
The July 2007 Yellow Book—Everything You Wanted to Know (but were afraid to ask)

**Association of Government Accountants
Denver Chapter
Spring Professional Development Conference**

May 14, 2007
Denver, Colorado

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Session Objectives

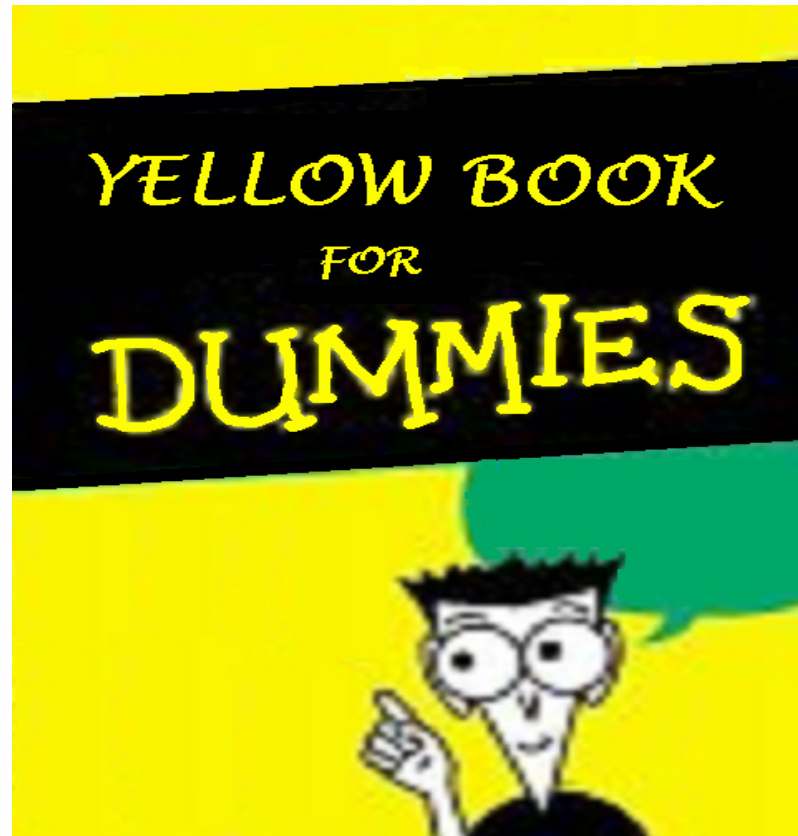
- **Discuss what's going on in the World of Standards**
 - **Highlight major revisions of the July 2007 Yellow Book and discuss common problem areas**
 - **Remind users of effective dates**
 - **Provide users with additional tools and guidance**
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Government Auditing Standards

July 2007 Revision

- 2007 replaces the 2003 revision—information available on GAO’s web site
 - For your information, auditors can now place orders with the Government Printing Office (not GAO!) for the printed FINAL 2007 Yellow Book at <http://bookstore.gpo.gov/collections/yellow-book.jsp>
 - \$12.00 per hard copy

Or, the soon to be released.....



It's a Wide World of Auditing Standards

Auditing Standards

- Creating the U.S. Auditing Standards Coordinating Forum (i.e., GAO, PCAOB, ASB)
- Promulgating and updating *Government Auditing Standards*
- Promoting the modernization of auditing standards and approaches by working cooperatively with other groups and providing technical assistance and policy input (e.g., PCAOB, AICPA, IAASB, INTOSAI, U.S. Intergovernmental Audit Forums)

Major Revisions in the 2007 Yellow Book

- Aligning GAGAS with major developments in the auditing community:
 - Terminology (Chapter 1)
 - Internal control deficiencies (financial audits)
 - Documentation (all types of GAGAS audits)
 - Developing an Ethical Framework (Chapter 2)
 - Performance Audit Framework (Chapters 7&8)
 - Quality Assurance (separately exposed, now in Chapter 3)
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Chapter 1:

Use and Application of GAGAS

- Introduction
- Purpose and Applicability of GAGAS
- Use of Terminology to Define Professional Requirements in GAGAS
- Citing Compliance with GAGAS in the Auditors' Report
- Relationship Between GAGAS and Other Standards
- Types of GAGAS Audits and Attestation Engagements

Must I Understand the New GAGAS Terminology? You Probably **Should!**

Consistent with SAS #102:

- MUST and IS REQUIRED indicate an unconditional requirement
- SHOULD indicates a presumptively mandatory requirement
- SHOULD CONSIDER – the consideration is presumptively mandatory, but doing a procedure is a matter of auditor judgment
- “May, might, could” – is explanatory material

Chapter 1: What Can I Say About GAGAS?

Citing GAGAS in auditors' report:

- Unmodified GAGAS – when all unconditional and presumptively mandatory requirements have been followed.
- Modified GAGAS – when all requirements are followed except for certain applicable standards.
- Negative GAGAS – when engagement was not performed in accordance with standards

Chapter 1:

GAGAS and Other Standards

Recognizing other sets of professional 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

NOTE: If the auditor is citing compliance with GAGAS and inconsistencies exist between GAGAS and other standards cited, the auditor should use GAGAS as the prevailing standard for conducting the audit and reporting the results.

Chapter 2: Ethical Principles in Government Auditing

Heightened emphasis on ethical principles

“Conducting audit work in accordance with ethical principles is a matter of personal and organizational responsibility. Ethical principles apply in preserving auditor independence, taking on only work that the auditor is competent to perform, performing high-quality work, and following the applicable standards cited in the audit report.”

Except from paragraph 2.03

Chapter 2: Ethical Principles

Five principles:

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

Chapter 3:

General Standards (Overview)

- Independence
 - Personal
 - External
 - Organizational
- Professional judgment
- Competence
 - Technical knowledge
 - Continuing Professional Education
- Quality Assurance
 - System of quality assurance
 - Peer review

Chapter 3: General Standards Non-Audit Services

- Moved nonaudit services from “personal impairments” to “organizational impairments”
- Created three distinct categories of nonaudit services, and consolidated and streamlined the examples previously interspersed throughout the independence section:
 - Nonaudit services that do not impair independence
 - Nonaudit services that would not impair independence if supplemental safeguards are complied with
 - Nonaudit services that do impair independence

Chapter 3: General Standards

Impairments to Independence

- When evaluating whether independence impairments exist, auditors and audit organizations must take into account the three general classes of impairments to independence—
 - personal,
 - external, and
 - Organizational
- If one or more of these impairments affects or can be perceived to affect independence, the audit organization (or auditor) should decline to perform the work

Chapter 3: General Standards - Other Independence Matters

- Streamlined requirements for auditors regarding independence when using the work of a specialist
- Added that an externally imposed restriction on access to records, government officials, or other individuals needed to conduct the audit may impair external independence
- Added steps that audit organizations should take if an impairment to independence is identified after the audit report is issued

Chapter 3: General Standards

Continuing Professional Education

- Incorporated the revised CPE requirements that were issued in April 2005 (GAO-05-568G) Under these requirements
 - All auditors should complete every 2 years at least 24 hours of CPE that relates to GAGAS
 - Auditors involved in planning, directing, or reporting on GAGAS assignments and all auditors who charge more than 20 percent or more of their time annually to GAGAS assignments, also should obtain at least an additional 56 hours of CPE that enhances the auditors' professional proficiency to conduct audits or attestation engagements
 - Clarified that auditors still are required to obtain 20 hours of CPE each year of a full 2-year CPE period
 - Clarified CPE requirements to include internal specialists who are part of the audit organization and part of the team
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Chapter 3: General Standards

Quality Control and Assurance (QCA)

Each audit organization performing audits or attestation engagements in accordance with GAGAS must:

- establish a system of quality control that is designed to provide the audit organization with reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements and
- have internal monitoring at least once every year
- have an external peer review at least once every 3 years.

Note: Requirements for system of quality control are consistent with the AICPA statement on Quality Control Standards except that the GAGAS requirements state that reviews of the work and the report that are normally part of supervision are not monitoring controls when used alone

Chapter 3: General Standards

QCA – New Policy Requirements

- Added a requirement that the quality control policies and procedures collectively address
 - Leadership responsibilities within the audit organization
 - Independence, legal, and ethical requirements
 - Initiation, acceptance, and continuance of audit and attestation engagements
 - Human resources
 - Audit and attestation engagement performance, documentation, and reporting
 - Monitoring of quality

Chapter 3: General Standards

QCA – Internal Monitoring

- Added requirements for:
 - Audit organizations to analyze and summarize the results of monitoring procedures at least annually
 - Include identification of any systemic issues needing improvement
 - Include recommendations for corrective action

Chapter 3: General Standards

QCA – External Peer Review

- Audit organizations performing audits and attestation engagements in accordance with GAGAS must have an external peer review performed by reviewers independent of the audit organization being reviewed at least once every 3 years
 - sufficient in scope to provide a reasonable basis for determining whether, for the period under review, the reviewed audit organization's system of quality control was suitably designed.
- The peer review team should include the following elements in the scope of the peer review:
 - review of the audit organization's quality control policies and procedures
 - consideration of the adequacy and results of the audit organization's internal monitoring procedures
 - review of selected reports and related documentation
 - review of other necessary documents
 - Interviews with a selection of professional staff

Chapter 3: General Standards

QCA's Impact on GAGAS Statement

- Clarified that an audit organization's:
 - noncompliance with peer review = a modified GAGAS statement (OUCH)
 - noncompliance with the requirements for a system of quality control does not impact the GAGAS statement but is monitored through peer review

Chapter 3: General Standards

Communicating QCA Results

- External audit organizations to make peer review reports publicly available
 - Does not include letter of comment
 - Can be done by posting the peer review report on an external Web site or to a publicly available file designed for public transparency of peer review results
 - Internal audit organizations to provide a copy of the external peer review report to those charged with governance
 - Government audit organizations should also communicate the overall results and the availability of their external peer review reports to appropriate oversight bodies
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Chapter 3: General Standards

QCA – Other Considerations

- Those audit organizations seeking to enter into a contract to perform a GAGAS audit or attestation engagement should provide the following to the party contracting for such services
 - The audit organization's most recent peer review report and any letter of comment
 - Any subsequent peer review reports and letters of comment received during the period of the contract
 - Auditors who are using another audit organization's work should request
 - The audit organization's latest peer review report
 - Any letter of comment
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Chapter 4: Financial Audit Field Work

Fraud and Illegal Acts

- Clarifies the existing standard but does not change auditors' responsibilities
- Under both the AICPA standards and GAGAS, auditors have the following responsibilities:
 - 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
 - Design the audit to provide reasonable assurance of detecting material misstatements resulting from illegal acts that could have a direct and material effect on the financial statements

Chapter 4: Financial Audit Field Work Abuse

- If auditors become aware of indications of abuse that could be material, auditors should apply audit procedures specifically to ascertain
 1. The potential effect on the financial statements, or
 2. The potential effect on other financial data significant to the audit objectives
- However, because the determination of abuse is subjective, auditors are not required to provide reasonable assurance of detecting abuse
- After performing additional work, auditors may discover that the abuse represents potential fraud or illegal acts

Chapter 4: Financial Audit Field Work

Provisions of Contracts or Grant Agreements

- Auditors should design the audit to provide reasonable assurance of detecting misstatements that result from violations of provisions of contracts or grant agreements that could have a direct and material effect on financial statement amounts or other financial data significant to the audit objectives
- When auditors conclude that a violation of provisions of contracts or grant agreements has or is likely to have occurred, they should determine the effect on the financial statements as well as implications for other aspects of the audit

Chapter 4: Financial Audit Field Work Audit Documentation

- Updated the standard to achieve consistency with SAS No. 103
- 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
 - That the accounting records agree or reconcile with the audited financial statements or other audited information
 - The conclusions reached on significant matters

Chapter 5: Financial Audit Reporting Internal Control

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.

Chapter 5: Financial Audit Reporting Internal Control

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.

Reporting Internal Control Deficiencies

Old Definitions

New Definitions

<p>Material weakness ('03 GAGAS para. 5.14 and SAS 60, para. 15)</p>	<p>Material weakness (AU 325.06 and '07 GAGAS para. 5.11b)</p>
<p>Reportable condition ('03 GAGAS para. 5.13 and SAS 60, para. 02)</p>	
<p>Management letter comment ('03 GAGAS para. 5.16)</p>	<p>Significant deficiency (AU 325.06 and '07 GAGAS para. 5.11a)</p>
	<p>Other matters related to internal control ('07 GAGAS para. 5.14)</p>

Chapter 5: Financial Audit Reporting

Reporting Fraud, Illegal Acts, Other Noncompliance, 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:

- Fraud and illegal acts that are greater than inconsequential
- Material violations of contracts or grant agreements
- Material abuse

Chapter 5: Financial Audit Reporting Communicating Significant Matters

- Auditors may communicate the following matters when they become aware that such issues exist:
 - Significant concerns or uncertainties about the fiscal sustainability of a government or program significant to the financial condition or operations
 - Unusual or catastrophic events that will likely have significant ongoing or future impact
 - Significant uncertainties
 - Any other matter that the auditors consider significant
 - Determining whether to communicate in the auditors' report is a matter of professional judgment
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Chapter 5: Financial Audit Reporting

Restatements-Increased Transparency

- Auditors should advise management to make appropriate disclosures when the auditors believe it is likely that previously-issued financial statements are misstated and the misstatement is or reasonably could be material (AU 561)
- Under GAGAS, auditors have additional responsibilities in the following areas:
 - Evaluate the timeliness and appropriateness of management's disclosure and actions to determine and correct misstatements in the previously-issued financial statements
 - Report on restated financial statements
 - Report directly to appropriate officials when the audited entity does not take the necessary steps

Chapter 5: Financial Audit Reporting

Restatements--Increased Transparency

Report on restated financial statements

Auditors should perform audit procedures sufficient to reissue or update the audit report on the restated financial statements regardless of whether the restated financial statements are separately issued or presented on a comparative basis

- Explanatory paragraph includes:
 - Disclosure that the previously-issued financial statements have been restated
 - Statement that previously-issued report is not to be relied on and is replaced by a revised report
 - Reference to the notes that discuss the restatement
 - If applicable, reference to the report on internal control

Chapter 6: Attestation Engagements

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
- Reporting views of responsible officials and confidential and sensitive information
- Issuing and distributing reports

Chapters 7 & 8: Who Put the **SALE** in Performance Audits?

Four key concepts in Performance Audits have been introduced or expanded (Chapters 7 & 8) :

- **S**ignificance (materiality)
- **A**udit Risk
- **L**evel of Assurance
- **E**vidence

Chapters 7 & 8: Significance (Materiality)

...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: 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: Audit Risk – the Auditor’s Responsibility

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: Level of Assurance

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: Evidence – is to be Appropriate and Sufficient

- Appropriate – is defined as a measure of **quality**, which encompasses relevance, reliability, and validity in providing support for audit objectives
- Sufficient – is defined as a measure of **quantity** and is evaluated based on the collective audit evidence supporting the findings, conclusions, or recommendations

Chapters 7 & 8: Information System Controls that are Significant to the Objective

Added a section (§§ 7.23-7.27) of information systems controls for the purpose of assessing audit risk and planning the audit

- Consist of those internal controls that are dependent on information systems processing
- Include general controls and application controls
- Are significant to the audit objectives if auditors determine that it is necessary to evaluate the effectiveness of information system controls in order to obtain sufficient, appropriate evidence
- If significant, auditors should evaluate the design and operating effectiveness of such controls by performing audit procedures

Chapters 7 & 8: Overall Assessment of Performance Audit Evidence

Added a section (§§ 7.68-7.71) describing the overall assessment of the collective evidence to support the findings and conclusions

- Assessment of evidence depends on the nature of the evidence, how it is used, and the audit objectives
- Evidence is sufficient and appropriate when it provides a reasonable basis for supporting the findings or conclusions within the context of the audit objectives
- Evidence is not sufficient and appropriate when it
 - Carries an unacceptably high risk that it could lead to an incorrect or improper conclusion
 - Has significant limitations
 - Does not provide an adequate basis for addressing the audit objectives or supporting the findings and conclusions

Chapters 7 & 8 Performance Audits

Fraud

In planning the audit, auditors should assess risks of fraud occurring that is significant within the context of the audit objectives

Auditors should

- Discuss fraud risks among the audit team
- Gather and assess information to identify risk of fraud that are significant within the scope of the audit objectives or that could affect the findings and conclusions

When auditors identify factors or risks related to fraud that has occurred or is likely to have occurred that are significant within the context of the audit objectives, they should design procedures to provide reasonable assurance of detecting such fraud

Chapters 7 & 8 Performance Audits Abuse

- If auditors become aware of indications of abuse that could be quantitatively or qualitatively significant to the program under audit, auditors should apply audit procedures specifically directed to ascertain
 - The potential effect on the program under audit within the context of the audit objectives
 - However, because the determination of abuse is subjective, auditors are not required to provide reasonable assurance of detecting abuse
 - After performing additional work, auditors may discover that the abuse represents potential fraud or illegal acts
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Chapters 7 & 8 Performance Audits

Legal and Regulatory Requirements, Provisions of Contracts or Grant Agreements

- Auditors should determine which laws, regulations, and provisions of contracts or grant agreements are significant within the context of the audit objectives and assess the risk that violations of those laws, regulations, and provisions of contracts or grant agreements could occur
- Auditors should design and perform procedures to provide reasonable assurance of detecting instances of violations of legal and regulatory requirements or violations of provisions of contracts or grant agreements that are significant within the context of the audit objectives

Chapters 7 & 8 Performance Audits: And From That I Conclude....

GAGAS statement in audit report

When auditors comply with all applicable GAGAS requirements, they should use 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 to provide 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.”

Chapters 7 & 8: Performance Audits

What if we discover that we blew it?

- If after the report is issued, auditors discover they did not have sufficient, appropriate evidence to support the reported findings or conclusions, they should communicate with
 - Those charged with governance
 - Appropriate officials of the audited entity
 - Appropriate officials of the organizations requiring or arranging for the audits
 - If report was posted to auditors' publicly accessible Web site
 - Remove the report
 - Post a public notification that the report was removed
 - Determine whether to conduct additional audit work necessary to reissue report with revised findings or conclusions
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Common Pitfalls - All Types of GAGAS Audits

Controls Over Electronic Audit Documentation

- Whether audit documentation is in paper, electronic, or other media
 - The integrity, accessibility, and retrievability of the underlying information could be compromised if
 - Documentation is altered, added to, or deleted without auditors' knowledge
 - Documentation is lost or damaged
- For documentation retained electronically, audit organization should establish IS controls concerning the accessing and updating the audit documentation

Common Pitfalls - All Types of GAGAS Audits

Reporting Confidential and Sensitive Information

- If information is excluded from the auditors' report, auditors
 - Should disclose that certain information has been omitted and reason for the omission
 - May issue a separate report and distribute it to only persons authorized to receive it
- If subject to public records laws, auditors should
 - Determine the impact of such laws on the availability of the separate report
 - Determine whether other means of communicating would be more appropriate

Common Pitfalls - All Types of GAGAS Audits

Reporting Views of Responsible Officials

- All performance audit reports and in financial audit reports that disclose deficiencies in internal control, fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse, auditors should
 - Obtain and report views of responsible officials concerning
 - Findings, conclusions, and recommendations
 - Planned corrective actions
- Include in report an evaluation of the comments, as appropriate
- If the audited entity does not provide comments, auditors may issue report indicating that the audited entity did not provide comments

Common Pitfalls - All Types of GAGAS Audits

Distributing reports

- Distribution of reports depends on
 - The relationship of the auditors to the audited organization
 - The nature of the information contained in the report
- Different requirements for
 - Government audit organizations (external)
 - Internal audit organizations in government
 - Public accounting firms

Appendix

Supplemental Guidance

Added an appendix to provide supplemental guidance to assist auditors in the implementation of GAGAS

- Does not establish additional GAGAS requirements
- Overall supplemental guidance includes examples of
 - Deficiencies in internal control
 - Abuse
 - Fraud Risk
- Overall guidance includes guidance on determining whether laws, regulations, or provisions of contracts or grant agreements are significant

July 2007 Revision Implementation Dates

- For performance audits, the standards are effective for audits beginning on or after January 1, 2008.
- For financial audits and attestation engagements, the standards are effective for audits of periods beginning on or after January 1, 2008.
 - Until the 2007 revision becomes effective, auditors should adopt the terminology and definitions of SAS No. 112 in reporting on internal control
- Early implementation is permissible and encouraged

If You Remember Only One Thing From This Presentation – USE THIS TOOL (GAO-08-210G)



Related Guidance that Accompanies the 2007 Revision

- Guidance on GAGAS Requirements for Continuing Professional Education (GAO-05-568G, April 2005)
- Answers to Independence Questions (GAO-02-870G, July 2002)
- Yellow Book available at <http://gao.gov/govaud/ybk01.htm>
- For technical assistance, contact us at yellowbook@gao.gov