



**U.S. Department of Housing and Urban
Development**

**Real Estate Assessment Center Quality Control
Reviews of Independent Auditors**



U.S. DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT
OFFICE OF INSPECTOR GENERAL

Issue Date: September 28, 2012

Audit Report Number: 2012-KC-0005

TO: David A. Vargas, Deputy Assistant Secretary, Real Estate Assessment Center,
Office of Public and Indian Housing, PX

//signed//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, OAGA

SUBJECT: HUD's Real Estate Assessment Center Did Not Always Ensure That Independent
Public Accountants Followed Statement on Auditing Standards (SAS) 99
Requirements

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General (OIG), final results of our review of the Real Estate Assessment Center (REAC).

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at (913) 551-5872.



Date of Issuance

**U.S. Department of Housing and Urban Development,
Real Estate Assessment Center Did Not Always Ensure
That Independent Public Accountants Followed
Statement on Auditing Standards 99 Requirements**

Highlights

Audit Report 20XX-XX-XXXX

What We Audited and Why

We audited REAC to determine whether it ensured that independent auditors followed Statement on Auditing Standards (SAS) 99 requirements.

What We Recommend

We recommend that the Deputy Assistant Secretary for Public and Indian Housing create and implement standard procedures that address each SAS 99 requirement and conclusions made on its review checklist.

What We Found

REAC did not always ensure that independent auditors followed SAS 99 requirements. It did not identify deficiencies in 10 of the 11 deficient engagements we reviewed. For the one other engagement, REAC identified a SAS 99 deficiency but did not include it in its report.

TABLE OF CONTENTS

Background and Objective	3
Results of Audit	
Finding 1: REAC Did Not Always Ensure That Independent Public Accountants Followed SAS 99 Requirements	4
Scope and Methodology	6
Internal Controls	7
Appendixes	
A. Auditee Comments and OIG’s Evaluation	8
B. Independent Auditor Engagements That Lacked Documentation	16
C. Criteria	17

BACKGROUND AND OBJECTIVES

The U.S. Department of Housing and Urban Development's (HUD) Real Estate Assessment Center (REAC) is a division of the Office of Public and Indian Housing within HUD. REAC's mission is to provide and promote the effective use of accurate, timely, and reliable information assessing the condition of HUD's portfolio; provide information to help ensure safe, decent, and affordable housing; and restore the public trust by identifying fraud, abuse, and waste of HUD resources.

REAC gathers data pertaining to each program recipient, including physical inspections, independent audits, management and performance assessments, and evaluations of resident satisfaction with management performance. The Uniform Financial Reporting Standards Rule (24 CFR (Code of Federal Regulations) Part 5) requires public housing authorities and multifamily projects to electronically submit financial information to REAC. REAC analyzes these financial data, develops objective performance scores, and delivers assessment results to HUD program staff and others charged with preserving America's housing stock.

REAC's Quality Assurance Subsystem helps ensure that the data submitted are accurate and complete, in part by conducting quality assurance reviews. Office of Management and Budget Circular A-133 prescribes that certain recipients of Federal funds be audited each year. Some of the recipients expend enough funds to require a "cognizant agency for audit" to perform reviews of these audits. The remaining recipients have an "oversight agency for audit," which may assume the responsibilities of the cognizant agency, including the quality assurance reviews. REAC has undertaken these roles for housing authorities, lenders, multifamily projects, and other entities.

REAC's reviews analyze the work of independent auditors to determine whether their audits and attestation services of HUD-funded entities and Federal Housing Administration (FHA) lenders were performed in accordance with applicable laws, regulations, and professional standards. Those standards include Statement on Auditing Standards (SAS) 99, which requires the independent auditors to perform specific steps to obtain reasonable assurance that the financial statements are free of material misstatement attributable to error or fraud and to document their steps.

Our objective was to determine whether REAC ensured that independent auditors followed SAS 99 audit requirements.

RESULTS OF AUDIT

Finding 1: REAC Did Not Always Ensure That Independent Public Accountants Followed SAS 99 Requirements

REAC did not always ensure that independent public accountants (independent auditors) followed SAS 99 requirements. This condition occurred because REAC did not have standard procedures for addressing each SAS 99 requirement on its review checklist. As a result, it could not provide assurance that the financial data submitted to HUD by program participants were satisfactorily tested for material misstatements due to error or fraud.

REAC Did Not Always Ensure that Independent Auditors Followed SAS 99

REAC indicated that some independent auditors met SAS 99 requirements when they had incomplete documentation or had performed insufficient audit procedures. REAC's review teams used the American Institute of Certified Public Accountants' (AICPA) peer-review checklists to conduct their reviews. These checklists served as REAC's workpapers and documented its methodology.

Of the 32 audit engagements we analyzed as part of our review, the independent auditors lacked documentation that they sufficiently performed SAS 99 procedures for 11 engagements (see appendix B). These 11 engagements were conducted by four of the nine independent auditors in our sample of reviews. In 10 of the 11 engagements, REAC indicated on its checklists that the SAS 99 requirements were met and thus did not report these deficiencies.

For 1 of the 11 engagements, REAC identified a SAS 99 deficiency but did not include it in its review report. For this engagement, the reviewer correctly noted on the checklist that the independent auditor did not meet the SAS 99 requirements. This audit engagement was one of five analyzed as part of a review of one independent auditor. REAC's report on this independent auditor listed the deficiencies found during the review and cited specific standards not met, but it did not mention the identified SAS 99 deficiency.

REAC Lacked Standard Procedures for Addressing Each SAS 99 Requirement

REAC did not have standard procedures for addressing each SAS 99 requirement on its review checklist.

Reviewers did not have any manuals or other written guidance to follow and were instead instructed to use their judgment when completing the checklist. The checklist evaluating SAS 99 procedures included a general fraud compliance question and paraphrased the SAS 99 documentation requirements. The reviewers indicated independent auditor compliance with the fraud procedures by marking a checkbox next to the general question and only documented exceptions. Some of the reviewers answered the general question only, while others indicated compliance only if all of the documentation requirements were met.

Financial Statements Could Contain Misstatements

REAC could not provide reasonable assurance for the engagements in our limited sample that the financial statements submitted by the independent auditors were free of material misstatement due to fraud. Since REAC did not adequately identify and report independent auditors' noncompliance with SAS 99, we could not conclude that the financial data submitted to HUD were accurate and free of material misstatement due to fraud.

Recommendation

We recommend that the Deputy Assistant Secretary for the Real Estate Assessment Center

- 1A. Create and implement standard procedures that address each SAS 99 requirement and conclusions made on its review checklist.

SCOPE AND METHODOLOGY

Our audit period covered the calendar years 2009 and 2010. We performed our fieldwork in September and October 2011 at the following locations:

Entity/firm	City
Real Estate Assessment Center	Washington, DC
Eide Bailly, LLP	Boise, ID
Mayer Hoffman McCann	Irvine, CA
Moss Adams, LLP	Seattle, WA
NSBN, LLP	Beverly Hills, CA
Wallace Rowe & Associates	Pleasant Hill, CA

To accomplish our objective, we interviewed REAC staff, reviewed REAC's quality assurance review checklist, and compared the completed checklists to the independent auditors' workpapers.

Our analysis of the quality assurance review fieldwork was limited to independent auditor compliance with SAS 99 and fraud testing. We ensured that the checklists complied with the relevant standards. We reviewed the independent auditors' workpapers to determine whether the independent auditors complied with SAS 99 audit requirements, and we reviewed REAC's checklists to evaluate its ability to accurately identify noncompliant independent auditors. Since this was a limited review, we are not offering an opinion on any other area of REAC's operations or on its operations in general.

Sample Selections

During our audit period, REAC performed 24 quality assurance reviews. These 24 reviews covered 87 audit engagements.

We selected 9 of the 19 quality assurance reviews that were performed during our audit period that did not result in a referral. These 9 reviews accounted for 32 audit engagements and were chosen based on the location of the independent auditors involved and travel considerations. Our sample was not statistically selected. However, based on the results of all our audit procedures, we expect our sample results to be representative of REAC's overall processes. We asked the nine independent auditors selected to send electronic copies of their workpapers to our office. For the five that could not, local Office of Inspector General (OIG) staff conducted the reviews on the independent auditors' premises.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objectives:

- Controls to ensure that REAC followed applicable laws and regulations with respect to monitoring independent auditors.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

We evaluated internal controls related to the audit objective in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of REAC's internal control.

Separate Communication of Minor Deficiencies

Minor deficiencies were reported to the auditee in a separate management memorandum.


APPENDIXES

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

	U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT 550 12 TH Street, SW Suite 200 Washington, DC 20410
OFFICE OF PUBLIC AND INDIAN HOUSING REAL ESTATE ASSESSMENT CENTER	
MEMORANDUM FOR:	Ronald J. Hosking, Regional Inspector General for Audit, 7AGA
FROM:	David A. Vargas, Deputy Assistant Secretary, Real Estate Assessment Center, PX
SUBJECT:	Response of Real Estate Assessment Center to Discussion Draft Report – Real Estate Assessment Center’s Monitoring of Independent Public Accountants
<p>The Real Estate Assessment Center (REAC) has reviewed your August 30, 2012, letter and revised draft audit report regarding its monitoring activities related to Independent Public Accountants' (IPAs') compliance with the American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards (SAS) No. 99, <i>Consideration of Fraud in a Financial Statement Audit</i>. I would like to note for the record that this revised draft report was submitted for comment 12 months after your office first notified me of this audit (August 29, 2011) and more than six months after the first draft was issued (February 23, 2012). REAC provided your office with a response to the first draft via email on March 22, 2012 (see Exhibit 1).</p>	
<p>www.hud.gov espanol.hud.gov</p>	

Comment 1

During a telephone conversation held on August 30, 2012, Tracey Vargas, Assistant Regional Inspector General for Audit, indicated to me that our response was due by September 7, 2012, so that your office could complete this report prior to the end of HUD's fiscal year. Since REAC was provided only one week to respond (and given that the remaining finding is virtually unchanged from the prior draft), please refer to Exhibit 1 for REAC's detailed response. I ask that you reproduce Exhibit 1 and the associated appendices in your final report in their entirety. It is REAC's position that the appendices are necessary to establish that the Inspector General's (IG) auditors misapplied the requirements of SAS No. 99 during this audit and, therefore, reached erroneous audit conclusions.

Comment 2

Comment 3

REAC is encouraged that the revised draft no longer includes Findings 2 and 3. As noted in our response to the first draft, the IG did not cite any relevant criteria for either of those findings. Appropriately, those findings were dropped. It is REAC's position that the remaining finding should be deleted for the same reason.

Comment 4

In the revised draft the IG cites as relevant criteria SAS No. 99 (see Appendix C, Criteria, page 12). SAS No. 99 is an auditing standard that applies to financial statement audits performed by non-federal auditors. That standard does not create a duty or responsibility for federal agencies. Specifically, the revised draft does not cite any criterion which requires federal agencies to "ensure" that auditors comply with SAS No. 99.

Comment 5

More troubling, the report's remaining finding and conclusion is not based on sufficient, appropriate evidence in relation to the IG's audit objective, which continued to change throughout the engagement (see discussion to follow). As further discussed in Exhibit 1, REAC reviewers tested IPA compliance with SAS No. 99 for each of the 32 audits selected by the IG. The IG's auditors concurred with the REAC reviewer's conclusions for 69% (22/32) of the audits they sampled.

Comment 6

For the remaining 10 engagements the IG reviewers concurred with REAC's conclusions for at least five of the nine attributes sampled (see revised report Appendix B, page 10). REAC's position is that the IG's auditors misapplied SAS No. 99 for the four most commonly cited deficiencies in the IG's report (see Exhibit 1). Even when the IG is given the benefit of the doubt on this issue, the total disagreement over the SAS No. 99 attributes tested occurred at a rate of less than 15%.

Comment 7

The AICPA’s practice aid directs reviewers to conclude on whether an IPA substantively complied with SAS No. 99 requirements. Keep in mind that SAS No. 99 is only one of numerous auditing standards and requirements covered by a QCR. Accordingly, the objective of a QCR is to determine whether an IPA complied in all material respects with professional standards. In other words, reviewers are not required to ensure absolute compliance with SAS No. 99. Clearly, REAC tested IPA audits for compliance with SAS No. 99 as part of its overall QCR approach, using a methodology generally accepted in the industry. The differences in professional judgment identified by the IG were not significant enough to support their conclusion. For the IPAs tested, the IG did not establish that REAC failed to ensure compliance with SAS No. 99.

Comment 5

Moreover, REAC is troubled by the ever-changing objectives and scope of this audit. In the original notification, REAC was told that the IG's objective was to determine whether REAC ensured the IPAs were adhering to SAS 99 *and* A-133 audit requirements (see Exhibit 1, Appendix A). However, page 4 of the initial draft indicates that the OIG, during the course of its audit, significantly changed its objective. That draft stated the objective was to “determine whether REAC ensured that IPAs followed SAS 99 audit requirements and whether *it* (emphasis added) followed Circular A-133 requirements when reviewing audits conducted by IPAs.”

Comment 8

In the second draft report, the IG revised its audit objective again. That report states that the objective is to “determine whether REAC ensured that independent auditors followed SAS 99 audit requirements.” The background and objective section of the revised draft (page 3) disingenuously implies that OMB Circular A-133 creates a duty for REAC to conduct QCRs of housing agencies, lenders, multifamily projects, and other entities. No such duty exists. As noted in REAC’s response to the first draft, the requirements of OMB Circular A-133 do not apply to audits of lenders and for-profit multifamily projects. More importantly, the revised draft omits any mention of REAC’s relationship with the IG with respect to HUD’s duty and responsibility for performing QCRs.

Comment 9

Comment 10

Prior to the creation of REAC in 1998, the IG performed all QCRs of non-federal auditors for HUD under the provisions of the Inspector General Act of 1978, as amended. Starting in 1998 REAC entered into an informal arrangement with the IG to conduct QCRs of IPAs that performed audits of entities covered under the Uniform Financial Reporting Standards (UFRS) regulation. The IG continues to perform QCRs at its own discretion. In effect, REAC received an informal delegation of authority from the IG to perform QCRs. HUD is the only federal agency with this type of arrangement. At all other federal agencies, QCRs are performed by an agency’s IG.

Comment 10

As I noted in our response to the first draft, since the IG plans to issue this report as final, we will temporarily suspend performing any QCR activities until the responsibility for this role is determined.

Comment 11

Your office has indicated that it is not the IG's duty and responsibility under the Inspector General's Act to conduct QCRs. In fact, you even provided an opinion from your legal counsel suggesting that QCRs are the HUD program office's duty and responsibility, not the IG's. REAC does not concur with that position.

Comment 10

Accordingly, upon your issuance of this report, I plan to refer this matter to the Council of the Inspectors General on Integrity and Efficiency (CIGIE). Since this issue impacts not only HUD but the entire federal Inspectors General community, I am requesting that the CIGIE provide guidance to federal agencies regarding the duty and responsibility to conduct QCRs.

Comment 12

Finally, REAC does not concur with the recommendation in the revised draft report. The IG wants REAC to create and implement standard procedures that address each SAS No. 99 requirement and conclusion documented on its review checklist. REAC finds this recommendation onerous and unnecessary.

Comment 13

As noted in Exhibit 1, during the period covered by this review, REAC was using AICPA peer review checklists to conduct and document its QCRs. This methodology is based on well-established industry practice using materials produced by the entity that wrote the standards. The AICPA's checklist asks reviewers to reach an overall conclusion on an IPA's compliance with SAS No. 99 (see Exhibit 1, Appendix C). It does not require reviewers to establish absolute compliance with each item listed on the checklist. Is the IG implying that the AICPA does not understand its own standards well enough to design a standard review methodology and checklist?

Comment 14

I am still hopeful that this matter can be resolved internally, without the IG issuing this report. If would like to discuss that possibility further, please feel free to free to contact me at (202) 475-8906.

Attachment

OIG Evaluation of Auditee Comments

- Comment 1** Although REAC was provided only one week to respond to this second draft of the audit report, the only substantive changes made from the first draft were to eliminate the second and third findings, which we will issue in a management memorandum to REAC. REAC had already responded once to the remaining finding and we believed one week was sufficient. We appreciate REAC's timely response.
- Comment 2** REAC asked us to include its response and appendices to our first draft of the report (its Exhibit 1). However, Exhibit 1 consisted of 40 pages relating to the original draft report. Due to its size and based on our current policy, we did not include it in this report to keep the report manageable. A copy of Exhibit 1 in its entirety is available upon request by calling (913) 551-5870.
- Comment 3** REAC stated in its response that Findings 2 and 3 of the original report did not cite any relevant criteria to support the findings so we dropped them from the report. However, our findings did include relevant criteria. After receiving REAC's comments to the initial draft report we decided that the two findings were relatively minor and were more appropriately communicated in a management memorandum.
- Comment 4** REAC's stated mission is to provide and promote the effective use of accurate, timely, and reliable information by assessing the condition of HUD's portfolio and to restore the public trust by identifying fraud, abuse, and waste of HUD resources. Further, REAC's reports to the independent auditors after its reviews stated its objective, "...was to determine if the Firm performed these engagements in accordance with...generally accepted government auditing standards..."
- SAS 99 requires independent auditors to consider fraud in the financial statement audit. Therefore, for REAC to meet its mission and the objective of its quality control reviews, it should ensure that independent auditors comply with SAS 99.
- Comment 5** REAC stated that it was troubled that our objective changed during the audit. We adjusted our objective during the audit to ensure that it accurately described the intent of the audit. According to the Yellow Book, section 7.07, planning is a continuous process throughout the audit and auditors may need to adjust the audit objectives as work is being completed. During the planning stage of the audit, we determined that Circular A-133 applied to the reviewer of independent auditors as well as to the independent auditors themselves and adjusted our objective accordingly.
- Comment 6** REAC's response states that we misapplied SAS 99 for the four most commonly cited deficiencies in our report. However, for each of the 11 sampled audits, the independent auditor's files did not document that it adequately performed SAS 99

procedures. When reviewing these files, we used the same checklist that REAC used during its reviews but did not come to the same conclusions as REAC. REAC's files did not adequately document how it reached its conclusions and its reviewers could not tell us what made them determine that SAS 99 testing was adequate when we determined that it was not.

Comment 7 We understand REAC's quality assurance reviews did not focus solely on the independent auditors' compliance with SAS 99. However, our objective was to determine whether REAC ensured that independent auditors followed SAS 99 requirements. Our objective was not to determine whether REAC identified material misstatements caused by fraud or that the independent auditors failed to identify such fraud as a result of the purported audit failures. The differences in our conclusions were not a case of differences in professional judgment, but a case of documentation. The REAC reviewers did not document the reasoning for their conclusions, could not later tell us why they came to the conclusions they did, and the independent auditor workpapers did not support that SAS 99 work was properly executed.

Comment 8 In accordance with OMB Circular A-133, the cognizant agency for audit shall obtain or conduct quality control reviews of selected audits performed by non-Federal auditors and provide the results, when appropriate, to other interested organizations. An auditee that does not have a designated cognizant agency for audit will be under the general oversight of a Federal agency. The oversight agency for audit may assume all or some of the responsibilities normally performed by a cognizant agency for audit. In performing quality control reviews of audits completed by independent auditors and making referrals of those independent auditors as appropriate, to the respective State licensing agencies and professional bodies for disciplinary action, REAC has assumed some of the responsibilities normally performed by a cognizant agency.

We concurred that OMB Circular A-133 did not apply to lenders and multifamily projects. However, HUD requires these entities to submit annual audited financial statements, which are subject to SAS 99. All independent auditors must comply with SAS 99 regardless of whether they are subject to the Single Audit Act. Also, HUD Handbook 2000.04 REV 2, which applied to for-profit entities, dictated that audits must be conducted in accordance with the Yellow Book, which encompasses SAS 99. Because REAC reviewed these independent auditors, and included reviews of SAS 99 in its quality control review methodology, we included these reviews within the scope of our audit.

Comment 9 REAC stated that the revised draft omitted any mention of its relationship with the IG with respect to HUD's duty and responsibility for performing quality control reviews. This relationship was not relevant to the objective of our audit. Whether it was the OIG's or HUD's duty to conduct quality control reviews, REAC was performing these reviews and it had the duty to ensure that

independent auditors performed their audits in accordance with requirements, including SAS 99.

Comment 10 REAC stated that if we issue the report, it intends to suspend its quality control reviews until the responsibility for performing the quality control reviews is determined. OMB Circular A-133 is clear that the agency, not the OIG, is responsible for conducting the reviews. REAC has been conducting these reviews for about 15 years and from a practical standpoint, HUD, not the OIG, has the greater interest in ensuring that audits are performed correctly. HUD uses the A-133 reports to oversee and monitor its programs and REAC's reviews help ensure that the financial reports submitted by the program participants are reliable.

Comment 11 The Inspector General Act of 1978, as amended, imposed a duty and responsibility on the Inspector General to: 1) comply with the standards established by the Comptroller General in the performance of any audits performed *by* the OIG; 2) establish guidelines for when to use the services of independent auditors in performing internal program audits of HUD; and 3) assuring that any work performed by non-Federal auditors hired by OIG or HUD or both to perform those internal audits complies with the standards established by the Comptroller General. This did not impose an obligation on the OIG to assure such compliance with regard to the audit work of independent auditors hired by grantees or other program participants that did not have a contract with OIG or HUD or both.

The IG Act of 1978, which granted the OIG broad investigative powers, together with the applicable provisions of the regulations and HUD Handbook provisions, gave the OIG full authority to access to *all* books, papers, and records of independent auditors for purposes of a quality control review or audit. However, the IG Act of 1978 does not require the OIG to conduct quality control reviews. Moreover, the Single Audit Act imposes the duty and responsibility to monitor and review the work of independent auditors performing Single Audit Act audits on HUD.

For all other audits performed by independent auditors of HUD grantees, recipients and participants not conducted in accordance with OMB Circular A-133 (e.g. audits of FHA-approved lenders) there is no clear statutory or handbook provision that imposes an obligation to monitor or review independent auditors. However, all such audits must be filed with HUD and the audits are a primary tool for HUD program managers to ensure compliance with program rules and regulations. Since the department monitors the performance of its program recipients and participants through direct performance monitoring and review of financial statements, it needs to review all audits for compliance with generally accepted auditing standards, generally accepted government auditing standards, and OMB Circular A-133 as a condition of acceptance.

- Comment 12** REAC believes the recommendation is onerous and unnecessary. We do not agree. The REAC reviewers did not document the reasoning for their conclusions so they could not later explain why they came to the conclusions they did even though the independent auditor workpapers did not support that SAS 99 work was properly executed. The additional documentation does not need to be extensive, but is necessary to support the conclusions made by the reviewers.
- Comment 13** REAC accurately explains that the AICPA’s peer review checklist asks reviewers to reach an overall conclusion on an independent auditor’s compliance with SAS No. 99, but does not require that reviewers establish absolute compliance with each item on the checklist. However, that does not address the point of our finding. The point of the finding is that REAC did not always identify independent auditor noncompliance with SAS 99 requirements and its files, including the completed checklists, did not include support for its conclusions.
- Comment 14** REAC suggested we resolve the issue internally without issuing the report. However, the Yellow Book, section 8.03 requires us to issue an audit report communicating the result of each completed performance audit.

Appendix B

INDEPENDENT AUDITOR ENGAGEMENTS THAT LACKED DOCUMENTATION

AICPA checklist's SAS 99 documentation requirements	Independent auditors' engagements (11 of the 32 reviewed)										
	1	2	3	4	5	6	7	8	9	10	11
Discussion among engagement personnel in planning the audit regarding the susceptibility of the entity's financial statements to material misstatement due to fraud.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	N
Inquiries of management and others within the entity about the risks of fraud.*	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	N
Consideration of preliminary analytical procedures including procedures specifically related to revenue.	Y	Y	Y	Y	Y	Y	Y	Y	Y	N	Y
Other procedures performed to obtain information necessary to identify and to assess the risks of material misstatement due to fraud.	N	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Specific risks of material misstatement due to fraud that were identified and a description of the auditor's overall and specific responses to those risks, if not adequately mitigated.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	N/A
The auditor's reasons supporting a conclusion that improper revenue recognition is not a risk of material misstatement due to fraud.	Y	N	N	N	N	N	N	Y	N	N	Y
Results of the procedures performed to further address the risk of management override of controls, including identification of journal entries tested.*	N	N	N	N	N	N	N	N	N	N	N
Other conditions and analytical relationships that caused the auditor to believe that additional auditing procedures or other responses were required and any further responses the auditor concluded were appropriate to address such risks or other conditions.	N	N	N	N	N	N	N	Y	N	N	N/A
The nature of communications about fraud made to management, the audit committee, and others.*	N/A	N	N	N	N	N	N	N/A	N	N	N/A

* Wording varied slightly between versions of the checklist.

Key:

Y Independent auditor had sufficient documentation of sufficient procedures.

N Independent auditor lacked sufficient documentation of sufficient procedures.

N/A Documentation or procedure was not applicable.

Appendix C

CRITERIA

The Statement on Auditing Standards No. 99: Consideration of Fraud in a Financial Statement Audit, also referred to as SAS 99, requires the auditor to conduct the following procedures to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.

- Discuss among the audit team members to consider how and where the entity's financial statements might be susceptible to material misstatement due to fraud and to reinforce the importance of adopting an appropriate mindset of professional skepticism.
- Obtain the information needed to identify risks of material misstatement due to fraud.
- Identify risks that may result in a material misstatement due to fraud.
- Assess the identified risks after taking into account an evaluation of the entity's programs and controls.
- Respond to the results of the assessment.
- Evaluate audit evidence.
- Communicate about fraud to management, those charged with governance, and others.
- Document the auditor's consideration of fraud.

OMB Circular A-123, Management's Responsibility for Internal Control

I. INTRODUCTION

“Management has a fundamental responsibility to develop and maintain effective internal control. The proper stewardship of Federal resources is an essential responsibility of agency managers and staff. Federal employees must ensure that Federal programs operated and Federal resources are used efficiently and effectively to achieve desired objectives. Programs must operate and and resources must be used consistent with agency missions, in compliance with laws and regulations, and with minimal potential for waste, fraud, and mismanagement.”