

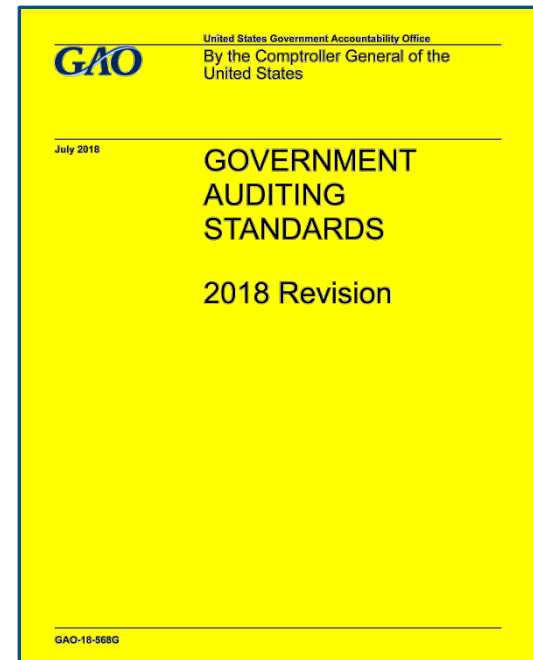


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# Update on the Developments in Government Auditing Standards

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**2018 Yellow Book Revision**

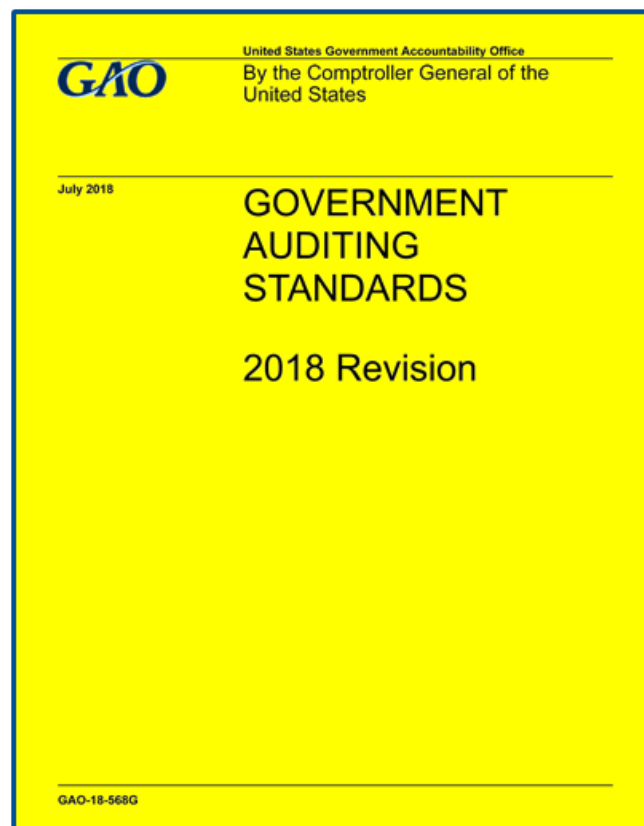


U.S. GOVERNMENT ACCOUNTABILITY OFFICE

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## Session Objective

Provide a summary of revisions to the Yellow Book



## Yellow Book Revision Process

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- Exposure draft was issued for public comment on April 5, 2017.
- GAO received 95 comment letters with over 1,700 individual comments on the exposure draft.
- The 2018 Revision was issued on July 17, 2018.

## Summary of Key Changes from 2011 Revision

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- New format and organization
  - Independence threats related to preparing financial statements
  - Guidance for CPE requirements
  - Competence of specialists
  - Peer review requirements
  - Quality control
  - Monitoring of quality
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## Summary of Key Changes from 2011 Revision

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- Internal control: financial audits and examination engagements
- Internal control: performance audits
- New considerations for addressing waste
- Standards for reviews of financial statements
- Management assertions

## New Format and Organization

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- Chapters are presented in a revised format that differentiates requirements from application guidance.
- Chapters are reorganized and realigned.
- Supplemental guidance from the appendix of the 2011 revision was either removed or incorporated into individual chapters.
- Hard copy version will be a larger size.

# New Format and Organization

## Chapter 5: Quality Control and Peer Review

5.01 This chapter establishes the generally accepted government auditing standards (GAGAS) requirements and guidance for quality control and assurance, and for administering, planning, performing, and reporting on peer reviews of audit organizations that conduct engagements in accordance with GAGAS. The requirements of this chapter are intended to be followed in conjunction with those of all other applicable GAGAS requirements.

### Quality Control and Assurance

#### Requirement: Quality Control and Assurance

5.02 An audit organization conducting engagements in accordance with GAGAS must establish and maintain 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.

#### Application Guidance: Quality Control and Assurance

5.03 An audit organization's system of quality control encompasses the organization's leadership, emphasis on performing high-quality work, and policies and procedures designed to provide reasonable assurance of complying with professional standards and applicable legal and regulatory requirements. The nature, extent, and formality of an audit organization's quality control system will vary based on the audit organization's circumstances, such as size, number of offices and geographic dispersion, knowledge and experience of its personnel, nature and complexity of its engagement work, and cost-benefit considerations.

### System of Quality Control

#### Requirement: System of Quality Control

5.04 An audit organization should document its quality control policies and procedures and communicate those policies and procedures to its personnel. The audit organization should document compliance with its

# Independence Threats related to Preparing Financial Statements & Accounting Records

Nonaudit services performed by auditors related to financial statements and accounting records either:

**Impair Independence**

No change from 2011 Yellow Book (para. 3.87)

**Are Significant Threats**

The auditor prepares financial statements in their entirety (para. 3.88).

**OR**

The auditor determines that a service related to preparing financial statements or accounting records is a significant threat (para. 3.93).

Document the threats and safeguards applied to eliminate and reduce threats to an acceptable level (para. 3.33).

**OR**

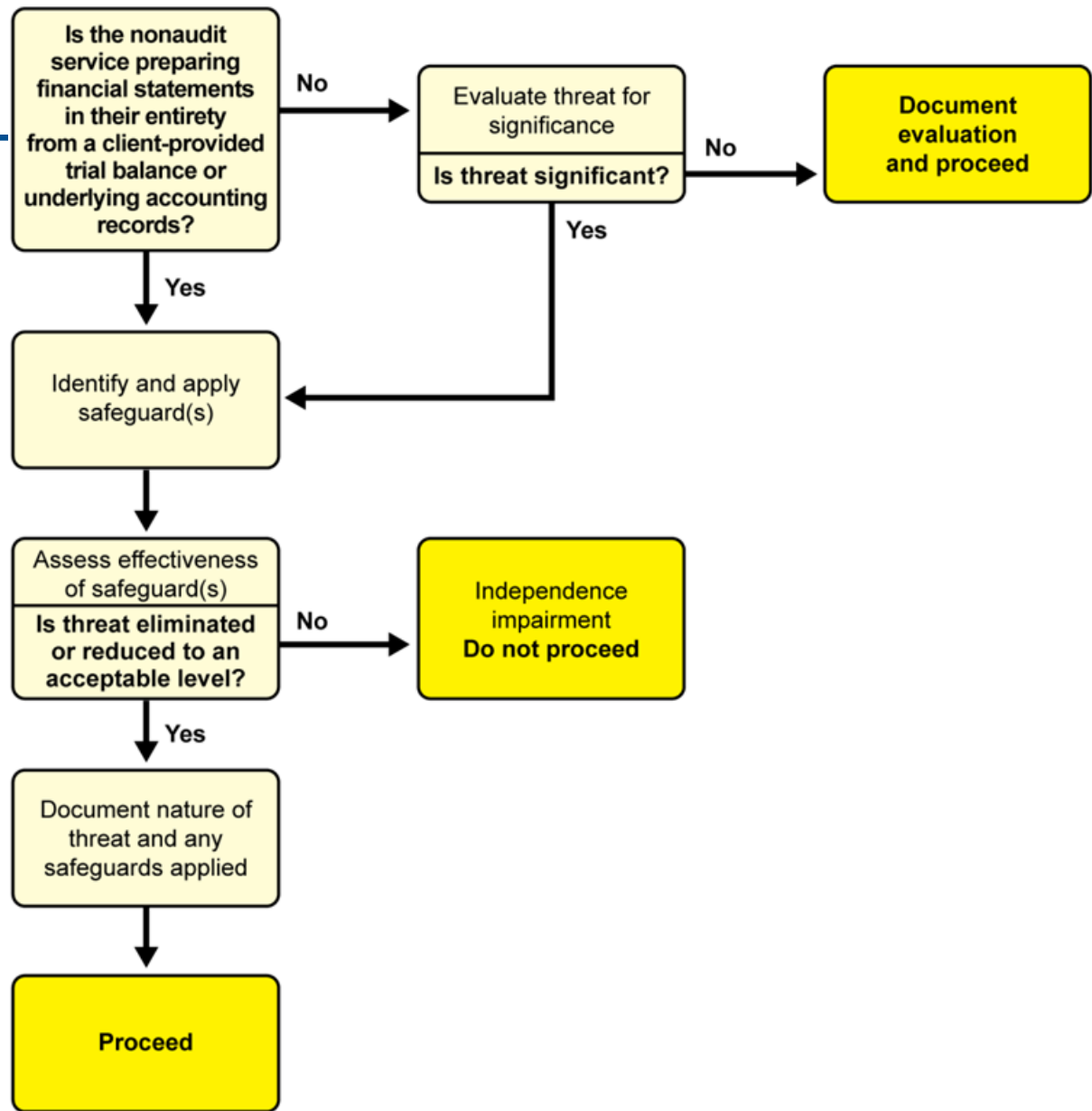
Decline to perform the service (para. 3.88).

**Are Threats**

- Evaluate threat and document evaluation (para. 3.90).
- Typing, formatting, printing, binding: not likely significant (para. 3.95)



# Independence Considerations for Preparing Accounting Records and Financial Statements



Source: GAO. | GAO-18-568G

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## Safeguards Related to Nonaudit Services

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Examples of safeguards for addressing threats to independence related to nonaudit services (para. 3.69):

- a. not including individuals who provided the nonaudit service as engagement team members;
- b. having another auditor, not associated with the engagement, review the engagement and nonaudit work as appropriate;
- c. engaging another audit organization to evaluate the results of the nonaudit service; or
- d. having another audit organization re-perform the nonaudit service to the extent necessary to enable that other audit organization to take responsibility for the service.

## **Nonaudit Services vs. Routine Activities**



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- Routine activities are not considered nonaudit services (para. 3.70).
- Examples include (paras. 3.70 & 3.71):
  - providing advice and responding to questions as part of an engagement, and
  - educating the audited entity on matters within the technical expertise of the auditors.

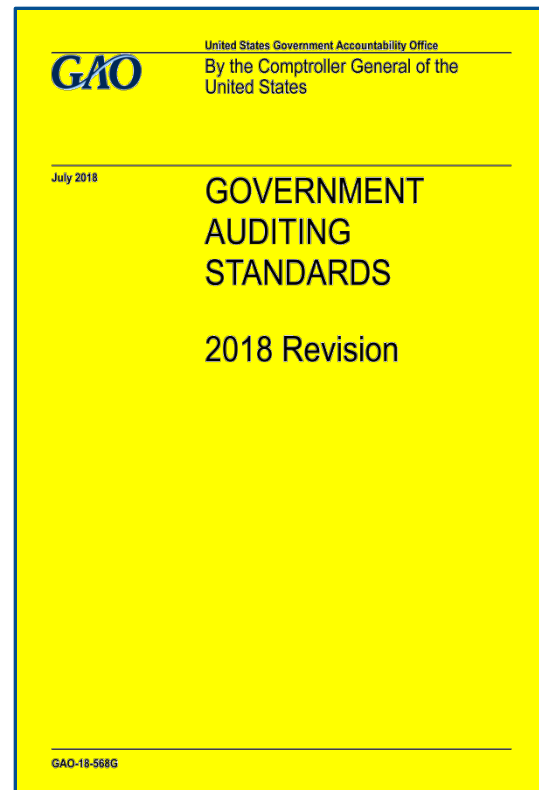
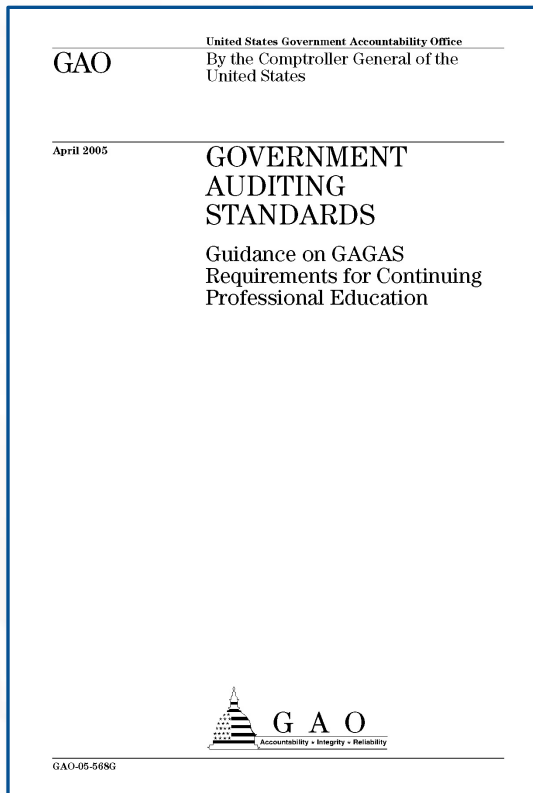
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## Additional Updates to Independence Guidance

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- Added application guidance to define management's “Skills, Knowledge and Experience” (SKE)  an indicator is management’s ability to recognize a material error (para. 3.79)
- Updated application guidance to clarify that certain services provided by government audit organizations would generally not create threats to independence  allowability of certain functions such as investigations (para. 3.72)

# Guidance for CPE Requirements



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## CPE Requirements and Guidance

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- Removed the 4-hour GAGAS Qualification CPE requirement proposed in the exposure draft
- Added application guidance related to obtaining GAGAS specific CPE each time a new Yellow Book revision is issued (para. 4.19)

## CPE Requirements and Guidance (cont.)

- Similar to the 2011 Yellow Book, CPE requirements are:

CPE Hours	Subject Matter Categories of CPE
24 hours	Subject matter directly related to the government environment, government auditing, or the specific or unique environment in which the audited entity operates
56 hours	Subject matter that directly enhance auditors' professional expertise to conduct engagements

(para. 4.16)

- Refined lists of examples of topics and subjects that qualify for the 24 hour and 56 hour requirements (paras. 4.21 - 4.24)

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## Competence of Specialists

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- Engagement team should determine whether specialists are qualified and competent in their areas of specialization (para. 4.12).
  
- External specialists are not subject to Yellow Book CPE requirements (para. 4.30).
  
- Internal specialists who are **not** involved in planning, directing, performing engagement procedures, or reporting are not subject to Yellow Book CPE requirements (para. 4.30).
  
- IT auditors are considered auditors and thus are subject to the CPE requirements (para. 4.13).



## Peer Review Requirements

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Peer review section differentiates requirements for those audit organizations affiliated with a recognized organization.



## Peer Review Requirements

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All audit organizations comply with GAGAS peer review requirements for:

- Assessment of peer review risk (paras. 5.66 & 5.67),
- Peer review report ratings (paras. 5.72 – 5.74), and
- Availability of peer review report to the public (paras. 5.77 – 5.80).

## Peer Review Requirements: Affiliated

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Audit organizations affiliated with a recognized organization also comply with the respective organization's peer review requirements (para. 5.61).

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## Peer Review Requirements: Not Affiliated

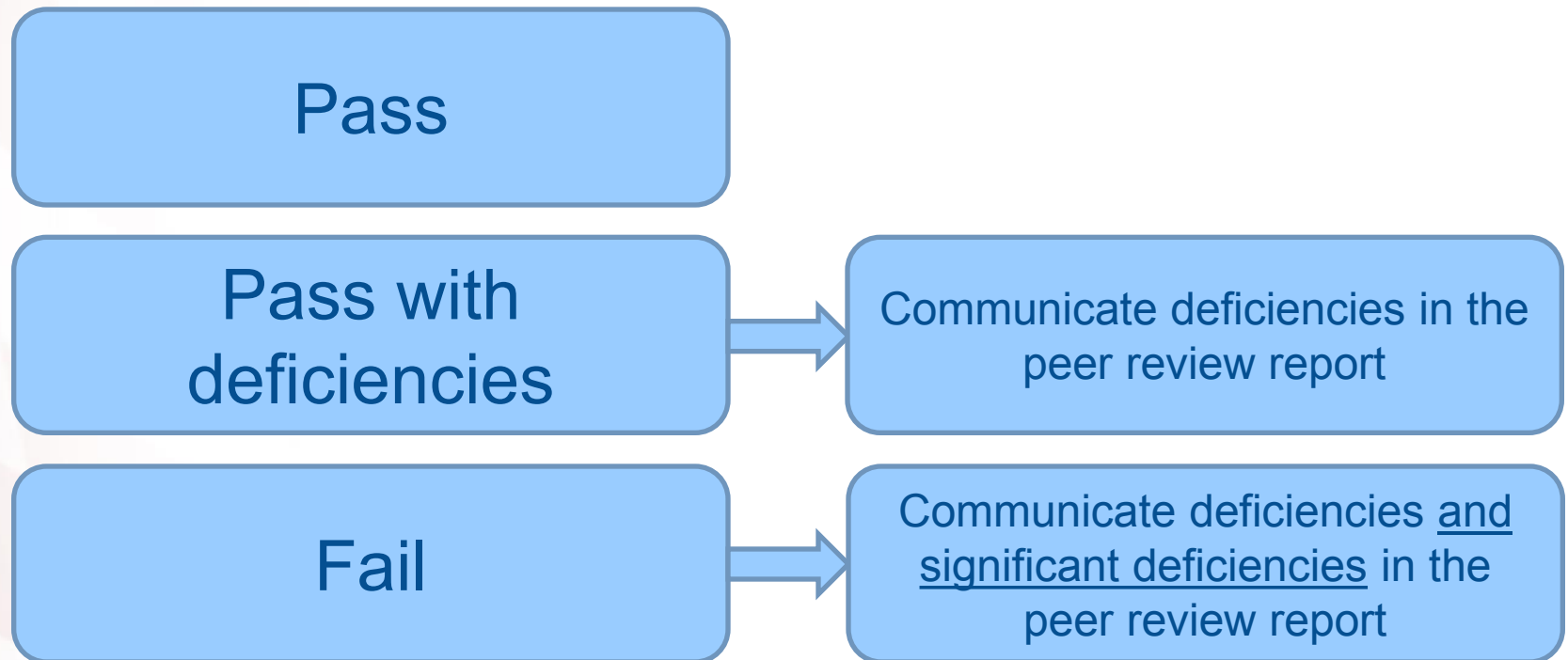
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Audit organizations not affiliated with a recognized organization also comply with additional GAGAS peer review requirements in areas including:

- Peer review scope (para. 5.82),
- Peer review intervals (para. 5.84),
- Written agreement for peer review (para. 5.86),
- Peer review team (para. 5.89),
- Report content (para. 5.91), and
- Audit organization's response to the peer review report (paras. 5.93 – 5.94).

## Peer Review Report Ratings

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## Quality Control

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New specific requirements for quality control related to:

- Annual independence affirmation (para. 5.09),
- Undertaking engagements only if the audit organization has the capabilities, including time and resources, to do so (para. 5.12),
- Consultation on difficult or contentious issues (para. 5.24),
- Supervision and review of work (para. 5.36), and
- Assigning an engagement partner or director to each engagement (para. 5.37).

## Monitoring of Quality

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New specific requirements for monitoring of quality related to:

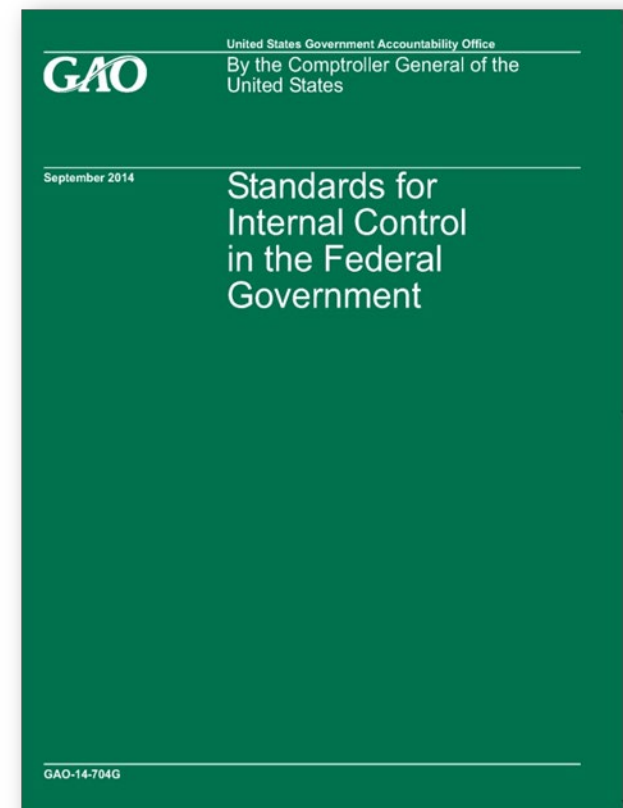
- Communication of monitoring sufficient to enable corrective actions (para. 5.44), and
- Evaluation of deficiencies noted during monitoring (para. 5.45).

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## Internal Control: Financial Audits and Examination Engagements

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Considering a comprehensive internal control framework such as *Standards for Internal Control in the Federal Government* or *Internal Control – Integrated Framework* can help auditors identify the **cause of findings** and develop recommendations. (paras. 6.18 & 7.20)





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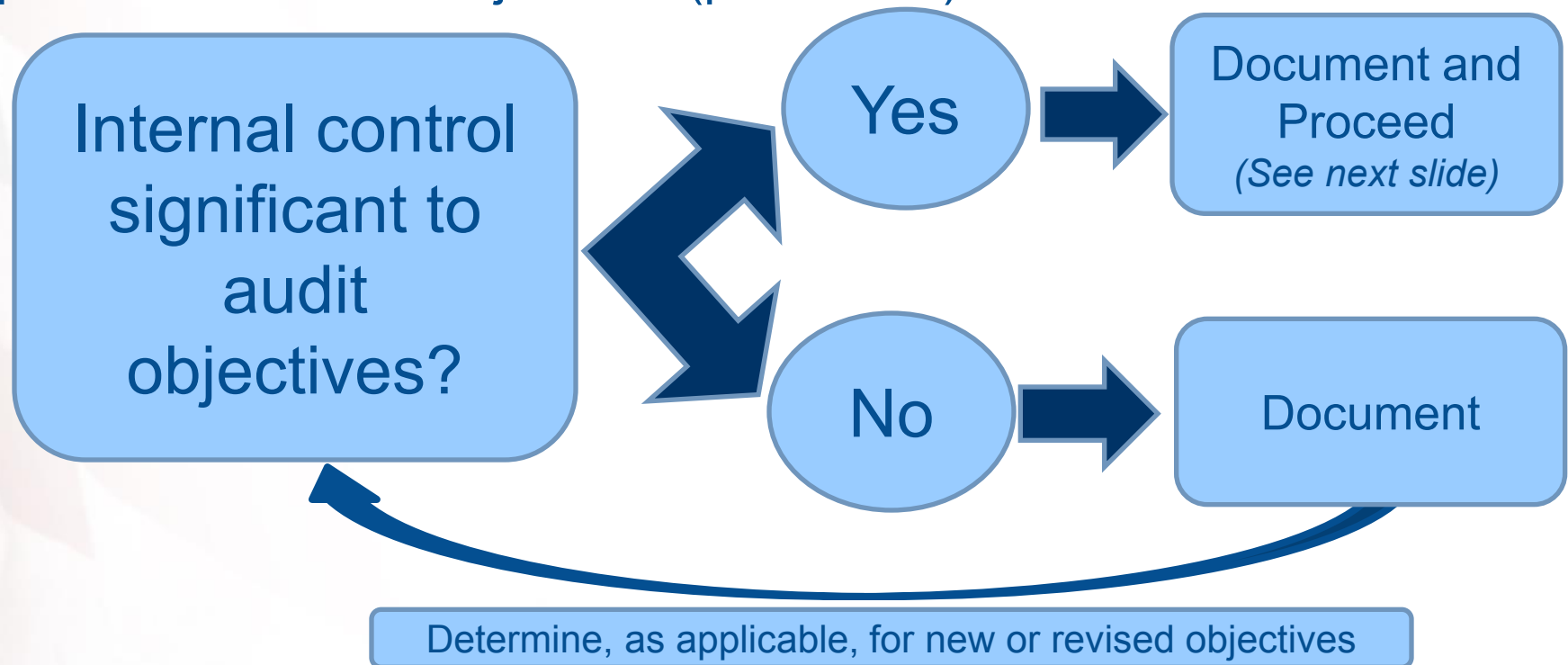
## Elements of a Finding

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- Condition: the situation that exists.
- Criteria: standards for what should be.
- **Cause**: the explanation of why the condition deviates (if it does) from the criteria.
- Effect: the actual or potential consequences of allowing the condition to persist.

## Internal Control: Performance Audits

Auditors should document the significance of internal control to performance audit objectives (para. 8.39).



## Internal Control: Performance Audits (cont.)

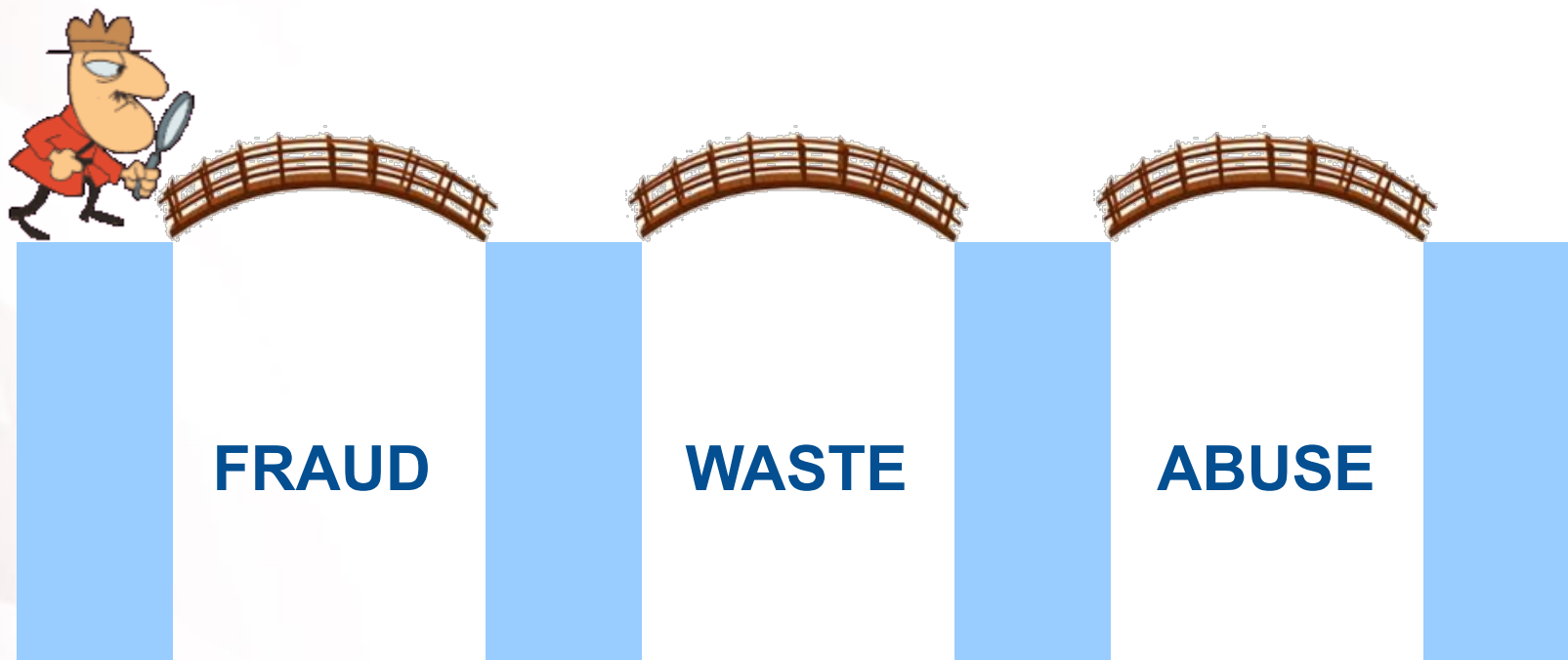
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Internal control significant to audit objectives = **Yes**

- Obtain an understanding of internal control that is significant to the audit objectives (para. 8.40).
- Assess and document the assessment of internal control to the extent necessary to address the audit objectives (para. 8.49).
- Evaluate and document the significance of identified internal control deficiencies within the context of the audit objectives (para. 8.54).
- Consider internal control deficiencies when developing the cause element of findings (para. 8.117).
- Identify in the audit report which internal control components and principles are significant (para. 9.30).

## Fraud, Waste, and Abuse

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## New Considerations for Addressing Waste

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- **Waste** is the act of using or expending resources carelessly, extravagantly, or to no purpose.
- Waste can include activities that do not include fraud and abuse and does not necessarily involve a violation of law.
- Waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight.

(paras. 6.21, 7.23, & 8.120)

## Waste and Abuse

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- Auditor considerations related to waste and abuse are intended to be consistent.
- Auditors are not required to perform procedures to detect waste or abuse.
- Evaluating internal control in a government environment may include consideration of internal control deficiencies that result in waste or abuse.

(paras. 6.20, 7.22, & 8.119)

## Standards for Reviews of Financial Statements

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- For auditors conducting reviews of financial statements in accordance with GAGAS, GAGAS incorporates AR-C, Section 90, *Review of Financial Statements* (para. 7.01).
- 2011 GAGAS only incorporated reviews performed under the Statements on Standards for Attestation Engagements (SSAE).
- Reviews of interim financial information in connection with audited financial statements are conducted under AU-C 930, plus the additional GAGAS requirements for reviews of financial statements.
- AR-C, Section 90, *Review of Financial Statements* is more general in nature and is not connected with audited financial statements.

## Management Assertions

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- Yellow Book has an explicit statement that assertions are not required for performance audits (para. 8.14).
- Assertions for examinations under AICPA attestation standards is a "hot topic".



## Effective Date

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- 2018 Revision is effective for
  - Financial audits, attestation engagements, and reviews of financial statements for periods ending on or after June 30, 2020, and
  - Performance audits beginning on or after July 1, 2019.
- Early implementation is not permitted.

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## Where to Find the Yellow Book

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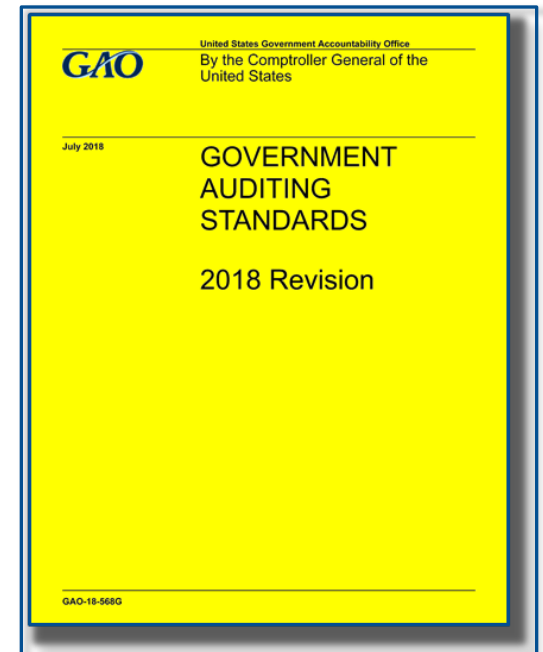
- The Yellow Book is available on GAO's website at:

[www.gao.gov/yellowbook](http://www.gao.gov/yellowbook)

- For technical assistance, contact us at:

[yellowbook@gao.gov](mailto:yellowbook@gao.gov)

or call (202) 512-9535



**Thank You**

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**Questions?**