


GAO  
UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

## Yellow Book Update: 2010 Exposure Draft

Mid Atlantic  
Intergovernmental  
Audit Forum

Kristen Kocielek  
and Eric Holbrook

Ocean City, Maryland  
June 3, 2010



## 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

## 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

## Why the Yellow Book is being revised

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

## 2011 Yellow Book Projected Dates

**June 2010:**

- Issue Exposure Draft of 2011 Revision of GAGAS

**September 2010:**

- Comments due on Exposure Draft

**February – March 2011:**

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

## Chapters 1 and 2

## Reorganization of Chapters 1 and 2

### Realigned Chapters 1 and 2

- Chapter 1 - concepts and ethics that serve as the foundation for the requirements and guidance for GAGAS
- Chapter 2 - requirements for the use and application of GAGAS

7

## Chapter 1 - Clarifications and Other Definitions

- Clarified or added definitions of
  - Auditor
  - Audit organization
  - Audit team
  - Audit period
- Transparency
- High-level of assurance

8

## Chapter 2 - Clarifications

### 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

### Clarified citing compliance with GAGAS

- Departures from presumptively mandatory requirements
- Using GAGAS with other standards

9

## Chapter 2 - Clarifications

### Clarified long-standing objective of a GAGAS financial audit to report on

- Deficiencies in internal control
- Compliance with laws and regulations, and provisions of contracts and grant agreements

10

## Attestation Engagements

- Auditors may cite compliance with GAGAS
- For examination-level attestation engagements or
- If a law or regulation requires auditors to perform a review-level or an agreed-upon procedures engagement in accordance with GAGAS and the auditor follows
  - AICPA SSAEs applicable to review-level or agreed-upon procedures and
  - GAGAS general standards in Chapter 3
- To prevent misunderstand the level of assurance being provided, GAGAS may provide certain language to use for the GAGAS compliance statement

11

## Chapter 3 General Standards

Independence  
Professional Judgment  
Competence  
Quality Control and Assurance

12

## Conceptual Framework Approach for Independence

- Current rules-based approach to independence does not provide needed flexibility
- AICPA and IFAC both have frameworks
- GAGAS framework includes independence of mind and independence of appearance
- GAGAS framework will:
  - Provide consistent results when compared with AICPA / IFAC
  - Address unique governmental structural issues

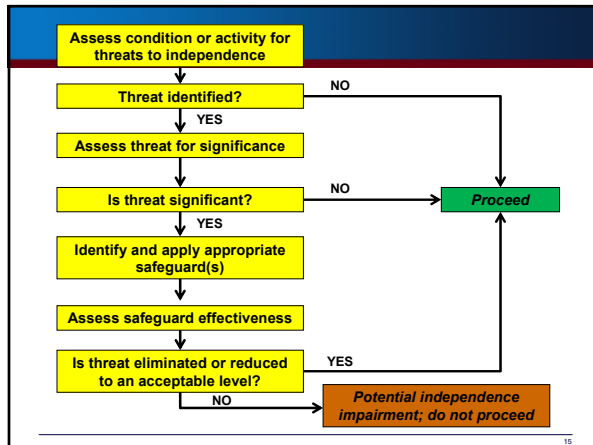
13

## Conceptual Framework Approach for Independence

Under the proposed GAGAS Conceptual Framework, auditors

- identify threats to independence;
  - evaluate the significance of the threats identified; and
  - apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level.
- GAO will retire current *Questions and Answers to Independence Standard Questions* guidance

14



15

## Broad Categories of Threats

### Seven categories of threats:

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

16

## Safeguards

Controls that eliminate or reduce to an acceptable level a threat's potential to impair independence

17

## Safeguards (Continued)

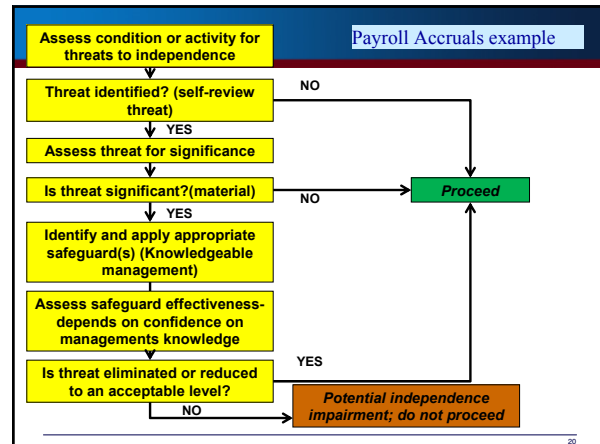
- Two broad categories:
  - Safeguards created by the profession, legislation, or regulation
  - Safeguards in the work environment

18

## 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

19

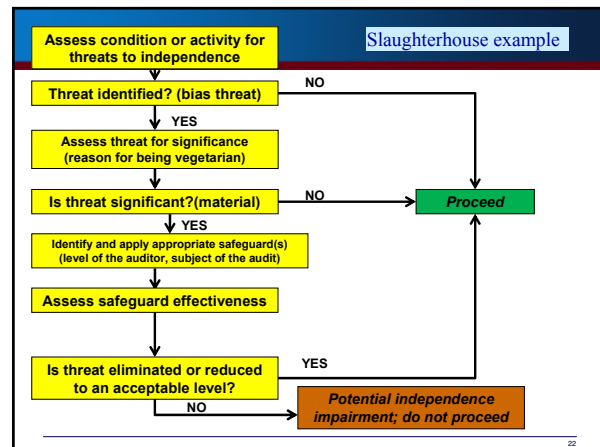


20

## 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)

21



22

## Prohibited Services

- Certain activities are so significant that no safeguard could reduce the threats to an acceptable level
  - Certain activities in preparing accounting records and financial statements
  - Certain internal audit services
  - Internal control assessments
  - Certain recruiting services
  - Certain valuation services
  - Certain IT services

23

## Professional Judgment

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

24

## 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

26

## Competence

### Clarified CPE requirements for specialists

- External specialists and internal specialists consulting on a GAGAS engagement should be qualified and maintain professional competence
- Internal specialists involved in planning, directing, performing audit procedures, or reporting should comply with GAGAS CPE requirements

26

## Quality Control and Assurance

### Expanded discussion for elements of the system of quality control

- Leadership responsibilities for quality within the audit organization
- Independence, legal, and ethical requirements
- Initiation, acceptance, and continuance of audit and attestation engagements
- Human resources
- Audit and attestation engagement performance, documentation, and reporting
- Monitoring of quality

27

## Quality Control and Assurance

### Additional requirements to

- communicate deficiencies noted during the monitoring process
- make recommendations for appropriate remedial action

### Consistent with AICPA Quality Control Standards

28

## Chapter 4 Financial Audits

29

## Financial Audits

### Clearly identified the additional GAGAS requirements beyond the AICPA

- Referenced the AICPA standards when applicable

### No new requirements were added for financial audits

30

## Financial Audits

Removed duplication between GAGAS and AICPA standards

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

31

## “New” vs. “Old” Internal Control Deficiency Definitions

	New Definition - SAS 115	2007 GAGAS Definition (SAS 112)
<b>Significant Deficiency</b>	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	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.
<b>Material Weakness</b>	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 <u>and corrected</u> on a timely basis	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

32

## Financial Audits

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

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

33

## Financial Audits

Deleted GAGAS requirements to:

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

34

## Chapter 5 Attestation Engagements

35

## Attestation Engagements

Clearly identified the additional GAGAS requirements beyond the AICPA

- Referenced the AICPA standards when applicable

No new requirements were added for attestation engagements

36

## Attestation Engagements

Removed duplication between GAGAS and AICPA standards

- Definitions of internal control deficiencies

37

## Attestation Engagements

Highlighted considerations for applying certain AICPA standards in a GAGAS attestation engagement

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

38

## Attestation Engagements

Deleted GAGAS requirements to:

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

39

## Chapters 6 and 7 Performance Audits

40

## Performance Audits

Added the following:

- Definition of waste
  - 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

41

## Performance Audits

Reporting requirements

- Modified the requirement for reporting all fraud
- Added reporting requirement for waste that is consistent with abuse

42

## Performance Audits

Deleted the requirement for the audit organization to develop policies to address requests by outside parties to obtain access to audit documentation

43

## Performance Audits

- Deleted the following:
  - Requirement for the audit organization to develop policies to deal with requests by outside parties to obtain access to audit documentation

44

## Performance Audits

Retained the documentation requirement pertaining to termination of an audit

- Proposed deletion for financial audits and attestation engagements

Added consideration for early communication of internal control deficiencies

45

## GAO's Accountability & Standards Team

### Yellow Book Team:

- Jim Dalkin (202) 512-3133
- Marcia Buchanan (202) 512-9321
- Cheryl Clark (202) 512-9377
- Kristen Kocielek (202) 512-2989
- Gail Vallieres (202) 512-9370
- Michael Hrapsky (202) 512-9535
- Heather Keister (202) 512-2943
- Theresa Phipps (202) 512-2574
- Tom Hackney (303) 572-7304
- Eric Holbrook (202) 512-5232
- Mark Kaufman (202) 512-9341
- Andrew Seehusen (202) 512-4896

### We also get lots of help from:

- Bob Dacey, GAO Chief Accountant
- Jennifer Allison, Advisory Council Administrator

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

46

Questions?

47

## Where to Find the Yellow Book

- 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)

48