



Chapter 1

Foundation and Principles for the Use and Application of *Government Auditing Standards*

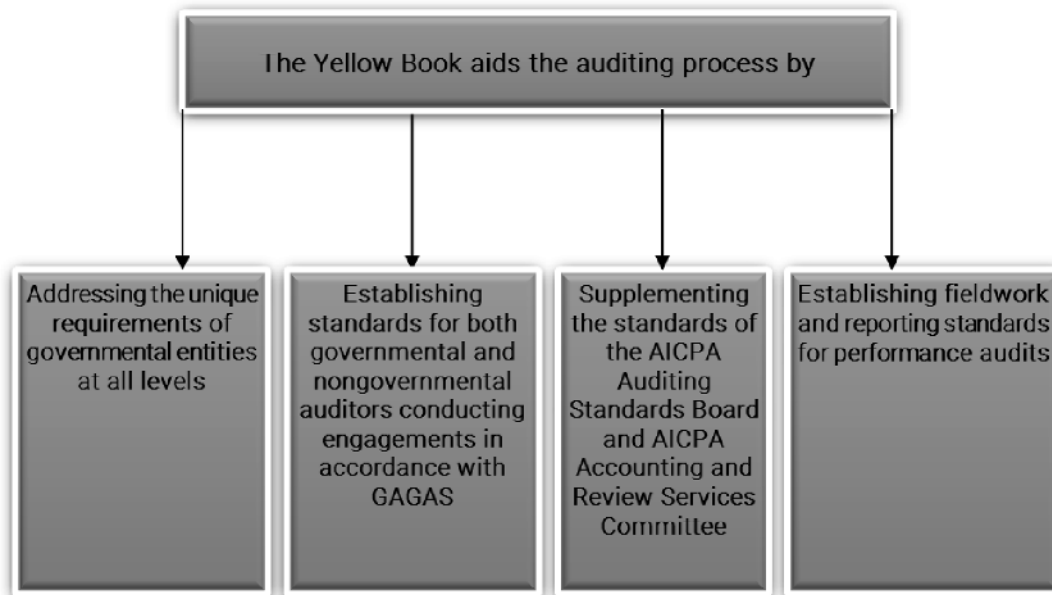
Learning objectives

- Recognize why engagements are conducted in accordance with generally accepted government auditing standards (GAGAS or Yellow Book).
- Recall revisions brought about by the 2018 revision to GAGAS.
- Identify the types of engagements that may be conducted under GAGAS.

What is GAGAS?

Generally accepted government auditing standards (GAGAS), issued by the U.S. Government Accountability Office (GAO), provide a framework of audit and attest standards for use by auditors of government entities, functions, activities, and programs, as well as for government assistance administered by nonfederal entities. GAGAS provides the foundation for auditors to lead by example in areas of independence, transparency, accountability, and quality through the audit process. The standards provide a framework for performing high-quality audit work with competence, integrity, objectivity, and independence with the overall objective of providing accountability and helping improve government operations and services.

Known widely as the “Yellow Book,” GAGAS aids the auditing process in four ways.



In this course, the terms GAS, GAGAS, and Yellow Book are used interchangeably.

Brief history of *Government Auditing Standards*

Beginning in the mid-1960s, both the number and the dollar amount of federal government programs and services increased substantially. This increase brought with it a demand for full accountability from those entrusted with public funds and the responsibility for managing government programs and services properly.

Origin of the standards

In 1969, the Comptroller General of the United States held a series of meetings with a group of state auditors and federal officials. These meetings identified a need to improve government auditing. One of the areas identified was the absence of formal GAS. In July 1969, the GAO initiated plans for an audit standards work group charged with the objective of developing GAS.

In 1970, the audit standards work group started the survey and research work on which the original 1972 standards were based. The work group included representatives from the GAO, federal departments and agencies, state and local government auditors, and professional organizations including the AICPA. Assistance was also provided by academics and public interest groups. In June 1972, the Comptroller General issued the original version of the Yellow Book, *Standards for Audits of Governmental Organizations, Programs, Activities & Functions*.

Yellow Book revisions

In 1979, the GAO started a project to revise the standards. Based on comments and suggestions the GAO had received since the standards were originally issued, a draft of proposed revised standards was prepared and released for comment in August 1980. Comments received were analyzed and evaluated for appropriate consideration in arriving at the final draft standards. The 1981 revision of GAGAS was signed by the Comptroller General on February 27, 1981.

In November 1985, the GAO started a project to clarify, update, and revise the 1981 revision of the Yellow Book. In December 1985, the Comptroller General appointed an Auditing Standards Advisory Council (ASAC) to advise him and the GAO on revising the standards. The council was composed of individuals from federal, state, and local governments; public accounting; academia; and other special interest groups. On March 16, 1987, an exposure draft was released for comment and was sent to audit officials at all levels of government and members of the public accounting profession, academia, professional organizations, and public interest groups. Comments received were analyzed and evaluated, and appropriate changes were made in the final draft. The final revised standards were released in August 1988, superseding the 1981 revision.

In July 1993, an exposure draft was released proposing changes to the 1988 Yellow Book revision. A revision, *Government Auditing Standards: 1994 Revision*, was released on June 6, 1994. Its provisions were effective for financial audits of periods ending on or after January 1, 1995, and performance audits beginning on or after January 1, 1995.

After the issuance of the 1994 revision of the Yellow Book, three amendments were issued as follows:

- Amendment No. 1: *Documentation Requirements When Assessing Control Risk at Maximum for Controls Significantly Dependent Upon Computerized Information Systems*, issued May 1999
- Amendment No. 2: *Auditor Communication*, issued July 1999
- Amendment No. 3: *Independence*, issued January 2002

In June 2003, the GAO released an omnibus revision to the Yellow Book. The standards became applicable for financial audits and attestation engagements of periods ending on or after January 1, 2004, and for performance audits beginning on or after January 1, 2004.

In July 2007, the GAO issued an omnibus revision to the Yellow Book. The 2007 Yellow Book became applicable for financial audits and attestation engagements for periods beginning on or after January 1, 2008, and for performance audits beginning on or after January 1, 2008.

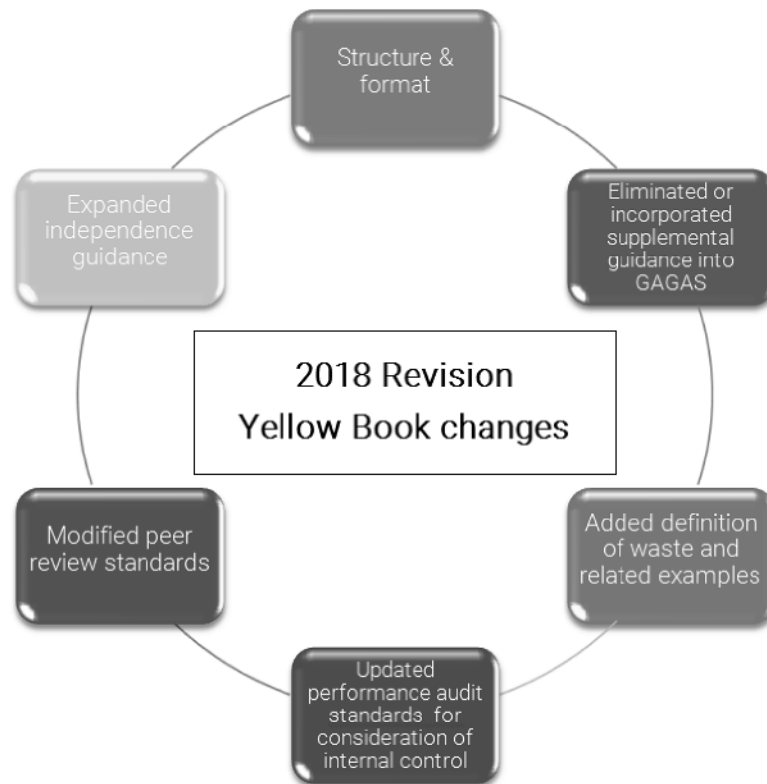
In December 2011, the GAO issued *Government Auditing Standards (2011 Revision)*, which superseded the 2007 revision.

In April 2017, GAO issued an exposure draft containing proposed changes to *Government Auditing Standards, December 2011 Revision*. The final document, entitled *Government Auditing Standards: 2018 Revision*, was issued on July 17, 2018. It is effective for financial audits, attestation engagements, and reviews of financial statements for periods ending on or after June 30, 2020 and was effective for performance audits performed as of July 1, 2019. The independence provisions of the *2018 revision* are effective as of July 1, 2019 for fiscal year engagements ending on June 30, 2020. The revision supersedes the December 2011 revision of the standards, the 2005 *Government Auditing Standards: Guidance on GAGAS Requirements for Continuing Professional Education*, and the 2014 *Government Auditing Standards: Guidance for Understanding the New Peer Review Ratings*.

This course presents the requirements and guidance found in GAGAS based on *Government Auditing Standards: 2018 Revision*.

The 2018 Yellow Book

The 2018 Yellow Book contains significant changes from the 2011 Yellow Book that are aimed at reinforcing the principles of transparency and accountability and strengthening the framework for high-quality governmental audit and attest engagements. These changes are summarized into the following categories:



Clarity in the new GAGAS format

The format of all chapters has been revised to differentiate GAGAS requirements from application guidance related to those requirements.

GAGAS requirements in the 2018 revision are differentiated from application guidance by borders surrounding the text. The requirements are followed immediately by application guidance that relates directly to the preceding requirements.

Supplemental guidance previously included in the appendix of the 2011 revision has been either incorporated into the individual chapters or removed. Additionally, content previously found in *Government Auditing Standards: Guidance on GAGAS Requirements for Continuing Professional Education* (GAO-05-568G, April 2005) and *Government Auditing Standards: Guidance for Understanding the New Peer Review Ratings* (D06602, January 2014) has either been incorporated into the 2018 revision or removed as guidance. These two publications will be retired upon the effective date of the 2018 revision.

In the 2018 revision, chapters were reorganized and realigned in the following ways:

- There are nine chapters, up from seven chapters in the 2011 revision.
- Ethical principles were moved from chapter 1 to chapter 3.
- Much of the material from chapter 2 of the 2011 revision is now in chapter 1.
- The topics of independence, competence, and quality control that were previously included in chapter 3 have each been expanded and afforded their own chapters.
- Standards for financial audits have been expanded and moved to chapter 6.
- Standards for attestation engagements and reviews of financial statements have been expanded and moved to chapter 7.
- Fieldwork and reporting standards for performance audits have been expanded and moved to chapters 8 and 9.

Government Auditing Standards, 2018 Revision 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.

Acquiring the *Government Auditing Standards* publication

Obtaining a copy of the GAO *Government Auditing Standards (2018 Revision)* is highly recommended for participants of this course. A PDF version can be downloaded from www.gao.gov/yellowbook/overview.

For technical assistance regarding the Yellow Book, please call (202) 512-9535 or email yellowbook@gao.gov.

Why is GAGAS important?

Our nation's governing processes count on the concept of accountability for use of public resources and government authority. It is the responsibility of management and officials entrusted with public resources to carry out public duties and provide services to the public in an effective, efficient, economical, and ethical manner within the context of the statutory boundaries of the specific government program.

Officials and management of government programs are responsible for providing reliable, useful, and timely information for transparency and accountability of these programs and their operations as reflected in applicable laws, regulations, agreements, and standards. Legislators, oversight bodies, those charged with governance, and the public need to know whether

- management and officials manage government resources and use their authority properly and in compliance with laws and regulations;
- government programs are achieving their objectives and desired outcomes; and
- government services are provided effectively, efficiently, economically, and ethically.

In the context of GAGAS, *those charged with governance* refers to the persons responsible for supervising the strategic direction of an entity and obligations related to the accountability of an entity. This supervision includes overseeing the financial reporting process, subject matter, or program under audit, including related internal controls. Those charged with governance may also be part of the entity's management. In some audited entities, multiple parties may be charged with governance, including oversight bodies, members or staff of legislative committees, boards of directors, audit committees, or parties contracting for the engagement.

Government audit and attest engagements are essential in providing accountability to legislators, oversight bodies, those charged with governance, and the public. GAGAS engagements provide an independent, objective, nonpartisan assessment of the stewardship, performance, or cost of government policies, programs, or operations, depending upon the type and scope of the engagement.

How does GAGAS achieve its objective?

GAGAS contains requirements and guidance dealing with ethics, independence, auditors' professional judgment and competence, quality control, peer review, conducting the engagement, and reporting.

Engagements conducted in accordance with GAGAS deliver information used for

- oversight,
- accountability,
- transparency, and
- improvements of government programs and operations.

GAGAS helps auditors in objectively obtaining and evaluating sufficient, appropriate evidence and reporting the results by providing auditing requirements and guidance. The work of auditors can lead to enhanced government management, better decision making and oversight, effective and efficient operations, and accountability and transparency for resources and results when they comply with GAGAS in the performance of their work and in reporting the results.

Who has to follow GAGAS?

An auditor has a responsibility to comply with professional standards and the applicable legal and regulatory requirements in any audit or attest engagement that they accept. As part of this responsibility, an auditor needs to determine whether the entity is subject to *Government Auditing Standards*.

Not all engagements are required to be conducted in accordance with GAGAS. Auditors should review whether laws, regulations, contracts, grant agreements, and policies to which the entity is subject contain provisions that would require that engagements be conducted in accordance with GAGAS. In addition, many auditors and audit organizations voluntarily choose to conduct their work in accordance with GAGAS. Auditors must follow the requirements and guidance in GAGAS in totality for engagements pertaining to government entities, programs, activities, and functions, and to government assistance administered by contractors, not-for-profit entities, and other nongovernmental entities when the use of GAGAS is required or voluntarily adopted.

The laws, regulations, and other authoritative sources that require the use of GAGAS include:

- The Inspector General Act of 1978, as amended (5 USC App.), requires that the federal inspectors general appointed under that act comply with GAGAS for audits of federal establishments, organizations, programs, activities, and functions.
- The Chief Financial Officers Act of 1990 (Public Law 101-576), as expanded by the Government Management Reform Act of 1994 (Public Law 103-356), requires that GAGAS be followed in audits of major executive branch departments' and agencies' financial statements. The Accountability of Tax Dollars Act of 2002 (Public Law 107-289) generally extends this requirement to most executive agencies not subject to the Chief Financial Officers Act.
- The Single Audit Act Amendments of 1996 (Public Law 104-156) requires that GAGAS be followed in audits of state and local governments and not-for-profit entities that receive federal awards. Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) — which provides the government-wide guidelines and policies on conducting compliance audits to comply with the Single Audit Act — reiterates the requirement to use GAGAS in a single audit.

Examples of engagements requiring the use of GAGAS are when a nonfederal entity receives

- grant funds from a federal agency (such as Department of Health and Human Services);
- federal funds from a passthrough entity; or
- federal funds from a state or local government agency.

Other laws, regulations, or authoritative sources may mandate the use of GAGAS. For instance, state and local laws and regulations may obligate auditors at the state and local government levels to follow

GAGAS. Moreover, the terms of an agreement or contract or federal audit guidelines pertaining to program requirements may mandate a requirement to follow GAGAS. Being aware of such other laws, regulations, or authoritative sources may assist auditors in conducting their work in accordance with the required standards.

Even if not required to do so, auditors, both in the United States and in other countries, voluntarily follow GAGAS as they find it useful in conducting engagements pertaining to federal, state, and local government programs as well as engagements pertaining to state and local government awards that contractors, not-for-profit entities, and other nongovernmental entities administer.

Types of GAGAS users

A wide range of auditors and audit organizations follow GAGAS in their audits of government entities, entities that receive government awards, and other entities. These auditors and audit organizations may also be subject to additional requirements unique to their environments. Examples of the various types of users who may be required or may elect to use GAGAS include the following:

Contract auditors

Audit organizations that specialize in conducting engagements pertaining to government acquisitions and contract administration

CPA firms

Public accounting organizations in the private sector that provide audit, attestation, or review services under contract to government entities or recipients of government funds

Federal inspectors general

Government audit organizations within federal agencies that conduct engagements and investigations relating to the programs and operations of their agencies and issue reports both to agency management and to third parties external to the audited entity

Federal agency internal auditors

Internal government audit organizations associated with federal agencies that conduct engagements and investigations relating to the programs and operations of their agencies

Municipal auditors

Elected or appointed officials in government audit organizations in the United States at the city, county, and other local government levels

State auditors

Elected or appointed officials in audit organizations in the governments of the 50 states, the District of Columbia, and U.S. territories

Supreme audit institutions

National government audit organizations, in the United States or elsewhere, typically headed by a comptroller general or auditor general

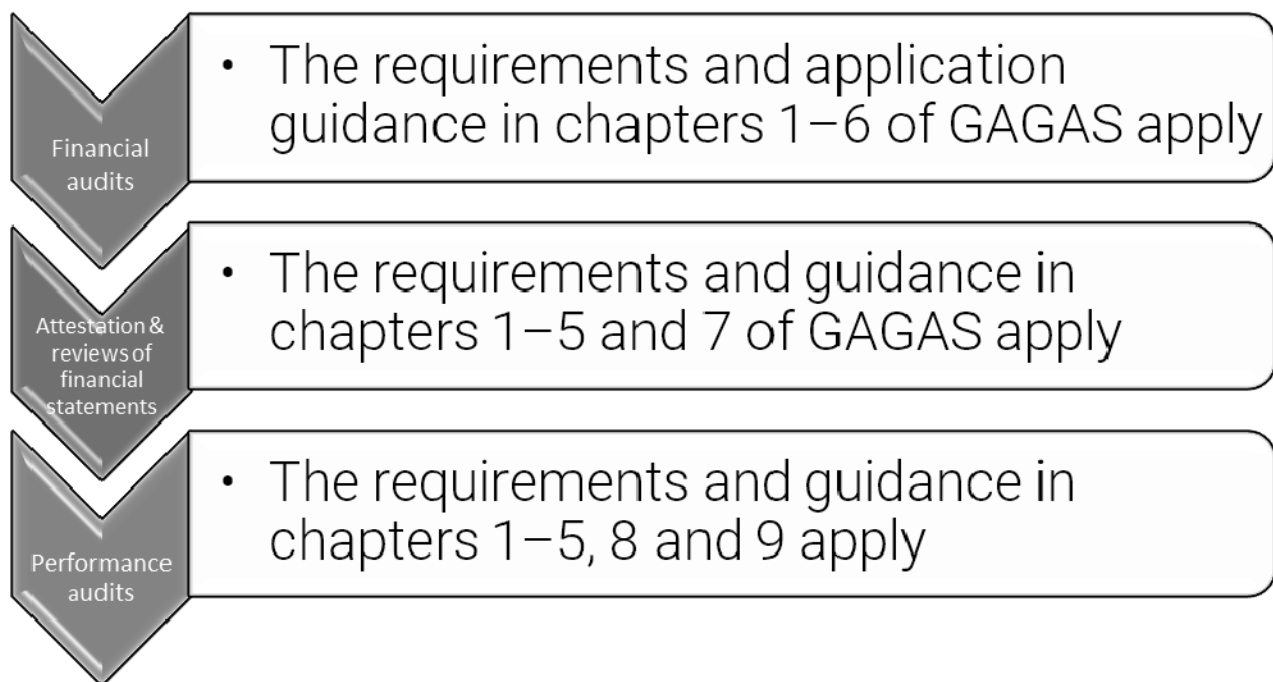
Types of GAGAS engagements

There are several types of engagements that audit organizations may conduct in accordance with GAGAS. GAGAS specifies that the guidance provided is not intended to limit or require the types of engagements that may be conducted in accordance with GAGAS.

All GAGAS engagements begin with objectives, and those objectives determine the type of engagement to be conducted and the applicable standards to be followed. GAGAS classifies financial audits, attestation engagements, reviews of financial statements, and performance audits, as defined by their objectives, as the types of engagements that are covered by GAGAS.

In some GAGAS engagements, the standards applicable to the specific objective will be obvious. For instance, if the objective is to express an opinion on financial statements, the standards for financial audits apply. However, some engagements may have objectives that could be met using more than one approach. This may occur, for example, if the objective is to determine the reliability of performance measures. Auditors can perform this work in accordance with either the standards for attestation engagements or performance audits.

GAGAS requirements and guidance apply to the types of engagements that auditors may conduct in accordance with GAGAS as follows:



What are financial audits?

Financial audits provide an independent assessment of whether an entity's reported financial information (such as financial condition, results, and use of resources) is presented fairly, in all material respects, in accordance with recognized criteria. Financial audits conducted in accordance with GAGAS include financial statement audits and other related financial audits.

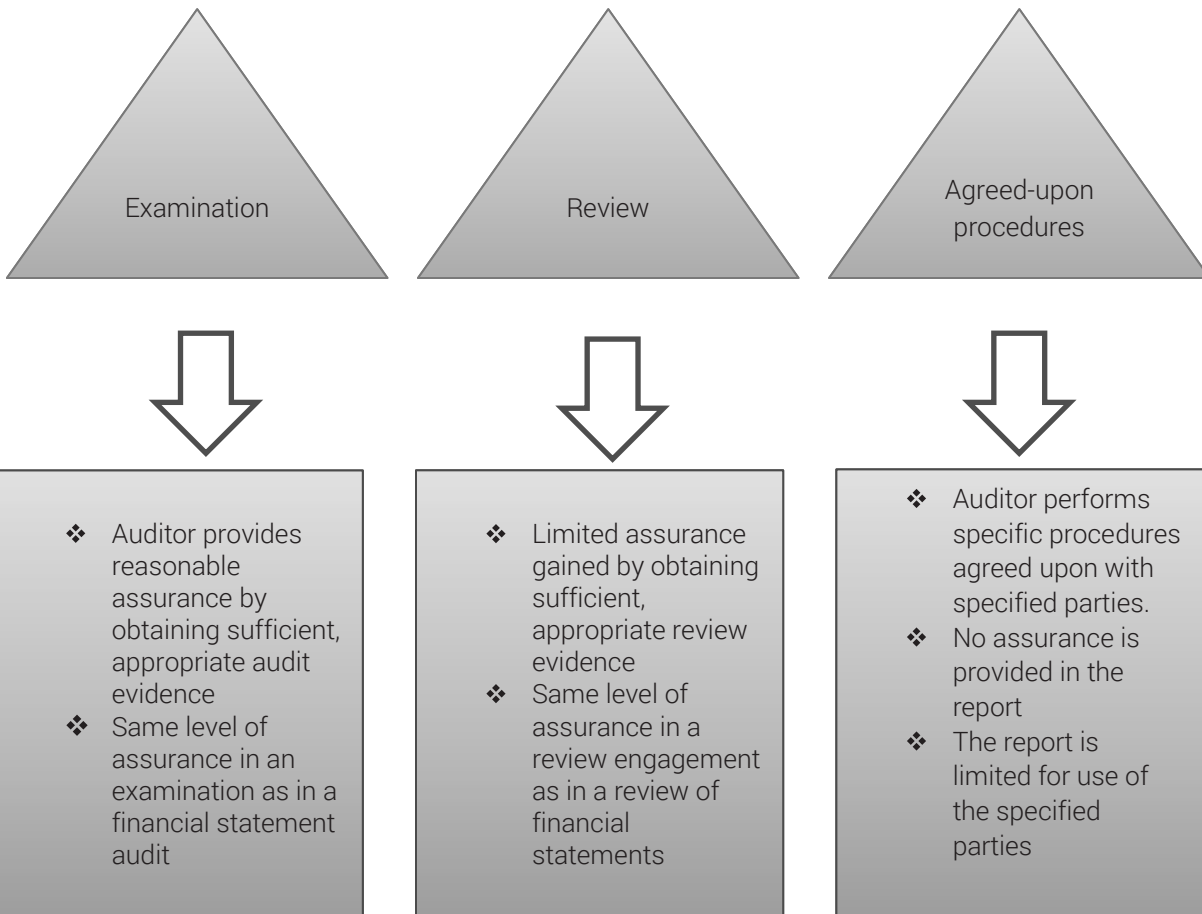
The primary purpose of a financial statement audit is for an auditor to provide financial statement users with an opinion on whether an entity's financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework. Financial statement audits conducted in accordance with GAGAS include reporting on internal control over financial reporting and on compliance with provisions of laws, regulations, contracts, and grant agreements that have a material effect on the financial statements.

Other types of financial audits conducted in accordance with GAGAS entail various scopes of work, including

- obtaining sufficient, appropriate evidence to form an opinion on a single financial statement or specified elements, accounts, or line items of a financial statement;
- issuing letters (commonly referred to as comfort letters) for underwriters and certain other requesting parties;
- auditing compliance and internal control requirements relating to one or more government programs; and
- conducting an audit of internal control over financial reporting that is integrated with an audit of financial statements (integrated audit).

What are attestation engagements?

An *attestation engagement* is one in which an auditor measures or evaluates subject matter or an assertion by an outside party in accordance with criteria suitable under the circumstances. Attestation engagements can cover a broad range of financial or nonfinancial objectives about the subject matter or assertion depending on the needs of the user. The type of attestation engagement governs the level of work performed by the auditor and the level of assurance provided. The three types of attestation engagements and the level of assurance associated with each of them are as follows:



The form of the subject matter of an attestation engagement may include

- historical or prospective performance or condition, historical or prospective financial information, performance measurements, or backlog data;
- physical characteristics such as narrative descriptions or square footage of facilities;
- historical events, for instance, the price of a market basket of goods on a certain date;
- analyses such as break-even analyses;
- systems and processes such as internal control; and
- behavior such as corporate governance, compliance with laws and regulations, and human resource practices.

What are reviews of financial statements?

The objective of a *review* of financial statements is to obtain limited assurance as a basis for reporting whether the auditor is aware of any material modifications that should be made to the financial statements in order for them to be in accordance with the applicable financial reporting framework. It is less in scope than an audit and does not include, among other things, obtaining an understanding of internal control and assessing fraud risk. Reviews of financial statements under GAGAS are performed under AR-C section 90, *Review of Financial Statements (AICPA, Professional Standards)*.

What are performance audits?

A *performance audit* provides objective analysis, findings, and conclusions. The purpose, among other things, is to help management and those charged with governance and oversight with improving program performance and operations, reducing costs, facilitating decision making by parties responsible for overseeing or initiating corrective action, and contributing to public accountability.

Different from financial audits, performance audit objectives can vary widely. Performance audit objectives include assessments of program effectiveness, economy, and efficiency; internal control; compliance; and prospective analysis. They may also relate to the current status or condition of a program. These overall objectives are not mutually exclusive, and each performance audit may have several objectives. For instance, a performance audit with an objective of determining or evaluating program effectiveness may involve an additional objective of evaluating the program's internal controls.

Knowledge check

1. An audit in accordance with the Yellow Book may be conducted because of all **except**
 - a. Contractual requirements.
 - b. Requirements in regulations.
 - c. Voluntary choice.
 - d. GAAS.

Terms used in this course and in GAGAS

The Yellow Book provides definitions of terms utilized in the standards. That guidance specifies that if terminology differs from that used at an organization subject to GAGAS, auditors are to use professional judgment to determine if there is an equivalent term. Some terms provided include:

Audit	Either a financial audit or performance audit conducted in accordance with GAGAS.
Audit organization	A government audit entity or a public accounting firm or other audit entity that conducts GAGAS engagements
Audit report	A report issued as a result of a financial audit, attestation engagement, review of financial statements, or performance audit conducted in accordance with GAGAS
Audited entity	The entity that is subject to a GAGAS engagement, whether that engagement is a financial audit, attestation engagement, review of financial statements, or performance audit
Auditor	An individual assigned to planning, directing, performing engagement procedures, or reporting on GAGAS engagements (including work on audits, attestation engagements, and reviews of financial statements) regardless of job title. Therefore, individuals who may have the title auditor, information technology auditor, analyst, practitioner, evaluator, inspector, or another similar title are considered auditors under GAGAS.
Control objective	The aim or purpose of specified controls; control objectives address the risks related to achieving an entity's objectives.
Engagement	A financial audit, attestation engagement, review of financial statements, or performance audit conducted in accordance with GAGAS
Engagement team (or audit team)	Auditors assigned to planning, directing, performing engagement procedures, or reporting on GAGAS engagements
Engaging party	The party that engages the auditor to conduct the GAGAS engagement
Entity objective	What an entity wants to achieve; entity objectives are intended to meet the entity's mission, strategic plan, and goals, as well as the requirements of applicable laws and regulations.
External audit organization	An audit organization that issues reports to third parties external to the audited entity, either exclusively or in addition to issuing reports to senior management and those charged with governance of the audited entity
Internal audit organization	An audit organization that is accountable to senior management and those charged with governance of the audited entity and that does not generally issue reports to third parties external to the audited entity
Responsible party	The party responsible for a GAGAS engagement's subject matter
Specialist	An individual or organization possessing special skill or knowledge in a particular field other than accounting or auditing that assists auditors in conducting engagements. A specialist may be either an internal specialist or an external specialist.

Knowledge check

2. All of the following meet the definition of an “auditor” within the guidance of GAGAS **except**:
- a. An actuary engaged by an audit team to assist in the performance of an engagement subject to GAGAS.
 - b. An engagement partner responsible for planning a performance audit conducted in accordance with GAGAS.
 - c. A federal internal inspector who reports on investigations related to the programs and operations of the federal agency.
 - d. A staff person performing agreed-upon procedures over a contract that is required to be conducted in accordance with the Yellow Book.

