



Chapter 1

GOVERNMENT AUDITING: FOUNDATION AND ETHICAL PRINCIPLES

LEARNING OBJECTIVES

After completing this chapter, you should be able to do the following:

- Recognize why engagements are performed under generally accepted government auditing standards (GAGAS or the Yellow Book).
- Identify the ethical principles presented in chapter 1 of the Yellow Book.
- Recognize why the ethical principles are so important in GAGAS.

INTRODUCTION

The concept of accountability for use of public resources and government authority is key to America's governing processes. Management and officials entrusted with public resources are responsible for carrying out public functions and providing service to the public legally, effectively, efficiently, economically, ethically, and equitably within the context of the statutory boundaries of the specific government program.

As reflected in applicable laws, regulations, agreements, and standards, management and officials of government programs are responsible for providing reliable, useful, and timely information for transparency and accountability of these programs and their operations. Legislators, oversight bodies,

those charged with governance, and the public need to know whether (1) entities manage government resources and use their authority properly and in compliance with laws and regulations; (2) government programs are achieving their objectives and desired outcomes; and (3) government services are provided effectively, efficiently, economically, ethically, and equitably.

Government auditing is essential in providing government accountability to legislators, oversight bodies, those charged with governance, and the public. Audits and attestation engagements provide an independent, objective, nonpartisan assessment of the stewardship, performance, or cost of government policies, programs, or operations, depending upon the type and scope of the audit.

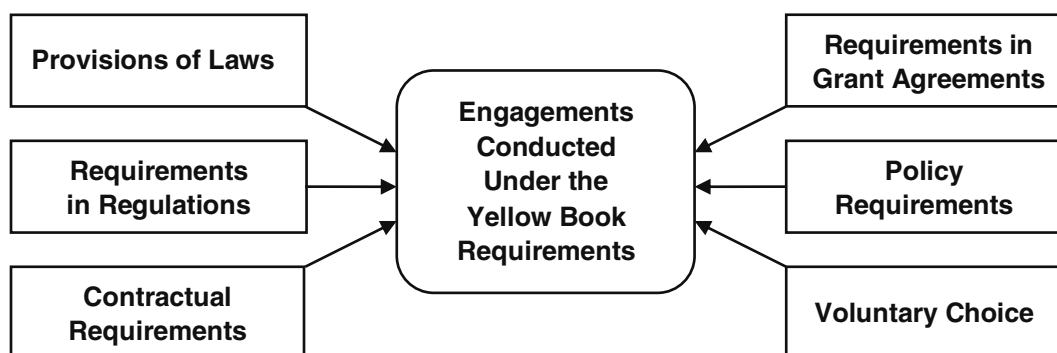
Purpose and Applicability of GAGAS

The professional standards and guidance contained in *Government Auditing Standards* provide a framework for conducting high quality audits with competence, integrity, objectivity, and independence. The Yellow Book standards are for use by auditors of governmental entities and entities that receive federal awards and audit organizations performing GAGAS audits. GAGAS contain requirements and guidance dealing with ethics, independence, auditors' professional judgment and competence, quality control, performance of the audit, and reporting.

Audits performed under GAGAS provide information used for oversight, accountability, transparency, and improvements of government programs and operations. GAGAS contain requirements and guidance to assist auditors in objectively acquiring and evaluating sufficient, appropriate evidence and reporting the results. When auditors perform their work in this manner and comply with GAGAS in reporting the results, their work can lead to improved government management, better decision making and oversight, effective and efficient operations, and accountability and transparency for resources and results.

As illustrated below provisions of laws, regulations, contracts, grant agreements, and policies frequently require audits in accordance with GAGAS. Auditors and audit organizations may voluntarily choose to perform their work in accordance with GAGAS.

Why Are Yellow Book Engagements Performed?



The requirements and guidance in the Yellow Book apply to audits and attestation engagements of governmental entities, programs, activities, and functions, and of government assistance administered by contractors, not-for-profit entities, and other nongovernmental entities when the use of GAGAS is required or is voluntarily followed.

Auditors, Audit Organizations, and Audits

As illustrated in the following section, the Yellow Book describes the usage of the terms *auditor* and *audit organizations*.

GAGAS DEFINITIONS OF *AUDITOR* AND *AUDIT ORGANIZATIONS*

The term *auditor* as it is used throughout GAGAS describes individuals performing work under GAGAS (including audits and attestation engagements) regardless of job title. Therefore, individuals who may have the titles auditor, analyst, practitioner, evaluator, inspector, or other similar titles are considered auditors in GAGAS.

The term *audit organizations* as it is used throughout GAGAS refers to government audit organizations as well as public accounting or other firms that perform audits and attestation engagements using GAGAS.

The term *audit* refers to financial audits, attestation engagements, and performance audits conducted in accordance with GAGAS.

A government audit organization can be structurally located within or outside the audited entity. Audit organizations that report to third parties external to the entity under audit are considered to be external audit organizations. Audit organizations that are accountable to top management and those charged with governance of the audited entity, and do not generally issue their reports to third parties external to the entity under audit, are considered internal audit organizations.

Some government audit organizations represent a unique hybrid of external auditing and internal auditing in their oversight role for the entities they audit. These audit organizations have external reporting requirements consistent with the reporting requirements for external auditors while at the same time are part of their respective agencies. These audit organizations often have a dual reporting responsibility to their legislative body as well as to the agency head and management. For purposes of GAGAS, these organizations are considered external audit organizations.

KNOWLEDGE CHECK

1. An audit in accordance with the Yellow Book may be required due to all EXCEPT
 - a. Contractual requirements.
 - b. Requirements in regulations.
 - c. Voluntary choice.
 - d. GAAS.

Ethical Principles

The ethical principles contained in the following sections provide the foundation, discipline, and structure as well as the climate, which influence the application of GAGAS. The ethical principles set forth fundamental principles rather than establishing specific standards or requirements.

Since auditing is essential to government accountability to the public, the public expects audit organizations and auditors who conduct their work in accordance with GAGAS to follow ethical principles. Management of the audit organization sets the tone for ethical behavior throughout the organization by maintaining an ethical culture, clearly communicating acceptable behavior and expectations to each employee, and creating an environment that reinforces and encourages ethical behavior throughout all levels of the organization. The ethical tone maintained and demonstrated by management and staff is an essential element of a positive ethical environment for the audit organization.

Conducting audit work in accordance with ethical principles is a matter of personal and organizational responsibility. Ethical principles apply in preserving auditor independence, taking on only work that the auditor is competent to perform, performing high-quality work, and following the applicable standards cited in the audit report. Integrity and objectivity are maintained when auditors perform their work and make decisions that are consistent with the broader interest of those relying on the auditors' report, including the public.

Other ethical requirements or codes of professional conduct may also be applicable to auditors who conduct audits in accordance with GAGAS. For example, individual auditors who are members of professional organizations or are licensed or certified professionals may also be subject to ethical requirements of those professional organizations or licensing bodies. Auditors in governmental entities may also be subject to government ethics laws and regulations.

The ethical principles that guide the work of auditors who conduct audits in accordance with GAGAS are

- the public interest;
- integrity;
- objectivity;
- proper use of government information, resources, and positions; and
- professional behavior.

THE PUBLIC INTEREST

The public interest is defined as the collective well-being of the community of people and entities the auditors serve. Observing integrity, objectivity, and independence in discharging their professional responsibilities assists auditors in meeting the principle of serving the public interest and honoring the public trust. These principles are fundamental to the responsibilities of auditors and critical in the government environment.

A distinguishing mark of an auditor is acceptance of responsibility to serve the public interest. This responsibility is critical when auditing in the government environment. GAGAS embody the concept of accountability for public resources, which is fundamental to serving the public interest.

INTEGRITY

Public confidence in government is maintained and strengthened by auditors performing their professional responsibilities with integrity. Integrity includes auditors conducting their work with an attitude that is objective, fact-based, nonpartisan, and nonideological with regard to audited entities and users of the auditors' reports. Within the constraints of applicable confidentiality laws, rules, or policies, communications with the audited entity, those charged with governance, and the individuals contracting for or requesting the audit are expected to be honest, candid, and constructive.

Making decisions consistent with the public interest of the program or activity under audit is an important part of the principle of integrity. In discharging their professional responsibilities, auditors may encounter conflicting pressures from management of the audited entity, various levels of government, and other likely users. Auditors may also encounter pressures to violate ethical principles to inappropriately achieve personal or organizational gain. In resolving those conflicts and pressures, acting with integrity means that auditors place priority on their responsibilities to the public interest.

OBJECTIVITY

The credibility of auditing in the government sector is based on auditors' objectivity in discharging their professional responsibilities. Objectivity includes being independent of mind and appearance when providing audit and attestation engagements, maintaining an attitude of impartiality, and having intellectual honesty. Maintaining objectivity includes a continuing assessment of relationships with audited entities and other stakeholders in the context of the auditor's responsibility to the public. The concepts of objectivity and independence are closely related. Independence impairments impair objectivity.

PROPER USE OF GOVERNMENT INFORMATION, RESOURCES, AND POSITIONS

Government information, resources, and positions are to be used for official purposes and not inappropriately for the auditor's personal gain or in a manner contrary to law or detrimental to the legitimate interests of the audited entity or the audit organization. This concept includes the proper handling of sensitive or classified information or resources.

In the government environment, the public's right to the transparency of government information has to be balanced with the proper use of that information. In addition, many government programs are subject to laws and regulations dealing with the disclosure of information. To accomplish this balance, exercising discretion in the use of information acquired in the course of the auditors' duties is an important part in achieving this goal. Improperly disclosing any such information to third parties is not an acceptable practice.

Accountability to the public for the proper use and prudent management of government resources is an essential part of auditors' responsibilities. Protecting and conserving government resources and using them appropriately for authorized activities is an important element in the public's expectations for auditors.

Misusing the position of an auditor for personal gain violates an auditor's fundamental responsibilities. An auditor's credibility can be damaged by actions that could be perceived by an objective third party with knowledge of the relevant information as improperly benefiting an auditor's personal financial interests or those of an immediate or close family member; a general partner; an organization for which the auditor serves as an officer, director, trustee, or employee; or an organization with which the auditor is negotiating concerning future employment.

PROFESSIONAL BEHAVIOR

High expectations for the auditing profession include compliance with laws and regulations and avoidance of any conduct that might bring discredit to auditors' work, including actions that would cause an objective third party with knowledge of the relevant information to conclude that the auditors' work was professionally deficient. Professional behavior includes auditors putting forth an honest effort in performance of their duties and professional services in accordance with the relevant technical and professional standards.

KNOWLEDGE CHECK

2. In GAGAS audits, under which ethical principle should auditors be independent of mind and appearance when providing audit and attestation engagements?
 - a. The public interest.
 - b. Objectivity.
 - c. Professional behavior.
 - d. Proper use of government information, resources, and position.

Key Foundational Points

1. Government auditing is essential in providing government accountability to legislators, oversight bodies, those charged with governance, and the public.
2. Management sets the tone for ethical behavior throughout the organization.
3. The ethical principles presented in chapter 1 of the Yellow Book provide the foundation, discipline, and structure as well as the climate, which influence the application of GAGAS.
4. Conducting audit work in accordance with ethical principles is a matter of personal and organizational responsibility.

