GAO

Update on
## *Government Auditing Standards* and
Standards for Internal Control in the Federal Government

New England
Intergovernmental Audit
Forum

October 23, 2014

Eric Holbrook

**GAO** U.S. GOVERNMENT ACCOUNTABILITY OFFICE
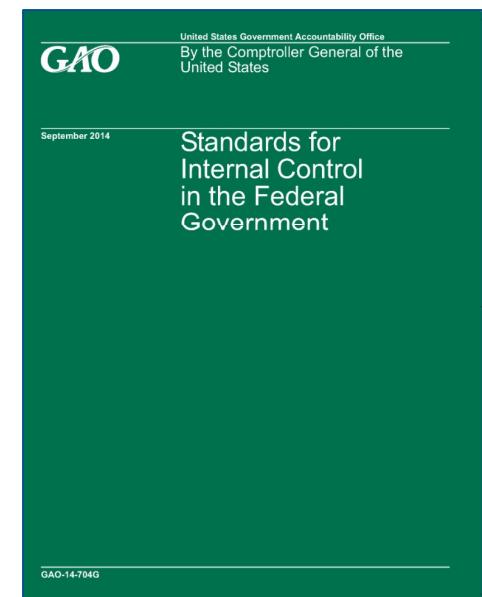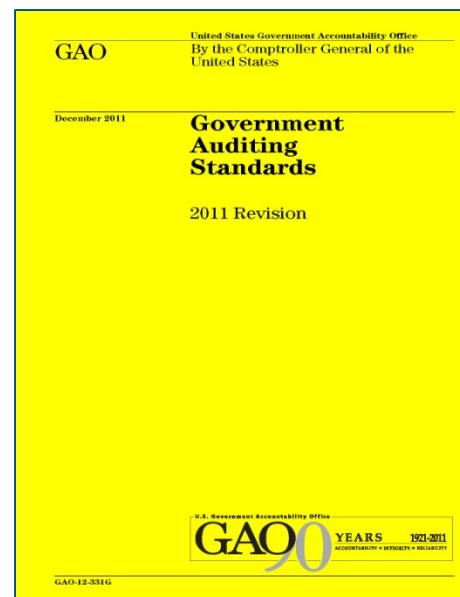
Session Objective

To provide an update on the audit and internal control standards promulgated by GAO.

Yellow Book = "GAGAS"

"generally accepted government auditing standards"
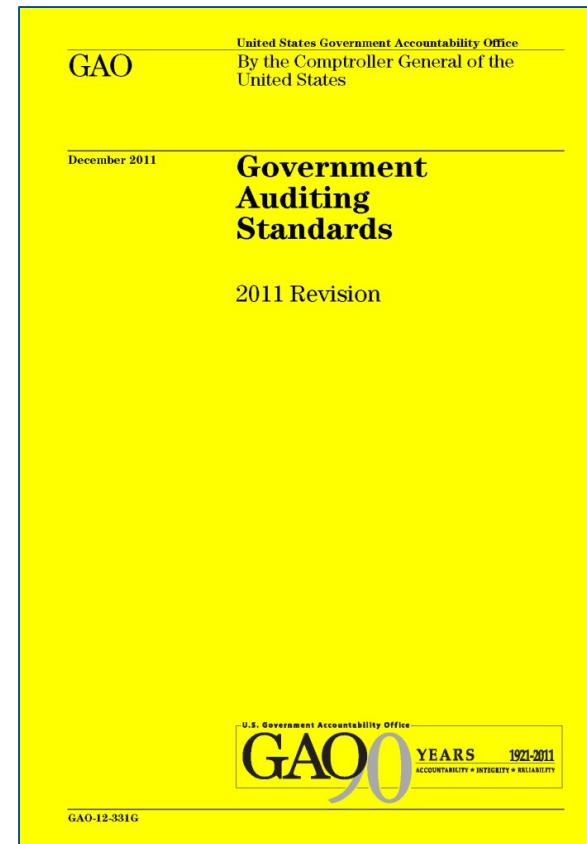
The 2011 Yellow Book: Applicability

- Chapters 1, 2, and 3 apply to all GAGAS engagements
  - ➤ Chapter 1: Government Auditing: Foundation and Ethical Principles
  - ➤ Chapter 2: Standards for Use and Application of GAGAS
  - ➤ Chapter 3: General Standards
- Chapter 4: Standards for Financial Audits – applies only to financial audits
- Chapter 5: Standards for Attestation Engagements - applies only to attestation engagements

The 2011 Yellow Book Applicability (Continued)

- Chapters 6 and 7 apply only to performance audits
  - Chapter 6: Field Work Standards for Performance Audits
  - Chapter 7: Reporting Standards for Performance Audits
- Appendix: Provides additional guidance (not requirements) for all GAGAS engagements
- Interpretations: Available on the Yellow Book web page. Provide additional guidance (not requirements) for areas of particular interest or sensitivity

Chapter 3: General Standards

- Independence
  - Conceptual framework
  - Provision of nonaudit services to auditees
- Professional judgment
- Competence
  - Technical knowledge
  - Continuing Professional Education
- Quality Assurance
  - System of quality assurance
  - Peer review

Independence: Applying the Conceptual Framework

1. Identify threats to independence
2. Evaluate the significance of the threats identified, both individually and in the aggregate
3. Apply safeguards as necessary to eliminate the threats or reduce them to an acceptable level
4. Evaluate whether the safeguard is effective

Documentation Requirement:

Para 3.24: When threats are not at an acceptable level and require application of safeguards, auditors should document the safeguards applied.

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Applying the Conceptual Framework: Categories of Threats

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

Nonaudit Services

1. Determine if there is a specific prohibition. Unless specifically prohibited, nonaudit services MAY be permitted but should be documented.

2. If not prohibited, assess the nonaudit service's impact on independence using the conceptual framework.

3. If the auditor assesses any identified threat to independence as higher than insignificant, <u>assess the sufficiency of audited entity management's skill, knowledge, and experience to oversee the nonaudit service</u>.

   And...

Nonaudit Services (Continued)

4. If the auditor concludes that performance of the nonaudit service will not impair independence, document assessments in relation to both:

    - safeguards applied in accordance with the conceptual framework and
    - the auditor's assessment of sufficiency of audited entity managements' skill, knowledge or experience to oversee the nonaudit service (paragraph 3.34).

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Peer Reviews

The peer review team uses professional judgment in deciding the type of peer review report. The following are the types of peer review reports:

- Peer review rating of pass
- Peer review rating of pass with deficiencies
- Peer review rating of fail

Chapter 4: Financial Audits

- Incorporate by reference AICPA Statements on Auditing Standards

- Additive requirements (performing and reporting) for financial audits

- Additional considerations for financial audits

Additional Requirements for Performing Financial Audits

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
- Audit Documentation

Additional Requirements for Reporting on Financial Audits

Additional requirements relate to

- Reporting auditors' compliance with GAGAS
- Reporting on internal control, compliance with provisions of laws, regulations, contracts, and grant agreements
- Communicating deficiencies in internal control, fraud, noncompliance with provisions of laws, regulations, contracts, and grant agreements, and abuse
- Reporting views of responsible officials
- Reporting confidential or sensitive information
- Distributing reports

Attestation Engagements

Separate sections for the requirements for engagements:

- Examination
- Review
- Agreed-Upon Procedures

Chapter 5: Attestation Engagements

Separate sections for the requirements for engagements:

- Examination
- Review
- Agreed-Upon Procedures

Attestation Engagements

- Incorporate by reference AICPA Statements on Standards for Attestation Engagements (SSAEs)
- Additive requirements (performing and reporting) for financial audits
- Additional considerations for GAGAS attestations

Additional Requirements for Performing Attestations

Additional requirements relate to

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

Additional Requirements for Reporting on Attestations

Additional requirements relate to

- Reporting auditors' compliance with GAGAS
- Reporting deficiencies in internal control, fraud, noncompliance with provisions of laws, regulations, contracts, and grant agreements, and abuse
- Reporting views of responsible officials
- Reporting confidential or sensitive information
- Distributing reports

Chapter 6: Performance Audit - Fieldwork

- Reasonable assurance
- Significance
- Audit Risk
- Planning

- Supervision

- Obtaining sufficient, appropriate evidence

- Audit documentation

Performance Audits - Criteria

- The laws, regulations, contracts, grant agreements, standards, measures, expected performance, defined business practices, and benchmarks against which performance is compared or evaluated.

- Examples of criteria:

  ➢ purpose or goals prescribed by law or regulation or set by officials of the audited entity

  ➢ policies and procedures established by officials of the audited entity

  ➢ Technical standards or norms

Chapter 7: Performance Audit Reporting - Report Contents

Auditors should prepare audit reports that contain

- Objectives, scope, and methodology of the audit
- Audit results, including findings, conclusions, and recommendations, as appropriate
- Statement about the auditors' compliance with GAGAS
- Summary of the views of responsible officials
- Nature of any confidential or sensitive information omitted

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

  or call (202) 512-9535

Standards for Internal Control in the Federal Government

"The Green Book"
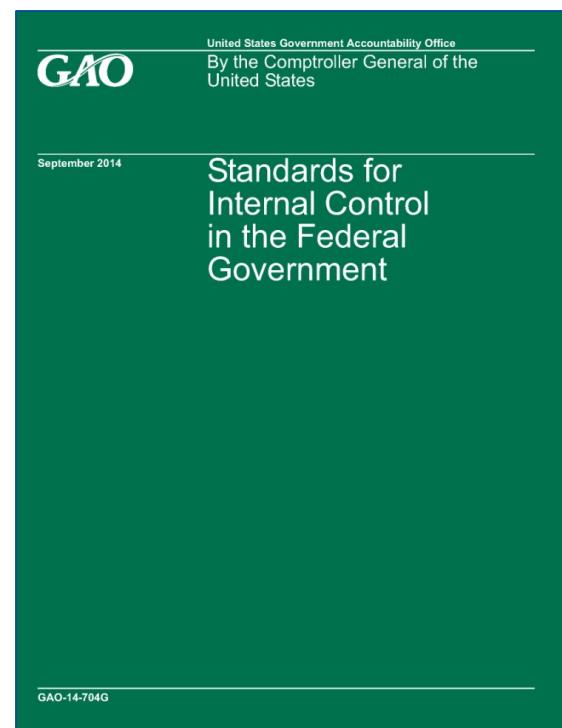
Green Book Advisory Council

Representation from:
- Federal agency management (nominated by OMB)
- Inspectors General
- State and local government
- Academia
- COSO
- Independent public accounting firms
- At large

![GAO logo]

Standards for Internal Control in the Federal Government

- Reflects federal internal control standards required per Federal Managers' Financial Integrity Act (FMFIA)

- Serves as a base for OMB Circular A-123

- Written for government
  - Leverages the COSO Framework
 - Uses government terms

What's in the Green Book
for State and Local Governments?

- May be an acceptable framework for internal control on the state and local government level under proposed OMB Uniform Guidance for Federal Awards

- Written for government
  - ➢ Leverages the COSO Framework
  - ➢ Uses government terms

What's in the Green Book
for Management and Auditors?

- Provides accepted standards for management
- Provides criteria for auditors
- Can be used in conjunction with other standards like the Yellow Book

Updated COSO Framework
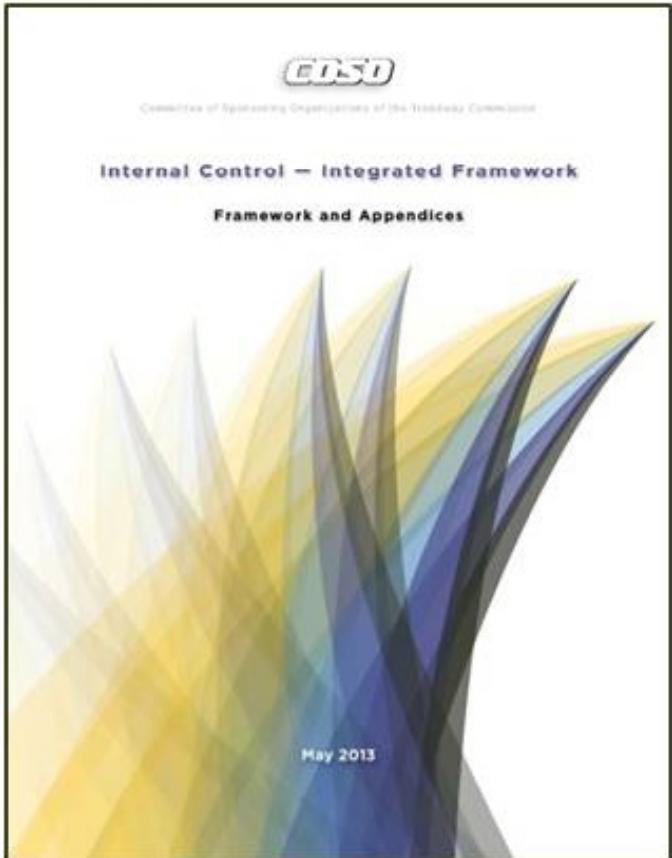
Released
May 14, 2013

The COSO Framework

COSO depicts the relationships as a cube.

- The three objectives are represented by the columns.
- The five components are represented by the rows.
- The entity's organization structure is represented by the third dimension.

Source: COSO

Harmonization from COSO to Green Book

Commercial Concepts

- Board of Directors
- Investors

Government Concepts

- Oversight Body
- Stakeholders
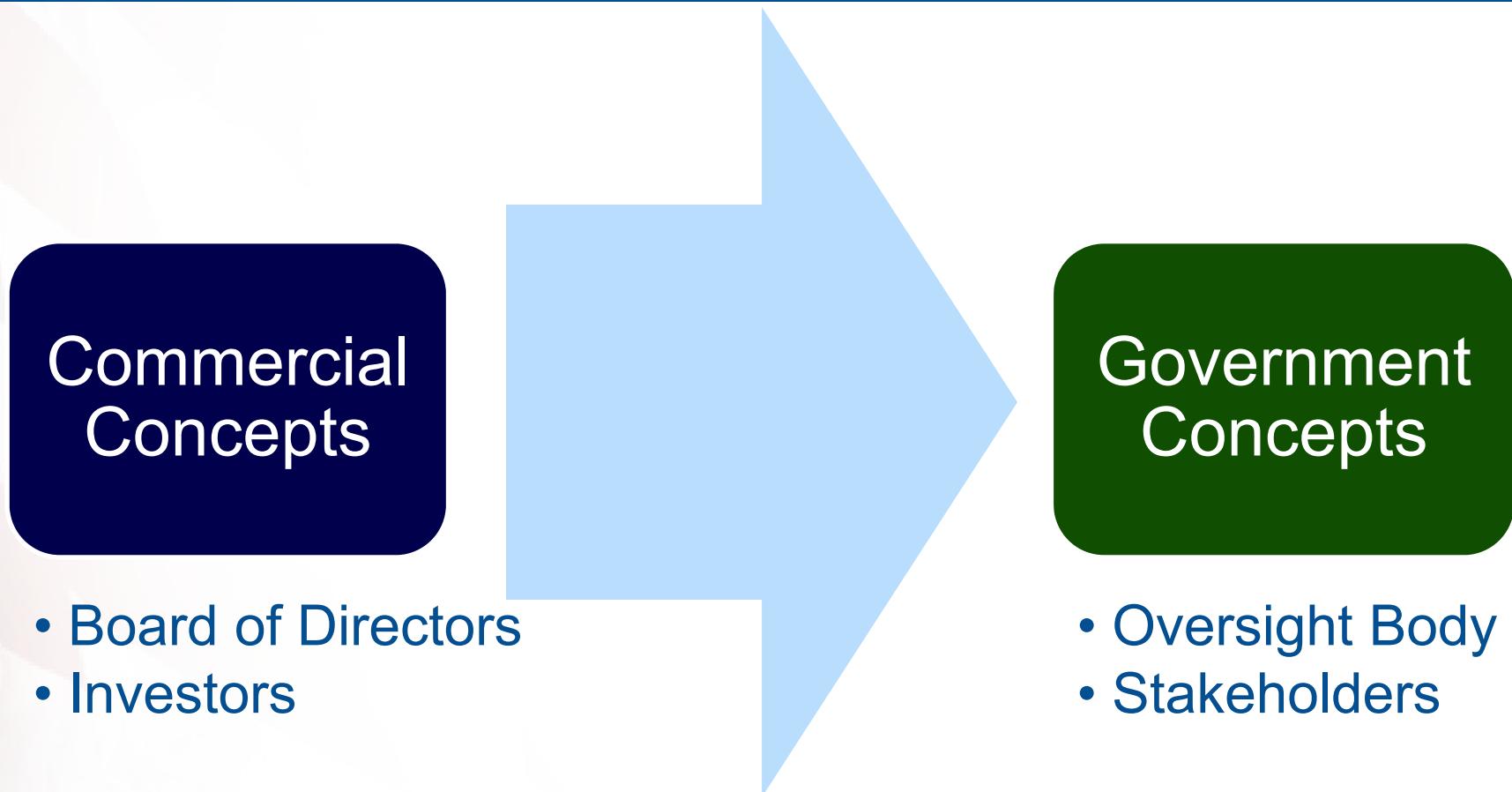
Revised Green Book: Standards for Internal Control in the Federal Government

United States Government Accountability Office
By the Comptroller General of the United States

September 2014

Standards for Internal Control in the Federal Government

GAO-14-704G
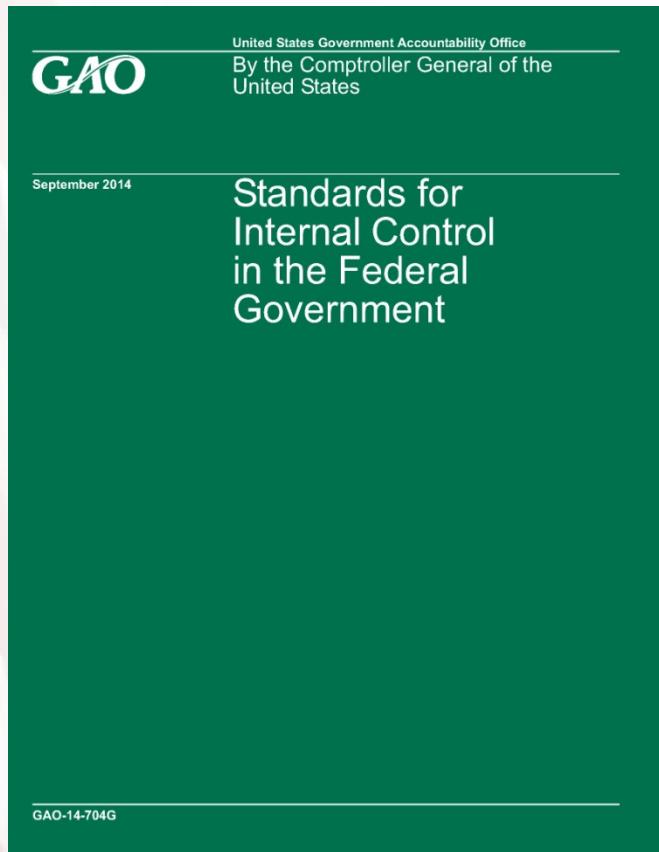
- Consists of two sections:
  - ➢ Overview
  - ➢ Standards

- Establishes:
  - ➢ Definition of internal control
  - ➢ Categories of objectives
  - ➢ Components and principles of internal control
  - ➢ Requirements for effectiveness

Definition of Internal Control

Internal control is a process effected by an entity's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved. These objectives and related risks can be broadly classified into one or more of the following three categories:

- Operations - Effectiveness and efficiency of operations

- Reporting - Reliability of reporting for internal and external use

- Compliance - Compliance with applicable laws and regulations

From OMB's New Grants Guidance

§ 200.61 Internal controls.

Internal controls means a process, implemented by a non-Federal entity, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

(a) Effectiveness and efficiency of operations;

(b) Reliability of reporting for internal and external use; and

(c) Compliance with applicable laws and regulations.

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From OMB's New Grants Guidance

§ 200.303 Internal controls.

The non-Federal entity must:

(a) Establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award. These internal controls should be in compliance with guidance in "Standards for Internal Control in the Federal Government" issued by the Comptroller General of the United States and the "Internal Control Integrated Framework", issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Components, Principles, and Attributes
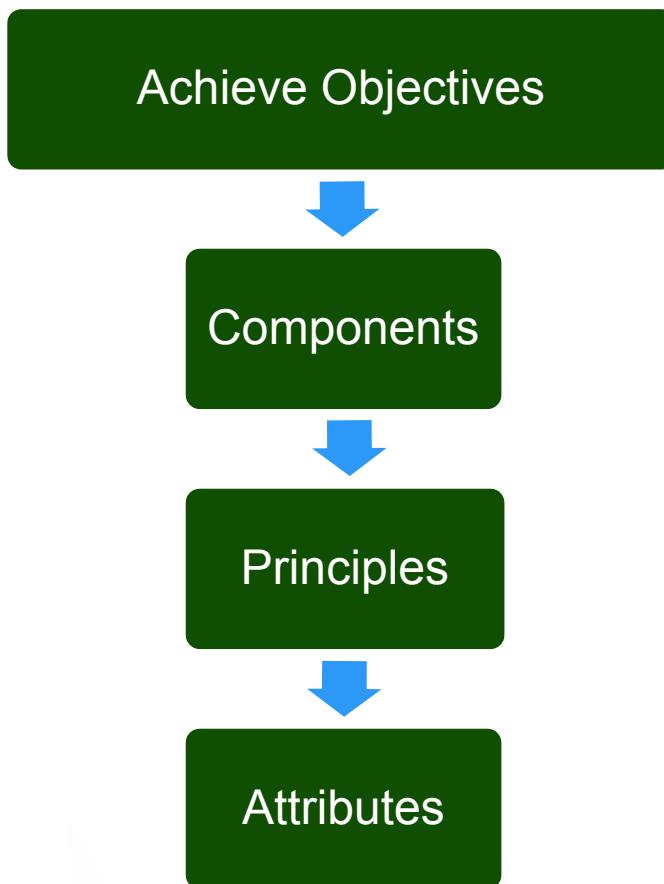
Components and Principles
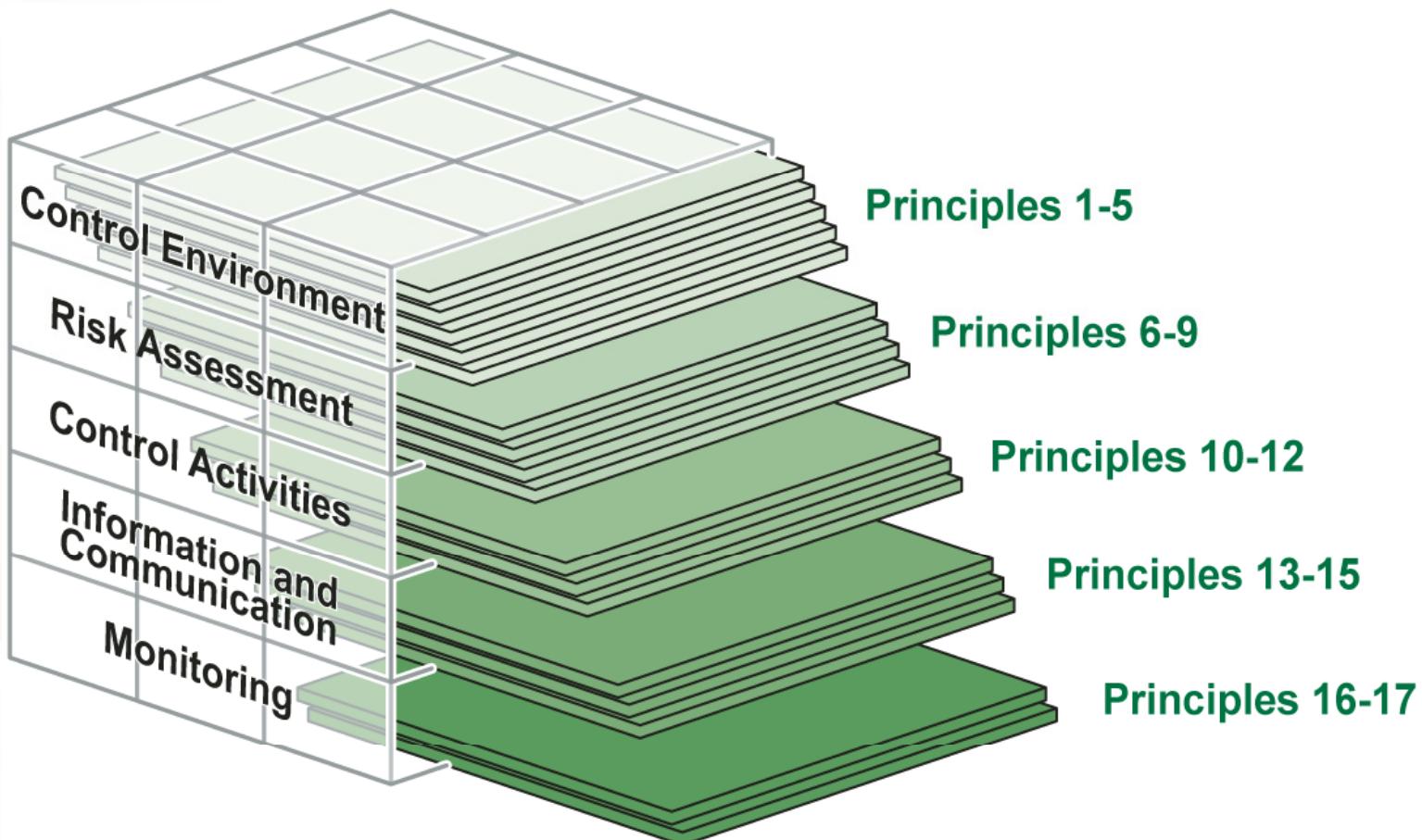
Components and Principles

Control Environment	1. Demonstrate Commitment to Integrity and Ethical Values 2. Exercise Oversight Responsibility 3. Establish Structure, Responsibility, and Authority 4. Demonstrate Commitment to Competence 5. Enforce Accountability
Risk Assessment	6. Define Objectives and Risk Tolerances 7. Identify, Analyze, and Respond to Risk 8. Assess Fraud Risk 9. Analyze and Respond to Change
Control Activities	10. Design Control Activities 11. Design Activities for the Information System 12. Implement Control Activities
Information & Communication	13. Use Quality Information 14. Communicate Internally 15. Communicate Externally
Monitoring Activities	16. Perform Monitoring Activities 17. Remediate Deficiencies

Controls Across Components

Controls embedded in other components may effect this principle

Control Environment

Human Resources review employee's confirmations to assess whether standards of conduct are understood and adhered to by staff across the entity

Information & Communication

Management obtains and reviews data and information underlying potential deviations captured in whistleblower hotline to assess quality of information

Monitoring Activities

Internal Audit separately evaluates Control Environment, considering employee behaviors and whistleblower hotline results and reports thereon

Principle

1. The organization demonstrates a commitment to integrity and ethical values

Component

Control Environment

Principles and Attributes

- In general, all components and principles are required for an effective internal control system

- Principles and Attributes

  ➤ Entity should implement relevant principles

  ➤ If a principle is not relevant, document the rationale of how, in the absence of that principle, the associated component could be designed, implemented, and operated effectively

  ➤ Attributes are considerations that can contribute to the design, implementation, and operating effectiveness of principles

Components, Principles, and Attributes

Component

Control environment

Principle

The oversight body and management should demonstrate a commitment to integrity and ethical values

Attributes

Set the Tone at the Top

Establish standards of conduct

Evaluate adherence to standards of conduct

COSO vs. Green Book

Component	COSO	Green Book
Control Environment	**5** Principles **20** Points of Focus	**5** Principles **13** Attributes
Risk Assessment	**4** Principles **27** Points of Focus	**4** Principles **10** Attributes
Control Activities	**3** Principles **16** Points of Focus	**3** Principles **11** Attributes
Information & Communication	**3** Principles **14** Points of Focus	**3** Principles **7** Attributes
Monitoring	**2** Principles **10** Points of Focus	**2** Principles **6** Attributes

Management Evaluation

- An effective internal control system requires that each of the five components are:
  - ➤ Effectively designed, implemented, and operating
  - ➤ Operating together in an integrated manner
- Management evaluates the effect of deficiencies on the internal control system
- A component is not effective if related principles are not effective

Revised Green Book: Standards

Source: COSO

Control Environment

Control Environment

1. Demonstrate Commitment to Integrity and Ethical Values
2. Exercise Oversight Responsibility
3. Establish Structure, Responsibility, and Authority
4. Demonstrate Commitment to Competence
5. Enforce Accountability

Risk Assessment

Risk Assessment

6. Define Objectives and Risk Tolerances
7. Identify, Analyze, and Respond to Risk
8. Assess Fraud Risk
9. Analyze and Respond to Change

Control Activities

Control Activities

10. Design Control Activities
11. Design Activities for the Information System
12. Implement Control Activities

Information & Communication

Information & Communication

13. Use Quality Information
14. Communicate Internally
15. Communicate Externally

Monitoring

Monitoring

16. Perform Monitoring Activities
17. Remediate Deficiencies

Controls Across Components

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Principle

1. The organization demonstrates a commitment to integrity and ethical values

Component

Control Environment

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Documentation Requirements

If management determines a principle is not relevant, management supports that determination with documentation that includes the rationale of how, in the absence of that principle, the associated component could be designed, implemented, and operated effectively.

Documentation Requirements (cont.)

- Control Environment
  - Management develops and maintains documentation of its internal control system.

- Control Activities
  - Management documents in policies the internal control responsibilities of the organization.

Documentation Requirements (cont.)

- Monitoring

  ➢ Management evaluates and documents the results of ongoing monitoring and separate evaluations to identify internal control issues.

  ➢ Management evaluates and documents internal control issues and determines appropriate corrective actions for internal control deficiencies on a timely basis.

  ➢ Management completes and documents corrective actions to remediate internal control deficiencies on a timely basis.

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Where to Find the Green Book

- The Green Book will be on GAO's website at: www.gao.gov

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