bodies and committees to persons who are not government accountants or auditors, but who are typically former government accountants and auditors.

Accordingly, qualified accountants and auditors in government should be considered for the AICPA Board of Directors. CPAs in government should work with their state societies to be appointed to the AICPA Council. Government auditor and financial manager associations, such as the NSAA, the GFOA, and the AGA, should seek qualified CPAs in public practice for membership on their committees and governing bodies.

### **Recommendation No. 25—Include Federal and State Auditors as Coinstructors**

**Federal and state auditors should be included as coinstructors for the AICPA governmental accounting and governmental auditing CPE courses; complimentary registrations should be given to members of their organizations.**

As stated previously, it is essential that CPAs in public practice and governmental auditors exchange information and views. Currently, the instructors for the AICPA's governmental accounting and governmental auditing CPE programs are usually CPAs in public practice, and they present the program from the perspective of a CPA in public practice.

The task force recommends that Inspector General and state auditor personnel be used as coinstructors for the programs. This would provide different perspectives for the students and thus enhance the quality of the

program. It would also provide another opportunity for exchange and for the resulting increase in understanding between CPAs in public practice and governmental auditors.

The AICPA or state societies sponsoring the CPE programs might not have sufficient funds to pay a second or third instructor. By the same token, however, the governmental auditor may be legally prohibited from receiving compensation from outside sources. The task force therefore suggests that the AICPA and the state societies reimburse the governmental instructors' organizations by providing complimentary registrations to the CPE program for members of the organizations. This approach has the added advantage of placing additional persons in the room who are not in public practice, and thereby further increasing the exchange.

Obviously, the instructors from government should have the same qualifications as the public practice instructors. This can be achieved by having the AICPA's CPE Division work with the AICPA's Members in Government Committee, the PCIE, the NSAA, and the NIAF to identify qualified federal and state auditors who would be coinstructors.

## Implementation

The following chart identifies the groups that can bring about the quickest and most effective implementation of the exchange recommendations.

<u>Recommendation No.</u>	<u>Auditor</u>	<u>Auditee</u>	<u>Audit Oversight Organization</u>
22. Membership in the National and regional Intergovernmental Audit Forums should be opened to CPAs in public practice.		NIAF(P), RIAF(P)	
23. The dialogue and exchange of information among the various individuals involved in governmental auditing should be expanded.	AICPA(P), NSAA(P), AGA(P)	GFOA(P)	PCIE(P)
24. The governing bodies and committees of the AICPA should include individuals from the governmental audit community, and the governing bodies and committees of	AICPA(P), NSAA(P), AGA(P)	GFOA(P)	

<u>Recommendation No.</u>	<u>Auditor</u>	<u>Auditee</u>
<p>the governmental auditor and financial management associations should include CPAs in public practice.</p> <p>25. Federal and state auditors should be included as coinstructors for the AICPA governmental accounting and governmental auditing CPE courses; complimentary registrations should be given to members of their organizations.</p>	<p>AICPA(P), SSOC(P)</p>	

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P = primary role; S = secondary role; AGA = Association of Government Accountants; AICPA = American Institute of Certified Public Accountants; GFOA = Governmental Finance Officers Association; NIAF = National Intergovernmental Audit Forum; NSAA = National State Auditors Association; PCIE = President's Council on Integrity and Efficiency; RIAF = Regional Intergovernmental Audit Forums; SSOC = state societies of CPAs.

## CHAPTER 7

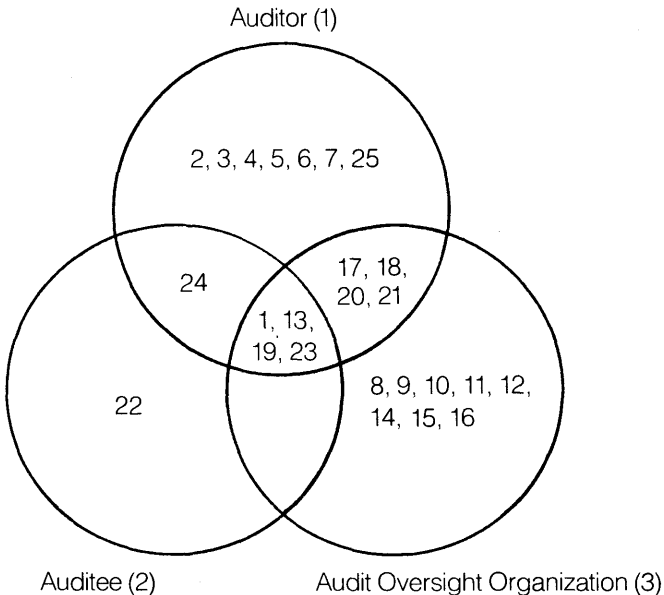
# Conclusion

Quality governmental audits are not impossible to achieve, provided that the unique elements of governmental auditing are addressed. As with any audit, however, they require the auditor's commitment to obtain a thorough knowledge of the industry, the client, and the audit requirements applicable to the engagement. That knowledge must then be used to fulfill the high standards of the profession.

The recommendations contained in this report result from, and continue to require, a high degree of communication and cooperation among the various segments of the audit community. Each segment has expressed its interest in auditors fulfilling the high standards. It is now up to each to undertake the steps that can assure that performance.

The prior chapters depicted which segment(s) in the audit community would be most appropriate to implement each recommendation. The need for this broad level of involvement and support is demonstrated even more emphatically with the following chart.

### **The Joint Responsibility for Implementing the Quality Control Recommendations**



The implementation responsibility is displayed by group for each of the recommendations discussed in the previous five chapters. The recommendations, all of which are listed again below, are identified by number. As stated throughout this report, some of the recommendations can be implemented entirely by one group. Many, however, require the joint efforts of two or more groups, as displayed on the chart. Definitions of *auditor*, *auditee*, and *audit oversight organization* are provided after the recommendations.

## **Recommendations**

### **1. *Require Auditors of Governmental Units to Complete Relevant Continuing Professional Education Programs***

Auditors of governmental organizations, programs, activities, and functions should be required to complete continuing professional education courses in the unique aspects of governmental accounting and governmental auditing.\*

### **2. *Ensure Quality of Continuing Professional Education Courses in Governmental Accounting and Governmental Auditing***

All new governmental accounting and governmental auditing courses offered by the AICPA, including the self-study programs discussed in Recommendation No. 4, should be reviewed before presentation by the AICPA's State and Local Government Committee. They should be reviewed annually and updated for continued relevance as necessary.

### **3. *Ensure Quality Instructors for Courses in Governmental Accounting and Auditing***

Steps should be taken to ensure that instructors of the AICPA governmental accounting and governmental auditing courses are properly qualified and adequately trained to teach the courses.\*

### **4. *Increase Marketing of Self-Study Programs***

Self-study programs in governmental accounting and governmental auditing, including video programs, should be marketed actively, particularly in geographic areas where it would be difficult for auditors to participate in a group study program.\*

### **5. *Work Together to Maximize the Quality of Courses Offered by All Organizations***

The AICPA should work with other organizations that offer governmental accounting and auditing courses to receive or provide information that would improve the quality of such courses.\*

### **6. *Develop a Statement on Auditing Standards on Compliance With Applicable Laws and Regulations***

A statement on auditing standards relating to auditing for and report-

ing on compliance with applicable laws and regulations should be developed and issued.

**7. Strengthen the Capability of the AICPA to Provide Timely Technical Advice**

The AICPA Technical Information Division's capacity to provide a timely response to questions relating to governmental accounting and governmental auditing should be strengthened and maintained.

**8. Strengthen the Capability of Government Officials to Provide Timely Technical Advice**

The capacity of the regional offices of Inspectors General and other governmental organizations to provide timely and proper guidance to recipients of federal financial assistance and their independent auditors should be strengthened and maintained.\*

**9. Review the Compliance Supplement Annually and Update if Necessary**

The *Compliance Supplement for Single Audits of State and Local Governments*, published by the Office of Management and Budget, should be reviewed annually, and updated as necessary.

**10. Develop Compliance Requirements and Suggested Audit Procedures for Programs Not Included in the Compliance Supplement**

The compliance requirements and suggested audit procedures for federal financial assistance programs not included in the *Compliance Supplement* should be developed by the respective agencies and made available to auditors.

**11. Update the OMB's Questions and Answers Booklet**

*Questions and Answers on the Single Audit Provisions of OMB Circular A-102 "Uniform Requirements for Grants to State and Local Governments,"* published by the Office of Management and Budget, should be updated to reflect the issuance of Circular A-128.

**12. Undertake a Study of the Audit Procurement Process**

A comprehensive study should be undertaken of the procurement of audit services and the way in which that process influences audit quality.

**13. Develop and Distribute a Model Request for Proposal**

A model request for proposal for audit services should be developed and widely distributed.\*

**14. Standardize Agency Implementation Regulations for the Single Audit**

The federal government's numerous rules that govern the conduct of a single audit should be consolidated into a single rule. The rules should be expanded to incorporate certain applicable recommendations discussed in this report.



**15. Place All Audit Quality Activities Under the Responsibility of Knowledgeable Officials**

Compliance with the requirements for audits conducted for or on behalf of governments should be monitored by an Office of Inspector General at the federal level, the respective state auditor's office at the state level, or the independent local auditor's office at the local level, if one exists.\*

**16. Expand Guidelines for PCIE Audit Report and Working Paper Reviews**

The guidelines for conducting audit report and working paper reviews included in the federal *Cognizant Agency Audit Organization Guidelines* should be expanded to assure comprehensive, consistent quality control reviews.

**17. Use Data Obtained From Audit Report and Working Paper Reviews**

The audit deficiency data collected during audit report and working paper reviews should be categorized by type of deficiency and solutions sought for recurring and systemic problems.

**18. Institute Positive Enforcement Programs**

A positive enforcement program that includes reviews of audits of governmental units should be instituted in each state.\*

**19. Require Participation in Peer Reviews**

Auditors and audit organizations performing audits of governmental funds should be required to participate in a peer review program that includes reviews of the governmental audits.

**20. Improve the System for Referring Substandard Audits**

The system for referring allegedly substandard audits to licensing authorities and professional organizations should be modified to lessen the paperwork required to initiate a referral, enable the investigation to be completed in less time, and provide feedback to the referring and other appropriate officials.\*

**21. Inform Government Oversight Officials About the Improved Referral System**

Guidelines should be developed and distributed to explain the referral process to organizations that would have a need to make referrals.\*

**22. Open Membership in the Intergovernmental Audit Forums to CPAs in Public Practice**

Membership in the National and regional Intergovernmental Audit Forums should be opened to CPAs in public practice.

**23. Expand the Dialogue and Exchange of Information**

The dialogue and exchange of information among the various individuals involved in governmental auditing should be expanded.\*

**24. Increase Participation in Governing Bodies and Committees**

The governing bodies and committees of the AICPA should include individuals from the governmental audit community, and the governing bodies and committees of the governmental auditors and financial management associations should include CPAs in public practice.\*

**25. Include Federal and State Auditors as Coinstructors**

Federal and state auditors should be included as coinstructors for the AICPA governmental accounting and governmental auditing CPE courses; complimentary registrations should be given to members of their organizations.\*

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\* A recommendation that can also be addressed at the individual state level by the state government official responsible for overseeing audits, the state society of CPAs, and the State Board of Accountancy.

(1) *Auditor* includes—

- Nonfederal auditors
- American Institute of Certified Public Accountants
- State societies of CPAs
- National State Auditors Association
- Association of Government Accountants

(2) *Auditee* includes—

- State or local government or other entities expending governmental funds
- National and regional Intergovernmental Audit Forums
- Governmental Finance Officers Association

(3) *Audit Oversight Organization* includes—

- Inspectors General
- General Accounting Office
- Office of Management and Budget
- President's Council on Integrity and Efficiency
- National Association of State Boards of Accountancy
- State boards of accountancy
- State or local audit oversight organizations

One final element is the need for a monitoring mechanism during the implementation process, both to assure that the recommendations are acted upon and to address additional problems that may arise. The task force recommends that an implementation steering committee be established consisting of representatives of the different parts of the AICPA to whom the recommendations pertain, the GAO, the OMB, the federal Inspectors General, the state and local governmental auditors, the state societies of CPAs, the state boards of accountancy, the GFOA, and the AGA. The steering committee should review the status of the implementa-

tion of each of the recommendations contained in this report. Members of the steering committee should note any delays in the implementation and work within their respective organizations to eliminate the reasons for delays caused by their organization. Status reports on the implementation of the recommendations should be prepared periodically and distributed to all organizations involved in the process. Those reports should be prepared no less than annually. Since the AICPA has a deep interest in the success of this effort, it should provide the staff support for the steering committee.

Another role the implementation steering committee could take is to assure that the project and recommendations are widely publicized, through speeches, articles, and other means, to the many nonfinance officials who can affect the governmental audit process. These would include council members, mayors, city and county managers, budget directors, and others in a similar position. The purpose of such presentations would be to make them aware of the auditors' concern for quality audits, explain their role in affecting this quality, and present what they should do to assure quality audits.

A similar joint effort to effectuate implementation can take place at the state level. In each state, the government official responsible for overseeing local government audits (for example, the state auditor), the chairman of the state society governmental accounting and auditing committee, and a representative of the state board of accountancy should meet periodically and discuss plans, progress, and problems for each of the foregoing recommendations that can be addressed at the state level. (See the list on pages 54-57 for an identification of those recommendations). They should also consider other possible programs for improving the quality of the audits of government in the state.

Assuming that this cooperative effort will continue, addressing the five E's—education, engagement, evaluation, enforcement, and exchange—will produce a sixth, the most important E—excellence.

# **Exhibits**

**Summary of Recommendations**  
**Contained in the Cherry Hill Colloquium Report, "The Procurement and Performance of Audits of Government Organizations and Programs," and Subsequent Actions**

**Exhibit 1**

Recommendations

1. Prepare a guide on how to effectively procure CPA services by government.

The guide is intended to provide guidance on preparing requests for proposals and other important aspects of the procurement process. The guide should be published jointly by the GAO and the AICPA.

2. Enhance existing procurement practices.

The recommended guide (recommendation 1 above) should be followed to the extent practicable. Appropriate recognition should be given to certain practices considered "key" to the engagement of qualified auditors and the performance of quality engagements. These practices include—

- The quality of audit services previously performed.
- Government-oriented continuing education courses taken by the engagement staff.
- The qualifications, appropriate experience, and education of those who will evaluate proposals.

3. Improve continuing professional education (CPE).

- a. The AICPA should establish a special CPE coordination task force to monitor and coordinate the efforts of the various professional organizations and government agencies involved in developing and scheduling courses in governmental accounting and auditing.

Subsequent Actions

1. The guide was not developed. Instead, the Western Intergovernmental Audit Forum published a document in 1981 titled *Guidelines for Preparation of Requests for Audit Proposals*. It was recently updated and submitted to the National Intergovernmental Audit Forum for review, further revision, and possible nationwide distribution.

2. The Western Intergovernmental Audit Forum Guidelines and similar documents have been widely used as the foundation for many state and local governments' requests for audit proposals. Although some reference was made to the quality of previous engagements, the continuing education of the government team and the qualifications of the evaluators in the Guidelines, the three practices defined as "key" were not explicitly set forth.

3.
  - a. This recommendation was considered by the AICPA, but not implemented. The AICPA concluded that each professional organization and government agency could best determine and meet the CPE needs of its members.
  - b. "A Common Body of Knowledge for Government

b. The Association of Government Accountants (AGA) should be commended for its project to develop "A Common Body of Knowledge for Government Accountants" and should be encouraged to complete the project as soon as possible.

c. Periodic technical conferences or continuing education programs should be conducted under the sponsorship of the AICPA for members of the AICPA, GAO, OMB, and the staffs of the Inspectors General to foster a better understanding of the profession's generally accepted auditing standards and the additional government audit standards expected to be followed on audit engagements.

d. Steps should be taken to identify appropriate governmental accounting and governmental auditing courses that should be included in college and university accounting curricula. Such courses should be included in the AICPA policies for academic preparation. The American Accounting Association should be encouraged to place more emphasis on governmental auditing and governmental accounting courses in college and university curricula.

e. The Uniform CPA Examination content specifications should, at an early date, include knowledge of *Standards for Audit of Governmental Organizations, Programs, Activities and Functions, Guidelines for Financial and Compliance Audits of Federally Assisted Programs* (Guidelines), and *OMB Circular A-102, Attachment P*.

\*Dr. John H. Engstrom, "Recent Trends in Public Sector Accounting Education: A Survey," *The Government Accountants Journal* (Winter 1984–85, vol. XXXIII, no. 4).

Accountants" was published by the AGA in January 1981.

c. The AICPA conducted fifty-four sessions of seven different technical conferences and group study programs in 1982, fifty-three sessions of five conferences and programs in 1983, thirty sessions of six conferences and programs in 1984, and ninety-seven sessions of seven conferences and programs in 1985. During the same four years, it sold 2,875 copies of seven different self-study and video programs. (See exhibit 2 for a list of the conferences and programs held.)

d. A survey published in the Winter 1984–85 issue of *The Government Accountants Journal* discussed that the number of institutions offering public sector accounting courses increased since the date of the recommendation.\* In addition, the publishers of *Accounting for Governmental and Non-Profit Entities*, (7th edition) and *Fund Accounting—Theory and Practice*, the two major college texts in governmental accounting, report that the texts have been adopted by 554 colleges and universities. This represents a substantial increase in recent years.

e. Questions of government or not-for-profit accounting have been included in the Accounting Practice and Accounting Theory parts in each of the Uniform CPA Examinations since the date of the recommendation. Questions on auditing a governmental or not-for-profit organization have appeared in the Auditing part of the May and November 1985 CPA Examinations.

**AICPA Conferences and Training Programs  
Pertaining to Governmental  
Accounting and Governmental Auditing**

<u>Course Title</u>	<u>1982</u>		<u>1983</u>		<u>1984</u>		<u>1985</u>		<u>1986</u>	
	<u>PH</u>	<u>P</u>	<u>PH</u>	<u>P</u>	<u>PH</u>	<u>P</u>	<u>PH</u>	<u>P</u>	<u>PH</u>	<u>P</u>
National Conferences										
Auditing Federal Assistance Programs	*	—	*	—	1	467	1	413	1†	—
Government Accounting and Auditing Update	*	—	*	—	1	250	1	214	1†	—
National Governmental Training Program	1	71	1	96	1	95	1	95	1	125
Group Study										
Local Government Auditing and Reporting	23	646	23	725	9	528	25	717	17	408
Single Audit Concepts	*	—	*	—	*	—	45	1447	50	1564
Governmental Accounting and Auditing Update	*	—	*	—	*	—	*	—	27	585
Audits of School Districts	14	413	16	423	13	418	16	518	11	271
Accounting and Reporting for Federally Assisted Programs	*	—	11	303	5	103	8	230	*	—
Accounting for Federal Grant Funds	3	83	2	61	*	—	*	—	*	—
CPA's Role in Federally Assisted Programs	5	134	*	—	*	—	*	—	*	—
Government Accounting	7	159	*	—	*	—	*	—	*	—
How to Develop an Indirect Cost Allocation Plan	1	27	*	—	*	—	*	—	*	—
Totals	54	1533	53	1608	30	1861	97	3634	107	2953

<u>Course Title</u>	<u>Units Sold</u>			
	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
Self-Study				
Introduction to Local Government Accounting	156	154	181	95
Audits of State and Local Government Units	337	215	261	123
Audits of Revenue Sharing Recipients	56	79	13	*
Audits of School Districts	134	79	119	12
Performing a Single Audit†	—	—	—	—
Subtotal	<u>683</u>	<u>527</u>	<u>574</u>	<u>230</u>
Video				
Basic Concepts of Local Government Accounting	194	61	165	112
Basic Concepts of Local Government Budgeting	82	13	20	14
Basic Concepts of Local Government Financial Reporting	*	*	<u>123</u>	<u>77</u>
Subtotal	<u>276</u>	<u>74</u>	<u>308</u>	<u>203</u>
Total Number of Tape Programs (Self-Study)				
Governmental Accounting and Financial Reporting‡	*	*	*	*
Governmental Accounting Reporting and Auditing Update‡	*	*	*	*
Totals	<u>959</u>	<u>601</u>	<u>882</u>	<u>433</u>

PH = presentations held; P = number of participants.

\* Course not offered.

† Combined into one conference.

‡ New for 1986.



**Chronology of Significant Events Relating to the Quality of Audits of Governmental Units**

October 1979	<i>Audit Requirements, OMB Circular A-102, Attachment P</i> promulgated.
December 1979	AICPA Ethics Division authorized review program in cooperation with Federal Departments and Agencies.
February 1980	<i>Guidelines for Financial and Compliance Audits of Federally Assisted Programs</i> issued by GAO.
June 1980	Statement on Auditing Standards No. 30, <i>Reporting on Internal Accounting Control</i> , issued by the AICPA (AICPA Professional Standards).
August 1980	<i>Compliance Supplement for Single Audits of State and Local Governments</i> issued by OMB.
October 1980	Cognizant Agency Assignments for State Entities issued by OMB.
November 1980	<i>The Performance and Procurement of Audits of Government Organizations and Programs</i> , a colloquium, sponsored by GAO and AICPA in Cherry Hill, New Jersey.
January 1981	"A Common Body of Knowledge for Governmental Accountants" published by AGA.
February 1981	<i>Revised Standards for Audit of Governmental Organizations, Programs, Activities and Functions</i> , published by GAO.
April 1981	"Planning Considerations for an Audit of a Federally Assisted Program," an Interpretation of SAS No. 22, issued by the AICPA.
January 1981	"Guidelines for Preparation of Request for Audit Proposal" published by the Western Intergovernmental Audit Forum.
August 1981	Ethics Interpretation 501-3 issued by the AICPA (AICPA Professional Standards).
October 1981	<i>Cognizant Agency Guidelines</i> issued by the Joint Financial Management Improvement Program.
December 1981	"Questions and Answers on the Single Audit Provisions of OMB Circular A-102 . . ." issued by OMB.
February 1982	AICPA Ethics Division issued status report, "Report on the Status of the Review Program Conducted by the AICPA's Professional Ethics Division in Cooperation With Agencies and Departments of the Federal Government."
March 1982	Cognizant Agency Assignments for local entities issued by OMB.
April 1982	Statement on Auditing Standards No. 41, <i>Working Papers</i> , issued by the AICPA (AICPA Professional Standards).
April 1982	"Report Required by U.S. General Accounting Office," an Interpretation of SAS No. 22 issued by the AICPA (AICPA Professional Standards).

December 1982 Revised *Compliance Supplement for Single Audits of State and Local Government* issued by OMB.

December 1983 "Report Required by U.S. General Accounting Office Based on a Financial and Compliance Audit When a Study and Evaluation Does Not Extend Beyond the Preliminary Review Phase," an Interpretation of SAS No. 30 issued by the AICPA (AICPA *Professional Standards*).

April 1984 *Desk Review Guide* issued by Mid-America Audit Forum.

August 1984 GAO Report, "Many Proprietary Schools Do Not Comply with Department of Education's Pell Grant Program Requirements," issued. Report describes instances of substandard performance by IPAs. (Available from GAO Order Department, no. GAO/HRD-84-17.)

September 1984 *Positive Enforcement Manual for State Boards of Accountancy* issued by NASBA.

October 1984 Single Audit Act of 1984 enacted.

October 1984 AICPA Ethics Division issues status report "Report on the Status of the Review Program Conducted by the AICPA's Professional Ethics Division in Cooperation with Agencies and Departments of the Federal Government" (revised as of December 1984).

October 1984 Exposure Draft of an AICPA Audit and Accounting Guide, *Audits of State and Local Governments*, issued.

December 1984 Exposure Draft of an AICPA Audit and Accounting Guide, *Audits of Federal Financial Assistance Programs*, issued.

April 1985 "Audits of State and Local Governments," Circular A-128, issued by OMB (April 12, 1985 Federal Register).

April 1985 Revised *Compliance Supplement* issued by OMB. (Available from U.S. Government Printing Office.)

October 1985 Revised *Cognizant Agency Audit Organization Guidelines* issued by the PCIE. (Available from U.S. Government Printing Office.)

November 1985 Hearing on the Quality of Governmental Audits held by the Legislation and National Security Subcommittee of the House Committee on Government Operations.

December 1985 GAO Report, "CPA Audit Quality—Inspectors General Find Significant Problems," issued. (Available from GAO Order Department, no. GAO/AFMD-86-20.)

January 1986 Revised Cognizant Agency Assignments issued by the OMB (January 6, 1986 Federal Register.)

February 1986 Audit and Accounting Guide, *Audits of State and Local Governmental Units*, which combined the two exposure drafts issued in October and December 1984, issued by the AICPA. (Available from AICPA, order no. 012050.)

March 1986 GAO report, "CPA Audit Quality—Many Governmental Audits Do Not Comply with Professional Standards," issued. (Avail-

- able from GAO Order Department, no. GAO/AFMD-86-33.)
- March 1986* Second Hearing on Quality of Governmental Audits held by Legislation and National Security Subcommittee of the House Committee on Government Operations.
- June 1986* Exposure Draft of Revised *Model Positive Enforcement Program for State Boards of Accountancy* issued by NASBA. (Available from National Association of State Boards of Accountancy.)

**Federal Agency Regulations  
Implementing Circular A-128**

<u>Federal Agency</u>	<u>Implementing Regulations</u>	<u>Differences Noted Between Agency Regulations &amp; Requirements of Circular A-128</u>
Agriculture	Final rule published January 14, 1986. Amends 7 CFR 3015 and includes Circular A-128 as an appendix.	<ul style="list-style-type: none"> <li>● Includes AICPA Audit and Accounting Guide <i>Audits of State and Local Governmental Units</i> as a reference document.</li> <li>● Uses operations and organization interchangeably.</li> <li>● Provides guidance to auditors for testing subrecipients.</li> <li>● Lists Office of Inspector General responsibilities that are different than those defined in Circular A-128.</li> </ul>
Commerce	Interim rule published July 26, 1985. Amends 15 CFR, part 8a.	<ul style="list-style-type: none"> <li>● Terminology and format</li> </ul>
Education	Final regulations published September 13, 1985. Amends 34 CFR, part 74, by including OMB Circular A-128 as a new appendix G.	<ul style="list-style-type: none"> <li>● Does not provide an effective date.</li> <li>● Does not provide sunset review date.</li> </ul>
Energy	Final rule published February 4, 1986. Amends 10 CFR, part 600, and adds a subpart D.	None noted.
Environmental Protection Agency	Final rule published February 21, 1986. Amends 40 CFR, part 30, by adding OMB Circular A-128 as appendix E.	None noted.

**Exhibit 4 (continued)**

<u>Federal Agency</u>	<u>Implementing Regulations</u>	<u>Differences Noted Between Agency Regulations &amp; Requirements of Circular A-128</u>
Federal Emergency Management Agency	Final rule published July 3, 1986. Amends 44 CFR, part 205, subpart H, and includes OMB Circular A-128 as appendix A.	None noted.
Health and Human Services	Interim final rules published August 6, 1985. Amends 45 CFR, part 74, by incorporating Circular A-128 into regulations.	None noted.
Housing and Urban Development	Final rule published August 27, 1985. Amends 24 CFR, part 44.	<ul style="list-style-type: none"> <li>• Requires that Community Development Block Grant costs that were not audited when the grant was closed out be subject to coverage in the recipient's next single audit.</li> </ul>
Interior	Final rule effective July 18, 1985. Incorporated as a separate subpart under 43 CFR, part 12.	<ul style="list-style-type: none"> <li>• Uses different language in the section concerning "audit costs." Subparagraph (b) has been rewritten and a subparagraph (c) has been added.</li> </ul>
Labor	Interim final rule published August 8, 1985. Amends 29 CFR, part 96, and includes OMB Circular A-128 as appendix A.	None noted.
Transportation	Final rule published August 19, 1985. Incorporates Circular A-128 into regulations as 49 CFR, part 90.	None noted.

Treasury

Interim rule published August 28, 1985.  
Amends 31 CFR, part 51, by including OMB  
Circular A-128.

- Provides additional definitions not contained in Circular A-128:
  - Compliance audit
  - Financial audit
  - Financial statements
  - Independent audit
- Provides additional clarification in the following areas:

- Procedures applicable to use of funds
- Auditing and evaluation
- Waiver of audit requirements
- Audits of secondary recipients

Veterans  
Administration

Final rule published July 1985. Amends 38 CFR  
by adding a new part 41 that adopts Circular  
A-128 in regulation format.

- Does not provide for superseding Attachment P.

**Membership of CPAs in Public Practice  
in Intergovernmental Audit Forums**

<u>Forum</u>	<u>Voting Membership</u>	<u>Nonvoting Associate Membership</u>	<u>No Membership</u>
National			x
Southeast		x	
New England			x
New York/New Jersey	x		
Mid-Atlantic		x	
Midwest			x
Mid-America	x		
Southwest		x	
Mountain and Plains			x
Western		x	
Pacific Northwest	x		

**Analysis of Total Costs of  
Peer Reviews Conducted by  
Committee-appointed Review Teams  
(1983–1985)**

<u>Size of Firm</u>	<u>Sample Size</u>	<u>Number of Professionals</u>	<u>Total Cost on an Annual Basis</u>	
			<u>Per Partner</u>	<u>Per Professionals</u>
Sole practitioners with no professional staff	14	1	\$373	\$373
Sole practitioners with some professional staff	35	4	756	195
Two-partner firms	72	6	448	149
Three-partner firms	70	9	340	124
Four-partner firms	36	10	320	113
Five-partner firms	37	13	331	120
Six-partner firms	17	17	298	101
Seven-partner firms	12	22	311	97
Firms with eight to thirteen partners	<u>11</u>	30	255	82
	<u>304</u>			

**Note:** The above data represents the median number or dollar amount in each category.

**Source:** AICPA, New York, NY.



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