

## Chapter 1

# Introduction and Overview of Government Auditing Standards

### © Update 1-1

*Government Auditing Standards, 2018 Revision* (2018 revision) was issued in July 2018. It is effective for financial audits, attestation engagements, and reviews of financial statements for periods ending on or after June 30, 2020, and for performance audits beginning on or after July 1, 2019. Early implementation is not permitted. However, because auditors need to be independent for any period of time that falls within the period covered by the financial statements or subject matter of the engagement and the period of professional engagement, auditors will have to consider the independence provisions found in the 2018 revision prior to the effective date (see chapter 2, "*Government Auditing Standards — Ethical Principles and General Standards*," for more information). This edition of the guide has not been updated for these standards; it is based on *Government Auditing Standards, 2011 Revision*. The new requirements and guidance found in *Government Auditing Standards, 2018 Revision* will be reflected in the 2020 edition of this guide. See the preface of this guide for more information about the independence and other changes contained in *Government Auditing Standards, 2018 Revision*.

## Purpose and Applicability of This Guide

1.01 This guide<sup>1</sup> has a two-fold purpose:

- a. The first purpose is to provide auditors with a basic understanding of the procedures to be performed and of the reports that should be issued for audits of financial statements conducted in accordance with *Government Auditing Standards* (also referred to as the Yellow Book), issued by the Comptroller General of the United States of the Government Accountability Office (GAO).<sup>2</sup>
- b. The second purpose is to provide auditors of states, local governments, and not-for-profit entities (NFPs) that receive federal awards with a basic understanding of the procedures to be performed and of the reports that should be issued for single audits and program-specific audits conducted in accordance with the Single Audit Act Amendments of 1996<sup>3</sup> and Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative*

<sup>1</sup> References to specific paragraph numbers throughout the guide are to paragraphs contained in the guide unless otherwise specified.

<sup>2</sup> *Government Auditing Standards* is available on the Yellow Book page of the U.S. Government Accountability Office (GAO) website at [www.gao.gov/yellowbook/overview](http://www.gao.gov/yellowbook/overview).

<sup>3</sup> The Single Audit Act Amendments of 1996 (Public Law 104-156) were enacted into law in July 1996 and replaced the Single Audit Act of 1984. Supplement A, "Single Audit Act Amendments of 1996," of this guide is a reprint of the act. Hereafter, this guide uses the term *Single Audit Act* to refer to this legislation.

*Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance).*<sup>4</sup>

**1.02** *Government Auditing Standards* contains requirements and guidance for financial audits, attestation engagements, and performance audits. This guide addresses the *Government Auditing Standards* requirements and guidance for financial audits, generally only as they relate to audits of financial statements prepared in accordance with generally accepted accounting principles or a special purpose framework, and compliance audits conducted in accordance with the Single Audit Act and the Uniform Guidance.

**1.03** *Government Auditing Standards* states that auditors may use *Government Auditing Standards* in conjunction with professional standards issued by the PCAOB and the International Auditing and Assurance Standards Board. For example, audits of certain for-profit entities whose financial statement audits are performed under PCAOB audit standards are also subject to *Government Auditing Standards* due to their participation in federal programs that require an audit under a federal agency audit guide. Such audits are not addressed in this guide. However, chapter 4, "Auditor Reporting Requirements and Other Communication Considerations of *Government Auditing Standards*," of this guide highlights certain reporting considerations when the financial statement audit is performed under PCAOB audit standards, GAAS, and *Government Auditing Standards*.

**1.04** *Government Auditing Standards* incorporates by reference AICPA Statements on Auditing Standards.<sup>5</sup> Therefore, auditors performing financial statement audits in accordance with *Government Auditing Standards* should comply with generally accepted auditing standards (GAAS), the requirements found in chapters 1–3 of *Government Auditing Standards*, and the additional requirements for financial audits found in chapter 4, "Standards for Financial Audits," of *Government Auditing Standards*. This guide does not contain all the GAAS requirements and guidance that an auditor will need to know and understand in order to perform an audit in accordance with *Government Auditing Standards*. The guide discusses GAAS requirements and guidance only to the extent necessary to provide the reader with an understanding of the additional requirements of *Government Auditing Standards* and also provides information on other GAAS guidance with particular relevance to an audit performed in accordance with *Government Auditing Standards*. Included in this guide's discussion of GAAS is information found in relevant AU-C section paragraphs titled "Considerations Specific to Governmental Entities" that highlight considerations specific to governmental entities, entities receiving government funding, and entities being audited in accordance with *Government Auditing Standards*. Additional information on GAAS requirements for financial statement audits can be found in the relevant professional standards and applicable Audit and Accounting Guides, such as *Not-for-Profit Entities; State and Local Governments; Health Care Entities; Gaming; Employee Benefit Plans; and Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies, and Mortgage Companies*.

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<sup>4</sup> Subpart F, "Audit Requirements" of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) can be found in supplement B, "Uniform Guidance Audit Requirements," of this guide. The Uniform Guidance in its entirety can be found on [www.ecfr.gov](http://www.ecfr.gov).

<sup>5</sup> Paragraph 4.01 of *Government Auditing Standards* notes that all sections of the Statements on Auditing Standards are incorporated into *Government Auditing Standards*, including the introduction, objectives, definitions, requirements, and application and other explanatory material.

**1.05** As further discussed in the preface to this guide, auditing guidance included in an AICPA Guide is recognized as an interpretive publication pursuant to AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.<sup>6</sup> Interpretive publications are not auditing standards. Interpretive publications are recommendations on the application of GAAS in specific circumstances, in this case to audits performed in accordance with *Government Auditing Standards* and to single and program-specific audits under the Uniform Guidance. GAO, OMB, and AICPA promulgate applicable standards and requirements. Refer to those organizations' websites<sup>7</sup> for the full text of the organizations' original standards and requirements.

**1.06** When covering certain topics, *Government Auditing Standards* contains information specific to internal audit organizations. This guide discusses the *Government Auditing Standards* guidance relevant to independent auditors and does not highlight guidance that is specific to internal audit organizations. Refer to *Government Auditing Standards* for information on, and requirements for, internal audit organizations.

**1.07** This guide is organized into two parts that discuss important considerations for audits performed under *Government Auditing Standards* (part I) and single audits and program-specific audits performed under the Uniform Guidance (part II). Each part presents chapters with topics relating to planning, performing, evaluating the results of, and reporting on those audits. See the table of contents for the specific topics addressed in each part and chapter.

**1.08** This guide is not a complete manual of procedures, and *Government Auditing Standards* states that the auditor must use professional judgment in planning and performing audit engagements and in reporting the results. Because of the variety and complexity of the laws and regulations that govern audits performed under *Government Auditing Standards* and the Uniform Guidance, the procedures included in this guide cannot cover all the circumstances or conditions that may be encountered in an audit.

**1.09** This guide does not address requirements when conducting a compliance audit of for-profit entities that participate in federal programs subject to an audit in accordance with a federal agency audit guide (for example, the U.S. Department of Housing and Urban Development [HUD] *Consolidated Audit Guide for Audits of HUD Programs* and the U.S. Department of Education audit guides, among others). Refer to AU-C section 935, *Compliance Audits*, and the specific federal agency audit guide for related requirements and guidance when performing such audits.

**1.10** Certain states have imposed additional audit requirements related to state or local financial assistance and may require additional audit procedures and reporting. Furthermore, pass-through entities may impose additional audit requirements on their subrecipients related to the financial assistance passed

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<sup>6</sup> All AU-C sections can be found in *AICPA Professional Standards*.

<sup>7</sup> See footnote 2 in paragraph 1.01 for a link to *Government Auditing Standards* and footnote 4 in paragraph 1.01 for a link to the Uniform Guidance. The Office of Management and Budget (OMB) website containing other single audit information is <https://www.whitehouse.gov/omb/information-for-agencies/circulars/>. (See the preface for additional information regarding access to the OMB website.) Also see the AICPA's website at [aicpa.org](http://aicpa.org) and the Governmental Audit Quality Center's website at [www.aicpa.org/gaqc](http://www.aicpa.org/gaqc).

through. The guidance in this guide generally does not discuss or extend to those requirements.

**1.11** The terminology found in *Government Auditing Standards* is consistent with the terminology found in the auditing sections of AICPA *Professional Standards*. Additionally, the terms used in this guide are intended to be consistent with the definitions in *Government Auditing Standards*, the Single Audit Act, the Uniform Guidance, and AU-C section 935. Note that the term *not-for-profit entity* as used in this guide is consistent with the definition of the term *nonprofit organization* as found in the Uniform Guidance<sup>8</sup> and includes not-for-profit institutions of higher education, hospitals, and other health care providers.

## Overview of Government Auditing Standards

### Applicability of Government Auditing Standards

**1.12** The professional standards and guidance for financial audits contained in *Government Auditing Standards* provide a framework for conducting high quality audits with competence, integrity, objectivity, and independence. Those requirements and guidance apply to audits of governmental entities, programs, activities, and functions. Those requirements and guidance also apply to audits of government assistance administered by contractors, NFPs, and other nongovernmental entities, including foreign entities, when the use of *Government Auditing Standards* is required or is voluntarily followed. Appendix I section A1.04 of *Government Auditing Standards* states that even if not required to do so, auditors may find it useful to follow *Government Auditing Standards* in performing audits of federal, state, and local government programs as well as audits of government awards administered by contractors, NFPs, and other nongovernmental entities.

**1.13** Entities for which an auditor may need to apply *Government Auditing Standards* when auditing financial statements include federal, state, and local governments; NFPs; health care entities; entities with mortgage banking, real estate, or student lending and servicing activities; Indian Tribes; and other entities receiving federal awards. As discussed in chapter 5, "Overview of the Single Audit Act, the Uniform Guidance Audit Requirements, and the *Compliance Supplement*," of this guide, audits required by the Single Audit Act and performed under the Uniform Guidance require the use of *Government Auditing Standards*. Other laws, regulations, agreements, contracts, or other authoritative sources may require the use of *Government Auditing Standards*. Federal audit guidelines pertaining to program requirements, such as those issued for HUD programs and Student Financial Assistance programs, also may require the use of *Government Auditing Standards*. In addition, state and local laws and regulations may require auditors of state and local governments to follow *Government Auditing Standards*. Therefore, reading an entity's grant agreements and contracts and relevant state and local laws may provide important information to the auditor about the type of audit the entity is required to undergo.

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<sup>8</sup> The term *nonfederal entity* is used throughout the Uniform Guidance. Subpart A, "Acronyms and Definitions," of the Uniform Guidance defines a *nonfederal entity* as a state, local government, Indian tribe, institution of higher education, or nonprofit organization that carries out a federal award as a recipient or subrecipient.

## Additional Requirements of *Government Auditing Standards*

**1.14** In conducting audits of financial statements in accordance with *Government Auditing Standards*, the auditor assumes certain responsibilities beyond those of audits performed in accordance with GAAS. The standards and guidance applicable to financial audits, including audits of financial statements, are contained in chapters 1–4 of *Government Auditing Standards* and include ethical principles, general standards, and additional standards for performing and reporting on financial audits. For example, in addition to an auditor's report that expresses an opinion or disclaimer of opinion on the financial statements as required by GAAS,<sup>9</sup> a written report on internal control over financial reporting and on compliance and other matters is required under *Government Auditing Standards*.

**1.15** It is important that both the auditor and management understand the type of engagement that is required to be performed. Chapter 3, "Planning and Performing a Financial Statement Audit in Accordance With *Government Auditing Standards*," of this guide further discusses GAAS and *Government Auditing Standards* requirements for agreeing upon the terms of the audit engagement with the auditee, which includes communicating with the auditee, through a written communication, the auditor's understanding of the services to be performed.

## Use of Terminology to Define *Government Auditing Standards* Requirements

**1.16** Auditors have a responsibility to consider the entire text of *Government Auditing Standards* when carrying out their work and in understanding and applying the requirements in those standards. Not every paragraph of the standard carries a requirement; rather, the requirements are identified through the use of specific language.

**1.17** Chapter 2, "Standards for Use and Application of GAGAS," of *Government Auditing Standards* uses two categories of professional requirements, identified by specific terms, to describe the degree of responsibility they impose on auditors and audit organizations.<sup>10</sup> Unconditional requirements are those requirements that the auditor and audit organization must comply with in all cases where such requirements are relevant. The word *must* is used to indicate an unconditional requirement. Presumptively mandatory requirements are indicated by the use of the word *should*. Presumptively mandatory requirements also must be complied with in all cases where such requirements are relevant. However, in rare circumstances an auditor or audit organization may determine it necessary to depart from a relevant presumptively mandatory requirement. This is expected to arise only when the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure

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<sup>9</sup> As explained in the AICPA Audit and Accounting Guide *State and Local Governments*, the auditor generally expresses or disclaims an opinion on a government's basic financial statements by providing an opinion or disclaimer of opinion on each opinion unit required to be presented in those financial statements. In addition, the auditor may provide opinions or disclaimers of opinions on additional opinion units if engaged to set the scope of the audit and assess materiality at a more detailed level than by the opinion units required for the basic financial statements. Throughout this guide, the use of the singular terms *opinion* and *disclaimer of opinion* encompasses the multiple opinions and disclaimers of opinion that generally will be provided on a government's basic financial statements.

<sup>10</sup> The terminology is consistent with the terminology defined in the auditing sections of AICPA *Professional Standards*.

would be ineffective in achieving the intent of the requirement. In this rare circumstance the auditor should perform alternative procedures to achieve the audit objective. Furthermore, auditors must document their justification for the departure and how the alternative procedures performed were sufficient to achieve the intent of the requirement.

**1.18** In addition to requirements discussed in the preceding paragraph, *Government Auditing Standards* contains related guidance in the form of application and other explanatory material that provides further explanation of the requirements and guidance for carrying out those requirements. In particular, it may explain more precisely what a requirement means or is intended to cover or include examples of procedures that may be appropriate in the circumstances. Although such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements. Auditors should have an understanding of the application and other explanatory material; how auditors apply the guidance in the audit depends on the exercise of professional judgment in the circumstances consistent with the objectives of the requirement. The words *may*, *might*, and *could* are used to describe these actions and procedures. Note that the application and other explanatory material may also provide background information on matters addressed in *Government Auditing Standards*.

**1.19** *Government Auditing Standards* states that in planning and performing audits of financial statements in accordance with *Government Auditing Standards*, auditors also use interpretative publications which are issued under the authority of GAO and provide recommendations on the application of *Government Auditing Standards* in specific circumstances. Interpretive publications, such as related *Government Auditing Standards* guidance documents and interpretations, are found on the GAO website.<sup>11</sup> Interpretive publications are not auditing standards, but have the same level of authority as application and other materials in *Government Auditing Standards*.

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<sup>11</sup> An example is the document "Government Auditing Standards: Guidance on GAGAS Requirements for Continuing Professional Education," that is found on the GAO website.