



UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

Yellow Book Update: 2010 Exposure Draft

NASACT Webinar

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July 21, 2010



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Session Objectives

- Review why *Government Auditing Standards* (the Yellow Book) is being revised
- Highlight areas that GAO expects to be revised in the next Yellow Book
- Discuss the anticipated timeline for the Yellow Book revision

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Disclaimer Required to Receive a Preview

The revisions discussed are preliminary and subject to change based on feedback from the Comptroller General's Advisory Council on Government Auditing Standards and comments received on the Exposure Draft

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Why the Yellow Book is being revised

- Promote the modernization of auditing standards
- Streamline with standard setters
- Address issues GAO has observed

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2011 Yellow Book Projected Dates

July-August 2010:

- Issue Exposure Draft of 2011 Revision of GAGAS

October-November 2010:

- Comments due on Exposure Draft

February – March 2011:

- Issue 2011 Revision of GAGAS
- Effective date to be determined

Changes to the Overall Format

Chapters 1 and 2 have been realigned.

- Along with the introduction, Chapter 1 now includes the foundation and ethical principles of government auditing.
- The overall discussion on the use and application of GAGAS is now in Chapter 2.

Changes to the Overall Format

All financial audit standards are now in Chapter 4.

- The chapters on financial audit performance and reporting, formerly Chapters 4 and 5 respectively, have been combined into one chapter.

Changes to the Overall Format

Use of footnotes is more consistent.

- Footnotes are now used strictly to refer to other sections of GAGAS and to other audit standards
- Other information that was in footnotes in previous GAGAS editions has either been moved into the GAGAS text itself or eliminated.

Chapter 1

Government Auditing: Foundation and Ethical Principles

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Chapter 1 – Government Auditing: Foundation and Ethical Principles

Clarified or added definitions of

- Auditor
- Audit organization
- Audit team
- Audit period

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Chapter 1 – Government Auditing: Foundation and Ethical Principles

The audit function's structural location relative to the audited entity.

- External audit organizations report to third parties externally.
- Internal audit organizations are accountable to top management and usually don't report externally.
- Government auditors who report to both third parties and top management are considered external auditors.

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Chapter 1 – Government Auditing: Foundation and Ethical Principles

Contains concepts and ethical principles that serve as the foundation for the requirements and guidance for GAGAS.

- Purpose and applicability of GAGAS (no major changes)
- Ethical principles (no major changes)

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Chapter 2

Standards for the Use and Application of GAGAS

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Chapter 2 – Standards for the Use and Application of GAGAS

Highlights:

- The consistency of GAGAS terminology with that used in the AICPA's Statements on Auditing Standards.
- The role of professional judgment in determining the appropriate type of GAGAS compliance statement.
- The longstanding GAGAS financial audit objective to report on deficiencies in internal control; compliance with laws and regulations; and provisions of contracts and grant agreements.

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Chapter 2 – Standards for the Use and Application of GAGAS

Overall discussion of audit documentation

- Not necessary to document every matter considered or professional judgment made
- Not necessary to document separately compliance that is demonstrated within audit documentation

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Chapter 2 – Standards for the Use and Application of GAGAS

Clarified citing compliance with GAGAS

- Determination of appropriate GAGAS compliance statement is a matter of professional judgment
- Departures from presumptively mandatory requirements
- Using GAGAS with other standards

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Chapter 3 General Standards

Independence
Professional Judgment
Competence
Quality Control and Assurance

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Chapter 3 – General Standards: Independence

GAGAS is adopting a conceptual framework approach to independence determinations.

- Provides a means for auditors to assess auditor independence in light of the unique circumstances that often apply to these determinations.
- Approach replaces consideration of independence in terms of the three categories of independence – personal, external, and organizational – included in previous editions of GAGAS.
- The framework includes definitions of both independence of mind and independence in appearance.

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Chapter 3 – General Standards: Independence

The conceptual framework for independence requires that auditors:

1. Identify threats to independence;
2. Evaluate the significance of the threats identified; and
3. Apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level.

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Chapter 3 – General Standards: Independence

GAGAS framework will:

- Provide consistent results when compared with AICPA and IFAC.
- Address unique governmental structural issues.

GAO will retire current *Questions and Answers to Independence Standard Questions* guidance

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Chapter 3 – General Standards: Independence

Threats to independence are circumstances that **could** impair independence.

- Usually, a threat to independence does **not** result in an independence impairment!

Safeguards are controls that eliminate or reduce to an acceptable level a threat's potential to impair independence.

Chapter 3 – General Standards: Independence

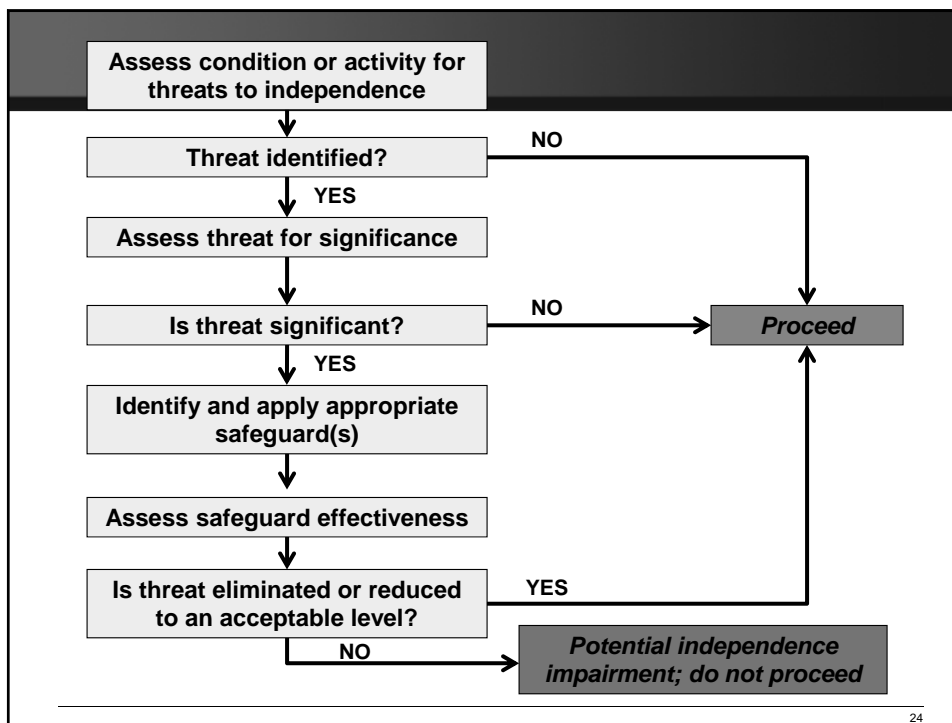
Seven categories of threats:

- Self-interest threat
- Self-review threat
- Bias threat
- Familiarity threat
- Undue influence threat
- Management participation threat
- Structural threat

Safeguards

- Safeguards created by the profession, legislation, or regulation
 - Professional or regulatory monitoring and disciplinary procedures
 - External review by a third party of the reports, communications or other information produced by the auditor
- Safeguards in the work environment
 - Using different management and engagement teams with separate reporting lines for the provision of nonaudit services to and audited entity
 - Having additional review of the nonaudit service or the audit by staff who was not involved in providing the service/working on the engagement
 - The audited entity provides appropriate oversight and communication regarding the nonaudit service and the audit engagement

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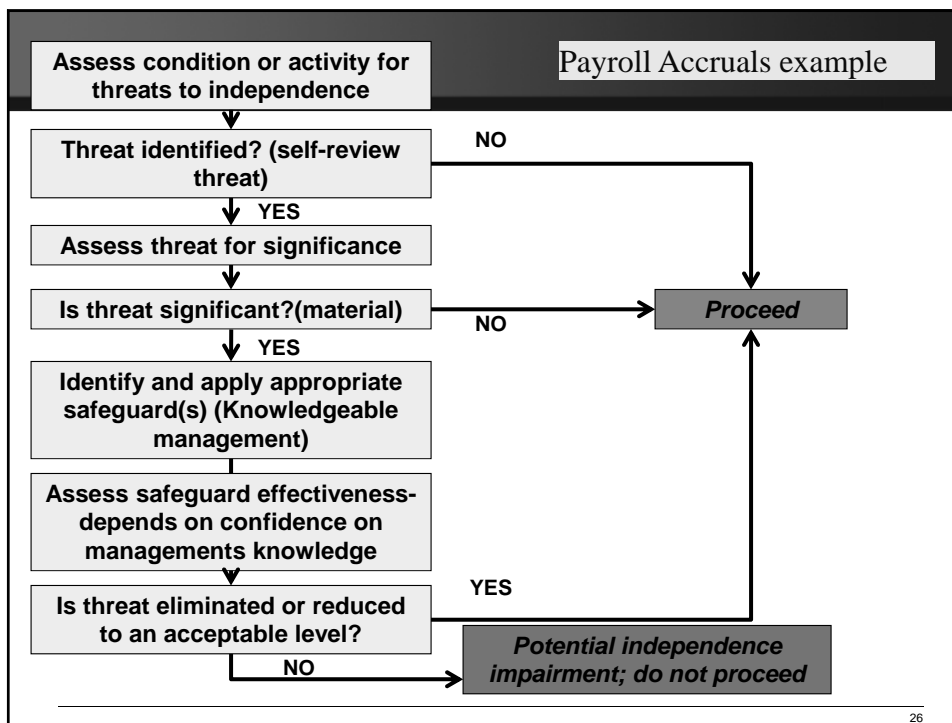


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Independence Framework Example Payroll Accruals

- Client requests auditor to assist with payroll accruals for financial statements prepared using GASB accounting standards
 - Threat—self-review threat
 - Safeguard-Knowledgeable staff at client that is able to review and check reasonableness of numbers based on analytical calculation
 - Safeguard-Staff assigned are not connected to the audit team

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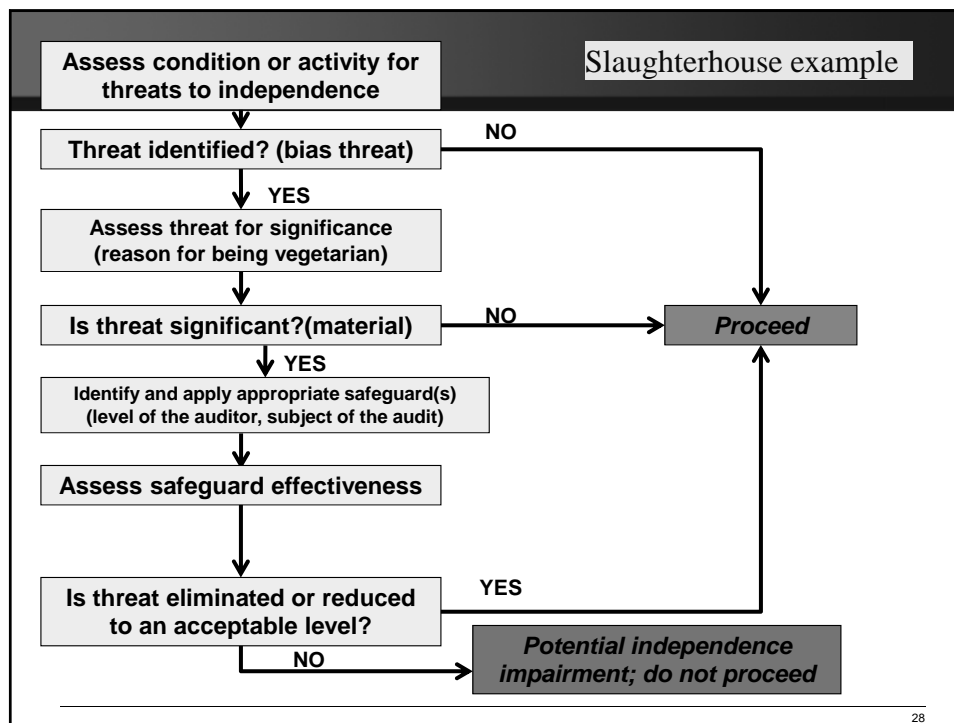


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Independence Framework Example Slaughterhouse

- Auditor, who is a vegetarian, is asked to work on an audit of a slaughterhouse
 - Threat – bias threat
- Significance of the threat
 - Why is the auditor a vegetarian? (Health or personal views)
- Safeguards
 - Role and responsibilities of the auditor on the engagement
 - Activity being audited (Payroll or slaughter operations)

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Activities so Significant that No Safeguard Could Reduce Threat to an Acceptable Level

- Certain activities in preparing accounting records and financial statements
 - Audit entity managers charged with overseeing the nonaudit service must possess suitable skill, knowledge, or experience to evaluate the adequacy and results of the services performed
 - Otherwise no safeguard could reduce the threat to an acceptable level

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Activities so Significant that No Safeguard Could Reduce Threat to an Acceptable Level

- Certain internal audit services provided by external auditors
 - Setting internal audit policies or the strategic direction of internal audit activities
 - Deciding which recommendations resulting from internal audit activities to implement
 - Taking responsibility for designing, implementing and maintaining internal control

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Activities so Significant that No Safeguard Could Reduce Threat to an Acceptable Level

- **Internal control assessments**
 - Assisting management in documenting or performing the internal control assessment
- **Certain recruiting services**
 - Recommending a single individual for a specific position that is key to the audited entity or program,
 - Ranking or influencing management's selection of the candidate, or
 - Conducting an executive search or a recruiting program for the audited entity

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Activities so Significant that No Safeguard Could Reduce Threat to an Acceptable Level

- **Certain IT services**
 - Design or development of a financial or other IT system that would be subject to or part of an audit
 - Services that entail making other than insignificant modifications to the source code underlying such a system
 - Operating or supervising the operation of such a system
- **IT Services – “no audit period”**
 - The “no audit period” extends for one year or one audit cycle past the project completion date for IT services such as system implementations

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Activities so Significant that No Safeguard Could Reduce Threat to an Acceptable Level

- Certain valuation services
 - If the valuation services would have a material effect, separately, or in the aggregate, on the financial statements or other information that is the subject of an audit, and the valuation involves a significant degree of subjectivity

Chapter 3 – General Standards: Professional Judgment

Emphasized that auditors use professional judgment in applying the conceptual framework for independence.

Chapter 3 – General Standards: Competence

Continuing professional education: The distinction between internal and external specialists was highlighted.

- External specialists should be qualified and maintain professional competence, but are not required to meet GAGAS CPE requirements.
- Internal specialists performing GAGAS work should comply with CPE requirements. Training in areas of specialization counts towards the required 24 hours of CPE that relate to government auditing.

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Chapter 3 – General Standards: Continuing Professional Education (CPE)

- 2007 Revision of GAGAS incorporated the revised CPE requirements that were issued in April 2005 (GAO-05-568G)
- No revision to overall requirements
 - 24 hours of CPE every 2 years directly related to GAGAS engagements
 - Additional 56 hours of CPE, involved in planning, directing, or reporting on GAGAS assignments or charge 20 percent or more of time annually to GAGAS assignments
 - 20 hours of CPE each year

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Chapter 3 – General Standards: Quality Control and Assurance

Proposed changes:

- Expand discussion for elements of the GAGAS system of quality control for more consistency with AICPA Quality Control Standards.

Chapter 3 – General Standards: Quality Control and Assurance

Additional requirements to

- Communicate deficiencies noted during the monitoring process.
- Make recommendations for appropriate remedial action.

Chapter 4 Financial Audits

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Chapter 4 - Financial Audits Change in Terminology

When referring to financial audits, terminology has been updated for consistency with other standards.

- The term “field work” has been replaced with “performance.”
- GAGAS still uses “field work” when discussing attestation engagements and performance audits.

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Chapter 4 - Financial Audits

No new requirements were added for financial audits.

Chapter 4 - Financial Audits: Reasonable Assurance

The discussion of reasonable assurance as it pertains to financial audits has been revised and concurs with revisions to the AICPA standards. The revised GAGAS language emphasizes that reasonable assurance:

- Is a high but not absolute level of assurance.
- Is obtained when the auditor has sufficient appropriate evidence to reduce audit risk to an acceptably low level.
- Is not an absolute level of assurance because audits have inherent limitations that result in most audit evidence being persuasive rather than conclusive.

Chapter 4 - Financial Audits GAGAS Requirements Beyond AICPA

Clearly identified the additional GAGAS requirements beyond the AICPA. As in previous editions, the additional requirements relate to:

- auditor communication
- previous audits and attestation engagements
- detecting material misstatements resulting from violations of provisions of contracts or grant agreements, or from abuse
- developing elements of a finding
- audit documentation

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Chapter 4 - Financial Audits Removal of Duplication with AICPA

Referenced the AICPA standards when applicable, allowing removal of duplication between GAGAS and AICPA standards in the areas of:

- Restatements
- Definitions of internal control deficiencies
- Communication of significant matters
- Consideration of fraud and illegal acts

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“New” vs. “Old” Definition of a Material Weakness

- New Definition- SAS No. 115:
A deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis
- 2007 GAGAS-SAS No. 112:
A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material misstatement of the financial statements will not be prevented or detected

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“New” vs. “Old” Definition of a Significant Deficiency

- New Definition- SAS No. 115:
A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance
- 2007 GAGAS-SAS No. 112:
A deficiency in internal control or combination of deficiencies, that adversely affects the entity’s ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP such that there is more than a remote likelihood that a misstatement of the entity’s financial statements that is more than inconsequential will not be prevented or detected

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Chapter 4 - Financial Audits AICPA Standards: Special Considerations for Government Audits

Highlighted considerations for applying certain AICPA standards in a GAGAS financial audit

- Materiality
 - Auditors may find it appropriate to use a lower materiality level in a governmental environment
- Ongoing investigations or legal proceedings
 - Avoid interfering since important to pursuing fraud, illegal acts, etc.
 - May evaluate the impact on the current audit
 - May work with investigators and/or legal authorities, or withdraw or defer further work

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Chapter 4 - Financial Audits Early Communication of Deficiencies

Highlighted considerations for applying certain AICPA requirements regarding early communication of control deficiencies in a GAGAS financial audit

- For some matters, early communication is important because of significance and the urgency of corrective action
- May communicate orally to management, and when appropriate those charged with governance, so timely remedial action can be taken to minimize risk of material misstatement

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Chapter 4 - Financial Audits: Deleted Requirements

Deleted GAGAS requirements that were adequately covered by AICPA or elsewhere in GAGAS:

- Document terminated engagements
- Develop policies to address requests by outside parties to obtain access to audit documentation

Chapter 5 Attestation Engagements

Chapter 5 - Attestation Engagements

No new requirements were added for attestation engagements

Language was modified to clearly identify the additional GAGAS requirements beyond the AICPA and to reference the AICPA standards when applicable

Chapter 5 - Attestation Engagements The Three Levels of Service

Realigned the chapter to place emphasis on the three levels of assurance provided by attestation engagements in accordance with the AICPA, and introduced separate sections for each

- Examination: High level of assurance
- Review: Moderate level of assurance
- Agreed-Upon procedures: No assurance

Chapter 5 - Attestation Engagements Requirements Beyond AICPA

For examination-level engagements, clearly identified the additional GAGAS requirements beyond the AICPA. As in previous editions, the additional requirements relate to

- Auditor communication
- Previous audits and attestation engagements
- Fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse that could have a material effect on the subject matter or an assertion about the subject matter
- Developing elements of a finding
- Documentation

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Chapter 5 - Attestation Engagements

For each level of service provided by attestation engagements, added language on

- Additional GAGAS requirements on citing compliance with GAGAS
- The importance of the required elements of AICPA reporting under each level of attestation engagements
- Establishing an understanding with the entity regarding the services to be performed

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Chapter 5 - Attestation Engagements Removal of Duplication with AICPA

Removed duplicate definitions of internal control deficiencies between GAGAS and AICPA standards

- Significant deficiency
- Material weakness

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Chapter 5 - Attestation Engagements Clarifications on Reporting Deficiencies

For examination engagements, added language on reporting deficiencies in internal control

- Auditors should include in the examination report all deficiencies, even those communicated early, that are considered significant deficiencies or material weaknesses
- Deficiencies remediated before the examination report is issued should be reported, along with notification of the remediation

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Chapter 5 - Attestation Engagements AICPA Standards: Special Considerations for Government Engagements

Highlighted considerations for applying certain AICPA standards in a GAGAS attestation engagement (consistent with Financial Audits)

- Materiality
- Ongoing investigations or legal proceedings
- Early communication of deficiencies

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Chapter 5 - Attestation Engagements Deleted Requirements

Deleted GAGAS requirements that were adequately covered by AICPA or elsewhere in GAGAS

- Document terminated engagements
- Develop policies to address requests by outside parties to obtain access to audit documentation

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Chapter 6

Field Work Standards for Performance Audits

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Chapter 6 - Performance Audits: Field Work Consideration of Waste

Added the following concerning waste

- Definition: “Waste is the intentional or unintentional careless expenditure, inappropriate consumption, mismanagement, inappropriate use, or squandering of government resources. Waste also includes incurring unnecessary costs as a result of inefficient or ineffective practices, systems, or controls.”
- Requirements regarding the auditor’s responsibilities concerning waste (similar to those for abuse)

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Chapter 6 - Performance Audits: Field Work - Deletion

Deleted the requirement that the audit organization develop policies to address requests by outside parties to obtain access to audit documentation since covered by Quality Control requirements of GAGAS

Chapter 6 - Performance Audits: Field Work

Retained the documentation requirement pertaining to termination of an audit

(We are proposing deleting this requirement for financial audits and attestation engagements)

Chapter 7

Reporting Standards for Performance Audits

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Chapter 7 - Performance Audits: Reporting - Modifications

Modified the reporting requirements

- The discussion of requirements for reporting deficiencies in internal control, instances of fraud, illegal acts, violations of provisions of contracts or grant agreements, abuse, and waste has been expanded, noting that professional judgment is required in making reporting determinations.
- The fraud reporting requirement is now limited to occurrences that are significant within the context of the audit.

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Chapter 7 - Performance Audits: Reporting – Modifications

Modified the reporting requirements
(continued)

- Added a requirement that auditors obtain and report views of responsible officials concerning the findings, conclusions, and recommendations included in the auditors' report, as well as planned corrective actions, has been added, consistent with the other GAGAS reporting standards
- Added reporting requirement for waste that is consistent with that for abuse

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Questions?

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Where to Find the Yellow Book

- The Yellow Book is available on GAO's website at:
www.gao.gov/govaud/ybk01.htm
- For technical assistance, contact us at
yellowbook@gao.gov

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