Top Ten Most Important Changes from the 2011 Yellow Book to the 2018 Yellow Book

Presented to the 41st Annual Conference of the National State Auditors Association at 10:00 AM on June 13, 2019 in Cherokee, North Carolina by Stephen L. Morgan, President, EGAPP egappmorgan@yahoo.com
Stephen Morgan, CIA, CGAP, CGFM, CFE, is the president of Excellence in Government Accountability and Performance Practices, Inc. (EGAPP), which specializes in training government auditors and managers. Over his career, Morgan has received top honors from the Comptroller General of the United States, American Society of Public Administration, and The IIA, including the Victor Z. Brink Memorial Award for Distinguished Service and election into the IIA’s American Hall of Distinguished Audit Practitioners.

Morgan became the City Auditor of Austin, Texas in 2000, responsible for directing performance audits, conducting fraud investigations, and performing consulting engagements. Previously, Morgan was an auditor in the U.S. Government Accountability Office’s National Productivity Group for eight years, responsible for auditing federal productivity programs. Morgan has served on the Advisory Council on Government Auditing Standards, as chairman of the National Intergovernmental Audit Forum’s Emerging Issues Committee, as an executive committee member of the Southwest Intergovernmental Audit Forum, and as Chairman of the IIA’s North American Board.

Throughout his career, Morgan has instructed, designed, and delivered courses on performance measurement, management, and auditing. For more than 25 years, he served as a faculty member for the Graduate School and the Government Audit Training Institute in Washington, D.C. Morgan has co-authored three performance auditing textbooks and contributed as co-author of a chapter for the 2007 World Bank publication Performance Accountability and Combating Corruption. He has spoken at IIA and other conferences around the world.
Presentation Objectives

• Understand the essence of some of the major changes from the 2011 Yellow Book Revision to the 2018 Yellow Book revision

• Obtain sources of more information on the significance of the changes for government auditors and CPA firms conducting performance or financial statement audits of government entities
Yellow Book=“GAGAS”

GAGAS are “Generally Accepted Government Auditing Standards”

• Broad statements of auditors’ responsibilities

• GAGAS provides an overall framework for ensuring that auditors have the competence, integrity, objectivity, and independence in planning, conducting, and reporting on their work and a way to lead by example in the areas of independence, transparency, accountability and quality through the audit process.
Background Information on Government Auditing Standards


- 52 pages in the 1972 Yellow Book compared to over 200 in 2011 and 2018.

- Yellow Book is supported by Green and Red Books. Now must know at least the Green Book, especially regarding its pertinence to causal elements of findings.
Generally Accepted Government Auditing Standards

General Standards (Chapters 1-5 in 2018 GAGAS Revision)
- All types and phases of audit process

Field Work Standards (Chapters 6-9)
- Survey, planning, evidence gathering and analysis, and finding development phases

Reporting Standards (Chapters 6, 7, and 9)
- Reporting phase
Timeframe for Implementation of the Government Auditing Standards 2018 Revision

• Effective for financial audits, attestation engagements, and reviews of financial statements for periods ending on or after June 30, 2020

• Effective for performance (and internal) audits beginning on or after July 1, 2019
Government Auditing in the United States is Supported By the Government Auditing Standards

- Credibility
- Quality Work
- Professional Standing
- Competence & Integrity
- Independence & Objectivity
- Standards
Where to Find the Yellow Book

- The Yellow Book is available on GAO’s website at:
  
  http://www.gao.gov/yellowbook

- For technical assistance, contact GAO staff at:
  
  http://www.yellowbook@gao.gov
POLL QUESTION ONE for “Top Ten Most Important Changes from the 2011 Yellow Book to the 2018 Yellow Book”

GAO establishes audit standards for many government auditors in the United States and CPA firms conducting work for government organizations in the United States.

Who signed each edition of the Government Auditing Standards?

a) The Auditor General of the United States
b) The Inspector General of the United States
c) The Comptroller General of the United States
d) The President of the United States
e) The Auditor of the United States
Summary of Major Changes From the 2011 Government Auditing Standards Revision to the 2018 Revision “My Top Ten” Not In Order of Importance But All Significant

1) Format and organization of GAGAS including four helpful flowcharts
2) Incorporation of the 2011 Revision’s Two Appendices
3) Independence concerns when auditors prepare financial statements from a client-provided trial balance or underlying accounting records
4) Competence and continuing professional education has a separate chapter reflecting a more comprehensive approach
5) Specialists—clarity of requirements for using specialists to accomplish engagements
6) Peer review standard modified to include requirements of audit organizations associated with “recognized” professional organizations and GAGAS

7) Comprehensive peer review requirements provided for audit organizations not affiliated with “recognized” professional organizations

8) Application of internal control standards (Green Book) to financial audits and examination level attestation engagements as a way to help identify the “root cause” of deficiency findings

9) Application of internal control standards (Green Book), in particular to performance audits, when internal control is significant to the audit objectives

10) Definition for waste—but no “proactive” requirements
1) New Format and Organization of GAGAS—differentiates requirements from guidance
2) Example from Chapter 9  Report Content—Application Guidance: Report Content, Including Objectives, Scope, and Methodology

• 9.17 Report quality elements incorporated from the 2011 Yellow Book Appendix I:
  – Complete
  – Accurate
  – Objective
  – Convincing
  – Clear
  – Concise
  – Timely
POLL QUESTION TWO for “Top Ten Most Important Changes from the 2011 Yellow Book to the 2018 Yellow Book”

GAO establishes audit standards for many government auditors in the United States and CPA firms conducting work for government organizations in the United States.

Which one of the following rationales for complying with GAGAS is invalid?

a) Laws, regulations, and other mandates require them to
b) Following GAGAS enables auditors to replace management in directing government programs
c) Even if not required to comply with GAGAS, auditors may find it useful to do so
d) Grant agreements require them to follow the GAGAS
e) Auditors believe their work would be higher quality so they voluntarily follow GAGAS
3) Consideration of Specific Nonaudit Services

Requirement: Preparing Accounting Records and Financial Statements

--Auditor should conclude that preparing financial statements in their entirety from a client-provided trial balance or underlying accounting records creates significant threats to auditor’s independence—document and apply conceptual framework or decline to provide the service. (2018 GAGAS, par 3.88)

--GAGAS provided a special flowchart to expand the conceptual framework to address threats associated with preparing accounting records and financial statements.
Figure 2: Independence Considerations for Preparing Accounting Records and Financial Statements

1. Is the nonaudit service preparing financial statements in their entirety from a client-provided trial balance or underlying accounting records?
   - No: Evaluate threat for significance
     - Is threat significant?
       - Yes: Document evaluation and proceed
       - No: Proceed
   - Yes: Identify and apply safeguard(s)

2. Assess effectiveness of safeguard(s)
   - No: Independence impairment
     - Do not proceed
   - Yes: Is threat eliminated or reduced to an acceptable level?
     - No: Document nature of threat and any safeguards applied
     - Yes: Proceed

Source: GAO | GAO-18-568G
4) Chapter 4 – Competence and Continuing Professional Education—Summary of Changes

--Management must assign auditors to conduct an engagement who possess the competence needed for their assigned roles which are defined in the chapter
--Competence of specialists (internal vs. external)
--Guidance for what topics are required by the 80-hour GAGAS CPE requirement
--Detailing exemptions to CPE requirements
5) Requirements: Competence

Requirement and Application Guidance: Specialists

The engagement team should determine that specialists assisting the engagement are qualified and competent in their areas of specialization.

--Competence of specialists relates to nature and level of expertise. Individuals with expertise in accounting, auditing, and information technology are not considered specialists.

--Many sources may inform the determination of specialist competence including certifications, licenses, and reputation.

(2018 GAGAS, paragraphs 4.12-4.15)
6) & 7) External Peer Review

Requirements: General

--Each audit organization conducting engagements in accordance with GAGAS must obtain a peer review conducted by reviewers independent of the audit organization being reviewed. Determine whether quality control system is suitably designed and whether the audit organization is complying with its quality control system so that it has “reasonable assurance.”

(2018 GAGAS, par 5.60)
6) & 7) External Peer Review

Requirements: General

--Audit organizations affiliated with “recognized organizations” should comply with the respective organization’s peer review requirements and GAGAS requirements listed in paragraphs 5.66-5.80.

--Any audit organization not affiliated with “recognized organizations” should meet the minimum (comprehensive) GAGAS peer review requirements throughout paragraphs 5.66-5.94 (5.95).

(2018 GAGAS, paragraphs 5.61 & 5.62)
POLL QUESTION THREE for “Top Ten Most Important Changes from the 2011 Yellow Book to the 2018 Yellow Book”

GAO established audit standards in Chapters 1-5 of the 2018 Revision that apply to all engagements conducted under GAGAS.

Organizations specifically recognized by GAO as having an established program to support Yellow Book peer review requirements include:

a) American Institute of Certified Public Accountants
b) Association of Local Government Auditors
c) National State Auditors Association
d) International Organization of Supreme Audit Institutions
e) All of the above
8) Internal Control: Financial Audits and Examination Level Attestation Engagements

- Requirements: Findings in Financial Audits and Examination Level Attestation Engagements

6.18 & 7.20 Auditors should consider internal control deficiencies when developing the cause element of the identified findings. (Application guidance follows including waste and abuse considerations. Also use professional judgment.)
8) Internal Control: Financial Audits and Examination Level Attestation Engagements

Considering a comprehensive internal control framework such as *Standards for Internal Control in the Federal Government* or *Internal Control – Integrated Framework* can help auditors identify the **cause of findings** and develop recommendations (Application Guidance 6.30 and 7.32)
9) Conducting the Performance Audit Engagement--Requirements: Determining Significance and Obtaining an Understanding of Internal Control

8.39 Auditors should determine and document whether internal control is significant to the audit objectives.

8.40 If it is determined that internal control is significant to the audit objectives, auditors should obtain an understanding of such internal control.

(Application guidance follows in 8.41-8.48 and use professional judgment.)
9) Revised COSO/ERM Model—"The Cube"
Seventeen Principles in the Green Book—“Standards for Internal Control in the Federal Government”

**CONTROL ENVIRONMENT**

(1) Demonstrate Commitment to Integrity and Ethical Values
(2) Exercise Oversight Responsibility
(3) Establish Structure, Responsibility, and Authority
(4) Demonstrate Commitment to Competence
(5) Enforce Accountability

**RISK ASSESSMENT**

(6) Define Objectives and Risk Tolerances
(7) Identify, Analyze, and Respond to Risks
(8) Assess Fraud Risks
(9) Identify, Analyze, and Respond to Change
Seventeen Principles in the Green Book—”Standards for Internal Control in the Federal Government”

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RISK ASSESSMENT
(6) Define Objectives and Risk Tolerances
(7) Identify, Analyze, and Respond to Risks
(8) Assess Fraud Risks
(9) Identify, Analyze, and Respond to Change
Considering a comprehensive internal control framework such as *Standards for Internal Control in the Federal Government* or *Internal Control – Integrated Framework* can help auditors identify the cause of findings and develop recommendations (Footnote 70 and Application Guidance 8.57 & 8.130)
9) Conducting the Performance Audit Engagement--Requirement: Assessing Internal Control

8.49 If internal control is determined to be significant to the audit objectives, auditors should assess and document their assessment of the design, implementation, and/or operating effectiveness of such internal control to the extent necessary to address the audit objectives.

(Flowchart provided and application guidance follows in 8.50-8.53. And use professional judgment.)
9) Conducting the Performance Audit Engagement--Requirement: Internal Control Deficiencies Considerations

8.54 Auditors should evaluate and document the significance of identified internal control deficiencies within the context of the audit objectives.

(Application guidance follows in 8.55-8.58 and use professional judgment.)
9) Conducting the Performance Audit Engagement--Requirements: Information Systems Controls Considerations

8.59 The effectiveness of significant internal controls frequently depends on the effectiveness of information systems controls. Thus, when obtaining an understanding of internal control significant to the audit objectives, auditors should also determine whether it is necessary to evaluate information systems controls. (More requirements in 8.60-8.62 and application guidance in 8.63-8.67 follow. And use professional judgement.)
POLL QUESTION FOUR for “Top Ten Most Important Changes from the 2011 Yellow Book to the 2018 Yellow Book”

GAO established audit standards for engagements in Chapters 6-9 of the 2018 Revision that apply to financial, attestation, or performance engagements conducted under GAGAS.

Determining whether internal control deficiencies are significant within the context of the audit objectives involves evaluating all but one of the following factors:

a) Magnitude of the impact
b) Likelihood of the occurrence
c) Nature of the deficiency
d) Qualifications of the audit team members
e) Information systems controls considerations
8.120 Waste is the act of using or expending resources carelessly, extravagantly, or to no purpose. Importantly, waste can include activities that do not include abuse and does not necessarily involve a violation of law. Rather, waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight.

Note: The same language defining waste and what to do about it is in Chapter 6, Financial Audits in 6.20 and 6.21 and in Chapter 7 for Examination Level Attestation Engagements in 7.22 & 7.23.
Evidence—Application Guidance: Findings

8.119  ... *Because the determination of waste and abuse is subjective, auditors are not required to perform specific procedures to detect waste or abuse in performance audits. However, auditors may consider whether and how to communicate such matters if they become aware of them. Auditors may also discover that waste or abuse are indicative of fraud or noncompliance with provisions of laws, regulations, contracts, and grant agreements.*
Other Sources of Comments on Changes in Government Auditing Standards from 2011 to 2018

- Government Accountability Office
- Association of Local Government Auditors
- American Institute of Certified Public Accountants
- Council of the Inspectors General on Integrity and Efficiency
Three More Important Points!

(1) Professional Judgment is the most important auditing standard.

(2) Government auditors can provide assistance without compromising independence by performing “Other Services” per the 2018 Yellow Book. We still may want to make the decision based on the conceptual model (threats and safeguards) but the “answer to every problem is not an audit.”

(3) Yellow Book tells auditors “what to do” not “how to do it.” See textbooks and courses on internal controls, performance auditing, and information technology applications.
(1) Professional Judgment

Requirement: Professional Judgement

Auditors must use professional judgment in planning and conducting the engagement and in reporting the results.”

(2018 GAGAS, par 3.109)
(2) Provision of Nonaudit Services to Audited Entities or the Engaging Party

Application Guidance: Nonaudit Services

--Summary—government auditors can provide a wide range of nonaudit or “other” services if the service does not relate to the specific subject matter of the engagement, are outside the period being audited, or are considered “routine activities.” The “other services” are sometimes provided to an “engaging party” rather than a “responsible party” and would generally not create a threat to independence.

(2018 GAGAS, paragraphs 3.65-3.72)
(3) How to Conduct GAGAS Audits: Textbooks and Instructors Provide Some of the Answers—Also Need Experience

- Steve Morgan instructs “Government Auditing Standards 2018 Revision and Summary of Major Changes”

- Drummond Kahn instructs “Update on GAO’s Green Book: What Government Auditors Need to Know About the New Internal Control Framework”

- Bruce Truitt instructs “Expanded Coverage of the 2018 Yellow Book’s Impact on Assessing Information Technology and Data Integrity”
POLL QUESTION FIVE for “Top Ten Most Important Changes from the 2011 Yellow Book to the 2018 Yellow Book”

GAO established audit standards for engagements in Chapters 6-9 of the 2018 Revision that apply to financial, attestation, or performance engagements conducted under GAGAS.

Ultimately the primary client for Yellow Book auditors is the:

a) Budget office
b) Management
c) Elected officials
d) Employee unions
e) The public
Why Should Audit Clients Care?

◆ Assurance/Accountability
◆ Better Government
◆ Public Trust
Thank You.

- More questions.
- More comments.
- Thank you, again.