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Comptroller General
of the United States

United States General Accounting Office
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Today, David M. Walker, Comptroller General of the United States and head of the U.S. General Accounting Office (GAO), announced release of important guidance on auditor independence requirements under *Government Auditing Standards*. These standards, which were first published in 1972 and are commonly referred to as the “Yellow Book,” cover federal entities and those organizations receiving federal funds. Various laws require compliance with the Comptroller General’s auditing standards in connection with audits of federal entities and funds. Furthermore, many states and local governments and other entities, both domestically and internationally, have voluntarily adopted these standards.

On January 25, 2002, GAO issued significant changes to *Government Auditing Standards* related to auditor independence, which substantially changed the previous standard especially regarding nonaudit, or consulting services. In issuing the new standards in January, the Comptroller General stated that protecting the public interest and ensuring public confidence in the independence of auditors of government financial statements, programs, and operations, both in form and substance, were the overriding considerations in his decision to issue these new standards. At the time, the Comptroller General urged the American Institute of Certified Public Accountants to raise its standards to those contained in *Government Accounting Standards*.

Because of the new independence standards’ significant effect on audit organizations, when GAO issued the standard, it indicated plans to subsequently provide further guidance to assist in its implementation. This new guidance responds to questions related to the independence standards’ effective date, implementation time frame, underlying concepts, and application in specific nonaudit circumstances.

In releasing this guidance, the Comptroller General emphasized that “recent private sector accounting and reporting scandals have served to re-enforce the critical importance of having tough but fair auditor independence standards to protect the public and insure the credibility of the auditing profession.” He again called on other standard setters “to follow the lead of government auditors by adopting principle-based standards that make clear that auditors are to be independent in both fact and appearance.

According to the Comptroller General, in making judgments on independence under *Government Auditing Standards* and applying the principles and safeguards established by the new independence standards, audit organizations should take a “substance over form” approach and consider the nature and significance of the services provided to the audited entity on a facts and circumstances basis. Before an audit organization agrees to perform nonaudit services, it should carefully consider the need to avoid situations that could lead reasonable third parties with knowledge of the relevant facts and circumstances to conclude that the auditor is not able to maintain independence in conducting audits. It is important that auditors always be viewed as independent both in fact and appearance.

Importantly, when the independence standard was issued, GAO called for its provisions to be applicable to all audits for periods beginning on or after October 1, 2002. Because of the breadth of changes in the amendment and to allow additional time for the new independence standard’s effective implementation, GAO is extending its effective date to be applicable to all audits for periods beginning on or after January 1, 2003.

Also, GAO’s original intent was that any nonaudit service contract awarded on or after January 25, 2002, would not be exempt, or grandfathered. However, GAO has found that some audit organizations may not have understood this or were not aware of the standard until sometime after it was issued on January 25, 2002. To be fair to these audit organizations and other interested parties, GAO will exempt, or grandfather, all nonaudit services that were initiated, agreed to, or performed by June 30, 2002, provided the work is completed by June 30, 2003.

The Comptroller General received input from his Advisory Council on Government Auditing Standards on the guidance and the major concepts were discussed with other interested parties. The council includes 21 experts in financial and performance auditing and reporting drawn from all levels of government, academia, private enterprise, and public accounting.

An electronic version of *Government Auditing Standards: Answers to Independence Standards Questions* (GAO-02-870G, July 2002) is available on the GAO Internet site (<http://www.gao.gov/govaud/ybk01.htm>). A printed version will be available in about 10 days.