



GAO's "Yellow Book" 2018 update: Summary of key changes

In July 2018, the Government Accountability Office (GAO) released an updated version of the Government Auditing Standards (Yellow Book) as a follow-on to a 2017 exposure draft. These standards help frame both the auditor's expectations on the scope of engagement and the agency's expectations when developing the audit contract or agreement. The updated version of the Yellow Book contains changes in six specific areas:

- 1) New format and presentation of requirements
- 2) Expanded independence standard
- 3) Includes a definition of waste
- 4) Updates made to performance audit standards to include consideration of internal control and its significance to audit objectives
- 5) Supplemental guidance from 2011 version has either been removed or

incorporated within chapters of the 2018 version

- 6) Modified Peer Review standard—it mandates compliance with peer review requirements of affiliated organizations and Generally Accepted Government Auditing Standards (GAGAS) peer review requirements

The update is effective on or after June 30, 2020 for audits, attest engagements, and reviews of financial statements. For performance audits, the updated standards must be used beginning on or after July 1, 2019. The 2018 version supersedes:

- The 2011 version of the Yellow Book
- 2005 Government Auditing Standards: Guidance on GAGAS Requirements for Continuing Professional Education
- 2014 Government Auditing Standards: Guidance for

Understanding the New Peer Review Ratings

New Format and Presentation

In the 2018 version of the Yellow Book, there is a clear separation between requirements and application guidance. Requirements appear in "boxes" and the application details follow the requirements boxes as shown in the example below from the updated version:

<p>Relationship between GAGAS and Other Professional Standards</p>	<p>Requirement: Relationship between GAGAS and Other Professional Standards</p> <p>2.11 When auditors cite compliance with both GAGAS and another set of standards, such as those listed in paragraphs 2.13, 2.15, 6.01, and 7.01, auditors should refer to paragraph 2.17 for the requirements for citing compliance with GAGAS. In addition to citing GAGAS, auditors may also cite the use of other standards in their reports when they have also met the requirements for citing compliance with the other standards. Auditors should refer to the other set of standards for the basis for citing compliance with those standards.</p>
	<p>Application Guidance: Relationship between GAGAS and Other Professional Standards</p> <p>2.12 Auditors may use GAGAS in conjunction with professional standards issued by other authoritative bodies.</p> <p>2.13 The relationship between GAGAS and other professional standards for financial audits, attestation engagements, and reviews of financial statements is as follows:</p> <p>a. The American Institute of Certified Public Accountants (AICPA) has established professional standards that apply to financial audits, attestation engagements, and reviews of financial statements.</p>



Additionally, the 2018 version presents a new organization scheme for the chapters. This results in a total of nine chapters, whereas the 2011 version had a total of seven. For example, the types of GAGAS engagements, now covered in chapter one of the current version, was previously covered in chapter two of the 2011 version. Ethical principles, now covered in chapter three of the current version, was previously covered in chapter one of the 2011 version.

Changes to Independence Standard

The 2018 version of the Yellow Book expands the independence standards by identifying significant threats to independence created during the performance of non-audit services. Auditors cannot prepare financial statements from client-provided trial balances or accounting records as this creates a significant threat to independence. Auditors will be required to document these threats and safeguards applied to mitigate them or decline to perform the service. Services that relate to preparing accounting records and financial statements create a threat to independence. While this may not necessarily be a significant threat, auditors will be required to document their evaluation for significance. The updated standards also provide examples of activities that impair auditor independence, such as preparation of the underlying

accounting records without management approval. Services involving the preparation of journal entries and authorizing transactions cannot be performed by the auditor. Agencies should be mindful of these limitations on the scope of their auditor's services when planning their financial reporting activities.

Definition of Waste

The 2011 version of the Yellow Book discusses abuse and states that auditors are not required to detect abuse in financial audits since the definition is subjective. The 2018 version considers waste in addition to abuse. It states that waste is the act of expending resources carelessly, or extravagantly. Furthermore it specifies that waste can include activities that do not constitute abuse and does not necessarily involve a violation of law. Rather, it relates predominantly to mismanagement, inappropriate actions, and inadequate oversight. For example, making travel choices that are unnecessarily extravagant or expensive or making procurement or vendor selections that are contrary to existing policies may be indications of waste.

Auditors are not required to create specific procedures to detect instances of waste, but if they identify waste during an audit, auditors should consider whether and how to communicate such matters. The 2018 guidance notes that the cause may include factors beyond management's control.

An auditor may conclude that waste is indicative of fraud or noncompliance with laws and regulations. Instances of waste may be handled similarly to instances of fraud. The independent auditor will determine if the waste is quantitatively or qualitatively material to the financial statements or other financial data significant to audit objectives. If the discovered waste is deemed material, the auditor will report the criteria, condition, cause, and effect of the identified waste.

Performance Audit Update

The updated Yellow Book also contains changes for performance audit standards. In performance audits, since it is the auditor that measures and evaluates the subject matter of the engagement, auditors will not obtain management assertions during a performance audit under the new Yellow Book requirements. Additionally, a new internal control requirement has been created for performance audits. Auditors must now determine and document the significance of internal control to the audit objectives. If it is determined that internal control is significant, auditors will then obtain an understanding of the internal control.

The following activities will be performed by the auditor in obtaining an understanding of internal controls:

- Assess and document the assessment of internal controls to the extent necessary to address audit objectives

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- Evaluate and document the significance of identified internal control deficiencies within the context of the audit objectives
- Consider root cause of internal control deficiencies when developing findings
- Identify which internal control components and principles are significant in the audit report.

Supplemental Guidance

Supplemental guidance is no longer present in the 2018 version, these

sections have either been removed or incorporated into the chapters. For example, "Obtaining an understanding of internal control," covered in paragraph 8.41 of the current version, was previously covered in appendix paragraph A.03 in the 2011 version.

Peer Review Standards

The peer review standard has been modified in the current version to differentiate requirements for audit organizations that are affiliated with a recognized peer review organization. If the auditor is affiliated with a recognized organization, then the current standards require that audit

organization comply with their respective affiliated organization's peer review requirements in addition to GAGAS peer review requirements. In cases where audit organizations are not affiliated with a recognized organization, they are required to comply with an expanded list of GAGAS guidelines.

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Resources

GAO Yellow Book—2018 Version: <https://www.gao.gov/products/GAO-18-568G>

GAO Yellow Book—2011 Version: <https://www.gao.gov/products/GAO-12-331G>

AICPA—The 2018 Yellow Book: What You Need To Know:

<https://www.aicpa.org/content/dam/aicpa/interestareas/governmentauditquality/resources/downloadabledocuments/newyellowbookgaqcwebevent2.pdf>

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