

(S. B. 1536)  
(Reconsidered)

**(No. 273)**

(Approved September 10, 2003)

## **AN ACT**

To establish the Contractual Standards for Independent External Audits of Government Entities Act and to establish the procedures for contracting external auditors.

### **STATEMENT OF MOTIVES**

For years the person of the external auditor has been established as one of the essential elements for achieving sound administration practices in the public as well as in the private sector. His or her intervention in the evaluation of controls, the detection of irregular situations and the preparation of financial reports, as well as recommendations for the improvement of the processes have made his or her presence increasingly recognizable. In the public sector, the function of the external auditor has also served to complement the supervisory function performed by the Office of the Controller of Puerto Rico.

On January 25, 2002, CPA David M. Walker, Comptroller General of the United States of America, approved significant amendments to the norms on independence of the Government Audit Standards, known as the Yellow Book, which would take effect October 1, 2002. These norms are applicable to all external auditors that audit public or private entities that receive Federal funds. These norms are also applicable to government entities that even though they do not receive Federal funds, require them as part of the scope of the audit of government-wide financial statements.

The amendments on the standards for independence approved by the Office of the Comptroller General of the United States (GAO, English acronym), are guided by the need to better serve the interests of the citizens and maintain a high degree of integrity, objectivity and independence in the audits made to government or private entities that receive federal funds. These standards encompass two general principles: external auditors shall not be able to perform functions or make decisions pertaining to the management of the entity and may not audit their own work or provide advisory services or non audit services in situation in which the amount or the services contracted are materially significant in relation to the audit.

The most significant changes are related to advisory services or non audit services performed by external auditors. External auditors are capable and able to perform various services for their clients. However, under certain circumstances, they are not allowed to perform for clients for whom they render auditing services, management consulting functions, accounting or bookkeeping functions, appraisal and evaluation services, and actuarial services, activities deemed to pertain to the management or administrators of the entity, recruiting and human resources services, and stockbroker services. Aside from the requirements mentioned on independence, the dynamics and magnitude of present public administration practices, as well as the interest of the Government to raise the level of transparency of administrative matters, these standards have made the person of the external auditor a prominent participant in the monitoring of financial and operational activities in the public sector, thus complementing the function of the Office of the Comptroller of Puerto Rico.

External auditors may perform specific services provided they are not materially significant to audits. Some of these services include those related

to bookkeeping, payroll processing, valuation of assets, information technology, human resources and the drafting of tax returns and proposals. Said professionals may participate in advisory committees, render routine advisory services, cooperate in establishing internal control systems, answer technical questions, offer training courses, tools and methodology for the processes for measuring results and conduct studies, among other things.

Pursuant to the public policy set forth and to the importance of the functions of the external auditor in relation to government entities, the Senate of the Commonwealth of Puerto Rico deems it necessary to establish standards to make the services these professionals provide more effective for the purposes of public administration.

**BE IT ENACTED BY THE LEGISLATURE OF PUERTO RICO:**

Section 1.- This Act shall be known as the " Contractual Standards for Independent External Audits of Government Entities Act ".

For the purposes of this Act, the phrase "any government entity" includes all bodies of the Executive, Legislative and Judicial Branches empowered to contract, including but not limited to departments, dependencies, municipalities, public corporations and their subsidiaries, affiliates or any government entities that have their own legal standing.

Section 2.- Every contract for advisory services, non audit services or audit services conducted by external auditors executed by any government or private entity that receives public funds in excess of two hundred thousand (200,000) dollars a year shall include provisions establishing that:

- a. The auditor shall not perform managerial or decision-making functions pertaining to the management of the entity;

- b. The auditors contracted as consultants or to perform non-audit services shall not provide audit services, management consulting functions, payroll processing, accounting or bookkeeping, valuation services and appraisals, actuarial services, activities deemed proper to the management or administrators of the entity, recruiting and human resources services, stockbroker services, and others of a similar nature;
- c. The employees of the auditing firm or the external auditor who shall render the consulting service, shall not participate in the planning of the audit, perform the audit or the review of related work;
- d. The contract shall not limit the scope and extent of the audit to a level inferior to that which would have been performed if another firm or external auditor would have rendered the consulting services;
- e. The peer review system of the external auditors office for matters related to its independence, shall include standards and procedures to consider the effects of the consulting services or non-audit services in present and future auditing services; and
- f. The external auditor shall have the obligation to report and deliver to the auditor who performs the peer review audit of his or her office this contract for advisory services or non audit services or any other, and all the files corresponding to the audits made of the entity, if any.

Section 3.- The contracts shall clearly establish the objectives, scope and final product of the advisory services or of the non audit services and the

responsibility of each of the parties in specific aspects. Among other things, management shall be responsible for:

1. Designating the management level in charge of supervising the advisory services or non audit services contracted;
2. supervising the performance of the services to ensure compliance with management's expectations;
3. making the decisions regarding the services contracted and accepting responsibility for said determinations;
4. assessing the adequacy of the services performed and the results obtained.

Section 4.- The external auditors shall appear before the chief officer of the entity, its board of directors or its audit committee, if any, within sixty (60) days after submitting the final audit report to explain their findings and recommendations in detail.

Section 5.- It shall be the obligation of the chief officer of the audited entity to remit a copy to the Office of the Comptroller within thirty (30) days of having received the management letters submitted by the external auditors during the audit and a copy of the final audit reports. He or she shall also remit the audited financial statements, compliance reports, if applicable, and those of internal control on compliance and the opinion on compliance, which shall be accompanied by a remittance slip duly completed and signed by the chief officer of the audited entity.

Section 6.- The external auditors shall keep, for a six (6) year period or an audit by the Comptroller, whichever occurs first, the work sheets and other attesting documents that will enable the auditors of the Office of the

Comptroller to examine them as part of the audits performed by them of the government or private entities that receive government funds.

Section 7.- In all cases in which a government entity is required by law, regulations, financing agreement or when deemed necessary, to contract external auditors to perform financial audits, the contract shall be executed ninety (90) days before the close of the fiscal year to be audited.

Section 8.- The Office of the Comptroller shall issue Circular Letters to establish the guidelines it deems proper in order for the government entities to comply with this Act. This includes, without it being a limitation, the issue of model forms that shall be adopted for the procedure related to the notices to be made to the Office of the Comptroller, and require the corresponding certifications. It shall also include requiring the information through the use of diskettes or other electronic means that are considered appropriate according to the technological advances.

Section 9.- This Act shall take effect thirty (30) days after its approval.

## CERTIFICATION

I hereby certify to the Secretary of State that the following Act No. 273 (S.B. 1536) (Reconsidered) of the 6<sup>th</sup> Session of the 14<sup>th</sup> Legislature of Puerto Rico:

**AN ACT** to establish the Contractual Standards for Independent External Audits of Government Entities Act and to establish the procedures for contracting external auditors,

has been translated from Spanish to English and that the English version is correct.

In San Juan, Puerto Rico, today 29<sup>th</sup> of December of 2003.

Elba Rosa Rodríguez-Fuentes  
Director

