



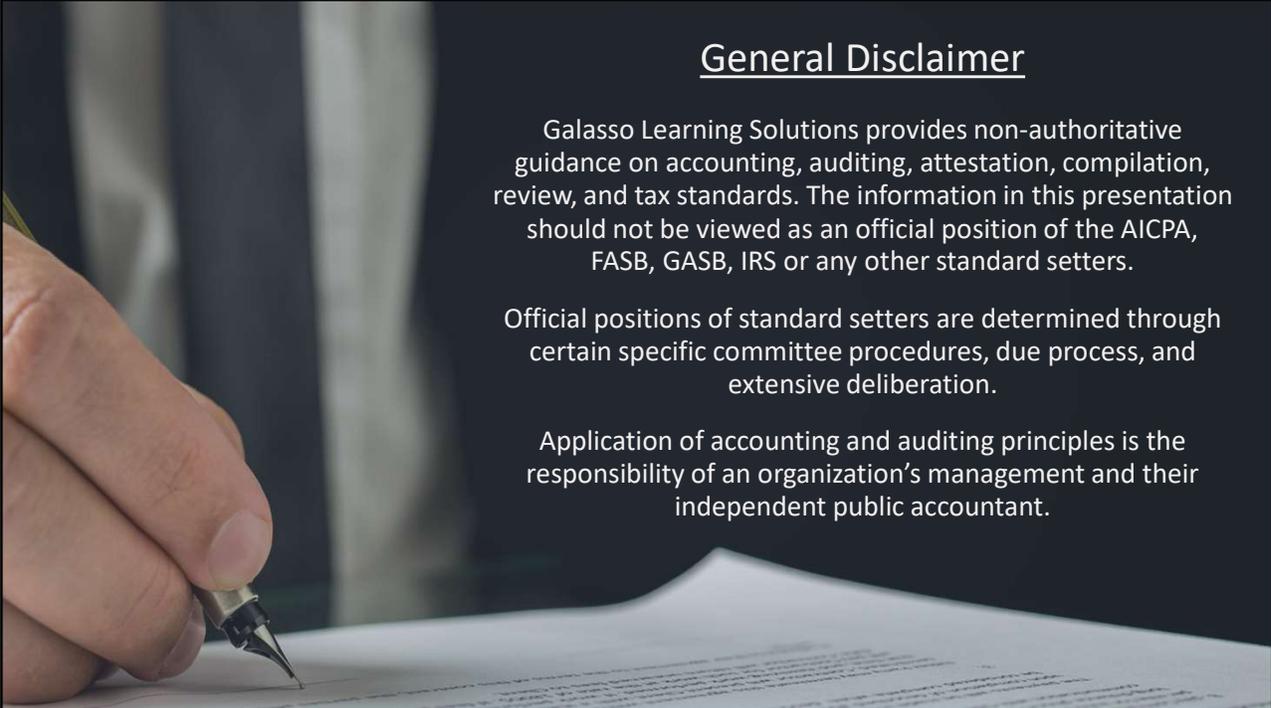
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NFP Auditing Basics: Introduction to Yellow Book

June 2, 2025

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1



General Disclaimer

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Official positions of standard setters are determined through certain specific committee procedures, due process, and extensive deliberation.

Application of accounting and auditing principles is the responsibility of an organization's management and their independent public accountant.

2

Learning Objectives

1. Recognize the unique auditing requirements in Yellow Book
2. Describe the independence requirements for Yellow Book engagements
3. Identify the CPE requirements for Yellow Book engagements
4. Recall the reporting requirements of Yellow Book



Agenda

Background

Ethics

General

Yellow Book Independence

Competence

Standards for Financial Audits

Example Reporting

Background



5

What is Yellow Book?

- Issued by the United States Government Accountability Office, Comptroller General of the United States
- Various Names:
 - Governmental Auditing Standards (GAS)
 - Generally Accepted Government Auditing Standards (GAGAS)
 - Yellow Book

6

When do I have to follow Yellow Book?

- Typically Audits of:
 - Governmental Entities
 - Not For Profit Entities
- Single Audits (Uniform Guidance)
- Required by certain laws or other regulations

7

Types of Engagements



8

Terminology

Must

Should

“May,”
“Might”
“Could”



Ethics



Ethics

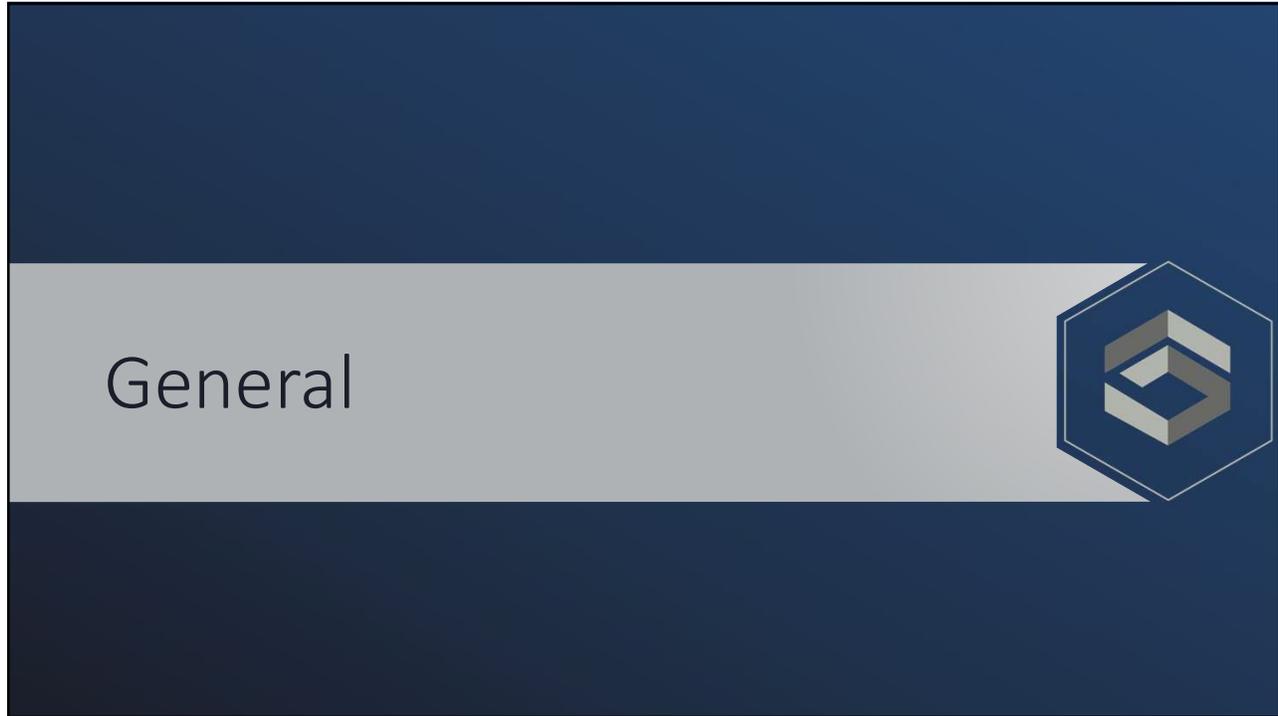
- Ethical principles apply in preserving auditor independence, taking on only work that the audit organization is competent to perform, performing high-quality work, and following the applicable standards cited in the auditors' report

11

Ethical Principles

- The ethical principles that guide the work of auditors who conduct audits in accordance with GAGAS are:
 - The public interest
 - Integrity
 - Objectivity
 - Proper use of government information, resources, and positions
 - Professional behavior

12



13

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Out of Scope

- GAGAS does not cover nonaudit services, which are defined as professional services other than audits or attestation engagements

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14

14

Reporting

- When auditors are required to perform an audit in accordance with GAGAS or are representing to others that they did so, they should cite compliance with GAGAS in the auditors' report
 - Unmodified GAGAS compliance statement
 - Modified GAGAS compliance statement

15

Yellow Book Independence



16

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Independence

Independence
of Mind

Independence
in Appearance

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17

17

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Common Confusion

- AICPA Code of Professional Conduct added threats and safeguards approach
- Does NOT perfectly align with Yellow Book

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18

Period of Independence

- Auditors should be independent from an audited entity during:
 - Any period of time covered by the audit
 - The period of professional engagement

19

Conceptual Framework

Framework that auditors use to:

- Identify
- Evaluate (individually and in the aggregate)
- Apply safeguards

to address threats to independence



20

Threats

- Threats to independence are circumstances that could impair independence

Whether independence is impaired depends on:

- The nature of the threat
- The significance of the threat
- The specific safeguards applied

21

Threats Cont'd



22

Safeguards

- Safeguards are actions or other measures, individually or in combination, that auditors and audit organizations take that effectively eliminate threats to independence or reduce them to an acceptable level
- Multiple safeguards may be necessary to address a threat

Possible Safeguards

- Consulting an independent third party, such as a professional organization, a professional regulatory body, or another auditor
- Removing an individual from an audit team when that individual's financial or other interests or relationships pose a threat to independence

Safeguards for Nonaudit Services

- The following are examples of actions that in certain circumstances could be safeguards in addressing threats to independence related to nonaudit services:
 - Not including individuals who provided the nonaudit service as engagement team members;
 - Having another auditor, not associated with the engagement, review the engagement and nonaudit work as appropriate;
 - Engaging another audit organization to evaluate the results of the nonaudit service; or
 - Having another audit organization re-perform the nonaudit service to the extent necessary to enable that other audit organization to take responsibility for the service

25

Identifying Threats

- Facts and circumstances that create threats to independence can result from events such as:
 - The start of a new audit
 - Assignment of new staff to an ongoing audit
 - Acceptance of a nonaudit service at an audited entity

26

Not Acceptable

- A threat to independence is not acceptable if it either:
 - Could impact the auditor's ability to perform an audit without being affected by influences that compromise professional judgment; or
 - Could expose the auditor or audit organization to circumstances that would cause a reasonable and informed third party to conclude that the integrity, objectivity, or professional skepticism of the audit organization, or a member of the audit team, had been compromised

27

Nonaudit Services

- Providing nonaudit services may create threats to an auditor's independence
- Must consider individually and in the aggregate

28

Impair Independence

- Determining or changing journal entries, account codes or classifications for transactions, or other accounting records for the entity without obtaining management's approval
- Authorizing or approving the entity's transactions
- Preparing or making changes to source documents without management approval

29

Preparation

- Auditors should conclude that preparing financial statements in their entirety from a client-provided trial balance or underlying accounting records creates **significant threats** to auditors' independence
 - Should document the threats and safeguards applied to eliminate and reduce threats to an acceptable level or decline to provide the services

30

Preparation Cont'd

- Threats
 - Recording transactions for which management has determined or approved the appropriate account classification, or posting coded transactions to an audited entity's general ledger
 - Preparing certain line items or sections of the financial statements based on information in the trial balance
 - Posting entries that an audited entity's management has approved to the entity's trial balance
 - Preparing account reconciliations that identify reconciling items for the audited entity management's evaluation

31

Evaluate Significance

- Factors that are relevant in evaluating the significance of any threats
 - The extent to which the outcome of the service could have a material effect on the financial statements,
 - The degree of subjectivity involved in determining the appropriate amounts or treatment for those matters reflected in the financial statements, and
 - The extent of the audited entity's involvement in determining significant matters of judgment

32

Removed As Explicitly Acceptable

- Proposing standard, adjusting, or correcting journal entries or other changes affecting the financial statements to an audited entity's management provided management reviews and accepts the entries and the auditor is satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements

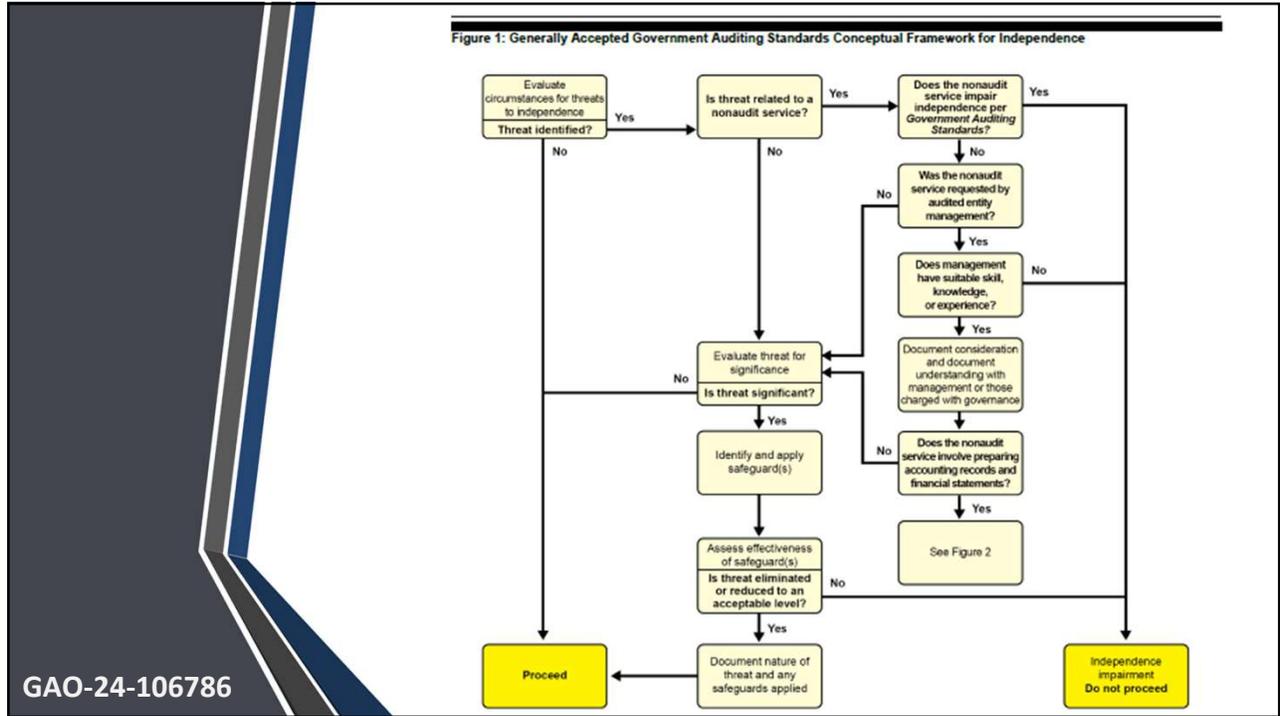
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Routine (Not Nonaudit)

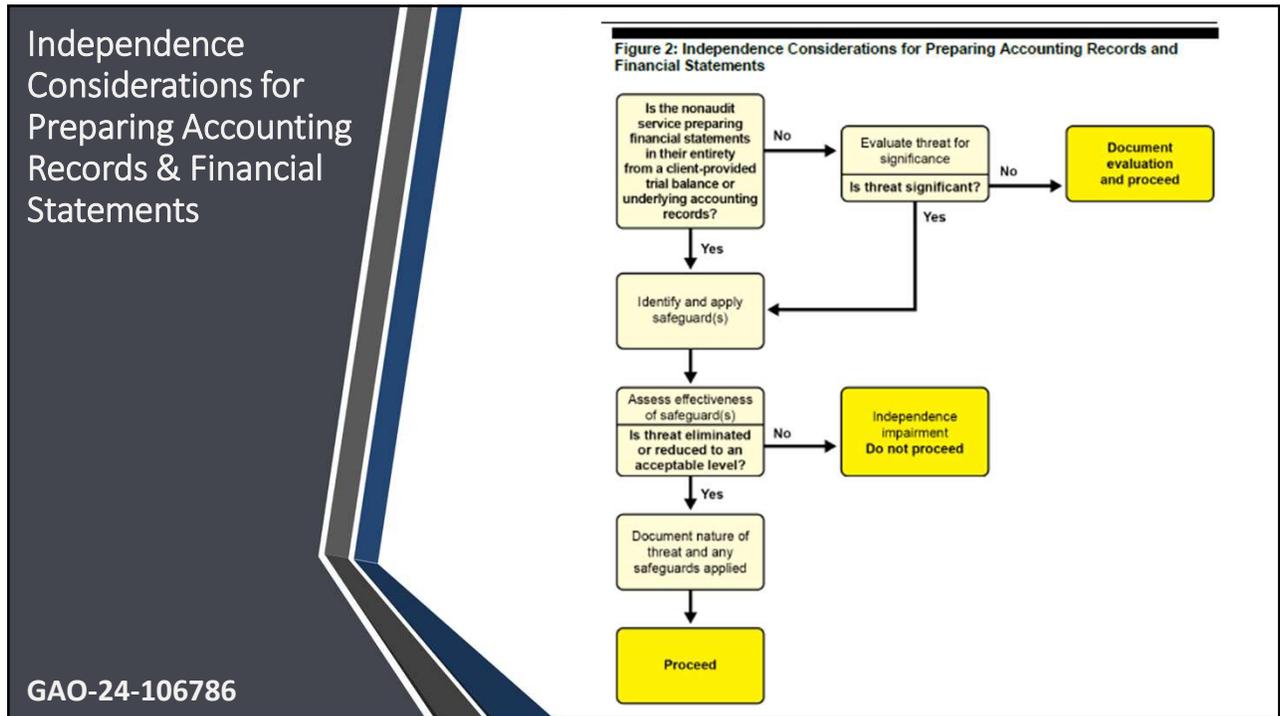
Routine activities directly related to an audit:

- Providing advice to the audited entity on an accounting matter as an ancillary part of the overall financial audit;
- Providing advice to the audited entity on routine business matters
- Educating the audited entity on matters within the technical expertise of the auditors
- Providing information to the audited entity that is readily available to the auditor

34



35



36

Management Responsibilities

- No safeguards can reduce to an acceptable level
- Management responsibilities involve leading and directing an entity, including:
 - Making decisions regarding the acquisition, deployment and control of human, financial, physical, and intangible resources

37

Management Responsibilities Cont'd

- Setting policies and strategic direction for the audited entity
- 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
- Accepting responsibility for management of an audited entity's project
- Accepting responsibility for designing, implementing, or maintaining internal control
- Providing services that are intended to be used as management's primary basis for making decisions that are significant to the subject matter of the audit

38

Nonaudit Services

- Obtain assurance that management performs the following functions in connection with nonaudit services:
 - Assumes all management responsibilities
 - Oversees the services, by designating an individual who possess suitable skill, knowledge, or experience
 - Evaluates the adequacy and results of the services
 - Accepts responsibility for results of the services

SKE

- The audited entity must designate an individual who possesses suitable **skill, knowledge, or experience**, and the individual understands the services to be performed sufficiently to oversee them
 - Must document this consideration

Indicators of Effective Oversight

- 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

41

Engagement Letter

Objectives of the nonaudit service

Services to be performed

Audited entity's acceptance of its responsibilities

Auditor's responsibilities

Any limitations of the nonaudit service

42

Documentation of Independence

- Document threats to independence that require the application of safeguards, along with safeguards applied, in accordance with the conceptual framework for independence
- Document consideration of audited entity management's ability to effectively oversee a nonaudit service
- Document the auditor's understanding with an audited entity for which the auditor will perform a nonaudit service

43

Competence



44

Competence

- Staff assigned to perform the audit must collectively possess adequate professional competence needed to perform a Yellow Book audit
 - Competence is a combination of education and experience

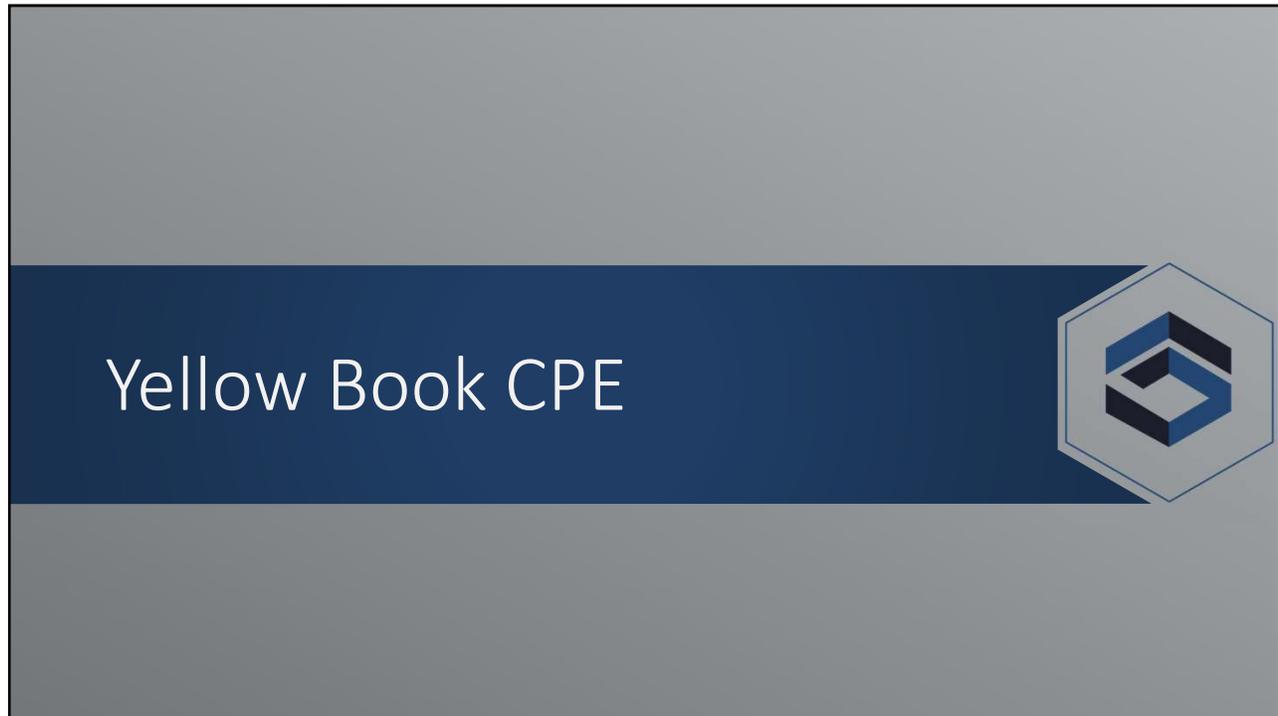
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Technical Knowledge

Staff should collectively possess:

- GAGAS
- Standards, statutory requirements, regulations, criteria, and guidance applicable to auditing or the objectives for the engagement(s) being conducted
- Techniques, tools, and guidance related to professional expertise applicable to the work being performed

46



47

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Who is Required to Get CPE?

- Auditors performing work in accordance with GAGAS, including planning, directing, performing audit procedures, or reporting on an audit conducted in accordance with GAGAS, should maintain their professional competence through CPE

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48

Definition

Directing

- Supervising the efforts of others who are involved in accomplishing the objectives of the engagement or **reviewing engagement work** to determine whether those objectives have been accomplished

Education

- Every 2 years, at least 24 hours of CPE that directly relates to government auditing or environment of client
- Additional 56 hours to enhance ability to conduct engagements
- Total of 80 hrs of Yellow Book CPE every 2 yrs
 - Minimum of 20 in any given year

24 Hour Requirement

- CPE used to fulfill the 24 hour requirement may be taken at any time during the 2-year measurement period
- The subject matter categories for the 24 hour requirement may be used to satisfy the 56 hour CPE requirement

51

CPE for Specialists

- The audit team should determine that external specialists assisting in performing a GAGAS audit are qualified and competent in their areas of specialization
 - External specialists are not required to meet the GAGAS CPE requirements

52

CPE for Specialists Cont'd

- Internal specialists, who are performing work in accordance with GAGAS as part of the audit team, including directing, performing audit procedures, or reporting on a GAGAS audit, must comply with GAGAS, including the CPE requirements

53

24 Hour Topics

GAGAS	Applicable SASes, SSARS, SSAEs	GAAP
COSO & Greenbook	Uniform Guidance	IT auditing topics applicable to the government environment
Performance Audits	Fraud topics applicable to a government environment	Government ethics and independence

54

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56 Hour Topics

Communicating
clearly and
effectively, both
orally and in writing

General ethics and
independence

Managing time and
resources

Leadership

Software
applications used in
conducting
engagements

Information
technology

Economics, human
capital
management

55

55

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Typically Don't Qualify

Taxation

Personal financial
planning and
investment

Taxation
strategies

Estate planning

Retirement
planning

Practice
management

56

56

Exemptions

- 56 hour exemption (NOT 24)
 - Charge less than 20% of their time annually to engagements conducted in accordance with GAGAS **and**
 - Are only involved in performing engagement procedures, but not involved in planning, directing, or reporting on the engagement

57

Exemptions Cont'd

- Full Exemption
 - **Nonsupervisory** auditors who charge less than 40 hours of their time annually to engagements conducted in accordance with GAGAS may be exempted by the organization from all CPE requirements

58

Standards for Financial Audits



59

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What makes it different?

It's an additional layer

GAAS

GAGAS

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60

60

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Additional Requirements

Compliance with Standards	Licensing & Certification	Auditor Communication
Results of Previous Audits	Investigations or Legal Proceedings	Noncompliance
Findings	Audit Documentation	Availability of Individuals and Documentation

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Compliance with Standards

- Auditors should comply with these additional requirements, along with the AICPA requirements for financial audits, when citing GAGAS in financial audit reports

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62

Licensing & Certification

- Auditors engaged to conduct financial audits in the United States who do not work for a government audit organization should be licensed CPAs, persons working for licensed certified public accounting firms, or licensed accountants in states that have multiclass licensing systems that recognize licensed accountants other than CPAs

Communication – Audience

- Auditors should communicate pertinent information that in the auditors' professional judgment needs to be communicated to individuals contracting for or requesting the audit, and to cognizant legislative committees when auditors perform the audit pursuant to a law or regulation, or they conduct the work for the legislative committee that has oversight of the audited entity

Investigations

- Auditors should inquire of management of the audited entity whether any investigations or legal proceedings have been initiated or are in process with respect to the period under audit, and should evaluate the effect of initiated or in-process investigations or legal proceedings on the current audit

Noncompliance

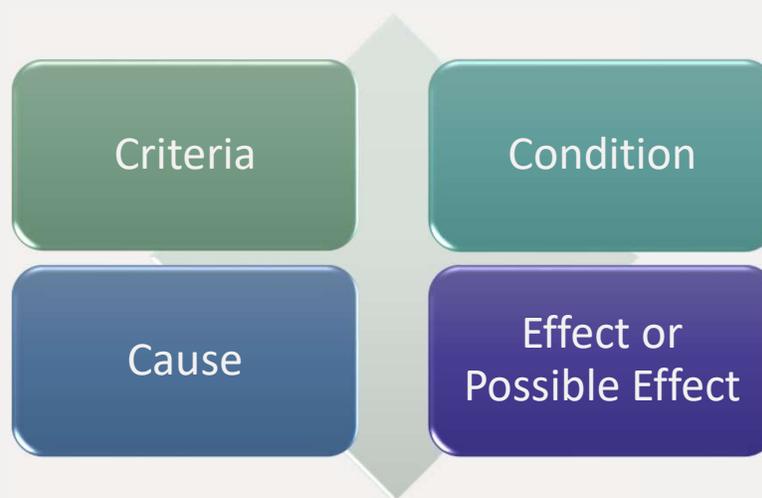
- Auditors should extend the AICPA requirements concerning consideration of noncompliance with laws and regulations to include consideration of noncompliance with provisions of contracts and grant agreements

Results of Previous Audits

- When planning the audit, auditors should ask management of the audited entity to identify previous audits, attestation engagements, and other studies that directly relate to the objectives of the audit, including whether related recommendations have been implemented
- Evaluate whether the audited entity has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a significant effect on the subject matter

67

Required Elements of a Finding



68

Abuse & Waste

- Waste is the act of using or expending resources carelessly, extravagantly, or to no purpose
- Can include activities that do not include abuse and does not necessarily involve a violation of law
 - Waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight

Abuse & Waste Cont'd

- Abuse is 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
- Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate

Abuse & Waste Cont'd

- Given the concept of accountability for use of public resources and government authority, evaluating internal control in a government environment may also include considering internal control deficiencies that result in waste or abuse
- 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

71

Audit Documentation

- Document supervisory review before the report release date
- Document departures from GAGAS

72

Availability

- Subject to applicable provisions of laws and regulations, auditors should make appropriate individuals and audit documentation available upon request and in a timely manner to other auditors or reviewers

73

Additional Reporting Requirements



74

Compliance with GAGAS

- Include statement in auditors' report that they performed audit in accordance with GAGAS

75

Reporting on Internal Control

- Requires reporting on ICFR
- Findings
 - Significant deficiencies and material weaknesses in internal control

76

Reporting on ICFR

Yellow Book

- In a written report on internal control over financial reporting
- Every audit

AU-C Section 265

- In a written communication to management and those charged with governance
- Only when significant deficiencies or material weaknesses are identified

77

Reporting Compliance

- Compliance with Provisions of Laws, Regulations, **Contracts, and Grant Agreements**
 - In addition to AU-C 250
- Finding:
 - Noncompliance with provisions of laws, regulations, contracts, or grant agreements that has a **material effect on the financial statements** or other financial data significant to the audit objectives

78

Fraud

- Fraud that is material, either quantitatively or qualitatively, to the financial statements or other financial data significant to the audit objectives

Common Confusion



Presenting Findings

- Develop the elements of the findings to the extent necessary to assist management or oversight officials of the audited entity in understanding the need for corrective action

81

Presenting Findings Cont'd

- Perspective
 - Place their findings in perspective by describing the nature and extent of the issues being reported and the extent of the work performed that resulted in the finding
 - To give the reader a basis for judging the prevalence and consequences of these findings, relate the instances identified to the population or the number of cases examined and quantify the results in terms of dollar value or other measures
 - If the results cannot be projected, auditors should limit their conclusions appropriately

82

Reporting Findings

- Auditors should report findings directly to parties outside the audited entity when:
 - Audited entity management fails to satisfy legal or regulatory requirements to report such information to external parties specified in law or regulation
 - When audited entity management fails to take timely and appropriate steps to respond to fraud or noncompliance that (1) is likely to have a material effect on the subject matter and (2) involves funding received directly or indirectly from a government agency

Views of Responsible Officials

- Auditors should obtain and report the views of responsible officials of the audited entity concerning the findings, conclusions, and recommendations in the audit report, as well as any planned corrective actions

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Reporting Confidential & Sensitive Information

Prohibitions on
public
disclosure

Confidential or
sensitive
information

Classified
information

Public safety,
privacy or
security
concerns

Remember
broad public
interest

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85

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Distribution of Reports

- Audit organizations in government entities
- Public accounting firms



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86

Example Reporting



87

Yellow Book Report

- Official Title – *Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards*

88

Introductory Paragraph

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of [name of govt entity] as of and for the year ended June 30, 20X1, and the related notes to the financial statements, which collectively comprise the [entity's] basic financial statements, and have issued our report thereon dated August 15, 20X1.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the [Entity]'s internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the [Entity]'s internal control. Accordingly, we do not express an opinion on the effectiveness of the [Entity]'s internal control.

Report on ICFR Cont'd

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

91

Report on ICFR Cont'd

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses or significant deficiencies may exist that were not identified.

92

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the [Entity]'s financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

93

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

94

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Close

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

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95

3, 2, 1 Method of Applying New Knowledge

3 things I learned

2 actions to apply what I learned

1 way I will share my learning



96

Let's Keep in Touch

-  gls.advancecpe.com (*webinar*)
-  gls.lcvista.com (*on-demand*)
-  moneymattersfornonprofits.com
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-  linkedin.com/company/galassolearning

97



What Questions Do You Have?



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Content last reviewed: 5/1/25
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98