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## **GAO Hot Topics: What You Need to Know About Yellow Book, and More**

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### **NSAA/NASC Middle Management Conference**

**Nashville, TN  
April 20, 2009**

**Marcia B. Buchanan, Assistant Director**

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### **Session Objectives**

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- Highlight recent ASB activity, including recently issued auditing and quality control standards
  - Highlight major revisions in the July 2007 Revision of the Yellow Book
  - Discuss guidance issued by GAO to assist auditors implement the July 2007 Yellow Book
  - Discuss other guidance issued by GAO to assist auditors
  - Discuss GAO's current work in the standards area
  - Touch on GAO's work on single audit
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## **AICPA Auditing Standards Board Update**

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### **SSAE 15 and SAS 115: Revisions to AT 501 and SAS 112**

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- Why revised?
    - To conform definitions of control deficiencies, material weakness and significant deficiency to PCAOB AS 5.
    - To provide for more professional judgment
    - Not intended to reduce quality of communication
  - Main Changes with SAS 115
    - No real change to material weakness definition
    - Significant deficiencies
      - Matters that merit the attention of governance
      - No longer a mathematical process
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## **SSAE 15 and SAS 115: Revisions to SAS 112**

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- Deficiencies
    - Consider entity control deficiencies with respect to design and operating effectiveness of preparing financial statements being audited
      - Not a matter of whether they have the skills or can they prepare
      - Question is what are the controls and are they effective
  - Documentation is still required
    - Both magnitude and likelihood should be considered
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5

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## **Communication Under SAS No. 115**

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- Needs to be in writing
  - Prior year comments can be communicated by reference to prior year letter
  - Best made by report release date but needs to be made by 60 days from release date
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## SSAE 15: Revisions of AT 501

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- Like AS 5, AT 501 examination is an **integrated** engagement with the audit of the financial statements
  - Only able to use AT 501 when financial statements are also audited
  - Examining and reporting on only design effectiveness on internal control moved to AT 101, where audited financial statements are not required
    - AT Interpretation No. 7, “Reporting on the Design of Internal Control”
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7

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## Proposed SAS, *Compliance Audits*

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- Supersedes AU 801 (SAS No. 74)
  - Comment period ends April 30, 2009
  - Responsive to PCIE report on Single Audit Quality
  - Proposed effective date – June 15, 2010
  - A Compliance examination performed when an audit is not required would continue to be performed under AT 601
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## Proposed SAS, *Compliance Audits*

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- Clarifies applicability
  - Updates standard for changes in the compliance audit environment
  - Establishes a requirement for the auditor to adapt and apply GAAS, including the risk assessment and fraud standards
  - Identifies the AU sections applicable to a compliance audit
  - Provided guidance on factors the auditor may consider in evaluating whether an entity has materially complied and the elements to include in an auditor's report on compliance
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9

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## Clarity

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- Convergence with ISAs removing unnecessary differences
  - Format includes objectives, definitions, requirements and application material
  - Special considerations sections
    - For governmental entities
    - For smaller, less complex entities
  - Project will take 2-3 years to complete
    - Will go through exposure and then finalized
    - Expect all “clarified standards” to be effective at the same time
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10

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## Statement Quality Control Standard No.7

- Effective January 1, 2009, supersedes all previous SQCSs
- Requires documented QC policies and procedures and communication to firm personnel
- Similar to GAGAS except in area of monitoring

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## ***Government Auditing Standards July 2007 Revision***

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## July 2007 Revision

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- July 2007 revision supersedes the 2003 revision
  - A listing of technical changes from the January 2007 revision is posted to the yellow book web page
- Effective date -- For financial audits and attestation engagements, the standards are effective for audits of periods beginning on or after January 1, 2008
- Still contains 8 chapters

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## Overview of July 2007 Revision Chapters 1-3

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- Standardized language to define auditor requirements
- Citing compliance with GAGAS
- Using GAGAS with other professional standards
- New chapter 2 – Ethical Principles in Government Auditing
- Clarified and streamlined the discussion of nonaudit services
- Incorporated the revised CPE requirements issued in 2005
- Internal specialists who are part of the audit organization and perform as a member of the audit team should comply with CPE requirements
- Added requirements for the audit organization's system of quality control

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## **Chapter 2: Ethical Principles**

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### **Five principles:**

- Public interest
- Integrity
- Objectivity
- Proper use of government information, resources, and position
- Professional behavior

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## **Chapter 3: General Standards Continuing Professional Education**

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- Incorporated the revised CPE requirements that were issued in April 2005 (GAO-05-568G) Under these requirements
  - All auditors should complete every 2 years at least 24 hours of CPE that relates to GAGAS
  - Auditors involved in planning, directing, or reporting on GAGAS assignments and all auditors who charge more than 20 percent or more of their time annually to GAGAS assignments, also should obtain at least an additional 56 hours of CPE that enhances the auditors' professional proficiency to conduct audits
  - Clarified that auditors still are required to obtain 20 hours of CPE each year
- Clarified CPE requirements to include internal specialists who are part of the audit organization and part of the team

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## **Chapter 3: General Standards**

### **Audit Quality Control and Assurance**

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- Added a requirement that the quality control policies and procedures collectively address
  - Leadership responsibilities within the audit organization
  - Independence, legal, and ethical requirements
  - Initiation, acceptance, and continuance of audit and attestation engagements
  - Human resources
  - Audit and attestation performance, documentation, and reporting
  - Monitoring of quality

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17

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## **Chapter 3: General Standards**

### **Audit Quality Control and Assurance**

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- Added requirements for
  - Audit organizations to analyze and summarize the results of monitoring procedures at least annually
    - Include identification of any systematic issues needing improvement
    - Include recommendations for corrective action

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18

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## Chapter 3: General Standards

### Audit Quality Control and Assurance

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- External audit organizations to make peer review reports publicly available
  - Does not include letter of comment
  - Can be done by posting the peer review opinion on an external website or to a publicly available file designed for public transparency of peer review results
- Internal audit organizations to provide a copy of the peer review report to those charged with governance
- Government audit organizations should also communicate the overall results and the availability of their external peer review reports to appropriate oversight bodies

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## Overview of July 2007 Revision

### Chapters 4-6

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- Updated for consistency with recent developments in financial auditing and internal control by aligning
  - Audit documentation with AICPA SAS No. 103, Audit Documentation
  - Definitions of internal control deficiencies with AICPA SAS No. 112, Communicating Internal Control Related Matters Identified in an Audit
- Requirements for reporting on the restatement of previously-issued financial statements
- Encouraged communication of significant concerns, uncertainties or other unusual or catastrophic events
- Clarified and revised the description of attestation engagements

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## **Chapter 4: Financial Audit Field Work Abuse**

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- If auditor becomes aware of indications of abuse that could be material, auditors should apply audit procedures specifically to ascertain
  1. whether material abuse has occurred, and
  2. the potential effect on the subject matter of the audit
- However, because the determination of abuse is subjective, auditors are not required to provide reasonable assurance of detecting abuse
- After performing additional work, auditors may discover that the abuse represents potential fraud or illegal acts

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21

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## **Chapter 5: Financial Audit Reporting Restatements-Increased Transparency**

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- Auditors should advise management to make appropriate disclosures when the auditors believe it is likely that previously-issued financial statements are misstated and the misstatement could be material (AU 561)
- Under GAGAS, auditors have additional responsibilities in the following areas:
  - Evaluate the timeliness and appropriateness of management's disclosure and actions to determine and correct misstatements in the previously-issued financial statements
  - Report on restated financial statements
  - Report directly to appropriate officials when the audited entity does not take the necessary steps

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22

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## **Overview of July 2007 Revision Chapters 7-8, Appendix**

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- Overall framework for high-quality performance audits
    - Reasonable assurance, significance, and audit risk
  - Revised definition of performance audits (chapter 1)
  - Internal control that is significant within the context of the audit objectives
  - Information systems controls to assess audit risk and plan the audit within the context of the audit objectives
  - Overall assessment of the sufficiency and appropriateness of evidence
  - Subsequent discovery that reported findings or conclusions were not supported by sufficient, appropriate evidence
  - Enhanced GAGAS compliance statement for performance audits
  - Appendix to provide supplemental guidance
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23

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## **Implementation of Government Auditing Standards**

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### **Professional Requirement Tools to Assist Audit Organizations and Auditors in Implementing the July 2007 Revision of Government Auditing Standards**

GAO-08-210G, December 2007

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## Professional Requirements Tools

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- Contains 4 parts
    - General requirements for audit organizations
    - Specific requirements for financial audits
    - Specific requirements for attestation engagements
    - Specific requirements for performance audits
  - Guidance to help auditors sort out the use of the terms “must” and “should”
  - Available on Yellow Book Web Page
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25

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## Professional Requirements Tools

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- For financial audits and attestation engagements, GAGAS incorporates
    - AICPA field work and reporting standards
      - The related Statements on Auditing Standards (SAS)
      - The related Statements on Standards for Attestation Engagements (SSAE)
  - Auditors need to comply with requirements in the AICPA standards in addition to the requirements listed in the tools
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26

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## Professional Requirements Tools

- May assist auditors with documenting compliance with GAGAS
- Use of the tools in isolation does not constitute adequate documentation with GAGAS requirements
- Columns to the right of the requirements may be used to support compliance with the GAGAS requirement
- Explanatory material that identifies and describes other procedures or actions does not impose additional requirements
- Significant sections of explanatory materials have been omitted
  - Auditors should read the entire text of the July 2007 Revision

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27

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## Other Guidance

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28

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## Interim Guidance on Reporting Deficiencies in Internal Control

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- Issued to assist auditors in complying with
  - SAS No. 115, *Communicating internal Control Related Matters Identified in an Audit*
  - SSAE No. 15, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*
- Revised AICPA standards have different definitions of material weaknesses and significant deficiencies than GAGAS
  - Can use revised definitions for GAGAS report if provide the revised definitions and describe the scope of testing performed on the entity's internal control over financial reporting

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29

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## Guidance on Complying with GAGAS CPE Requirements for Internal Specialists

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- July 2007 GAGAS clarified CPE requirements to include internal specialists who are part of the audit organization and part of the team
  - Members of the audit team means involved in planning, directing, performing field work, or reporting
  - Does not include specialists whose role is solely limited to providing technical advice
  - Can satisfy the 24-hour CPE requirement by taking training in areas of specialization related to the specialist's roles, responsibilities, professional and technical development, and the subject matter of the specialists' assignments

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30

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## Complying with GAGAS Reporting Requirements for Entities Subject Both PCAOB & GAGAS Requirements

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- For auditors of these entities must meet the requirements of both sets of standards
  - To do this, auditors:
    - Include in the GAGAS report any material weakness reported in the report issued to satisfy the PCOAB requirement
    - Report also any other control deficiencies that meet the definitions of “material weakness” or “significant deficiency” as defined by SAS No. 112
    - If use definitions of PCAOB, state the PCAOB definitions were used, describe the scope of the work performed, and provide appropriate definitions of applicable PCAOB terminology
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31

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## Future Work in the Standards Area

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## GAO's Auditing Standards Team Mission and Activities

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**Mission**-to support and advance the Comptroller General's goal of transforming and modernizing the accountability profession and to fulfill GAO's auditing standards setting responsibilities and act as a catalyst for reform in this area

**Work activities:**

1. Develop and maintain auditing standards that are tailored to government's unique characteristics and are generally accepted
2. Provide leadership, advocacy, and tangible input for high quality government and private sector auditing standards
3. Provide technical advice and leadership to GAO

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## Updates in Future Planned Work on Government Auditing Standards

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**Planned Projects**

- Crosswalk between GAGAS and INTOSAI standards
- Public sector perspectives for AICPA "clarified" standards
- Develop guidance to address commonly asked questions
- Revise Government Auditing Standards based on
  - Issues associated with independence
  - Revisions/issues raised by other standard setters

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## Work on Independence Issues

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## Overview of Current GAGAS Independence Standards

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- Organization and scope of GAGAS independence standards
    - Q&A addresses specific situations rather than a comprehensive approach, resulting in de facto rules
    - Q&A is dated and does not fully conform with the 2007 GAGAS
    - 2007 GAGAS recognizes ethical principles but does not provide a uniform approach for dealing with ethical issues
    - Other standard-setting bodies have made significant developments in the area of auditor independence since 2002
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36

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## Independence Definitions/Independence in Fact and Appearance

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### Issues:

- GAGAS does not explicitly define independence in appearance or the types of independence
  - Personal independence
  - External independence
  - Organizational independence
- Council also recommended discussing conflicts of interest

### Action items:

- Add definitions to GAGAS
    - Independence in fact and in appearance
    - Types of independence
    - Third parties
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37

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## Conceptual Framework: Principles vs. Rules

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- A conceptual framework
  - provides a common risk-based approach, including threats and safeguards, for use in analyzing independence matters
  - requires the use of professional judgment

### Action items:

- Continue working with AICPA and others on the conceptual framework
  - Reconsider GAO's Independence Q&A
  - Update independence standard as necessary
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38

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## Legislative Mandates

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### Issues:

- Government auditors are sometimes mandated to perform nonaudit services and audit services
- These nonaudit services may impair the GAGAS organizational independence to perform the mandated audits

### Action items:

- Provide guidance to assist auditors when the audit organization has a mandate to perform both the audit and the nonaudit service

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## Single Audit Issues

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## Recent Events

- July 2007 PCIE Study on Single Audit Quality
- October 2007 Hearing – Senate Subcommittee on Federal Financial Management, Committee on Homeland Security and Governmental Affairs
- Establishment of Federal Workgroups and AICPA task forces
- AGA Partnership project – Leveraging Single Audits
- Ongoing Congressional interest and expectations
- Persistent single audit quality problems affect grants management and accountability
- March 2009 GAO report (GAO-09-307R), Single Audit Improvements

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41

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## Evolution of Single Audit Act and Its Underlying Principles

- Congress passed the Single Audit Act in response to concerns
  - that large amounts of federal financial assistance were not subject to audit and
  - that agencies sometimes overlapped on oversight activities
- Objectives of the Single Audit Act:
  - promote sound financial management and effective internal control over federal awards
  - establish uniform requirements for audits of those awards
  - promote the efficient and effective use of audit resources
  - reduce burdens on grant recipients

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42

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## PCIE Report and Recommendations

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- PCIE report presents compelling evidence that there continues to be a serious problem with single audit quality
  
  - PCIE report recommended a three-pronged approach to improving the quality of single audits:
    1. improving standards and guidance
    2. establishing continuing professional education as a prerequisite to conducting single audits
    3. enhancing the professional disciplinary processes for unacceptable audits
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43

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## GAO– Oct 2007 Testimony (GAO-08-213T)

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- Actions must be taken to improve single audit quality and the related accountability over federal awards
  
  - There may be opportunities for
    - Considering size characteristics when implementing actions to improve single audit quality
    - Strengthening the cognizant agency oversight for larger auditees
  
  - Considering the recommendations of the PCIE within this larger context is important in achieving the proper balance between risk and cost-effective accountability
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44

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## **Larger Effort To Review the Overall Framework**

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- Effort could include answering questions such as the following:
    - What types of simplified alternatives exist for meeting the accountability objectives for the smallest audits?
    - Is the current federal oversight structure adequate and consistent across federal agencies?
    - What alternative federal oversight structures could improve overall accountability and oversight in the single audit process?
    - What role can the auditing profession play in increasing single audit quality?
    - Do the specific requirements in Circular A-133, the compliance supplement, and/or the Single Audit Act need updating or streamlining?
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45

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## **Opportunities Exist to Improve Single Audit Process and Oversight**

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- Issued March 13, 2009, released to public on April 10, 2009 (GAO-09-307R)
  - In order to monitor risk, cost-benefit, and efficiency and effectiveness of the single audit process, we recommend OMB take the following actions:
    - Designate an entity to (1) evaluate and comprehensively monitor the single audit process government-wide, (2) assess the efficiency and effectiveness of how agencies carry out their single audit responsibilities, and (3) identify additional guidance and resources need to carry out single audit requirements;
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46

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## Opportunities Exist to Improve Single Audit Process and Oversight (Con't.)

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- Designate a federal workgroup to evaluate the current single audit process to identify simplified alternatives for meeting the accountability objectives of the Single Audit Act for the audits of small entities, while achieving the proper balance between risk and cost-effective accountability for the smallest to the largest entities; and
  - Monitor the status of OMB workgroups, AICPA task forces, and NASBA referral project activities, and evaluate completed actions and their impact on addressing the PCIE report recommendations to improve single audit quality
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47

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## GAO's Accountability & Standards Team

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### Yellow Book Team:

- Jeanette Franzel (202) 512-9471
- Marcia Buchanan (202) 512-9321
- Gail Vallieres (202) 512-9370
- Michael Hrapsky (202) 512-9535
- Heather Keister (202) 512-2943
- Eric Holbrook (202) 512-5232

### We also get lots of help from:

- Bob Dacey, GAO Chief Accountant
- Abe Akresh, GAO Senior Expert, Auditing Standards
- Jennifer Allison, Advisory Council Administrator

Contact us at [yellowbook@gao.gov](mailto:yellowbook@gao.gov)

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48

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## GAO Hot Topics

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Questions or Comments?

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## Where to Find the Yellow Book

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

[www.gao.gov/govaud/ybk01.htm](http://www.gao.gov/govaud/ybk01.htm)

- For technical assistance, contact us at  
[yellowbook@gao.gov](mailto:yellowbook@gao.gov)
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