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# **2006 Government Auditing Standards Revision**

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**Mid Atlantic Intergovernmental Audit Forum**  
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Williamsburg, VA

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U.S. Government Accountability Office

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# Session Objectives

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- Explain GAO's efforts to modernize and transform the accountability profession
  - Highlight key proposed revisions in the 2006 Yellow Book Exposure Draft
  - Present overview of GAO's process for addressing comments on the Exposure Draft
  - Summarize common themes expressed in the comments
  - Review current milestones and timing for the 2006 Yellow Book
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# **GAO's Accountability and Standards Team**

## **Our Goals:**

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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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***Government Auditing Standards***  
***2006 Revision***  
***Exposure Draft***

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# 2006 Yellow Book Exposure Draft

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## Major areas of revisions

- Bringing performance audits 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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# Process for Analyzing Comments

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- Comments received
  - 118 commenters
  - > 2,100 comments
- Systematic review process to analyze every comment
  - All comments entered into an Access database
  - Collaborative team review of comments

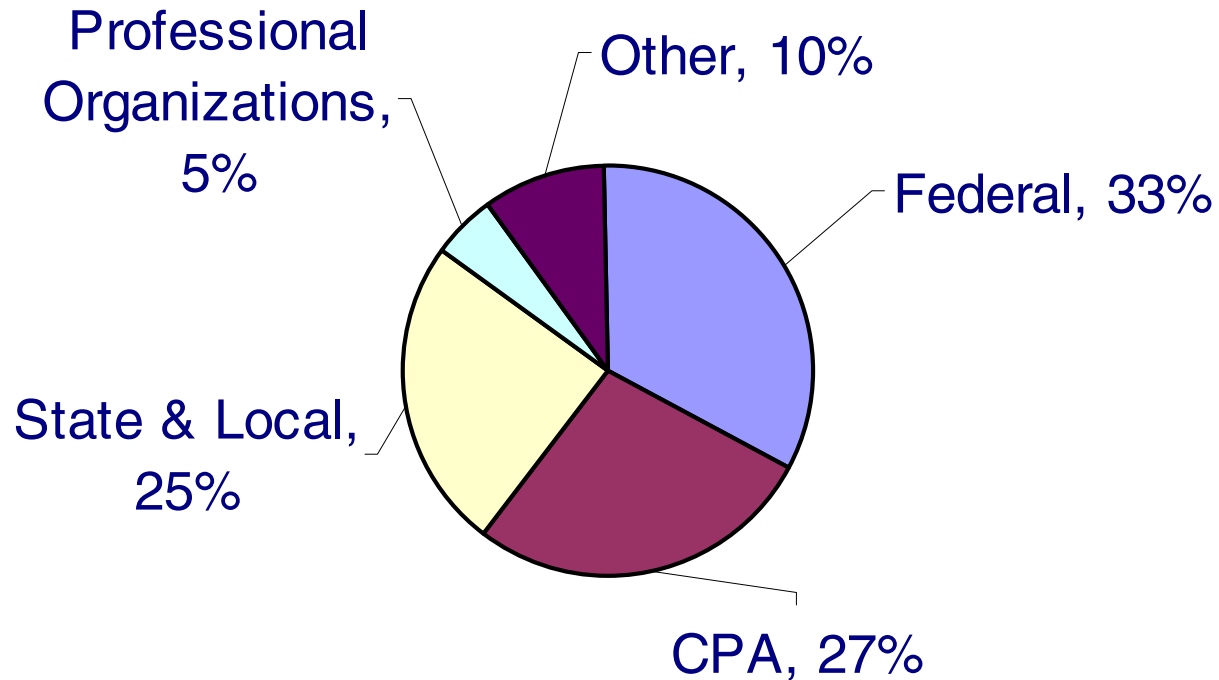
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## Percentage of Commenters by Organization Categories

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- Federal – 33%
- State & Local – 25%
- CPA firms & societies – 27%
- Professional organizations – 5%
- Other – 10%

# Percentage of Commenters by Organization Categories



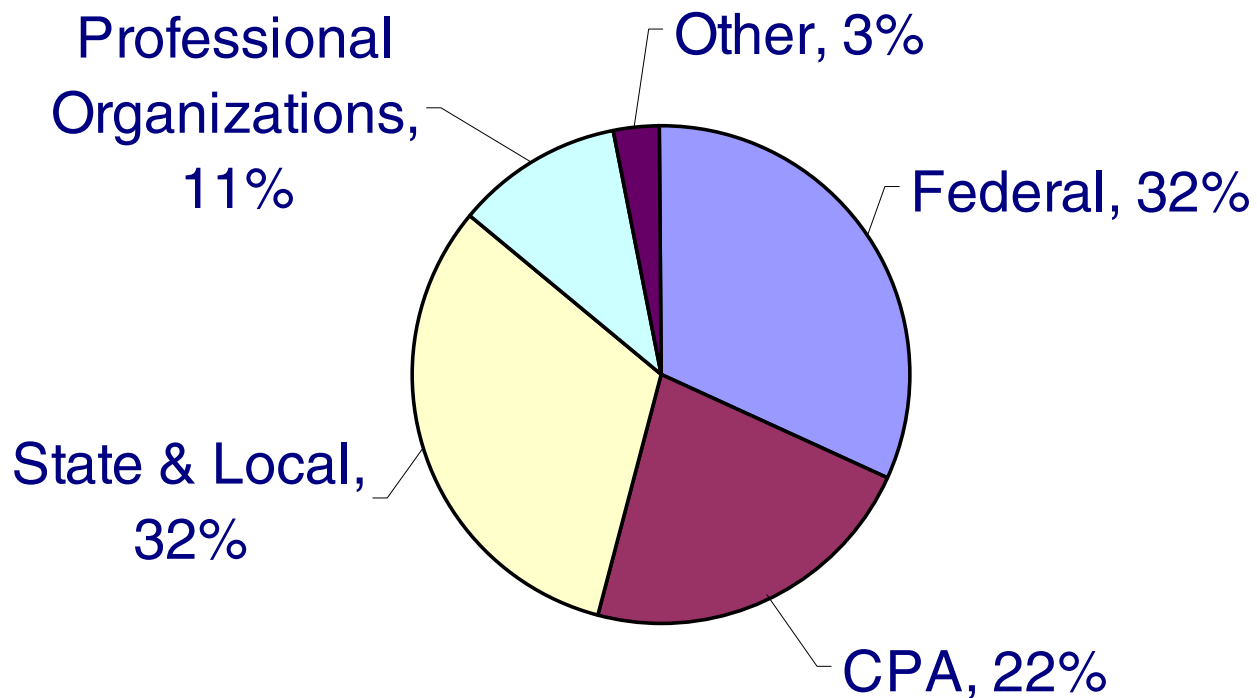
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## Percentage of Comments by Organization Categories

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- Federal – 32%
- State & Local – 32%
- CPA firms & societies – 22%
- Professional organizations – 11%
- Other – 3%

# Percentage of Comments by Organization Categories



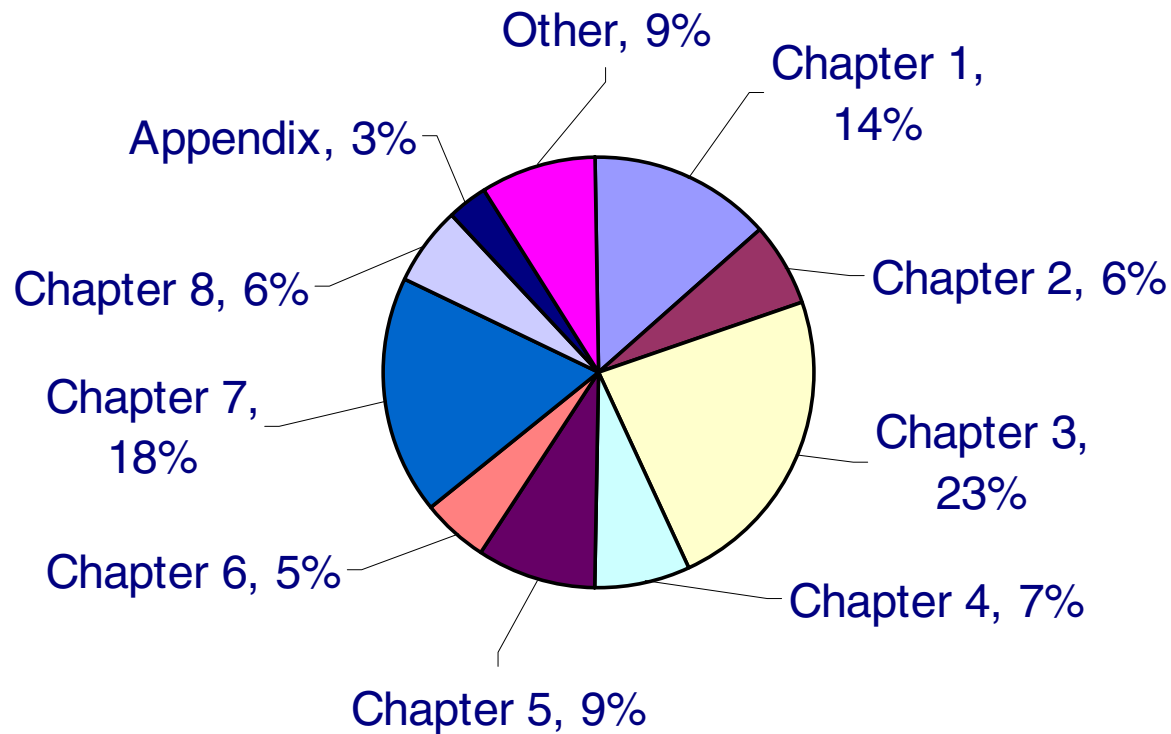
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# Categories of Overall Analysis

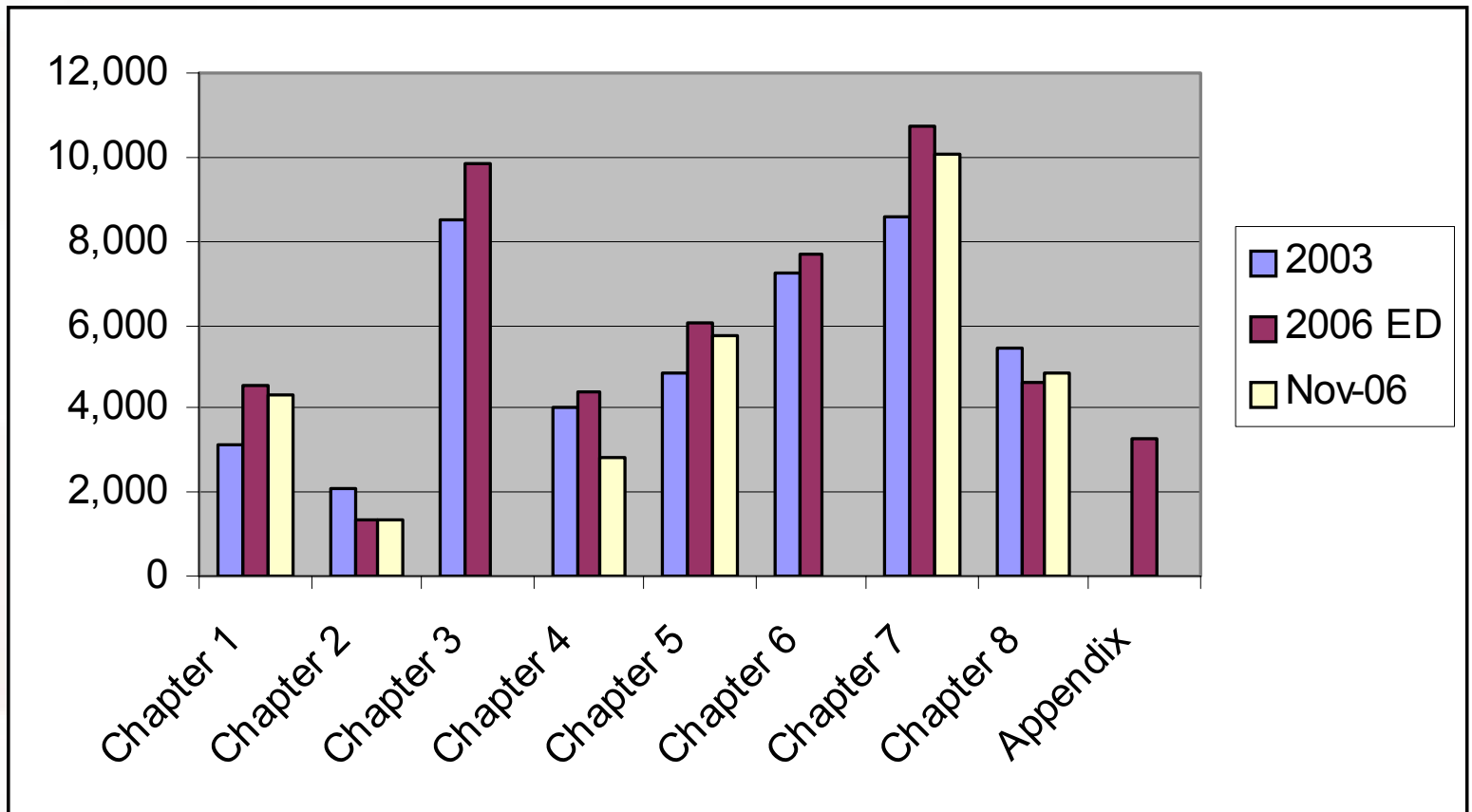
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- Agreed with Exposure Draft
- Substantive Technical Issue
- No action needed
- Minor Revision (including clarity/present tense usage)
- Future Project
- Descriptive
- Explicitly stated “No comment”

# Percentage of Comments by Chapter



# Yellow Book Word Count



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# Chapter 1

## Use and Applicability of GAGAS

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- 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

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## Consistent with SAS No. 102:

- **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

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# Chapter 1 Citing Compliance with GAGAS

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- **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

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# Chapter 1 Relationship Between GAGAS and Other Standards

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- 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

## Chapter 2

# Auditor's Ethical Principles

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Overarching auditor ethical framework 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

## Chapter 2

# Auditor's Ethical Framework

Ethical principles that provide the framework for auditors' work:

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

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# Chapter 3

## General Standards

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

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# Chapter 3

## General Standards

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### 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

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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

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Audit organizations should make the results of external peer reviews public

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

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# Chapter 3

## Audit Quality/ Peer Review

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### 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

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# Chapter 3

## Audit Quality/ Peer Review

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### 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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# Chapters 4 and 5

## Financial Audit Standards

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

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## Chapters 4 and 5

# Financial Audit Standards

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### Definitions of Internal Control Deficiencies (Consistent with SAS No. 112):

**Significant deficiency** – 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 generally accepted accounting principles 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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## Chapters 4 and 5

# Financial Audit Standards

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### Definitions of Internal Control Deficiencies (Consistent with SAS No. 112):

**Material weakness** – a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

# Financial Audits- Internal Control Deficiencies

## Old Definitions

## New Definitions – SAS 112

<b>Material weakness</b> ( <i>GAGAS</i> paragraph 5.14 and AU 325.15)	<b>Material weakness</b>
<b>Reportable condition</b> ( <i>GAGAS</i> paragraph 5.13 and AU 325.02)	
<b>Management letter comment</b> ( <i>GAGAS</i> paragraph 5.16)	<b>Significant deficiency</b>
	<b>Other matters related to internal control</b>

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## Chapters 4 and 5

# Financial Audit Standards

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### 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.

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# Chapters 4 and 5

## Financial Audit Standards

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### Fraud and Illegal Acts

Under both the AICPA standards and GAGAS, auditors have the following responsibilities:

- to plan and perform the audit to obtain reasonable assurance about whether the financials statements are free of material misstatement, whether caused by error or potential fraud.
- to plan and perform the audit to provide reasonable assurance of detecting material misstatements resulting from illegal acts that have a direct and material effect on the determination of financial statement amounts.

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## **Chapters 4 and 5**

# **Financial Audit Standards**

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### **Violations of Contract Provisions or Grant Agreements**

Auditors should design the audit to provide reasonable assurance of detecting misstatements resulting from violations of provisions of contracts of grant agreements that have a material effect on the determination of financial statement amounts or other financial data significant to the audit objectives.

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## Chapters 4 and 5

# Financial Audit Standards

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### 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

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## Chapters 4 and 5

# Financial Audit Standards

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### 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

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## Chapters 4 and 5

# Financial Audit Standards

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### Audit Documentation:

- Updated the standard to achieve consistency with SAS No. 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

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## Chapters 4 and 5

# Financial Audit Standards

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### Communicating significant matters in the auditors' report

Auditors may communicate 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

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### 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

## 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

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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

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## Chapters 7 & 8

# Performance Audits

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- Concept of significance (materiality)
- 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

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## Chapters 7 & 8

# Performance Audits

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### 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 in relation to the subject matter, the nature and effect on the subject matter, and the needs and interests of intended users or recipients.

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## Chapters 7 & 8

# Performance Audits

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### 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

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## Chapters 7 & 8

# Performance Audits

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### 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.

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## Chapters 7 & 8

# Performance Audits

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### 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.

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## **Chapters 7 & 8**

# **Performance Audits**

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### **Level of assurance in performance audits**

Performance audits provide reasonable assurance that the auditor has sufficient, appropriate evidence to support the conclusions reached.

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## Chapters 7 & 8

# Performance Audits

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### 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

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### 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

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### 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.

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## Chapters 7 & 8

# Performance Audits

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### **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.”

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## ***2006 Yellow Book***

# **Proposed Implementation Dates**

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- 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.
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# GAO's Accountability & Standards Team

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## Yellow Book Team:

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## 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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## ***2006 Yellow Book***

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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)