



Considering Risk in Performance Audits

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U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Learning Objectives

- Understand the planning process of a Performance Audit
- Identify relevant and significant risks during the planning phase
- Understand how to determine if internal control is significant

Presentation Topics

- Refresher on Yellow Book Performance Audit Basics
 - Considering Risks during the Planning Phase of a Performance Audit
 - Determining Significance of Internal Control to Audit Objectives
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Effective date of implementation of 2018 GAGAS for Performance Audits

- The 2018 revision of Government Auditing Standards is effective for performance audits beginning on or after July 1, 2019.
- Early implementation is not permitted.

Compliance with GAGAS

GAGAS uses two categories of requirements, identified by specific terms, to describe the degree of responsibility they impose on auditors and audit organizations:

- a. Unconditional requirements: Auditors and audit organizations must comply with an unconditional requirement in all cases where such requirement is relevant. GAGAS uses “must” to indicate an unconditional requirement.
- b. Presumptively mandatory requirements: Auditors and audit organizations must comply with a presumptively mandatory requirement in all cases where such a requirement is relevant. GAGAS uses “should” to indicate a presumptively mandatory requirement.

What is a Performance Audit

Performance audits provide objective analysis, findings, and conclusions to assist management and those charged with governance and oversight with, among other things:

- improving program performance and operations,
- reducing costs,
- facilitating decision making by parties responsible for overseeing or initiating corrective action, and
- contributing to public accountability.

Objectives of Performance Audits

Performance audit objectives vary widely and include assessments of program effectiveness, economy, and efficiency; internal control; compliance; and prospective analyses. Audit objectives may also pertain to the current status or condition of a program. These overall objectives are not mutually exclusive. Key categories of performance audit objectives include the following:

- a. Program effectiveness and results audit objectives
- b. Internal control audit objectives
- c. Compliance audit objectives
- d. Prospective analysis audit objectives

Fieldwork requirements for Performance Audit

The fieldwork requirements for performance audits relate to:

- Planning the audit;
- Conducting the engagement;
- Supervising staff;
- Obtaining sufficient, appropriate evidence; and
- Preparing audit documentation.

The concepts of evidence, significance, and audit risk form a framework for applying these requirements.

General requirements of planning the Performance Audit

- Auditors must adequately plan the work necessary to address the audit objectives. Auditors must document the audit plan.
- Auditors must plan the audit to reduce audit risk to an acceptably low level.
- In planning the audit, auditors should assess significance and audit risk. Auditors should apply these assessments to establish the scope and methodology for addressing the audit objectives. Planning is a continuous process throughout the audit.
- Auditors should design the methodology to obtain sufficient, appropriate evidence that provides a reasonable basis for findings and conclusions based on the audit objectives and to reduce audit risk to an acceptably low level.
- Auditors should identify and use suitable criteria based on the audit objectives.

Why does risk assessment matter?

- The goals of identifying, assessing and responding to risk are at the core of every audit.
- Identifying and assessing a client's specific risks drives the audit procedures you should perform and helps you avoid inefficient over-auditing.
- Risk assessment helps auditors avoid a failure to obtain sufficient appropriate audit evidence to support audit opinion.
- Risk assessment is crucial for a quality audit.

Identify Risk Factors

The auditor should perform risk assessment procedures to identify key risks. Some examples of possible risk questions as follows :

- What can go wrong?
- What can be the risk?
- What assets are at risk - property, resources, information, reputation, legality?; from what sources – internal or external?; at which level: internal, external, legal, strategic, operational, organizational or administrative?
- With whom does the risk lie?

Identify Risk Factors (cont)

- What factors are / can be constraining performance (effectiveness, economy, and efficiency)?
 - What could be the cause (including weaknesses in controls)?
 - What could be the consequences or the impact?
 - How could this risk be managed?
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Audit risk components

- Audit risk is the risk that the auditor expresses an inappropriate audit opinion.
- Audit risk is composed of the following risks:
 - Inherent Risk
 - Control Risk
 - Detection Risk

Audit risk components - continued

- Inherent risk - The risk to an entity prior to considering management's response to the risk
- Control risk – The risk to an entity which will not be prevented or detected by the entity's internal control
- Detection Risk – The risk that will not be detected by the auditor

Audit Risk = Inherent Risk x Control Risk x Detection Risk

Audit Assurance = 1 - Audit Risk

Process for identifying risk factors

In the planning phase, the auditor can:

- identify conditions that significantly increase inherent and control risk; and

Factors to consider in identifying risks and deficiencies are general in nature and require the auditor's judgment in determining

- the extent of procedures (testing) to identify the risks and deficiencies and
- the impact of such risks and deficiencies on the entity's performance.

Process for Identifying Risks

- Competence of the Team
 - Initial review of prior audit reports/Other sources of information
 - Brainstorming Session
 - Designing a written audit plan
 - Begin to execute the audit plan
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Requirements of assigning auditors

Audit management should assign sufficient auditors with adequate collective professional competence to conduct the audit. Staffing an audit includes, among other things:

- a. assigning auditors with the collective knowledge, skills, and abilities appropriate for the audit;
- b. assigning a sufficient number of auditors to the audit;
- c. providing for on-the-job training of auditors; and
- d. engaging specialists when necessary.

Requirements of assigning auditors - continued

If planning to use the work of specialists, auditors should document the nature and scope of the work to be performed by the specialists, including:

- a. the objectives and scope of the specialists' work,
- b. the intended use of the specialists' work to support the audit objectives,
- c. the specialists' procedures and findings so they can be evaluated and related to other planned audit procedures, and
- d. the assumptions and methods used by the specialists.

Requirements of nature and profile of the program and user needs

Auditors should obtain an understanding of the nature of the program or program component under audit and the potential use that will be made of the audit results or report as they plan a performance audit. The nature and profile of a program include:

- a. visibility, sensitivity, and relevant risks associated with the program under audit;
- b. age of the program or changes in its condition;
- c. the size of the program in terms of total dollars, number of citizens affected, or other measures;

Requirements of nature and profile of the program and user needs - continued

- d. level and extent of review or other forms of independent oversight;
- e. the program's strategic plan and objectives; and
- f. external factors or conditions that could directly affect the program.

Requirements of results of previous engagements

- Auditors should evaluate whether the audited entity has taken appropriate corrective action to address findings and recommendations from previous engagements that are significant within the context of the audit objectives.
- When planning the audit, auditors should ask management of the audited entity to identify previous engagements or other studies that directly relate to the objectives of the audit, including whether related recommendations have been implemented.

Requirements of results of previous engagements - continued

- Auditors should use this information in assessing risk and determining the nature, timing, and extent of current audit work, including determining the extent to which testing the implementation of the corrective actions is applicable to the current audit objectives.

Requirements of investigations or legal proceedings

Auditors should inquire of management of the audited entity whether any investigations or legal proceedings significant to the audit objectives have been initiated or are in process with respect to the period under audit, and should evaluate the effect of initiated or in process investigations or legal proceedings on the current audit.

Brainstorming about the risks of material misstatement

During brainstorming discussions, engagement team members should set aside beliefs that they may have that management and those charged with governance are honest and have integrity, and should, in particular, also address:

- known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud;
- risk of management override of controls;
- the importance of maintaining professional skepticism throughout the audit; and

Requirements of preparing a written audit plan

Auditors must prepare a written audit plan for each audit. Auditors should update the plan, as necessary, to reflect any significant changes to the plan made during the audit. A written audit plan provides an opportunity for audit organization management to supervise audit planning and to determine whether:

- a. the proposed audit objectives are likely to result in a useful report;
- b. the audit plan adequately addresses relevant risks;
- c. the proposed audit scope and methodology are adequate to address the audit objectives;

Requirements of preparing a written audit plan - continued

- d. available evidence is likely to be sufficient and appropriate for purposes of the audit; and
- e. sufficient staff, supervisors, and specialists with adequate collective professional competence and other resources are available to conduct the audit and to meet expected time frames for completing the work.

Requirements of auditor communication

- Auditors should communicate an overview of the objectives, scope, and methodology and the timing of the performance audit and planned reporting (including any potential restrictions on the report), unless doing so could significantly impair the auditors' ability to obtain sufficient, appropriate evidence to address the audit objectives. Auditors should communicate such information with the following parties, as applicable:
 - a. management of the audited entity, including those with sufficient authority and responsibility to implement corrective action in the program or activity being audited;
 - b. those charged with governance;
 - c. the individuals contracting for or requesting audit services, such as contracting officials or grantees; or

Requirements of auditor communication - continued

d. the cognizant legislative committee, when auditors conduct the audit pursuant to a law or regulation or when they conduct the work for the legislative committee that has oversight of the audited entity.

- In situations where the parties required to receive communications are not clearly evident, auditors should document the process followed and conclusions reached in identifying the appropriate individuals to receive the required communications. Auditors should retain any written communication resulting from the above-mentioned procedures.

Consideration of Risks - Conclusion

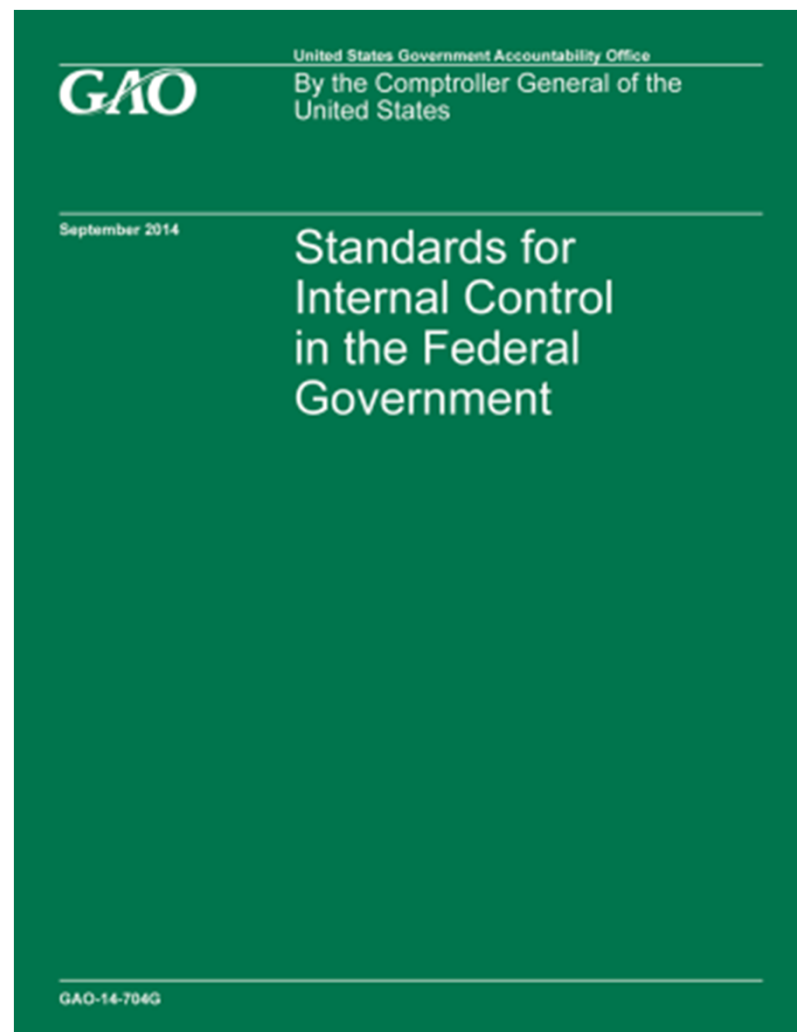
- Audit process is iterative
- Important to revisit key decisions throughout the audit
- If new information arises, may need to change scope and methodology to accommodate new risks

Internal Control

What is internal control?

Internal control is a process effected by an entity's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved.

Auditors can use internal control standards – such as the Green Book - to help assess the extent to which federal agencies are achieving their mission, goals, or objectives.



Six Main Internal Control Requirements for Performance Audits

Step 1: Determine and document whether internal control is significant to the audit's researchable questions (8.39).

Step 2: Obtain an understanding of internal control (8.40).

Step 3: Assess internal control (8.49).

Step 4: Evaluate the significance of identified internal control deficiencies (8.54).

Step 5: Develop the elements of any finding (8.75, 8.116, and 8.117).

Step 6: Report (9.29 and 9.30).

Review of Green Book Principles

Component	Principles
<p style="text-align: center;">Control Environment</p>	<p>1. The oversight body and management should demonstrate a commitment to integrity and ethical values.</p>
	<p>2. The oversight body should oversee the entity’s internal control system.</p>
	<p>3. Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity’s objectives.</p>
	<p>4. Management should demonstrate a commitment to recruit, develop, and retain competent individuals.</p>
	<p>5. Management should evaluate performance and hold individuals accountable for their internal control responsibilities.</p>

Review of Green Book Principles

Component	Principle
<p style="text-align: center;">Risk Assessment</p>	<p>6. Management should define objectives clearly to enable the identification of risks and define risk tolerances.</p>
	<p>7. Management should identify, analyze, and respond to risks related to achieving the defined objectives.</p>
	<p>8. Management should consider the potential for fraud when identifying, analyzing, and responding to risks.</p>
	<p>9. Management should identify, analyze, and respond to significant changes that could impact the internal control system.</p>
Component	Principle
<p style="text-align: center;">Control Activities</p>	<p>10. Management should design control activities to achieve objectives and respond to risks.</p>
	<p>11. Management should design the entity’s information system and related control activities to achieve objectives and respond to risks.</p>
	<p>12. Management should implement control activities through policies.</p>

Review of Green Book Principles

Component	Principle
<p style="text-align: center;">Information and Communication</p>	<p>13. Management should use quality information to achieve the entity's objectives.</p>
	<p>14. Management should internally communicate the necessary quality information to achieve the entity's objectives.</p>
	<p>15. Management should externally communicate the necessary quality information to achieve the entity's objectives.</p>
Component	Principle
<p style="text-align: center;">Monitoring</p>	<p>16. Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.</p>
	<p>17. Management should remediate identified internal control deficiencies on a timely basis.</p>

Step 1: Determine and Document Whether Internal Control is Significant to the Audit Objectives

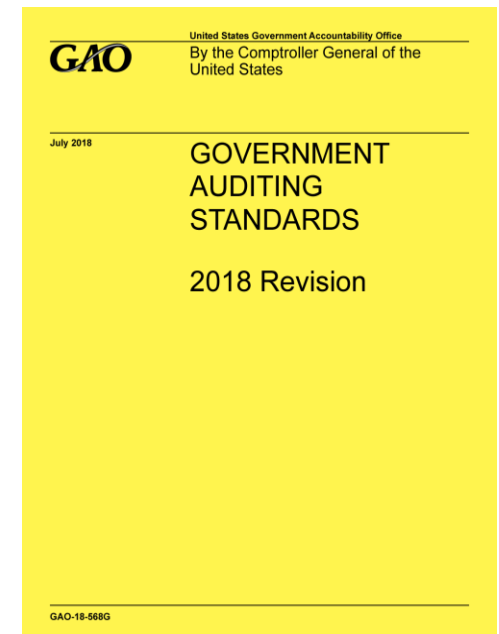
Senior Audit Team Management makes an initial determination on the *potential* significance of internal control at beginning of engagement.

Step 1: Determine and Document Whether Internal Control is Significant to the Audit Objectives - Significance of Internal Control

Determination of internal control significance key to developing scope and methodology.

Important to make preliminary determination early in audit.

Developing scope and methodology appropriately allows auditors to cite the Green Book in findings.



Step 1: Determine and Document Whether Internal Control is Significant to the Audit Objectives - Definition of Significance



What is meant by the term “significance”??

Defined in Yellow Book paragraph 8.15.

Ask: Is internal control important or key to addressing audit objectives and developing findings?

Senior audit team management and staff use their professional judgment to make initial internal control significance determination.

Step 1: Determine and Document Whether Internal Control is Significant to the Audit Objectives - Considerations for Determining Significance of Internal Control

Senior audit team management may consider the following in making the initial determination on the potential significance of internal control:

- Is internal control relevant? *Relevancy is a broader concept than significance. Internal control is likely to be relevant when the audit objectives involve reviewing processes, goals, and objectives*
- What is the inherent risk that the Agency does not achieve its objectives? *Inherent risks are the risks that something could go wrong that would prevent an audited entity from achieving a goal without considering any actions that the agency is taking to reduce that risk.*
- Would internal control problems potentially impact the audit objectives or findings? *Considerations include the likelihood that internal control problems would provide evidence to support findings and conclusions or could be the cause of an issue under audit.*

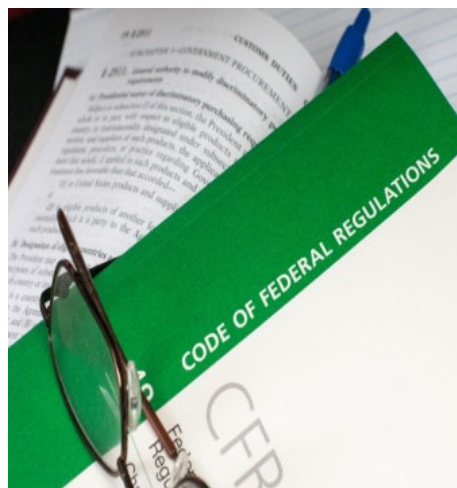
Step 1: Determine and Document Whether Internal Control is Significant to the Audit Objectives - Considerations for Determining Significance of Internal Control

Senior audit team management may consider the following in making the initial determination on the potential significance of internal control:

- How significant is the impact of information systems on audit evidence? *Considerations include whether an information controls assessment is necessary to make an overall assessment.*
- Can internal control be assessed? *Considerations include whether the entity has internal controls in place.*
- What conclusions do we want to draw from the audit? Will internal control work enable us to better reach these conclusions? *Considerations include whether internal controls work will meet the needs and interests of audit report users.*

Obtain Background Information

- Audit team obtains background information at the beginning of the audit.
- All performance audits are required to obtain background information.



Source: GAO. | www.gao.gov

Obtain Background Information

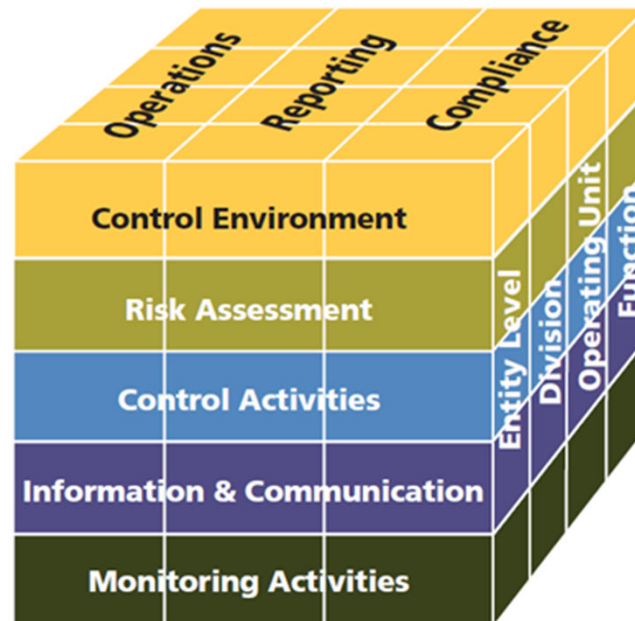
Obtaining background information may help the audit team:

- clarify audit objectives/researchable questions,
- determine which components of internal control are significant, and
- obtain an understanding of internal control.



Step 1: Determine and Document Whether Internal Control is Significant to the Audit Objectives -Determine Significant Components

- What components of internal control are significant to the audit objectives?



Step 1: Determine and Document Whether Internal Control is Significant to the Audit Objectives -Determine Significant Components

The team considers the following when determining which internal control components are significant to audit objectives:

1. Control Environment – Does the audit objective assess the structure, roles, or responsibilities that management designs and assigns to personnel? Does the audit objective assess standards of conduct, training, competence, or accountability of personnel?
2. Risk Assessment – Do any of the audit objectives assess the organization’s definition of objectives or identification or analysis of risk?

Step 1: Determine and Document Whether Internal Control is Significant to the Audit Objectives -Determine Significant Components

3. Control Activities – Does the audit objective assess the design or implementation of the organization’s policies, procedures, information systems, or actions that have been established to achieve its objectives and respond to risks?

4. Information and Communication: Does the audit objective assess the organization’s use of information to communicate within the organization or to external parties?

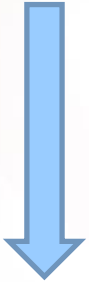
5. Monitoring: Does the audit objective assess the organization’s identification of internal control deficiencies and corrective actions of deficiencies?

Step 1: Determine Whether Internal Control is Significant to Audit Objectives –Document

- Yellow Book requires documentation of internal control determination.
- Documentation can occur in forms, memorandums, or other audit documentation as determined appropriate by the auditor and in compliance with the audit entity's system of quality control.

Step 1: Determine Whether Internal Control is Significant to Audit Objectives

- If audit objectives change



- Have to revisit and may have to revise conclusions about whether internal control is significant and which components are significant.

Internal Control Assessment Types

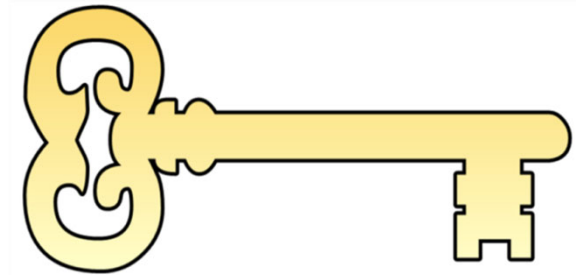
- As required by paragraph 8.49, the team determines what type of Types of internal control assessment:

Type of Assessment	What the Auditor Should Ask
Design	Will the control work in theory?
Design and implementation	Will the control work in theory, and has it been put into operation?
Design, implementation, and operating effectiveness	In addition to the previous questions, has the control been used consistently over time?

Step 2: Obtain an Understanding of Internal Control – Identify Key Controls Relevant to Audit Objectives

Identifying Key Controls:

- Allows the team to focus the scope of their work.
- Provides sufficient, appropriate evidence that can answer researchable questions.



Helpful Hints:

- To identify key controls, focus on the “what could go wrongs” in the process that would significantly affect the achievement of the federal entity’s goal or objective.
- Key controls are the controls that ultimately prevent or detect these more critical “what could go wrongs”. A key control may be a grouping of controls; it does not have to be a single control.

Questions?

Further Resources

Access the Yellow Book

www.gao.gov/yellowbook

Technical Assistance

yellowbook@gao.gov