
Government Auditing Standards 2010 Update

Summary of Preliminary Revisions

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GAO – GOVERNMENT AUDITING STANDARDS, 2010 UPDATE

SUMMARY OF PRELIMINARY REVISIONS

INTRODUCTION

The revisions summarized in this document are preliminary and subject to change. The GAO is in the process of soliciting feedback from the Comptroller General's Advisory Council on Government Auditing Standard (GAGAS) as well as comments on the Exposure Draft. The feedback received may result in changes to the preliminary revisions.

The Exposure Draft is scheduled to be released in August of 2010. All comments are due back to GAO by October/November 2010. The final revisions are expected to be released in February/March 2011. The effective date for the revisions has not yet been determined.

The GAO has undertaken the project of revising GAGAS not only to make technical adjustments, but also to promote the modernization of auditing standards. In addition, they have attempted, where possible, to converge with other standards (AICPA, PCOB, etc), and address other issues they have observed.

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FORMATTING CHANGES

Several changes have been made to the overall format of Yellow Book.

Chapters 1 and 2 have been realigned. Chapter 1 now includes the foundation and ethical principles of government auditing, along with the introduction. Chapter 2 now contains the overall discussion regarding the use and application of GAGAS.

The chapters covering financial audit performance and reporting, formerly Chapters 4 and 5, have now been combined into one chapter, Chapter 4.

The use of footnotes has been reduced and they are now used more consistently. Although footnotes are still used, much of the information formerly included in footnotes is now included as part of the text, in the appendix, or has simply been removed. Footnotes are now used strictly to refer to other sections of GAGAS and to other audit standards.

CHAPTER 1 – GOVERNMENT AUDITING: FOUNDATION AND ETHICAL PRINCIPLES

Although Chapter 1 no longer contains any professional requirements, it still contains important information to be aware of. Many definitions have been added or clarified, including: Auditor, Audit Organization, Audit Team, and Audit Period.

The audit function's structural location relative to the audited entity is now addressed in this chapter. External audit organizations should report to third parties externally. Internal Audit organizations should be accountable to top management and usually don't report externally. Government auditors who report to both third parties and top management are considered external auditors.

Chapter 1 still contains the concepts and ethical principals that serve as the foundation for the requirements and guidance for GAGAS. There have not been any major changes to this information.

CHAPTER 2 – STANDARDS FOR THE USE AND APPLICATION OF GAGAS

Changes have been made, where possible, to provide consistence of GAGAS terminology with the AICPA's Statement on Auditing Standards.

Additional information has been provided regarding overall audit documentation. It is not necessary to document every matter considered or professional judgment made. It is also not necessary to separately document compliance that is demonstrated within audit documentation.

Clarification has been provided for citing compliance with GAGAS. The revisions should allow for more discretion than in the past. The determination of the appropriate GAGAS compliance statement is considered a matter of professional judgment.

CHAPTER 3 – GENERAL STANDARDS

INDEPENDENCE

With these revisions, GAGAS is moving to a conceptual framework approach to independence determinations. This is more flexible than the rule based approach that has been used in the past. Although the framework now takes the conceptual approach, not all the “rules” have been eliminated.

The new conceptual framework is intended to provide a means for auditors to assess auditor independence in light of the unique circumstances that often apply to these determinations. This approach replaces considerations of independence in terms of the three categories of independence (personal, external, and organizational) included in the previous editions of GAGAS. The new framework includes definitions of both independence of mind and independence in appearance.

The new GAGAS framework is intended to provide consistent results when compared with AICPA and IFAC, and address unique government structural issues.

GAO will retire the current *Questions and Answers to Independence Standard Questions* guidance.

The conceptual framework requires that auditors identify threats to independence; evaluate the significance of the threats identified; and apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level. According to the new framework, threats to independence are circumstances that could impair independence. Usually, a threat to independence does not necessarily result in an independence impairment. Safeguards are defined as controls that eliminate or reduce to an acceptable level a threat’s potential to impair independence.

There are seven categories of threats identified: self-interest threats, self-review threats, bias threats, familiarity threats, undue influence threats, management participation threats, and structural threats.

There are two categories of safeguards that have been identified. The first is safeguards that are created by the profession, legislation, or regulation. These included professional or regulatory monitoring and disciplinary procedures; and external review by a third party of the reports, communications, or other information produced by the auditor. The second category of safeguards is those in the work environment. These include using different management and engagement teams with separate reporting lines for the provision of non-audit services to an audited entity; having additional review of the non-audit services or the audit by staff who was not involved in providing the services or working on the engagement; or the audited entity provides appropriate oversight and communication regarding the non-audit service and the audit engagement.

There are seven activities that are identified as being so significant that no safeguard could reduce the threat to an acceptable level.

1. Certain activities in preparing accounting records and financial statements. An audit entity manger that is charged with overseeing the non-audit service must possess suitable knowledge, skills, or experience to evaluate the adequacy and results of the services performed, otherwise no safeguard could reduce the threat to an acceptable level.
2. Certain internal audit services provided by external auditors. These include: setting internal audit policies or the strategic direction of internal audit activities; deciding which recommendations resulting from internal audit activities to implement; and taking responsibility for designing, implementing and maintaining internal control.
3. Assisting management in documenting or performing an internal control assessment.
4. Certain recruiting services, including: recommending a single individual for a specific position that is key to the audited entity or program; ranking or influencing

- management's selection of a candidate; or conducting an executive search or a recruiting program for the audited entity.
5. Certain IT services, including design or development of a financial or other IT system that would be subject to or part of an audit; services that entail making other than insignificant modifications to the source code underlying such a system; and operating or supervising the operation of such a system.
 - 6.
 7. Certain valuation services: if the valuation services would have a material effect, separately, or in the aggregate, on the financial statements of other information that is the subject of an audit, and the valuation involves a significant degree of subjectivity.

PROFESSIONAL JUDGMENT

Adjustments have been made to emphasize that auditors use professional judgment in applying the conceptual framework for independence.

COMPETENCE

No actual changes have been made to the requirements, but clarification has been added. The distinction between internal and external specialists has been highlighted regarding continuing professional education (CPE). External specialists should be qualified and maintain professional competence, but are not required to meet GAGAS CPE requirements. Internal specialists performing GAGAS work should comply with CPE requirements. Training in areas of specialization count towards the required 24 hours of CPE that relate to government auditing.

CONTINUING PROFESSIONAL EDUCATION

No changes were made to the overall requirements for CPE.

QUALITY CONTROL ASSURANCE

GAO has proposed changes to expand discussion for elements of the GAGAS system of quality control for more consistency with AICPA Quality Control Standards.

Additional requirements have also been added to communicate deficiencies noted during the monitoring process, and make recommendations for appropriate remedial action.

CHAPTER 4 – FINANCIAL AUDITS

No new requirements have been added for financial audits. However, changes have been made to the existing requirements.

Terminology has been updated with respect to financial audits in order to be more consistent with other standards. The term “field work” has been replaced with “performance.” Although, the term “field work” is still used when referring to attestation engagements and performance audits. Reasonable assurance, with respect to financial audits, has been revised to concur with revisions to the AICPA standards. The updated language emphasizes that reasonable assurance is a high, but not absolute, level of assurance; it is obtained when the auditor has sufficient appropriate evidence to reduce audit risk to an acceptably low level; and since audits have inherent limitations that result in most audit evidence being persuasive rather than conclusive, reasonable assurance is not absolute.

The additional requirements of GAGAS, beyond those of the AICPA, have been clearly identified. The additional requirements relate to:

- Auditor communication
- Previous audits and attestation engagements

- Detecting material misstatements resulting from violations of provisions of contracts or grant agreements, or from abuse
- Developing elements of a finding
- Audit documentation

Additional changes have been made to this section in order to provide a more streamlined document. When applicable, reference has been made to the AICPA standards, this allowed for the removal of duplicate information between the two sets of standards. This also emphasizes that Yellow Book should be used in conjunction with AICPA standards. Areas that have been affected by this include:

- Restatements
- Definitions of internal control deficiencies
- Communication of significant matters
- Consideration of fraud and illegal acts

Changes have also been made to the definitions of Material Weakness and Significant Deficiency to align with SAS No. 115 and replace the definitions in SAS No. 112. The updated definitions are:

Material Weakness

- SAS No. 115 – A deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.
- SAS No. 112 – A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material misstatement of the financial statements will not be prevented or detected

Significant Deficiency

- SAS No. 115 – A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance
- SAS No. 112 – 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 GAAP 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

The revisions also underscore certain consideration that should be made for applying AICPA standards in GAGAS financial audits. These include:

- Materiality – it may be appropriate to use a lower materiality level in a government environment than the private sector.
- Ongoing investigations and legal proceedings – avoid interfering since it is important that fraud and illegal acts be pursued. However, it may be useful to evaluate the impact such investigation have on a current audit. It may also be beneficial to work with investigators and authorities.
- Early communication of control deficiencies – for some issues early communication is important because of the significance and urgency of potential corrective action. Therefore, auditors may communicate orally to management to ensure timely remedial action can be taken to minimize risks of material misstatements.

CHAPTER 5 – ATTESTATION ENGAGEMENTS

No new requirements were added to chapter 5; however language has been modified to more clearly identify the additional GAGAS requirements that go beyond the AICPA standards.

Modifications were also made to reference the AICPA standards when applicable. As in previous editions of the Yellow Book, the additional GAGAS requirements relate to:

- Auditor communication;
- Previous audits and attestation engagements;
- Fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse that could have a material effect on the subject matter or an assertion about the subject matter;
- Developing elements of a finding; and
- Documentation.

In addition, the chapter has been realigned to emphasize the three levels of assurance provided by attestation engagements in accordance with AICPA standards. Each of the levels is introduced in a separate section:

- Examination: high level of assurance;
- Review: moderate level of assurance; and
- Agreed-upon procedures: no assurance.

For each of the levels of service provided by attestation engagements, language has been added regarding:

- Additional GAGAS requirements on citing compliance with GAGAS;
- The importance of the required elements of AICPA reporting under each level of attestation engagements; and
- Establishing an understanding with the entity regarding the service to be performed.

Requirements have been deleted that were adequately covered by the AICPA standards or elsewhere in GAGAS. These include documenting terminated engagements, and developing policies to address requests by outside parties to obtain access to audit documentation. In addition, modifications have also been made within chapter 5 to remove duplicative definitions of internal control deficiencies between GAGAS and AICPA standards. For examination engagements, language has been added regarding reporting deficiencies in internal controls:

- Auditors should include in the examination report all deficiencies that are considered significant deficiencies or material weaknesses, even those that were communicated early; and
- Deficiencies remediated before the examination report is issued should be reported, along with notification of the remediation.

Changes were made to highlight special considerations for government engagements in applying certain AICPA standards in a GAGAS attestation engagement regarding materiality, ongoing investigations or legal proceedings, and early communication of deficiencies.

CHAPTER 6 – FIELD WORK STANDARDS FOR PERFORMANCE AUDITS

The most significant revision that was made to this edition of the Yellow Book is in chapter 6 and is regarding waste, this only applies to performance audits. Requirements have been added regarding the auditor's responsibilities concerning waste; these are similar to those for abuse. In addition, a definition was added: "Waste is the intentional or unintentional careless expenditure, inappropriate consumption, mismanagement, inappropriate use, or squandering of government resources. Waste also includes incurring unnecessary costs as a result of inefficient or ineffective practices, systems, or controls."

The requirement that the audit organization develop policies to address requests by outside parties to obtain access to audit documentation has been deleted since this is covered by the Quality Control requirements of GAGAS.

The requirement to retain documentation pertaining to the termination of an audit has been retained, although it is proposed to be deleted from the financial audits, and attestation engagements sections.

CHAPTER 7 – REPORTING STANDARDS FOR PERFORMANCE AUDITS

Several modifications have been made to the reporting requirements for performance audits. The discussion regarding requirements for reporting deficiencies in internal control, instances of fraud, illegal acts, violations of provisions of contracts or grant agreements, abuse, and waste have been expanded, acknowledging that professional judgment is required in making reporting determinations. In addition, the fraud reporting requirement is now limited to occurrences that are significant within the context of the audit. A reporting requirement has been added concerning waste; this is consistent with the requirement for abuse. A requirement has been added that auditors obtain and report views of responsible officials concerning the findings, conclusions, and recommendations included in the auditors' report, as well as planned corrective actions. This is consistent with other GAGAS reporting standards. This has always been required, but was inadvertently removed from the 2007 edition of the Yellow Book.