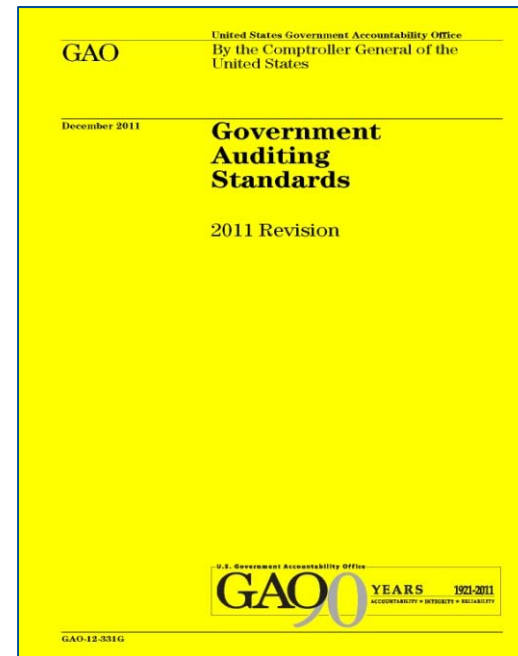




2017 Yellow Book Exposure Draft

**NOVAGA 2017 Spring
Workshop**

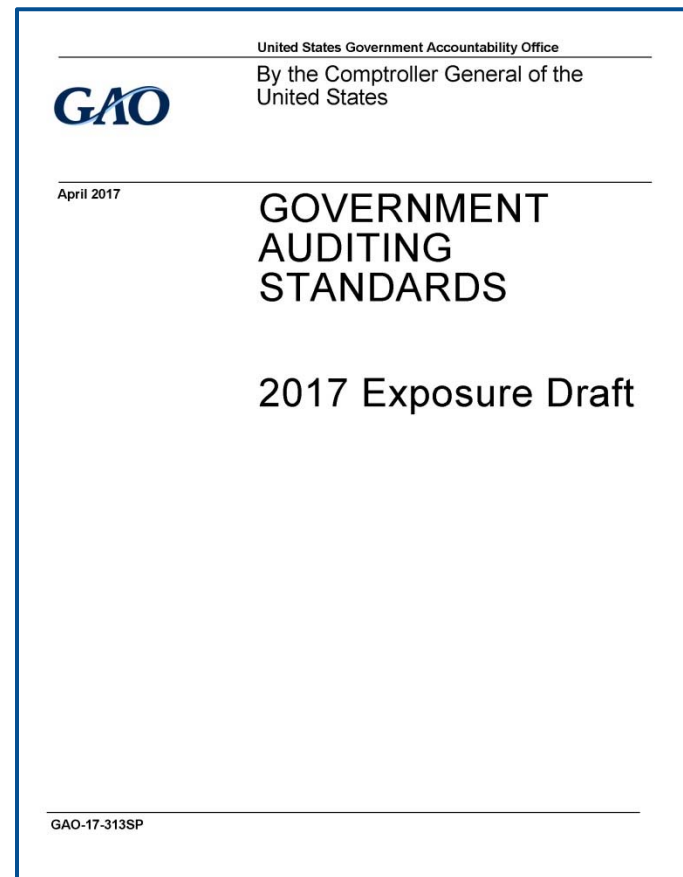
April 28, 2017



U.S. GOVERNMENT ACCOUNTABILITY OFFICE

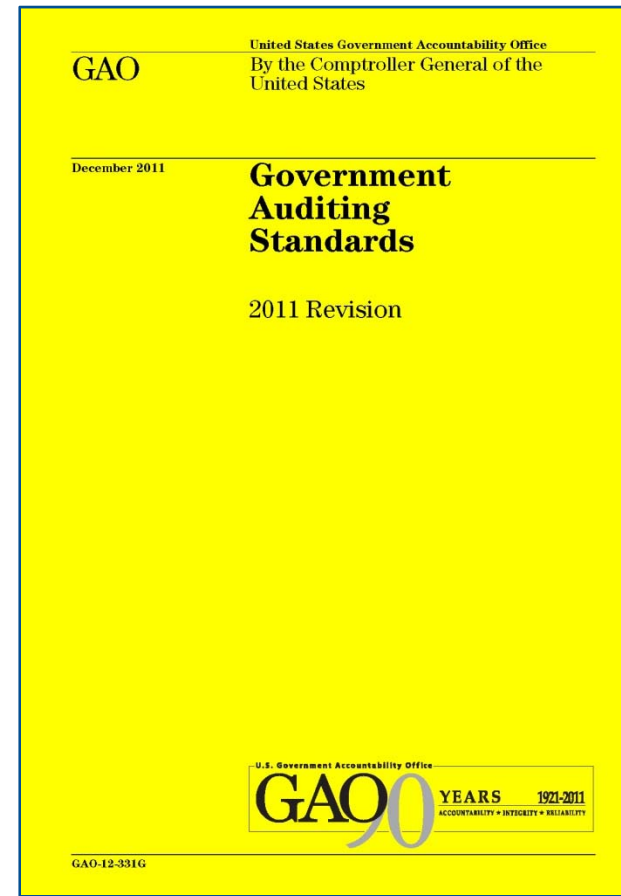
Session Objective

Provide an update on proposed revisions in the 2017 Yellow Book Exposure Draft



Yellow Book = “GAGAS”

“generally accepted government auditing standards”



Summary of Key Changes

- New format and organization of GAGAS
- Independence threats related to preparing accounting records and financial statements
- Independence guidance related to three-party arrangements
- Independence guidance related to professional services in government
- GAGAS qualification CPE requirement
- CPE guidance for 24-hour and 56-hour requirements

Summary of Key Changes (continued)

- Peer review requirements
- Internal control: financial audits, examination engagements, and performance audits
- New requirements for waste
- Standards for reviews of financial statements

New Format and Organization of GAGAS

- 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 is either removed or incorporated into individual chapters

Independence Threats related to Preparing Accounting Records and Financial Statements

- Standard is expanded to state that any services performed by auditors related to preparing accounting records and financial statements, other than those defined as impairments, create significant threats to auditors' independence
- Auditors should:
 - Document the threats and safeguards applied to eliminate and reduce threats to an acceptable level
- OR
- Decline to perform the service

Independence Guidance related to Three-Party Arrangements

- The independence requirements of the auditor when the engaging party differs from the responsible party are further explained and examples are provided
- Proposed GAGAS independence requirements apply to the relationship between the auditors and the responsible party

Independence Guidance related to Professional Services in Government

- Guidance for professional services in government is further explained and examples are provided
- Provided auditors do not set direction or accept responsibility for key processes or controls, professional services do not pose management participation threats
- Examples: investigating possible fraud, reducing the risk of management override of controls, or improving governance

GAGAS Qualification CPE Requirement

- Standards are revised to require that auditors who conduct an engagement in accordance with GAGAS complete GAGAS Qualification requirements by completing 4 hours of CPE in GAGAS topics:
 - Supervisors and partners or directors should obtain GAGAS Qualification before completing work on their first GAGAS engagement
 - Entry-level staff should obtain GAGAS Qualification by the end of their first full 2-year CPE period

GAGAS Qualification CPE Requirement (continued)

- To update their GAGAS Qualification, auditors should complete at least 4 hours of CPE in GAGAS topics each time the Comptroller General issues a revision of GAGAS. These CPE hours should be completed by the end of each auditor's next full 2-year CPE period after the GAGAS revision is issued

GAGAS Qualification CPE Requirement (continued)

- The requirements for continuing professional education (CPE) are revised to promote greater proficiency in GAGAS, including introducing a new 4-hour requirement in GAGAS topics. GAGAS topics include:
 - Standards for ethics, independence, professional judgment, competence and CPE, quality control, and peer review as established in GAGAS
 - The types of GAGAS engagements
 - The relationship between GAGAS and other standards
 - Stating compliance with GAGAS in the auditor's report

GAGAS Qualification CPE Requirement (continued)

- (continued) GAGAS topics include:
 - Additive GAGAS requirements for financial audits and examination engagements
 - Additive GAGAS requirements for review and agreed-upon procedures engagements
 - GAGAS fieldwork standards for performance audits
 - GAGAS reporting standards for performance audits
 - Internal control as addressed in GAGAS

CPE Guidance for 24-hour and 56-hour Requirements

- The guidance for CPE is revised to promote greater proficiency in GAGAS, including:
 - Providing application guidance on topics required by the 24-hour and 56-hour GAGAS CPE requirements
 - Incorporating elements of the GAGAS guidance on CPE into the exposure draft to address common questions on CPE

CPE Guidance for 24-hour and 56-hour Requirements (continued)

<u>CPE hours</u>	<u>Subject matter categories of CPE</u>
24 hours	Standards, statutory requirements, regulations, criteria, and guidance applicable to auditing or the objectives for the GAGAS engagement(s) being conducted (<u>includes the 4 hours of GAGAS topics for GAGAS Qualification when applicable</u>)
56 hours	Subject matter or topics that directly enhance auditors' professional expertise to conduct GAGAS engagements

Peer Review Requirements

- The standards for peer review are revised to differentiate requirements for those audit organizations affiliated with a recognized organization
- Standards require that audit organizations affiliated with a recognized organization comply with the respective organization's peer review requirements and additional GAGAS peer review requirements in areas such as: (1) selection of GAGAS engagements, (2) peer review report ratings, and (3) availability of peer review report to the public

Peer Review Requirements (continued)

- Standards require that audit organizations not affiliated with a recognized organization comply with GAGAS peer review requirements in areas such as:
 - Peer review scope
 - Peer review intervals
 - Written agreement for peer review
 - Peer review team
 - Follow-up on prior peer review
 - Assessment of peer review risk
 - Report content
 - Peer review report ratings
 - Audit organization's response to the peer review report
 - Availability of the peer review report to the public

Peer Review Requirements (continued)

- Peer review scope is expanded to include review of:
 - Documentation of terminated engagements
 - Prior peer review reports, if applicable

Peer Review Requirements (continued)

- Peer review interval: Organization should obtain a peer review report dated no later than 3 years and 6 months from the year-end of the previous peer review
- Written agreement for peer review: Includes a written agreement between the peer review team and the reviewed audit organization to avoid potential misunderstandings
- Peer review team: Team leadership should possess sufficient expertise and position within the reviewing audit organization that ensures the team's independence and objectivity

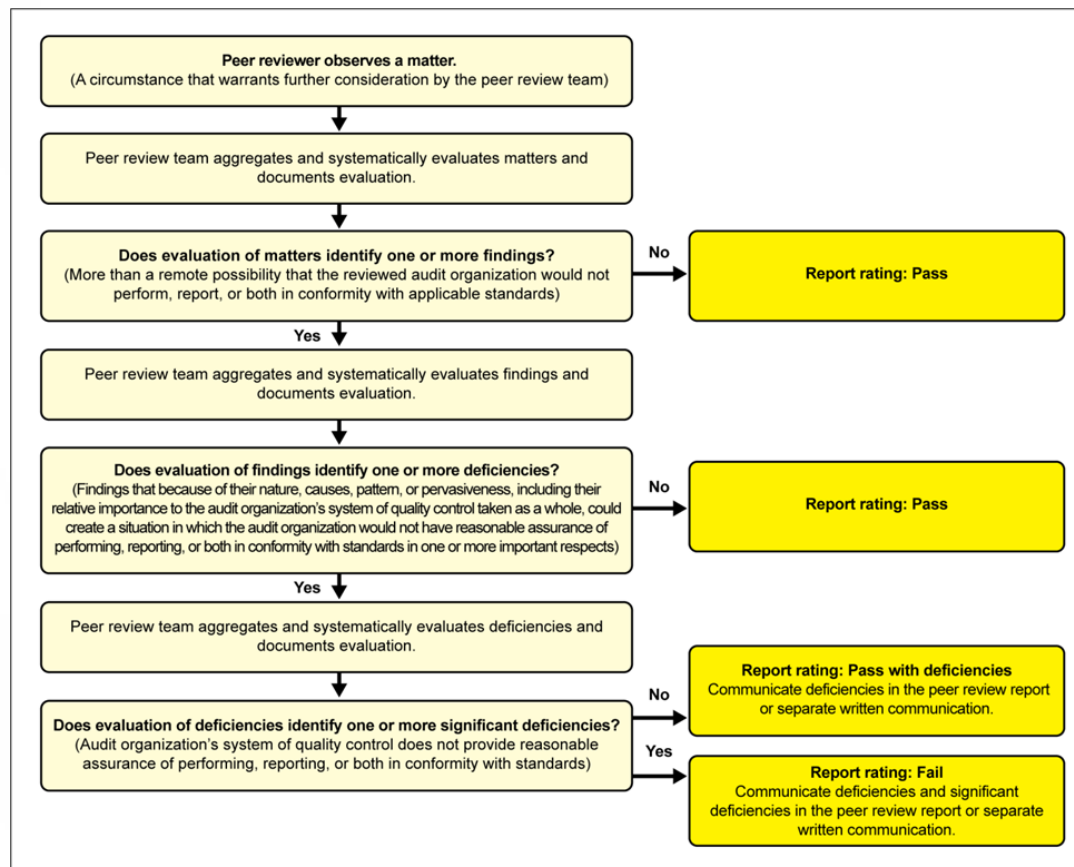
Peer Review Requirements (continued)

- Follow-up on prior peer review report: Teams assess the effectiveness of the corrective actions implemented by the reviewed audit organization in response to recommendations linked to a deficiency
- Report content: Reports include a statement that the review was conducted in accordance with GAGAS peer review requirements

Peer Review Requirements (continued)

- Peer review report ratings:
 - Determine the type of peer review rating to issue based on the observed matters' importance to the audit organization's system of quality control and the nature, causes, patterns, and pervasiveness of those matters
 - Aggregate and systematically evaluate any observed matters and document their evaluation

Figure 2: Developing Peer Review Communication for Observed Matters in Accordance with GAGAS



Source: GAO.

Peer Review Requirements (continued)

- Audit organization's response to the peer review report:
 - Organizations that receive peer review ratings of “Pass with Deficiencies” or “Fail” respond in writing to the deficiencies and related recommendations. For each deficiency, the response should describe:
 - (1) corrective actions already taken, target dates for planned corrective actions, or both
 - OR
 - (2) why corrective action is not considered necessary

Internal Control: Financial Audits and Examination Engagements

- Standard is expanded to require auditors to consider potential internal control deficiencies in their evaluation of the cause of identified findings when internal control is significant to the audit objectives

Internal Control: Performance Audits

- Internal control requirements and guidance are updated in areas such as:
 - Documenting the significance of internal control to the audit objectives
 - Obtaining and documenting an understanding of internal control that is significant to the audit objectives
 - Assessing and documenting the design, implementation, and operating effectiveness of internal control to the extent that internal control is significant to the audit objectives
 - Evaluating and documenting the significance of identified internal control deficiencies to the audit objectives

Internal Control: Performance Audits (continued)

- Standard is expanded to require that auditors consider potential internal control deficiencies in their evaluation of identified findings when developing the cause element of the identified findings
- Standard is expanded to require that when internal control is significant to the audit objectives, the audit report should discuss how the auditors considered the concept of accountability for use of public resources and government authority while assessing audit risk associated with internal control

Internal Control: Performance Audits (continued)

- Standard is expanded to require that auditors indicate in their report that the audit did not consider all internal control components if internal control that is significant to the audit objectives does not include all internal control components and underlying principles
 - For example, this could occur in an audit where only the control activities component of internal control is significant to the audit objectives, although deficiencies in the other components could impair the effectiveness of the control activities

New Requirements for Waste

- For financial audits, examination engagements, and performance audits, standards are expanded to require that auditors perform audit procedures to ascertain the potential effect on the audit objectives if they become aware of waste
 - Auditors are required to report when waste has occurred that is material or has a significant effect on the audit objectives for financial audits, examination engagements, and performance audits
 - Auditors are required to communicate in writing waste that does not have a material or significant effect on the audit objectives but warrants the attention of those charged with governance for financial audits, examination engagements, and performance audits

New Requirements for Waste (continued)

- For review and agreed-upon procedures engagements, standards are expanded to require that auditors communicate to those charged with governance and audited entity officials as appropriate instances of waste that come to their attention that warrant the attention of those charged with governance

Standards for Reviews of Financial Statements

- Statement on Standards for Accounting and Review Services No. 21, Section 90 (Review of Financial Statements) is incorporated for auditors conducting reviews of financial statements in accordance with GAGAS

Additional Proposed Changes

- Chapter 1: Government Auditing: Foundation and Principles for the Use and Application of GAGAS
- Chapter 2: General Requirements for Complying with Government Auditing Standards
- Chapter 3: Ethics, Independence, and Professional Judgement
- Chapter 4: Competence and Continuing Professional Education
- Chapter 5: Quality Control and Peer Review
- Chapter 6: Standards for Financial Audits
- Chapter 7: Standards for Attestation Engagements and Reviews of Financial Statements
- Chapter 8: Fieldwork Standards for Performance Audits
- Chapter 9: Reporting Standards for Performance Audits

Chapter 1: Government Auditing: Foundation and Principles for the Use and Application of GAGAS

- Examples of types of GAGAS users are addressed
- Integrated audit added to the types of financial audits
- Descriptions of attestation engagements, reviews of financial statements, and performance audits are expanded
- Definition of common terms used in GAGAS are expanded
 - Terms such as engaging party, audited entity, responsible party, and specialist

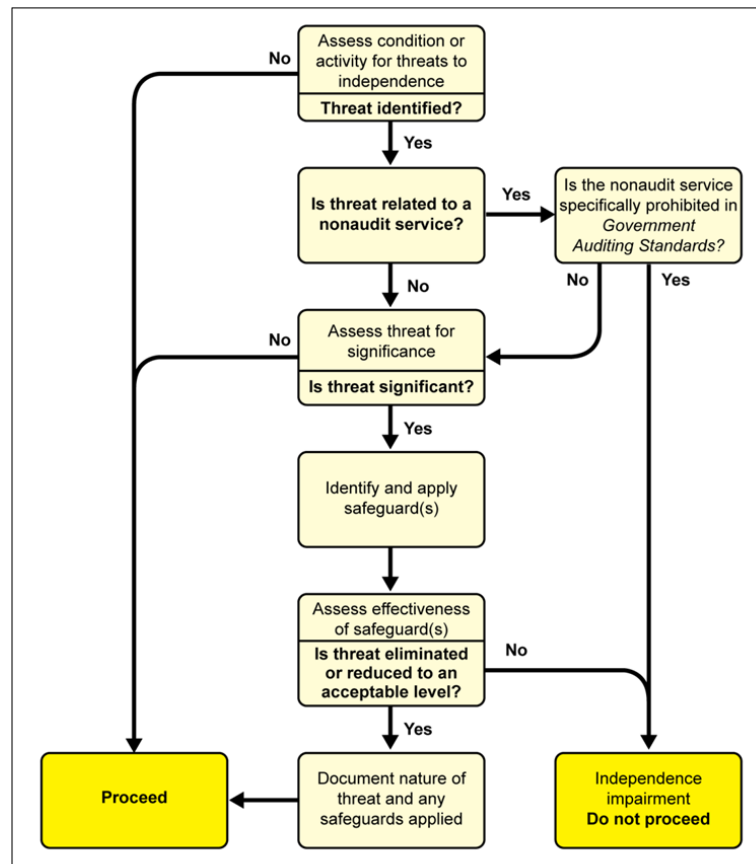
Chapter 2: General Requirements for Complying with Government Auditing Standards

- Guidance is expanded to explain that for financial audits, attestation engagements, and reviews of financial statements, GAGAS does not incorporate the AICPA Code of Conduct by reference
 - CPAs may use or be required to use the code in conjunction with GAGAS

Chapter 3: Ethics, Independence, and Professional Judgement

- Guidance is added to address situations in which government auditors work in conditions that do not permit independence; a modified GAGAS compliance statement may be applicable
- Standard is expanded to require that auditors reevaluate threats to independence, including any safeguards applied, whenever the audit organization becomes aware of new information or changes in facts and circumstances

Figure 1: GAGAS Conceptual Framework for Independence



Source: GAO.

Chapter 4: Competence and Continuing Professional Education

- Standard is revised to require that management assign auditors to conduct an engagement who possess the competence needed for their assigned roles at the time of their assignment
- Competence discussed further in application guidance, including the following:
 - Levels of GAGAS proficiency expected at the entry level, supervisory, and partner and director levels
 - Competence and qualifications of specialists

Chapter 5: Quality Control and Peer Review

- Standard is modified to require that audit organizations at least annually obtain written affirmation of compliance with policies and procedures on independence from all personnel required to be independent

Chapter 5: Quality Control and Peer Review (continued)

- Standard is expanded to require that audit organizations (1) assign responsibility for each engagement to a partner or director with authority to assume that responsibility and (2) establish policies and procedures requiring the audit organization to:
 - Communicate the identity and role of the engagement partner or director to management and those charged with governance of the audited entity
 - Clearly define the responsibilities of the engagement partner or director and communicate them to that individual

Chapter 5: Quality Control and Peer Review (continued)

- Standard is expanded to require that audit organizations establish policies and procedures for appropriate consultation to provide reasonable assurance that:
 - Consultation takes place on contentious issues
 - Sufficient resources are available
 - Nature and scope are documented and agreed upon
 - Resulting conclusions are documented and implemented

Chapter 6: Standards for Financial Audits

- Standard is modified to require that auditors, when reporting separately from a financial audit, make reports available in the same manner as the financial audit reports to which they relate

Reports include:

- Internal control over financial reporting
 - Compliance with provisions of laws, regulations, contracts, and grant agreements
- Guidance is provided to explain that reporting on internal control and compliance with provisions of laws, regulations, contracts, and grant agreements relates only to the most recent reporting period included, when comparative financial statements are presented

Chapter 7: Standards for Attestation Engagements and Reviews of Financial Statements

- Statement on Standards for Attestation Engagements No. 18, Attestation Standards: Clarification and Recodification, is incorporated by reference

Chapter 8: Fieldwork Standards for Performance Audits

- Guidance is revised to further explain that management assertions are not required when conducting a GAGAS performance audit

Chapter 9: Reporting Standards for Performance Audits

- Standard is revised to require that audit organizations that meet the independence requirements for internal auditors include in the GAGAS compliance statement, where applicable, a statement that they are independent per the GAGAS requirements for internal auditors



GAGAS Technical Assistance

Common GAGAS Technical Assistance Questions

GAGAS References from FY 2011 Yellow Book

Example 1

Question:

Does an audit of a tribe's 401k plan need to be done in accordance with GAGAS?

Example 1

- **GAGAS Issue:** Who or what determines whether an audit should be performed under Generally Accepted Government Auditing Standards?
- **GAGAS Reference:** Paragraph 1.06

Example 2

Question:

When auditing an entity that received a Federal grant under the Uniform Grants Guidance, how should the recipient entity charge indirect costs?

Example 2

- **GAGAS Issue:** What GAGAS requirements are relevant to specific single audit requirements?
- **GAGAS Reference:** GAGAS requirements generally do not address issues at this detailed level. Instead, the Uniform Grants Guidance addresses more specific questions. Refer to the cognizant or oversight agency contact.

Example 3

Question:

Is there an independence threat related to an auditor's preparation of financial statements for an audit client?

Example 3

- **GAGAS Issue:** Are there any independence requirements in GAGAS that prohibit the auditors from preparing the client's financial statements?
- **GAGAS Reference:** 3.34, 3.50 - 3.52, and 3.59

Example 4

Question:

An audit organization audits a public authority. The Office of the State Comptroller issued a report with findings and the public authority needs to create a corrective action plan. Would helping the audit organization's attest client (the public authority) with the corrective actions create an independence issue?

Example 4

- **GAGAS Issue:** Would helping the public authority in creating a corrective action plan pose a threat to the auditor's independence necessary to conduct a GAGAS audit?
- **GAGAS Reference:** Paragraphs 3.34, 3.35, 3.36, 3.40, and 3.41

Example 5

Question:

An auditor's prospective new client, who has never undergone an audit before, requested assistance with audit preparation. Can the auditor advise the client as to what documentation would be needed for review by the auditor?

Example 5

- **GAGAS Issue:** Would helping the client in preparing for an audit pose a threat to the auditor's independence necessary to conduct a GAGAS audit?
- **GAGAS Reference:** Paragraphs 3.08, 3.13, 3.34, 3.40, and 3.41

Example 6

Question:

If an audit organization that conducts performance audits obtains continuous access to the audited entity's databases for purposes such as follow up on corrective actions, what are some GAGAS considerations?

Example 6

- **GAGAS Issue:** Are there any independence or performance audit field work requirements in GAGAS that prohibit the auditors from obtaining continuous database access?
- **GAGAS Reference:** 3.07, 3.14, 6.36, and 6.47

Example 7

Question:

An employee of an audit organization was a college intern for 1.5 years and was then employed full time for the last .5 year of the Continuing Professional Education (CPE) reporting cycle. Does the employee's college classwork apply toward the GAGAS CPE requirements?

Example 7

- **GAGAS Issue:** What types of coursework can be counted toward an auditor's GAGAS CPE requirements?
- **GAGAS Reference:** Paragraph 3.76 and 3.77 and *Guidance on GAGAS Requirements for Continuing Professional Education, 2005*

Example 8

Question:

Can CPE hours used to fulfill the state board of accountancy's accounting & auditing requirement be used to fulfill the 24-hour GAGAS CPE requirement?

Example 8

- **GAGAS Issue:** What topics count for the 24-hour GAGAS CPE requirement?
- **GAGAS Reference:** Paragraph 3.76 and 3.77 and *Guidance on GAGAS Requirements for Continuing Professional Education*, 2005: Paragraphs 17, 18, 23 and 24

Example 9

Question:

What if, due to unusual difficulty or hardship, an entity needs a peer review extension?

Example 9

- **GAGAS Issue:** What is the process for receiving a peer review extension?
- **GAGAS Reference:** Paragraph 3.97

Where to Find the Yellow Book

- The Yellow Book is available on GAO's website at:
www.gao.gov/yellowbook
- Please send your comments to:
yellowbookcomments@gao.gov
- For technical assistance, contact us at:
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Thank You

Questions?