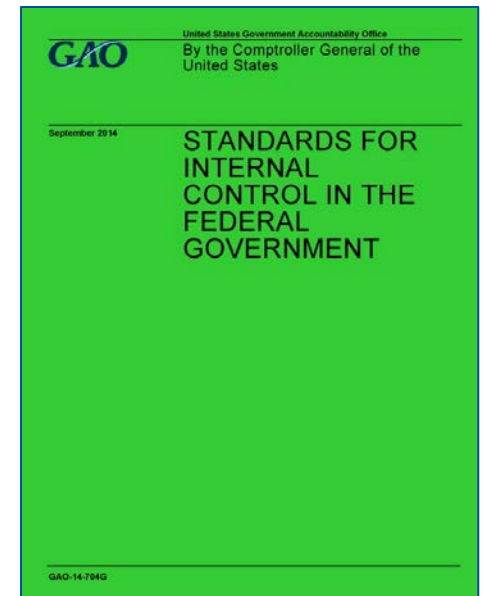
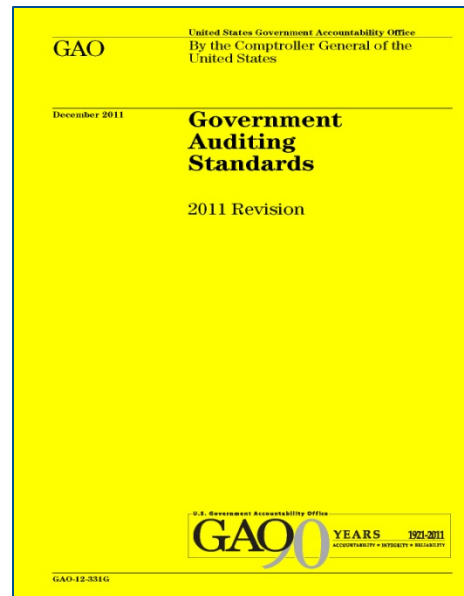




Government Auditing Standards and Standards for Internal Control in the Federal Government: An Ethics Perspective

**2014 National
Government
Ethics Summit**

Eric Holbrook



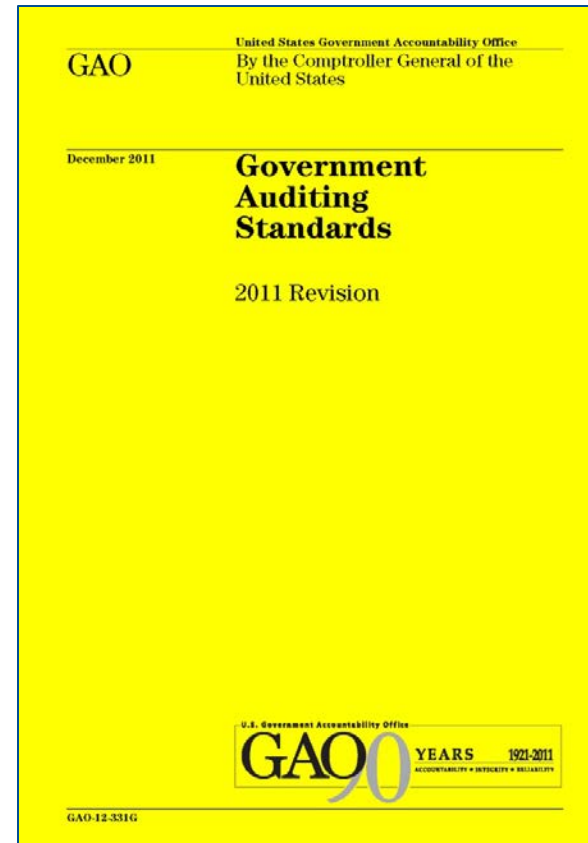
U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Session Objective

To provide an overview of the audit and internal control standards promulgated by GAO with a focus on ethical considerations.

Yellow Book = “GAGAS”

“generally accepted
government
auditing standards”



Yellow Book = “GAGAS”

- Broad statements of auditors’ responsibilities
- An overall framework for ensuring that auditors have the competence, integrity, objectivity, and independence in planning, conducting, and reporting on their work
- For financial audits and attestation engagements, incorporates and builds on the AICPA standards (SASs and SSAEs)

The 2011 Yellow Book: Applicability

- Chapters 1, 2, and 3 apply to all GAGAS engagements
 - Chapter 1: Government Auditing: Foundation and Ethical Principles
 - Chapter 2: Standards for Use and Application of GAGAS
 - Chapter 3: General Standards
- Chapter 4: Standards for Financial Audits – applies only to financial audits
- Chapter 5: Standards for Attestation Engagements - applies only to attestation engagements

The 2011 Yellow Book Applicability (Continued)

- Chapters 6 and 7 apply only to performance audits
 - Chapter 6: Field Work Standards for Performance Audits
 - Chapter 7: Reporting Standards for Performance Audits
- Appendix: Provides additional guidance (not requirements) for all GAGAS engagements
- Interpretations: Available on the Yellow Book web page. Provide additional guidance (not requirements) for areas of particular interest or sensitivity.

Chapter 1: Five Ethical Principles

- Public interest
- Integrity
- Objectivity
- Proper use of government information, resources, and position
- Professional behavior

Chapter 2: Types of GAGAS Engagements

- All audits begin with objectives, and those objectives determine the type of audit to be performed and the applicable standards to be followed.
- The types of audits that are covered by GAGAS, as defined by their objectives, are classified in the Yellow Book as
 - Financial audits,
 - Attestation engagements, and
 - Performance audits.

Chapter 3: General Standards

- Independence
 - Conceptual framework
 - Provision of nonaudit services to auditees
- Professional judgment
- Competence
 - Technical knowledge
 - Continuing Professional Education
- Quality Assurance
 - System of quality assurance
 - Peer review

Chapter 3: Independence

- In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, must be independent.
- Independence comprises:
 - Independence of Mind
 - Independence in Appearance

Independence

- Conceptual Framework
 - Allows the auditor to assess unique circumstances
 - Adaptable
 - Consistent with AICPA and IFAC frameworks

- Significant differences from ET-101-3
 - Entry point for independence assessment
 - Emphasis on services “in aggregate”
 - Documentation requirements

Applying the Framework

- New approach combines a conceptual framework with certain rules (prohibitions)
 - Balances principle and rules based standards
 - Serves as a hybrid framework
- Certain prohibitions remain
 - Generally consistent with Rule AICPA 101
- Beyond a prohibition
 - Apply the conceptual framework
 - Will be used more often than AICPA

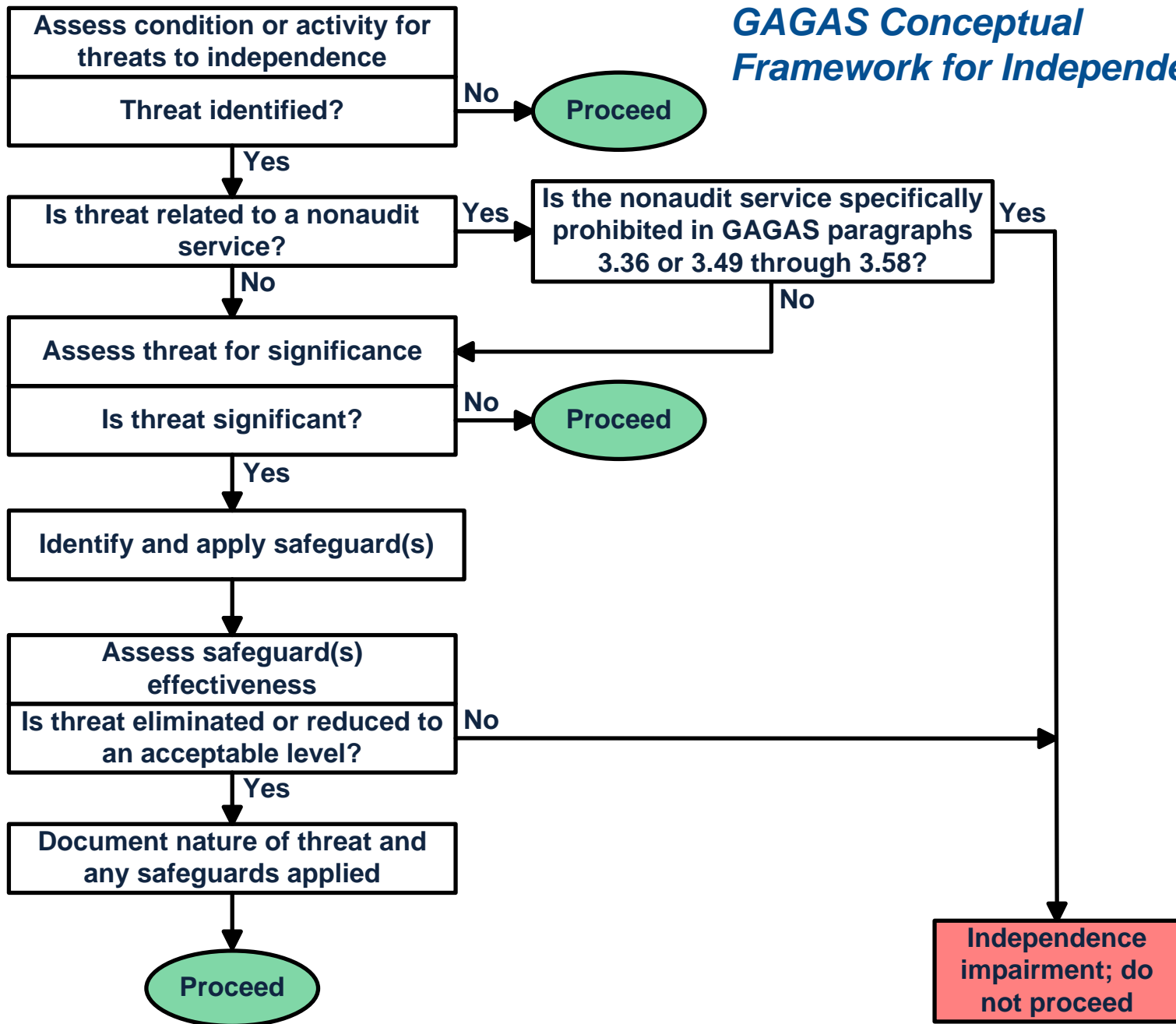
Applying the Framework

1. Identify threats to independence
2. Evaluate the significance of the threats identified, both individually and in the aggregate
3. Apply safeguards as necessary to eliminate the threats or reduce them to an acceptable level
4. Evaluate whether the safeguard is effective

Documentation Requirement:

Para 3.24: When threats are not at an acceptable level and require application of safeguards, auditors should document the safeguards applied.

GAGAS Conceptual Framework for Independence



Applying the Framework: Categories of Threats

1. Management participation threat
2. Self-review threat
3. Bias threat
4. Familiarity threat
5. Undue influence threat
6. Self interest threat
7. Structural threat

Applying the Framework: Examples of Safeguards

- Reassign individual staff members who may have a threat to independence.
- Have separate staff perform the non-audit and audit services.
- Have professional staff from outside of the team review the work.
- Use or consult with an independent third party.
- Involve another audit organization.
- Decline to do the requested scope of the non-audit service.

Nonaudit Services

1. Determine if there is a specific prohibition. Unless specifically prohibited, nonaudit services MAY be permitted but should be documented.
2. If not prohibited, assess the nonaudit service's impact on independence using the conceptual framework.
3. If the auditor assesses any identified threat to independence as higher than insignificant, assess the sufficiency of audited entity management's skill, knowledge, and experience to oversee the nonaudit service.

And...

Nonaudit Services (Continued)

4. If the auditor concludes that performance of the nonaudit service will not impair independence, document assessments in relation to both:
 - safeguards applied in accordance with the conceptual framework and
 - the auditor's assessment of sufficiency of audited entity managements' skill, knowledge or experience to oversee the nonaudit service (paragraph 3.34).

Preconditions to Performing Nonaudit Services

- Management should take responsibility for nonaudit services performed by the auditors.
- Auditors should document (GAGAS and AICPA) their understanding with management regarding the nonaudit service.
- Auditors should assess (AICPA) and document (GAGAS) whether management possesses suitable skill, knowledge, or experience to oversee the nonaudit service.

Assessing Management' s Skill, Knowledge, and Experience

- Factors to document include management' s:
 - Understanding of the nature of the nonaudit service
 - Knowledge of the audited entity' s mission and operations
 - General business knowledge
 - Education
 - Position at the audited entity
- Some factors may be given more weight than others
- GAGAS does not require that management have the ability to perform or reperform the service

Sufficiency of Skills, Knowledge and Experience

Sufficient skills, knowledge and experience may be judged based in part on:

- Ability of the responsible audited entity personnel to understand the nature and results of the nonaudit service.
- Ability of the responsible person to identify material errors or misstatements in a nonaudit service work product.
- Ability and willingness and of the responsible person to take meaningful action in the event of identification of a problem with the nonaudit service.

Safeguards – Non-audit services

Auditors should document safeguards when significant threats are identified.

- Auditor has responsibility to perform the assessment, this cannot be a management assertion
- Assessment should be in writing and indicate actions the auditor has taken to mitigate the threat
- Assessment should include a conclusion
- Auditor should document actions taken to mitigate the threat (safeguards)
- An example of safeguards for nonaudit services may include actions taken by the auditor to preserve independence such as an extra level of review or secondary review

Prohibited Nonaudit Services

Management responsibilities (not a comprehensive list):

- Setting policies and strategic direction for the audited entity
 - Directing and accepting responsibility for the actions of the audited entity's employees in the performance of their routine, recurring activities
 - Having custody of an audited entity's assets
 - Reporting to those charged with governance on behalf of management
 - Deciding which of the auditor's or outside third party's recommendations to implement
-

Independence: Documentation Requirements

- Threats that require the application of safeguards along with the safeguards applied
- Safeguards in place if an audit organization is structurally located within a government entity
- Consideration of sufficiency of audited entity management's skill, knowledge, and experience to take responsibility for and effectively oversee the nonaudit services
- The auditor's understanding with an audited entity regarding nonaudit services to be provided

Chapter 3 – General Standards: Continuing Professional Education

- Minimum of 24 hours of CPE every 2 years
 - Government
 - Specific or unique environment
 - Auditing standards and applicable accounting principles
- Additional 56 hours of CPE for auditors involved in
 - Planning, directing, or reporting on GAGAS assignments; or
 - Charge 20 percent or more of time annually to GAGAS assignments
- Minimum of 20 hours of CPE each year

Chapter 3 - General Standards: System of Quality Control

Each audit organization must document its quality control policies and procedures and communicate those policies and procedures to its personnel.

Chapter 3 - General Standards: System of Quality Control

Quality control policies and procedures should collectively address:

- Leadership responsibilities for quality within the audit organization
- Independence, legal, and ethical requirements
- Initiation, acceptance, and continuance of audit and attestation engagements
- Human resources
- Audit and attestation engagement performance, documentation, and reporting
- Monitoring of quality

Chapter 3 - General Standards: Quality Control Monitoring Procedures

Audit organizations should analyze and summarize, in writing, the results of monitoring procedures at least annually:

- Include identification of any systemic issues needing improvement
- Include recommendations for corrective action
- Communicate deficiencies noted to appropriate personnel and make recommendations for remedial action

Chapter 3 - General Standards: Peer Reviews

The peer review team uses professional judgment in deciding the type of peer review report. The following are the types of peer review reports:

- Peer review rating of pass
- Peer review rating of pass with deficiencies
- Peer review rating of fail

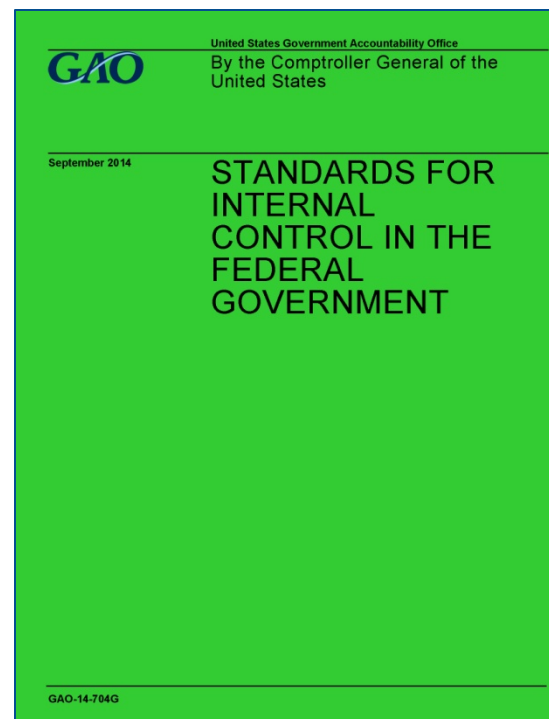
Where to Find the Yellow Book

- The Yellow Book is available on GAO's website at:
www.gao.gov/yellowbook
- For technical assistance, contact us at:
yellowbook@gao.gov
or call (202) 512-9535



Standards for Internal Control in the Federal Government

“The Green Book”



Green Book Advisory Council

Representation from:

- Federal agency management (nominated by OMB)
- Inspectors General
- State and local government
- Academia
- COSO
- Independent public accounting firms
- At large

Implications of Ineffective Internal Controls

More than \$154 Million in Questioned and Unsupported Costs in [Grant Recipients] Proposed Budget

Improper Release of Personally Identifiable Information

Internal Controls Over [Entity's] Staff Retreats Could Be Improved

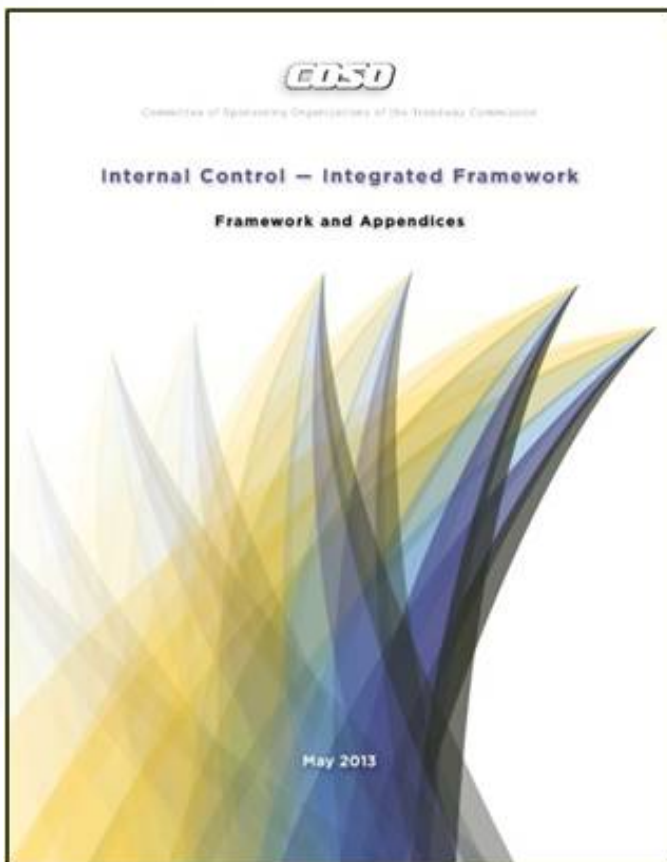
More than \$6.3 Million of Questioned Costs at the University of [Green's Higher Education]

Additional Audit Work Confirms \$88 Million of Unallowable Contingency Costs in Construction Budget

Standards for Internal Control in the Federal Government

- Reflects federal internal control standards required per Federal Managers' Financial Integrity Act (FMFIA)
- Serves as a base for OMB Circular A-123
- Written for government
 - Leverages the COSO Framework
 - Uses government terms
- May be an acceptable framework for internal control on the state and local government level under proposed OMB Uniform Guidance for Federal Awards

Updated COSO Framework



Released
May 14, 2013

The COSO Framework

COSO depicts the relationships as a cube.

- The three objectives are represented by the columns.
- The five components are represented by the rows.
- The entity's organization structure is represented by the third dimension.



Source: COSO

Five Components Please



Harmonization from COSO to Green Book



Commercial Concepts

- Board of Directors
- Investors

Government Concepts

- Oversight Body
- Stakeholders

COSO vs. Green Book

Component	COSO	Green Book
Control Environment	5 Principles 20 Points of Focus	5 Principles 13 Attributes
Risk Assessment	4 Principles 27 Points of Focus	4 Principles 10 Attributes
Control Activities	3 Principles 16 Points of Focus	3 Principles 11 Attributes
Information & Communication	3 Principles 14 Points of Focus	3 Principles 7 Attributes
Monitoring	2 Principles 10 Points of Focus	2 Principles 6 Attributes

Harmonization Example

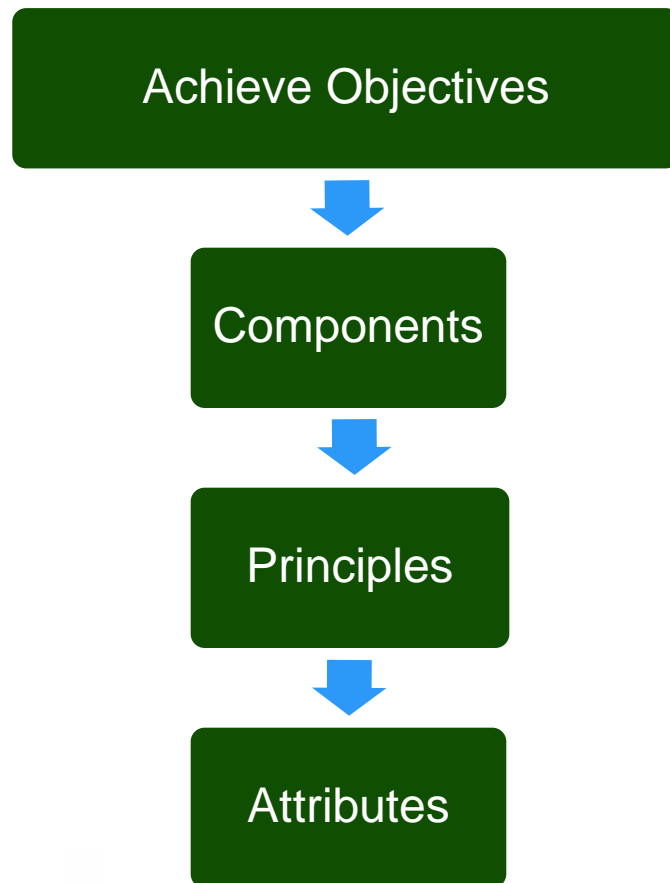
COSO (Principle 2)

“The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.”

Green Book (Principle 2)

“The oversight body should oversee the entity’s internal control system.”

Components, Principles, and Attributes



Components and Principles

Control Environment

1. Demonstrate Commitment to Integrity and Ethical Values
2. Exercise Oversight Responsibility
3. Establish Structure, Responsibility, and Authority
4. Demonstrate Commitment to Competence
5. Enforce Accountability

Risk Assessment

6. Define Objectives and Risk Tolerances
7. Identify, Analyze, and Respond to Risk
8. Assess Fraud Risk
9. Analyze and Respond to Change

Control Activities

10. Design Control Activities
11. Design Activities for the Information System
12. Implement Control Activities

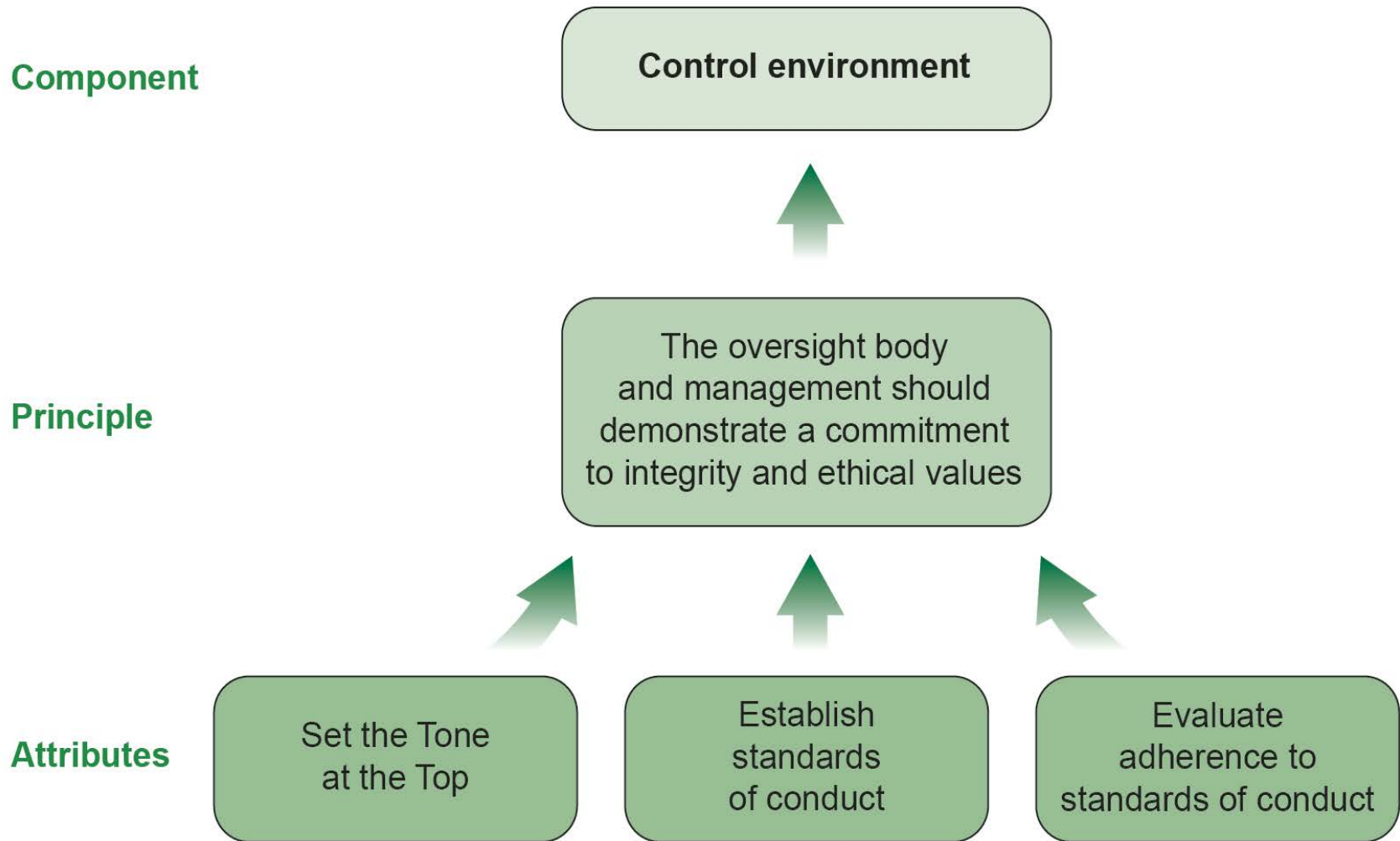
Information & Communication

13. Use Quality Information
14. Communicate Internally
15. Communicate Externally

Monitoring Activities

16. Perform Monitoring Activities
17. Remediate Deficiencies

Components, Principles, and Attributes



Controls Across Components

Controls embedded in other components may effect this principle

Control Environment

Human Resources review employee's confirmations to assess whether standards of conduct are understood and adhered to by staff across the entity

Information & Communication

Management obtains and reviews data and information underlying potential deviations captured in whistleblower hotline to assess quality of information

Monitoring Activities

Internal Audit separately evaluates Control Environment, considering employee behaviors and whistleblower hotline results and reports thereon

Principle

1. The organization demonstrates a commitment to integrity and ethical values

Component

Control Environment

Where to Find the Green Book

- The Green Book will be on GAO's website at:
www.gao.gov
- For technical assistance, contact us at:
greenbook@gao.gov