

# **2009 Annual Conference of the APIPA: Review of Emerging Issues in Government Auditing Standards and Practices**

**Presented by Stephen Morgan  
July 27, 2009**

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## **Outline – Emerging Issues in Government Auditing Standards and Practices**

- I. Where does information on emerging issues come from?**
- II. What are the imminent emerging issues or issues on the horizon?**
- III. Governance Issues from the perspective of Performance, Human Resources, and Information Technology**
- IV. What are the processes to identify emerging issues?**
- V. What are the issues beyond the horizon that can be anticipated?**
- VI. Conclusion/Questions**

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## **I. Where Does Information on Emerging Issues Come From?**

- **Research**
- **Contacts/networks**
- **Other audit offices**
- **Other non-audit offices**
- **Professional organizations with emerging issues committees**
- **Conferences and training**

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## **Professional Organizations Provide Audit Guidance and Technical Assistance**

- **GAO issues professional standards updates and technical guidance through the Yellow Book website including regulatory and accounting updates**
- **IIA publishes the International Professional Practices Framework**
- **AICPA issues SASs and technical guidance**
- **International Auditing and Assurance Standards Board issues International Standards on Auditing (Financial Only)**

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## Where to Find the Yellow Book

- **The Yellow Book is available on GAO's website at:**

<http://www.gao.gov/govaud/ybk01.htm>

- **For technical assistance, contact GAO staff at:**

<http://www.yellowbook@gao.gov>

Michael C. Hrapsky

Manager, GAGAS Technical Assistance

(202) 512-9535

## Feelings and Imagination Exercise

- **What do you see as the emerging issues facing auditors in our profession and in the audit environment?**
- **How can auditors contribute to societal or organizational solutions?**

## **II. What are the imminent emerging issues or issues on the horizon?**

- **Auditor's role and responsibilities**
- **Auditor skills**
- **Audit processes and standards**
- **Audit environment including accounting issues**

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## **II. A. Auditor's Role and Responsibilities**

- **Governance**
- **Audit vs. Non-audit Services**
- **Ethics**

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## **II. A.1. Governance Issues Facing Government Auditors**

- **Auditor Reporting Structures: Independence and Objectivity**
- **Auditing Standards Issues: Compatibility and Convergence**
- **Stakeholder Relationships**

## **II. A.2. Audit vs. Non Audit Services**

- What is an audit?
- What is a non audit service?

❖ Discuss GAGAS, Chapter 3, section on non audit services

## **II. A.3. Ethics Issues Facing Government Auditors**

- Ethical Cultures in the Workplace
  - Ethics/Governance Audit Issues
  - Barriers to Integrity
- ❖ Discuss Chapter 2, 2007 GAGAS
- ❖ Discuss IIA Code of Ethics

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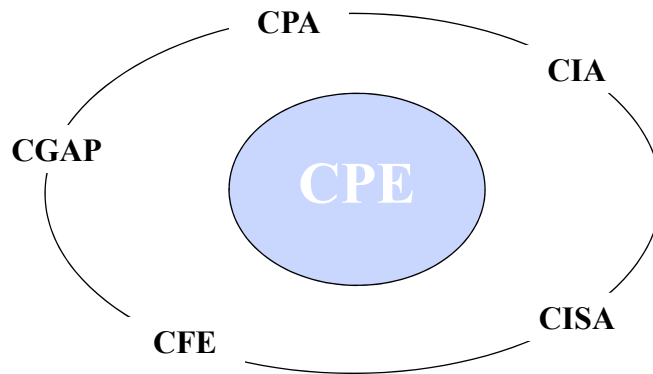
## **II. B. Auditor Skills**

- University Programs
- Certifications
- Conferences and Training
- Publications

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## II. B. Certifications are Proliferating



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## Technology Tools

- **ACL**
- **SAS**
- **GIS**

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## **II. C. Audit Processes**

- **Assurance/Accountability (Audit)**
- **Consulting/Assistance**
- **Integrity – Investigative Audits**
  - Deterrence
  - Detection
  - Investigation
  - Follow Through

### **II. C.1. Assurance/Accountability/Audit Process**

- **Audit Standards and Planning**
  - Types of Audits
  - Standards Changes and Issues
  - Risk and Vulnerability Assessment
- **Audit Models**
  - COSO/ERM
  - Performance
- **Audit Methodology, Evidence,  
Fieldwork, and Reporting**



## **Audit Standards and Planning**

Audit Types Include:

- Financial statements
- Attestation (agreed upon procedures, review, and examination)
- Performance

## **2007 Yellow Book**

### **Major Areas of Revisions – General:**

- Bringing performance audits under a professional assurance framework using concepts of audit risk, significance, and sufficient, appropriate evidence
- Emphasizing the critical role of government audits in achieving credibility and accountability in government

## 2007 Yellow Book

### Major Areas of Revisions – General:

- Expanding and strengthening the discussion and guidance on audit quality
- Outlining overarching ethical framework in government audits
- Modernizing GAGAS and updating for major developments in the accountability and audit environment

## 2007 Yellow Book

### Major Areas of Revisions – General:

- Two forms of GAGAS statement (modified and unmodified)
- Change in CPE requirements – for some
- Reiterating the importance of data reliability, internal controls, and sufficiency/appropriateness of evidence

## **Issues in Implementing 2007 Yellow Book Standards**

- **Financial Audits-changes in AICPA Standards, Regulatory Guidance, and Accounting Standards and Guidance**
- **Attestation Engagements-limitations of different levels of assurance especially with respect to making recommendations**
- **Performance Audits-data reliability, internal controls, and audit objectives**

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## **Performance Audit Planning**

- Office/Entity Level R/V
- Audit Project Level R/V

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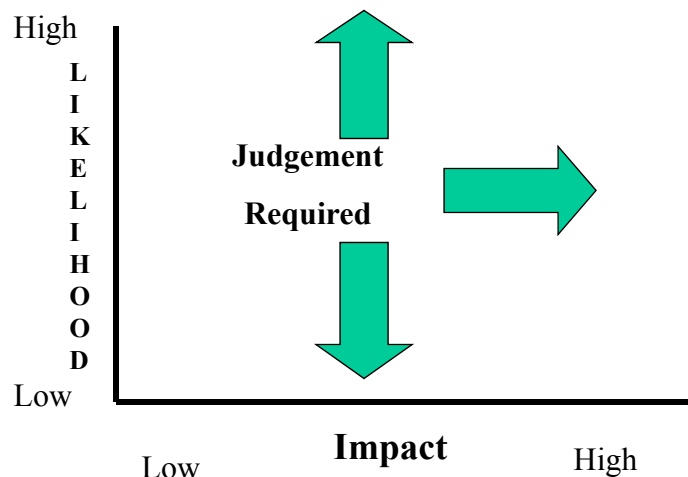
## Types of Risk—Can you define these?

- Inherent risk
- Control risk
- Audit risk
- Reputational risk

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## Evaluating Risk and Selecting Programs to Audit



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## Critical Factors

- **Judgment & courage**

- Some people consistently identify the right programs to audit the high risks & the high impact issues
- Others develop mediocre issues - avoid controversy, do not take on the tough issues, no insight, limited experience or knowledge, and ultimately audit the wrong programs.

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**Example: Which police program do we propose for the annual audit plan?**

**SWAT vs. Patrol**

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## Audit Planning – Develop Audit Objectives Based on Risk and Vulnerability Assessment Within a Government Program

- Assess inherent risk (significance, sensibility, and susceptibility)
- Assess vulnerability (control risk)
- Assess auditability

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## Risk/Control Relationships

### Relationships Between Inherent Risks, Internal Controls and Control Risks

Inherent Risk	Internal Controls	Control Risk
High	Weak Adequate Strong	High Moderate to High Low to Moderate
Moderate	Weak Adequate Strong	Moderate to High Low to Moderate Low
Low	Weak Adequate Strong	Low to Moderate Low Very Low

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## Criteria for Judging Internal Controls

- **Weak** = controls missing, management unaware or management aware, but no action
- **Adequate** = controls exist but may not be best practice, or action is insufficient
- **Strong** = controls effective or best practice

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## Vulnerability Table

Inherent Risk	High/Low	High/High ★
	Low/Low	Low/High
		Control Risk

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**Example: Which audit objective do we propose for field work?**

**Police Patrol: Use of guns  
Vs.  
Police Patrol: Use of tasers**

## **Auditability**

**Auditability is determined by:**

- **Audit skill**
- **Audit power**
- **Audit hours**
- **Audit morale**
- **Availability of Evidence/Information**
- **Timeframe**



## Audit Planning Grid

	QII	QI
Vulnerable		
	QIII	QIV
Not Vulnerable		
	Not Auditable	Auditable

## Develop Audit Objectives

- **Rank Vulnerability/Final Risk**
  - Inherent Risk
    - Risk without controls**
  - Control Risk
    - risk with controls**
- **Assess Auditability**
- **Propose Risks/Vulnerabilities for audit and develop audit objectives**

## What Audit Planning Success Looks Like

- **Select the most important programs to audit**
- **Select the most important risks and vulnerabilities within the programs**
- **Develop significant effects through measurement based performance auditing**
- **Base recommendations on underlying causes**

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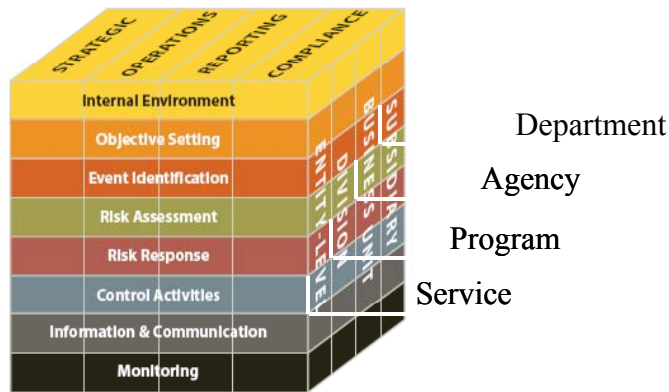
## Controls vs. Measurement Based Approach

- **COSO/ERM**
- **Input-Process-Output Outcome (IPOO)**

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## COSO/ERM Model in Government



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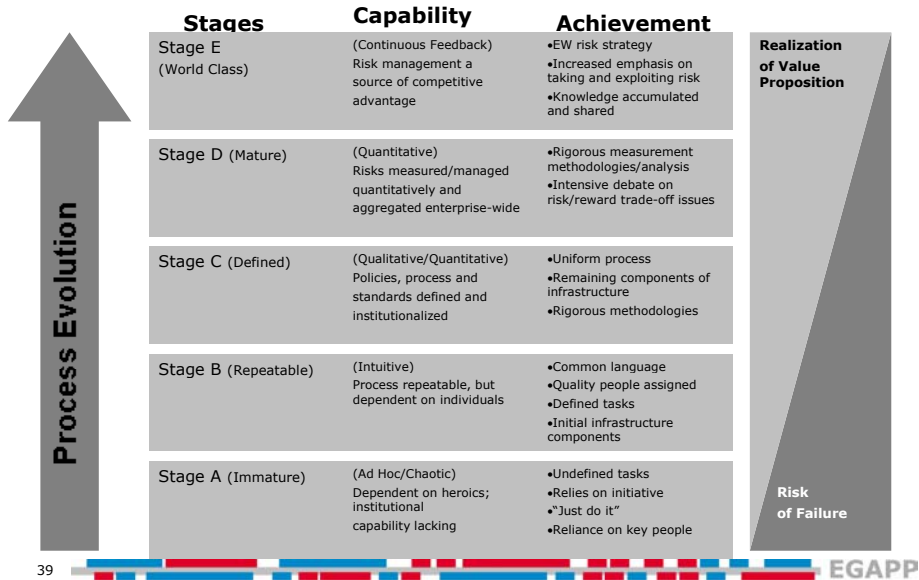
## Enterprise Risk Management Defined

- **Enterprise risk management is a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise (department/agency), designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.**

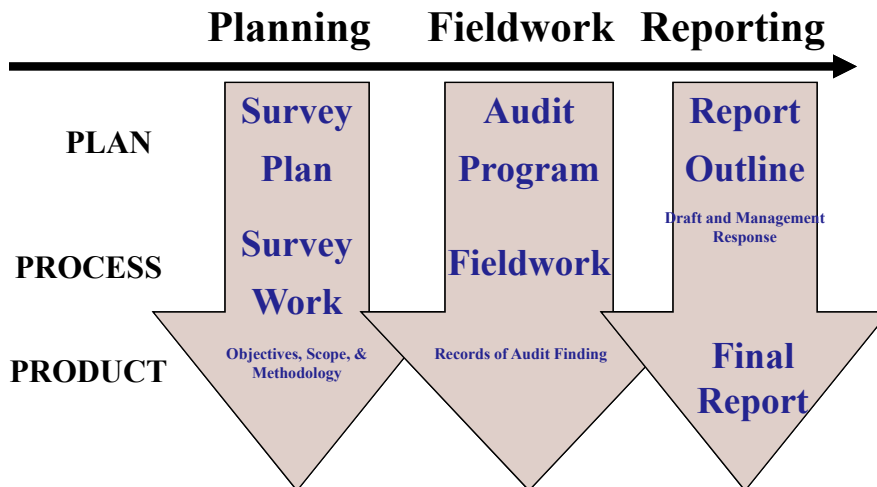
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# Capability Stages of Maturity



# Performance Audit Process



## How to Conduct a Measurement Based Performance Audit

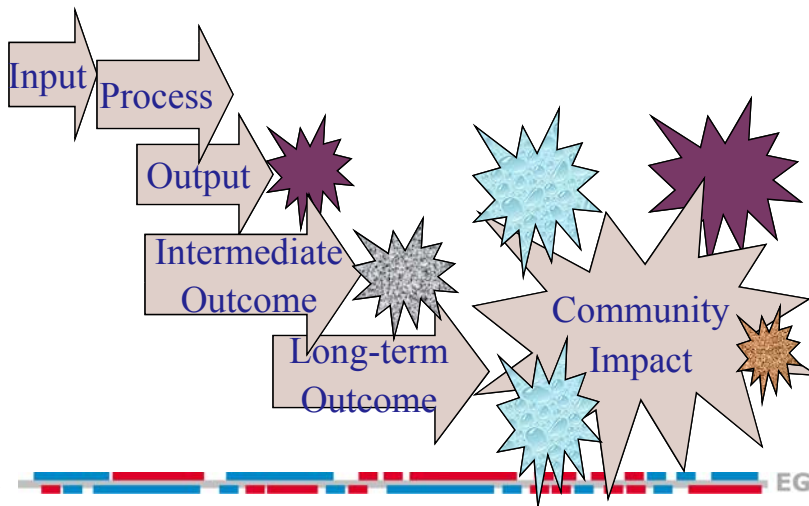
- Identify the program's inputs, processes, outputs, and outcomes
- Identify program's performance expectations
- Develop performance audit objectives based on risk and vulnerability assessment or client request
- Assess existing performance measurement system including relevance and reliability of measures
- Develop and implement "ad hoc" performance measurement system
- Using selected performance expectations as "criteria" and measures as "condition," analyze program performance
- Identify causes of variances and develop audit recommendations

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## Measurement Based Approach:

**Define Government Program Before Assessing Risk and Measuring Performance**



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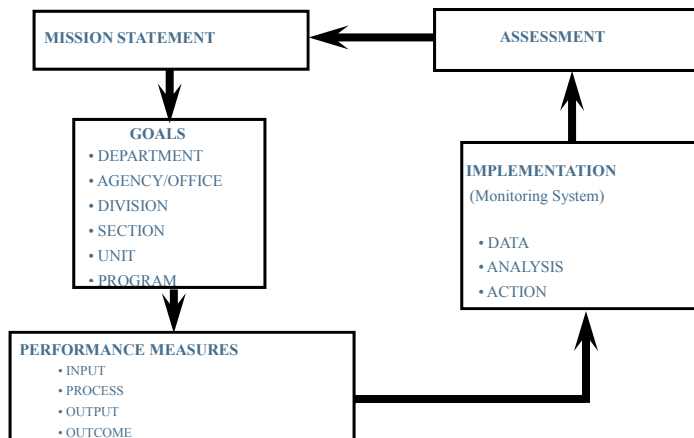
# Audit Planning – Identify Program Performance Expectations

COMPONENTS OF PERFORMANCE ACCOUNTABILITY			
MISSION PERFORMANCE GOALS			
<b>INPUT ECONOMY</b> ♦ Financial - amount - timing ♦ Physical - quantity - quality - timing - price	<b>PROCESS EFFICIENCY</b> ♦ Productivity ♦ Unit Cost	<b>OUTPUT EFFECTIVENESS</b> ♦ Quantity ♦ Quality - products - delivery ♦ Timeliness ♦ Price/Cost	<b>OUTCOME EFFECTIVENESS</b> ♦ Mission & Outcome Goal Achievement ♦ Financial Viability ♦ Cost-Benefit ♦ Cost-Effectiveness
CROSSCUTTING PERFORMANCE GOALS			
←----- Compliance with Laws and Regulations -----→			
←----- resources - Safeguarding - infrastructure -----→			
←----- Continuous Improvement -----→			
←----- Reliability, Validity, & Availability of Information-----→			
←----- Underlying Values (ethics, equity) -----→			
←----- Customer and Stakeholder Satisfaction -----→			

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# Assess Program's Performance Measurement System



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## Identify/Validate Sources of Criteria for Verifying or Asserting Performance Expectations (“audit criteria”)

- **Historical trends and baselines**
- **Program requirements or intent**
- **Customer expectations or demands**
- **Industry or sector standards**
- **Benchmarking within the organization**
- **Benchmarking outside the organization**

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## Analyze Program Performance

Model Component	Expectation	Measure
Input Economy	In FY 09, decrease the procurement office's personnel allocation by five full-time positions.	Number of procurement office positions deleted in FY 09.
Process Efficiency	In FY 09, provide branch library services at the staff cost of \$5 or less per patron.	Average branch library staff costs per patron in FY 09.
Output Quality (accuracy)	In FY 09, reduce the restaurant critical inspection error rate by 10 percent.	Restaurant critical inspection error rate in FY 09.
Output Quantity	In FY 09, expand curbside recycling services to 1000 additional homes.	Number of additional homes in FY 09 receiving curbside recycling services.
Output Timeliness	In FY 09, all Level 1 emergency calls will be responded to with a unit on site within six minutes.	Response times (range) to Level 1 emergency calls in FY 09.
Outcome Effectiveness	In FY 09, place in permanent jobs 15 at-risk youth enrolled in a pilot employment program.	Number of pilot program participants placed in permanent jobs in FY 09.

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## Why Program Goals Are Not Accomplished

- Theoretical framework is flawed, i.e., no direct cause and effect relationship exists between program and desired outcomes
- Intervening or external variables which negate, deflect, or mask the program's effect, i.e., GASB's emphasis on explanatory information
- Management systems/processes are deficient
- Program goals/expectations are unrealistic/unattainable
- Inputs/resources are inadequate
- Act of providence intercedes

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## Audit Methodology

### To Select the Most Appropriate Methodology

1. Know the audit objective
2. Know the possibilities
  - Background research
  - Methodology manuals
  - Benchmarking to other audit offices
  - Experts

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## Audit Methodology

### To Select the Most Appropriate Methodology (continued)

3. Consider the quality, strength, and persuasiveness of evidence
  - Standards
    - Sufficient
    - Appropriate (relevant, valid, and reliable)
  - Types
    - physical
    - documentary
    - Analytical (Now in 2007 GAS App I)
    - testimonial

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## Audit Methodology

### To Select the Most Appropriate Methodology (continued)

4. Determine the cost/benefit (Auditability)
  - Existing vs. new data
  - Previous experience using the methodology
  - Hiring an "expert"
  - Timeframe

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## **Audit Reporting**

- Alternative Media
- Web Readability
- Publicity/Public Relations

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## **New Book on Performance Auditing from theIIA.org**

### **Performance Auditing: A Measurement Approach (Second Edition)**

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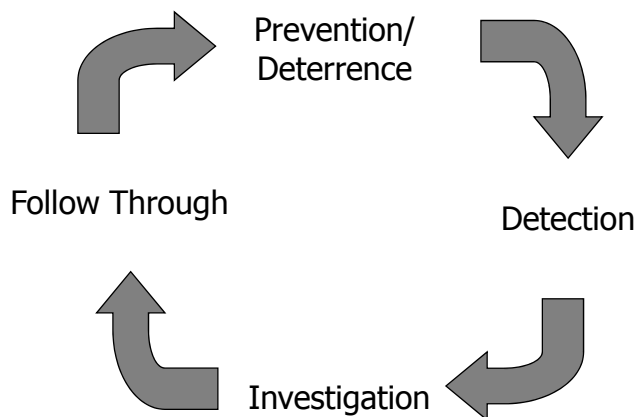
## II. C.2. Consulting Services

- Advisory assistance vs. decision making
- Design vs. implementation
- Adding value through expertise

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## II. C.3. Integrity Services/System



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## **II. D. Audit Environment**

- Human Capital
- Knowledge/Information Management
- Economic and Financial Sustainability
- Globalization
- Accounting and Reporting

### **Human Capital**

- Diversity of the workforce (values, ages, ethnicities, cultures)
- Mobility of the workforce
- Adaptability of the workforce
- Competence of the workforce
- Level of funding for audit resources

## **Knowledge/Information Management**

- Succession strategies
- Physical vs. virtual workplace
- Technology solutions



## **Financial Sustainability**

- Entitlements (especially health care)
- Economy (bailout and recovery programs)
- Intergenerational burdens (especially baby boom and global warming)
- Demand for resources (especially oil)



## **GLOBALIZATION**

- West vs. East
- North vs. South
- Global vs. National
- National vs. Regional
- Regional vs. Local



## **GOVERNMENT ACCOUNTING AND REPORTING**

- Recognizing liabilities now (accounting for promises made but not funded)
  - Pensions
  - Pollution remediation
  - Social insurance
- Integrating financial and performance reporting
  - Inputs
  - Outputs
  - Outcomes



## **GOVERNMENT ACCOUNTING AND REPORTING—CONT**

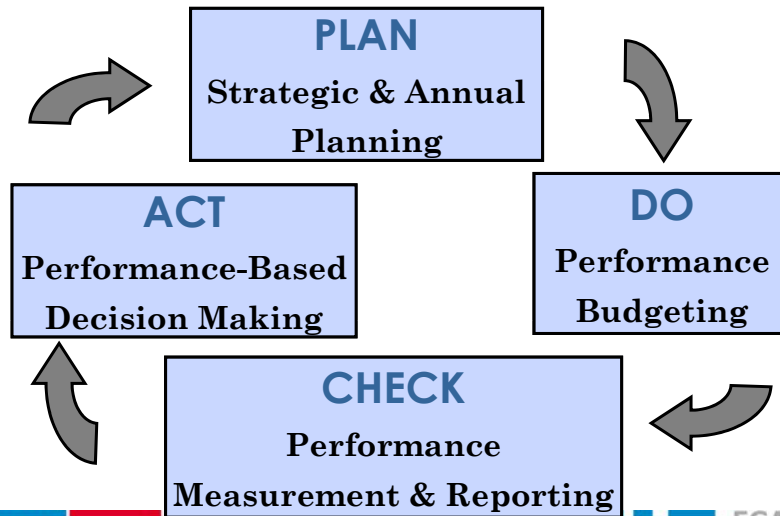
- Citizen centric reporting
  - Transparency
  - "Easy to understand" financial and performance information
  - Customized analysis and reporting
- Convergent standards among nations
  - Generally accepted models
  - Compatible standards



## **III. Governance Structures**

- Performance management
- Human resources
- Information technology

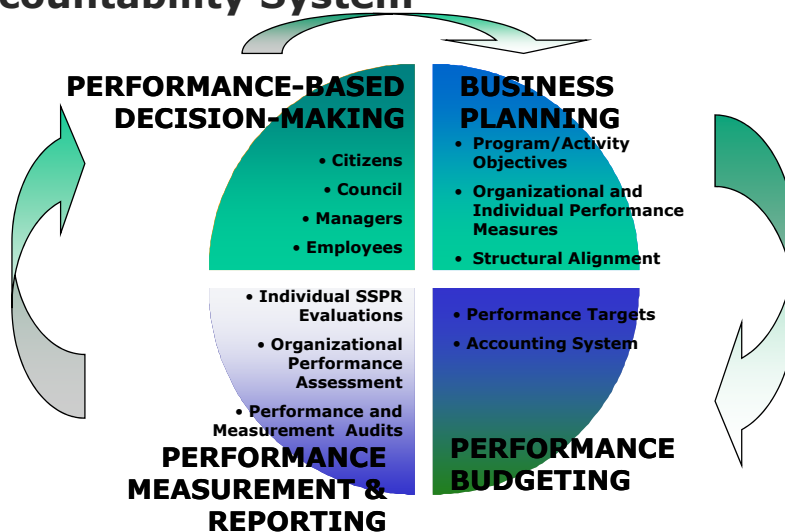
### III. A. 1. Governance: Performance Management Government Performance Accountability System



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### III. A. 2. Governance: Performance Management Government Performance Accountability System



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### III. A. 3. Governance: Performance Management

What are the five roles auditors play in Government Performance Measurement?

**Role 1 – Auditing Performance and Performance Management Systems**

**Role 2 – Assessing the Quality of Performance Information or Performance Reports**

**Role 3 – Developing Performance Measures or Measuring Performance Outside the Traditional Audit Process**

**Role 4 – Planning, Designing, Improving, or Advocating for Performance Management Systems and Their Use**

**Role 5 – External Reporting, Capacity Building, or Advocacy for the Use of Performance Information**

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### III. B. Human Resources Governance Structure



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### III. C. IT Governance Structure

#### COBIT: An IT Control Framework

- ◆ Starts from the premise that IT needs to deliver the information that the enterprise needs to achieve its objectives.
  - ◆ Promotes process focus and process ownership
  - ◆ Divides IT into 34 processes belonging to four domains and provides a high level control objective for each
  - ◆ Looks at fiduciary, quality and security needs of enterprises, providing seven information criteria that can be used to generically define what the business requires from IT
  - ◆ Is supported by a set of over 300 detailed control objectives
- 
- ◆ Planning
  - ◆ Acquiring & Implementing
  - ◆ Delivery & Support
  - ◆ Monitoring
- ◆ Effectiveness
  - ◆ Efficiency
  - ◆ Availability
  - ◆ Integrity
  - ◆ Confidentiality
  - ◆ Reliability
  - ◆ Compliance

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### IV. How do you currently identify emerging issues in government auditing as it pertains to your audit environment?

**(List processes, tools, techniques, etc.)**

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## Processes to identify emerging issues

- **Individual planning/networking**
- **Project level planning**
- **Annual office level planning**
- **Strategic planning**

## Visioning

If you fell asleep and didn't wake up until the year 2029, what changes in government auditing would you see around you when you opened your eyes?

## **V. What Issues are Beyond the Horizon?**

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### **V. 1. Issues Beyond the Horizon**

- Auditing ethics and corruption
- Auditing governance structures
- Auditing through intergovernmental and global partnerships
- Auditing with “worldwide best practices”
- Auditing values

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## **V. 2. Issues Beyond the Horizon**

- **University level, interdisciplinary auditing curricula**
- **Manage and audit the “virtual workforce”**
- **Impact of technological innovation**
- **Auditors without “adjectives”**

## **V. 3. Issues Beyond the Horizon: IIA Public Sector Governance Initiatives**

- **Transparency/visibility**
- **Legislation – elected officials**
- **Culture of tolerance – by top management for the “non-party line”**

## **VI. Conclusion/Questions**

### **VI. 1. Conclusion/Questions**

#### **Will Pressure on Public Sector Auditors Accelerate?**

- **More visibility for emerging “accountability” profession**
- **Recognizing differences between new Yellow and Red Books (See “A Comparison”)**
- **High and perhaps unreasonable criteria and media expectations of government**
- **Accelerating “citizen” access to performance and financial information**
- **High visibility issues requiring “partnership audits” including the economy, homeland security, transportation, and the environment**
- **Opportunity for transformation and even stronger role in public accountability and government transparency (chasing bailout money; auditing spending and results of recovery program)**

## **VI. 2. Conclusion/Questions**

Auditor of the Future – “Integrated” Skills

- **Performance**
- **Financial**
- **Information Technology**
- **Human/Management**

**Can YOU be an “auditor of the future?”**