



UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

# **Yellow Book: What You Need to Know**

**Annual Conference  
of Federal Audit  
Executive Council  
(FAEC)**

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# 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

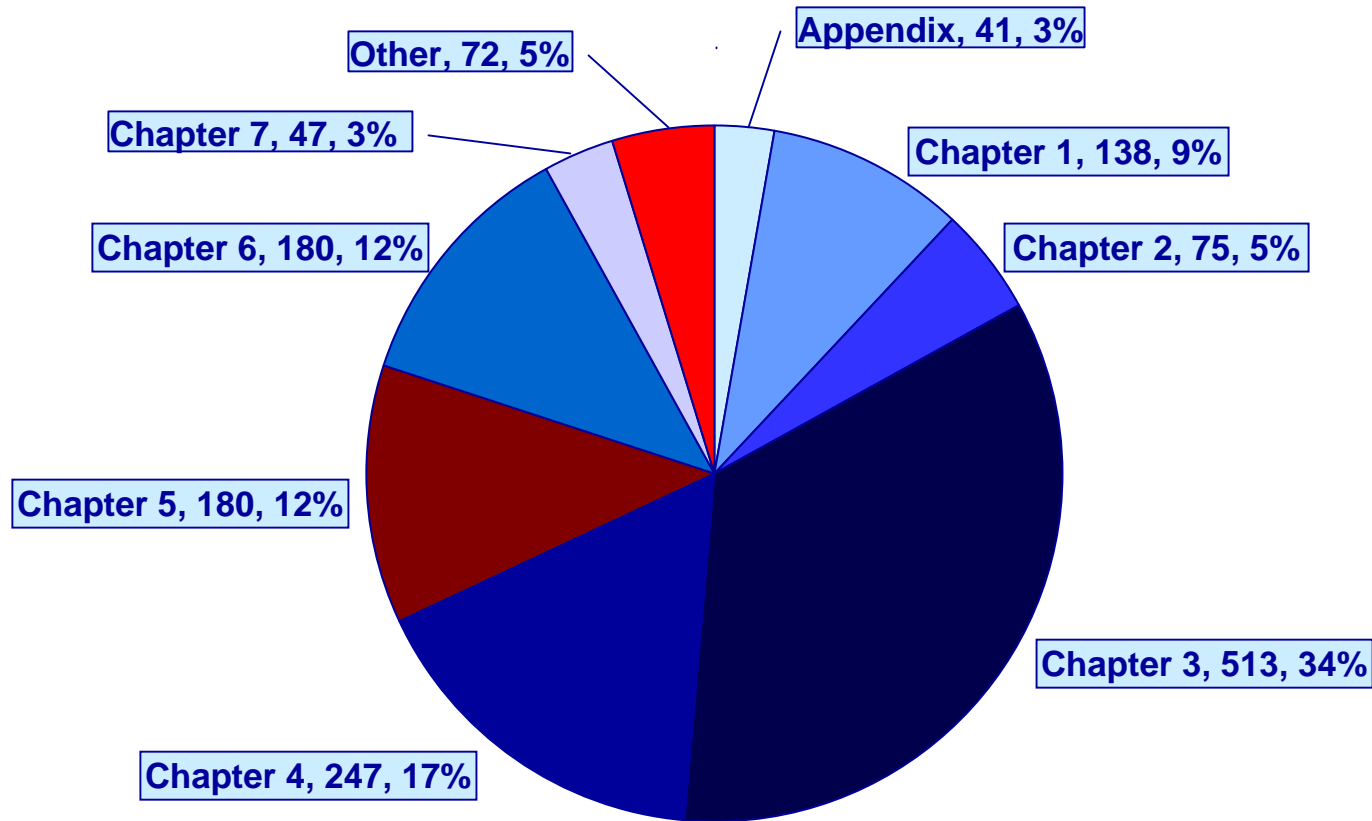
- Documenting independence for nonaudit services
- Assessing independence in appearance
  - Aggregate nonaudit services
- Adding a more comprehensive list of prohibited services

# Number of Commenters by Group Type

<b>Group Type</b>	<b>Number of Commenters</b>
Federal Audit	12
State and Local Auditors	15
Professional Organizations	17
Large CPA Firms	4
Small CPA Firms	15
Users	10
Other	7
<b>TOTAL</b>	<b>80</b>



# Comment Count by Chapter



# Chapter 1 – Government Auditing: Foundation and Ethical Principles

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)

# Chapter 2 – Standards for the Use and Application of GAGAS

## 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

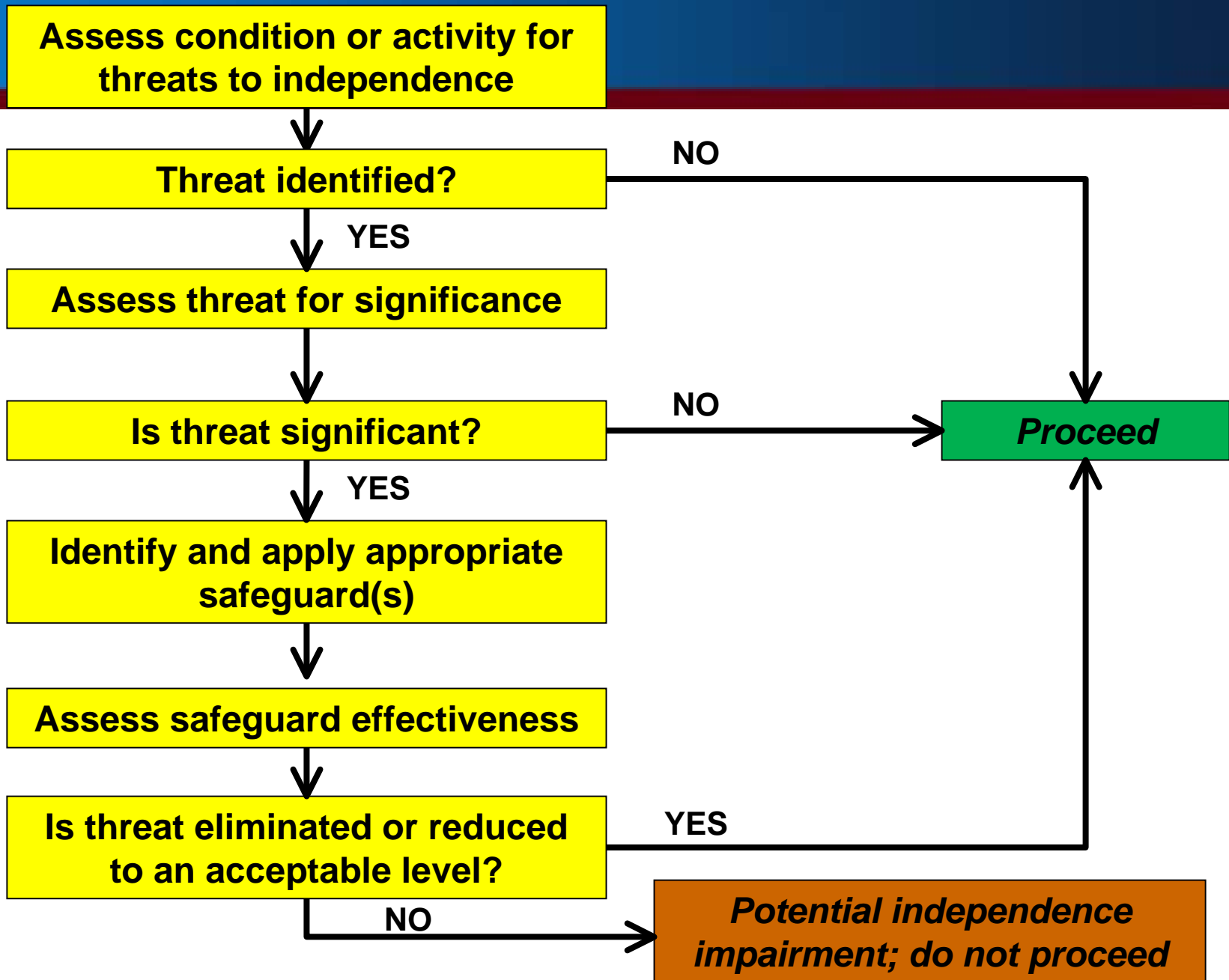
# Chapter 3 – General Standards: Independence

## **Threats could** impair independence

- Do **not** necessarily result in an independence impairment

## **Safeguards could** mitigate threats

- Eliminate or reduce to an acceptable level





# 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



# Bookkeeping and Financial Statement Preparation

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

# Prohibitions Related to Internal Control Monitoring

## 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***

# Prohibitions within IT Services

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

# Additional Documentation Requirements

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

# Chapter 3 – General Standards: Quality Control and Assurance

Harmonized quality control system with AICPA standards

Additional requirements for consistency with AICPA

- Communicate deficiencies noted
- Recommend remedial action

# Overall Changes for Financial Audits

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- 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***

# Requirements Beyond AICPA

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

# Chapter 7 - Performance Audits: Reporting - Modifications

## 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



# GAO's Accountability & Standards Team

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## We also get lots of help from:

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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](http://www.gao.gov/yellowbook)
- For technical assistance, contact us at  
[yellowbook@gao.gov](mailto:yellowbook@gao.gov)