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New GAO Amendment Strengthens Auditor Independence Standards

An amendment to the *Government Auditing Standards* (commonly referred to as the Yellow Book) significantly strengthens auditor independence standards.

The new standard, issued by the General Accounting Office on Jan. 25, 2002, was designed to better serve the public interest and maintain a high degree of integrity, objectivity, and independence for audits of government entities and organizations receiving federal funds. The standard must be applied to all audits for periods beginning on or after Jan. 1, 2003.

While the new standard deals with a range of auditor independence issues, the most significant change relates to the rules associated with nonaudit, or consulting services.

The standard for nonaudit services is based on two overarching principles:

1. Auditors should not perform management functions or make management decisions.
2. Auditors should not audit their own work or provide nonaudit services in situations where the amounts or services involved are significant or material to the subject matter of the audit.

The independence standard permits several key activities that would not impair independence. For example, an auditor can provide advice to the organization and its management on establishing internal controls or implementing audit recommendations. The auditor can also provide tools and methodologies, such as best practice guides, benchmarking studies, and internal control assessment methodologies.

The auditor cannot, however, serve as a member of the organization's management decision-making committee or on its board of directors; make policy

decisions affecting the direction and operation of programs; supervise employees; authorize transactions; or maintain custody of assets.

Organizations and board members need to understand the new standards and meet with their auditors to discuss the next steps. Although some nonaudit services are not allowed under the new rules, many services that benefit not-for-profits are still permitted and worth exploring.



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