

North Carolina  
Office of the State Controller

The New and Improved  
Yellow Book??

June 5, 2019

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*The Opinions expressed during this presentation are my own. They do not necessarily represent the views of the Tennessee Comptroller of the Treasury, his representatives, or the Tennessee Department of Audit.*

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# A Little History

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## Government Auditing Standards

- ▶ Why is the Yellow Book called the Yellow Book?
  - As one story goes, the original title of the Yellow Book was supposed to be “The Golden Rule of Government Auditing” and the cover was supposed to be Gold.
  - You will notice that this is not the title and the cover is not Gold. Again, as the story goes, the printing office did not have Gold cover paper, so they used Yellow. And the rest, as they say, is History.
  - So, since its first publishing date, it has been a rather bold Yellow Book.

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## Government Auditing Standards

- ▶ A slightly different story was told by Marcia Buchanan who was responsible for the Yellow Book development over a period of 22 years.
- ▶ "Well, the Yellow Book is Generally Accepted Government Auditing Standards. It is a publication that GAO's been producing since [redacted]. And the way the first Yellow Book happened was, the State Audit Community came to the Congress and said"
- ▶ "Gee, we need a set of standards that increase accountability and transparency for government money." The Congress turned to GAO and asked us to put together a set of auditing standards. Interesting enough, the Government Auditing Standards, known as the Yellow Book, is named the Yellow Book because the group that put it together in [redacted] thought that it oughtta have a gold cover on it, called it the "Golden Rules of Auditing."
- ▶ And the Comptroller General at the time, Elmer Staats, thought that was very presumptuous. And so it became, then, the Yellow Book. It got close to the gold but not completely. So the Yellow Book it became. And the only thing that will never change on the Yellow Book is the color of the cover.

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## Government Auditing Standards

- ▶ Why was the Yellow Book first published?
  - The Yellow Book was published for use by the Federal Government by the GAO.
  - The GAO is the Auditor for the Federal Government, and the Yellow Book was designed for use by Federal Auditors.
  - It was intended as set of Federal Audit "Standards" for Federal Government Auditors. State and Local governments could adopt the standard by law or other methods.
  - Although, the Yellow Book is a GAO document, it was created at the request of state and local governments and their professional associations including AGA.

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## Government Auditing Standards

- ▶ But something happened in 1984 that had a significant influence on the adoption of the Yellow Book by state and local governments. What was it?
  - GASB was established in 1984
  - The Single Audit Act was passed in 1984
  - GAO required all state and local governments to use the Yellow Book
  - AGA established a best practice document encouraging all state and local governments to use the Yellow Book

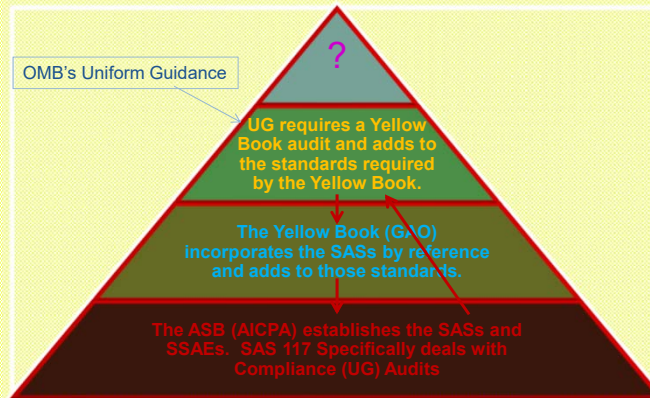
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## Government Auditing Standards

- ▶ How many states have adopted the Yellow Book?
  - The Yellow Book has been adopted by all but 2 or 3 States. This usually means for local governments as well.
  - Tennessee uses the Yellow Book standards for audit for Financial, Attestation, and Performance Audits.
  - What about North Carolina?

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# Auditing Standards



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## Government Auditing Standards

- ▶ When was the first Yellow Book published?
  - 1972
  - 1974
  - 1981
  - 1984

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# Government Auditing Standards

- ▶ When was the first Yellow Book published?
  - 1972 - Standards for Audit of Governmental Organizations, Programs, Activities and Functions
  - 1974
  - 1981
  - 1988 - Government Auditing Standards
  - 1994
  - 1999 - Two Amendments, not full revision
  - 2003
  - 2007
  - 2011
  - 2018

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## Government Auditing Standards - 1972

54 Pages



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# Government Auditing Standards – 1972

<u>C o n t e n t s</u>		<u>P a g e</u>
PART		
I	INTRODUCTION	1
II	SUMMARY	6
III	GENERAL STANDARDS	10
Chapter 1	Scope of audit work	10
2	Qualifications	13
3	Independence	15
4	Due professional care	19
IV	EXAMINATION AND EVALUATION STANDARDS	21
Chapter 1	Planning	21
2	Supervision	26
3	Legal and regulatory requirements	28
4	Internal control	32
5	Evidence	35
V	REPORTING STANDARDS	39
Chapter 1	Form and distribution	39
2	Timeliness	41
3	Content	42
4	Financial reports	49
APPENDIX		
I	Qualifications of independent auditors engaged by governmental organizations	54

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# Government Auditing Standards

- ▶ Who uses the Yellow Book?
  - Federal Inspectors General Auditors must use the Yellow Book
  - Auditors of most Federal Agencies must use the Yellow Book
  - Auditors of Federal Programs under OMB's Uniform Guidance must use the Yellow Book
  - Internal Auditors for Federal Agencies generally use the Yellow Book.
- What about the rest of us?

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## Government Auditing Standards

- ▶ “Yellow Book” or
- ▶ GAS
- ▶ Generally Accepted Government Auditing Standards (“GAGAS”)
- ▶ 7 x 10 size

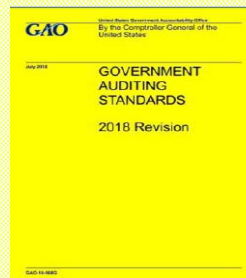


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## Government Auditing Standards

- ▶ “Yellow Book” or
- ▶ GAS
- ▶ Generally Accepted Government Auditing Standards (“GAGAS”)
- ▶ Now 8 ½ by 11 size.



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## GAO's *Government Auditing Standards*

- ▶ Exposure Draft issued April 5, 2017
  - First proposed changes since 2011
  - Public comments were due to GAO no later than July 6, 2017
  - Why Issued?
    - Represents a modernized version that takes into account developments in the accounting and auditing professions
    - Intended to reinforce principles of transparency and provide a framework for high quality government audits
  - GAO received 95 comment letters with over 1,700 individual comments on the exposure draft.

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## GAO's *Government Auditing Standards*

- ▶ Final Version was issued July 17, 2018
  - Effective Date: **Financial Audits, Attestation Engagements, and Reviews of Financial Statements** = Periods ending on or after June 30, 2020.
    - Calendar Year 2020
    - Fiscal Years Ending on June 30, 2021
  - Effective Date: **Performance Audits** beginning on or after July 1, 2019
  - Early implementation is **not** permitted.

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## *2018 Yellow Book*

- ▶ <http://www.gao.gov/yellowbook/overview>

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## *GAO's Government Auditing Standards*

- ▶ Just a personal thought from me as we begin:
  - There are more and more standards that must be followed by auditors.
  - Sometimes the overload creates ethical dilemmas for auditors.
    - I don't have time. I will be over my time budget.
    - We've always audited this way and its been OK up until now.
    - Who will notice. Our quality control is not that great anyway.
    - It is unlikely peer review will pick this audit.
    - If I write this finding, I will probably lose this client.
    - Independence does not apply to my situation.

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## *GAO's Government Auditing Standards*

- ▶ What I consider as the most important changes:
  1. New format and organization of GAGAS
  2. Independence threats related to preparing records and financial statements (Chapter 3)
  3. Documenting SKE (Chapter 3) (application guidance)
  4. Changes to Waste and Abuse (definition of waste, and reporting of waste and abuse) (Chapters 6, 7, 8, and 9)
  5. Quality Control Expanded Requirements (Chapter 5)

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## *GAO's Government Auditing Standards*

- ▶ What I consider as the most important changes:
  6. Peer review requirements (Chapter 5)
  7. Internal control: financial audits, examination engagements, and **performance audits**. Should consider internal control when determining the cause of any finding. (2011 YB referred to Internal Controls 142 times, the 2018 YB refers to Internal Controls 202 times) (Chapters 8 and 9)
  8. Internal Control documentation and reporting for Performance Audit (Chapters 8 and 9)

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## *General Changes*

- ▶ Overall Changes
  - From 235 to 224, but larger format
  - Chapters – From 7 to 9
  - Chapters – Reorganized and Realigned
  - All Chapters – Revised Format
  - Supplemental Appendix Guidance – Removed or Incorporated into Chapters

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## Chapter Comparison

### Old Yellow Book

1. Government Auditing: Foundation and Ethical Principles
2. Standards for Use and Application of GAGAS
3. General Standards
4. Standards for Financial Audits

### New Yellow Book

1. Foundation and Principles for the Use and Application of Government Auditing Standards
2. General Requirements for Complying with Government Auditing Standards
3. Ethics, Independence, and Professional Judgment
4. Competence and Continuing Professional Education

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## Chapter Comparison

Old Yellow Book	New Yellow Book
<ul style="list-style-type: none"><li>5 Standards for Attestation Engagements</li><li>6 Field Work Standards for Performance Audits</li><li>7 Reporting Standards for Performance Audits</li></ul>	<ul style="list-style-type: none"><li>5. Quality Control and Peer Review</li><li>6. Standards for Financial Audits</li><li>7. Standards for Attestation Engagements and Reviews of Financial Statements</li><li>8. Fieldwork Standards for Performance Audits</li><li>9. Reporting Standards for Performance Audits</li></ul>

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## GAO's *Government Auditing Standards*

- ▶ **Application Guidance:**
  - **2.05** Auditors should have an understanding of the entire text of applicable chapters of GAGAS, including application guidance, and any amendments that GAO issued, to understand the intent of the requirements and to apply the requirements properly.
  - **2.07** GAGAS contains requirements together with related explanatory material in the form of application guidance. Not every paragraph of GAGAS carries a requirement. Rather, GAGAS identifies the requirements through use of specific language. GAGAS also contains introductory material that provides context relevant to a proper understanding of a GAGAS chapter or section. Having an understanding of the entire text of applicable GAGAS includes an understanding of any financial audit, attestation, and reviews of financial statement standards incorporated by reference.

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## GAO's Government Auditing Standards

- ▶ **Application Guidance (Cont'd):**
  - **2.09** The application guidance provides further explanation of the requirements and guidance for applying them. In particular, it may explain more precisely what a requirement means or is intended to address 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. "May," "might," and "could" are used to describe these actions and procedures. The application guidance may also provide background information on matters addressed in GAGAS.

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## Remember – this is not GASB

- The "Yellow Book" = GAGAS
- GAGAS = Generally Accepted *Government Auditing Standards*:
  - Overlay of Generally Accepted Auditing Standards (GAAS) issued by the Auditing Standards Board.
- GAGAS contains the framework for ensuring that auditors possess competence, integrity, objectivity, and independence in planning, conducting, and reporting on their work.
- GAGAS *is required* when audits of states, local governments, tribal nations and not-for-profits meet certain criteria in the Uniform Guidance (Title 2, Code of Federal Regulations, Part 200) (Uniform Guidance or UG):
  - Also required by State Law, Regulation, Outside Grantors, Lenders etc.
- Applying for federal grants *may* require GAGAS.

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## Internal Audit in the Yellow Book

- ▶ The 2018 Yellow Book has 36 references to Internal Audit
  - Certain entities employ auditors to work for entity management. These auditors may be subject to administrative direction from persons involved in the entity management process. Such audit organizations are internal audit functions and are encouraged to use the Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing, in conjunction with GAGAS. (3.57)
  - Most of those references relate to Independence in Chapter 3 and Competence in Chapter 4.
  - An internal audit organization that reports internally to management and those charged with governance should provide a copy of its peer review report to those charged with governance. (5.77)
  - External Auditors using the work of Internal Auditor. (Chapter 8)
  - Report Distribution in Chapter 9. (9.57)

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## Chapter 1

- ▶ Chapter 1 – Government Auditing: Foundation and Principles for the Use and Application of Generally Accepted Government Auditing Standards
  - Examples of types of GAGAS users are addressed. (para. 1.12)
  - Integrated audit is added to the types of financial audits. (para. 1.17.b)
  - Descriptions of attestation engagements, reviews of financial statements, and performance audits are expanded. (paras. 1.18 through 1.26)
  - Definitions of common terms used in GAGAS are expanded. Definitions for terms such as engaging party, audited entity, responsible party, and specialist are added. (para. 1.27) (Also a Glossary in the Back)

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## Chapter 2

### ▶ Chapter 2 – General Requirements for Complying with Government Auditing Standards

- Guidance is expanded to explain that for financial audits, attestation engagements, and reviews of financial statements, GAGAS does **not** incorporate the American Institute of Certified Public Accountants Code of Conduct by reference but recognizes that certain certified public accountants (CPA) may use or may be required to use the code in conjunction with GAGAS. (para. 2.14)

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## Key Changes – Format

- New format, similar to *Codification* of GAAS
  - Requirements separated from application guidance and other explanations
  - Requirements are in boxes

Thinking Inside  
the Box

Typical section of  
requirements and  
application guidance

#### Requirement: Appraisal, Valuation, and Actuarial Services

**3.104** Auditors should conclude that independence is impaired if an audit organization provides appraisal, valuation, or actuarial services to an audited entity when (1) the services involve a significant degree of subjectivity and (2) the results of the service, individually or when combined with other valuation, appraisal, or actuarial services, are material to the audited entity's financial statements or other information on which the audit organization is reporting.

#### Application Guidance: Appraisal, Valuation, and Actuarial Services

**3.105** A valuation comprises the making of assumptions with regard to future developments; the application of appropriate methodologies and techniques; and the combination of both to compute a certain value, or range of values, for an asset, a liability, or an entity as a whole.

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## Auditors need to know the language – still the same under 2018 Yellow Book

- **Unconditional requirements** – ‘must’ – comply where relevant
- **Presumptively mandatory requirements** – ‘should’ – if the auditor departs from requirements, must document why
- **Application guidance** – ‘may’, ‘might’, ‘could’ – further explanations provided

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## Key differences between the yellow book and the cpa’s code of conduct

- **Yellow Book:**
    - **Preparing financial statements in their entirety** is always a significant threat
    - **Documentation and evaluation of significance of threats for preparing accounting records and financial statements** is required
    - **Documentation of skills, knowledge and experience**
  - **Similarities, but not quite aligned –**
    - Threats and safeguards approach used by both – but Yellow Book requires it on all circumstances that may result in threats to independence
    - Nonaudit services are permitted by AICPA unless there are significant threats
    - Nonaudit services are also allowed by Yellow Book but may require safeguards
- Note: Impairments do not always = bans. Safeguards may be available

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## Skills, Knowledge, or Experience (i.e. ske)

- Auditors required to determine that the audited entity has designated an individual who possesses suitable skills, knowledge **or** experience and that *understands* the services to be provided sufficiently to oversee them **before** auditors agree to perform nonaudit services and Ske should be documented at the beginning the audit. (3.73)
  - Management is **not required** to possess the expertise to perform or reperform services
- If SKE is not present, independence impaired and no safeguards can overcome a lack of SKE

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## Skills, Knowledge, or Experience (i.e. ske)

- 3.79 (application guidance) “is not required to possess the expertise to perform or re-perform the services. However, **indicators** of management’s ability to effectively oversee the nonaudit service include management’s ability to determine the reasonableness of the results of the nonaudit services provided, and to recognize a material error, omission, or misstatement in the results of the nonaudit services provided.”
  - Think “**Examples**” as another word for “**indicators**.”
  - “Other things (examples) could be used” to demonstrate management’s SKE (Skills, Knowledge, or Experience)
  - What GAO is trying to achieve is “Not just blind acceptance”.
  - This is implementation guidance.
- The word “indicator” is used in other places in the standard (4.07 and following).

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## Independence Threats Related to Preparing Financial Statements & Accounting Records

Nonaudit services performed by auditors related to financial statements and accounting records either:

Impair Independence

→ No change from 2011 Yellow Book (para. 3.87)

Are Significant Threats

→ The auditor prepares financial statements in their entirety (para. 3.88).

OR

→ The auditor determines that a service related to preparing financial statement or accounting records is a significant threat (para. 3.93).

→ Document the threats and safeguards applied to eliminate and reduce threats to an acceptable level (para. 3.33).

OR

→ Decline to perform the service (para. 3.88).

Are Threats

- Evaluate threat and document evaluation (para. 3.90).
- Typing, formatting, printing, binding: not likely significant (para. 3.95)

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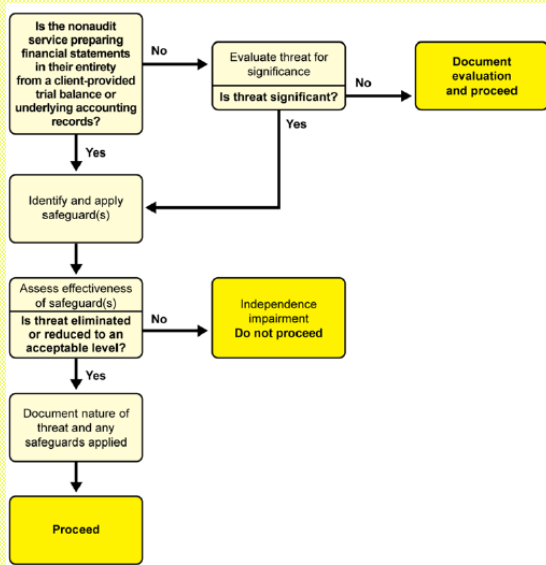
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## Additional on preparing records and financial statements

- Any other services related to preparing accounting records (e.g. payroll) and financial statements create a **threat**
  - Auditors required to evaluate if it is significant and document
- Could occur when auditor
  - Records transactions for which *management* has determined or approved the appropriate account classification or posting the coded transactions to the GL
  - Prepares certain line items or sections of the financials based on trial balance
  - Posts entries after management approval
  - Prepares accounting reconciliations that identify reconciling items for management to evaluate and approve

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### New GAO decision tree *just on financial statement preparation*



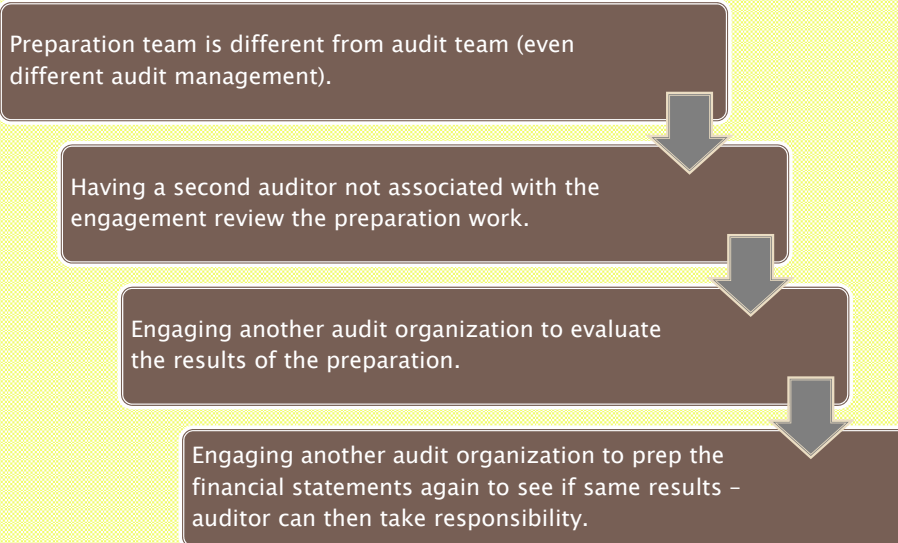
Binding, typing, formatting usually not significant to be an issue. But prepping without safeguards is.

Providing advice, responding to questions, training does not impair independence.

Preparing Audit Adjustments as part of the audit is not a nonaudit service.

Source: GAO. | GAO-18-558G

### What are some of these safeguards?



## What about government audit organizations?

- **Par. 3.72:** These activities **are not** going to create threats, if performed by a State audit organization providing:
  - Assistance and technical expertise to Legislative bodies
  - Assistance in reviewing budgets
  - Audit, investigative, oversight that does not involve a GAGAS engagement, including
    - **Fraud investigations**
    - Periodic follow ups to engagements and reports
- Otherwise, follow statute or constitution and then the framework

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## To wrap it all up – framework for all independence issues



*Includes all threats – not just financial statement preparation..*

- *Self-Interest*
- *Self-Review*
- *Bias*
- *Familiarity*
- *Undue Influence*
- *Mgmt. Participation*
- *Structural Threat*

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## Chapter 4 – CPE and Peer Review

- **Good news!** – 4 hour transition requirement as proposed not in final version!
- Good idea to obtain CPE specifically on GAGAS this year and next due to the revisions in the standards
  - Will assist you in maintaining competence necessary to conduct GAGAS audits (4.19)
- Audit organization still has responsibility for
  - Assigning competent auditors
  - Ensuring the collective competence of the team before beginning the engagement
  - Keeping documentation of CPE

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## Chapter 4 – CPE

- Certain exceptions to CPE
  - Illness, sabbaticals, maternity / paternity and other leave, military service
  - Non-supervisory auditors (low-level roles) that charge less than 40 hours to audits, exempted from CPE
  - Specialists must be qualified and competent in their area of expertise – not required to take full GAGAS CPE
    - External specialists not subject to GAGAS CPE
    - Internal specialists who are not involved in the planning, directing, performing the audit – not required to take GAGAS CPE – but areas of specialization qualifies under 24 hour provisions
    - Documentation still required of all
- ▶ Key requirements for all others – 20 hours minimum each year

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## Chapter 4 CPE

CPE Hours	Subject Matter Categories of CPE
24 Hours	Subject matter directly related to government, government auditing, or specific, unique operating environment of entity
56 Hours	Subject matter that 'enhances professional expertise to conduct engagements'

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## CPE SUBJECTS – 24 hour requirement

GAGAS	GAAP (FASAB, GASB, FASB)	Audit standards, guides, (IT, forensics)	Statutory / regulatory	Performance auditing topics
AICPA Audit Standards	Green Book	IT auditing topics	Relevant subject matters to engagements	Ethics and independence
AICPA Attestation Standards	COSO	Fraud topics	Government operations, finance etc.	Public / private partnerships
PCAOB	Program audit requirements	Statutory requirements – specific to entity	Specialized audit techniques, statistical analysis, sampling	Legislative policies, procedures
			Compliance with laws and regulations	Fraud, waste, abuse, improper payments

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## CPE SUBJECTS – 56 hour requirement

- All 24 hour subjects
- General ethics and independence
- Accounting, asset management, budgeting, cash management, data analysis, procurement and similar
- Communications – oral and written
- Managing time and resources
- Leadership
- Software applications in engagements
- Information technology
- Economics
- Human capital
- Social / political sciences

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## CPE – WHAT QUALIFIES

- Internal training
- Educational and development – conferences, meetings etc.
- Training by audit organizations, foundations, associations
- Internet / e-learning
- Audio conferences
- College / university (credit and noncredit)
- Correspondence courses – self study
- Public speaking, panelists, discussion leaders
- Preparing review courses
- Publishing articles / books

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## Chapter 5

- ▶ Several Changes that relate to quality control. **(Chapter 5)** that will likely require some changes to your firm's quality control polices and procedures.
  - Standard is modified to require that audit organizations at least annually obtain written affirmation of compliance with policies and procedures on independence from all audit organization personnel required to be independent. (para. 5.09)
  - The policies and procedures should require that experienced engagement team members review the work of less experienced engagement team members.

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## Chapter 5

- ▶ Several Changes that relate to quality control. (Chapter 5) that will likely require some changes to your firm's quality control polices and procedures.
  - The audit organization should assign responsibility for each engagement to an engagement team partner or director with authority to assume that responsibility. (5.37)
  - The audit organization should establish policies and procedures requiring the audit organization to communicate the identity and role of the engagement partner or director to management and those charged with governance of the audited entity. (5.37)

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## Chapter 5

- ▶ Several Changes that relate to quality control. (Chapter 5) that will likely require some changes to your firm's quality control polices and procedures.
  - The audit organization should establish policies and procedures requiring the audit organization to clearly define the responsibilities of the engagement partner or director and communicate them to that individual. (5.37)

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## Chapter 5

- ▶ Standard is modified to require that audit organizations affiliated with a recognized organization comply with the respective organization's peer review requirements and additional GAGAS peer review requirements. **(para. 5.60–62)**
  - American Institute of Certified Public Accountants
  - Council of the Inspectors General on Integrity and Efficiency
  - Association of Local Government Auditors
  - International Organization of Supreme Audit Institutions
  - National State Auditors Association

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## Overview

- ▶ Definitions and Differences: Fraud, Waste, and Abuse
- ▶ Why Fraud, Waste, and Abuse in Government is Different than Fraud, Waste, and Abuse Elsewhere
- ▶ The Fraud, Waste, and Abuse Requirements in the New 2018 Yellow Book

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## Fraud or Was It?

### An Illustrative Case Study

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## Waste, Abuse, or Fraud?

- Jeff Neely was GSA regional commissioner and oversaw a lavish \$822,751 training conference in Las Vegas in 2010 for approximately 300 GSA employees
  - \$136,504 for pre-conference travel, catering, vendors, and other hotel costs
  - \$686,247 for conference travel, catering, and vendors

Source: GSA OIG Report, 2 April 2012

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## Waste, Abuse, or Fraud?

- Expenditures included:
  - \$136,504 on 8 pre-conference scouting trips, including 6 to the Las Vegas hotel (5 to 31 GSA employees per trip)
  - \$146,000 for catered food
  - \$44 per person daily breakfasts
  - \$95 per person closing dinner including \$525 in bartender service fees
  - \$5,600 for semi-private catered in-room parties
  - \$6,325 on commemorative Recovery Act coins housed in velvet boxes
  - \$8,130 for attendee “yearbooks”
  - \$75,000 on a bicycle-building training exercise.

Source: GSA OIG Report, 2 April 2012

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## Waste, Abuse, or Fraud?

### CONCLUSION

The excessive pre-conference planning, catering, and other costs, as well as the luxury accommodations and overall approach, show that GSA's planning and expenditures for the 2010 WRC were incompatible with its obligation to be a responsible steward of the public's money. As the agency Congress has entrusted with developing the rules followed by other federal agencies for conferences, GSA has a special responsibility to set an example, and that did not occur here.

Source: GSA OIG Report, 2 April 2012

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#1 The Scandal Over GSA's  
Spending of Taxpayer Money  
Video

<https://video.foxbusiness.com/v/1569827371001/#sp=show-clips>

#2 The Senate weighs in on  
GSA's Spending of Taxpayer  
Money Video

<https://www.bing.com/videos/search?q=gsa+scandal+fox+business+video&view=detail&mid=FAE8F3A207AEA478F23E&FORM=VIRE>

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## Fraud or Was It?

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## Fraud

Involves obtaining something of value through willful misrepresentation.

Whether an act is, in fact, fraud is determined through the judicial or other adjudicative system and is beyond auditors' professional responsibility.

[2018 Yellow Book, page 214]

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## Waste

The act of using or expending resources carelessly, extravagantly, or to no purpose.

Waste can include activities that do not include abuse and does not necessarily involve a violation of law.

[2018 Yellow Book, pages 220-221]

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## Examples of Waste

- a. Making travel choices that are contrary to existing travel policies or are unnecessarily extravagant or expensive.
- b. Making procurement or vendor selections that are contrary to existing policies or are unnecessarily extravagant or expensive.

[GAGAS 6.22]

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## Examples of Waste

- a. Making travel choices that are contrary to existing travel policies or are unnecessarily extravagant or expensive.
- b. Making procurement or vendor selections that are contrary to existing policies or are unnecessarily extravagant or expensive.

*Interestingly, these were cited as examples of abuse in the 2011 Yellow Book.*

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## Abuse

Behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances, but excludes fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements.

[2018 Yellow Book, page 211]

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## Examples of Abuse

- a. Creating unneeded overtime.
- b. Requesting staff to perform personal errands or work tasks for a supervisor or manager.
- c. Misusing the official's position for personal gain ...

*These were cited as examples of abuse in the 2011 Yellow Book.*

[GAGAS 6.24]

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**So was this Case about Fraud or Waste or Abuse based on the GAO definitions?**

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## Waste, Abuse, or Fraud?

- Neely was indicted in September 2014 on five counts of falsely claiming reimbursement for pleasure trips or airplane tickets that he did not use
- Neely pleaded guilty to one count of fraud against the government in April 2015
- Neely was sentenced in June 2015 to 3 months in prison, 3 months under home confinement, and 3 years of probation
- Neely was ordered to pay \$8,000 in restitution, a \$2,000 fine, and a \$100 special assessment penalty

Source:  FEDERAL NEWS RADIO

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## Waste, Abuse, or Fraud?

- The \$822,000 spent on the training conference in Las Vegas was approximately  $\sim 0.000024\%$  of the \$3,456,000,000,000 federal budget for 2010

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# GSA Scandal Fallout

Key Player	GSA Position	Outcome
Martha Johnson	Administrator	Resigned
Jeff Neely	Regional Commissioner	Convicted; sentenced
Robert Peck	Public Buildings Service Commissioner	Fired; working in private sector
Paul Prouty	Regional Commissioner	Fired, but reinstated by MSPB
Jim Weller	Regional Commissioner	Fired, but reinstated by MSPB
Robin Graf	Regional Commissioner	Retired
Stephen Leeds	Senior Counsel	Fired; working in private sector

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## Government made \$137 billion in improper payments in 2015, largest figure on record



By Jared Serbu | @jserbuWFED  
February 26, 2016 5:36 am



Federal agencies issued an estimated \$136.7 billion in improper payments during fiscal year 2015, the largest annual tally since 2004 when agencies first began reporting data on the subject.

The figure, reported as part of the release of the government's [consolidated annual financial statements](#) Thursday afternoon, was \$12 billion higher than the Office of Management and Budget had previously projected for 2015 and raised the cumulative total of improper payments since 2004 [above \\$1 trillion for the first time](#). More precisely: \$1.137 trillion.

As in past years, the Medicare and Medicaid programs were responsible for the lion's share of the overall total. Increased error rates in Medicaid during 2015 were the main culprit in driving up the governmentwide improper payments figure.

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Improper payments are not necessarily fraudulent... but, they could be

“Improper payments” occur when:

- federal funds go to the wrong recipient,
- the recipient receives the incorrect amount of funds (either an underpayment or overpayment),
- documentation is not available to support a payment, or,
- the recipient uses federal funds in an improper manner.

Each component could include fraud, waste, or abuse

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Characteristics of Fraud in Government and Government Programs

- ✓ Blurred lines between fraud, waste, abuse, and mismanagement
- ✓ “Materiality” has a different meaning to taxpayers and taxpayers don’t really differentiate between fraud, waste, abuse, and mismanagement
- ✓ Virtually everything is in the public domain
- ✓ Governments have strong and visible audit and investigation capabilities (GAO, IGs, state auditors, etc.)
- ✓ VERY LARGE amounts of money are involved
- ✓ Program objectives are often in conflict with strong/strict accountability

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## Program objectives not always consistent with strict accountability

### Example

- The objective of disaster relieve programs is to alleviate the impact of disasters quickly
- Requiring checks, balances, thorough documentation (i.e., *prevention controls*) would interfere with achieving that objective
- Detective controls are more appropriate, but chasing fraudulent benefits paid is very difficult and expensive

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## Characteristics of Fraud in Government and Government Programs

- ✓ Governments do not always have the best accounting systems and capabilities
- ✓ Government accounting principles, laws, rules, and regulations create opportunities for fraud
- ✓ Power corrupts
  
- ✓ WHAT ELSE ???

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# The Fraud, Waste, and Abuse Requirements in the New 2018 Yellow Book

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## GAGAS Requirements Related to Fraud

### Financial Audits:

- The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. [SAS 99; GAGAS 6.01]
- Auditors should include in their report on internal control or compliance the relevant information about noncompliance and fraud when auditors, based on sufficient, appropriate evidence, identify or suspect ... fraud that is material, either quantitatively or qualitatively, to the financial statements or other financial data significant to the audit objectives. [GAGAS 6.41]

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## GAGAS Requirements Related to Fraud

### Financial Audits:

- Auditors should communicate in writing to audited entity officials when ... the auditor has obtained evidence of identified or suspected instances of fraud that have an effect on the financial statements or other financial data significant to the audit objectives that are **less than material** but warrant the attention of those charged with governance. [GAGAS 6.44]

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## GAGAS Requirements Related to Fraud

### Performance Audits:

- Auditors should assess the risk of fraud occurring that is significant within the context of the **audit objectives**.
- Audit team members should discuss among the team fraud risks, including factors such as individuals' incentives or pressures to commit fraud, the opportunity for fraud to occur, and rationalizations or attitudes that could increase the risk of fraud.
- Auditors should gather and assess information to identify the risk of fraud that is significant within the scope of the audit objectives or that could affect the findings and conclusions. [GAGAS 8.71]

***I.e., the "brainstorming" requirement in SAS 99***

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## GAGAS Requirements Related to Fraud

### Performance Audits:

- Assessing the risk of fraud is an ongoing process throughout the audit. When information comes to the auditors' attention indicating that fraud, significant within the context of the audit objectives, may have occurred, auditors should extend the audit steps and procedures, as necessary, to (1) determine whether fraud has likely occurred and (2) if so, determine its effect on the audit findings. [GAGAS 8.72]

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## GAGAS Requirements Related to Fraud

### Performance Audits:

- Auditors should report a matter as a finding when they conclude, based on sufficient, appropriate evidence, that fraud either has occurred or is likely to have occurred that is significant to the audit objectives. [GAGAS 9.40]
- Auditors should communicate findings in writing to audited entity officials when the auditors detect instances of fraud that are not significant within the context of the audit objectives but warrant the attention of those charged with governance. [GAGAS 9.41]

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## GAGAS Requirements Related to Waste and Abuse

### Financial Audits

- Because the determination of waste and abuse is subjective, auditors are **not** required to perform specific procedures to detect waste or abuse in financial audits.
- However, auditors may consider whether and how to communicate such matters if they become aware of them.
- Auditors may also discover that waste or abuse are indicative of fraud or noncompliance with provisions of laws, regulations, contracts, and grant agreements. [GAGAS 6.20]

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## GAGAS Requirements Related to Waste and Abuse

### Performance Audits

- Because the determination of waste and abuse is subjective, auditors are **not** required to perform specific procedures to detect waste or abuse in performance audits.
- However, auditors may consider whether and how to communicate such matters if they become aware of them.
- Auditors may also discover that waste or abuse are indicative of fraud or noncompliance with provisions of laws, regulations, contracts, and grant agreements. [GAGAS 8.119]

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## 2018 GAGAS Requirements Related to Fraud, Waste, and Abuse are Essentially the Same as the 2011 GAGAS Requirements

	2011 GAGAS	2018 GAGAS
The word "fraud" appears	117 times	95 times
The word "waste" appears	2 times	29 times
The word "abuse" appears	108 times	29 times
Total pages	241	232

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## End Thoughts: Best Advice

- ▶ Fraud is a legal determination "beyond auditors' professional responsibility"
- ▶ The determination of waste, and abuse is subjective
- ▶ Waste and abuse are difficult to distinguish
- ▶ Auditors are better off avoiding the use of these terms
- ▶ Just stick to condition, criteria, effect

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## Chapter 7

- ▶ **Standards for Attestation Engagements and Reviews of Financial Statements**
  - Chapter 7: Standards for Attestation Engagements and Reviews of Financial Statements Statement on Standards for Attestation Engagements No. 18, Attestation Standards: Clarification and Recodification, is incorporated into this chapter by reference for auditors conducting attestation engagements in accordance with GAGAS. (para. 7.01)
  - Statement on Standards for Accounting and Review Services No. 21, section 90 (Review of Financial Statements) is incorporated into GAGAS for auditors conducting reviews of financial statements in accordance with GAGAS. (para. 7.01)

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## Chapters 8 and 9

- In many ways – fastest growing area of government engagement, even though been in practice since 1970's.
- Not meant to replace a financial audit – but:
  - May be easier to understand for Citizens and decision-makers.
- **Common performance audits:**
  - Is the government doing what it is supposed to do as effectively as possible?
  - Are our operational practices in line (or exceed) our peers?
  - Does the government's organization chart make sense?
  - Is a program staffed effectively?
  - Is the government managing its funds or investing prudently?
  - Is payroll and overtime reported transparently?
  - Is the payment cycle (procure to pay) as efficient as possible?
  - Is there a 'skills gap' at key positions?
  - And many others...
- New clarity in Yellow Book for receiving assertions, testing internal controls and reporting related to performance audits.
- Management assertions are not required for performance audits.

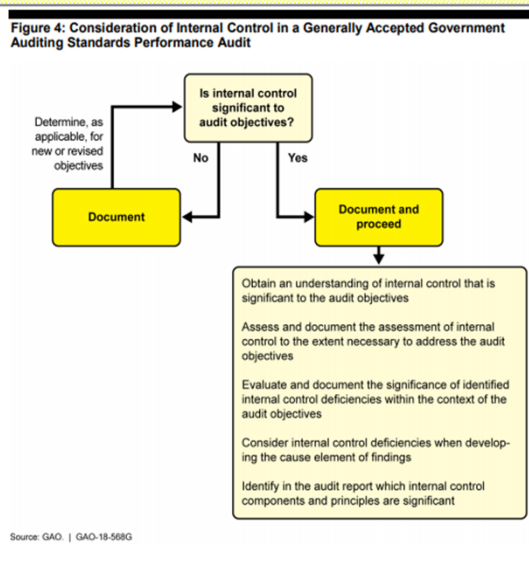
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# Chapter 8

## Fieldwork Standards for Performance Audits

- Chapter 8: Fieldwork Standards for Performance Audits Guidance is revised to further explain that management assertions are not required when conducting a performance audit in accordance with GAGAS. (para. 8.14)
- Discussion of suitable criteria, including attributes and examples, is provided. (paras. 8.17 through 8.19) These criteria were in the Appendix to the 2011 Yellow Book.
- If internal control is determined to be significant to the audit objectives, auditors should assess and document their assessment of the design, implementation, and/or operating effectiveness of such internal control to the extent necessary to address the audit objectives. (8.49)
- Internal control requirements and guidance are updated to align with the revised Standards for Internal Control in the Federal Government and Internal Control – Integrated Framework. (paras. 8.38 through 8.67) (e.g. 8.130)
- Standard is expanded to require that auditors consider potential internal control deficiencies in their evaluation of identified findings when developing the cause element of the identified findings. (para. 8.38–8.67)

# Chapter 8





## Exposure Draft – Chapter 9

- ▶ Standard is expanded to require that auditors report findings of **waste** when they conclude based on sufficient, appropriate evidence that instances of waste have occurred that are material, either quantitatively or qualitatively, and are significant to the audit objectives. (para. 9.32)
- ▶ Standard is expanded to require that auditors communicate findings of **waste** in writing to audited entity officials when the auditors detect potential instances that are not significant within the context of the audit objectives but warrant the attention of those charged with governance. (para. 9.33)

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## Chapter 9

- ▶ **Reporting Standards for Performance Audits**
  - Reporting Standards for Performance Audits Standard is revised to require that audit organizations that meet the independence requirements for internal auditors include in the GAGAS compliance statement, where applicable, **a statement that they are independent per the GAGAS requirements for internal auditors.** (para. 9.03)
  - Standard is expanded to require that when internal control is significant within the context of the audit objectives, auditors include in the audit report discussion of how the auditors considered the concept of accountability for use of public resources and government authority while assessing audit risk associated with internal control. (para. 9.29–31)
  - Standard is expanded to require that auditors **indicate in their report that the audit did not consider all internal control components** if internal control that is significant to the audit objectives does not include all internal control components and underlying principles. (para. 9.30)

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## Questions?

- ▶ What, you too GAO.
- ▶ You get a penalty for piling on!!