
2006 Government Auditing Standards Revision

NASACT Training Directors Forum
September 12, 2006
Helena, Montana

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Session Objectives

- Explain GAO's efforts to modernize and transform the accountability profession
 - Highlight key revisions to AICPA standards
 - Highlight key proposed revisions in the 2006 Yellow Book Exposure Draft
 - Review current milestones and timing for the 2006 Yellow Book
 - Highlight areas for staff training
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GAO's Accountability and Standards Team

Our Goals:

Develop high quality Government Auditing Standards that are well understood, highly regarded, widely used, and serve as a model for other environments such as the private sector and other governments around the world.

Provide leadership in modernizing and transforming the accountability profession in the public and private sectors, both domestically and internationally.

Provide a foundation for an accountability profession that is

- effective,
 - ethical, and
 - prepared for the challenges of the 21st century.
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AICPA Standards Update

As of July 1, 2003

AICPA Standards

Effective immediately

- Defining professional standards (SAS 102)

Effective for audits of calendar 2006 or 2007 financial statements

- Audit documentation (SAS 103)
- Communicating internal control matters (SAS 112)

Effective for audits of calendar 2007 or FY 2008 financial statements

- Risk assessment suite of standards (SASs 104-111)
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AICPA standards SAS No. 102 and SSAE No. 13

Defining professional requirements

- Defines terminology to describe degree of responsibility to auditor
 - Unconditional – “Must” or “is required”
 - Presumptively mandatory—”Should”
 - Explanatory—Descriptive guidance rather than imperative
 - Applies to existing standards
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AICPA standards
SAS No. 103, Audit Documentation

- In sufficient detail for an *experienced* auditor *without* connection to the audit to understand:
 - o Work performed
 - o Results of that work
 - o Evidence obtained
 - o Conclusions reached
 - o Accounting records agree or reconcile with the financial statements or other information
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AICPA standards
SAS No. 103, Audit Documentation

*Oral explanations are **not** sufficient to support work performed or conclusions reached*

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**AICPA standards
Audit Documentation Guidance**

What should be in or out:

- Electronic media
- Abstracts and copies
- Significant findings and issues
- Superseded drafts and notes
- Prior versions

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**AICPA standards
Audit Documentation Guidance**

Identify preparer and reviewer:

- Who performed the audit work
- The date such work was completed
- Who reviewed specific documentation
- The date and extent of such review

Document specific items tested

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**AICPA standards
New Dates to Remember**

Field Work:

- No earlier than when sufficient evidence exists to support the opinion

Audit files assembled

- Within *60 days after* report release

Retention

- Minimum *5 years after* report release
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**AICPA standards, SAS Nos. 104-111,
Assessment Suite Of Standards**

- Most far-reaching changes in standards in 20 years
 - Amends or revises 8 existing standards
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AICPA standards, SAS Nos. 104-111, Standards Amended or Revised

- Amends SAS 1, Due Professional Care
 - Amends SAS 95, GAAS
 - Amends SAS 39, Audit Sampling
 - Planning and Supervision
 - Understanding the Entity and Assessing Risks
 - Audit Evidence
 - Audit Risk and Materiality
 - Performing Audit Procedures and Evaluating Evidence
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Assessment Suite Of Standards Objectives

- More in-depth understanding of entity and internal control
 - More rigorous assessment of risks of misstatement
 - Improved linkage between assessed risks and audit procedures performed
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The Three Amendments

- Due professional care—high level of assurance
- Field Work standards—conforming language
- Audit sampling—conforming guidance and appendix

Planning and Supervision

- Written understanding of auditor and auditee responsibilities
- Audit strategy
- Audit plan
- Determining involvement of others

Understanding Entity/Assessing Risks

- Gaining understanding about entity, its environment, internal controls
- Brainstorming session
- Evaluate internal control design and implementation
- Identify and assess risks to design additional procedures
- Consider risks at financial and assertion levels
- Identify significant risks (Required testing of those identified)

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New Assertions

	Class Trans.	Acct. Bal.	Pres./Discl.
Occurrence/Existence	X	X	X
Rights and Obligations		X	
Completeness	X	X	X
Accuracy/Valuation	X	X	X
Cut-off	X		
Classification/Understandability	X		X

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AICPA standards Audit Evidence

- “All the information the auditor uses”
 - Risk Assessment procedures
 - Tests of controls
 - Substantive tests
- Risk assessment procedures does not equal sole basis of evidence
- Inquiry alone does not equal tests of controls

AICPA standards Risk and Materiality

- Determine materiality for:
 - Financial statement level risks
 - Assertion level risks
 - Tolerable misstatements
- Emphasize quantitative and qualitative
- Evaluating misstatements
 - Known and likely
 - Individually and in aggregate
 - Qualitative, offsetting, and prior periods

AICPA standards Performing Procedures

- Do procedures that respond to risks
 - Overall response
 - Procedures at assertion level
- Always perform:
 - Tests for assertions for T, A, D
 - F/S tie to the accounting records
 - Material JEs and F/S adjustments

AICPA standards Tests of Controls

- Auditors cannot default to “the Max”
- Tests of controls required if:
 - Expectation of control’s effectiveness
 - Substantive procedures alone insufficient
- Rotate tests of controls every 3 years
 - If annual update confirms no changes
 - If unrelated to reliance on controls over significant risks

AICPA standards, SAS No. 112, Communication of Internal Control Matters

Changes

- New definitions
- New thresholds
- New reporting timeframes

AICPA standards Definitions

A control deficiency with more than a remote likelihood that a misstatement:

- Is greater or equal to significant deficiency
- Is material = material weakness

Effect of the New Definitions

Old Definitions	New Definitions
Material weakness (<i>GAGAS</i> paragraph 5.14 and AU 325.15)	Material weakness (SAS 112, paragraph 6)
Reportable condition (<i>GAGAS</i> paragraph 5.13 and AU 325.02)	
Management letter comment (<i>GAGAS</i> paragraph 5.16)	Significant deficiency (SAS 112, Paragraph 6)
	Other matters related to internal control (SAS 112, Paragraph 19)

AICPA standards, SAS No. 112 Reporting Considerations

- In writing to management and “those charged with governance”
- Not later than 60 days after audit report issued
- Other issues—material audit adjustments, prior year uncorrected, shock and horror to our auditees

AICPA standards, Future Issues

- Auditor's report
- Alignment with International standards
 - Process of revising standards
 - Format of revisions in future

Government Auditing Standards 2006 Revision Exposure Draft

2006 Yellow Book Exposure Draft Major areas of revisions

- Bringing performance audit standards under a professional assurance framework using concepts of audit risk, significance, and sufficient, appropriate evidence
 - Emphasizing the critical role of government audits in achieving credibility and accountability in government
 - Expanding and strengthening the discussion and guidance on audit quality
 - Outlining overarching ethical framework in government audits
 - Modernizing GAGAS and updating for major developments in the accountability and audit environment
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Chapter 1 Use and Applicability of GAGAS

- Emphasis of the key role of government auditing
 - Use of terminology to define professional requirements
 - Citing compliance with GAGAS in the Auditors' Report
 - Relationship between GAGAS and other professional standards
 - Types of government audits and attestation engagements, including revised definition of performance audits
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Chapter 1 Use of terminology to define professional requirements

- **Must** and **is required** indicate an unconditional requirement
- **Should** indicates a presumptively mandatory requirement
- **Should consider** indicates that the consideration is presumptively required; carrying out the procedure or action is a matter of auditor professional judgment based on existing facts and circumstances
- Text not using the above conventions is considered explanatory material

Chapter 1 Citing Compliance with GAGAS

- **Unqualified GAGAS compliance statement** – Engagement was performed in accordance with GAGAS
- **Qualified GAGAS compliance statement** – Engagement was performed in accordance with GAGAS, except for specific applicable standards that were not followed
- **Negative GAGAS compliance** – Engagement was not performed in accordance with GAGAS

Chapter 1 Relationship Between GAGAS and Other Standards

- AICPA field work and reporting standards are incorporated by reference for financial statement audits
 - PCAOB and IAASB standards can be used in conjunction with GAGAS for financial statement audits
 - IIA standards can be used in conjunction with GAGAS for performance audits
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Chapter 2 Auditor's Ethical Responsibilities

Overarching auditor ethical concepts to uphold and protect the public trust.

“While audit organizations have overall responsibility for creating the environment to promote conducting audit work in accordance with ethical principles, ethics are also a matter of personal responsibility. It is essential that government auditors observe overarching ethical concepts in the performance of their professional responsibilities.”

Except from paragraph 2.02

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Chapter 2

Auditor's Ethical Framework

Ethical concepts that provide the framework for auditors' work:

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

Chapter 3

General Standards

- Independence
- Quality control and assurance
- Audit quality/peer review
- Professional judgment
- Competence

Chapter 3

General Standards

Independence

Moved non-audit services from “personal impairments” to “organizational impairments”

Created three distinct categories of non-audit services, and consolidated and streamlined the examples previously interspersed throughout the independence section:

- Non-audit services that do not impair auditor independence
- Non-audit services that would not impair independence if supplemental safeguards are complied with.
- Non-audit services that impair independence

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Chapter 3

Audit Quality Control and Assurance

Discussion expanded to describe a system of quality control, which consists of policies and procedures addressing each of the following elements:

- Ethics
- Initiation and continuance of audit and attestation engagements
- Human capital management
- Engagement performance and reporting
- Monitoring of quality

Audit organizations are strongly encouraged to implement monitoring procedures that include enhanced quality assurance criteria

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Chapter 3

Audit Quality/ Peer Review

Audit organizations should make the results of external peer reviews public

New peer review timeframes, based on risk and underlying quality assurance system

Chapter 3

Audit Quality/ Peer Review

Proposed New Peer Review Timeframes

- 18 months, if the most recent peer review opinion is adverse or modified.
- Every three years if the audit organization has an unmodified peer review opinion and does not meet the enhanced quality assurance criteria for a five year cycle, or does not chose a five-year cycle
- Every five years if the audit organization has an unmodified peer review opinion and meets the enhanced quality assurance criteria

Chapter 3

Audit Quality/ Peer Review

Enhanced Quality Assurance Criteria

- Description of overall quality assurance system is made public
- The audit organization has a functioning annual internal quality inspection process that meets the stated criteria
- The audit organization provides its oversight organization with an assertion about the effectiveness of its quality assurance program annually

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Chapter 3

Competence: CPE

No change to 2005 CPE Technical Amendment

- Every 2 years auditors need
 - 80 hours of CPE that enhances their proficiency to perform audits and/or attestations
 - 24 hours of the 80 hours must relate to government auditing, the government environment, or the unique environment
- Auditors are subject only to the 24 hour requirement if
 - they are only involved in field work and not involved in planning, directing or reporting and
 - they charge less than 20% of their time annually to GAGAS engagements

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Chapters 4 and 5

Financial Audit Standards

- Definitions of internal control deficiencies
- Fraud and illegal acts
- Abuse
- Documentation
- Emphasizing significant matters in auditors' report
- Restatements

Chapters 7 & 8

Performance Audits

- Concept of significance
- Audit risk
- Level of assurance in performance audits
- Sufficient, appropriate evidence
- Auditor's responsibility for fraud
- Auditor's responsibility for abuse
- GAGAS statement in auditor's report

Chapter 7 & 8

Revised Performance Audit Definition

- Provide assurance or conclusions relating to audit objectives that provide an evaluation against objective criteria.
- The levels of evidence and tests of evidence will vary based on audit objectives and conclusions.
- Auditors use professional judgment in determining the audit scope and methodology needed to address the audit's objectives.

Chapters 7 & 8

Performance Audits

Concept of significance in a performance audit

Significance is defined as the relative importance of a matter within the context in which it is being considered, in terms of both quantitative and qualitative factors, such as relative magnitude, the nature and effect on the subject matter, and the needs and interests of intended users or recipients.

Chapters 7 & 8

Performance Audits

Concept of significance in a performance audit

Auditors consider significance when deciding the type and extent of audit work to perform, when evaluating results, and developing the report.

Auditors consider

- quantitative or qualitative factors that would affect auditor findings, conclusions, or recommendations.
- whether the matter would change or influence the judgment of a reasonable person relying on the auditor's report

Chapters 7 & 8

Performance Audits

Audit risk

Audit risk is the risk that the auditor may provide improper findings, conclusions, recommendations, or assurance because the information obtained is not sufficient or not appropriate, the audit process was inadequate, or intentional omissions or misleading information existed due to misrepresentation or fraud.

Chapters 7 & 8 Performance Audits

Audit risk

Auditors **must** plan the audit so that audit risk is reduced to a level that is sufficiently low for the auditor to provide reasonable assurance that the evidence is sufficient and appropriate to achieve the audit objectives and support the conclusions reached.

Chapters 7 & 8 Performance Audits

Level of assurance in performance audits

Performance audits provide reasonable assurance that the auditor has sufficient, appropriate evidence concerning the achievement of the audit objectives and the conclusions reached.

Chapters 7 & 8

Performance Audits

Sufficient, appropriate evidence

Appropriate evidence is defined as a measure of quality, which encompasses relevance, reliability, and validity in providing support for audit objectives.

Sufficiency is defined as a measure of quantity and is evaluated based on the collective audit evidence supporting the findings, conclusions, or recommendations related to the audit objectives.

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Chapters 7 & 8

Performance Audits

Auditors' responsibility for fraud

In planning the audit, auditors should assess risks of potential significant fraud within the scope of the audit objectives.

Auditors' should

- discuss potential fraud risks with management and the audit team
- gather and assess information necessary to identify potential fraud risks

When auditors identify risk of significant fraud, they should design procedures to provide reasonable assurance of detecting potential fraud significant to the audit objectives

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Chapters 7 & 8

Performance Audits

Auditors' responsibility for abuse

If auditor becomes aware of indications of significant abuse, auditors perform audit procedures to determine

1. whether 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.

Chapters 7 & 8

Performance Audits

GAGAS statement in auditor's report

If auditors comply with GAGAS in all respects, they should include the following language in the report:

“We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives”

Chapters 4 and 5 Financial Audit Standards

Conformed definitions to SAS No. 112:

- Significant deficiency
- Material deficiencies
- Other control deficiencies

Chapters 4 and 5 Financial Audit Standards

Internal Control Deficiencies:

GAGAS has the following reporting requirements:

- For all financial audits, auditors should report deficiencies in internal control considered to be significant deficiencies, including material weaknesses.
- Auditors should include all material weaknesses and other significant deficiencies in the auditor's report on internal control.
- Auditors should communicate deficiencies that are not significant deficiencies or material weaknesses separately in a management letter, unless clearly inconsequential.

Chapters 4 and 5 Financial Audit Standards

Fraud and Illegal Acts

No change in standard and the same as the AICPA

Violations of Contract Provisions or Grant Agreements

No change in standard

Chapters 4 and 5 Financial Audit Standards

Abuse

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 financial statements.

However, because the determination of abuse is subjective, auditors are not required to provide reasonable assurance of detecting abuse

Chapters 4 and 5 Financial Audit Standards

Reporting fraud, illegal acts, material violations of contracts or grant agreements, material abuse

When auditors conclude that any of the following has occurred or is likely to have occurred, they should include in the audit report the relevant information about:

- Potential fraud and illegal acts that are greater than inconsequential
- Material violations of contracts or grant agreements
- Material abuse

Chapters 4 and 5 Financial Audit Standards

Audit Documentation:

- Conform to SAS 103:
- Audit documentation is an essential element of audit quality.
- The auditor should prepare audit documentation that enables an experienced auditor, having no previous connection to the audit to understand:
 - nature, timing and extent of procedures performed
 - the results of procedures performed and evidence obtained
 - how the audit evidence relates to the audit conclusions
 - the conclusions reached on significant matters

Chapters 4 and 5 Financial Audit Standards

Audit Documentation

Assemble the final audit engagement file within 60 days following the report release date.

- After 60 days – no deletion or discarding of existing audit documentation
- After 60 days – appropriately document subsequent additions

File retention period -- five years from the report release date.

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Chapters 4 and 5 Financial Audit Standards

Emphasizing significant matters in the auditors' report

Auditors should consider emphasizing the following matters when they become aware that such issues exist:

- Concerns or significant uncertainties about the fiscal sustainability of a government or program significant to the financial condition or operations
 - Unusual or catastrophic events that likely will have significant ongoing or future impact
 - Significant uncertainties
 - Any other matter that the auditor considers significant
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Chapters 4 and 5 Financial Audit Standards

Restatements:

Auditors have the following professional responsibilities when they become aware of known or potential misstatements that might affect their report on previously issued financial statements:

- Determine if previously issued financial statements were materially misstated.
- Determine whether the misstatements affect the auditor's report and whether persons are currently relying or likely to rely on the financial statements.
- Determine whether management has appropriately disclosed the misstatements.
- If the audited entity refuses to disclose the misstatements, then the auditors should notify those charged with governance, oversight bodies, and funding organizations.

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Chapters 4 and 5 Financial Audit Standards

Restatements

When management restates previously-issued financial statements auditors should perform audit procedures sufficient to reissue or update the auditors report on the reissued financial statements, and include the following in the auditors' report:

- A statement that the previously issued financial statements have been restated.
- A statement that the previously-issued financial statements were materially misstated and that the previously-issued auditors report is withdrawn and replaced by the current report.
- A reference to the notes to the restated financial statements that discussed the restatement.

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Chapter 6

Attestation Engagements

Conforming changes have been made for the following items:

- Definitions of internal control deficiencies
- Description of abuse
- Audit documentation
- Use of terminology to define professional requirements

2006 Yellow Book

Proposed Implementation Dates

- For performance audits, the standards are proposed to become effective for audits beginning on or after July 1, 2007.
- For financial audits and attestation engagements, the standards are proposed to become effective for audits of periods ending on or after July 1, 2007.
 - Certain standards issued by the AICPA's Auditing Standards Board (ASB) have earlier effective dates. For financial statement audits performed under GAGAS, the effective dates of those new ASB standards will apply.
- Early implementation of the 2006 revision of *Government Auditing Standards* will be permitted.

GAO's Accountability & Standards Team

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2006 Yellow Book

Questions or Comments?

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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
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