

**Government Auditing Standards:  
Temporary Exemptions and Guidance  
in Response to Hurricanes Katrina and Rita**

Hurricanes Katrina and Rita have presented an unprecedented need for government assistance to citizens, local governments, businesses, and others affected by the disasters. Significant amounts of taxpayer funds are being used to assist victims and to support a long and costly reconstruction effort. Government auditing plays a key role in protecting the public interest and enhancing accountability over the use of public funds. In light of the unprecedented disasters in the wake of Hurricanes Katrina and Rita, the Comptroller General has made temporary exemptions from certain provisions of *Government Auditing Standards*<sup>1</sup> for audit organizations impacted by the disasters and is providing additional guidance to protect the public interest related to accountability for public funds in the relief efforts.

Hurricanes Katrina and Rita have presented the need for high levels of government funding and an efficient, effective, and economical response under high-risk and extraordinarily difficult circumstances. Under these circumstances, there will be situations in which the public interest is best served if the government audit function is used in real time to promote accountability and control over public resources, prevent fraud, and evaluate whether government services are provided efficiently, effectively, and in compliance with laws and regulations

There will be situations in which an audit is required and an audited entity's records and supporting documentation are lost or destroyed or in which audit documentation has been lost or destroyed prior to completion of the audit or issuance of the report. In determining how to proceed in such situations, audited entities and the audit organization should use professional judgment to weigh the costs and benefits of completing audits in these situations with the need for public accountability for the use of funds. Consultations will also be needed with entities requiring or requesting the audits to determine how to meet legal and other requirements.

To help audit organizations and audited entities deal with these situations, the Comptroller General is issuing temporary exemptions and guidance. Audit organizations that employ the temporary exemptions should provide to their peer reviewers as part of the next peer review the list of engagements in which these temporary exemptions were applied along with the related documentation required.

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<sup>1</sup>*Government Auditing Standards, 2003 Revision* (GAO-03-763G, June 2003)

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### Temporary exemption from certain independence standards for affected organizations

#### Management services related to accountability and internal control over relief efforts:

1.01 Audit organizations that have audit responsibilities for entities affected by Hurricanes Katrina and Rita are temporarily exempt from certain independence requirements of *Government Auditing Standards* that prohibit or place restrictions on providing nonaudit services that involve performing management functions **other than accounting and bookkeeping services** if all of the conditions in (a) through (h) exist. The temporary exemption applies for financial statement audits of periods ending through September 30, 2006 and for performance audits and attestation engagements of activity through September 30, 2006.

- a. The nonaudit services deal with the expenditure of federal, state, and local government funds for hurricane relief efforts in Presidentially Declared Disaster Areas.
- b. The audit organization's involvement is directed toward enhancing and improving assurance over accountability, internal control, or proper use of government funds in the relief efforts.<sup>2</sup>
- c. The audited entity and the audit organization conclude that the public interest is better served and protected by the involvement of the audit organization in designing, managing, and executing the relief efforts that go beyond providing technical assistance and the conclusion and the reasons therefor are documented.
- d. The audit organization and the audited entity conclude that under the circumstances, the audited entity has no other viable option<sup>3</sup> for addressing the emergency, and the conclusion and reasons therefor are documented (the audit organization should obtain input from the audited entity, as it is the responsibility of the audited entity to evaluate its options).
- e. The planned role of the audit organization and the understanding between the audit organization and the audited entity is documented and approved at the appropriate levels of both the audit organization and the audited entity, including (1) audit organization management and (2) the head of the audited entity. (Where applicable, these agreements should also be approved by the

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<sup>2</sup>The temporary exemption from independence requirements does not apply to services for restoring an audited entity's overall operating procedures and controls.

<sup>3</sup>In making this conclusion, the concept of reasonableness should be applied. For example, although other options may be available, they may not represent viable options if they would cause undue or unjustifiable hardship for the audited entity based on facts and circumstances. Professional judgment will be required in reaching this conclusion.

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audited entity's audit committee, board of directors, or other equivalent governance committee.)

- f. The audited entity and the audit organization communicate in writing to the appropriate external oversight or regulatory bodies for the required audits the determination that conditions in (c) and (d) exist and the planned role of the audit organization in the relief efforts
- g. In subsequent audits performed by the audit organization in which the subject of the nonaudit services provided is significant or material to the subject of the audit, the audit organization takes the following actions:
  - 1. To meet the overarching principle on auditor independence in paragraph 3.13 of *Government Auditing Standards*, that auditors should not audit their own work, the audit organization should preclude personnel who provided the nonaudit services from planning, conducting, or reviewing audit work involving the subject of an audit in which the audit organization took on a management function. (If the audit organization cannot take this action, it should not provide an opinion or other form of assurance.)
  - 2. To provide transparency and full disclosure, audit reports should include a clear disclosure of the role of the audit organization in performing the nonaudit services and a statement that the audit organization met the criteria and requirements set forth in the Comptroller General's temporary exemption from the independence requirements.
- h. The safeguards in *Government Auditing Standards* paragraphs 3.17b through 3.17e and 3.17g are met by the audit organization. (Those safeguards include requirements for documentation, management acceptance of responsibility, precluding personnel who performed the nonaudit services from performing subsequent audit work related to those services, precluding a reduction in the scope of audit work as a result of the nonaudit services, and requirements to disclose the nonaudit services and related documentation in subsequent peer reviews.)

1.02 Examples of the types of activities in which an audit organization's involvement in the management and execution of relief programs may help promote the public interest could include (1) providing internal audit services, (2) providing assistance in developing and designing internal controls related to the relief efforts, (3) providing assistance in designing accountability mechanisms, reporting, and/or the related systems for tracking the progress and spending in the relief efforts, and (4) reviewing procurements or payments related to the relief efforts before they are executed (but not as the sole reviewer).

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1.03 Auditors who are subject to the independence and ethics requirements of professional associations or regulatory bodies need to comply with the independence and ethics requirements of those entities.

### **Accounting and bookkeeping services for reconstruction of lost or destroyed records:<sup>4</sup>**

1.05 Audit organizations that have audit responsibilities for entities whose records were lost or destroyed in Hurricanes Katrina and Rita are exempt from the independence requirements of *Government Auditing Standards* that prohibit or place restrictions on accounting and bookkeeping services if all of the following conditions exist.

- a. The audit organization and the audited entity conclude that under the circumstances, the audited entity has no other viable option<sup>5</sup> for addressing the emergency and the conclusion and reasons therefor are documented (the audit organization should obtain input from the audited entity, as it is the responsibility of the audited entity to evaluate its options).
- b. Services provided by the audit organization are limited to the reconstruction of previously existing accounting records that were lost or destroyed as a result of the hurricanes, and such services cease as soon as the client's lost or destroyed records are reconstructed.
- c. Audit reports covering the subject for which the audit organization provided accounting and bookkeeping services to reconstruct lost or destroyed records should include a clear disclosure of the role of the audit organization in those efforts and a statement that the audit organization met the criteria and requirements set forth in the Comptroller General's temporary exemption from the independence requirements.
- d. The safeguards in *Government Auditing Standards* paragraphs 3.17b through 3.17e and 3.17g are met by the audit organization. (Those safeguards include requirements for documentation, management acceptance of responsibility, precluding personnel who performed the nonaudit services from performing subsequent audit work related to those services, precluding a reduction in the scope of audit work as a result of the nonaudit services, and requirements to disclose the nonaudit services and related documentation in subsequent peer reviews.)

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<sup>4</sup>This temporary exemption expands the timeframes under which accounting and bookkeeping services are allowed in emergency situations beyond those that are set forth in Question 54, *Government Auditing Standards: Answers to Independence Standards Questions* (GAO-02-870G, July 2002).

<sup>5</sup>In making this conclusion, the concept of reasonableness should be applied. For example, although other options may be available, they may not represent viable options if they would cause undue or unjustifiable hardship for the audited entity based on facts and circumstances. Professional judgment will be required in reaching this conclusion.

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1.06 Auditors who are subject to the independence and ethics requirements of professional associations or regulatory bodies need to comply with the independence and ethics requirements of those entities.

### **Temporary exemptions from peer review requirements for affected audit organizations**

2.01 GAO recognizes that some audit organizations will not be able to meet the peer review requirements in paragraph 3.52 of *Government Auditing Standards* due to the extenuating circumstances of Hurricanes Katrina and Rita. Affected audit organizations or CPA firms in the Presidentially Declared Disaster Areas that are unable to meet the *Government Auditing Standards* peer review requirement because a substantial portion of their audit documentation and records has been lost or destroyed and/or there has been a significant disruption of operations are exempt from the peer review requirements of paragraph 3.52 until 2007. The determination that the audit organization is unable to meet the peer review requirements and the reasons therefor should be documented and approved by the head of the audit organization and communicated to the administering peer review organizations as soon as possible in order to minimize the risk of misunderstandings or disagreements at a later date. The documentation should also be provided to the peer reviewers in the next peer review. The next required peer review for those organizations meeting the criteria for the temporary exemption is as of the date in 2007 that coincides with the “as of” date for the previous peer review cycle. This temporary exemption results in a 2-year deferral of peer review requirements for affected entities that had a peer review cycle ending in 2005 and a 1-year deferral for audit organizations that had a peer review cycle ending in 2006.

2.02 Audit organizations that are subject to peer review requirements of other regulatory bodies or other standards-setting bodies should contact their respective peer review oversight entities to ensure that they are in compliance with the peer review requirements of those other entities. If the audit organization proceeds with its peer reviews during 2005–2006, the audit organization’s work performed under GAGAS should also be included in those peer reviews, notwithstanding the above temporary exemption.

### **Exemptions from the continuing professional education requirements for affected audit organizations and auditors**

3.01 GAO recognizes that some auditors and audit organizations will not be able to meet the continuing professional education (CPE) requirements in paragraph 3.45 of *Government Auditing Standards* and the related guidance issued by GAO in April of 2005<sup>6</sup> due to the extenuating circumstances caused by Hurricanes Katrina and Rita.

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<sup>6</sup>*Government Auditing Standards: Guidance on GAGAS Requirements for Continuing Professional Education*, (GAO-05-568G, April 2005).

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3.02 Paragraph 9 of GAO's April 2005 CPE guidance document allows audit organizations, at their discretion, to grant exemptions from a portion of the CPE requirements in the event of disasters and other extenuating circumstances that prevent auditors from fulfilling the CPE requirements. Audit organizations should use professional judgment in determining an appropriate portion of the CPE requirement from which auditors may be exempt, the period of time covered by the exemption, and the auditors or groups of auditors to exempt. The exemptions from CPE requirements should be documented and approved at the appropriate level within the audit organization and provided to the peer reviewers in the next peer review cycle.

3.03 This exemption does not affect CPE requirements of professional associations or other regulatory bodies. Auditors subject to CPE requirements of other entities need to comply with those requirements unless exempted by the entities.

### **Guidance for situations in which an audit is required and an audited entity's financial records, program records, or supporting documentation are lost or destroyed**

4.01 There will be situations in which an audited entity's financial records, program records, or supporting documentation needed to conduct or complete an audit have been lost or destroyed. A key requirement in *Government Auditing Standards* is that "sufficient, competent, and relevant evidence is to be obtained to provide a reasonable basis for the auditor's findings and conclusions."<sup>7</sup>

4.02 In determining how to proceed in such situations, audited entities and their auditors will need to use professional judgment to weigh the costs and benefits of completing audits with the need for public accountability for the use of funds. Consultations will also be needed with external oversight organizations to determine whether there is a legal or regulatory requirement for the audit, and if so, how to meet those requirements.

4.03 Audit organizations should take the following steps in situations in which an audited entity's financial records, program records, or supporting documentation are lost or destroyed and an audit is required or has been requested.

- a. In conjunction with the audited entity, (1) assess the extent of the audited entity's destroyed records or supporting documentation and its importance to the audit and (2) consider the feasibility, timing, cost, and extent of work needed to replace or reconstruct the lost or destroyed records or supporting documentation such that an audit can be conducted.

For financial statement audits, there may be instances in which the cost of recreating financial records and support to produce auditable financial

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<sup>7</sup>*Government Auditing Standards*, paragraphs 4.03c, 6.04b, and 7.48

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statements may be greater than the benefits or usefulness of such actions. For example, depending on individual facts and circumstance, financial statements as of a date prior to Hurricanes Katrina and Rita may have limited relevance and could be misleading, given the devastating impact of the disasters.

- b. If there are legal, regulatory, or funding-related requirements for the audit, recommend that the audited entity communicate with the relevant government oversight agency or organization and/or the entity providing funding or financing regarding whether and to what extent options are available for another form of reporting, a different scope of audit, or a temporary waiver from the audit requirement.
- c. In the absence of a legal or regulatory requirement for the audit, work with the audited entity to communicate with the appropriate external oversight bodies that have requested or required the audit about other reporting options.
- d. Agreements between the audited entity and external oversight bodies should be documented and approved at appropriate levels, including (1) audit organization management and (2) the head of the audited entity. Where applicable, those agreements should also be approved by the audited entity's audit committee, board of directors, or other equivalent governance committee.
- e. For financial statement audits, consider the impact of the lost or destroyed financial records on the ability to issue an audit opinion and on additional information and disclosures that need to be made in the auditor's report. In all cases, audit organizations also need to follow all applicable standards and guidance<sup>8</sup> in order to render an audit opinion.

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<sup>8</sup>Applicable standards include *Government Auditing Standards*, which incorporate the American Institute of Public Accountants (AICPA) fieldwork and reporting standards. (See *Government Auditing Standards*, paragraphs 2.06, 4.01-4.03, 5.01-5.03.) Applicable guidance includes the AICPA's recently issued Technical Practice Aids, TIS 8345.01 – *Audit Considerations When Client Evidence and Corroborating Evidence in Support of the Financial Statements Has Been Destroyed by Fire, Flood, or Natural Disaster*, and TIS 8345.02 – *Considerations When Audit Documentation Has Been Destroyed by Fire, Flood, or Natural Disaster*. For audits performed under the Single Audit Act requirements, relevant guidance includes OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and the *Compliance Supplement Updates*.

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- f. For financial statement audits, the following also applies.
  1. If a disclaimer of opinion or a qualified opinion is issued, describe the reasons for the disclaimer or qualified opinion in the report.<sup>9</sup>
  2. If the audit organization concludes that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time, it should include in the audit report an explanatory paragraph to reflect that conclusion.<sup>10</sup>
  3. If Hurricanes Katrina and Rita occurred after the date of the audited entity's financial statements but before the issuance of the audit report, both the financial statement disclosures and the audit report should include information about the impact of the hurricanes so that the financial statements are not misleading.<sup>11</sup>
  4. Audit organizations should also consider using explanatory paragraphs in the auditor's report to emphasize matters related to the financial statements in order to highlight information that would be useful to the reader's understanding of the government entity's situation.<sup>12</sup>

### **Guidance for situations in which audit documentation is lost or destroyed before issuance of a report**

5.01 Audit organizations may encounter situations in which the audit work and audit documentation were completed but the audit documentation was lost or destroyed before issuance of the audit report, or in which the audit work was partially completed and the audit documentation was lost or destroyed.

5.02 *Government Auditing Standards* require that "sufficient, competent, and relevant evidence is to be obtained to provide a reasonable basis for the auditors' findings and conclusions."<sup>13</sup> *Government Auditing Standards* also require that "audit

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<sup>9</sup>*AICPA Professional Standards* state "The auditor can determine that he or she is able to express an unqualified opinion only if the audit has been conducted in accordance with generally accepted auditing standards and if he or she has therefore been able to apply all the procedures he considers necessary in the circumstances. Restrictions on the scope of the audit, whether imposed by the client or by circumstances, such as the timing of his or her work, the inability to obtain sufficient competent evidential matter, or an inadequacy of the accounting records, may require the auditor to qualify his or her opinion or to disclaim an opinion. In such circumstances, the reasons for the auditor's qualification of opinion or disclaimer of opinion should be described in the report." (AU 508.22)

<sup>10</sup>*AICPA Professional Standards*, AU 341.12.

<sup>11</sup>*AICPA Professional Standards*, AU 560.05-09. For additional guidance, see recently issued AICPA Technical Practice Aid TIS 9070.05, *Consideration of Impact of Losses from Natural Disasters Occurring after Completion of Field Work and Signing of the Auditor's Report but before Issuance of the Auditor's Report and Related Financial Statements*.

<sup>12</sup>*AICPA Professional Standards*, AU 508.11-19.

<sup>13</sup>*Government Auditing Standards*, paragraph 7.48



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documentation should contain support for findings, conclusions, and recommendations before auditors issue their report.”<sup>14</sup>

5.03 In determining how to proceed in such situations, audited entities and their auditors will need to use professional judgment to weigh the costs and benefits of recreating audit documentation or reperforming audit work with the need for public accountability. Consultations will also be needed with external oversight organizations to determine whether there is a legal or regulatory requirement for the audit, and if so, how to meet those requirements.

5.04 Audit organizations should take the following steps in situations in which audit documentation has been lost or destroyed before an audit has been completed>

- a. Assess the extent of lost or destroyed audit documentation and the importance of that documentation for supporting the conclusions of the audit; and consider the feasibility, timing, cost, and extent of work needed to recreate the audit documentation or reperform the audit work; and communicate the results of the assessment to the audited entity.

Auditors should exercise professional judgment in considering whether to recreate the audit documentation that supported the report’s findings, conclusions and recommendations or to reperform the audit work.

- b. If there is a legal or regulatory requirement for the audit, recommend that the audited entity communicate with the relevant government oversight organization regarding whether and to what extent options are available for another form of reporting, a different scope of audit, or a waiver from the requirement.
- c. In the absence of a legal or regulatory requirement for the audit, work with the audited entity to communicate with the appropriate external oversight bodies that have requested or required the audit about other possible reporting options.
- d. Agreements between the audited entity and external oversight bodies should be documented and approved at appropriate levels, including (1) audit organization management and (2) the head of the audited entity. Where applicable, these agreements should also be approved by the audited entity’s audit committee, board of directors, or other equivalent governance committee.
- e. For performance audits, audit organizations should evaluate the extent of the audit documentation that was lost or destroyed and the impact on the audit, and consider whether a modification to the report, following the guidance of paragraph 8.12 of *Government Auditing Standards*, would provide an

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<sup>14</sup>Government Auditing Standards, paragraphs 4.22, 6.22, 7.66

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appropriate reporting mechanism under the circumstances. Paragraph 8.12 of the standards provides specific guidance for describing in the audit report situations in which there were limitations on the scope of work performed, any applicable standards that were not followed, and the reasons, and how not following the applicable standards affected or could affect the results of the work.<sup>15</sup>

- f. When performing a financial statement audit, consider the impact of the lost or destroyed audit documentation on the audit organization's ability to issue an opinion and on additional information and disclosures that need to be made in the auditor's report. Audit organizations will also need to follow all applicable standards and guidance.<sup>16</sup>

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<sup>15</sup>*Government Auditing Standards*, paragraph 8.12.

<sup>16</sup>Applicable standards include *Government Auditing Standards*, which incorporate the American Institute of Public Accountants (AICPA) fieldwork and reporting standards. (See *Government Auditing Standards*, paragraphs 2.06, 4.01-4.03, 5.01-5.03.) Applicable guidance includes the AICPA's recently issued Technical Practice Aids, TIS 8345.01 – *Audit Considerations When Client Evidence and Corroborating Evidence in Support of the Financial Statements Has Been Destroyed by Fire, Flood, or Natural Disaster*, and TIS 8345.02 – *Considerations When Audit Documentation Has Been Destroyed by Fire, Flood, or Natural Disaster*. For audits performed under the Single Audit Act, relevant guidance includes OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and the *Compliance Supplement Updates*.