



# Government Auditing Standards

A Report on Revision Efforts ~ 2006

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# Comptroller General's Advisory Council on Government Auditing Standards

- The Advisory Council
  - provides advice and guidance to the Comptroller General on government auditing standards
  - consists of 27 highly qualified individuals who are from state and local governments, academia, the federal government, and the private sector
  - meets as needed and provides input to GAO's technical standards projects and the drafting of the Yellow Book

# GAO's Yellow Book Team



- Jeff Steinhoff
- Jeanette Franzel
- Marcia Buchanan
- Mike Hrapsky
- Gail Vallieres
- Heather Keister

in consultation with:

- Bob Dacey, GAO Chief Accountant
- Abe Akresh, Technical Expert and Advisor

# Government Auditing Standards Team Goals

- ❖ Develop high quality *Government Auditing Standards* that are well understood, highly regarded, widely used, and serve as a model for 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.
- ❖ Build a solid foundation for an accountability profession that is
  - effective,
  - ethical, and
  - prepared for 21st century challenges

# Government Auditing Standards

## Team Strategies

- Identify potential accountability issues of critical importance to the US public sector on which GAO should assume a leadership position.
- Advocate for high quality AICPA fieldwork and reporting standards, which are incorporated into the Yellow Book.
- Continuously evaluate newly-issued PCAOB, AICPA, IAASB, and IIA standards and make timely changes to the Yellow Book reflecting the updates or deciding to take a different action on the issues.
- Address deficiencies in other standards by adopting mitigating or compensating Yellow Book standards.
- Provide training and outreach to government auditors to promote high quality government auditing in a challenging environment of (1) significant pressures for increased government performance and accountability in an era of unsustainable government operations, and (2) rapid and constant change in technology, financial systems, government operations, and auditing.

# Government Auditing Standards 2006 Workplan—Projects

- Audit quality assurance, monitoring, inspection, peer review
- Level of assurance, evidence, and data reliability in performance audits
- Expanding and clarifying the categories of nonaudit services
- Reporting deficiencies in internal control for financial audits
- Ethics/professional judgment
- Auditor's responsibility for evaluating and disclosing financial statement restatements
- Use of GAGAS with other standards (PCAOB, AICPA, IIA, IAASB)
- GAGAS clarification and “clean up”



# Strengthened Audit Quality Assurance

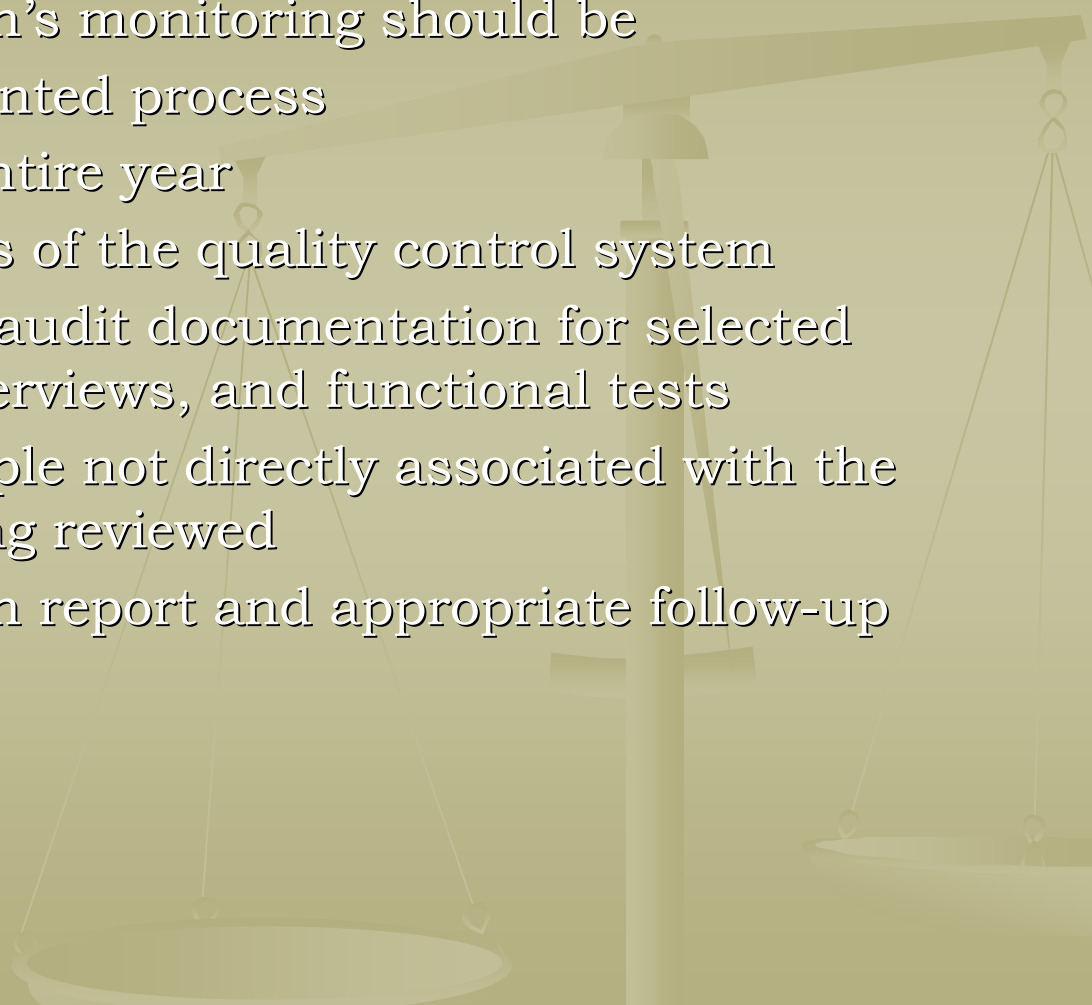
# Reasons for the Project

- GAGAS does not provide a fully developed discussion of quality assurance.
- Increased emphasis on internal quality assurance will help improve overall audit quality.
- Increased transparency will help improve quality assurance.
- The GAGAS peer review standard is “one size fits all” without regard for the effectiveness of an audit organization’s quality control system or peer review results.

# Proposed Changes: Quality Assurance

1. An audit organization's system of quality control should include policies and procedures to address the following elements:
  - Ethical requirements
  - Acceptance and continuance of engagements
  - Human resources
  - Engagement performance and reporting
  - Monitoring of quality

# Proposed Changes: Quality Assurance

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2. An audit organization's monitoring should be
- A formal, documented process
  - Planned for the entire year
  - Cover all elements of the quality control system
  - Include review of audit documentation for selected engagements, interviews, and functional tests
  - Performed by people not directly associated with the engagements being reviewed
  - Result in a written report and appropriate follow-up

# Proposed Changes: Quality Assurance

## 3. New external peer review timeframes

- **Annual external peer reviews** required if the most recent peer review opinion is **adverse**.
- **Annual limited follow-up engagements** required if the most recent peer review opinion is **modified**.
- **Every 3 years** if the most recent peer review opinion is **unmodified and the audit organization lacks an enhanced quality assurance system** or fails to meet other criteria.
- **Every 5 years** if the most recent peer review opinion is **unmodified and the audit organization employs a rigorous annual internal inspection program** as part of its monitoring, and meets transparency and other criteria.

# Proposed Changes: Quality Assurance

- Rigorous, annual inspection program with the objective of evaluating the adequacy of the audit organization's quality control policies and procedures and their implementation, including
  - Review of documentation related to independence and human capital management
  - Review of audit documentation for an appropriate sized sample of audit engagements
  - Discussions/interviews with personnel
  - Formal report to top management, including discussion of findings that indicate improvements are needed
  - Consideration of findings by management personnel who are in a position to take corrective action

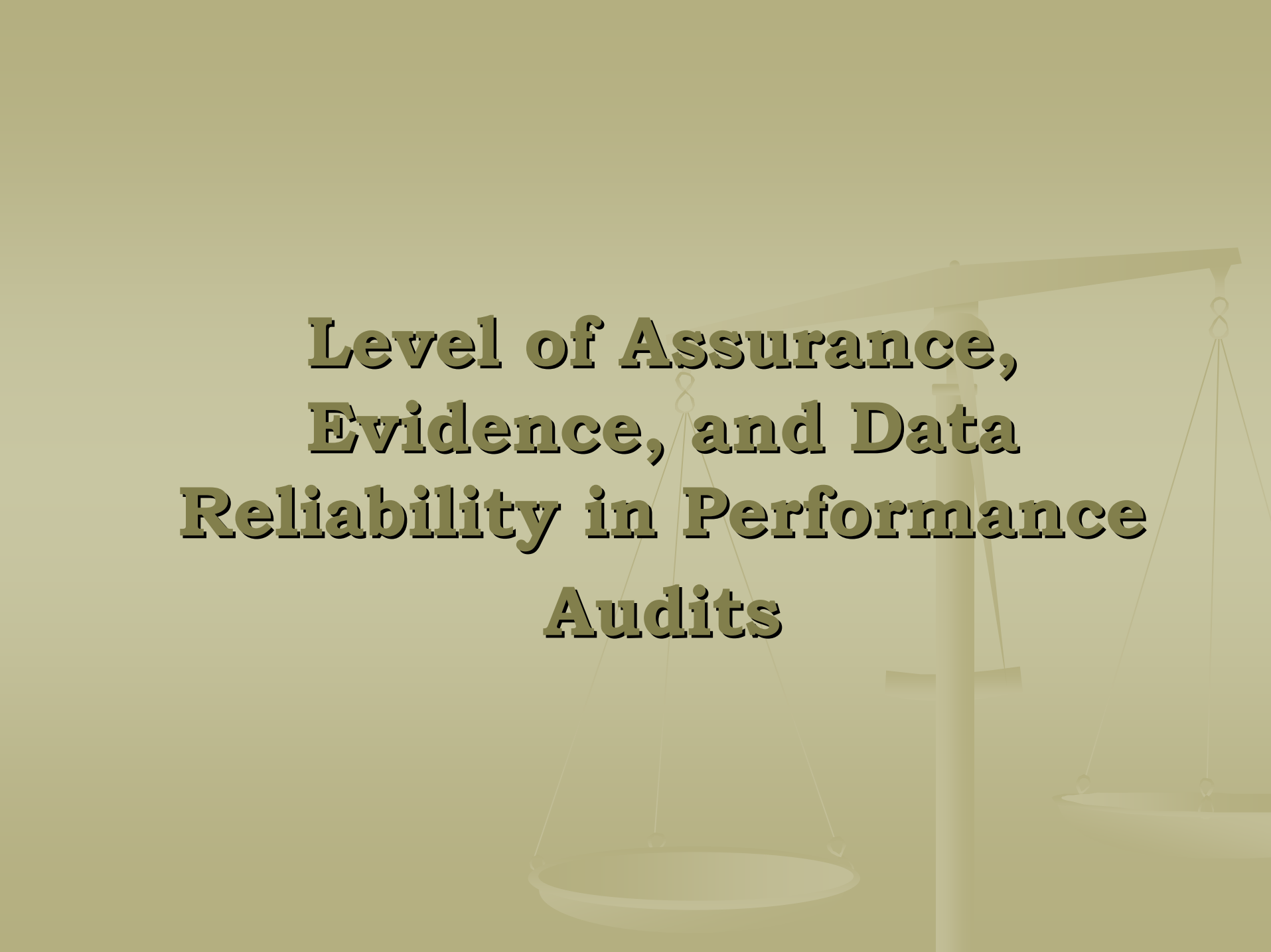
# Proposed Changes: Quality Assurance

Transparency criteria: Audit organizations should make public

- a description of their overall system of quality assurance
- results of their annual inspection processes and conclusions about the design and effectiveness of their quality assurance system
- copies of their external peer review opinion and letter of comment

Other criteria:

- Most recent peer review included a review of the organization's inspection process
- Audit organization has not undergone major changes, such as merger or restructuring
- Audit organization does not have any citations of violations



**Level of Assurance,  
Evidence, and Data  
Reliability in Performance  
Audits**

# Reasons for the Project

- GAGAS is intended to provide reasonable assurance that the auditor has obtained sufficient, appropriate evidence to provide a reasonable basis for meeting audit objectives.
- The level of assurance was not clearly articulated or emphasized in the 2003 Yellow Book
- Because objectives of performance audits range from narrow to broad, the amount and type of evidence obtained varies widely among audits.
- There have been ongoing questions and variability in practice among auditors conducting performance audits.
- Other standards have been updated to include the concept of “appropriateness” of data and information used as evidence.
- Project was discussed at both the Advisory Council’s 2004 and 2005 meetings as a priority area.

# Proposed Changes: Performance Audits

## 1. Level of assurance in performance audits:

- A performance audit provides reasonable assurance over the answers to the audit questions and that the auditor has adequate support to achieve the audit objectives.
- The levels of evidence and tests of evidence will vary based on the audit objectives and conclusions.
- Audit objectives for performance audits range from narrow questions requiring specific evidence, broad questions requiring extensive evidence, to general questions which may require general answers.
- Auditors should use professional judgment in determining the audit scope and methodology needed to address the objectives of the audit, while providing the appropriate level of assurance given the objectives of the audit.

## Proposed Changes: Performance Audits

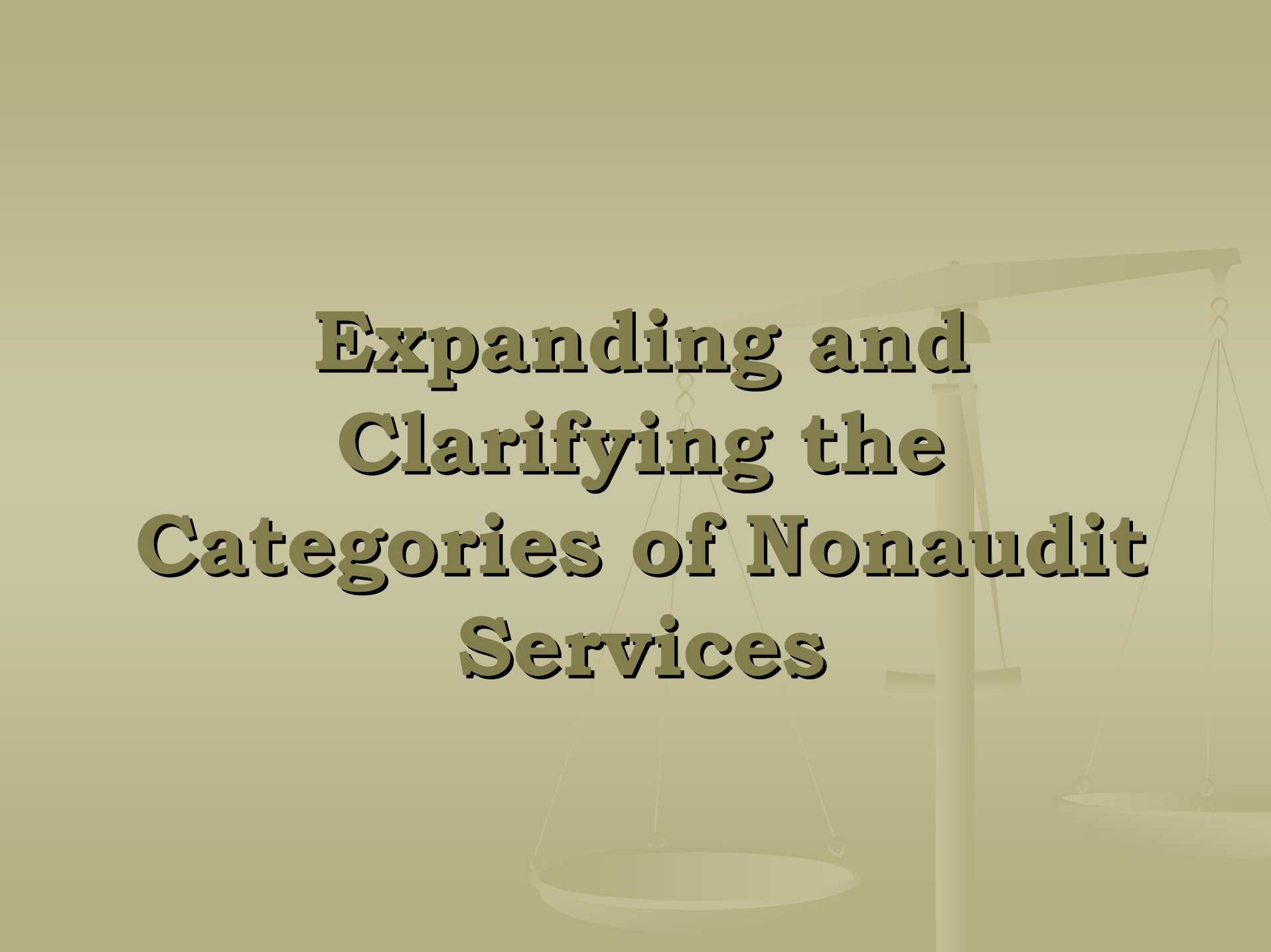
2. Replace the requirement for “sufficient, competent, and relevant evidence” with “sufficient, appropriate evidence” to achieve consistency with other standards
  - Previous definition of “competent” evidence included
    - “valid”
    - “reliable”
  - Definition of “appropriate” evidence is a measure of overall quality, which includes
    - “relevant”
    - “reliable”
    - “valid”

# Proposed Changes: Performance Audits

3. New section, “Overall Assessment of Evidence”
- provides discussion and clarification for evaluating the sufficiency and appropriateness of evidence.
  - calls for assessment of data and information used in a performance audit as
    - (1) appropriate– using the information provides the basis for a strong analysis and provides reasonable assurance over the answers to the audit questions
    - (2) not appropriate– using the information carries an unacceptably high risk that it could lead to an unintended or incorrect message
    - (3) of undetermined appropriateness– the auditor cannot conclude about the appropriateness of the information

# Proposed Changes: Performance Audits

4. Auditors should address issues surrounding appropriateness of available information and data in the planning phase and throughout the audit
5. Emphasis on professional judgment and the varying nature of types of performance audits
6. Expanded discussion of importance of objectives, scope, and methodology in the report.
7. Expanded GAGAS report language:  
“This performance audit was conducted in accordance with GAGAS. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.”



**Expanding and  
Clarifying the  
Categories of Nonaudit  
Services**

# Reasons for the Project

GAGAS defines nonaudit services as

- performing tasks requested by management that directly support the entity's operations
- providing information without verification, analysis, or evaluation and without basis for conclusions, recommendations, or opinions

Current GAGAS definition of nonaudit services does not include other types of services frequently performed by government auditors, even though some of those types of services were listed in the Independence section (Chapter 3)

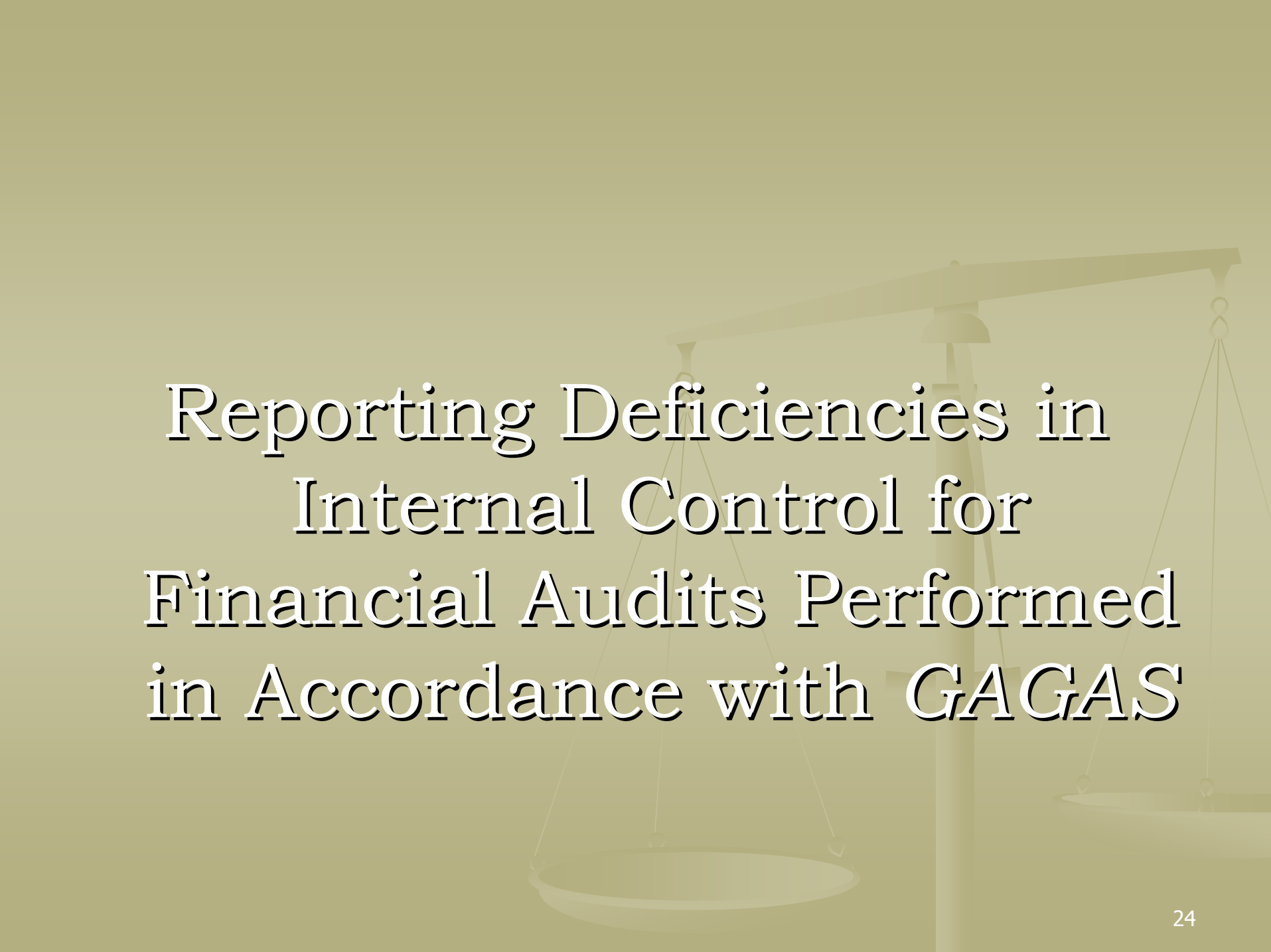
# Proposed Changes: Nonaudit Services

## Proposed categories of non-audit services:

1. Non audit services performed for or under the authority of the audit organization, a legislative body, or an independent, external organization.
  - Info or data to a requesting party without independent validation/verification
  - Collaborating with other professional organizations to advance government auditing
  - Providing technical assistance and expertise to legislative bodies or independent external organizations
  - Audit, investigative, and oversight-related services that do not involve a full-scope audit
  - Periodic audit recommendation follow-up engagements and reports, etc.

# Proposed Changes: Nonaudit Services

2. Routine nonaudit services performed for current or likely audit/attest entities that
  - (a) Are routine by their very nature and would not impair auditor independence and would not require the audit organizations to apply the safeguards.
  - (b) Would generally not impair independence if the safeguards were applied
  - (c) Would impair independence to perform an audit



Reporting Deficiencies in  
Internal Control for  
Financial Audits Performed  
in Accordance with GAGAS

# Reasons for the Project

- AICPA's Auditing Standards Board has approved revisions to SAS 60 that adopt new terminology and definitions used to communicate internal control deficiencies, similar to provisions of PCAOB's Audit Standard No. 2
- Consistency among US auditing standards setters in terminology and definitions for communicating internal control deficiencies will help improve audit efficiency and effectiveness
- *GAGAS* reporting requirements will need updating to align with new terminology and definitions for communicating internal control deficiencies

# Reasons for the Project

## Terminology and Definitions for Internal Control Deficiencies

### Old Definitions

### New Definitions

<p><b>Material weakness</b>  <i>GAGAS</i> paragraph 5.14 and            AU 525.15)</p>	<p><b>Material weakness</b>            (proposed revised SAS 60, paragraphs            3            and 17)</p>
<p><b>Reportable condition</b>            (<i>GAGAS</i> paragraph 5.13 and            AU 325.02)</p>	<p><b>Significant deficiency</b>            (proposed revised SAS 60, Paragraphs            4            and 17)</p>
<p><b>Management letter comment</b>            (<i>GAGAS</i> paragraph 5.16)</p>	<p><b>Other matters related to internal            control</b>            (proposed revised SAS 60, Paragraph            19)</p>

# Proposed Changes: Internal Control Deficiencies

1. For financial audits, auditors should report, as applicable, deficiencies in internal control considered to be significant deficiencies or material weaknesses.
2. Auditors should include all material weaknesses in the auditors' report on internal control.
3. Significant deficiencies should be reported in either the auditors' report on internal control or a separate report to be issued to the same recipients of the original audit reports within 45 days of the issuance of the other audit reports.



# Ethics / Professional Judgment

# Reasons for Project

- Although many ethical requirements were discussed in Chapter 1 (Introduction), they were not separately labeled as “ethical requirements,” but instead were included in a section labeled “Auditor’s Responsibilities.”
- Given the government auditor’s critical role in government accountability and credibility, it is important to highlight ethical responsibilities.
- Provide an expanded discussion of the professional judgment used in making decisions throughout the engagement.

# Proposed Changes: Ethics

- Restructure Chapters 1 and 2
- Chapter 1– Purpose and Applicability of GAGAS
- Chapter 2– Essential Role of Auditors in Government Accountability
  - Accountability
  - Auditors Responsibilities
  - Ethical Concepts that should guide the work of government auditors
    - The public interest
    - Professional behavior
    - Integrity
    - Objectivity
    - Proper use of government information, resources, and position



# Auditor's Responsibility for Evaluating and Disclosing Financial Statement Restatements

# Description of Project: Restatements

- Currently looking at the auditor's responsibilities for evaluating management's response and disclosures related to restated financial statements.
- Potential requirements for the auditors to highlight restatements in the auditor's report.

# Proposed GAGAS Additions/Changes

## Auditors should assess

- judgments made by management in addressing the misstatement
- the adequacy and timeliness of management's disclosure of the misstatement.

## Auditors should communicate with

- the audited entity if the previous audit report is not reliable
- legislative or regulatory oversight bodies, federal inspector(s) general, funding entities, and other oversight bodies if the audited entity fails to do so



# Use of GAGAS with Other Standards

# Reasons for the Project

- GAGAS specifically incorporates the AICPA field work and reporting standards for financial audits and attestation engagements
- Other standards are not incorporated, but can be used in conjunction with GAGAS
- GAGAS not clear about how to use other sets of standards in conjunction with GAGAS, especially for financial statement audits, where the AICPA standards are specifically incorporated

# Proposed Changes: Use of GAGAS with Other Standards

- For financial audits, provide guidance for using GAGAS with standards issued by
  - Public Company Accounting Oversight Board (PCAOB)
  - International Auditing and Assurance Standards Board (IAASB)
  - American Institute of Public Accountants
- For performance audits, provide guidance for following both Institute of Internal Audit standards and Yellow Book, for offices that implement both.

# Audit Documentation



# Project Objectives: Audit Documentation

- Project Objectives:
  - To update and strengthen the audit documentation standards
  - To have consistency between the audit documentation standards between the type of audit

# Reasons for the Project

AICPA revised its audit documentation standard in December 2005 (SAS No. 103)

- GAO Representatives served on the AICPA task force
- Revision adopted concept from the Yellow Book that auditor should prepare audit documentation that enables an experienced auditor, having no previous connection to the audit, to understand the significant judgments and conclusions
- Revision also contains the requirement that documentation needs to be complete, including supervisory review before the auditor issues the report
- Selected requirements of the AICPA standard were incorporated into the draft GAGAS language

To emphasize the importance of the audit documentation standard in GAGAS

To build on GAGAS requirements

To add parallel standards for attestation engagements and performance audits

# Reasons for the Project

**IAASB also issued a revised audit documentation standard in October 2005**

Revision adopted concept from the Yellow Book that auditor should prepare audit documentation that enables an experienced auditor, having no previous connection to the audit, to understand the significant judgments and conclusions

**PCAOB also issued a revised audit documentation standard in August 2005**

Revision adopted concept from the Yellow Book that auditor should prepare audit documentation that enables an experienced auditor, Having no previous connection to the audit, to understand the significant judgments and conclusions

# Proposed Changes: Audit Documentation



Revised the standard to clarify that audit documentation must provide link between the evidence and the conclusion

Added the purposes of audit documentation

Added that audit documentation is an essential element of audit quality

Clarified that the form, content, and extent of audit documentation depend on the circumstances of the engagement, and that oral explanations are not sufficient support but can be used to clarify or explain the information in the documentation

Requires the documentation of discussions of significant findings or issues

Requires documentation of contradictory or inconsistent information and the resolution of this information in forming a conclusion

# Proposed Changes: Audit Documentation



Requires documentation of justification of any departure of GAGAS and how the alternative procedures performed were sufficient to meet the objectives of the requirement

Requires that the report be dated after the auditor has sufficient and appropriate evidence to support the conclusion or opinion

Requires that the auditor have reasonable procedures to retain and access audit documentation (but does not specify a retention period)

Requires the assembly of the final audit file on a timely basis, prohibits Discarding documentation after assembly, and provides guidance to auditors in making additions to the audit file

Cautions auditors about the possibility of compromising the documentation if it is altered, added to, or deleted, and requires controls from improper alternation, destruction, and unauthorized Access

Applicable to attestation engagements and performance audits

# Next Steps

- Advisory Council Meeting April 6, 2006
- Finalization of projects, incorporating Council comments and comments received in forums such as this.
- Exposure draft issued for comment: Late April/Early May
- Final, 2006 Revision of Yellow Book, issued late summer/ early fall.

# Questions or Comments?

