

Memorandum

Date: September 22, 2010

To: GAO's Financial Management and Assurance Team (FMA)
CIGIE Financial Audit Community

From: James R. Dalkin, Director - FMA

Subject: Professional Standards Update No. 53*
July 2010 through September 2010

In order to alert you to changes in professional standards, we issue Professional Standards Updates. The purpose of these updates is to highlight the issuance and some key points of recent standards. Professional Standards Updates do not contain a complete summary of the standards. Those affected by the new standards should refer to the standard for details. Thanks to Tom Hackney and Gail Vallieres for their contributions to this issue which contains summaries of:

Auditing and Attestation Standards and Guidance

Government Accountability Office (GAO)

- 2010 Exposure Draft of the 2011 Revision of GAGAS

American Institute of Certified Public Accountants (AICPA)

- Clarity Project Update
- Convergence Milestone (*Journal of Accountancy, August 2010*)
- Replacing SAS 70 (*Journal of Accountancy, August 2010*)

Institute of Internal Auditors (IIA)

- Global Technology Audit Guide 14: *Auditing User-development Applications*
- Global Technology Audit Guide 15: *Information Security Governance (ISG)*
- Practice Guide: Chief Audit Executives - *Appointment, Performance Evaluation and Termination*

Public Company Accounting Oversight Board (PCAOB)

PCAOB Audit Risk Suite: *The Auditor's Assessment and Response to Risk*

- Auditing Standard 8 (AS No. 8) – *Audit Risk*
- Auditing Standard 9 (AS No. 9) – *Audit Planning*
- Auditing Standard 10 (AS No. 10) – *Supervision of the Audit Engagement*
- Auditing Standard 11 (AS No. 11) – *Consideration of Materiality in Planning and Performing an Audit*

* Previously issued Professional Standards Updates can be found at <http://www.gao.gov/govaud/psu.htm>

- Auditing Standard 12 (AS No. 12) – *Identifying and Assessing Risks of Material Misstatement*
- Auditing Standard 13 (AS No. 13) – *The Auditor’s Responses to the Risks of Material Misstatement*
- Auditing Standard 14 (AS No. 14) – *Evaluating Audit Results*
- Auditing Standard 15 (AS No. 15) – *Audit Evidence*

Regulatory Requirements

Office of Management and Budget (OMB)

- 2010 edition of the OMB Circular A-133 Compliance Supplement (*June 2010*)
- OMB Circular A-11, Preparation, Submission and Execution of the Budget (*July 2010*)
- M-10-24, Performance Improvement Guidance: Management Responsibilities and Government Performance and Results Documents (*June 2010*)

Accounting Standards and Guidance

Federal Accounting Standards Advisory Board (FASAB)

- SFFAS 39, Subsequent Events: *Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statement on Auditing Standards*
- Technical Release 12, *Accrual Estimates for Grant Programs*

Financial Accounting Standards Board (FASB)

- Accounting Standards Update No. 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*

Other Guidance

Committee of Sponsoring Organizations of the Treadway Commission (COSO)

- COSO Fraud Study

Auditing and Attestation Standards and Guidance

Government Auditing Standards 2010 Exposure Draft

www.gao.gov

 **2010 Exposure Draft of the 2011 Revision of GAGAS** (*August 2010*)
Relevance to Government Audits: HIGH

GAO has issued for comment a proposed 2011 revision to Government Auditing Standards (*GAGAS* or *Yellow Book*) that modernizes GAGAS with several updates to reflect major developments in the accountability and audit environment. Some of the other major changes include:

- Chapters 1 and 2 will be realigned. Chapter 1 will now include the foundation and ethical principles of government auditing, and the use and application of GAGAS will now be located in chapter 2.
- Chapter 3 includes a conceptual framework approach to independence, an update of the financial audit standards to more clearly identify the GAGAS requirements that are supplemental to the American Institute of Certified Public Accountants (AICPA) requirements, and emphasizes specific considerations applicable to a government environment.
- Chapter 4 will contain all the financial audit standards. The previous chapters on financial audit performance and reporting will be combined into one chapter.
- Chapter 5 will contain standards for attestation engagements. Examination-level attestation engagements are defined using AICPA language.
- Chapter 6 has added waste as an item of consideration for auditors. Waste is discussed in language similar to the existing language on abuse.
- Chapter 7 has expanded the discussion of requirements for reporting deficiencies, and the fraud reporting requirement is now limited to occurrences that are significant within the context of the audit.
- Terminology has been updated for consistency with standards issued by other standard setters.
- Consistency of the use of footnotes has been improved.

GAO issued the 2010 Exposure Draft of the 2011 Revision of GAGAS in August 2010 with comments due on the Exposure Draft on November 22, 2010, and an issue date expected in February - March of 2011. The effective date for the 2011 Revision of GAGAS is to be determined in coordination with the other standard setters.

For more information, please see the GAO's Government Auditing Standards (*Yellow Book*) website: <http://www.gao.gov/govaud/ybk01.htm>

American Institute of Certified Public Accountants (AICPA)

www.aicpa.org/

 **Clarity Project Update**
Relevance to Government Audits: HIGH

At its May 2010 meeting, the Auditing Standards Board (ASB) voted to change the effective date of clarity standards finalized by the ASB, but not yet issued as authoritative. The new effective date is for periods ending on or after December 15, 2012, and early adoption is not permitted. All AU sections of currently effective Statements on Auditing Standards (SASs) are being clarified to converge with International Standards on Auditing (ISAs) and to make the standards easier to understand and apply. Many of the finalized clarity standards will be issued as one SAS that will be codified in AU section format. More information about the Clarity Project is available at the ASB Clarity Project page www.aicpa.org/ImprovingClarityStandards.aspx.

Journal of Accountancy www.journalofaccountancy.com

✚ **Convergence Milestone** (*Journal of Accountancy, August 2010*)
Matthew G. Lamoreaux and Kim Nilsen
Relevance to Government Audits: MEDIUM

FASB and the IASB completed the first of three rounds of issuing proposed standards in their final push toward U.S. GAAP-IFRS convergence, and released a revised work plan that extended by six months their self-imposed June 2011 deadline for completing convergence projects. The new plan limits to four the number of significant or complex exposure drafts issued in any one quarter, with revenue recognition, financial instruments, the reporting of other comprehensive income and fair value measurement comprising the first round.

✚ **Replacing SAS 70** (*Journal of Accountancy, August 2010*)
Judith M. Sherinsky
Relevance to Government Audits: HIGH

The guidance for CPAs who audit the financial statements of entities that outsource work to service organizations, and those who report on controls at service organizations, is being revamped and relocated. SAS No. 70 has been divided and replaced by two new standards; the requirements for reporting on controls at service organizations have been placed in SSAE No. 16, *Reporting on Controls at a Service Organization* and the requirements for auditing the financial statements of entities that use service organizations remains in the auditing standards in a newly proposed SAS, *Audit Considerations Relating to an Entity Using a Service Organization*.

Institute of Internal Auditors (IIA)

www.theiia.org

✚ **Global Technology Audit Guide (GTAG) 14: Auditing User-development Applications**

Christine A. Bellino, Douglas Ochab, and Jeffery S. Rowland
Relevance to Government Audits: MEDIUM

Almost every organization uses some form of User-Development Applications (UDAs) because they can be more easily developed, are less costly to produce, and can typically be changed with relative ease versus programs developed by IT personnel. However, once end users are given freedom to extract, manipulate, summarize, and analyze their UDA data without assistance, end users may inherit risks once controlled by IT. These risks include data integrity, availability, and confidentiality.

This Guide provides:

- direction on how to scope an internal audit of UDAs.
- considerations for internal auditors when performing UDA audits.
- a sample UDA process flow as well as a UDA internal audit program and supporting worksheets to help internal auditors organize and execute an audit.

Global Technology Audit Guide (GTAG) 15: Information Security Governance

Paul Love, James Reinhard, A.J. Schwab, and George Spafford

Relevance to Government Audits: MEDIUM

This GTAG provides a thought process to assist the chief audit executive (CAE) in incorporating an audit of information security governance (ISG) into the audit plan, focusing on whether the organization's ISG activity delivers the correct behaviors, practices, and execution of IS. GTAG 15: *Information Security Governance* will assist efforts to:

- define ISG.
- help internal auditors understand the right questions to ask and know what documentation is required.
- describe the internal audit activity's (IAA) role in ISG.

IIA members can download a copy of these GTAGs, or nonmembers can purchase these GTAGs for download from the IIA at <http://www.theiia.org/bookstore/>

Practice Guide: Chief Audit Executives -Appointment, Performance Evaluation and Termination

Relevance to Government Audits: MEDIUM

This IIA Practice Guide includes topics relating to the appointment, evaluation, and termination of the Chief Audit Executive (CAE).

PCAOB Audit Risk Suite: The Auditor's Assessment and Response to Risk

Relevance to Government Audits: MEDIUM

On August 5, 2010, the Public Company Accounting Oversight Board (PCAOB) adopted a suite of eight auditing standards related to the auditor's assessment of, and response to, risk in an audit.

The suite of risk assessment standards, **Auditing Standards No. 8 through No. 15**, sets forth requirements that enhance the effectiveness of the auditor's assessment of, and response to, the risks of material misstatement in the financial statements and supersedes six PCAOB interim standards and related amendments: AU sec. 311, *Planning and Supervision*; AU sec. 312, *Audit Risk and Materiality in Conducting an Audit*; AU sec. 313, *Substantive Tests Prior to the Balance Sheet Date*; AU sec. 319, *Consideration of Internal Control in a Financial Statement Audit*; AU sec. 326, *Evidential Matter*; and AU sec. 431, *Adequacy of Disclosure in Financial Statements*. The risk assessment standards address audit procedures performed throughout the audit, from the initial planning stages through the evaluation of the audit results. These standards, if approved by the Securities and Exchange Commission (SEC), will become effective for audits of fiscal periods beginning on or after Dec. 15, 2010. These standards

Auditing Standard 8 (AS No. 8) – Audit Risk


This standard discusses the auditor's consideration of audit risk in an audit of financial statements as part of an integrated audit or an audit of financial statements only. It describes the components of audit risk and the auditor's responsibilities for reducing audit risk to an appropriately low level in order to obtain reasonable assurance that the financial statements are free of material misstatement.

Auditing Standard 9 (AS No. 9) – Audit Planning


This standard establishes requirements regarding planning an audit, including assessing matters that are important to the audit, and establishing an appropriate audit strategy and audit plan. It also notes that the auditor should modify the overall audit strategy and the audit plan if circumstances change significantly during the course of the audit, including changes due to a revised assessment of the risks of material misstatement or the discovery of a previously unidentified risk of material misstatement.

Auditing Standard 10 (AS No. 10) – Supervision of the Audit Engagement


This standard sets forth requirements for supervision of the audit engagement, including, in particular, supervising the work of engagement team members.

 **Auditing Standard 11 (AS No. 11) – Consideration of Materiality in Planning and Performing an Audit**

This standard describes the auditor's responsibilities for consideration of materiality in planning and performing an audit.

 **Auditing Standard 12 (AS No. 12) – Identifying and Assessing Risks of Material Misstatement**


This standard establishes requirements regarding the process of identifying and assessing risks of material misstatement of the financial statements. The risk assessment process discussed in the standard includes information-gathering procedures to identify risks and an analysis of the identified risks.

 **Auditing Standard 13 (AS No. 13) – The Auditor's Responses to the Risks of Material Misstatement**

This standard establishes requirements for responding to the risks of material misstatement in financial statements through the general conduct of the audit and performing audit procedures regarding significant accounts and disclosures. It also notes that the auditor must design and implement audit responses that address the risks of material misstatement that are identified and assessed in accordance with Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*.

 **Auditing Standard 14 (AS No. 14) – Evaluating Audit Results**

This standard establishes requirements regarding the auditor's evaluation of audit results and determination of whether the auditor has obtained sufficient appropriate audit evidence. The evaluation process set forth in this standard includes, among other things, evaluation of misstatements identified during the audit; the overall presentation of the financial statements, including disclosures; and the potential for management bias in the financial statements.

 **Auditing Standard 15 (AS No. 15) – Audit Evidence**

This standard explains what constitutes audit evidence and establishes requirements for designing and performing audit procedures to obtain sufficient appropriate audit evidence to support the opinion expressed in the

auditor's report. This standard discusses sufficient appropriate audit evidence, relevance and reliability of evidence, and audit procedures for obtaining audit evidence.

Regulatory Requirements

Office of Management and Budget (OMB)

www.whitehouse.gov/omb

 **2010 OMB Circular A-133 Compliance Supplement** (*June 2010*)

Relevance to Government Audits: HIGH

This Circular A-133 Compliance Supplement provides guidance to assist auditors in determining compliance requirements relevant to the Single Audit Act of 1984 for entities that administer Federal financial assistance programs. For single audits, this Supplement replaces agency audit guides and other audit requirement documents for individual Federal programs. The 2010 OMB Circular A-133 Compliance Supplement also includes an appendix (Appendix V) which provides a list of changes from the March 2009 Circular A-133 Compliance Supplement.

 **OMB Circular A-11, Preparation, Submission and Execution of the Budget** (*July 2010*)

Relevance to Government Audits: HIGH

This OMB Circular provides guidance on preparing the FY 2012 Budget and instructions on budget execution, and applies to all Executive departments and establishments. The Circular provides an overview of the budget process, discusses the basic laws that regulate the budget process, describes the Administration's approach to performance management and requirements for strategic plans and annual program performance reports, and provides an overview of the performance budget.

 **M-10-24, Performance Improvement Guidance: Management Responsibilities and Government Performance and Results Documents** (*June 2010*)

Relevance to Government Audits: HIGH

This memorandum provides guidance to all Federal agencies on their Government Performance and Results Act (GPRA) and other performance management activities, and provides general direction on expectations for management accountability and GPRA documents. It includes elements that should be included in GPRA documents to make them more useful to agency leadership, managers, employees, Congress, delivery partners, and the public.

For more information on these OMB documents or other circulars, bulletins, and memoranda for this year or previous years, please see the OMB website: <http://www.whitehouse.gov/omb/agency/default/>

Accounting Standards and Guidance

Federal Accounting Standards Advisory Board (FASAB) www.fasab.gov

✚ **SFFAS 39, Subsequent Events: *Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statement on Auditing Standards* (August 2010)**

Relevance to Government Audits: HIGH

Events or transactions that affect the basic information or required supplementary information (RSI) may occur subsequent to the end of the reporting period but before the financial report is issued. Some of those transactions and events require adjustments to the basic information or RSI while others may require disclosure in the basic information or RSI. SFFAS 39 addresses the circumstances that may require adjustments or disclosure. Accounting and financial reporting guidance had been in AICPA AU section 560, *Subsequent Events*, and the objective of this Statement is to incorporate that guidance into the authoritative literature of the FASAB. This Statement amends footnote 17 of the current SFFAS No. 5 to conform to this standard's requirements, and applies to the basic information and RSI of all federal reporting entities that are presented in conformity with GAAP. The requirements in this Statement are effective upon issuance.

✚ **Technical Release 12, *Accrual Estimates for Grant Programs* (August 2010)**


Relevance to Government Audits: HIGH

This Technical Release (TR) addresses materiality considerations, risk assessment, and procedures for estimating accruals for grant programs, and also provides guidance on acceptable sources of documentation for grant accrual estimates; internal controls, including monitoring of internal controls and validation of grant accrual estimates; and monitoring of grantee reporting. It also includes factors that management should consider in determining which grant programs may have a higher risk of material misstatement that might cause financial statement users to make incorrect assessments regarding the efficiency and effectiveness of the program. This technical release is effective for periods beginning after September 30, 2010, with earlier implementation encouraged.

For more information on this document, or to access other FASAB standards or publications, please see the FASAB website: <http://www.fasab.gov/>

Financial Accounting Standards Board (FASB)

www.fasb.org

 **Accounting Standards Update No. 2010-20—Receivables (Topic 310):
*Disclosures about the Credit Quality of Financing Receivables and the
Allowance for Credit Losses (July 2010)***

Relevance to Government Audits: MEDIUM


This Accounting Standards Update provides additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. The amendments in this Update apply to all entities, both public and nonpublic. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010, and the disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. For nonpublic entities, the disclosures are effective for annual reporting periods ending on or after December 15, 2011.

For more information on this document, or to access other FASB publications for this year or previous years, please see the FASB website: <http://www.fasb.org/>

Other Guidance

Committee of Sponsoring Organizations of the Treadway Commission (COSO)

<http://www.coso.org>

 **COSO Fraud Study *Fraudulent Financial Reporting: 1998-2007 An
Analysis of U.S. Public Companies (May 2010)***

Mark S. Beasley, Joseph V. Carcello, Dana R. Hermanson , and Terry L. Neal

Relevance to Government Audits: MEDIUM

COSO has released a new research study, *Fraudulent Financial Reporting: 1998-2007*, that examines 347 alleged accounting fraud cases investigated by the SEC over a ten-year period (ending December 31, 2007). It provides an in-depth analysis of the nature, extent and characteristics of accounting frauds occurring throughout the ten years, and provides helpful insights regarding new and ongoing issues needing to be addressed. Click on the link to view the research report of the study's findings. <http://www.coso.org/documents/COSOFRAUDSTUDY2010.pdf>.