

Yellow Book Update



Federal Financial Statements
Audit Forum
President's Council on Integrity
and Efficiency
September 19, 2000



Revisions Made Since 1994

- Amendment No. 1, Documentation Requirements When Assessing Control Risk at Maximum for Controls Significantly Dependent Upon Computerized Information Systems
- Amendment No. 2, Auditor Communication



Purpose of Amendment No. 1

- To tighten the rigor applied to the audit
- To heighten auditors' awareness of the risks associated with auditing computerized information systems
- To help ensure that auditors do not inadvertently rely on computer-generated evidence



Amendment No. 1

- What Changed in Yellow Book?
 - Establishes a new field work standard requiring documentation in the planning of financial statement audits in certain circumstances
- Effective for financial statement audits of periods ending on or after September 30, 1999



What Does the New Standard Require?

- Auditors to document in the working papers
 - the basis of assessing control risk at the maximum level for assertions related to
 - material account balances,
 - material transaction classes, and
 - material disclosure components
 - when such assertions are significantly dependent on computerized information systems



What Does the New Standard Require?

- Auditors to document in the working papers
 - their consideration that the planned audit procedures are designed
 - to achieve audit objectives and
 - to reduce audit risk to an acceptable level



What Other Changes in Yellow Book?

- Provides discussion of factors auditors need to consider in obtaining an understanding of internal control over an entity's computer processing
- changes were made to conform to AICPA standards on internal control and fraud



Purpose of Amendment No. 2

■ Purpose

- To address expectation gap that the auditor's opinion on the financial statements extends to compliance and internal control



Amendment No. 2

- What Changed in Yellow Book?
 - Adds a field work standard and amends a reporting standard to improve auditor communications with the auditee and users of the reports
- Effective for financial statement audits of periods ending on or after January 1, 2000.



What will Amendment No. 2 Do?

- Broadens who the auditor must communicate with
- Specifies when the communication takes place
- Specifies what the auditor must communicate
- Helps prevent the communication getting lost in the auditors' report



Who Does the Auditor Communicate With?

- Broadens the definition of client/auditee to include:
 - the organization being audited
 - the individual responsible for the financial reporting process
 - the individuals contracting for or requesting the audit services
 - if performing the audit pursuant to law or regulation, the legislative members who have oversight of the auditee



When Does the Communication Take Place?

- Requires the communication take place during the **planning** stages of an audit



What the Auditor Needs to Communicate?

- Requires the auditor to communicate:
 - the nature and extent of planned testing of compliance and internal control
 - whether the auditor is planning on providing opinions on compliance and internal control



Prevent the Communication From Getting Lost

- The auditor is required to emphasize in the auditor's report on the financial statements the importance of the reporting on compliance with laws and regulations and internal control over financial reporting when these reports are issued separately from the report on the financial statements



Other Issues Under Council Consideration

- Independence
- Performance Auditing
- Attestation Engagements
- Continuing Professional Education



Derivation of Preliminary Views

- Council identified as top issue to be addressed at February 1997 meeting
- Independence Working Group established
 - Dan Kyle
 - June Gibbs Brown
 - Margaret Kelly
 - Woody Jackson
 - Gaston Gianni
 - Barb Hinton
 - Sam McCall
 - Leslie Ward
- Independence Working Group



Purpose of the Preliminary Views Document

- To reach out to users of standards to help formulate solutions
- To identify additional issues that need to be considered regarding independence



Who Commented?

- 99 letters received from all levels of government and other organizations and groups
 - 43 from IGs
 - 15 from state auditors
 - 7 from local government auditors
 - 3 from military auditors general
 - 15 from internal auditors
 - 16 from users, CFOs, and private citizens



Nature of Comment Letters Received

- 77 nonsupportive
- 16 supportive
- 6 neutral



Major Points Raised in Comment Letters

- Conflicts with the Inspector General Act
- Disenfranchises internal auditors
- Allows audit organizations that are not independent to issue reports
- Ignores other safeguards that maybe in place to ensure independence of organization



Performance Auditing

- Why are changes needed?
 - To broaden the umbrella of users
 - To make the standards more user friendly
 - To recognize the variety of services provided by audit organizations and assess adequacy of current standards



Continuing Professional Education

- Strengthen the value of continuing professional education



What's next?

- August 29th working group meeting
- October 16-17, 2000 meeting
 - open to the public
 - agenda items
 - discuss comments on independence PV
 - focus on performance audit
- Visit web site for highlights and products
 - www.gao.gov/govaudit/ybk01.htm