

The New 2006 Yellow Book

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**Gail Flister Vallieres, Assistant Director
U.S. Government Accountability Office**

Session Objectives

- Explain GAO's efforts to modernize and transform the accountability profession
 - Highlight key proposed revisions in the 2006 Yellow Book Exposure Draft
 - Discuss the reasons for the changes and what these changes will mean for government auditors
 - Review current milestones and timing for the 2006 Yellow Book
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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.

Collaboration With Other Standard Setters

- American Institute of CPAs (AICPA)
- International Auditing and Assurance Standards Board (IAASB)
- International Organization of Supreme Audit Institutions (INTOSAI)
- Institute of Internal Auditors (IIA)
- Public Company Accounting Oversight Board (PCAOB)

Comptroller General's Advisory Council on Government Auditing Standards

Experts drawn from all levels of government, public accounting, academia, private enterprise, and the user community

At present the Council includes

- 7 independent public accountants
- 4 federal inspectors general
- 5 state auditors general
- 4 academics
- 3 city auditors
- 1 county auditor
- 1 federal CFO
- Bond rating agency team leader of state and local government

2006 Yellow Book Exposure Draft

Major areas of revisions

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

Chapter 1

Use and Applicability of GAGAS

- Use of terminology to define professional requirements
- Citing compliance with GAGAS
- Relationship between GAGAS and other professional standards
- Types of government audits and attestation engagements, including revised definition of performance audits

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 1 Types of Engagements and Revised Performance Audit Definition

Discussion of types of GAGAS engagements moved from chapter 2

Rewrote the description of performance audits to clarify the level of assurance and evidence needed in performance audits and to reflect changes in chapters 7 and 8.

Chapter 1

Types of Engagements

Discussion of types of GAGAS engagements moved from chapter 2:

Financial audits

Attestation engagements

Performance audits

Chapter 1

Revised Performance Audit Definition

- Provide assurance or conclusions relating to audit objectives that provide an evaluation against objective criteria.

“Performance audits provide reasonable assurance that the auditors have sufficient, appropriate evidence concerning the achievement of the audit objectives and the conclusions reached. 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, While providing the appropriate level of assurance that the evidence obtained is sufficient and appropriate to meet the audit’s objectives.” Except from paragraph 1.35

Chapter 1 Types of Engagements and Revised Performance Audit Definition

Performance audits

- Program effectiveness and results
- Economy and efficiency
- Internal control
- Compliance
- Prospective analysis

Chapter 2

Auditor's Ethical Responsibilities

Overarching auditor ethical responsibilities 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 Responsibilities

Ethical concepts that provide the framework for auditors' work:

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

Chapter 2

Auditor's Ethical Responsibilities

Public interest

- The public interest is defined as the interests of those relying on the auditors' work, including the public.
- Auditors observe the principles of public interest by maintaining the highest degree of integrity, objectivity, and independence.

Chapter 2

Auditor's Ethical Responsibilities

Professional behavior

- Complying with laws and regulations, and acting in a manner consistent with high expectations for the profession.
- Professional behavior of auditors practicing in government is expected to be beyond reproach.

Chapter 2

Auditor's Ethical Responsibilities

Integrity

- Conducting work with an attitude that is objective, fact-based, nonpartisan, and non-ideological.
- Integrity can accommodate inadvertent error and honest differences of opinion; it cannot accommodate deceit or subordination of the principles of fairness and objectivity to personal gain.

Chapter 2

Auditor's Ethical Responsibilities

Objectivity

- Being independent in fact and appearance,
- maintaining an attitude of impartiality,
- having intellectual honesty, and
- being free of conflicts of interest.

Chapter 2

Auditor's Ethical Responsibilities

Proper use of Government Information, Resources, and Position

- Government information, resources and positions are to be used for official purposes and not for the auditor's personal gain.
- This concept also includes proper handling of sensitive or classified information or resources.

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

Chapter 3

General Standards

Independence

Included additional guidance in the appendix dealing with non-audit services provided that do not involve a current or potential audit/attest entity.

- These types of services are often performed by government audit organizations, in contrast to the consulting types of engagements performed by independent public accounting firms.

No change to the overall independence standard, but the changes above clarify and facilitate implementation of the standard.

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:

- Ethical requirements
- 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.

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

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 to only 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
- Violations of contract provisions or grant agreements
- Abuse
- Audit documentation
- Restatements
- Emphasizing significant matters in auditors' report

Chapters 4 and 5

Financial Audit Standards

Internal Control Deficiencies:

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.

Chapters 4 and 5

Financial Audit Standards

Internal Control Deficiencies:

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

Material weakness (<i>GAGAS</i> paragraph 5.14 and AU 325.15)	Material weakness (<i>GAGAS</i> paragraph 5.13b and 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 (<i>GAGAS</i> paragraph 5.13a and SAS 112, paragraph 6)
	Other matters (<i>GAGAS</i> paragraph 5.18 and SAS 112, paragraph 24)

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.
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Chapters 4 and 5

Financial Audit Standards

Fraud and Illegal Acts

Auditors should plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.

Auditors should design the audit to provide reasonable assurance of detecting material misstatements resulting from direct and material illegal acts.

Chapters 4 and 5

Financial Audit Standards

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 or grant agreements that have a material effect on the determination of financial statement amounts or other financial data significant to the audit objectives.

Chapters 4 and 5

Financial Audit Standards

Abuse

If indications of abuse that could be material exist, auditors should apply audit procedures specifically directed to ascertain

1. whether material abuse has occurred, and
2. the 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

Audit Documentation:

- Updated the standard to achieve consistency with 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

Oral explanations on their own do not represent sufficient support for work the auditor performed or conclusions reached

- May be used to clarify or explain audit documentation

Document audit evidence that is contradictory or inconsistent with final conclusions and how the auditor addressed the contradiction or inconsistency

Dating of the auditor's report:

- Not earlier than the date on which the auditor has obtained sufficient appropriate evidence to support the opinion.
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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

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 have affected 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 nature, cause, and amount of the restatement.

Chapters 4 and 5

Financial Audit Standards

Emphasizing significant matters in the auditors' report

Auditors should

- use professional judgment to determine whether to emphasize a matter in the auditors' report.
 - present such explanatory material in a separate paragraph or separate section of the auditors report.
 - obtain sufficient appropriate evidence about any matter emphasized.
 - describe significant uncertainties and their possible impact on the reported information in cases of significant uncertainties where sufficient appropriate evidence may not be available.
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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:

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

Chapter 6

Attestation Engagements

Conforming changes will be made for the following items:

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

Chapters 7 & 8

Performance Audits

- Concept of significance
 - Audit risk
 - Level of assurance in performance audits
 - Sufficient, appropriate evidence
 - Planning
 - Information system controls
 - Auditor's responsibility for fraud
 - Auditor's responsibility for abuse
 - Audit documentation
 - Auditor's report
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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 should 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

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.

Chapters 7 & 8

Performance Audits

Planning

Auditors **must** adequately plan and document the planning of the work necessary to achieve the audit objectives.

Chapters 7 & 8

Performance Audits

During planning, auditors should assess risk and significance by considering

- The nature and profile of the programs and the needs of potential report users,
 - Internal control as it relates to the specific audit objectives and scope,
 - Information systems controls for purposes of assessing audit risk and planning,
 - Legal and regulatory requirements, contract provisions or grant agreements, potential fraud, or abuse that are significant, and
 - The results of previous relevant audits and attestation engagements
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Chapters 7 & 8

Performance Audits

During planning, auditors also should

- Identify the potential criteria needed to evaluate matters subject to audit,
 - Identify potential sources of audit evidence and consider the amount and type of evidence needed,
 - Consider whether the work of other auditors and experts may be used to satisfy some audit objectives,
 - Assign sufficient staff and specialists with adequate collective professional competence and identify other resources needed to perform the audit,
 - Communicate about planning and performance of the audit to management and those charged with governance, and
 - Prepare an audit plan
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Chapters 7 & 8

Performance Audits

Information System Controls

Auditors should obtain a sufficient understanding of information systems controls necessary to assess audit risk and plan the audit.

Auditors should determine the extent of audit procedures related to information systems controls that are necessary to obtain sufficient, appropriate evidence to support the audit findings, conclusions, and recommendations.

Chapters 7 & 8

Performance Audits

Information System Controls

Auditors should consider

- the extent to which internal controls that are significant to the audit are dependent on information systems
 - the availability of other evidence to support the findings, conclusions, and recommendations
 - the relationship of information systems controls to data reliability testing.
 - assessing the effectiveness of information systems controls as an audit objective.
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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

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

Audit Documentation:

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 7 & 8

Performance Audits

Audit Documentation

Oral explanations on their own do not represent sufficient support for work the auditor performed or conclusions reached, but may be used to clarify or explain audit documentation

Auditors should document audit evidence that is contradictory or inconsistent with final conclusions and how the auditor addressed the contradiction or inconsistency

Chapters 7 & 8

Performance Audits

Audit Documentation

Auditors should make appropriate audit staff and individuals, as well as audit documentation available, upon request, in a timely manner to other auditors or reviewers. It is also essential that contractual arrangements for GAGAS audits provide for full and timely access.

Chapters 7 & 8

Performance Audits

Auditors **must** prepare audit reports communicating the results of each audit.

The purpose of audit reports is to

1. Communicate the results of audits to those charged with governance and appropriate entity and oversight officials,
 2. Make the results available to the public, and
 3. Facilitate follow-up to determine whether appropriate corrective actions have been taken
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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”

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.
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GAO's Accountability & Standards Team

Our core team:

- Jeanette Franzel (202) 512-9471
- Marcia Buchanan (202) 512-9321
- Gail Vallieres (202) 512-9370
- Mike Hrapsky (202) 512-9535
- Heather Keister (202) 512- 2943

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

2006 Yellow Book

The 2006 Yellow Book Exposure Draft
is posted at:

<http://www.gao.gov/govaud/ybk01.htm>

2006 Yellow Book

Questions or Comments?