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
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

• Issue interim revision of GAGAS in August

• Effective for financial audit periods ending on or after December 15, 2012

• Effective for attestation periods ending on or after December 15, 2012

• Effective for performance audits starting on or after December 15, 2012
Issuance Timing

We expect to post an online version in August
• Pending AICPA Clarity Project
• Pending AICPA Code of Professional Conduct ET 101-3 revision

Open issues include:
• Restricted/Intended use
• Nonaudit Services
Changes from Exposure Draft

Clarifications included:

- Financial statement preparation
- Assessing internal controls and monitoring
- Determining period of impairment for nonaudit services
- Assessing management’s skill, knowledge, and/or experience
- Peer review periods
- CPE requirements
Additional Revisions for Independence

- Documenting independence for nonaudit services
- Assessing independence in appearance
  - Aggregate nonaudit services
- Adding a more comprehensive list of prohibited services
## Number of Commenters by Group Type

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<th>Group Type</th>
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<td>Federal Audit</td>
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<td>State and Local Auditors</td>
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Comment Count by Chapter

- Chapter 7, 47, 3%
- Chapter 1, 138, 9%
- Chapter 2, 75, 5%
- Chapter 3, 513, 34%
- Chapter 4, 247, 17%
- Chapter 5, 180, 12%
- Chapter 6, 180, 12%
- Appendix, 41, 3%
- Other, 72, 5%
Contains concepts and ethical principles that serve as the foundation for the requirements and guidance for GAGAS

- Purpose and applicability of GAGAS (no major changes)
- Ethical principles (no major changes)
Clarified citing compliance with GAGAS

- Determining appropriate GAGAS compliance statement is a matter of professional judgment
- Departures from presumptively mandatory requirements
- Using GAGAS with other standards
Chapter 3 – General Standards: Independence

• Defines independence of mind and in appearance

• Emphasizes the importance of considering individual threats to independence both individually and in aggregate
Chapter 3 – General Standards: Independence

Conceptual Framework

• Allows the auditor to assess unique circumstances
• Adaptable
• Incorporates the familiar categories
  • Personal
  • External
  • Organizational
Chapter 3 - Revising Independence

• New approach combines a conceptual framework with certain rules (prohibitions)
  • Outcome generally consistent with IFAC and AICPA

• Certain prohibitions remain
  • Generally consistent with Rule 101 AICPA

• Beyond a prohibition
  • Apply the conceptual framework
Chapter 3 – General Standards: Independence

**Threats could** impair independence
- **Do not** necessarily result in an independence impairment

**Safeguards could** mitigate threats
- Eliminate or reduce to an acceptable level
Assess condition or activity for threats to independence

Threat identified?

Assess threat for significance

Is threat significant?

Identify and apply appropriate safeguard(s)

Assess safeguard effectiveness

Is threat eliminated or reduced to an acceptable level?

Potential independence impairment; do not proceed

Proceed

NO

YES

NO

YES

NO

YES
Chapter 3 – General Standards: Independence

Seven Categories of Threats

1. Self-interest threat
2. Self-review threat
3. Bias threat
4. Familiarity threat
5. Undue influence threat
6. Management participation threat
7. Structural threat
Safeguard Examples

• Safeguards in the work environment
  • Select non-impaired auditor
  • Separate engagement teams (for services that are not prohibited)
  • Secondary reviews
Chapter 3 – General Standards: Independence

GAO will retire current Government Auditing Standards: Questions and Answers to Independence Standard Questions guidance
Nonaudit Services

• Certain services may be permitted
• First, determine if there is a specific prohibition
• If not, the auditor should assess the nonaudit service’s impact on independence using the conceptual framework
Preconditions to Performing Nonaudit Services

• Management should take responsibility for nonaudit services performed by the auditors

• Auditors should document their understanding with management regarding the nonaudit service

• Auditors should assess (AICPA) and document (GAGAS) whether management possesses suitable skill, knowledge, or experience to oversee the nonaudit service
Assessing Management’s Skill, Knowledge, or Experience

Factors to document include management’s:

• Understanding of the nature of the service
• Knowledge of the audited entity’s mission and operations
• General business knowledge
• Education
• Position at the audited entity

Some factors may be given more weight than others

GAGAS does not require that management have the ability to perform or reperform the service
Routine Audit Services and Nonaudit Services

Routine audit services pertain directly to the audit and include:

- Providing advice related to an accounting matter
- Researching and responding to an audited entity’s technical questions
- Providing advice on routine business matters
- Educating the audited entity on technical matters

Other services not directly related to the audit are considered nonaudit services
Routine Audit Services and Nonaudit Services

Services that are considered non-audit services include:

- Financial statement preparation
- Bookkeeping services
- Cash to accrual conversions (a form of bookkeeping)
- Other services not directly related to the audit

Unless specifically prohibited, nonaudit services MAY be permissible but should be documented

- In relation to the conceptual framework
- In relation to the auditor’s assessment of managements’ skill, knowledge or experience
May be performed provided the auditor does not

- Determine or change journal entries, account codes or classifications for transactions, or other accounting records without obtaining client approval
- Authorize or approve transactions
- Prepare source documents
- Make changes to source documents without client approval

Consistent with AICPA ET 101-3
Prohibitions within Internal Audit

Services provided by external auditors

• Setting internal audit policies or the strategic direction

• Deciding which recommendations resulting from internal audit activities to implement

• Taking responsibility for designing, implementing and maintaining internal control
External auditors

- May not provide ongoing monitoring services
- May not design the system of internal controls and then assess its effectiveness

- May evaluate the effectiveness of controls

*Management is responsible for designing, implementing and maintaining internal control*
External auditors may not
• Design or develop an IT system that would be subject to or part of an audit
• Make significant modifications to an IT system’s source code
• Operate or supervise an IT system
Prohibitions within Valuation Services

External auditors may not provide valuation services that

• Would have a material effect,
• Involve a significant degree of subjectivity, and
• Are the subject of an audit
Prohibited Nonaudit Services
Timeframes

Impairment exists during

• The period of the audit
• The professional engagement
Revisions to Timeframes Related to IT and Other Services

Q&A guidance prohibited installing or designing a system and subsequently performing an audit
  • This prohibition has been deleted

Other potential considerations
  • Independence in appearance for subsequent periods

Possible Safeguard: One audit cycle performed by another audit organization after the nonaudit service completion date provide a safeguard
1. The auditor’s application of safeguards to eliminate threats or reduce them to an appropriate level

2. Consideration of audited entity management’s ability to effectively oversee a nonaudit service to be provided by the auditor

3. The safeguards required if a audit organization is structurally located within a government entity and is considered independent based on those safeguards (not an engagement-specific requirement)
Chapter 3 – General Standards: Continuing Professional Education (CPE)

No revision to overall requirements:
- Minimum of 24 hours of CPE every 2 years
  - Government
  - Specific or unique environment
  - Auditing standards and applicable accounting principles
- Additional 56 hours of CPE for auditors involved in
  - Planning, directing, or reporting on GAGAS assignments; or
  - Charge 20 percent or more of time annually to GAGAS assignments
- Minimum of 20 hours of CPE each year
Chapter 3 – General Standards: Competence

CPE requirements for external specialists:

• External specialists are not required to meet GAGAS CPE requirements, but should be qualified and maintain professional competence
Chapter 3 – General Standards: Competence

CPE requirements for internal specialists:

• Internal specialists serving as auditors are subject to all CPE requirements
  • Specialized CPE count towards the required 24 hours

• Internal consulting specialists are not required to meet GAGAS CPE requirements, but should be qualified and maintain professional competence
Harmonized quality control system with AICPA standards

Additional requirements for consistency with AICPA

• Communicate deficiencies noted
• Recommend remedial action
Overall Changes for Financial Audits
Overall Changes for Financial Audits

- Considered Clarity Project conventions
- Streamlined language to harmonize with AICPA
- Clarified additive requirements

No new requirements were added for financial audits and attestation engagements
Requirements Beyond AICPA

Additional requirements relate to

- Auditor communication
- Previous audits and attestation engagements
- Noncompliance with provisions of contracts or grant agreements, or abuse
- Developing elements of a finding
- Documentation

For attestation engagements, this applies only at the examination level
Additional requirements relate to

- Reporting auditors’ compliance with GAGAS
- Reporting on internal control, compliance with provisions of laws, regulations, contracts, and grant agreements, and other matters
- Reporting views of responsible officials
- Reporting confidential or sensitive information
- Distributing reports
Special Considerations for Government Engagements

Applying certain AICPA standards

• Materiality
• Early communication of deficiencies (SAS No. 115)
 Removed Duplicative Requirements

Financial Audits
• Restatements
• Internal control deficiency definitions
• Communication of significant matters
• Consideration of fraud and illegal acts

Attestation Engagements
• Internal control deficiency definitions
Deleted Requirements

Covered by the Quality Control system
• Develop policies to address requests by outside parties to obtain access to audit documentation

Covered by AICPA Standards
• Document terminated engagements
  • Retained requirement for performance audits
Chapter 5
Attestation Engagements
Chapter 5 - Attestation Engagements

Separated attest requirements

• Examination
• Review
• Agreed-Upon Procedures

Update considerations

• Identified practice issue
• Clarified distinctions between engagement types
• Emphasized AICPA reporting requirements
Chapter 5 - Attestation Engagements

Within each section, emphasized

- Citing compliance with GAGAS
- Required elements of AICPA reporting
- Communicating the services to be performed
Chapters 6 & 7
Field Work & Reporting
Standards for Performance Audits
Updates to fraud requirements

- Emphasized fraud reporting to occurrences significant to the audit objectives
- Fraud that is not significant within the context of the audit objectives but warrants the attention of those charged with governance should still be communicated in writing to officials
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We also get lots of help from:

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- Jennifer Allison, Advisory Council Administrator

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Questions?
Where to Find the Yellow Book

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

- For technical assistance, contact us at yellowbook@gao.gov