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Advanced Topics in a Single Audit

Melisa Galasso, CPA

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Use of materials

This course manual accompanies all formats in which the course is offered, including self-study text, self-study online, group study, in-firm, and other formats, as applicable. Specific instructions for users of the various formats are included in this section.

CPAs are required to participate in continuing professional education (CPE) to maintain their professional competence and provide quality professional services. CPAs are responsible for complying with all applicable CPE requirements, rules, and regulations of state licensing bodies, other governmental entities, membership associations, and other professional organizations or bodies.

Professional standards for CPE programs are issued jointly by the American Institute of Certified Public Accountants (AICPA) and the National Association of State Boards of Accountancy (NASBA) to provide a framework for the development, presentation, measurement, and reporting of CPE programs. The Statement on Standards for CPE Programs (CPE standards)
is available as part of AICPA *Professional Standards*, either in paperback or as an online subscription through the Association's Online Professional Library.

Review questions and exercises for self-study participants
The CPE standards require that self-study programs include review questions/exercises that provide feedback for both correct and incorrect responses. Note that these reviews are provided only as learning aids and do not constitute a final examination.

Requirements for claiming and receiving CPE credit
CPE standards place responsibility on both the individual participant and the program sponsor to maintain a record of attendance at a CPE program. CPAs who participate in only part of a CPE program, should claim CPE credit only for the portion that they attended or completed.

You must document your claims of CPE credit. Examples of acceptable evidence of completion include:

- For group and independent study programs, a certificate or other verification supplied by the CPE program sponsor
- For self-study programs, a certificate supplied by the CPE program sponsor after satisfactory completion of an examination

When you participate in group study and other live presentations, you will receive a completion certificate from the program sponsor. CPE program sponsors are required to keep documentation on programs for five years, including records of participation.

When you participate in self-study, you must complete the exam within one year of the date of course purchase to receive a certificate indicating satisfactory completion of the CPE program.

- The exam for self-study in print format is located in the "Examination" section at the end of the course manual.
- You can find the course code number for both the self-study exam and the self-study evaluation in the examination's introductory material. You will complete the self-study exam and evaluation online at https://cpegrading.aicpa.org. You must provide the unique serial number printed on the inside front cover of this publication and you must achieve a minimum passing grade of at least 70% to qualify for CPE credit.
  - Upon achieving a passing grade, you will receive a certificate displaying the number of CPE credits earned based on a 50-minute learning segment, in compliance with CPE standards. The grading system provides a completion certificate online, which you may print or save as a PDF. The grading system maintains a transcript of your completed courses.
  - If you do not achieve a passing grade, the online grading system notifies you of this and also provides instructions for retaking the exam. You have three attempts to pass the exam. If you do not pass the exam in three attempts, please contact the Global Engagement Center at 1.888.777.7077 to obtain additional attempts.

Program evaluations
The information accumulated from participant evaluation forms is important in our continual efforts to provide high quality continuing education for the profession. When you participate in group study and other live presentations, please return your evaluation forms prior to departing your program sessions. When you participate in self-study, please complete the course evaluation online. Your comments are very important to us.

Customer service
For help and support, including information on refund claims and complaint resolutions, please call the Global Engagement Center at 1.888.777.7077, or visit the online help page at https://www.aicpa.org/cpe-learning.

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Advanced Topics in a Single Audit: Introduction to Single Audits

Learning objectives

- Determine the auditor's responsibilities when performing a single audit.
- Evaluate the federal regulations applicable to a compliance audit.

What is a single audit?

The Single Audit Act Amendments of 1996 and Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), require a single or program-specific audit for a nonfederal entity that expends $750,000 or more of federal awards in a fiscal year. The Single Audit Act requires that audits be conducted by an independent auditor in accordance with *Government Auditing Standards* and authorizes the director of the Office of Management and Budget (OMB) to develop governmentwide guidelines and policy on performing audits to comply with the act. The Uniform Guidance establishes such audit requirements in addition to guidelines and policies on aspects of managing federal awards. Individual federal departments and agencies have adopted the Uniform Guidance in regulation.

Note: The 2022 Compliance Supplement offered certain state and local governments the option of a compliance examination performed under the SSAEs and GAGAS for recipients of the Coronavirus State and Local Fiscal Recovery Funds (CSLFRF). The final rule offers a standard allowance of revenue loss of up to $10 million. Recipients that select the standard allowance (in many cases for their full award) may use that amount for government services with streamlined reporting requirements. The Compliance Supplement provides an alternative examination engagement (in lieu of a single audit) for entities who receive less than $10 million in CSLFRF funding and would not otherwise need a single audit.

In a single audit, the auditor has the following objectives, each of which results in the issuance of certain auditor reports:

- Audit of the entity's financial statements and reporting on the supplementary schedule of expenditures of federal awards (SEFA)
  - Determine whether the financial statements of the auditee are presented fairly in all material respects in accordance with generally accepted accounting principles. (Note that the Uniform Guidance does not prescribe the basis of accounting for financial statement preparation.)
  - Determine whether the SEFA is stated fairly in all material respects in relation to the auditee's financial statements as a whole.
- Compliance audit of federal awards
  - Obtain an understanding of internal control over federal programs sufficient to plan the audit to support a low assessed level of control risk of noncompliance for major programs; plan the testing of internal control over compliance for major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program; and perform testing of internal control as planned.
  - Determine whether the auditee has complied with federal statutes, regulations, and the terms and conditions of federal awards that may have a direct and material effect on each of its major programs.

Auditors performing financial statement audits and Uniform Guidance compliance audits in accordance with *Government Auditing Standards* should comply with generally accepted auditing standards (GAAS), the requirements found in chapters 1–5 of *Government Auditing Standards*, and the additional standards and related requirements for financial audits found in chapter 6, "Standards for Financial Audits," of *Government Auditing Standards*.

Federal statutes, regulations, and the terms and conditions of federal awards

The nonfederal entity is responsible for complying with all requirements of a federal award. The Uniform Guidance uses the terminology "federal statutes, regulations, and the terms and conditions of federal awards," which is equivalent to "provisions of laws regulations, contracts, and grant agreements," as found in *Government Auditing Standards*.

What this phrase encompasses is better understood by looking at the requirements for federal awarding agencies. According to the Uniform Guidance, the federal awarding agency must manage and administer the federal award in a manner so as to ensure that federal funding is expended and associated programs are implemented in full accordance with the U.S. Constitution, federal law, and public policy requirements including, but not limited to, those protecting free speech, religious liberty, public welfare, the environment, and prohibiting discrimination. The federal awarding agency must communicate to the nonfederal entity all relevant public policy requirements, including those in general appropriations provisions, and incorporate them either directly or by reference in the terms and conditions of the federal award.

Therefore, nonfederal entities must comply with federal statutes and regulations in addition to complying with the terms and conditions of the federal award imposed by the federal agency. No terms or conditions of an award can impose requirements that conflict with federal statutes and regulations.

Uniform administrative requirements, cost principles, and audit requirements for federal awards

The Uniform Guidance establishes uniform administrative requirements, cost principles, and audit requirements for federal awards to nonfederal entities. The Uniform Guidance applies to both the federal agencies making federal awards and the nonfederal entities that expend them. *Nonfederal entities* include state and local governments, Indian tribes, institutions of higher education, and nonprofit organizations.

The Uniform Guidance includes the following sections:

• Subpart A	Acronyms and Definitions	200.0–200.1
• Subpart B	General Provisions	200.100–200.113
• Subpart C	Pre-Federal Award Requirements and Contents of Federal Awards	200.200–200.216
• Subpart D	Post-Federal Award Requirements	200.300–200.346
• Subpart E	Cost Principles	200.400–200.476
• Subpart F	Audit Requirements	200.500–200.521

Subparts B through D set forth the uniform administrative requirements for grants and cooperative agreements, including the requirements for federal awarding agency management of federal grant programs before the federal award has been made and the requirements federal awarding agencies may impose on nonfederal entities in the federal award.

Subpart E establishes principles for determining the allowable costs incurred by nonfederal entities under federal awards.

Subpart F sets forth standards for obtaining consistency and uniformity among federal agencies for the audit of nonfederal entities expending federal awards.

The following appendixes follow Subpart F in the Uniform Guidance:

• Appendix I to Part 200	Full Text of Notice of Funding Opportunity
• Appendix II to Part 200	Contract Provisions for Non-Federal Entity Contracts Under Federal Awards
• Appendix III to Part 200	Indirect (F&A) Costs Identification and Assignment, and Rate Determination for Institutions of Higher Education (IHEs)
• Appendix IV to Part 200	Indirect (F&A) Costs Identification and Assignment, and Rate Determination for Nonprofit Organizations
• Appendix V to Part 200	State/Local Governmentwide Central Service Cost Allocation Plans
• Appendix VI to Part 200	Public Assistance Cost Allocation Plans
• Appendix VII to Part 200	States and Local Government and Indian Tribe Indirect Cost Proposals
• Appendix VIII to Part 200	Nonprofit Organizations Exempted From Subpart E of Part 200
• Appendix IX to Part 200	Hospital Cost Principles
• Appendix X to Part 200	Data Collection Form (Form SF-SAC)
• Appendix XI to Part 200	Compliance Supplement
• Appendix XII to Part 200	Award Term and Condition for Recipient Integrity and Performance Matters

Effective date of the Uniform Guidance

In August 2020, the OMB issued a revision to the Uniform Guidance, which was the culmination of a required five-year review. The revisions were generally effective on November 12, 2020, although two sections were effective August 13, 2020 (those relate to termination of federal awards and new prohibitions on certain telecommunications and video surveillance services or equipment). The revised Uniform Guidance will apply to new awards issued on or after the effective date. Federal agencies may also have to take action to adopt the updated regulation in their individual agency regulations.

Must and should

The use of the term *must* in the Uniform Guidance indicates a requirement. This is consistent with the use of the term *must* in GAAS and *Government Auditing Standards*. The use of the term *should* in the Uniform Guidance indicates a best practice or recommended approach. However, GAAS and *Government Auditing Standards* use the term *should* to indicate a presumptively mandatory requirement. An auditor must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant, except in rare circumstances.

Protected personally identifiable information

When establishing a system of internal control, nonfederal entities must take reasonable measures to safeguard protected personally identifiable information (PII) and other information that the federal awarding agency or pass-through entity designates as sensitive or that the nonfederal entity considers sensitive, consistent with applicable federal, state, local, and tribal laws regarding privacy and responsibility over confidentiality. Furthermore, auditees and auditors must ensure that their respective parts of the reporting package do not include protected PII.

> *Protected PII* refers to an individual's first name or first initial and last name in combination with any one or more types of information, including, but not limited to, the individual's Social Security number; passport number; credit card numbers; clearances; bank numbers; biometrics; date and place of birth; mother's maiden name; criminal, medical, and financial records; and educational transcripts. This does not include PII that is required by law to be disclosed.

Knowledge check

1. Which statement is accurate regarding a federal award?

    a. The auditee must comply with the terms and conditions of a federal award under all circumstances.
    b. The auditee is responsible for complying with either federal statutes and regulations or the terms and conditions of the award, depending on the type of federal award.
    c. As part of the federal award document, the federal awarding agency is required to communicate only the terms and conditions of the federal award because federal statutes and regulations must always be followed.
    d. As part of the federal award document, the federal awarding agency is required to communicate to the nonfederal entity all relevant public policy requirements and incorporate them either directly or by reference into the award.

2. How does the use of the terms *must* and *should* differ in the Uniform Guidance from their use in GAAS and *Government Auditing Standards*?

    a. The term *must* indicates a mandatory requirement in the Uniform Guidance, GAAS, and *Government Auditing Standards*. The term *should* indicates a best practice or recommendation in the Uniform Guidance, but indicates a mandatory requirement in GAAS and *Government Auditing Standards*.

    b. The term *must* indicates a mandatory requirement in the Uniform Guidance, GAAS, and *Government Auditing Standards*. The term *should* indicates a mandatory requirement in the Uniform Guidance, but indicates a best practice or recommendation in GAAS and *Government Auditing Standards*.

c. The terms *must* and *should* are used interchangeably in the Uniform Guidance, GAAS, and *Government Auditing Standards*.

d. The terms *must* and *should* are used in the same way in the Uniform Guidance, GAAS, and *Government Auditing Standards*. They do not differ depending on the guidance.

Resources and reference materials

The AICPA created the Governmental Audit Quality Center (GAQC), a voluntary membership organization for CPA firms and state audit organizations, to improve the quality and value of governmental audits. For purposes of the GAQC, *governmental audits* include compliance audits (referred to as *single audits*) performed under the Single Audit Act Amendments of 1996 and the Uniform Guidance; program-specific audits, as defined under the Uniform Guidance; and other compliance audits and attestation engagements performed as required by federal, state, or local laws and regulations. Governmental audits also include financial statement audits performed under *Government Auditing Standards* on entities such as states, local governments, nonprofit organizations, institutions of higher education, and certain for-profit organizations.

The GAQC keeps members apprised of the latest developments and gives them tools and information to help them better manage their audit practice. Some content on the GAQC's website may be restricted to GAQC members only.

For more information about the GAQC and other single audit resources, visit the links listed in the following table.

AICPA	Summaries of recent auditing and other professional standards as well as other AICPA activities	www.aicpa.org
Assistance Listings	An electronic searchable version of the Assistance Listing numbers useful for identifying or verifying these numbers	sam.gov
Department of Education, Office of Inspector General Non-Federal Audit Team	Provides sources, including various audit guides, to assist in the conduct and understanding of single audits and audits of student financial aid	www2.ed.gov/about/offices/list/oig/index.html
Chief Financial Officers Council	Addresses ARP funding.	www.cfo.gov
Department of Health and Human Services (HHS), Office of Inspector General	Provides information regarding HHS agencies and their programs, including inspections of grant programs	www.oig.hhs.gov

Department of Housing and Urban Development (HUD), Office of Inspector General	Among the items found on this website is the Consolidated Audit Guide for Audits of HUD Programs	www.hudoig.gov
Federal Audit Clearinghouse	Website used for submission of data collection forms; the repository of record for data collection forms and reporting packages	facweb.census.gov
Government Accountability Office	Policy and guidance materials (including *Government Auditing Standards* or the Yellow Books) and reports on federal agency major rules	www.gao.gov
GAQC	A membership center for firms and state audit organizations providing information and resources to those performing governmental audits	www.aicpa.org/topic/government
U.S. Government Publishing Office	Includes a comprehensive list of available official federal resources (and related links) and is the official online bookstore for government publications	www.gpo.gov
IGnet	Includes electronic versions of the audit review guidelines that the federal inspectors general use when reviewing selected single audits	www.ignet.gov
OMB *Compliance Supplement*	The OMB *Compliance Supplement*, updated annually, is required to be used when performing a compliance audit under the Uniform Guidance.	www.whitehouse.gov/omb/office-federal-financial-management

Summary

Key foundational points	
1.	The Uniform Guidance requires a single or program-specific audit for a nonfederal entity that expends $750,000 or more of federal awards in a fiscal year.
2.	A single audit encompasses an audit of the entity's financial statements and reporting on the SEFA and an audit of compliance with federal awards.
3.	Under the Single Audit Act and the Uniform Guidance, an auditor has additional testing and reporting responsibilities for compliance and internal control over compliance, beyond the responsibilities involved in a financial statement audit performed in accordance with GAAS and *Government Auditing Standards*.

Solutions

Advanced Topics in a Single Audit: Introduction to Single Audits

Knowledge check solutions

1.

   a. Incorrect. The auditee must comply with the terms and conditions of a federal award except when a term or condition is in conflict with federal statutes or regulations.
   b. Incorrect. The auditee is responsible for complying with federal statutes, regulations, and the terms and conditions of the federal awards. It is not one or the other depending on the award.
   c. Incorrect. Although terms and conditions of the award are required to be communicated, direct information or a reference to such information must also be made of the statutory and regulatory requirements that are applicable to the funding.
   d. Correct. The federal awarding agency is required to communicate to the nonfederal entity, directly or by reference, all relevant public policy requirements.

2.

a. Correct. The term *must* indicates a mandatory requirement in the Uniform Guidance, GAAS, and *Government Auditing Standards*. The term *should* indicates a best practice or recommendation in the Uniform Guidance, but indicates a mandatory requirement in GAAS and *Government Auditing Standards*.

b. Incorrect. Although the term *must* indicates a mandatory requirement in the Uniform Guidance, GAAS, and *Government Auditing Standards*, the term *should* is **not** used as described.

c. Incorrect. The terms *must* and *should* are **not** used interchangeably in the Uniform Guidance, GAAS, and *Government Auditing Standards*.

d. Incorrect. The terms *must* and *should* are **not** used in the same way in the Uniform Guidance, GAAS, and *Government Auditing Standards*. There are differences depending on the guidelines.

Advanced Topics in a Single Audit: Planning a Uniform Guidance Compliance Audit

Learning objectives

- Determine the application of auditing standards to a single audit.
- Evaluate planning considerations for a Uniform Guidance compliance audit.
- Apply planning considerations related to risk assessment.

Terms of engagement

In planning an audit to meet the requirements of Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), auditors need to consider matters ordinarily associated with an audit of financial statements in accordance with generally accepted auditing standards (GAAS) and additional considerations that relate to both financial statement audits performed under *Government Auditing Standards* and compliance audits performed under the Uniform Guidance. In any audit, the agreed upon terms of the audit engagement should be documented in an engagement letter or other suitable form of written agreement. AU-C section 210, *Terms of Engagement*,[1] describes the general requirements for this communication.

Government Auditing Standards

When engaged to perform an audit of financial statements in accordance with *Government Auditing Standards*, auditors may consider including the following in the engagement letter, as applicable:

- A description of the financial statements to be audited and of the reports the auditor expects to prepare and issue
- The reporting period
- The auditing standards and requirements that will be followed (that is, GAAS and *Government Auditing Standards*)
- A description of management's responsibility for the following:
  - Assuring the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework
  - Complying with applicable laws and regulations
  - Implementing systems designed to achieve compliance with applicable laws and regulations
  - Establishing and maintaining effective internal control to help ensure that appropriate goals and objectives are met, following laws and regulations, and ensuring that management and financial information is reliable and properly reported
  - Identifying and providing report copies of previous audits, attestation engagements, or other studies that directly relate to the objectives of the audit, including whether related recommendations have been implemented
  - Addressing the findings and recommendations of auditors and establishing and maintaining a process to track the status of such findings and recommendations
  - Taking timely and appropriate steps to remedy fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements that the auditor reports
- A description of management and auditor responsibilities for additional information that accompanies the basic financial statements; for example, supplementary information and required supplementary information

[1] All AU-C sections can be found in AICPA *Professional Standards*.

- The following items when nonaudit services are to be performed:
  - Objectives of the nonaudit service
  - Nonaudit services to be performed
  - Auditee's acceptance of its responsibilities, including a statement that it assumes all management responsibilities; that it oversees the nonaudit services by designating an individual, preferably within senior management, who possesses suitable skill, knowledge, or experience; that it evaluates the adequacy and results of the nonaudit services provided; and that it accepts responsibility for the results of the nonaudit services
  - The auditor's responsibilities
  - Any limitations of the nonaudit service
- Pertinent information that, in the auditor's professional judgment, needs to be communicated to individuals contracting for or requesting the audit and to those legislative committees, if any, that have ongoing oversight responsibilities for the auditee when the auditor is performing the audit pursuant to a law or regulation
- Report-distribution responsibilities, including which officials or organizations will receive the report and the steps to be taken to make the report available to the public when the audit organization is responsible for report distribution
- A statement that, subject to applicable laws and regulations, appropriate individuals as well as audit documentation, will be made available on request and in a timely manner to appropriate auditors and reviewers
- A statement that receipt of written representations related to management's responsibilities will be expected along with written representations required by other AU-C sections

Uniform Guidance compliance audit

In addition to the matters communicated as part of the financial statement audit performed in accordance with *Government Auditing Standards,* an engagement letter should include matters related to the Uniform Guidance compliance audit. The communication should include the planned work and level of assurance related to internal control over compliance and compliance with federal statutes, regulations, and the terms and conditions of federal awards necessary for an audit in accordance with the Uniform Guidance. Examples of the types of information that might be included in the communication when performing an audit in accordance with the Uniform Guidance follow:

- The objective of an audit in accordance with the Uniform Guidance
- A description of management's responsibility for the following:
  - Identifying all federal awards received and understanding and complying with the compliance requirements
  - Preparing the SEFA (including noncash assistance received and notes) in accordance with Uniform Guidance requirements
  - Designing, implementing, and maintaining effective internal controls over compliance that provide reasonable assurance that the entity administers federal awards in compliance with the compliance requirements
  - Complying with federal laws, statutes, regulations, rules, and provisions of contracts or grant agreements of federal awards
  - Following up and taking corrective action on audit findings, including the preparation of a summary schedule of prior audit findings and a corrective action plan
  - Submitting the reporting package and data collection form

- A description of the auditor's responsibility in a compliance audit of major programs under the Uniform Guidance, including the determination of major programs, consideration of internal control over compliance, and reporting responsibilities
- A statement that the objectives of the auditor are to obtain reasonable assurance about whether material noncompliance with the applicable compliance requirements occurred, whether due to fraud or error, and express an opinion on the entity's compliance based on the audit
  - State that reasonable assurance is a high level of assurance but is not absolute assurance and, therefore, is not a guarantee that an audit conducted in accordance with GAAS, Government Auditing Standards, and the Uniform Guidance will always detect material noncompliance when it exists.
  - State that the risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, because fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
  - State that noncompliance with the compliance requirements is considered material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about the entity's compliance with the requirements of the federal programs as a whole.
- A statement that, in performing an audit in accordance with GAAS, *Government Auditing Standards*, and the Uniform Guidance, the auditor's responsibilities are to
  - exercise professional judgment and maintain professional skepticism throughout the audit;
  - identify and assess the risks of material noncompliance, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the entity's compliance with compliance requirements subject to audit and performing such other procedures as the auditor considers necessary in the circumstances; and
  - obtain an understanding of the entity's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances, and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over compliance. Accordingly, no such opinion is expressed.
- A statement that the auditor is required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that the auditor identified during the audit
- A description of the additional reports required by the Uniform Guidance that the auditor is expected to prepare and issue, including any limitation on their use
- A statement that any supplementary schedules to be considered in the audit include the schedule of expenditures of federal awards (SEFA)
- A statement that management will make the auditor aware of significant contractor relationships in which the contractor is responsible for program compliance (so that the auditor can determine if additional procedures on contractor records will be necessary)
- A statement that the parties to whom audit documentation will be made available upon request include federal agencies and the U.S. Government Accountability Office (GAO)

Schedule of expenditures of federal awards

The auditor should obtain the agreement of management that it acknowledges and understands its responsibilities related to the SEFA, as follows:

- To prepare the SEFA in accordance with the Uniform Guidance
- To provide the auditor with certain written representations
- To include the auditor’s report on the SEFA in any document that contains the schedule and that indicates that the auditor has reported on such information
- To present the SEFA with the audited financial statements or, if the schedule will not be presented with the audited financial statements, to make the audited financial statements readily available to the intended users of the schedule no later than the date of issuance of the schedule and the auditor’s report thereon

Planning the Uniform Guidance compliance audit

Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. The engagement partner and other key members of the engagement team should be involved in planning the audit, including planning and participating in the discussion among engagement team members. The involvement of the engagement partner and other key members of the engagement team in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process. The engagement partner may delegate portions of the planning and supervision of the audit to other firm personnel. This course does not go into the fundamentals of planning. However, it is important for auditors to understand the key role that planning plays in performing a quality audit.

An important step in planning the Uniform Guidance compliance audit is the identification of additional audit requirements that are supplementary to GAAS and *Government Auditing Standards*. A compliance audit is based on the premise that management is responsible for identifying the entity's government programs and understanding and complying with the compliance requirements. As part of the compliance audit, the auditor should determine which of those government programs and compliance requirements to test in accordance with the Uniform Guidance.

The auditor must use the Office of Management and Budget *Compliance Supplement* (*Compliance Supplement*) as a primary source for identifying compliance requirements for federal programs in a Uniform Guidance compliance audit. For major programs included in the *Compliance Supplement*, the auditor first determines the types of compliance requirements that are identified as subject to audit in the *Compliance Supplement*. From those requirements subject to audit, the auditor then determines which might have a direct and material effect on a major program and tests those requirements. For programs not included in the *Compliance Supplement*, the auditor must follow the guidance in Part 7, "Guidance for Auditing Programs Not Included in This Compliance Supplement," of the *Compliance Supplement* to determine which types of compliance requirements to test. The auditor reviews federal award documents and referenced laws and regulations applicable to the program, the Assistance Listings, and the types of compliance requirements in Part 3, "Compliance Requirements," to identify the requirements subject to audit that are direct and material.

Government Auditing Standards considerations

The Uniform Guidance compliance audit is required to be performed in accordance with both GAAS and *Government Auditing Standards*.

Competence

Government Auditing Standards notes that the audit organization's management must assign auditors to perform the audit who, before beginning work on the audit, collectively possess the competence needed to address the audit objectives and perform the work in accordance with *Government Auditing Standards*.

Accordingly, the audit organization should have a process for recruitment, hiring, continuous development, assignment, and evaluation of personnel that assures the workforce has the essential knowledge, skills, and abilities necessary to conduct the audit. The nature, extent, and formality of the process will depend on factors such as the size of the audit organization, its structure, and its work.

The audit organization's management must assign auditors who, before beginning work on the audit, possess the competence needed for their assigned roles. *Government Auditing Standards* provides a listing of the technical knowledge, skills, and abilities needed when conducting an engagement in accordance with *Government Auditing Standards.* In addition, auditors performing financial audits should be knowledgeable in U.S. generally accepted accounting principles (GAAP) or with the applicable financial reporting framework being used and familiar with AICPA Statements on Auditing Standards (SASs); auditors should be competent in applying AICPA SASs to the audit work.

When assigning auditors to audit teams, audit organizations may consider the level of proficiency needed for each role. On *Government Auditing Standards* audits, roles generally include the following:

- *Nonsupervisory auditors*. Auditors in these roles plan or perform audit procedures. Work situations for these auditors are characterized by low levels of ambiguity, complexity, and uncertainty. The nonsupervisory role necessitates at least a basic level of proficiency.
- *Supervisory auditors*. Auditors in these roles plan audits, perform audit procedures, or direct audits. Work situations for these auditors are characterized by moderate levels of ambiguity, complexity, and uncertainty. The supervisory auditor role necessitates at least an intermediate level of proficiency.
- *Partners and directors*. Auditors in these roles plan audits, perform audit procedures, or direct or report on audits. Partners and directors also may be responsible for reviewing engagement quality prior to issuing the report, for signing the report, or both. Work situations for these auditors are characterized by high levels of ambiguity, complexity, and uncertainty. The partner and director role necessitates an advanced level of proficiency.

Government Auditing Standards provides definitions for key terms used when assigning roles such as planning, directing, performing audit procedures, and reporting.

Auditors engaged to perform financial audits in the United States in accordance with *Government Auditing Standards* who do not work for a government audit organization should be licensed CPAs, persons working for licensed CPA firms, or licensed accountants in states that have multiclass licensing systems that recognize licensed accountants other than CPAs.

In addition to auditors, some audits may necessitate the use of specialists skilled in applying specialized techniques or methods. The audit team should determine that specialists assisting the audit team on a *Government Auditing Standards* audit are qualified and competent in their areas of specialization. *Government Auditing Standards* provides additional information on the use of specialists and on evaluating their competency and professional qualifications. Individuals with special skills or knowledge related to specialized areas *within* the field of accounting or auditing — such as income taxation and information technology — are not considered specialists; these individuals are considered auditors.

Continuing professional education

Auditors who plan, direct, perform audit procedures for, or report on an audit conducted in accordance with *Government Auditing* Standards should develop and maintain their professional competence by completing at least 80 hours of continuing professional education (CPE) in every two-year period, as follows:

- Twenty-four CPE hours should be in subject matter directly related to the government environment, government auditing, or the specific or unique environment in which the auditee operates.
- Fifty-six CPE hours should be in subject matter that directly enhances an auditor's professional expertise to conduct audits.

The subject matter categories for the 24-hour CPE requirement may be used to satisfy the 56-hour CPE requirement. CPE used to fulfill the 24-hour requirement may be taken at any time during the two-year period. However, auditors should complete at least 20 hours of CPE in each year of the two-year period.

An audit organization may exempt auditors from the 56-hour CPE requirement — but not from the 24-hour requirement — if those auditors (*a*) charge less than 20% of their time annually to *Government Auditing Standards* audits; (*b*) are involved only in performing audit procedures; and (*c*) are not involved in planning, directing, or reporting on the audit. Auditors hired or initially assigned to audits performed in accordance with *Government Auditing Standards* after the beginning of an audit organization's 2-year CPE period may complete a prorated number of CPE hours. The audit organization may exempt nonsupervisory auditors from all CPE requirements listed in *Government Auditing Standards* if those nonsupervisory auditors charge fewer than 40 hours of their time annually to audits conducted in accordance with *Government Auditing Standards*.

Independence

Government Auditing Standards notes that, in all matters relating to *Government Auditing Standards* audit work, the auditors and audit organizations must be independent from an auditee. Auditors and audit organizations should avoid situations that could lead reasonable and informed third parties to conclude that the auditors and audit organizations are not independent and therefore incapable of exercising objective and impartial judgment on all issues associated with conducting the audit and reporting on the work. If independence is impaired, auditors should decline to accept an audit or should terminate an audit in progress. Except under the limited circumstances discussed in *Government Auditing Standards*, auditors should be independent from an auditee during

- any period of time that falls within the period covered by the financial statements or subject matter of the audit; and
- the period of the professional engagement, which begins when the auditors either sign an initial engagement letter or other agreement to perform an audit or begin to perform an audit, whichever is earlier.

The *period of the professional engagement* lasts for the entire duration of the professional relationship (which, for recurring audits, could cover many periods) and ends with the formal or informal notification, either by the auditors or the auditee, of the termination of the professional relationship or by the issuance of a report, whichever is later. Accordingly, the period of professional engagement does not necessarily end with the issuance of a report and recommence with the beginning of the following year's audit or a subsequent audit with a similar objective.

Government Auditing Standards establishes a conceptual framework that auditors use to identify, evaluate, and apply safeguards to address threats to independence. The conceptual framework helps auditors maintain both independence of mind and independence in appearance. The framework can be applied to many different circumstances that create threats to independence. It allows auditors to address threats to independence that result from activities not specifically prohibited by *Government Auditing Standards*.[2] Auditors should apply the conceptual framework at the audit organization, audit team, and individual auditor levels to

- identify threats to independence;
- evaluate the significance of the threats identified, both individually and in the aggregate; and
- apply safeguards as necessary to eliminate the threats or reduce them to an acceptable level.

Auditors should use professional judgment when applying the conceptual framework and should conclude that their independence is impaired if no safeguards have been effectively applied to eliminate an unacceptable threat or reduce it to an acceptable level. If independence is impaired, the auditor should decline to accept an audit or should terminate an audit in progress. Auditors should reevaluate threats to independence, including any safeguards applied, whenever the audit organization or auditors become aware of new information or changes in facts or circumstances that could affect whether a threat has been eliminated or reduced to an acceptable level.

Under *Government Auditing Standards*, the conceptual framework is used to evaluate threats to independence when making decisions on conditions or activities that are not specifically prohibited by *Government Auditing Standards*. The AICPA conceptual framework should be used when making decisions on independence matters that are not explicitly addressed by the Code of Professional Conduct. Consequently, the *Government Auditing Standards* conceptual framework will be used more often than the AICPA conceptual framework.

When applying the *Government Auditing Standards* conceptual framework, auditors should evaluate the following broad categories of threats to independence:

- *Self-interest threat*. This is the threat that a financial or other interest will inappropriately influence an auditor's judgment or behavior.
- *Self-review threat*. This is the threat that an auditor or audit organization that has provided nonaudit services will not appropriately evaluate the results of previous judgments made or services provided as part of nonaudit services when forming a judgment significant to a *Government Auditing Standards* audit.
- *Bias threat*. This is the threat that an auditor will, because of political, ideological, social, or other convictions, take a position that is not objective.
- *Familiarity threat*. This is the threat that aspects of a relationship with management or personnel of an auditee, such as a close or long relationship, or that of an immediate or close family member, will lead an auditor to take a position that is not objective.
- *Undue influence threat*. This is the threat that influences or pressures from sources external to the audit organization will affect an auditor's ability to make objective judgments.
- *Management participation threat*. This is the threat that results from an auditor taking on the role of management or otherwise performing management functions on behalf of the auditee, which will lead an auditor to take a position that is not objective.

[2] See the exhibit "*Government Auditing Standards* conceptual framework for independence."

- *Structural threat*. This is the threat that an organization's placement within a government entity, in combination with the structure of the government entity being audited, will affect the audit organization's ability to perform work and report results objectively.

Threats to independence may be created by a wide range of relationships and circumstances. Circumstances that result in a threat to independence in one threat category may create additional threats. *Government Auditing Standards* provides examples of circumstances that create various types of threats for auditors.

Nonaudit services

Auditors traditionally have provided a range of nonaudit services to entities for which they also perform audits. Providing nonaudit services may create threats to the independence of an auditor or audit organization. *Government Auditing Standards* provides information and guidance related to the performance of nonaudit services, including the evaluation of threats to independence and examples of safeguards that may address those threats. In addition, those standards set forth specific nonaudit services that *always* impair independence with respect to auditees.

Auditors may be able to provide nonaudit services in the broad areas discussed in *Government Auditing Standards* without impairing independence if

- the nonaudit services are not expressly prohibited in *Government Auditing Standards*;
- the auditors have determined that the requirements of *Government Auditing Standards* for providing nonaudit services have been met; and
- any significant threats to independence have been eliminated or reduced to an acceptable level through the application of safeguards.

Auditors should use the conceptual framework to evaluate independence given the facts and circumstances of individual services not specifically prohibited in *Government Auditing Standards*.

Government Auditing Standards notes that routine activities performed by auditors that relate directly to the performance of an audit are not considered nonaudit services and gives examples of some of these routine activities. It is important to note that activities such as financial statement preparation, cash to accrual conversions, and reconciliations are considered nonaudit services under both *Government Auditing Standards* and GAAS and are not considered routine activities related to the performance of an audit. Such services are evaluated using the conceptual framework.

Audit organizations in government entities frequently provide services that differ from the traditional professional services that an accounting or consulting firm provides to or for an auditee. These types of services are often provided in response to a statutory requirement, at the discretion of the authority of the audit organization, or to an engaging party (such as a legislative oversight body or an independent external organization) rather than a responsible party and would generally not create a threat to independence. *Government Auditing Standards* provides examples of such services.

Before auditors agree to provide a nonaudit service to an audited entity, they should determine whether providing such a service would create a threat to independence, either by itself or in aggregate with other nonaudit services provided, with respect to any *Government Auditing Standards* audit they conduct. A critical component of this determination is consideration of management's ability to effectively oversee the nonaudit service to be performed. Before auditors agree to provide nonaudit services to an auditee that the auditee's management requested and that could create a threat to independence either by themselves or in aggregate with other nonaudit services provided, with respect to any *Government Auditing Standards* audit they conduct, auditors should determine whether the audited entity has designated an individual who possesses suitable skill, knowledge, or experience, and that the individual understands the services to be provided sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or reperform the services. Auditors should document their consideration of management's ability to effectively oversee nonaudit services to be provided, regardless of whether any threats to independence are determined to be significant. *Government Auditing Standards* explains that 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. If an auditee does not have suitable skill, knowledge, or experience as it relates to the service, then independence would be impaired if the nonaudit service were performed.

Auditors should conclude that management responsibilities that the auditors perform for an auditee are impairments to independence. If the auditors were to assume management responsibilities for an auditee, the management participation threats created would be so significant that no safeguards could reduce them 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. Whether an activity is a management responsibility depends on the facts and circumstances; auditors exercise professional judgment in identifying these activities. *Government Auditing Standards* provides examples of activities considered management responsibilities that would, therefore, impair independence if performed for an auditee.

Auditors that provide nonaudit services to auditees should obtain agreement from auditee management that auditee management performs the following functions in connection with the nonaudit services:

- Assumes all management responsibilities
- Oversees the services by designating an individual, preferably within senior management, who possesses suitable skill, knowledge, or experience
- Evaluates the adequacy and results of the services provided
- Accepts responsibility for the results of the services

In cases where the auditee is unable or unwilling to assume these responsibilities (for example, the auditee does not have an individual with suitable skill, knowledge, or experience to oversee the nonaudit services provided or is unwilling to perform such functions because of a lack of time or desire), auditors should conclude that the provision of these services is an impairment to independence.

In connection with nonaudit services, auditors should establish and document their understanding with auditee management or those charged with governance, as appropriate, regarding the following:

- Objectives of the nonaudit service
- Services to be provided
- Auditee's acceptance of its responsibilities
- The auditors' responsibilities
- Any limitations on the provision of nonaudit services

Preparing accounting records and financial statements

Under *Government Auditing Standards*, management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; this is true even if the auditor assisted in drafting those financial statements. Consequently, auditors who accept responsibility for the preparation and fair presentation of financial statements that they will subsequently audit or that will otherwise be the subject matter of an audit would impair the auditor's independence. Auditors should conclude that the following services involving preparation of accounting records impair independence with respect to an auditee:

- 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

Auditors should conclude that preparing financial statements in their entirety from a client-provided trial balance or underlying accounting records creates significant threats to their independence; auditors should document such threats along with safeguards they have applied to eliminate and reduce threats to an acceptable level in accordance with *Government Auditing Standards* or should decline to provide the services.[3]

Auditors should identify as threats to independence any services related to preparing accounting records and financial statements, other than those defined as impairments to independence and significant threats in *Government Auditing Standards*. These services include the following:

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

Determining whether providing such services, as discussed in *Government Auditing Standards*, are significant threats and require safeguards is a matter of professional judgment. In evaluating the significance of the threats created by providing those services, an auditor can consider factors such as 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 amounts or treatment for those matters reflected in the financial statements, and the extent of the auditee's involvement in determining significant matters of judgment. *Government Auditing Standards* indicates that providing clerical assistance — such as typing, formatting, printing, and binding financial statements — is unlikely to be a significant threat. Auditors are required under *Government Auditing Standards* to evaluate the significance of threats to independence created by providing those services and to document this evaluation.

Auditors who previously provided nonaudit services for an entity that is a prospective subject of an audit should evaluate the effect of those nonaudit services on independence before agreeing to conduct a

[3] See the exhibit "Independence considerations for preparing accounting records and financial statements."

Government Auditing Standards audit. If auditors provided a nonaudit service in the period covered by the audit, they should (1) determine if *Government Auditing Standards* expressly prohibits the nonaudit service; (2) if auditee management requested the nonaudit service, determine whether the skills, knowledge, or experience of the individual responsible for overseeing the nonaudit service were sufficient; and (3) determine whether a threat to independence exists and address any such threats in accordance with the conceptual framework. Nonaudit services provided by auditors can affect independence of mind and in appearance in periods after the nonaudit services were provided.

Auditors in a government entity may be required to provide a nonaudit service that impairs the auditors' independence with respect to a required audit. If, because of constitutional or statutory requirements over which they have no control, the auditors can neither implement safeguards to reduce the resulting threat to an acceptable level nor decline to provide or terminate a nonaudit service that is incompatible with audit responsibilities, auditors should disclose the nature of the threat that could not be eliminated or reduced to an acceptable level and modify the *Government Auditing Standards* compliance statement as discussed therein. Determining how to modify the *Government Auditing Standards* compliance statement in these circumstances is a matter of professional judgment.

Documentation of independence

Although insufficient documentation of an auditor's compliance with the independence standard does not itself impair independence, auditors should prepare appropriate documentation under *Government Auditing Standards* quality control and assurance requirements. *Government Auditing Standards* includes the following documentation requirements, where applicable:

- Document threats to independence that require the application of safeguards, along with safeguards applied, in accordance with the conceptual framework for independence.
- Document the safeguards required by *Government Auditing Standards* if an audit organization is structurally located within a governmental entity and is considered structurally independent based on those safeguards.
- Document consideration of auditee management's ability to effectively oversee a nonaudit service to be provided by the auditor.
- Document the auditor's understanding with an audited entity for which the auditor will perform a nonaudit service.
- Document the evaluation of the significance of any threats created by providing any of the services discussed in *Government Auditing Standards*.

The consideration of independence is especially important when the auditor performs nonaudit services to the auditee.

Exhibit: *Government Auditing Standards* conceptual framework for independence

Figure 1 in chapter 3 of *Government Auditing Standards* includes the following flowchart to assist auditors in the application of the conceptual framework for independence. (Figure 2 referenced in this exhibit is the subsequent exhibit, "Independence considerations for preparing accounting records and financial statements.")

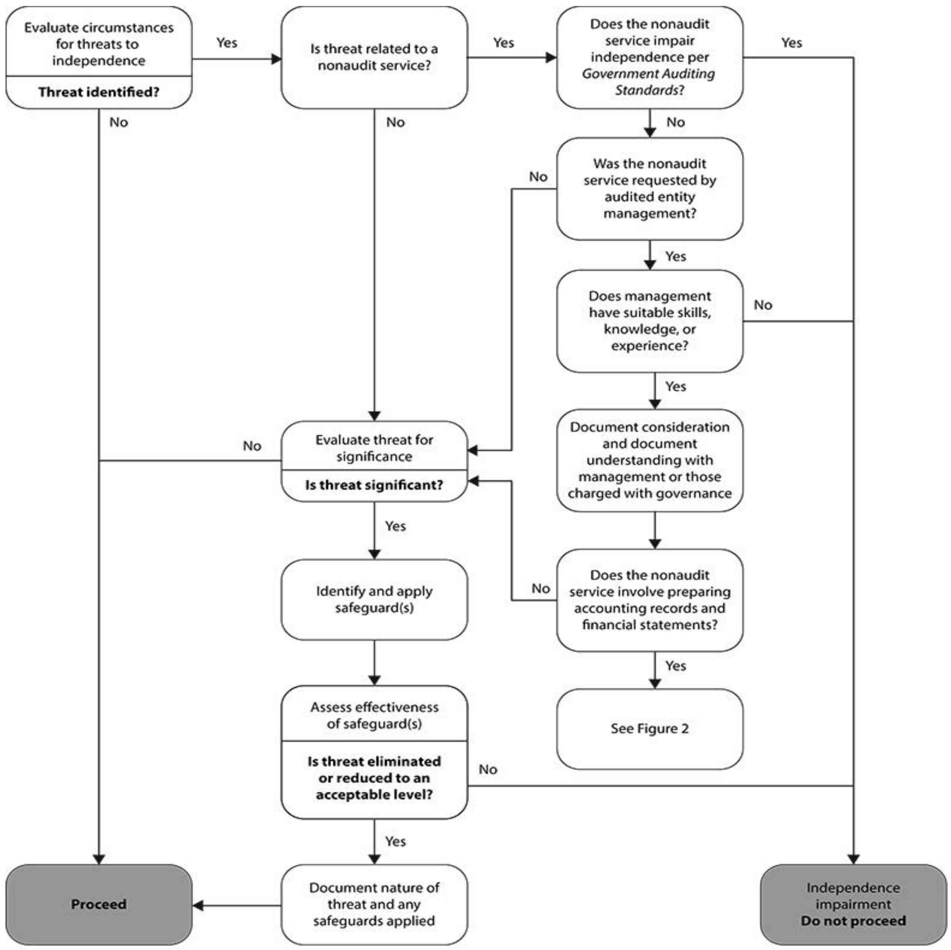
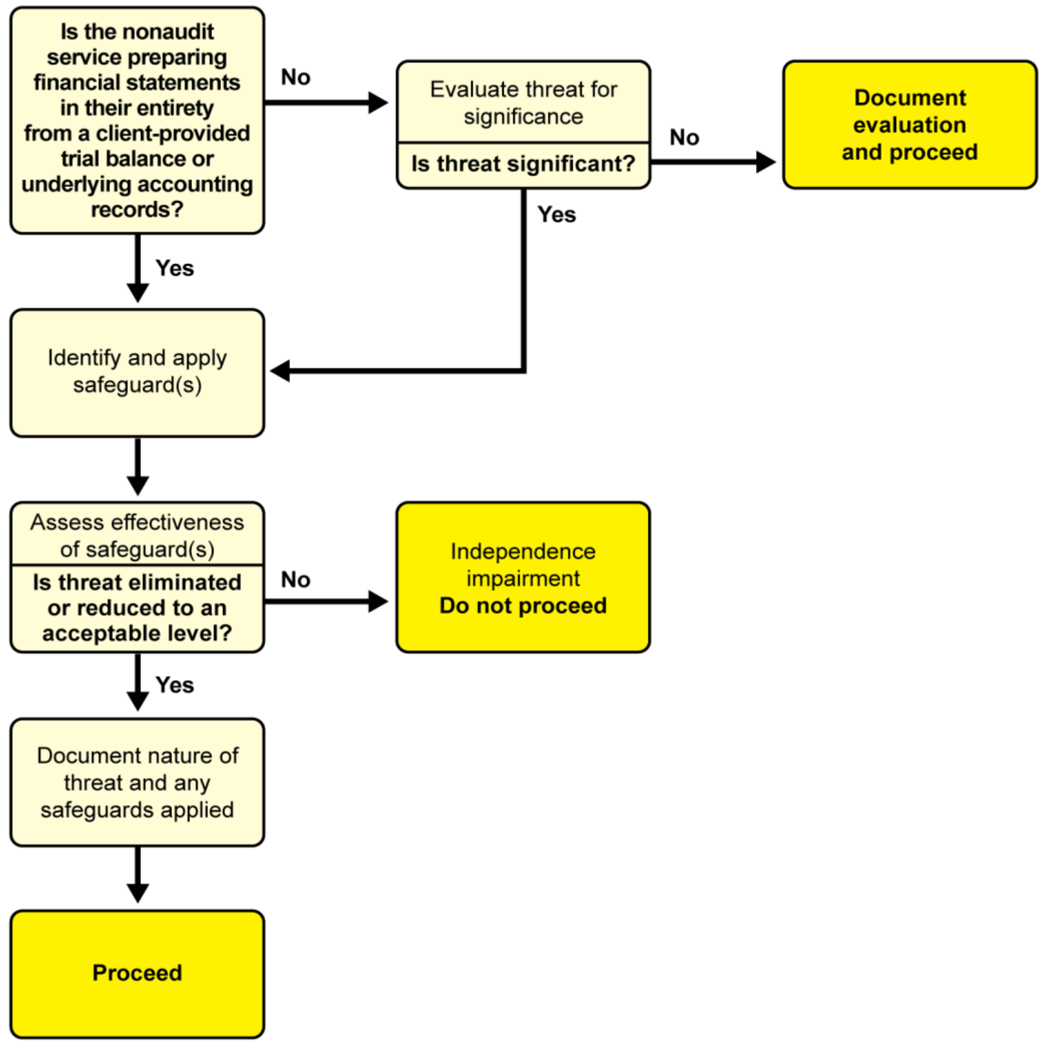


Exhibit: Independence considerations for preparing accounting records and financial statements

Figure 2 in chapter 3 of *Government Auditing Standards* provides a flowchart to assist auditors with the independence considerations for preparing accounting records and financial statements. This flowchart is used for services not expressly prohibited by *Government Auditing Standards*.



Source: GAO. | GAO-18-568G

The course "Yellow Book: Staying Compliant With *Government Auditing Standards*," presents guidance for engagements conducted in accordance with *Government Auditing Standards*.

Knowledge check

1. What is the role of the engagement partner when planning a Uniform Guidance compliance audit?

    a. Does not need to be involved.
    b. Should be involved and may delegate some of the responsibilities for planning.
    c. Must be involved in all aspects of planning the audit.
    d. Is required to perform certain procedures related to planning.

2. What is the role of a supervisory auditor as defined by *Government Auditing Standards*?

    a. Having work situations with low levels of ambiguity.
    b. Reporting on audits.
    c. Reviewing engagement quality prior to issuing the report.
    d. Having moderate levels of ambiguity, complexity, and uncertainty.

3. Of the 80 hours of CPE in every 2-year period required of auditors who plan, direct, perform audit procedures for, or report on an audit conducted in accordance with *Government Auditing Standards,* how many hours should be in subject matter directly related to the government environment, government auditing, or the specific unique environment in which the auditee operates?

    a. 80.
    b. 56.
    c. 40.
    d. 24.

4. As it relates to independence, which is ***not*** required to be documented under *Government Auditing Standards*?

    a. Threats to independence, along with the safeguards applied.
    b. Safeguards required if an audit organization is structurally located within a governmental entity and is considered independent based on those safeguards.
    c. The auditor's understanding with an auditee for which the auditor will perform a nonaudit service.
    d. Consideration of management's ability to perform the nonaudit service.

Defining the entity

What is a nonfederal entity?

A *nonfederal entity* is defined in the Uniform Guidance as a state, local government, Indian tribe, institution of higher education, or nonprofit organization that carries out a federal award as a recipient or subrecipient.

One of the initial tasks during the planning process of a single audit is determining whether management has properly defined the entity to be audited. The Uniform Guidance explains that the audit must cover the entire operations of the auditee, or, at the option of the auditee, such audit must include a series of audits that cover an auditee's departments, agencies, and other organizational units that expended or otherwise administered federal awards during the audit period. If an auditee elects this option, each audit must encompass the financial statements and the schedule of expenditures of federal awards for each such department, agency, or other organizational unit, which must be considered a nonfederal entity. The financial statements and schedule of expenditures of federal awards must be for the same audit period. In these circumstances, the nonfederal entity-wide financial statements may also include the departments, agencies, or other organizational units that have separate audits and prepare separate financial statements.

For example, if a local government has its school districts audited separately, it would be acceptable for the local government's financial statements to include the school districts, even though the school districts were not included in the local government's Uniform Guidance compliance audit (and, consequently, the schedule of expenditures of federal awards for the local government did not include the school districts' federal awards) because a separate Uniform Guidance compliance audit was conducted on the school districts. However, if separate financial statements were not prepared for the school districts, it would be unacceptable for a separate Uniform Guidance compliance audit to be conducted on the school districts (that is, the local government's entity-wide financial statements could not be used as a substitute for separate financial statements for the school districts).

Group audit considerations in the compliance audit

The requirements of AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, address special considerations that apply to group audits of financial statements that include the financial information of more than one component (that is, group financial statements). AU-C section 600 is, in part, intended to address the audit risk that results from the aggregation of component financial information (referred to here as *aggregation risk*). It also establishes requirements for when it is appropriate to refer to a component auditor in the auditor's report on the financial statements. In accordance with AU-C section 935, *Compliance Audits*, the auditor should use professional judgment to adapt and apply the provisions in the AU-C sections to meet the objective of a compliance audit. Therefore, it will be necessary for the auditor to use professional judgment when adapting and applying the provisions of AU-C section 600 to a Uniform Guidance compliance audit because of the differing nature and objectives of such an engagement.

The concept of aggregation risk in AU-C section 600 is not directly applicable to Uniform Guidance compliance audits because each major program is being opined on separately. Unlike in a financial statement audit, there is no entity-wide opinion on compliance in a Uniform Guidance compliance audit. Additionally, even when a major program is administered by multiple organizational units, locations, or branches within a major program because the focus of the Uniform Guidance compliance audit is attribute-based (that is, there is either compliance or noncompliance), the concepts of aggregation risk and component materiality as contemplated in AU-C section 600 would not be relevant. Instead, the auditor may have additional sampling considerations in this situation. Therefore, as a result of the unique nature of a Uniform Guidance compliance audit, the concept of a component in AU-C section 600 generally should be applied only when other auditors have been separately engaged to perform a portion of a Uniform Guidance compliance audit. In those cases, the auditor should follow the guidance in AU-C section 600 as it relates to other auditors (that is, component auditors), including considerations of whether to make reference to the other auditors in the auditor's report on compliance and on internal control over compliance.

Governmental entities and entities that receive governmental assistance may engage independent accounting firms on a joint venture or subcontract basis. This sometimes occurs due to legal or contractual requirements to make positive efforts to use small businesses, minority-owned firms, and women-owned business enterprises. Referring to other auditors in these circumstances is usually not appropriate. In the case of a joint audit, each auditor participating in the audit will sign the audit reports. The guidance in AU-C section 600 is appropriate only when each auditor or firm has complied with GAAS and *Government Auditing Standards* and is in a position that would justify being the only signatory of the report. In the case of a subcontract relationship, the subcontracting auditor often does not issue a separate report. Therefore, without a separate report, it would also not be appropriate to refer to the subcontracting auditor.

Note: SAS No. 149, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)* was issued in March 2023. SAS No. 149 removes the applicability of AU-C 600 by directly addressing the auditor's requirements for aggregation risk in compliance audits. SAS No. 149 is effective for audit periods ending on or after December 15, 2026.

Considerations related to the internal audit function

There are additional considerations in a Uniform Guidance compliance audit when a nonfederal entity has an internal audit function. AU-C section 610, *Using the Work of Internal Auditors*, states that the external auditor (auditor) has sole responsibility for the audit opinion expressed and that responsibility is not reduced by the external auditor's use of the work of the internal audit function. In the situation where the nonfederal entity has an internal audit function and the auditor expects to use the work of internal auditors to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the auditor, the objectives of the external auditor are as follows:

- Determine whether to use the work of the internal audit function in obtaining audit evidence or to use internal auditors to provide direct assistance and, if so, in which areas and to what extent.
- If using the work of the internal audit function in obtaining audit evidence, determine whether that work is adequate for purposes of the audit.
- If using internal auditors to provide direct assistance, appropriately direct, supervise, and review their work.

When gaining an understanding of internal control, the auditor should obtain an understanding of the internal audit function sufficient to identify internal audit activities relevant to planning the audit. The work of internal auditors may affect the nature, timing, and extent of the procedures the auditor performs (*a*) to obtain an understanding of the entity and its environment, including its internal control over compliance; (*b*) to assess risk; and (*c*) in response to the assessed risk. In obtaining an understanding of the internal audit function as it relates to compliance requirements in a Uniform Guidance compliance audit, the following may be helpful in assessing the relevance of internal audit activities:

- Consideration of knowledge from prior-year audits
- Review of how internal auditors allocate their audit resources to compliance activities

- Review of internal audit reports to obtain detailed information about the scope of internal audit activities as it relates to compliance with compliance requirements subject to audit that are direct and material

Using the work of the internal auditor in obtaining audit evidence

The external auditor may be able to use the work of the internal audit function in obtaining audit evidence. This depends on

- the level of competency of the internal audit function;
- whether the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; and
- whether the function applies a systematic and disciplined approach, including quality control.

In making judgments about the extent of the effect of the internal auditor's work on the auditor's procedures over compliance requirements subject to audit that are direct and material, the auditor considers both the risks of material noncompliance (comprising inherent risk of noncompliance and control risk of noncompliance) and the degree of subjectivity involved in the evaluation of the audit evidence gathered in support of compliance with compliance requirements subject to audit that are direct and material. As either the degree of risk of material noncompliance rises or the degree of subjectivity increases, so increases the need for the auditor to perform tests in addition to the internal auditor's tests.

In cases where the work of internal auditors significantly affects the nature, timing, and extent of the auditor's procedures, the auditor should perform procedures to evaluate the quality and effectiveness of the internal auditor's work. In making this evaluation, the auditor should test some of the internal auditor's work relating to each compliance requirement subject to audit that is direct and material. These tests may be accomplished by either (*a*) examining some of the controls or transactions examined or compliance requirements tested by the internal auditor or (*b*) examining similar controls or transactions not actually examined or compliance requirements not actually tested by the internal auditor. In reaching conclusions about the internal auditor's work, the results of the auditor's tests should be compared with the results of the internal auditor's work. This evaluation of the internal auditor's work will assist the auditor in determining the nature, timing, and extent of further audit procedures.

As noted in AU-C section 610, and as it relates to a compliance audit, the more judgment involved, the higher the assessed risk of material noncompliance, the less the internal audit function's organization status and relevant policies and procedures adequately support the objectivity of the internal auditors, or the lower the level of competence of the internal audit function, the more audit procedures are needed to be performed by the external auditor on the overall body of work of the internal audit function to support the decision to use the work of the function in obtaining sufficient appropriate audit evidence on which to base the opinion.

When using the work of the internal audit function, the external auditor should make all significant judgments in the audit engagement. The auditor should evaluate whether, in aggregate, using the work of the internal audit function in obtaining audit evidence to the extent planned, together with any planned use of internal auditors to provide direct assistance, would result in the auditor still being sufficiently involved in the audit, given the auditor's sole responsibility for the audit opinion expressed.

Using internal auditors to provide direct assistance to the auditor

In performing the single audit, the auditor may request direct assistance from the internal auditors. *Direct assistance* relates to the use of internal auditors to perform procedures under the direction, supervision, and review of the auditor. For example, internal auditors may assist the auditor in obtaining an understanding of internal control over compliance or performing tests of controls or tests of compliance. Prior to using internal auditors to provide direct assistance, the auditor should obtain written acknowledgment from management or those charged with governance, as appropriate, that internal auditors providing direct assistance will be allowed to follow the auditor's instructions and that the entity will not intervene in the work the internal auditors are providing to the auditor. The auditor should direct, supervise, and review the work performed by internal auditors on the engagement in accordance with AU-C section 220, *Quality Control for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards*. AU-C section 610 provides requirements regarding documentation when using the work of the internal audit function or using internal auditors to provide direct assistance on the audit.

AU-C section 610 also provides information on determining the nature and extent of work that can be assigned to internal auditors providing direct assistance. When direct assistance is provided, the auditor should assess the internal auditor's competence and objectivity and supervise, review, evaluate, and test the work performed by internal auditors to the extent appropriate in the circumstances. The auditor should inform the internal auditors of their responsibilities, the objectives of the procedures they are to perform, and matters that may affect the nature, timing, and extent of audit procedures, such as possible compliance and auditing issues. The auditor should also inform the internal auditors that all significant compliance and auditing issues identified during the audit should be brought to the auditor's attention.

State and local compliance requirements

In addition to testing and reporting on the compliance requirements as provided by *Government Auditing Standards* and the Uniform Guidance, there may be state-imposed requirements on state funds provided to political subdivisions or not-for-profit entities (in this example, the state is not a pass-through entity). Even though such nonfederal awards are not considered part of the total federal awards expended by the auditee and are not subject to audit in accordance with the Uniform Guidance, in a single audit the auditor would still need to consider such laws and regulations under GAAS and *Government Auditing Standards*. Therefore, in connection with the financial statement audit, auditors should obtain an understanding of applicable state and local compliance and reporting requirements that have a direct and material effect on the financial statements being audited.

The auditor may be engaged separately to perform work regarding state and local compliance requirements due to the nonfederal entity's reporting responsibilities related to those awards.

Planning considerations related to risk assessment

An important part of planning a Uniform Guidance compliance audit is the planning related to identifying and assessing risk. Risk assessment provides auditors with information regarding potential areas of risk as it relates to noncompliance with federal statutes, regulations, and the terms and conditions of federal awards. It also helps auditors determine the nature and extent of compliance testing to perform related to assessed risks, therefore allowing the auditor to focus on riskier areas.

Audit risk of noncompliance

Audit risk of noncompliance is the risk that the auditor expresses an inappropriate audit opinion on the entity's compliance when material noncompliance exists. The requirements and guidance related to an auditor's consideration of the audit risk of noncompliance and materiality when planning and performing a compliance audit are found in AU-C section 935 and AU-C section 320, *Materiality in Planning and Performing an Audit*. Audit risk of noncompliance and materiality, among other matters, need to be considered together for each major program being audited as well as for each compliance requirement subject to audit that is direct and material in determining the nature, timing, and extent of audit procedures and in evaluating the results of those procedures.

The Uniform Guidance states that the auditor must determine whether the auditee has complied with federal statutes, regulations, and the terms and conditions of federal awards subject to audit that may have a direct and material effect on each of its major programs. Therefore, in developing an audit plan for a single audit, the auditor should assess both the risk that noncompliance may have a material effect on the financial statements and the risk that noncompliance may have a material effect on each major program.

Components of audit risk of noncompliance

Audit risk of noncompliance is a function of the risk of material noncompliance and the detection risk of noncompliance.

Risk of material noncompliance

Risk of material noncompliance is the risk that material noncompliance exists before the audit. It consists of inherent risk of noncompliance and control risk of noncompliance.

> *Inherent risk of noncompliance*. This is the susceptibility of a major program's compliance requirements to noncompliance that could be material, either individually or when aggregated with other instances of noncompliance before consideration of any related controls over compliance.
>
> *Control risk of noncompliance*. This is the risk that noncompliance with a compliance requirement that could occur and that could be material to a major program, either individually or when

> aggregated with other instances of noncompliance, will not be prevented, or detected and corrected, on a timely basis by the entity’s internal control over compliance.

Detection risk of noncompliance

Detection risk of noncompliance is managed by the auditor’s response to the risks of material noncompliance.

> *Detection risk of noncompliance.* This is the risk that the procedures performed by the auditor to reduce audit risk of noncompliance to an acceptably low level will not detect noncompliance that exists and that could be material to a major program, either individually or when aggregated with other instances of noncompliance.

In determining an acceptable level of detection risk of noncompliance, auditors consider their assessments of inherent risk of noncompliance and control risk of noncompliance and the extent to which they seek to restrict the audit risk of noncompliance related to the major program. As assessed inherent risk of noncompliance or control risk of noncompliance decreases, the acceptable level of detection risk of noncompliance increases. The auditor may alter the nature, timing, and extent of the compliance tests performed based on the assessments of inherent risk of noncompliance and control risk of noncompliance.

Performing risk assessment procedures

As part of planning, the auditor should perform risk assessment procedures to obtain a sufficient understanding of the compliance requirements subject to audit that are direct and material and the entity’s internal control over compliance with those compliance requirements. Risk assessment should be done for each of the major programs and compliance requirements subject to audit that are direct and material selected for testing. This establishes a frame of reference within which the auditor plans the compliance audit and exercises professional judgment about assessing risks of material noncompliance and responding to those risks throughout the compliance audit.

When performing risk assessment procedures, the auditor should inquire of management about whether there are findings and recommendations in reports or other written communications resulting from previous audits, attestation engagements, and internal or external monitoring that directly relate to the objectives of the compliance audit. The auditor should gain an understanding of management’s response to findings and recommendations that could have a material effect on the entity’s compliance with the applicable compliance requirements. This information should be used to identify and assess risks of material noncompliance and determine the nature, timing, and extent of the audit procedures for the compliance audit, including determining the extent to which testing the implementation of any corrective actions is applicable to the audit objectives. These procedures are performed to assist the auditor in understanding whether management responded appropriately to such findings.

AU-C section 935 states that the auditor should identify and assess the risks of material noncompliance whether due to fraud or error for each applicable compliance requirement and should consider whether any of those risks are pervasive to the entity’s compliance. If the risks are pervasive, they may affect the entity’s compliance with many compliance requirements. Examples of situations in which there may be a risk of material noncompliance that is pervasive to the entity's noncompliance are (*a*) an entity that is experiencing financial difficulty and for which there is an increased risk that grant funds will be diverted for unauthorized purposes and (*b*) an entity that has a history of poor recordkeeping for its federal programs.

As part of a Uniform Guidance compliance audit, members of the audit team (including the auditor with final responsibility for the audit) should discuss the susceptibility of the entity's major programs to material noncompliance with compliance requirements in the planning meeting of the financial statement audit. This discussion may also be held separately from the general planning meeting if the planning of the Uniform Guidance compliance audit is done at a later date.

In identifying and assessing the risks of material noncompliance, the auditor should

- identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks;
- relate the identified risks to what can go wrong at the relevant compliance level;
- consider whether the risks are of a magnitude that could result in noncompliance with requirements subject to audit that have a direct and material effect on one or more of the entity's major programs; and
- consider the likelihood that the risks could result in noncompliance with requirements subject to audit that have a direct and material effect on one or more of the entity's major programs.

The process of assessing inherent risk of noncompliance and control risk of noncompliance provides audit evidence about the risk that material noncompliance may exist. The auditor uses this audit evidence as part of the basis for the opinion on compliance. It is important to note that AU-C section 935 states that risk assessment procedures, tests of controls, and analytical procedures alone are not sufficient to address a risk of material noncompliance. Furthermore, the Uniform Guidance requires compliance testing to include tests of transactions and such other auditing procedures necessary to provide the auditor with sufficient appropriate audit evidence to support an opinion on compliance. This compliance testing serves to limit detection risk of noncompliance.

Identifying and assessing the risk of material noncompliance due to fraud

In a Uniform Guidance compliance audit, one of the audit findings required to be reported relates to known or likely fraud affecting a federal award. As part of the risk assessment process, the auditor should specifically identify and assess the risks of material noncompliance with each major program's compliance requirements occurring due to fraud (fraud risk). The auditor should consider that assessment in designing the audit procedures to be performed. The assessment of fraud risk should be ongoing throughout the audit.

As part of the Uniform Guidance compliance audit, the auditor, using professional judgment, should adapt AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*, to the objectives of a compliance audit. Procedures that may be useful in identifying fraud risks include the following:

- Conduct a meeting of audit team members to discuss the risks of material noncompliance due to fraud. Depending on the number of major programs and the size of the overall audit team, it may be most effective to hold a separate meeting for each major program or groups of major programs audited by an individual segment of the overall audit team. For smaller engagements, holding one meeting covering all major programs may be sufficient.

- Gather information necessary to identify and assess fraud risk factors for major programs prior to the audit team meeting. This may include considering the results of the financial statement fraud risk assessment to determine the applicability to the compliance audit's fraud risk assessment procedures. When identifying fraud risk factors, the auditor assesses whether those risk factors, individually or in combination, present a risk of material noncompliance with compliance requirements subject to audit that could have a direct and material effect on a major federal program.
- Document entity-wide programs and controls in place to prevent, detect, and deter fraud; auditor identification and evaluation of the suitability of the design; and whether such programs and controls have been implemented. Many of these programs and controls may have been considered and documented as part of the fraud risk assessment related to the financial statement audit.
- Inquire of management (including those involved with grants management), those charged with governance, internal audit, and others about the risks of fraud related to major programs. The auditor inquires about instances of possible or actual noncompliance of broad programs and controls that have come to their attention occurring during the period under audit or the period subsequent to that date. The inquiries may cover more than one major program.

Based on the information gathered, analyses, and communication among the audit team members, the auditor identifies and documents specific fraud risks (including the risk of management override of controls) that may result in material noncompliance with a major program's compliance requirements due to fraud. Consideration of any programs and controls in place to mitigate the risk of such fraud helps the auditor in the assessment of control risk of noncompliance of the related compliance requirement subject to audit that is direct and material. The auditor then determines the planned audit response (including consideration of testing major program journal entries) based on the specific fraud risks identified and the results of tests of design and implementation of controls.

On completion of Uniform Guidance compliance audit procedures, the auditor considers whether the results of audit procedures performed, and other conditions affect the assessment of fraud risk made when planning the audit. This evaluation may provide further insight about the risks of material noncompliance due to fraud and whether there is a need to perform additional or alternative audit procedures.

Note: SAS No. 148, *Amendment to AU-C Section 935,* confirms that paragraphs 27*a* of SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement,* which relates to controls over significant risks, and paragraph 40, which relates to classes of transactions, account balances, and disclosures that are not significant but are material, are not applicable in a compliance audit. Historically, the concept of significant risks has not been applicable to a compliance audit. Likewise, the concept of classes of transactions, account balances, and disclosures that are material is not applicable to a compliance audit.

Knowledge check

5. Which term represents the susceptibility of a major program's compliance requirements to noncompliance that could be material, either individually or when aggregated with other instances of noncompliance, before consideration of any related controls over compliance?

   a. Control risk of noncompliance.
   b. Audit risk of noncompliance.
   c. Inherent risk of noncompliance.
   d. Detection risk of noncompliance.

Common deficiencies found in single audits

The AICPA has identified three key factors driving single audit quality:

- The more single audits a firm performs every year (regardless of firm size), the more likely a given single audit is to conform to professional standards.
- Governmental Audit Quality Center (GAQC) firm members have two times greater conformity than non-members.
- Number of single audits the engagement partner performs annually.

GAQC members who perform 11 or more single audits annually have been found to be in conformity 100% of the time. The theme is practice makes perfect and commitment to quality is key to audit quality success.

Common deficiencies are presented to assist auditors in preparing for the government-wide audit quality project set forth in the Uniform Guidance. The following common deficiencies relate to planning a single audit:

- Failure to properly document independence considerations required by *Government Auditing Standards*, including evaluation of management's skills, knowledge, or experience to effectively oversee nonaudit services performed by the auditor; evaluation of significant threats; and safeguards applied to reduce threats to an acceptable level
- Failure to meet *Government Auditing Standards* CPE requirements, which includes 80 hours of audit and accounting and 24 hours of CPE that directly relates to government auditing, the government environment, or the specific or unique environment in which the auditee operates
- Lack of documentation of the risk of material noncompliance for the major program's compliance requirements occurring due to fraud

Summary

Key foundational points	
1.	The agreed upon terms of the audit engagement should be documented in an engagement letter or other suitable form of written agreement.
2.	In planning an audit to meet the requirements of the Uniform Guidance, auditors need to consider matters ordinarily associated with an audit of financial statements in accordance with GAAS and additional considerations that relate to both financial statement audits performed under *Government Auditing Standards* and compliance audits performed under the Uniform Guidance.
3.	As part of planning, the auditor should perform risk assessment procedures to obtain a sufficient understanding of the compliance requirements subject to audit that are direct and material and the entity's internal control over compliance with those compliance requirements.

Solutions

Advanced Topics in a Single Audit: Planning a Uniform Guidance Compliance Audit

Knowledge check solutions

1.

   a. Incorrect. The engagement partner and other key members of the engagement team should be involved in planning the audit.

   b. Correct. Although the engagement partner should be involved, some responsibilities may be delegated.

   c. Incorrect. The engagement partner should be involved in planning the audit but there is no requirement to be involved in all aspects of planning the audit.

   d. Incorrect. No specific procedures are required as part of planning the compliance audit.

2.

   a. Incorrect. Nonsupervisory auditors have work situations with low levels of ambiguity.

   b. Incorrect. Partners and directors report on audits.

   c. Incorrect. Partners and directors may review engagement quality prior to issuing the report.

   d. Correct. Supervisory auditors have work situations with moderate levels of ambiguity, complexity, and uncertainty.

3.

   a. Incorrect. Auditors should complete at least 80 hours of CPE in every 2-year period. Of those, 24 hours should be in the government environment, government auditing, or the specific unique environment in which the auditor operates.

   b. Incorrect. Of the 80 hours required in every 2-year period, 56 hours should be in subject matter that directly enhances auditors' professional expertise to conduct audits.

   c. Incorrect. Of the 80 hours required in every 2-year period, 24 hours should be in the government environment, government auditing, or the specific unique environment in which the auditor operates.

   d. Correct. Of the 80 hours required in every 2-year period, 24 hours should be in the government environment, government auditing, or the specific unique environment in which the auditee operates.

4.

a. Incorrect. Threats to independence, along with the safeguards applied, are required to be documented.
b. Incorrect. The auditor is required to document the safeguards required if an audit organization is structurally located within a governmental entity and is considered independent based on those safeguards.
c. Incorrect. The auditor's understanding with an auditee for which the auditor will perform a nonaudit service is required to be documented.
d. Correct. Consideration of management's ability to oversee the nonaudit service is required to be documented. There is no requirement to document the ability of management to perform the nonaudit service.

5.

a. Incorrect. Control risk of noncompliance is the risk that noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis by the entity's internal control over compliance.
b. Incorrect. Audit risk of noncompliance is the risk that the auditor expresses an inappropriate audit opinion on the entity's compliance when material noncompliance exists.
c. Correct. Inherent risk of noncompliance is the susceptibility of a major program's compliance requirements to noncompliance that could be material, either individually or when aggregated with other instances of noncompliance, before consideration of any related controls over compliance.
d. Incorrect. Detection risk of noncompliance is the risk that the procedures performed by the auditor to reduce audit risk of noncompliance to an acceptably low level will not detect noncompliance that exists.

Advanced Topics in a Single Audit: Schedule of Expenditures of Federal Awards

Learning objectives

- Distinguish an auditee's responsibilities for the schedule of expenditures of federal awards (SEFA).
- Evaluate an auditor's responsibilities for the SEFA.
- Assess the reporting required as it relates to the SEFA.

Auditee’s responsibility for the SEFA

The SEFA is a required part of the financial statements under Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). The Uniform Guidance requires the auditee to prepare the SEFA for the period covered by the financial statements that includes certain required elements, including total federal awards expended for each individual federal program.

As part of the Uniform Guidance compliance audit, the auditor must decide whether the SEFA is stated fairly in all material respects in relation to the auditee’s financial statements as a whole. Because the SEFA serves as the primary basis for the auditor’s major program determination, appropriate major program determination by the auditor depends on the SEFA’s accuracy and completeness.

Key point

The auditee-prepared SEFA serves as the primary basis for the auditor’s major program determination. Therefore, it is important that the SEFA be accurate and complete.

The Uniform Guidance sets forth the required elements of the SEFA. However, the auditee may choose to provide additional information requested by federal awarding agencies and pass-through entities to make the schedule easier to use. For example, when a federal program has multiple federal award years, the auditee may list the amount of federal awards expended for each federal award year separately.

The Uniform Guidance does not specifically prescribe the basis of accounting to be used by the auditee to prepare the SEFA. For example, the basis of accounting used may be a special-purpose framework. However, the Uniform Guidance does state that the determination of when a federal award is expended must be based on when the activity related to the federal award occurs. A SEFA, or certain awards in the schedule, may be presented on a basis of accounting that differs from that used in the financial statements. In any case, the auditee must clearly disclose the significant accounting policies used in preparing the SEFA in the notes to the schedule. The auditee should also be able to reconcile amounts presented in the financial statements to related amounts in the SEFA.

Key point

Some states specify which basis of accounting an auditee must use. Therefore, management should be aware of state law.

Required SEFA content

The Uniform Guidance requires the SEFA to present certain information on the face of the SEFA and additional information in the notes to the SEFA.

	At a minimum, the face of the SEFA must do the following:
✓	List individual federal programs by federal agency. For a cluster of programs, provide the cluster name, list individual federal programs within the cluster of programs, and provide the applicable federal agency name. For research and development (R&D), total federal awards expended must be shown either by individual federal award or by federal agency and major subdivision within the federal agency. For example, the National Institutes of Health is a major subdivision in the Department of Health and Human Services. Note: When a nonfederal entity has incurred expenditures under only one program within a cluster of programs, the name of the cluster of programs is required to be provided on the SEFA, regardless of whether the expenditures were incurred under only one program or multiple programs within the cluster of programs.
✓	For federal awards received as a subrecipient, include the name of the pass-through entity and the identifying number assigned by the pass-through entity.
✓	Provide the total federal awards expended for each individual federal program and the Assistance Listing number or other identifying number when the Assistance Listing information is not available. For a cluster of programs, also provide the total for the cluster. Note that under the Uniform Guidance, the total federal awards expended for all types of awards must go on the face of the schedule.
✓	Include the total amount of federal awards expended for loan or loan guarantee programs.
✓	Include the total amount provided to subrecipients from each federal program.

Practice issue

To maximize the transparency and accountability of COVID-19-related award expenditures, appendix VII, "Other Audit Advisories," of the *Compliance Supplement* notes that nonfederal entities should separately identify COVID-19 expenditures on the SEFA. This includes both existing programs with incremental COVID-19 funding and the new COVID-19-only programs. This may be accomplished by identifying COVID-19 expenditures on the SEFA on a separate line by Assistance Listing number with "COVID-19" as a prefix to the program name.

Example:

COVID-19 Temporary Assistance for Needy Families	93.558	$1,000,000
Temporary Assistance for Needy Families	93.558	$3,000,000
Total: Temporary Assistance for Needy Families		$4,000,000

The Uniform Guidance provides that the following must be included in the notes to the schedule:

- The significant accounting policies used in preparing the schedule
- The balances of loan and loan guarantee programs (loans) outstanding at the end of the audit period for those loans described in 2 CFR 200.502(b)
- Whether or not the auditee elected to use the 10% de minimis indirect cost rate

Key point

The preparation of the SEFA is a management responsibility. When the auditor is performing the single audit and prepares the SEFA, there are auditor independence considerations under *Government Auditing Standards* and generally accepted auditing standards (GAAS). The auditor should assess the impact that providing this nonaudit service has on independence and respond to any identified threats to independence using the conceptual framework in *Government Auditing Standards*.

Assistance Listing number not available

When no Assistance Listing number is assigned or when an Assistance Listing number is not available, it is recommended that the auditee use the reporting format prescribed by the Federal Audit Clearinghouse (FAC) in the SEFA. Although the Uniform Guidance does not specifically require that the SEFA follow the FAC reporting requirement when the Assistance Listing number is unknown, doing so is considered best practice to ensure consistency between the reporting in the SEFA and the data collection form (Form SF-SAC).

As noted in the instructions to the data collection form (Form SF-SAC), the required first two digits of the Assistance Listings number identify the federal awarding agency. If the three-digit Assistance Listing extension is unknown, the auditee will enter the letter "U" followed by a two-digit number. Therefore, the first federal program with an unknown three-digit extension would be "U01" for all award lines associated with that program; the second would be "U02," and so on. For example, the number for the first Department of Health and Human Services (HHS) program with an unknown Assistance Listing number would be 93.U01. The two-digit extension number can start over for each federal agency or continue through the reminder of the data collection form (Form SF-SAC). If the program is part of the R&D cluster, then the instructions to Form SF-SAC state that "RD" is required as the Assistance Listing extension (for example, "93.RD" for an HHS program in the R&D cluster with an unknown Assistance Listing extension). The FAC also requires that additional award identification be provided when the Assistance Listing extension is unknown. This additional information used to identify the award may be the program year, contract number, or another such identifying number.

Considerations regarding types of federal awards

The Uniform Guidance addresses how to determine the value of certain types of federal financial assistance. The following table summarizes the bases for valuing federal awards expended.

Determining the value of federal financial assistance expended

Type of federal financial assistance	Basis used to determine the value of federal awards expended
Loans and loan guarantees (loans), including interest subsidies	Amount expended equals the value of new loans made or received during the audit period plus the beginning of the audit period balance of loans from previous years for which the federal government imposes continuing compliance requirements, plus any interest subsidy, cash, or administrative cost allowance received. (The proceeds of loans received and expended in prior years are not considered federal awards expended under the Uniform Guidance when the federal statutes, regulations, and terms and conditions of federal awards pertaining to such loans impose no continuing compliance requirements other than to repay the loans.)
Loans at IHE	Amount expended is the same as for loans and loan guarantees (loans), including interest subsidies, mentioned previously. There is an exception. When loans are made to students of an institution of higher education (IHE), but the IHE does not make the loans, then only the value of loans made during the audit period must be considered federal awards expended in that audit period. The balance of loans for previous audit periods is not included as federal awards expended because the lender accounts for the prior balances.

Determining the value of federal financial assistance expended (continued)

Type of federal financial assistance	Basis used to determine the value of federal awards expended
Insurance	Amount expended equals the fair value of the insurance contract at the time of receipt or the assessed value provided by the federal agency.
Endowments	Amount expended equals the cumulative balance of federal awards for endowment funds that are federally restricted in each audit period in which the funds are still restricted.
Free rent	Amount expended equals the fair value at the time of receipt or the assessed value provided by the federal agency. Free rent is not considered an award expended unless it is received as part of an award to carry out a federal program.
Food commodities and donated property (including donated surplus property)	Amount expended equals the fair value at the time of receipt or the assessed value provided by the federal agency.

Knowledge check

1. Which is accurate regarding SEFA requirements?

    a. The significant accounting policies used in preparing the schedule must go on the face of the schedule.
    b. Total amounts provided to subrecipients from each federal award must be included in the SEFA.
    c. Identification of the award year when federal award expenditures are made for multiple award years must be included in the SEFA.
    d. Whether the auditee elected to use the 10% de minimis indirect cost rate must go on the face of the schedule.

2. When must beginning-of-the-year loan balances be included in total federal awards expended for the program on the SEFA?

    a. They are never included in total federal awards expended for the program.
    b. They are always required to be included in total federal awards expended for the program.
    c. They are included in total federal awards expended for the program when the loans made have continuing compliance requirements.
    d. They are always included in total federal awards expended for the program for loans made by HUD.

Auditor’s responsibility regarding the SEFA

Along with an opinion on the financial statements, the Uniform Guidance requires an auditor to decide whether the SEFA is stated fairly in all material respects in relation to the auditee’s financial statements as a whole. This, and the fact that the SEFA is used as a basis for determining major programs, illustrate the importance of the auditor’s work around the SEFA.

Auditor’s procedures related to the SEFA

AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*), includes requirements and guidance for reporting on supplementary information, such as the SEFA, when engaged to report on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole. When issuing an in-relation-to opinion on the SEFA, the auditor need not apply procedures as extensive as would be necessary to express an opinion on the SEFA on a stand-alone basis.

Using the same materiality level used in the audit of the financial statements, the auditor should do all the following:

- Inquire of management about the criteria used by management to prepare the SEFA.
- Determine whether the form and content of the SEFA complies with the Uniform Guidance.
- Obtain an understanding of the methods of preparing the SEFA and determine whether these methods have changed from those used in the prior period and, if so, the reasons why.
- Compare and reconcile the SEFA to the underlying accounting and other records used in preparing the financial statements or to the financial statements themselves.
- Inquire of management about any significant assumptions or interpretations underlying the measurement or presentation of the SEFA.
- Evaluate the appropriateness and completeness of the information contained in the SEFA, considering the results of the procedures performed and other knowledge obtained during the audit of the financial statements.
- Obtain certain written representations from management.

The auditor may consider materiality when determining which information to compare and reconcile to the underlying accounting and other records or to the financial statements. In addition, when evaluating the appropriateness and completeness of supplementary information, the auditor may consider testing accounting or other records through observation or examination of source documents or other procedures ordinarily performed in an audit of the financial statements.

Because the SEFA serves as the primary basis for the auditor’s major program determination, audit procedures should be performed to obtain sufficient appropriate audit evidence supporting the accuracy and completeness of the SEFA, including the identification of federal programs in the schedule. The auditor may use evidence obtained from audit procedures performed during the audit of the financial statements and the Uniform Guidance compliance audit regarding the accuracy, completeness, and classification of recorded revenues and expenditures. Additionally, the auditor may consider

- reviewing an auditee-prepared reconciliation of amounts reported in the SEFA and the related notes to corresponding amounts reported in the financial statements or other underlying records used to prepare the schedule (for example, the general ledger, reimbursement requests, loan agreements, or other supporting documentation); and
- sending confirmations to federal awarding agencies or pass-through entities (in an audit of a subrecipient).

Finally, because the Uniform Guidance requires the auditee to include certain elements in the SEFA, the procedures should also include a review of the auditee's schedule for the required elements set forth in the Uniform Guidance.

Additional auditor requirements relating to compliance audit objectives and internal control over compliance

Although AU-C section 725 does not require the auditor to obtain a separate understanding of the entity's internal control or to assess fraud risk with respect to supplementary information, the auditor has additional responsibilities regarding internal control related to the SEFA in a Uniform Guidance compliance audit. For example, as part of the Uniform Guidance compliance audit, the auditor has a responsibility to consider internal control over compliance, including a consideration of internal control over the accuracy and completeness of the expenditure amounts reported on the SEFA and controls over the accuracy of the Assistance Listings numbers.

Procedures may include inquiring of entity personnel, observing the application of specific controls, and inspecting documents and reports used in the preparation of the SEFA. The auditor's understanding should be sufficient for the auditor to assess the risks of material misstatement of the SEFA and to design the nature, timing, and extent of further audit procedures to test the accuracy and completeness of the schedule.

What if deficiencies are found?

When the auditor identifies deficiencies in internal control that relate to the auditee's preparation of a complete and accurate SEFA, the auditor should evaluate the severity of each deficiency in internal control identified to determine whether the deficiency, individually or in combination, is a significant deficiency or material weakness in internal control over financial reporting, internal control over compliance, or both. If a deficiency in internal control is determined to be a significant deficiency or material weakness, the auditor must report the finding in the appropriate section of the schedule of findings and questioned costs.

Subsequent events

AU-C section 725 states that the auditor has no responsibility for the consideration of subsequent events with respect to the supplementary information. However, the relevant requirements of AU-C section 560, *Subsequent Events and Subsequently Discovered Facts* (AICPA, *Professional Standards*), should be applied if information comes to the auditor's attention

- prior to the release of the auditor's report on the financial statements regarding subsequent events that affect the financial statements or
- subsequent to the release of the auditor's report on the financial statements regarding facts that, had they been known to the auditor at the date of the auditor's report, may have caused the auditor to revise the auditor's report.

Although AU-C section 725 does not impose a subsequent event requirement with respect to supplementary information, there are additional subsequent event considerations relating to the compliance audit.

Management representations relating to the SEFA

In addition to the written representations typically obtained in the financial statement audit and the Uniform Guidance compliance audit, an auditor should obtain certain additional representations related to the SEFA. Specifically, the auditor should obtain the following representations from management:

- That management is responsible for the preparation of the SEFA
- That management acknowledges and understands its responsibility for the presentation of the SEFA in accordance with the Uniform Guidance
- That management believes that the SEFA, including its form and content, is fairly presented in accordance with the Uniform Guidance
- That the methods of measurement or presentation have not changed from those used in the prior period or, if the methods of measurement or presentation have changed, the reasons for such changes
- About any significant assumptions or interpretations underlying the measurement or presentation of the SEFA
- That, when the SEFA is not presented with the audited financial statements, management will make the audited financial statements readily available to the intended users of the schedule no later than the issuance date by the entity of the SEFA and the auditor's report thereon

These representations should be made as of the date of the auditor's report on the financial statements. Therefore, two separate management representation letters may be necessary when the financial statement opinion and the SEFA in-relation-to opinion contain different dates. This would occur when the audit procedures related to the SEFA are completed subsequent to the financial statement report date.

Knowledge check

3. When performing procedures on the amounts on the SEFA to provide an in-relation-to opinion, what is the basis for the materiality level used?

   a. The total amount of expenditures for major programs divided by the number of major programs.
   b. The amount of total federal expenditures on the SEFA.
   c. The materiality level used in the audit of the financial statements.
   d. The materiality level used in the compliance audit as it relates to the nonfederal entity's largest major program.

Other SEFA considerations

Combined schedule of federal and state awards

Several state governments have auditing and reporting requirements for state awards that are similar to those for federal awards under the Uniform Guidance. In these states, auditors may be engaged to test and report on compliance with the state compliance requirements as provided in the state award and under applicable state laws or regulation. Some states require a separate compliance audit with a separate schedule of expenditures of state awards. However, other states accept a combined schedule of federal and state awards along with additional testing of the state expenditures. If state (or other nonfederal) awards are included in the SEFA, they are required to be segregated and clearly designated as nonfederal. Additionally, totals for federal awards must be shown separately and exclude nonfederal amounts to meet the Uniform Guidance requirement that the schedule provide the total federal awards expended for each individual federal program. The title of the schedule should also be modified to indicate that nonfederal awards are included.

Commingled assistance

The individual sources (federal, state, and local) of federal awards may not be separately identifiable because of commingled assistance from different levels of government. If the commingled portion cannot be separated to specifically identify individual funding sources, it is suggested that the total amount be included in the SEFA with a note to the schedule describing the commingled nature of the funds.

Schedule may not agree with other federal award reporting

The information included in the SEFA may not fully agree with other federal award reports that the auditee submits directly to federal awarding agencies or pass-through entities. AU-C section 725 requires the information in the SEFA to relate to the same period as the financial statements. However, federal award reports submitted directly to an awarding agency may be prepared for a different fiscal period and may include cumulative (from prior years) data rather than data for the current year only.

Knowledge check

4. How should the auditee treat state (or other nonfederal) awards as they relate to inclusion in the SEFA?

    a. They should be listed with related federal programs along with a note to the SEFA listing all nonfederal amounts.
    b. They should be segregated and clearly designated as nonfederal.
    c. They should be identified without dollar amounts and explained more fully in the notes to the SEFA.
    d. They should not be included because it is prohibited to include nonfederal amounts in the SEFA.

Reporting on the SEFA

The auditor should include the required in-relation-to reporting on the SEFA in either

1. a separate section in the auditor's report on the financial statements with the heading "Supplementary Information," or other appropriate heading, in the reporting on compliance and internal control over compliance under the Uniform Guidance, or
2. a separate report on the SEFA as supplementary information. Separate reporting on the SEFA may be accomplished either by including the in-relation-to reporting in the reporting on compliance and internal control over compliance required under the Uniform Guidance or in a separate report on supplementary information.

Elements of the in-relation-to report on the supplementary SEFA

The following elements should be included in the in-relation-to report:

- A statement that the audit was conducted for the purpose of forming an opinion on the financial statements as a whole
- A statement that the SEFA is presented for purposes of additional analysis and is not a required part of the financial statements
- A statement that the SEFA is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements
- A statement that the SEFA has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves and other additional procedures, in accordance with GAAS
- If the auditor issues an unmodified opinion on the financial statements and the auditor has concluded that the SEFA is fairly stated, in all material respects, in relation to the financial statements as a whole, a statement that, in the auditor's opinion, the SEFA is fairly stated in all material respects in relation to the financial statements as a whole
- If the auditor issues a qualified opinion on the financial statements and this qualification has an effect on the SEFA, a statement that, in the auditor's opinion, except for the effects on the SEFA of [refer to the paragraph in the auditor's report explaining the qualification], such information is fairly stated in all material respects in relation to the financial statements as a whole

SEFA not presented with the financial statements

When the SEFA is not presented with the financial statements and the auditor includes the in-relation-to reporting in either the report on compliance and on internal control over compliance required by the Uniform Guidance or in a separate report, the following additional elements should be included:

- A reference to the report on the financial statements
- The date of that report
- The nature of the opinion expressed on the financial statements
- Any report modifications

Furthermore, when the auditor includes the in-relation-to reporting in either the report on compliance and on internal control over compliance required by the Uniform Guidance or in a separate report, the auditor may consider including an alert that restricts the use of the separate report solely to the appropriate specified parties. For more information, see AU-C section 905, *Alert That Restricts the Use of the Auditor's Written Communication* (AICPA, *Professional Standards*).

The AICPA Audit Guide Government Auditing Standards *and Single Audits* recommends that, when possible, the auditor report on the SEFA as supplementary information in the report on the financial statements.

Potential report modifications when reporting on the SEFA

AU-C section 725 notes that if the auditor concludes, on the basis of the procedures performed, that the SEFA is materially misstated in relation to the financial statements as a whole, the auditor should discuss the matter with management and propose an appropriate revision of the schedule. If management does not revise the SEFA, the auditor should either (*a*) modify the auditor's opinion on the schedule and describe the misstatement in the auditor's report or, (*b*) if a separate report is being issued on the schedule, withhold the auditor's report on the schedule.

When reporting on supplementary information, the auditor should consider the effect of any modifications to the report on the financial statements. When the auditor's report on the audited financial statements contains an adverse opinion or disclaimer of opinion and the auditor has been engaged to provide an in-relation-to opinion on the SEFA, the auditor is precluded from expressing an in-relation-to opinion on the SEFA. When permitted by law or regulation, the auditor may withdraw from the engagement to report on such supplementary information. If the auditor does not withdraw, the auditor's report on the SEFA should state that, because of the significance of the matter disclosed in the auditor's report, it is inappropriate to — and the auditor does not — express an opinion on the SEFA.

Dating the report on the SEFA

AU-C section 725 states that the date of the auditor's report on supplementary information in relation to the financial statements as a whole should not be earlier than the date on which the auditor completed the procedures required in AU-C section 725. Therefore, the date of the auditor's report on the SEFA may be the same date as the financial statement report or a later date. In no case would the date of the in-relation-to opinion on the SEFA be earlier than the date of the financial statement report.

SEFA presented with the financial statements

When the reporting on the SEFA is included in the auditor's report on the financial statements, the date of the report on the schedule depends on when the auditor has completed the procedures relating to the SEFA, as follows:

- When procedures related to the SEFA are performed concurrent with financial statement audit procedures, the date of the report on the SEFA will be the same as that of the auditor's report on the financial statements

- When procedures related to the SEFA are completed subsequent to the financial statement report date, the reporting on the schedule will carry a later date than that of the financial statement report, therefore resulting in a dual-dated report.

When the auditor has completed the procedures related to the SEFA after the date of the auditor's report on the financial statements, Interpretation No. 1, "Dating the Auditor's Report on Supplementary Information," of AU-C section 725, provides guidance related to the use of a separate section to make it clear that no additional procedures were performed on the audited financial statements subsequent to the date of the auditor's report on those financial statements. The interpretation, which also includes illustrative report wording, notes that, although not required, an auditor may,

- when issuing a separate report on the supplementary information, include in the report a statement that the auditor has not performed any auditing procedures with respect to the audited financial statements subsequent to the date of the auditor's report on those financial statements.
- when reissuing a report on the audited financial statements to include a separate section to report on the supplementary information, include two report dates to indicate that the date of reporting on the supplementary information is as of the later date.

SEFA presented with the report required under the Uniform Guidance

As noted previously, there may be circumstances in which the auditor includes the in-relation-to opinion on the SEFA in the report on compliance and on internal control over compliance required by the Uniform Guidance. In that situation, the date of the report on the SEFA depends on the date the underlying audit procedures are completed. If using the same date is not possible because the procedures to satisfy the Uniform Guidance requirements are not completed as of the date the procedures related to the SEFA are completed, the auditor has the following two options:

a. The auditor can dual-date the report on compliance and on internal control over compliance required by the Uniform Guidance. The date related to the portion of the report pertaining to the in-relation-to opinion on the SEFA would be when the audit procedures performed are completed. The date pertaining to the remainder of the report would be the date when the audit procedures performed to satisfy the Uniform Guidance requirements are completed.

b. The auditor can issue a separate report on the SEFA. This report should be given the date on which the auditor completed the procedures required under AU-C section 725.

Issuing an opinion on the SEFA under AU-C Section 805

In some instances, the auditor may be engaged to issue a stand-alone opinion on the SEFA, either as part of the report issued to meet the requirements of the Uniform Guidance or separately. When an auditor is engaged to perform only the compliance audit required under the Uniform Guidance, and not the financial statement audit, an in-relation-to opinion may not be issued. When this occurs, the auditee may consider engaging the auditor to issue an opinion on the SEFA under AU-C section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement* (AICPA, *Professional Standards*). Although this engagement would be performed under *Government Auditing Standards*, because the SEFA (the financial statement) presents only the activities of the federal program, the auditor is not required to issue a separate report on internal control over financial reporting and on compliance with provisions of laws, regulations, contracts, and grant agreements to meet the reporting requirements of *Government Auditing Standards*. However, the auditor has the option of issuing a separate *Government Auditing Standards* report.

Knowledge check

5. What is the SEFA reporting date?

    a. The date the first award listed on the SEFA was received.
    b. The date of the report that contains the SEFA reporting.
    c. The date the procedures on the SEFA were completed or the date of the report on compliance for major programs, whichever is later.
    d. The date the procedures on the SEFA were completed or the date of the report on the financial statements, whichever is later.

Common deficiencies found in single audits

Common SEFA-related deficiencies include

- Missing information, such as the following:
  - The Assistance Listing number (or some other identifying number when Assistance Listing information is not available)
  - The name of the federal agency or the name of pass-through entity and identifying number assigned by the pass-through entity
  - The total federal expenditures for each federal program
  - Total amounts provided to subrecipients
  - Disclosure in the notes of whether the auditee elected to use the 10% de minimis indirect cost rate
  - Notes describing the significant accounting policies used in preparing the SEFA
  - Improper clustering or no clustering of programs
- Lack of documentation, such as the following:
  - Internal controls over preparation of the SEFA
  - Procedures to determine whether the SEFA is fairly presented in all material respects
  - Appropriateness and completeness of the SEFA
  - Reconciliation of the SEFA to amounts in the financial statements
- Reporting, or referring to the reporting, on supplementary information and required supplementary information was not done.

Summary

Key foundational points	
1.	The Uniform Guidance requires the auditee to prepare a SEFA for the period covered by the auditee's financial statements that includes certain required elements, including total federal awards expended for each individual federal program.
2.	The Uniform Guidance requires the auditor to determine whether the SEFA is fairly stated, in all material respects, in relation to the audited entity's financial statements as a whole.
3.	The auditor should include the required in-relation-to reporting on the SEFA in either a. a separate section in the auditor's report on the financial statements with the heading "Supplementary Information," or other appropriate heading, in the reporting on compliance and internal control over compliance under the Uniform Guidance; or b. a separate report on the SEFA as supplementary information. Separate reporting on the SEFA may be accomplished either by including the in-relation-to reporting in the reporting on compliance and internal control over compliance required under the Uniform Guidance or in a separate report on supplementary information.

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Case Study University Schedule of Expenditures of Federal Awards

This appendix is included for supplementary purposes only and is not required for CPE credit.

Appendix

Schedule of Expenditures of Federal Awards — Case study

You are a senior manager at a public accounting firm. You are given a draft of the Schedule of Expenditures of Federal Awards (SEFA) that your client, Case Study University, has prepared. Review the SEFA and identify any errors or possible errors (other than footing errors).

What errors did you find?

What should be investigated further?

Case Study University

Schedule of Expenditures of Federal Awards

For the year ended June 30, 20X3

Federal grantor/Pass-through grantor/Program or cluster title	Federal Assistance Listings number	Pass-through entity identifying number	Total federal expenditures
Student financial assistance — Cluster			
Department of Education			
Federal Pell Grant Program	84.063		$ 8,000,000
Federal Direct Student Loans	84.268		5,000,000
Federal Supplemental Educational Opportunity Grants	84.007		2,000,000
Federal Work-Study Program	84.033		600,000
Teacher Education Assistance for College and Higher Education Grants (TEACH)	84.379		550,000
Federal Perkins Loan Program (note 4)	84.038		500,000
Total Department of Education			$16,650,000
Department of Health and Human Services			
Nursing Student Loans (note 4)	93.364		$ 1,000,000
Health Professions Student Loans (note 4)	93.342		3,000,000
Total Department of Health and Human Services			$4,000,000
Total student financial assistance cluster			$20,650,000
Research and Development — Cluster			
Department of Defense			
Department of Army			
Collaborative Research and Development	12.114		$1,000,000
Military Medical Research and Development	12.420		750,000
XYZ Labs — Effects of Ice on Radar Images	12.UNKNOWN	4532	100,000
Total Department of Defense			$1,850,000

Case Study University

Schedule of Expenditures of Federal Awards

For the year ended June 30, 20X3 (continued)

Federal grantor/Pass-through grantor/Program or cluster title	Federal Assistance Listings number	Pass-Through Entity identifying number	Total federal expenditures
National Science Foundation			
Geosciences	47.050		$ 395,000
Biological Sciences	93.074		125,000
ABC University — Atmospheric Effects of Volcano Eruptions			125,000
Total National Science Foundation			$645,000
Department of Health and Human Services			
National Institutes of Health			
Mental Health Research Grants	93.242		$125,000
Drug Abuse and Addiction Research Programs	93.279		100,000
ABC Hospital — Heart Research	93.UNKNOWN	5489-5	200,000
Centers for Disease Control and Prevention			
Chronic Diseases: Research, Control, and Prevention	93.068		150,000
Total Department of Health and Human Services			$575,000
Total Research and Development Cluster			$3,070,000
Trio Cluster			
Department of Education			
TRIO — Talent Search	84.044		$600,000
TRIO — Upward Bound	84.047		175,000
Other programs			
Department of State			
Academic Exchange Programs — Scholars	19.401		$500,000
Total Department of State			$500,000

Case Study University

Schedule of Expenditures of Federal Awards

For the year ended June 30, 20X3 (continued)

Federal grantor/Pass-through grantor/Program or cluster title	Federal Assistance Listings number	Pass-Through Entity identifying number	Total federal expenditures
Department of Education			
Funds for Improvement of Postsecondary Education	84.116		$750,000
Funds for Improvement of Postsecondary Education	84.116	374-15-9248	250,000
School Safety National Activities	84.184		75,000
X State Department of Education — Adult Education — Basic Grants to States	84.002		400,000
X State Department of Education — Career and Technical Education — Basic Grants to States	84.048	874-90-5473	755,000
Total Department of Education			$2,230,000
Total expenditures of federal awards			**$27,225,000**
The accompanying notes are an integral part of this schedule.			

Note 1. Basis of presentation

The accompanying SEFA (the schedule) includes the federal award activity of Case Study University under programs of the federal government for the year ended June 30, 20X3. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the schedule presents only a selected portion of the operations of Case Study University, it is not intended to and does not present the financial position, changes in net assets, or cash flows of Case Study University.

Case Study University

Notes to the Schedule of Expenditures of Federal Awards

For the year ended June 30, 20X3

Note 2. Federal student loan programs

The federal student loan programs listed subsequently are administered directly by Case Study University; balances and transactions relating to these programs are included in Case Study University's basic financial statements. Loans outstanding at the beginning of the year and loans made during the year are included in the federal expenditures presented in the schedule. The balance of loans outstanding at June 30, 20X3 consists of

Assistance Listings number	Program name	Outstanding balance at June 30, 20X3
84.038	Federal Perkins Loan	$491,000
93.364	Nursing Student Loans	$ 4,100,000
93.342	Health Professional Student Loans	$ 2,950,000

Note 3. Subawards

Case Study University passed through federal awards to certain subrecipients. The programs and amounts passed through follow.

Assistance Listings number	Program name	Subawards for the year ended June 30, 20X3
12.114	Collaborative Research and Development	$550,000
12.420	Military Medical Research and Development	650,000
47.050	Geosciences	200,000
93.074	Biological Sciences	100,000
93.242	Mental Health Research Grants	25,000
93.279	Drug Abuse and Addiction Research Programs	120,000
93.068	Chronic Diseases Research, Control, and Prevention	100,000
	Total subawards	$1,745,000

Solutions

Advanced Topics in a Single Audit: Schedule of Expenditures of Federal Awards

Appendix: Schedule of Expenditures of Federal Awards case study solution

What errors did you find?

1. Amounts passed through to subrecipients are required to be on the face of the schedule. Therefore, the information in note 3 should be on the SEFA and the note should be deleted.

2. The National Science Foundation (NSF) program, Biological Sciences, has an incorrect Assistance Listings number. The prefix is shown as 93 instead of the NSF prefix 47.

3. The NSF program titled ABC University — Atmospheric Effects of Volcano Eruptions as found in the R&D cluster is missing an Assistance Listings number and pass-through entity identifying number. If no Assistance Listings number exists for the program, some other identifying number should be used.

4. There is no total for the Trio cluster.

5. The Department of Education (ED) pass-through program from the X State Department of Education — Adult Education — Basic Grants to States (84.002) does not have a pass-through entity identifying number.

6. A subtotal for the federal program Funds for Improvement of Postsecondary Education (Assistance Listings number 84.116) is missing.

7. The pass-through award for Assistance Listings number 84.116 (as evidenced by a pass-through entity identifying number), does not name the pass-through entity.

8. The note indicating significant accounting policies is missing.

9. The required note about whether or not the entity elected to use the 10% de minimis indirect cost rate is missing.

10. Possible error. Assistance Listings numbers indicated as 12.UNKNOWN and 93.UNKNOWN could be presented as 12.RD and 93.RD.

What should be investigated further?

1. The amount of federal expenditures found on the SEFA for Nursing Student Loans (93.364) should be double checked. The amount shown on the face of the SEFA is $1 million. Note 2 indicates an end-of-fiscal-period loan balance for 93.364 is $4.1 million. As evidenced by it being included in that note, the beginning-of-the-year loan balance is required to be included as federal awards expended on the face of the SEFA. Because the amount of the outstanding balance at the fiscal period end is much higher than the amount federal expenditures on the SEFA, it appears the beginning-of-the-year loan balances may not be included as federal awards expended for the year, or that the ending loan balance is incorrect.
2. In note 3, a subaward for $120,000 is shown for the program, Drug Abuse and Addiction Research Programs (93.279). However, total federal awards expended for the year on the SEFA show expenditures of $100,000. This discrepancy should be investigated. (Note that this discrepancy would be more obvious if the amounts passed through to subrecipients was on the face of the SEFA, as required.)

Knowledge check solutions

1.
   a. Incorrect. The significant accounting policies used in preparing the schedule must be included in the SEFA notes, **not** on the face of the schedule.
   b. Correct. Total amounts provided to subrecipients from each federal award is required content of the SEFA.
   c. Incorrect. The award year is not required to be included in the SEFA, including when awards are made for multiple award years.
   d. Incorrect. Whether the auditee elected to use the 10% *de minimis* indirect cost rate must be included in the SEFA notes, **not** on the face of the schedule.

2.
   a. Incorrect. Beginning-of-the-year loan balances should be included in federal awards expended for the program under certain circumstances.
   b. Incorrect. Beginning-of-the-year loan balances are not always required to be included in federal awards expended for the program.
   c. Correct. Beginning-of-the-year loan balances are required to be included in federal awards expended for the program when the loans made have continuing compliance requirements.
   d. Incorrect. Although beginning-of-the-year loan balances may be required to be included in total federal awards expended for loans made by HUD, whether these balances are required depends on other circumstances.

3.

a. Incorrect. Materiality is **not** based on the total amount of expenditures for major programs divided by the number of major programs in this scenario.
b. Incorrect. Total federal expenditures is **not** the basis for determining materiality in this scenario.
c. Correct. When performing procedures on the SEFA, the materiality level is based on that used in the audit of the financial statements.
d. Incorrect. The materiality level used in the compliance audit is **not** the basis for determining materiality in this scenario.

4.

a. Incorrect. They should **not** be listed with related federal programs along with a note to the SEFA listing all nonfederal amounts.
b. Correct. If state (or other nonfederal) awards are included in the SEFA, they are required to be segregated and clearly designated as nonfederal.
c. Incorrect. Identifying awards without dollar amounts and explaining them more fully in the notes to the SEFA is **not** how the auditee should treat state (or other nonfederal) awards.
d. Incorrect. State (or other nonfederal) awards are permitted to be included on the SEFA if Uniform Guidance requirements are met.

5.

a. Incorrect. The date the first award listed on the SEFA was received does **not** determine the SEFA reporting date.
b. Incorrect. The date of the report that contains the SEFA reporting does **not** determine the SEFA reporting date.
c. Incorrect. The date of the report on compliance for major programs has no effect on the SEFA report date.
d. Correct. The date of the SEFA reporting is the date the procedures on the SEFA were completed or the date of the report on the financial statements, whichever is later.

Advanced Topics in a Single Audit: Determination of Major Programs

Learning objectives

- Assess the process for determining programs to be audited as major programs.
- Select major programs under the Uniform Guidance.
- Calculate the percentage of coverage needed in a Uniform Guidance compliance audit.
- Evaluate whether an auditee qualifies as a low-risk auditee.

Considerations in determining major programs

Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) places the responsibility for identifying major programs on the auditor and provides the criteria to be used in that determination. The auditor's determination of the programs to be audited is based on the Uniform Guidance requirement to use a risk-based approach to determine which federal programs are major programs..

The schedule of expenditures of federal awards (SEFA) prepared by an auditee forms the basis for identifying major programs. Using the SEFA, the auditor identifies each federal program and cluster. At that point, the type A threshold is determined, and the auditor proceeds to identify major programs using a four-step process.

Certain programs and types of programs affect major program determination. This is important to know before beginning the process of determining major programs.

Large loan and loan guarantee programs in type A program determination

Under the Uniform Guidance, the inclusion of large loans and loan guarantees must not result in the exclusion of other federal programs as type A programs. Therefore, prior to major program determination, the auditor must determine whether a given loan program is a large loan program that must be considered in major program determination. The effect of large loan and loan guarantees on the identification of the type A threshold is summarized as follows:

- For the purpose of this calculation, a program is considered a *federal program providing loans* if the value of federal awards expended for loans within the program comprises 50% or more of the total federal awards for the program. (Remember that a cluster of programs is treated as one program.)
- When a federal program providing loans or loan guarantees exceeds four times the largest nonloan program, it is considered a *large loan program*; the auditor must consider this federal program a type A program and exclude its value in determining the type A threshold.
- The type A threshold is then calculated after removing the total of all large loan programs.

Clusters of programs

The Uniform Guidance defines a *cluster of programs* as a grouping of closely related federal programs that share common compliance requirements. The types of clusters are research and development, student financial assistance, and other clusters. *Other clusters* are defined by the Office of Management and Budget (OMB) in the *Compliance Supplement* or are designated by a state for the federal awards the state provides to its subrecipients that meet the definition of a cluster of programs. Neither auditees nor auditors may create their own cluster of programs based on programs that share common compliance requirements. Furthermore, they may not de-cluster a cluster of programs that is defined by OMB or designated by a state. When a state designates federal awards as an *other cluster*, it must identify the federal awards included in the cluster and advise the subrecipients of the compliance requirements applicable to the cluster consistent with 2 CFR 200.332(a) of Subpart D, “Post Federal Award Requirements,” of the Uniform Guidance. A cluster of programs must be considered as one program when determining major programs.

Federal agency considerations

Request for program to be audited as a major program

A federal awarding agency may request an auditee to have a particular federal program audited as a major program in lieu of the federal agency conducting or arranging for additional audits. To allow for planning, such requests should be made at least 180 days prior to the end of the fiscal year to be audited. After consulting with its auditor, the auditee should promptly respond to such a request by informing the federal awarding agency whether the program would otherwise be audited as a major program using the risk-based approach and, if not, the estimated incremental cost. The federal awarding agency must then promptly confirm to the auditee whether it wants the program audited as a major program. If the program is to be audited as a major program at the federal awarding agency's request and the federal awarding agency agrees to pay the full incremental costs, then the auditee must have the program audited as a major program. This approach also may be used by pass-through entities for a subrecipient.

Identification of a program as higher risk in the *Compliance Supplement*

The Uniform Guidance provides that federal agencies, with the concurrence of OMB, may identify federal programs that are higher risk. That identification is provided by OMB in the *Compliance Supplement*. For example, the U.S. Department of Health and Human Services has identified Medicaid as a program of higher risk in the *Compliance Supplement*. Although such an identification by a federal agency does not preclude an auditor from determining that a program is low risk (because, for example, prior audits have shown strong internal control and compliance), the consideration of this identification of higher risk is part of the risk assessment process.

In the 2022 Compliance Supplement[1], Appendix IV, “Internal Reference Tables,” was expanded to identify several programs as “higher risk.” All new American Rescue Plan Act (ARP) programs are considered “higher risk.”

Under 2 CFR 200.518(c), for a type A program to be considered low risk, it must have been audited as a major program in at least one of the two most recent audit periods. However, even if a program had been audited, Appendix IV provides a list of programs considered to be higher risk.

A “higher risk” designation will often result in a type A program or other cluster being audited as a major program. However, an auditor is not precluded from determining that a “higher risk” type A program or other cluster qualifies as a low-risk type A program if both of the following criteria are met:

1. The program otherwise meets the criteria for a low-risk type A program in 2 CFR 200.518.

[1] The 2023 Compliance Supplement was not available at time of publishing.

2. The percentage of COVID-19 funding in the program or other cluster during the nonfederal entity's fiscal year is not material to the program or other cluster as a whole. For example, a recipient's schedule of expenditures of federal awards (SEFA) may include the Airport Improvement Program. However, the expenditures relevant to COVID-19 funding included in the program during the June 30, 2022, fiscal year end is not material. Alternatively, a recipient's SEFA may include Coronavirus Relief Fund expenditures for the June 30, 2022, fiscal year end, which would be considered material because COVID-19 funding comprises the entire program.

Note that the inclusion of COVID-19 funding within the Research & Development (R&D) cluster does not create a "higher risk" designation for the R&D cluster.

There are no changes to the normal risk assessment process for "higher risk" type B programs. That is, the "higher risk" identification must be considered with the other factors in 2 CFR 200.519. Further, the auditor is not required to prioritize the assessment of risk for "higher risk" type B programs over other type B programs.

Auditors should prepare audit documentation supporting the risk considerations and conclusions for "higher risk" programs.

Request for a program to be considered other than low risk

The Uniform Guidance permits a federal awarding agency to request that a type A program for certain recipients be considered other than low risk so that it would be audited as a major program. For example, it may be necessary for a large type A program to be audited as major each year for particular recipients to allow the federal agency to comply with the Government Management Reform Act of 1994. In this instance, the Uniform Guidance requires the federal awarding agency to obtain approval from OMB. (OMB has not yet made any such approvals.) Furthermore, the federal awarding agency must notify the recipient and, if known, the auditor, at least 180 days before the end of the fiscal year end to be audited.

Audit documentation

The Uniform Guidance states that the auditor must include in the audit documentation the risk analysis process used in determining major programs. Based on this and the requirements of generally accepted auditing standards and *Government Auditing Standards*, the auditor is required to develop adequate audit documentation, which includes documentation supporting the determination of major programs.

Auditor judgment

The Uniform Guidance states that when the auditor makes and documents the determination of major programs in accordance with the Uniform Guidance, the auditor's judgment in applying the risk-based approach to determine major programs must be presumed correct. Challenges by federal agencies and pass-through entities must be only for clearly improper use of the requirements in Subpart F, "Audit Requirements," of the Uniform Guidance. However, federal agencies and pass-through entities may provide the auditor with guidance about the risk of a particular federal program; and the auditor must consider this guidance in determining major programs for audits not yet completed.

Major program determination under the Uniform Guidance

The SEFA prepared by an auditee forms the basis for an auditor's identification of type A and type B programs. Using the SEFA, the auditor identifies each federal program and cluster. After determining the type A threshold amount, the auditor identifies the federal programs as being either type A or type B. As defined in the Uniform Guidance, *type A programs* generally are larger federal programs and *type B programs* are smaller federal programs. For purposes of determining type A and type B programs, federal awards expended are the amount of cash and noncash awards, after all adjustments are made, in the final current-year SEFA. An auditor using the prior-year SEFA or current-year estimates to plan the audit should recalculate the threshold for type A programs based on the final amounts; this ensures that federal awards are properly classified as type A or B. For purposes of determining major programs, federal awards with the same Assistance Listing number are considered one program.

Major programs are programs that the auditor has determined are required to be tested as a major program as part of the Uniform Guidance compliance audit. Under the Uniform Guidance, major program determination is a four-step process that uses a risk-based approach.

Step 1: Determination of type A and type B programs

Type A programs are programs with total federal awards expended that exceed the thresholds in the following table. Programs that do not meet the threshold for type A programs are type B programs.

Total federal awards expended[1]	Type A threshold
Equal to or exceed $750,000 but less than or equal to $25 million	$750,000
Exceed $25 million but less than or equal to $100 million	Total federal awards expended times 0.03
Exceed $100 million but less than or equal to $1 billion	$3 million
Exceed $1 billion but less than or equal to $10 billion	Total federal awards expended times 0.003
Exceed $10 billion but less than or equal to $20 billion	$30 million
Exceed $20 billion	Total federal awards expended times 0.0015

[1] Includes both cash and noncash awards.

Step 2: Identification of low-risk type A programs

The auditor must assess risk for each type A program to identify those that are low risk. In determining whether a type A program is low risk, the auditor must consider whether there are any indications of significantly increased risk that would preclude the program from being low risk. Indicators of increased risk that the auditor may consider follow:

- Oversight exercised by federal agencies and pass-through entities (For example, monitoring that disclosed significant problems would indicate higher risk)
- The results of audit follow-up
- Any changes in personnel or systems affecting the program

These are the only criteria that the Uniform Guidance permits the auditor to consider in evaluating whether there is significantly increased risk for a type A program; that is, the auditor may not use judgment based on the *inherent* risk of a type A program.

Furthermore, to be considered low risk a program must meet the following criteria:

- The program must have been audited as a major program in at least one of the two most recent audit periods.
- The program must not have had any of the following in the most recent audit period:
  - Internal control deficiencies that were identified as material weaknesses in the auditor's report on internal control for major programs
  - A modified opinion on the program in the auditor's report on major programs
  - Known or likely questioned costs that exceed 5% of the total federal awards expended for the program

> **Key point**
>
> If there are no type A programs or if no low-risk type A programs are identified in step 2, the auditor skips step 3 and goes directly to step 4.

Step 3: Identification of high-risk type B programs

Using professional judgment and the following criteria, the auditor must identify type B programs that are high risk:

- Current and prior audit experience
- Oversight exercised by federal agencies and pass-through entities
- Inherent risk of noncompliance of the federal programs

However, the auditor is not required to identify more high-risk type B programs than at least one-fourth the number of type A programs identified as low risk under step 2. Once this number of high-risk type B programs have been identified (that is, at least one-fourth the number of low-risk type A programs), the auditor may discontinue further risk assessments of type B programs. The Uniform Guidance encourages the auditor to use an approach that provides an opportunity for different high-risk type B programs to be audited as major over a period of time.

If the auditor identifies more high-risk type B programs than are needed to satisfy step 3, the auditor must test those high-risk type B programs as major programs. Therefore, it is imperative to properly train staff and seniors to stop risk assessment once the appropriate number of high-risk programs have been identified.

> **Key point**
>
> The Uniform Guidance does not require a specific number of high-risk type B programs to be identified. It is possible to assess risk for each of an auditee's type B programs and determine that fewer than one-quarter the number of low-risk type A programs are high-risk type B programs or that none are high-risk type B programs.

The auditor is not expected to perform risk assessments on relatively small federal programs. Therefore, the auditor is required to perform risk assessments only on type B programs that exceed 25% (0.25) of the type A threshold determined in step 1. For example, if the type A threshold is $750,000, then the auditor would not be required to risk assess small type B programs with federal awards expended of $187,500 or less.

> **Key point**
>
> When the type A threshold calculation is required to be adjusted for large loan or loan guarantee programs under 2 CFR 200.518(b)(3), the type A threshold used for this 25% calculation for small, type B programs is the same as the adjusted type A threshold; this must be reported in the summary of the auditor's results in the schedule of findings and questioned costs.

When all type B programs are relatively small programs, the auditor does not have to assess risk for or identify any high-risk type B programs. However, the auditor may need to select some of those relatively small programs to meet the percentage of coverage (discussed later).

Step 4: Determination of programs to be audited as major programs

After completing steps 1–3, the auditor is ready to identify the major programs. At a minimum, the auditor must audit all the following as major programs:

- Type A programs not identified as low risk
- Type B programs identified as high risk under step 3
- Programs to be audited as major programs based on a federal agency or pass-through entity request
- Additional programs, if any, necessary to meet the percentage-of-coverage rule

Practice issue

It is important for auditors to note that every type A program that was not audited in one of the two prior years is required to be audited as a major program. If a type A program is new to an entity in the current year, it must be audited as a major program in the current year because it was not audited in one of the prior two years.

For existing programs with COVID-19 funding, type A programs that would have otherwise been low risk would change to high risk if the auditor determines that changes in personnel or systems due to COVID-19 significantly increases program risk and precludes the program from being considered low risk.

New COVID-19 programs could also be type B programs. Again, the auditor needs to consider that new COVID-19 programs have never been audited, among other factors, when determining federal program risk.

The auditor needs to consider whether the influx of COVID-19 funds to existing programs triggers any new risk factors when performing type B risk assessments. Inherent risk may also be considered for the purpose of determining whether a type B program is high risk.

The Uniform Guidance states that the auditor must include in the audit documentation the risk analysis process used in determining major programs.

Knowledge check

1. Which statement is accurate regarding the use of professional judgment in determining major programs?

   a. Professional judgment is used only in determining low-risk type A programs.
   b. Professional judgment is not used in any part of the major program process under the Uniform Guidance.
   c. Professional judgment is used to determine that a prior-year audit finding does not affect the current-year risk assessment for a type A program.
   d. Professional judgment is used in determining high-risk type B programs.

2. What is a major program?

   a. All type A programs only.
   b. All type B programs only.
   c. Programs required to be audited.
   d. Programs with expenditures greater than $750,000.

3. Which is a characteristic of a type B federal program?

   a. Less than $5,000.
   b. Low risk.
   c. Not labeled as type A.
   d. Less than $10,000.

4. Which is accurate regarding the assessment of risk for type B programs?

   a. Risk assessment of type B programs continues until the calculated number of high-risk type B programs have been identified or until there are no more type B programs to assess for risk.
   b. Risk assessment of type B programs continues until the required number (one-fourth the number of low-risk type A programs) have been assessed for risk.
   c. Risk assessment of type B programs is optional under the Uniform Guidance.
   d. Risk assessment of type B programs is required. However, the risk assessment depends on the option chosen.

5. Which statement is accurate regarding the major program determination process under the Uniform Guidance?

   a. Federal agencies may not identify federal programs that are higher risk.
   b. Instead of the risk-based approach for determining major programs being used, there are specific calculations that determine major programs.
   c. The determination of type A and type B programs is based on the SEFA.
   d. The auditee is responsible for the determination of major programs.

Percentage-of-coverage rule

The auditor must audit as major programs those programs with federal awards expended that, in the aggregate, constitute at least 40% of total federal awards expended.

If the auditee meets the criteria for a low-risk auditee, the auditor need only audit as major programs those programs with federal awards expended that, in the aggregate, constitute at least 20% of total federal awards expended.

Key point

The *percentage-of-coverage rule* represents the minimum coverage to be achieved; the minimum coverage is calculated after completing step 4, the determination of programs to be audited.

Key point

The determination of the major programs required to be tested under the percentage-of-coverage rule is based on final total federal expenditures. This calculation should be redone if preliminary expenditures were initially used or if any adjustments were made to total federal expenditures during the audit. Any additional major programs need to be tested to meet the required percentage of coverage.

Criteria for low-risk auditees

An auditee must meet all the following conditions for each of the preceding two audit periods to qualify as a low-risk auditee and be eligible for reduced audit coverage:

- Single audits were performed annually in accordance with the Uniform Guidance, including submitting the data collection form and reporting package to the Federal Audit Clearinghouse within the **earlier** of 30 calendar days after receipt of the auditor's report or nine months after the end of the audit period. An auditee that has biennial audits does not qualify as a low-risk auditee.
- The auditor's opinion that the auditee's financial statements were prepared in accordance with generally accepted accounting principles (GAAP) or with a basis of accounting required by state law, was unmodified. (Therefore, unless required by state law, an auditee that prepares its financial statements on a non-GAAP basis of accounting, such as the cash or modified cash basis, cannot be considered a low-risk auditee.)
- The auditor's in-relation-to opinion on the SEFA was unmodified.
- There were no deficiencies in internal control over financial reporting identified as material weaknesses under the requirements of *Government Auditing Standards*.
- The auditor did not report a substantial doubt about the auditee's ability to continue as a going concern.
- None of the federal programs had audit findings from any of the following in either of the preceding two audit periods in which they were classified as type A programs:
  - Internal control deficiencies identified as material weaknesses in the auditor's report on internal control for major programs
  - A modified opinion on a major program in the auditor's report on major programs
  - Known or likely questioned costs that exceed 5% of the total federal awards expended for a type A program during the audit period

Key point

An auditor may not use professional judgment to override these required conditions for low-risk auditee status. For example, it would not be appropriate for an auditor to make a determination that a material weakness under the requirements of *Government Auditing Standards* that was reported in one of the preceding two audit periods would not be important enough to cause an entity to lose its low-risk auditee status.

Practice issue

Due to COVID-19 funding, many entities will likely be subjected to Single Audit requirements for the first time. These entities cannot meet the criteria for low-risk auditees because they have not had single audits in the preceding two years.

Knowledge check

6. Which is a condition that must be met for an auditee to meet the criteria as a low-risk auditee?

    a. There were no deficiencies in internal control over financial reporting identified as significant deficiencies or material weaknesses under the requirements of *Government Auditing Standards* in the two preceding audit periods.
    b. There were no known questioned costs in any of the audit findings in the preceding audit period.
    c. No nonmajor program had a modified opinion in the auditor's report on major programs in the preceding audit period.
    d. The auditor did not report a substantial doubt about the auditee's ability to continue as a going concern in the preceding two audit periods.

Common deficiencies found in single audits

Common deficiencies related to major program determination include

- The auditor failed to accurately identify or test (or both) all major programs in accordance with the requirements. The most common reasons were that the auditor
  - used preliminary expenditures when the final expenditures resulted in a program being an other-than-low-risk program,
  - failed to properly perform type A and type B program risk assessments,
  - failed to combine expenditures from various funding agents having the same Assistance Listing number,
  - improperly clustered related program Assistance Listing numbers,
  - used an improper threshold, and
  - failed to consider large loans in the major program threshold assessment.
- Auditees were improperly identifed as low risk because the auditor failed to consider the following, resulting in insufficient coverage:
  - The auditee did not file a data collection form in a prior year.
  - A modified opinion was issued within the prior two years regarding either the financial statements or the SEFA.
  - There were material weaknesses in internal controls over financial reporting or federal compliance within the last two years.
  - There was material noncompliance in federal programs within the last two years.

Summary

Key foundational points	
1.	The Uniform Guidance states that the auditor must use a risk-based approach to determine which federal programs are major programs.
2.	The SEFA prepared by an auditee forms the basis for an auditor's identification of type A and type B programs. An auditor using the prior-year SEFA or current-year estimates to plan the audit should recalculate the threshold for type A programs based on the final amounts; this ensures that federal awards are properly classified as type A or B.
3.	The auditor must audit as major programs those programs with federal awards expended that, in the aggregate, constitute at least 40% of total federal awards expended. If the auditee meets the criteria for a low-risk auditee, the auditor need only audit as major programs those programs with federal awards expended that, in the aggregate, constitute at least 20% of total federal awards expended.
4	The Uniform Guidance establishes certain criteria for determining whether an auditee is low risk. An auditee that meets all of the criteria for each of the two preceding audit periods must qualify as a low-risk auditee and be eligible for the reduced audit coverage under the percentage-of-coverage rule.

Case study: Preliminary SEFA

Your client provides you the preliminary SEFA for Case Study University. You are the senior manager on the audit team. Using the Appendix: Preliminary Schedule of Expenditures of Federal Awards, determine the programs to be audited as major by applying the four-step process as set forth in the Uniform Guidance.

Step 1: Determination of type A and type B programs

3. Identify the clusters. How many programs are there?

4. Does the Student Financial Assistance cluster qualify as a loan program? If so, is it a large loan program?

5. What amount is the type A threshold based on? What is the type A threshold?

Case study: Preliminary SEFA (continued)

Step 1: Determination of type A and type B programs, cont.

6. Determine the type A and type B programs by listing them on the following table. (You may not need all the lines.) How many programs are type A programs?

Program name and Assistance Listing number	Type A	Type B

Case study: Preliminary SEFA (continued)

Step 2: Identification of low-risk type A programs

1. Determine the low-risk type A programs. Determine the other-than-low-risk type A programs.

Additional information needed to determine low-risk type A programs:

- No type A program risk criterion indicates a higher risk for any type A programs.
- No agency has requested any program be considered other than low risk.
- The Student Financial Assistance cluster was audited as a major program last year.
- Funds for Improvement of Post-secondary Education (84.116) was audited as a major program two years ago.
- The TRIO cluster was audited as a major program three years ago.
- Career & Technical Education Grant — Basic Grants to States (84.048) was audited as a major program three years ago.
- The R&D Cluster is a new program this year.
- No type A program, in the most recent audit period, had
  - internal control deficiencies identified as material weaknesses in the auditor's report on internal control for major programs,
  - a modified opinion on the program in the auditor's report on major programs, or
  - known or likely questioned costs that exceed 5% of the total federal awards expended for the program.

Low-risk type A programs =

Other-than-low-risk type A programs =

Case study: Preliminary SEFA (continued)

Step 3: Identification of high-risk type B programs

1. The auditor is not required to identify more high-risk type B programs than at least one-fourth the number of low-risk type A programs. What is the maximum number of high-risk type B programs required to be identified?

2. Which programs are not required to be assessed for risk because they are considered "relatively small" programs?

3. Identify the high-risk type B programs.

4. How many type B programs did the auditor have to assess for risk?

Additional information needed regarding the determination of high-risk type B programs:

> Based on the assessment of risk of the type B programs, the Department of Education program **Adult Education — Basic Grants to States (84.002)** is considered a low-risk type B program.
>
> Based on the assessment of risk of the type B programs, **Academic Exchange Programs — Scholars (19.401)** is considered a high-risk type B program.

Case study: Preliminary SEFA (continued)

Step 4: Determination of programs to be audited as major

1. Assuming the entity is **not** a low-risk auditee, what is the amount of federal awards required to be audited as major programs?

2. Based on this exercise, which programs are required to be audited as major programs? (Assume there were no federal agency requests for a program to be audited as major.) If necessary, which programs would you select to meet the percentage of coverage?

Assistance Listing number of major program	Dollar amount of major program

Case study: Final SEFA

Your client informs you that they made minor changes to the SEFA and that it now is final. Using the Appendix: Final Schedule of Expenditures of Federal Awards, identify any changes the client made to it and how they affect which programs would be selected.

Step 1: Determination of type A and type B programs

1. Does the Student Financial Assistance cluster qualify as a loan program? If so, is it a large loan program?

2. What amount is the type A threshold based on? What is the type A threshold?

Case study: Final SEFA (continued)

Step 1: Determination of type A and type B programs, cont.

3. Determine the type A and type B programs by listing them on the following table. (You may not need all the lines.) How many programs are A programs?

Program name and Assistance Listing number	Type A	Type B

Which programs would be affected by the entity's changes?

Case study: Final SEFA (continued)

Step 2: Identification of low-risk type A programs

1. Determine which programs are low-risk type A programs and which are other-than-low-risk type A programs.

Additional information needed to identify low-risk type A programs:

- No type A program risk criteria indicate a higher risk for any type A programs.
- No agency has requested any program be considered other than low risk.
- The **Student Financial Assistance cluster** was audited as a major program last year.
- **Funds for Improvement of Post-secondary Education (84.116)** was audited as a major program two years ago.
- The **R&D Cluster** is a new program this year.
- In the most recent audit period, no type A program had
  - internal control deficiencies identified as material weaknesses in the auditor's report on internal control for major programs,
  - a modified opinion on the program in the auditor's report on major programs, or
  - known or likely questioned costs that exceed 5% of the total federal awards expended for the program.

Low-risk type A programs =

Other-than-low-risk type A programs =

How do these changes affect the number of other-than-low-risk and low-risk type A programs?

Case study: Final SEFA (continued)

Step 3: Identification of high-risk type B programs

1. The auditor is not required to identify more high-risk type B programs than at least one-fourth the number of low-risk type A programs. What is the maximum number of high-risk type B programs required to be identified? How was this affected by the entity's changes to the SEFA?

2. Which programs are not required to be assessed for risk because they are considered "relatively small" programs?

3. Identify the high-risk type B programs.

4. How many type B programs did the auditor have to assess for risk?

Additional information needed to identify high-risk type B programs

Based on the assessment of risk of the type B programs, the following programs are considered low risk:

- TRIO cluster
- X State Department of Education — Adult Education — Basic Grants to States (84.002)
- X State Department of Education — Career and Technical Education — Basic Grants to States (84.048)

Based on the assessment of risk of the type B programs, Academic Exchange Programs — Scholars (19.401) *is* considered a high-risk type B program.

Case study: Final SEFA (continued)

Step 4: Determination of programs to be audited as major

1. Assume the entity is **not** a low-risk auditee. What is the amount of federal awards required to be audited as major programs?

2. Based on this exercise, which programs are required to be audited as major programs? (Assume there were no federal agency requests for a program to be audited as major.) If necessary, which programs would you select to meet the percentage of coverage?

Assistance Listing number of major program	Dollar amount of major program

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Preliminary Schedule of Expenditures of Federal Awards

Case Study University Preliminary Schedule of Expenditures of Federal Awards

This appendix is required for CPE credit.

Appendix

Note: This illustrative schedule of expenditures of federal awards (SEFA) is provided as a base for certain course material and case studies. The programs and amounts provided are for example purposes only and do not necessarily reflect what a federal agency may provide or a nonfederal entity may receive.

Preliminary SEFA

Case Study University Preliminary Schedule of Expenditure of Federal Awards[1] For the year ended June 30, 20X1				
Federal grantor/Pass-through grantor/Program or cluster title	**Federal Assistance Listing number**	**Pass-through entity identifying number**	**Passed through to subrecipients**	**Total federal expenditures**
Student financial assistance — cluster[2]				
Department of Education				
Federal Pell Grant Program	84.063			$ 8,000,000
Federal Direct Student Loans	84.268			5,000,000
Federal Supplemental Educational Opportunity Grants	84.007			1,000,000
Federal Work-Study Program	84.033			600,000
Teacher Education Assistance for College and Higher Education Grants (TEACH)	84.379			550,000
Federal Perkins Loan Program (note 4)	84.038			500,000
Total Department of Education				$15,650,000

[1] To meet state or other requirements, auditees may decide to include certain nonfederal awards (for example, state awards) in this schedule. If such nonfederal awards are presented, they should be segregated and clearly designated as nonfederal. The title of the schedule also should be modified to indicate that nonfederal awards are included.

[2] Institutions of higher education often participate in certain loan and loan guarantee programs, as shown here. The Uniform Guidance requires that when loans are made to students, but the institution of higher education does not make the loans, the value of the loans made during the year is considered federal awards expended. Under the Uniform Guidance, those loans and loan guarantees are required to be reported on the face of the schedule.

Case Study University Preliminary Schedule of Expenditure of Federal Awards For the year ended June 30, 20X1 (continued)				
Federal grantor/Pass-through grantor/Program or cluster title	Federal Assistance Listing number	Pass-through entity identifying number	Passed through to subrecipients	Total federal expenditures
Department of Health and Human Services				
Nursing Student Loans (note 4)	93.364			$ 2,000,000
Health Professions Student Loans (note 4)	93.342			3,000,000
Total Department of Health and Human Services				$5,000,000
Total Student Financial Assistance Cluster				$20,650,000
Research and Development — Cluster[3]				
Department of Defense				
Department of Army				
Collaborative Research and Development	12.114		$550,000	$1,000,000
Military Medical Research and Development	12.420		650,000	750,000
XYZ Labs — Effects of Ice on Radar Images	12.RD	4532		100,000
Total Department of Defense			$1,200,000	$1,850,000
National Science Foundation				
Geosciences	47.050		$200,000	$ 395,000
Biological Sciences	47.074		100,000	125,000
ABC University — Atmospheric Effects of Volcano Eruptions	47.ABC-852	ABC-852		125,000
Total National Science Foundation			$300,000	$645,000

Case Study University Preliminary Schedule of Expenditure of Federal Awards For the year ended June 30, 20X1 (continued)				
Federal grantor/Pass-through grantor/Program or cluster title	**Federal Assistance Listing number**	**Pass-through entity identifying number**	**Passed through to subrecipients**	**Total federal expenditures**
Department of Health and Human Services				
National Institutes of Health				
Mental Health Research Grants	93.242		$25,000	$125,000
Drug Abuse and Addiction Research Programs	93.279		60,000	100,000
ABC Hospital — Heart Research	93.RD	5489-5		200,000
Centers for Disease Control and Prevention				
Chronic Diseases: Research, Control, and Prevention	93.068		100,000	150,000
Total Department of Health and Human Services			$185,000	$575,000
Total research and development cluster			$1,685,000	$3,070,000
TRIO cluster				
Department of Education				
TRIO — Talent Search	84.044			$600,000
TRIO — Upward Bound	84.047			175,000

[3] For research and development, the Uniform Guidance states that total federal awards expended must be shown either by individual award or by federal agency and major subdivision within the federal agency. This example illustrates the individual award option.

Total TRIO cluster				$775,000

Case Study University Preliminary Schedule of Expenditure of Federal Awards For the year ended June 30, 20X1 (continued)				
Federal grantor/Pass-through grantor/Program or cluster title	**Federal Assistance Listing number**	**Pass-through entity identifying number**	**Passed through to subrecipients**	**Total federal expenditures**
Other Programs				
Department of State				
Academic Exchange Programs — Scholars	19.401			$500,000
Total Department of State				$500,000
Department of Education				
Funds for Improvement of Postsecondary Education	84.116			$750,000
XYZ University — Funds for Improvement of Postsecondary Education	84.116	374-15-9248		250,000
Subtotal	84.116			$1,000,000
School Safety National Activities	84.184			75,000
X State Department of Education — Adult Education — Basic Grants to States	84.002	25-8594-2167		400,000
X State Department of Education — Career and Technical Education — Basic Grants to States	84.048	874-90-5473		755,000
Total Department of Education				$2,230,000
Total expenditures of federal awards			$1,685,000	$27,225,000
The accompanying notes are an integral part of this schedule.				

Case Study University notes to the preliminary SEFA for the year ended June 30, 20X1

Note 1. Basis of Presentation4

The accompanying SEFA (the schedule) includes the federal award activity of Case Study University under programs of the federal government for the year ended June 30, 20X1. The information in this schedule is presented in accordance with the requirements of Code of Federal Regulations, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, Title 2, Section 200 (the Uniform Guidance). Because the schedule presents only a selected portion of the operations of Case Study University, it is not intended to and does not present the financial position, changes in net assets, or cash flows of Case Study University.

Note 2. Summary of Significant Accounting Policies[5]

Expenditures reported on the schedule are reported on the [identify basis of accounting] basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance,[6] wherein certain types of expenditures are not allowable or are limited with regard to reimbursement. Negative amounts shown on the schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years

Note 3. Indirect Cost Rate[7]

Case Study University has elected not to use the 10% *de minimis* indirect cost rate allowed under the Uniform Guidance.

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[4] This note is included to meet the Uniform Guidance requirement that the schedule include notes that describe the significant accounting policies used in preparing the schedule.

[5] See footnote 5.

[6] There may be situations in which federal expenditures presented in the SEFA also include expenditures subject to pre-Uniform Guidance requirements. In this situation, the second sentence of this illustrative note may be modified as appropriate for the type of entity being audited. For a not-for-profit entity, an example follows:

> Such expenditures are recognized following, as applicable, either the cost principles in Office of Management and Budget Circular A-122, *Cost Principles for Non-Profit Organizations*, or the cost principles contained in Code of Federal Regulations, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, Title 2, Section 200, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

[7] The Uniform Guidance specifically requires the auditee to include in the notes whether or not the auditee elected to use the 10% *de minimis* cost rate.

Note 4. Federal Student Loan Programs[8,9]

The federal student loan programs listed subsequently are administered directly by Case Study University; balances and transactions relating to these programs are included in Case Study University's basic financial statements. Loans outstanding at the beginning of the year and loans made during the year are included in the federal expenditures presented in the schedule. The balance of loans outstanding at June 30, 20X1, consists of the following:

Assistance Listing number	Program name	Outstanding balance at June 30, 20X1
84.038	Federal Perkins Loan	$491,000
93.364	Nursing Student Loans	$1,875,000
93.342	Health Professional Student Loans	$2,950,000

[8] This note is intended to meet the Uniform Guidance requirement that the balances of loan or loan guarantees outstanding at year-end be included in the notes to the schedule. The total federal awards expended for loan or loan guarantee programs must be included on the face of the schedule of expenditures of federal awards. The basis used to determine loan or loan guarantees expended is the amount of new loans made or received during the fiscal year plus the balance of loans from previous years for which the federal government imposes continuing compliance requirements, plus any interest subsidy, cash, or administrative cost allowance received.

[9] This note reflects an institution of higher education (IHE) that makes loans to its students. When loans are made to students of an IHE, but the IHE does not make the loans, the basis used to determine loans or loan guarantees expended is the amount of new loans made during the fiscal year. The balance for loans for previous periods is not included as federal awards expended because the lender accounts for the prior balances. Therefore, an IHE that does not make the loans will not have loan balances to disclose in the notes to the schedule because the lender accounts for the prior balances.

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Final Schedule of Expenditures of Federal Awards

Case Study University Final Schedule of Expenditures of Federal Awards

This appendix is required for CPE credit.

Appendix

Note: This illustrative schedule of expenditures of federal awards (SEFA) is provided as a base for certain course material and case studies. The programs and amounts provided are for example purposes only; they do not necessarily reflect what a federal agency would provide or a nonfederal entity would receive.

Final SEFA

Case Study University Schedule of Expenditure of Federal Awards[1] For the year ended June 30, 20X1				
Federal grantor/Pass-through grantor/Program or cluster title	**Federal Assistance Listing number**	**Pass-through entity identifying number[2]**	**Passed through to subrecipients**	**Total federal expenditures**
Student Financial Assistance Cluster[3]				
Department of Education				
Federal Pell Grant Program	84.063			$ 8,000,000
Federal Direct Student Loans	84.268			5,000,000
Federal Supplemental Educational Opportunity Grants	84.007			2,000,000
Federal Work-Study Program	84.033			600,000
Teacher Education Assistance for College and Higher Education Grants (TEACH)	84.379			550,000
Federal Perkins Loan Program (note 4)	84.038			500,000
Total Department of Education				$16,650,000

[1] To meet state or other requirements, auditees may decide to include certain nonfederal awards (for example, state awards) in this schedule. If such nonfederal awards are presented, they should be segregated and clearly designated as nonfederal. The title of the schedule also should be modified to indicate that nonfederal awards are included.

[2] When awards are received as a subrecipient, the schedule must include the identifying number assigned by the pass-through entity.

[3] As shown here, institutions of higher education (IHEs) often participate in certain loan and loan guarantee programs. The Uniform Guidance requires that when loans are made to students but the IHE does not make the loans, the value of the loans made during the year is considered federal awards expended. Under the Uniform Guidance, those loans and loan guarantees are required to be reported on the face of the schedule.

Case Study University Schedule of Expenditure of Federal Awards For the year ended June 30, 20X1 (continued)				
Federal grantor/Pass-through grantor/Program or cluster title	**Federal Assistance Listing number**	**Pass-through entity identifying number**	**Passed through to subrecipients**	**Total federal expenditures**
Department of Health and Human Services				
Nursing Student Loans (note 4)	93.364			$ 1,000,000
Health Professions Student Loans (note 4)	93.342			3,000,000
Total Department of Health and Human Services				$4,000,000
Total Student Financial Assistance Cluster				$20,650,000
Research and Development Cluster[4]				
Department of Defense				
Department of Army				
Collaborative Research and Development	12.114		$550,000	$1,000,000
Military Medical Research and Development	12.420		650,000	750,000
XYZ Labs — Effects of Ice on Radar Images	12.RD	4532		100,000
Total Department of Defense			$1,200,000	$1,850,000
National Science Foundation				
Geosciences	47.050		$200,000	$ 395,000
Biological Sciences	47.074		100,000	125,000
ABC University — Atmospheric Effects of Volcano Eruptions	47.ABC-852	ABC-852		125,000
Total National Science Foundation			$300,000	$645,000

[4] For research and development, the Uniform Guidance states that total federal awards expended must be shown either by individual award or by federal agency and major subdivision within the federal agency. This example illustrates the individual award option.

Case Study University Schedule of Expenditure of Federal Awards For the year ended June 30, 20X1 (continued)				
Federal grantor/Pass-through grantor/Program or cluster title	**Federal Assistance Listing number**	**Pass-through entity identifying number**	**Passed through to subrecipients**	**Total federal expenditures**
Department of Health and Human Services				
National Institutes of Health				
Mental Health Research Grants	93.242		$25,000	$125,000
Drug Abuse and Addiction Research Programs	93.279		60,000	100,000
ABC Hospital — Heart Research	93.RD	5489-5		200,000
Centers for Disease Control and Prevention				
Chronic Diseases: Research, Control, and Prevention	93.068		100,000	150,000
Total Department of Health and Human Services			$185,000	$575,000
Total Research and Development Cluster			$1,685,000	$3,070,000
TRIO Cluster				
Department of Education				
TRIO — Talent Search	84.044			$600,000
TRIO — Upward Bound	84.047			175,000
Total TRIO Cluster				$775,000

Case Study University Schedule of Expenditure of Federal Awards For the year ended June 30, 20X1 (continued)				
Federal grantor/Pass-through grantor/Program or cluster title	**Federal Assistance Listing number**	**Pass-through entity identifying number**	**Passed through to subrecipients**	**Total federal expenditures**
Other programs				
Department of State				
Academic Exchange Programs — Scholars	19.401			$500,000
Total Department of State				$500,000
Department of Education				
Funds for Improvement of Postsecondary Education	84.116			$750,000
XYZ University — Funds for Improvement of Postsecondary Education	84.116	374-15-9248		250,000
Subtotal	84.116			$1,000,000
School Safety National Activities	84.184			75,000
X State Department of Education — Adult Education — Basic Grants to States	84.002	25-8594-2167		400,000
X State Department of Education—Career and Technical Education—Basic Grants to States	84.048	874-90-5473		755,000
Total Department of Education				$2,230,000
Total expenditures of federal awards			$1,685,000	$27,225,000
The accompanying notes are an integral part of this schedule.				

Case Study University notes to the SEFA for the year ended June 30, 20X1

Note 1. Basis of presentation5

The accompanying SEFA (the schedule) includes the federal award activity of Case Study University under programs of the federal government for the year ended June 30, 20X1. The information in this schedule is presented in accordance with the requirements of Code of Federal Regulations, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, Title 2, Section 200 (the Uniform Guidance). Because the schedule presents only a selected portion of the operations of Case Study University, it is not intended to and does not present the financial position, changes in net assets, or cash flows of Case Study University.

Note 2. Summary of significant accounting policies[6]

Expenditures reported on the schedule are reported on the [identify basis of accounting] basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance,[7] wherein certain types of expenditures are not allowable or are limited as to reimbursement. Negative amounts shown on the schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years.

Note 3. Indirect cost rate[8]

Case Study University has elected to not use the 10% *de minimis* indirect cost rate allowed under the Uniform Guidance.

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[5] This note is included to meet the Uniform Guidance requirement that the schedule include notes that describe the significant accounting policies used in preparing the schedule.

[6] See footnote 5.

[7] There may be situations in which federal expenditures presented in the schedule of expenditures of federal awards (SEFA) also include expenditures subject to pre-Uniform Guidance requirements. In this situation, the second sentence of this illustrative note may be modified as appropriate for the type of entity being audited. For a not-for-profit entity, an example follows.

> Such expenditures are recognized following, as applicable, either the cost principles in Office of Management and Budget Circular A-122, *Cost Principles for Non-Profit Organizations*, or the cost principles contained in Code of Federal Regulations, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, Title 2, Section 200, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

[8] The Uniform Guidance specifically requires the auditee to include in the notes whether the auditee elected to use the 10% *de minimis* cost rate.

Note 4. Federal student loan programs[9,10]

The federal student loan programs listed subsequently are administered directly by Case Study University; balances and transactions relating to these programs are included in Case Study University's basic financial statements. Loans outstanding at the beginning of the year and loans made during the year are included in the federal expenditures presented in the schedule. The balance of loans outstanding at June 30, 20X1, consists of the following:

Assistance Listing number	Program name	Outstanding balance at June 30, 20X1
84.038	Federal Perkins Loan	$491,000
93.364	Nursing Student Loans	$957,500
93.342	Health Professional Student Loans	$2,950,000

[9] This note is intended to meet the Uniform Guidance requirement that the balances of loan or loan guarantees outstanding at year-end be included in the notes to the schedule. The total federal awards expended for loan or loan guarantee programs must be included on the face of the SEFA. The basis used to determine loan or loan guarantees expended is the amount of new loans made or received during the fiscal year plus the balance of loans from previous years for which the federal government imposes continuing compliance requirements, plus any interest subsidy, cash, or administrative cost allowance received.

[10] This note reflects an IHE that makes loans to its students. When loans are made to students of an IHE, but the IHE does not make the loans, the basis used to determine loans or loan guarantees expended is the amount of new loans made during the fiscal year. The balance for loans for previous periods is not included as federal awards expended because the lender accounts for the prior balances. Therefore, an IHE that does not make the loans will not have loan balances to disclose in the notes to the schedule because the lender accounts for the prior balances.

Solutions

Advanced Topics in a Single Audit: Determination of Major Programs

Case study solutions

Case Study: Preliminary SEFA

Step 1: Determination of type A and type B programs

1. Identify the clusters. How many programs are there?

    The clusters are research and development (R&D), Student Financial Assistance (SFA), and TRIO.

    There are eight programs. (three clusters plus 19.401, 84.116, 84.184, 84.002, 84.048)

2. Does the SFA cluster qualify as a loan program? If so, is it a large loan program?

    Loan programs = $10,500,000 (84.268, 84.038, 93.364, 93.342)

    Yes, the SFA cluster qualifies as a loan program.

    (10,500,000/20,650,000) = 51%

    SFA cluster = $20,650,000

    Largest non-loan program (R&D) times 4: $3,070,000 × 4 = $12,280,000

    Yes, the SFA cluster is a large loan program for major program determination purposes since it is greater than four times the largest non-loan program.

3. What amount is the type A threshold based on?

    Total expenditures of federal awards minus the SFA cluster:

    $6,575,000 = ($27,225,000 – $20,650,000)

    What is the type A threshold? $750,000

4. Determine the type A and type B programs by listing them on the following table. (You may not need all the lines.)

Case Study: Preliminary SEFA (continued)

Program name and Assistance Listing number	Type A	Type B
SFA cluster	20,650,000	
R&D cluster	3,070,000	
TRIO cluster	775,000	
Funds for Improvement of Post-secondary Education (84.116)	1,000,000	
Academic Exchange Programs — Scholars (19.401)		500,000
School Safety National Activities (84.184)		75,000
X State Department of Education — Adult Education — Basic Grants to States (84.002)		400,000
X State Department of Education — Career and Technical Education — Basic Grants to States (84.048)	755,000	

There are five type A programs.

Step 2: Identification of low-risk type A programs

1. Determine the low-risk type A programs. Determine the other than low-risk type A programs.

Low-risk type A programs =

SFA cluster

84.116

Other than low-risk type A programs =

R&D

TRIO cluster

84.048

Case Study: Preliminary SEFA (continued)

Step 3: Identification of high-risk type B programs

1. The auditor is not required to identify more high-risk type B programs than at least one-fourth the number of low-risk type A programs. What is the maximum number of high-risk type B programs required to be identified?

   One (2 ÷ 4 = 0.50) [must round up]

2. What programs are not required to be assessed for risk because they are considered "relatively small" programs?

   84.184

3. Identify the high-risk type B programs.

   Based on the risk assessment, 19.401 is a high-risk type B.

   Note: In general, if all type B programs (other than relatively small programs) have been risk assessed without identifying the calculated number of high-risk type B programs, the high-risk type B programs identified (if any) are audited as major, and the auditor proceeds to step 4.

4. How many type B programs did the auditor have to assess for risk?

   It depends on which type B program was assessed for risk first. If program 84.002 was assessed for risk first, then two programs had to be assessed for risk. (That is, until one high-risk type B program was identified.) If program 19.401 was assessed for risk first, then one program had to be assessed for risk. (That is, until one high-risk type B program was identified.)

Step 4: Determination of programs to be audited as major

1. Assuming the entity is *not* a low-risk auditee, what is the amount of federal awards that is required to be audited as major programs?

   $10,890,000 ($27,225,000 × .40)

2. Based on this exercise, which programs are required to be audited as major programs? (Assume there were no federal agency requests for a program to be audited as major.)

Case Study: Preliminary SEFA (continued)

Assistance Listing Number of major program	Dollar amount of major program
Required to be audited as a major program:	
Type A programs identified as other than low risk: R&D = $3,070,000 TRIO cluster = $775,000 84.048 = $755,000	$4,600,000
Type B programs identified as high risk: 19.401 is a high-risk type B	500,000
Subtotal	$ 5,100,000
Total type A and type B programs required to be audited as major based on steps 2 and 3 is $5,100,000. Percentage of coverage requires $10,890,000 of federal awards to be audited as major programs. Therefore, programs totaling at least $5,790,000 must be selected as additional major programs.	
Which additional programs would you select to test to meet the percentage of coverage rule? **Note:** No particular programs are required to be selected to meet the percentage of coverage needed. Select programs such that total major programs audited equal or exceed $10,890,000.	

Case Study: Final SEFA

Step 1: Determination of type A and type B programs

1. Does the SFA cluster qualify as a loan program? If so, is it a large loan program?

   Loan programs = $9,500,000 (84.268, 84.038, 93.364, 93.342)

   No, the SFA cluster does not qualify as a loan program. (9,500,000 ÷ 20,650,000) = 46%

   A large loan program = **N/A**

2. What amount is the type A threshold based on?

   Total expenditures of federal awards: $27,225,000
   What is the type A threshold? $27,225,000 × .03 = $816,750

Case Study: Final SEFA (continued)

3. Determine the type A and type B programs by listing them on the following table. (You may not need all the lines.)

Program name and Assistance Listing number	Type A	Type B
SFA cluster	20,650,000	
R&D cluster	3,070,000	
TRIO cluster		775,000
Funds for Improvement of Post-secondary Education (84.116)	1,000,000	
Academic Exchange Programs — Scholars (19.401)		500,000
School Safety National Activities (84.184)		75,000
X State Department of Education — Adult Education — Basic Grants to States (84.002)		400,000
X State Department of Education — Career and Technical Education — Basic Grants to States (84.048)		755,000

There are three type A programs.

Which programs would be affected by the entity's changes?

TRIO and 84.048 are no longer type A programs.

Step 2: Identification of low-risk type A programs

1. Determine which programs are low-risk type A programs and which are other-than-low-risk type A programs.

Low-risk type A programs =

SFA cluster

84.116

Other-than-low-risk type A programs =

R&D

How do these changes affect the number of other-than-low-risk and low-risk type A programs?

Now we have two low-risk A programs and only 1 other-than-low-risk A. Two programs that were other than low risk are now B programs. This reduces the number of "must select" A programs.

Case Study: Final SEFA (continued)

Step 3: Identification of high-risk type B programs

1. The auditor is not required to identify more high-risk type B programs than at least one-fourth the number of low-risk type A programs. What is the maximum number of high-risk type B programs required to be identified?

   One (2 ÷ 4 = 0.50) [must round up] No change because the number of low-risk A programs stayed the same.

2. Which programs are not required to be assessed for risk because they are considered "relatively small" programs?

   84.184

3. Identify the high-risk type B programs.

   Based on the risk assessment, 19.401 is a high-risk type B.

   Note: In general, if all type B programs (other than relatively small programs) have been assessed for risk without identifying the calculated number of high-risk type B programs, the high-risk type B programs identified (if any) are audited as major, and the auditor proceeds to step 4.

4. How many type B programs did the auditor have to assess for risk?

   It depends on which type B program was assessed for risk first. If program 19.401 was assessed for risk first, then one program had to be assessed for risk. (That is, until one high-risk type B program was identified.) Otherwise, type B programs had to be assessed for risk until the high-risk program was identified. At most the 4 type B programs with expenditures greater than the relatively small program threshold of $204,188 ($816,750 × .25) had to be assessed for risk.

STEP 4 — Determination of Programs to be Audited as Major

1. Assume the entity is not a low-risk auditee. What is the amount of federal awards required to be audited as major programs?

   $10,890,000 ($27,225,000 × .40)

2. Based on this exercise, which programs are required to be audited as major programs? (Assume there were no federal agency requests for a program to be audited as major.)

Case Study: Final SEFA (continued)

Assistance Listing number of major program	Dollar amount of major program
Required to be audited as a major program:	
Type A programs identified as other than low risk: R&D = $3,070,000	$3,070,000
Type B programs identified as high risk: 19.401 is a high-risk type B	500,000
Subtotal	$ 3,570,000
Total type A and type B programs required to be audited as major based on steps 2 and 3 is $3,570,000. Percentage of coverage requires $10,890,000 of federal awards to be audited as major programs. Therefore, programs totaling at least $7,320,000 must be selected as additional major programs.	
Which additional programs would you select to test to meet the percentage of coverage rule? **Note:** No particular programs are required to be selected to meet the percentage of coverage needed. Select programs such that total major programs audited equal or exceed $10,890,000.	

Knowledge check solutions

1.

   a. Incorrect. An auditor is **not** restricted to using professional judgment when determining low-risk type A programs.
   b. Incorrect. The use of professional judgment is required in certain areas of major program determination.
   c. Incorrect. An auditor may not use professional judgment to determine that an audit finding in a prior year does not preclude a program from being a low-risk type A program in the current year.
   d. Correct. Professional judgment is used in determining high-risk type B programs.

2.

a. Incorrect. Type A programs selected to be audited are major programs. However, major programs include other than type A programs.
b. Incorrect. Type B programs selected to be audited are major programs. However, major programs include other than type B programs.
c. Correct. Major programs include those programs selected to be audited.
d. Incorrect. Major programs do not depend solely on the amount of federal awards expended.

3.

a. Incorrect. A type B program may have expenditures of greater than $5,000.
b. Incorrect. The assessed risk of a program is not a determining factor as to whether it is a type A or type B program.
c. Correct. A federal program not identified as a type A program is a type B program.
d. Incorrect. A type B program may have federal awards expended of greater than $10,000.

4.

a. Correct. Risk assessments of type B programs must continue until the calculated number of high-risk type B programs are identified (at least one-quarter the number of low-risk type A programs) or there are no more type B programs left to assess.
b. Incorrect. Risk assessments of type B programs does not depend on the number of low-risk type A programs.
c. Incorrect. Risk assessment of type B programs is required.
d. Incorrect. There is one process for determining high-risk type B programs.

5.

a. Incorrect. Federal agencies and pass-through entities may provide the auditor with guidance as to the risk of a particular federal program. The auditor must consider this in determining major programs for audits not yet completed.
b. Incorrect. The Uniform Guidance uses a risk-based approach to determine major programs.
c. Correct. The determination of type A and type B programs is based on the SEFA.
d. Incorrect. The auditee is not responsible for the determination of major programs.

6.

a. Incorrect. Significant deficiencies are not part of these criteria, only material weaknesses.
b. Incorrect. The criteria related to questioned costs is regarding known or likely questioned costs exceeding 5% of total federal awards expended for a type A program.
c. Incorrect. The modified opinion criteria apply to a major program, not a nonmajor program.
d. Correct. The low-risk auditee criteria includes the condition that, in the preceding two audit periods, the auditor must not have reported a substantial doubt about the auditee's ability to continue as a going concern.

Advanced Topics in a Single Audit: Internal Control Over Compliance

Learning objectives

- Assess the nonfederal entity’s basic responsibility regarding internal control over compliance.
- Evaluate the auditor’s responsibility regarding internal control over compliance.
- Identify areas of special consideration related to internal control over compliance.

Nonfederal entity responsibilities

Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), establishes requirements for additional audit procedures and reporting relative to the auditor's consideration of internal control over compliance for major programs. These requirements are beyond those of a financial statement audit conducted in accordance with generally accepted auditing standards (GAAS) and *Government Auditing Standards* (GAGAS).

The Uniform Guidance defines *internal controls* for nonfederal entities as processes designed and implemented by nonfederal entities to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of reporting for internal and external use
- Compliance with applicable laws and regulations

The Uniform Guidance provides requirements regarding an auditee's internal control responsibilities in 2 CFR 200.303 of subpart D, "Post Federal Award Requirements Standards for Financial and Program Management." As noted in that section, a nonfederal entity must

- establish and maintain effective internal control over federal awards;
- comply with the U.S. Constitution, federal statutes, regulations, and the terms and conditions of federal awards;
- evaluate and monitor the nonfederal entity's compliance with statutes, regulations, and the terms and conditions of federal awards;
- take prompt action when instances of noncompliance are identified, including noncompliance identified in audit findings; and
- take reasonable measures to safeguard protected personally identifiable and other sensitive information.

Under the Uniform Guidance, nonfederal entities must establish and maintain effective internal control over federal awards that provides reasonable assurance that the entity is managing federal awards in compliance with federal statutes, regulations, and the terms and conditions of federal awards. Internal controls that auditees establish should comply with guidance in the *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) or that found in *Standards for Internal Control in the Federal Government* (known as the Green Book) issued by the Comptroller General of the United States.

Key point

The use of COSO's *Internal Control — Integrated Framework* and the Green Book is not required but is a best practice and the recommended approach.

control; both provide a framework for organizations to design, implement, and operate internal controls to achieve objectives related to operations, reporting, and compliance. The five components of internal control are as follows:

1. Control environment
2. Risk assessment
3. Control activities
4. Information and communication
5. Monitoring

These components assist an auditor in considering how the different aspects of an entity's internal control over compliance may affect an audit. When considering internal control over compliance for major programs, the auditor focuses on the internal control objective related to compliance with federal statutes, regulations, and the terms and conditions of the federal award.

Knowledge check

1. Which is included in the definition of *internal control*?

    a. Risk assessment.
    b. Reliable reporting for internal and external use.
    c. Information and communication.
    d. Maintenance of infrastructure assets.

Auditor’s responsibility regarding internal control

As it relates to internal control, the Uniform Guidance provides that the auditor must, in addition to the requirements of GAAS and GAGAS,

- perform procedures to obtain an understanding of internal control over federal programs sufficient to plan the audit to support a low assessed level of control risk of noncompliance for major programs;
- plan the testing of internal control over compliance for major programs to support a low assessed level of control risk of noncompliance for the assertions relevant to the compliance requirements for each major program;
- perform testing of internal control as planned; and
- report on internal control over compliance, describing the scope of testing of internal control and the results of the tests and, where applicable, referring to the separate schedule of findings and questioned costs.

Obtaining an understanding of internal control over compliance

Controls relevant to an audit of compliance with requirements applicable to major federal programs are referred to collectively in this course as *internal control over compliance* and are encompassed in the report on internal control over compliance required by the Uniform Guidance. In a particular single audit engagement, some controls may be relevant to both the audit of the financial statements and to the audit of compliance. When this occurs, those controls would be encompassed in both internal control reports.

Key point

Internal control over financial reporting considers the risk of material misstatement and focuses on financial statement assertions (such as, cutoff, existence, completeness). *Internal control over compliance* considers the risk of noncompliance and focuses on compliance requirements (such as, allowability of cost, period of performance, eligibility).

The auditor’s consideration of internal control over compliance for each major program is similar to the consideration of internal control over financial reporting in a financial statement audit. The same concepts apply for understanding internal control over compliance, assessing risk, and testing controls; however, the Uniform Guidance adds requirements to plan the audit to support a low assessed level of control risk of noncompliance for major programs, to perform related procedures and testing, and to report on internal control over compliance. An important aspect of the consideration of internal control over compliance in an audit under the Uniform Guidance is that the objective of internal control is compliance with federal statutes, regulations, and the terms and conditions of federal awards.

When considering internal control over compliance, the auditor should obtain an understanding of the aforementioned five components of internal control sufficient to assess the risks of material noncompliance with each compliance requirement subject to audit that is direct and material for each major program. The auditor should obtain a sufficient understanding by performing risk assessment procedures to evaluate the design of controls relevant to the compliance audit and to determine whether they have been implemented. The auditor should use the information gathered by performing the risk assessment procedures — including the audit evidence obtained in evaluating the design of controls and determining whether they have been implemented — as audit evidence to support the risk assessment. The risk assessment should be used to determine the nature, timing, and extent of further audit procedures to be performed.

Assessing control risk of noncompliance

Control risk of noncompliance is the risk that noncompliance with a compliance requirement that could occur and that could be material, either individually or when aggregated with other instances of noncompliance, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control over compliance. After obtaining an understanding of internal control over compliance for major programs, the auditor makes a preliminary assessment of control risk of noncompliance related to the compliance requirements subject to audit that are direct and material for each major program. This information is used to determine whether the auditor can support a low assessed level of control risk of noncompliance. When the auditor believes, based on the understanding of internal control, that controls are capable of effectively preventing, or detecting and correcting, material noncompliance, the auditor may initially assess control risk of noncompliance at less than the maximum during the risk assessment phase of the audit.

The *assessment of control risk of noncompliance* is the process of preliminarily evaluating the effectiveness of an entity's internal control over compliance in preventing, or detecting and correcting, material noncompliance with the compliance requirements for each major program. The auditor's basis for judgment of the assessed level of control risk of noncompliance should be documented to support the decisions made.

Compliance Supplement

Part 6, Appendix 1 of the *Compliance Supplement* provides illustrative entity-wide controls over compliance for four of the five components of internal control, as follows: control environment, risk assessment, information and communication, and monitoring. For this purpose, *entity-wide controls* are defined as governance controls that apply to most, if not all, types of compliance requirements for one or more federal programs. Entity-wide controls are generally governance controls established at the entity-wide level versus at the level of federal programs or types of compliance requirements. For example, an entity may establish controls related to the control environment for all types of compliance requirements for an individual federal program or even across all federal programs. When nonfederal entities implement internal controls in this manner, auditors may obtain an understanding of these controls and test them at the entity-wide level. Auditors may also prepare related documentation at an entity-wide level.

Part 6, Appendix 2 of the *Compliance Supplement* provides illustrative specific controls over compliance for control activities, the remaining component of the five components of internal control. For this purpose, *specific controls* are considered operational-level controls that apply to individual types of compliance requirements. For example, an entity may establish controls related to control activities at the applicable type of compliance requirement level (such as allowable costs, eligibility, and reporting, among others) for the federal programs that it participates in. When nonfederal entities implement internal controls in this manner, auditors should obtain an understanding of controls, test specific controls related to control activities, and prepare related documentation at that level.

As it relates to IT controls, Appendix 1 of Part 6 includes illustrative general IT controls as entity-wide controls in the information and communication systems component in areas such as security administration, program maintenance, and program execution. General IT controls are necessary for the effective operation of application IT controls. Appendix 2 includes specific IT controls in the section relating to Principle 11, "Design Activities for the Information System."

Internal control is not one event or circumstance; rather, it is a dynamic and iterative process. Embedded within this process are controls that comprise policies and procedures. Part 6 defines a *process* as a series of actions that lead to a particular result (for example, charging costs to a federal award). It is during a process when noncompliance with allowable costs, cost principles, or other requirements could occur. This potential noncompliance is often referred to as a "what-could-go-wrong" (WCGW). Controls are designed to prevent or timely detect noncompliance. Controls do not themselves introduce noncompliance into a process. When identifying controls, it is important to first consider the processes and the resulting WCGWs. Because controls should be designed, implemented, and maintained to be responsive to risk and WCGWs, it is difficult to determine the appropriateness of specific controls without understanding the process and the WCGWs.

Controls may be viewed as part of a process and of the flow of transactions, but they must be *separately* identified. When it is difficult to identify the difference between a process and its controls, it is often because a control is missing. Several important related considerations follow:

- Process owners are often referred to as *doers*; control owners are often referred to as *reviewers*.
- A well-designed system of internal control assigns a control to each WCGW. An entity could have one control that addresses one WCGW, a suite of controls that addresses one WCGW, or one control that addresses multiple WCGWs.
- Controls are often described in terms of a control category, such as authorization, management review, segregation of duties, or system access.

Part 6 of the *Compliance Supplement* states that control activities may be preventive or detective. A preventive control is designed to avoid an unintended event or result at the time of the transaction; a detective control is designed to discover an unintended event or result after the initial processing has occurred but before the ultimate objective has concluded. Entities usually employ a mix of both.

Controls need to be designed in such a way that they *would* prevent or detect a WCGW — not just that they *could* prevent or detect a WCGW. Controls also need to be evaluated for the precision of their efforts. Generally, management has a greater need for precision and redundancy than do auditors. That is, external auditors are focused on material noncompliance while management is focused on compliance.

Importantly, as noted in both the Green Book and in COSO's *Internal Control — Integrated Framework*, all five components of internal control must be effectively designed, implemented, and operating, and they must be operating together in an integrated manner for an internal control system to be effective (that is, control activities on their own are not an effective system of internal controls). Even within control activities, controls rely on the effective design and operation of other controls. For example, a management review control generally uses information produced by the entity. Therefore, a management review control is effective only if there are controls over the information used in the review.

Key point

Auditors are cautioned that the approach taken in the *Compliance Supplement* to present four of the five control components as being subject to entity-wide controls and the remaining component as being subject to specific controls may not reflect how a particular entity designs and implements internal control.

Consider the following, for example:

- Some entities may establish specific controls (versus entity-wide controls) relating to certain of the control components discussed in Appendix 1 as typically having entity-wide controls.
- Federal programs also may be administered under multiple internal control structures. This occurs when multiple organizational units are involved in the administration of federal programs, such as a university that has multiple campuses administering a federal program, each having differing internal control structures.

In these situations, auditors should obtain an understanding of controls and test controls at a level that reflects the way management designs and implements internal control and should prepare related audit documentation at that level.

Finally, the illustrative controls in the *Compliance Supplement* are not intended to be all-inclusive or a checklist of required internal control characteristics. That is, nonfederal entities could have adequate internal control even though some of or all the illustrative controls are not present. Further, nonfederal entities could have other appropriate internal controls operating effectively not included among the illustrations.

Alert — The 2023 *Compliance Supplement*

The 2023 *Compliance Supplement* was not yet available when this course was updated; therefore, information in this course is based on prior-year supplements. Once the 2023 supplement is issued, auditors should carefully evaluate it for any effect its revisions will have on compliance audits. See the Governmental Audit Quality Center website at www.aicpa.org/topic/government for additional information.

Planning the testing of internal control over compliance

Under the Uniform Guidance, an auditor must plan the test of internal control over compliance for major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program except for when the auditor has found the controls to be ineffective. The auditor should obtain sufficient appropriate audit evidence to support that assessed level of control risk of noncompliance. Professional judgment is needed in determining the extent of control testing necessary to obtain a low level of control risk of noncompliance. This requirement is intended to alert federal agencies when conditions indicate that auditees have failed to implement adequate internal control over compliance for federal programs to ensure compliance with federal statutes, regulations, and the terms and conditions of federal awards.

The auditor should test controls for the particular time or throughout the period for which the auditor intends to rely on those controls. If the auditor intends to rely on a control over a period, then audit evidence that pertains only to a point in time may be insufficient; and the auditor should supplement those tests with other tests of controls capable of providing audit evidence that the control operated effectively at relevant times during the period under audit. Along with the Uniform Guidance requirement to test internal control to support a low assessed level of control risk of noncompliance, this supports the annual testing of internal control over compliance.

As it relates to a Uniform Guidance compliance audit, when controls are designed effectively and the auditor has an expectation that controls are operating effectively, the auditor should design and perform tests of controls to obtain sufficient appropriate audit evidence that the controls are operating effectively for each compliance requirement subject to audit that is direct and material for each major program throughout the period of reliance. The following factors may influence the extent of the tests of controls:

- The frequency of the performance of the control by the entity during the period
- The length of time during the audit period that the auditor relies on the operating effectiveness of the control
- The expected deviation from the control
- The relevance and reliability of the audit evidence to be obtained in supporting that the control prevents, or detects and corrects, material noncompliance with respect to the type of compliance requirement being considered
- The extent to which audit evidence is obtained from tests of other controls related to the type of compliance requirement

Testing internal control over compliance

The Uniform Guidance explains that auditors must perform tests of internal control over compliance as planned. Additionally, the auditor should design and perform tests of controls when the auditor's risk assessment includes an expectation of the operating effectiveness of controls. These tests ordinarily include procedures such as

- inquiries of appropriate entity personnel, including grant and contract managers;
- inspection of documents, reports, or electronic files indicating performance of the control;
- observation of the application of specific controls; and
- reperformance by the auditor of the application of the control.

AU-C section 935 states that certain paragraphs found in AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (AICPA, *Professional Standards*), are not applicable to a compliance audit. Those paragraphs address the use of audit evidence obtained in prior audits related to testing the operating effectiveness of controls (and the rotation of such testing). Therefore, in a Uniform Guidance compliance audit, controls that address the risks of noncompliance with the types of compliance requirements that are identified as subject to audit that are direct and material for major programs should be tested annually.

Testing the operating effectiveness of controls is different from obtaining an understanding of and evaluating the design and implementation of controls. That said, the same types of audit procedures are used. The auditor may therefore decide it is efficient to test the operating effectiveness of controls at the same time the auditor is evaluating their design and determining that they have been implemented. This includes obtaining audit evidence about how controls were applied at relevant times during the period under audit, the consistency with which they were applied, and by whom or by what means they were applied.

Evaluation of controls testing

Based on the audit procedures performed related to controls and the audit evidence obtained, the auditor should evaluate whether the assessment of the risk of material noncompliance of relevant compliance requirements remains appropriate. As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing, or extent of other planned audit procedures. Information may come to the auditor's attention that differs significantly from the information on which the risk assessments were based. Furthermore, the auditor should not assume that an instance of fraud or error is an isolated occurrence — indeed, the auditor should consider how the detection of such noncompliance affects the assessed risks of material noncompliance.

Key point

Auditors should consider taking the following steps when evaluating internal controls:

Step 1: Identify the control objectives.

Step 2: Understand the auditee's business process of compliance.

Step 3: Evaluate the risks (the WCGWs) (for example, the risks of material noncompliance).

Step 4: Understand controls over the risk of WCGW (for example, controls designed to prevent or to timely detect and correct material noncompliance).

Step 5: Evaluate whether controls are designed effectively and have been implemented (placed into operation).

Step 6: If controls are designed effectively and implemented (placed into operation), test relevant controls for operating effectiveness.

Step 7: Document the entire sequence.

Before concluding an audit, the auditor should evaluate whether audit risk of noncompliance has been reduced to an appropriately low level and whether the nature, timing, and extent of the audit procedures need reconsideration. The auditor should conclude whether sufficient appropriate audit evidence has been obtained to reduce the risks of material noncompliance with compliance requirements to an appropriately low level. In developing an opinion on compliance, the auditor should consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the relevant assertions.

If, when evaluating the results of tests of controls, the auditor is not able to support a low assessed level of control risk of noncompliance for a compliance requirement subject to audit that is direct and material for a major program, the auditor is not required to expand testing of internal control over compliance for that compliance requirement. The auditor may choose to perform no further tests of controls. In such a case, the auditor would assess control risk of noncompliance at other than low, design tests of compliance accordingly, and consider the need to report an audit finding. The auditor generally will need to report a significant deficiency or material weakness in internal control over compliance.

The auditor should evaluate the severity of each deficiency in internal control over compliance identified during the audit to determine whether the deficiency, individually or in combination, is a significant deficiency or material weakness in internal control over compliance. The severity of deficiencies depends on the magnitude of potential noncompliance resulting from the deficiencies and whether there is a reasonable possibility that the entity's controls will fail to prevent, or detect and correct, noncompliance with a type of compliance requirement. In a Uniform Guidance compliance audit, the significance of a deficiency in internal control over compliance depends on the *potential* for noncompliance; it does not depend on whether noncompliance actually has occurred. Accordingly, the absence of identified noncompliance does not prove that identified deficiencies in internal control over compliance are not significant deficiencies or material weaknesses.

Key point

In a Uniform Guidance compliance audit, the auditor's determination of whether a deficiency in internal control over compliance is a significant deficiency or material weakness for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program identified in the *Compliance Supplement*. Furthermore, significant deficiencies or material weaknesses in internal control over compliance for a major program may not necessarily be considered significant deficiencies or material weaknesses in internal control over financial reporting.

Knowledge check

2. What does the Uniform Guidance require an auditor to do regarding internal control?
    a. Plan the audit to support a low assessed level of control risk.
    b. Perform a statistical test of transactions.
    c. Monitor the auditee's internal control over compliance.
    d. Test the internal control using the guidance in the COSO framework.

3. Which statement is accurate regarding an auditor's testing of internal control over compliance?
    a. Tests of controls over compliance with direct and material compliance requirements are not required to be tested in the current year when there is an expectation that controls are effective based on prior-year testing.
    b. Testing the operating effectiveness of controls is equivalent to evaluating the design of a control.
    c. Testing the operating effectiveness of controls may include the inspection of documents, reports, or electronic files indicating the performance of a control.
    d. Inquiry of appropriate personnel is not one of the procedures that may be performed when testing the operating effectiveness of internal controls.

Considerations regarding internal control over compliance

Ineffective internal control

When an auditor determines that internal control over some of or all the compliance requirements for a major program is likely to be ineffective in preventing or detecting noncompliance, the auditor is not required to plan and perform tests of internal control over compliance for those compliance requirements. The auditor must report, however, a significant deficiency or a material weakness in internal control over compliance as part of the audit findings, assess control risk at the maximum, and consider whether any additional compliance tests are required because of ineffective internal control.

Key point

The assessment of the effectiveness of internal control over compliance in preventing, detecting, and correcting noncompliance is determined in relation to each individual type of compliance requirement subject to audit that is considered direct and material to a major program. For example, controls over compliance with requirements for eligibility may be ineffective because of a lack of segregation of duties. In this case, the auditor would do the following:

- Report the lack of segregation of incompatible duties as it relates to eligibility as a significant deficiency or a material weakness in internal control over compliance.
- Assess the control risk of noncompliance related to requirements for eligibility at the maximum.

Consider the lack of effective control when designing the nature, timing, and extent of procedures to test compliance with requirements for eligibility of the major program. In most cases, the extent of testing would need to be expanded.

Designing tests of controls

In designing and performing tests of internal control over compliance, the auditor should obtain more persuasive audit evidence when the auditor plans to place greater reliance on the effectiveness of a control. In addition, as the rate of expected deviation from a control increases, the auditor should increase the extent of testing. The auditor should consider whether the rate of expected deviation indicates that obtaining audit evidence from the performance of control tests will be insufficient to reduce the control risk of noncompliance for the assertions relevant to the compliance requirement. If the rate of expected deviation is expected to be high, the auditor may determine that tests of controls for a particular type of compliance requirement may be inappropriate.

Internal control testing versus compliance testing

The auditor should design and perform substantive procedures for all relevant assertions related to the compliance requirements subject to audit that are direct and material for each major program. Because effective controls generally reduce (but do not eliminate) risks of material noncompliance, tests of controls reduce (but do not eliminate) the need for substantive procedures.

When evaluating the operating effectiveness of internal control over compliance, the auditor should consider instances of noncompliance detected when performing compliance tests. (For example, during a test of compliance for activities allowed or unallowed, it was noted that equipment was charged to a major program when the grant agreement does not allow program funds to be spent on equipment.) Detection of these instances of noncompliance is relevant, reliable audit evidence about the relative ineffectiveness of the related internal control over compliance. Noncompliance detected by the auditor that was not identified by the entity is evidence of a deficiency in internal control over compliance and may indicate a significant deficiency or a material weakness in internal control over compliance.

> **Key point**
>
> The absence of noncompliance detected by a compliance test does not provide audit evidence that controls related to a compliance requirement are effective.

Dual-purpose testing

When responding to the risk assessment, the auditor may design a test of controls to be performed concurrently with a test of details on the same transactions. Although the purpose of a test of controls is different from that of a test of details, both tests may be performed concurrently on the same transaction (a dual-purpose test). For example, the auditor may examine an invoice to determine whether it has been approved and whether it provides substantive evidence of a transaction. A dual-purpose test is designed and evaluated by considering each purpose of the test separately. Also, when performing the tests, the auditor should consider how the outcome of the test of controls may affect the auditor's determination about the extent of substantive procedures to be performed.

Key point

Quality-control reviews performed by federal agency staff have shown that, in some cases, auditors (when using dual-purpose testing) have not clearly identified the procedures performed to test the operating effectiveness of internal control over compliance versus those performed to test compliance. It is important that audit documentation relating to dual-purpose tests clearly distinguish how individual tests that are performed accomplish both the testing of internal control over compliance and of compliance along with the results of those tests. Documentation may be made through such mechanisms as narratives, tick marks, attribute descriptions, or similar notations.

Auditor responsibility for internal control over compliance for programs that are not major

The auditor has no responsibility under the Uniform Guidance to obtain an understanding of internal control over compliance for programs not considered major or to plan or perform any related testing of internal control over compliance for those programs except for any procedures the auditor may choose to perform as part of the risk assessment process in determining major programs. A program that is not considered major could, however, still be material to the financial statements. In that situation, in conjunction with the financial statement audit, the auditor may need to obtain an understanding of that program's internal control over financial reporting.

Subrecipient considerations

Many entities make subawards and disburse their own funds as well as federal funds to subrecipients. The auditor of a pass-through entity has certain responsibilities related to the entity's internal control over the monitoring of subrecipients. If significant subawards are made, subrecipient considerations could have a major impact on the risk assessment and internal control procedures performed.

Program cluster considerations

In a Uniform Guidance compliance audit, an entity may have separate controls related to federal programs treated as a cluster of programs, such as student financial assistance (SFA) and research and development (R&D). In this case, when evaluating whether an identified deficiency is a significant deficiency or a material weakness in internal control over compliance, the significance of the deficiency in relation to the type of compliance requirement for the cluster is an important factor.

Some examples follow:

- When college work-study program expenditures are significant in relation to SFA programs, deficiencies in specific controls over the time cards of work-study students would likely be considered significant deficiencies or material weaknesses in internal control over compliance.
- When considered in relation to the total expenditures of R&D programs, deficiencies in controls over a single campus or university department that conducts significant amounts of federally funded research would likely be significant deficiencies or material weaknesses in internal control over compliance.
- A deficiency in an SFA or R&D program that was clearly insignificant to the SFA or R&D program as a whole would not necessarily be considered a significant deficiency or material weakness in internal control over compliance.

Documentation of work performed

The auditor should document the following:

- The risk assessment procedures performed, including those related to gaining an understanding of internal control over compliance.
- The auditor's responses to
  - the assessed risks of material noncompliance,
  - the procedures performed to test compliance with applicable compliance requirements, and
  - the results of those procedures, including any tests of controls over compliance.
- How the auditor complied with the specific governmental audit requirements that are supplementary to GAAS and GAGAS.

AU-C section 230 contains guidance on

- documenting significant findings or issues;
- identifying the preparer and reviewer of audit documentation;
- documenting specific items tested;
- documenting departures from relevant Statements on Auditing Standards (AICPA *Professional Standards*);
- revising audit documentation after the date of the auditor's report; and
- ownership and confidentiality of audit documentation.

GAGAS includes an additional requirement that auditors should document, before the report release date, the supervisory review of the evidence that supports the findings and conclusions contained in the auditor's report.

The form and extent of this documentation are influenced by the size and complexity of the auditee and by the nature of the auditee's internal control over compliance.

Common deficiencies found in single audits

Common deficiencies related to internal control over compliance included the following:

- Auditors improperly used dual-purpose testing.
- Auditors often did not adequately design procedures to meet compliance requirements.
- Auditors failed to understand the difference between internal control testing and compliance testing.
- Auditors failed to document an understanding of internal control over compliance of federal awards sufficient to plan the audit to support a low assessed level of control risk for major programs, including consideration of the risk of material noncompliance related to each compliance requirement and major program.
- Auditors failed to adequately document procedures performed.
- Auditors failed to document required communications with those charged with governance, including proper communication of internal control findings.

Summary

Key foundational points	
1.	Under the Uniform Guidance, nonfederal entities must establish and maintain effective internal control over federal awards that provides reasonable assurance that the entity is managing federal awards in compliance with federal statutes, regulations, and the terms and conditions of federal awards.
2.	As it relates to internal control, the Uniform Guidance provides that the auditor must, in addition to the requirements of GAAS and GAGAS, • perform procedures to obtain an understanding of internal control over federal programs sufficient to plan the audit to support a low assessed level of control risk of noncompliance for major programs; • plan the testing of internal control over compliance for major programs to support a low assessed level of control risk of noncompliance for the assertions relevant to the compliance requirements for each major program; • perform testing of internal control as planned; and • report on internal control over compliance, describing the scope of testing of internal control and the results of the tests and, where applicable, referring to the separate schedule of findings and questioned costs.
3.	It is important to adequately document the work done regarding internal control over compliance.

Exercise: Ineffective internal control

How does it affect audit planning and reporting when an auditor has determined that internal control over compliance for some of or all the types of compliance requirements have not been implemented or are likely to be ineffective in preventing or detecting noncompliance?

Exercise: Operating effectiveness

An auditor documents his or her understanding of internal control in accordance with the components of internal control and identifies controls within the five components. In arriving at this understanding, the auditor performed procedures over the design and implementation of the controls.

Should those controls be subject to tests of operating effectiveness?

Solutions

Advanced Topics in a Single Audit: Internal Control Over Compliance

Exercise solutions

Exercise: Ineffective internal control

The auditor is not required to plan and perform tests of internal control over compliance for those compliance requirements. However, the auditor must report a significant deficiency or a material weakness in internal control over compliance as part of the audit findings. In addition, the auditor must assess control risk at the maximum and consider whether any additional compliance tests are required because of ineffective internal control.

Exercise: Operating effectiveness

The auditor should design and perform tests of controls when the auditor's risk assessment includes an expectation of the operating effectiveness of the control.

Knowledge check solutions

1.

   a. Incorrect. Internal control does not include a process to provide risk assessment.
   b. Correct. Internal control includes a process to provide reliable reporting for internal and external use.
   c. Incorrect. Internal control does not include a process for information and communication.
   d. Incorrect. Internal control does not include a process to provide maintenance of infrastructure assets.

2.

   a. Correct. The auditor is required to plan the audit to support a low assessed level of control risk.
   b. Incorrect. The Uniform Guidance does not specify any particular tests required to be performed.
   c. Incorrect. The auditee, not the auditor, is responsible for monitoring internal control over compliance.
   d. Incorrect. There are no Uniform Guidance requirements regarding testing internal control using the COSO framework.

3.

a. Incorrect. When there is an expectation that controls are effective in the current year, tests of controls over compliance with compliance requirements subject to audit that are direct and material are required to be tested. The results of testing in prior years should not influence testing in the current year.
b. Incorrect. Testing the operating effectiveness of controls is not the same as evaluating the design of a control. However, the same types of procedures may be used in each analysis.
c. Correct. Testing the operating effectiveness of controls may include the inspection of documents, reports, or electronic files indicating the performance of a control.
d. Incorrect. Inquiry of appropriate personnel is one of the procedures that may be performed when testing the operating effectiveness of internal controls.

Advanced Topics in a Single Audit: Compliance Auditing

Learning objectives

- Identify the auditor's responsibilities in a Uniform Guidance compliance audit.
- Identify the audit procedures necessary to obtain sufficient appropriate audit evidence in order to express an opinion on compliance for each major program.
- Evaluate the evidence obtained in order to express an opinion on compliance for each major program.
- Evaluate the role of the *Compliance Supplement* in a compliance audit.

Performing the single audit

This course addresses the auditor's consideration of compliance requirements applicable to major programs under Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). In addition to the requirements of *Government Auditing Standards* (GAGAS) and generally accepted auditing standards (GAAS), an auditor must determine whether the auditee has complied with federal statutes, regulations, and the terms and conditions of federal awards that may have a direct and material effect on each of its major programs. The Uniform Guidance compliance audit concludes with the auditor expressing an opinion on the auditee's compliance with compliance requirements for each of its major programs.

To express such an opinion, the auditor accumulates sufficient appropriate audit evidence by planning, performing risk assessment procedures, and performing tests of transactions and such other audit procedures necessary to support the auditee's compliance with compliance requirements subject to audit that are direct and material, thereby limiting audit risk of noncompliance to an appropriately low level.

An auditor has the following objectives in a single audit, each of which results in the issuance of certain auditor reports:

- Audit of the entity's financial statements and reporting on the supplementary schedule of expenditures of federal awards (SEFA)
  - Determine whether the financial statements of the auditee are presented fairly, in all material respects, in accordance with generally accepted accounting principles.
  - Determine whether the SEFA is stated fairly in all material respects in relation to the auditee's financial statements as a whole.
- Compliance audit of federal awards
  - Obtain an understanding of internal control over federal programs sufficient to plan the audit to support a low assessed level of control risk of noncompliance for major programs; plan the testing of internal control over compliance for major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program; and perform testing of internal control as planned.
  - Determine whether the auditee has complied with federal statutes, regulations, and the terms and conditions of federal awards that may have a direct and material effect on each of its major programs.

Audit documentation

AU-C section 935, *Compliance Audits*,[1] contains requirements and guidance related to documentation of audit procedures performed in a compliance audit. In addition to the documentation requirements related to the risk assessment process and internal controls, AU-C section 935 notes that the auditor should document

- materiality levels and the basis on which they were determined;
- how the auditor complied with any specific governmental audit requirements that are supplementary to GAAS and GAGAS.

> **Document, document, document**
>
> If it is not documented, it was not done!

The requirements for documentation for an audit of financial statements are found in AU-C section 230, *Audit Documentation*, and should be adapted and applied to Uniform Guidance compliance audits. Specific documentation requirements may also be found in other AU-C sections, other standards, and supplementary audit requirements in federal statutes and regulations applicable to compliance audits.

Under AU-C section 230, the auditor should prepare audit documentation sufficient to enable an experienced auditor, having no previous connection to the audit, to understand

- the nature, timing, and extent of the audit procedures performed;
- the results of audit procedures performed and the audit evidence obtained; and
- significant findings or issues arising during the audit, the conclusions reached, and significant professional judgments made in reaching those conclusions.

AU-C section 230 contains guidance on the following:

- Documenting significant findings or issues
- Identifying the preparer and reviewer of audit documentation
- Documenting specific items tested
- Documenting departures from relevant Statements on Auditing Standards (AICPA *Professional Standards*)
- Revising audit documentation after the date of the auditor’s report
- Maintaining ownership and confidentiality of audit documentation

GAGAS includes an additional requirement that auditors should document, before the report release date, the supervisory review of the evidence that supports the findings and conclusions contained in the auditor’s report. As part of the supervisory review of the compliance audit, the audit documentation should be evaluated to ensure it supports that the audit was performed in accordance with the relevant standards and requirements and that the audit documentation itself meets the requirements of those standards.

[1] All AU-C sections can be found in AICPA *Professional Standards*.

Although most requirements around audit documentation are found in GAAS, the Uniform Guidance has some specific guidance regarding documentation in the compliance audit. That guidance provides that, as it relates to major programs, the auditor must include in the audit documentation the risk analysis process used to determine major programs.

The Uniform Guidance also provides additional requirements regarding audit documentation access. It notes that audit documentation must be made available upon request to the cognizant or oversight agency for audit or its designee, cognizant agency for indirect cost, a federal agency, or the U.S. Government Accountability Office at the completion of the audit, as part of a quality review to resolve audit findings, or to carry out oversight responsibilities,. It also states that access to the audit documentation includes the right of federal agencies to obtain copies as is reasonable and necessary. Interpretation No. 1, “Providing Access to or Copies of Audit Documentation to a Regulator,” (AU-C section 9230 par. .01–.15) of AU-C section 230 contains guidance for when a regulator requests access to audit documentation pursuant to law, regulation, or audit contract.

Under the Uniform Guidance, auditors must retain audit documentation and reports for a minimum of three years after the date of issuance of the auditor’s report to the auditee. This retention period may be extended if the auditor is notified in writing by certain parties (including the cognizant agency for audit, cognizant agency for indirect costs, oversight agency for audit, or pass-through entity). AU-C section 230, unlike the Uniform Guidance, states that audit documentation should be retained for no less than five years from the report release date. Furthermore, federal statutes, regulations, the audit firm’s quality control policies, or a state board of accountancy may dictate a still longer retention period. Auditors should retain audit documents for the longest required retention period. When the auditor is aware that the federal awarding agency, pass-through entity, or auditee is contesting an audit finding, the auditor must contact the contesting parties for guidance before destroying audit documentation and reports.

Key point

In the course of quality control reviews they performed, federal agency staff found instances when audit documentation did not contain sufficient evidence that work was performed to support the auditor's opinion on compliance for one or more major programs. In some cases, staff found that the audit documentation included no evidence that the auditor tested certain compliance requirements subject to audit that are direct and material to a major program. Alternatively, they found that auditors did not explain why certain compliance requirements identified in the Office of Management and Budget (OMB) *Compliance Supplement* with a "Y" in the Part 2 matrix were not direct and material to a major program. The individual tests auditors perform, and the results of those tests, are among the items auditors should document when testing compliance requirements.

Use of professional judgment

Auditors are required to exercise professional judgment in planning, conducting, and evaluating the results of compliance testing in a Uniform Guidance compliance audit. The auditor may consider the following factors when applying professional judgment in the compliance audit:

- The assessment of audit risk of noncompliance
- The assessment of materiality
- The evidence obtained from other audit procedures
- The amount of expenditures for the program
- The diversity or homogeneity of program expenditures
- The length of time that the program has operated or changes in its conditions
- The current and prior auditing experience with the program, particularly findings in previous audits and other evaluations (such as inspections, program reviews, or system reviews required by the Federal Acquisition Regulations (FAR) found in 48 CFR)
- The extent to which the program is carried out through subrecipients as well as related monitoring activities
- The extent to which the program contracts for goods or services
- The level to which the program already is subject to program reviews or other forms of independent oversight
- The expectation of noncompliance or compliance with the compliance requirements subject to audit that are direct and material
- The extent to which computer processing is used to administer the program as well as the complexity of the processing
- Whether the program has been identified as being higher risk in the *Compliance Supplement*

Identifying direct and material compliance requirements

In a Uniform Guidance compliance audit, the compliance requirements to be tested are those subject to audit that may have a direct and material effect on a major program. The auditor must use the *Compliance Supplement* as a primary source for identifying compliance requirements for federal programs in a Uniform Guidance compliance audit. For major programs, the auditor first determines which types of compliance requirements are subject to audit. Part 2 of the *Compliance Supplement* identifies the compliance requirements that the federal government has determined are subject to audit for the federal programs included in the *Compliance Supplement*.

In looking at the Part 2 matrix, the box for each type of compliance requirement will either contain a "Y" (for "Yes" if the type of compliance requirement is subject to audit) or contain an "N" (if the requirement is not subject to audit for the program). Auditors are not expected to test requirements that have been noted with an "N."

Next, the auditor determines which requirements may have a direct and material effect on a major program and tests them. The auditor should use professional judgment when determining which compliance requirements of those subject to audit are direct and material.

Even though a "Y" indicates that the compliance requirement is subject to audit, it may not apply at a particular nonfederal entity, either because that entity does not have activity subject to that type of compliance requirement or the activity could not have a direct and material effect on a major program.

> **Key point**
>
> The auditor should exercise professional judgment when determining which compliance requirements marked "Y" need to be tested. In making a determination not to test a type of compliance requirement identified as subject to audit for a particular program, the auditor should conclude either that the requirement does not apply to the particular auditee or that noncompliance with the requirements could not have a direct and material effect on a major program. No testing would be required on types of compliance requirements not considered direct and material, but the auditor's conclusion relating to this determination should be documented.

The *Compliance Supplement* states that the auditor should perform reasonable procedures to ensure that compliance requirements identified in the supplement as subject to audit are current and should also determine whether any additional provisions of federal awards are relevant to the compliance requirements subject to audit and should be covered by the audit. *Reasonable procedures* include an inquiry of nonfederal entity management and a review of the federal awards for major programs.

For programs not included in the *Compliance Supplement*, the auditor must follow the guidance included in Part 7, "Guidance for Auditing Programs Not Included in This *Compliance Supplement*" to determine which types of compliance requirements to test. The auditor must refer to Part 3, "Compliance Requirements," and Part 5, "Clusters of Programs," and determine the requirements governing the federal program by reviewing the provisions of the federal award and the laws and regulations referenced in such awards to identify the compliance requirements to test and report on. Part 7 outlines the following steps to determine which compliance requirements to test:

a. Identify the program objectives, program procedures, and compliance requirements for a specific program.
b. Determine which of the compliance requirements identified in item *a* could have a direct and material effect on the major program.
c. Determine which of the compliance requirements identified in item *b* are susceptible to testing by the auditor.
d. Determine into which of the 12 types of compliance requirements the compliance requirements identified in item *c* belong.
e. For special tests and provisions, determine the applicable audit objectives and audit procedures.

Next, the auditor needs to use Part 3 as well as Part 4, "Agency Program Requirements," to determine the appropriate audit procedures. First, the auditor should go to Part 3 to find generic details about all the types of compliance requirements and to review the related suggested audit procedures. The auditor then goes to Part 4 (Part 5 for a cluster) to learn more about the program-specific requirements.

Alert — OMB *Compliance Supplement*

The 2023 *Compliance Supplement* was not yet available when this course was updated; therefore, information in this course is based on prior-year supplements. Once the 2023 supplement is issued, auditors should carefully evaluate it for any effect its revisions will have on compliance audits. See the Governmental Audit Quality Center website at www.aicpa.org/topic/government for additional information.

Relationship of the Compliance Supplement to federal program audit guides

The *Compliance Supplement* states that it replaces federal agency audit guides and other audit requirement documents for individual federal programs. Therefore, for a federal program included in the *Compliance Supplement* and having a separate federal program audit guide or other federal program audit requirement documents, the auditor needs to consider only those types of compliance requirements in the *Compliance Supplement* when performing a Uniform Guidance compliance audit.

Knowledge check

1. Which statement regarding an auditor's objective in a single audit is accurate?

    a. Auditors can meet their overall audit objectives without documenting their work.
    b. An auditor must determine whether the SEFA is stated fairly, in all material respects, in accordance with GAAP.
    c. The auditor should plan the testing of internal control over compliance for major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program.
    d. An oral explanation can substitute for written documentation to meet the audit objectives.

Audit risk of noncompliance and performing further audit procedures in response to assessed risks

To express an opinion on compliance, the auditor accumulates sufficient appropriate audit evidence in support of compliance, thereby reducing audit risk of noncompliance to an appropriately low level. Requirements and guidance related to the auditor's consideration of audit risk and materiality, as found in AU-C section 320, *Materiality in Planning and Performing an Audit*, should be adapted and applied to the Uniform Guidance compliance audit when planning and performing the audit. Audit risk of noncompliance and materiality, among other matters, need to be considered together for each major program being tested as well as for each compliance requirement subject to audit that is direct and material in determining the nature, timing, and extent of audit procedures and in evaluating the results of those procedures.

The auditor should design and perform further audit procedures, including tests of details (which may include tests of transactions) to obtain sufficient appropriate audit evidence about the auditee's compliance with each of the compliance requirements subject to audit that are direct and material in response to the assessed risks of material noncompliance. Risk assessment procedures, tests of controls, and analytical procedures alone are not sufficient to address a risk of material noncompliance.

Materiality in a Uniform Guidance compliance audit

The consideration of materiality in a Uniform Guidance compliance audit is different from the auditor's consideration of materiality in a financial statement audit. In a compliance audit, materiality is affected by

- the nature of the compliance requirements, which may not be quantifiable in monetary terms;
- the nature and frequency of any noncompliance identified with an appropriate consideration of sampling risk; and
- qualitative considerations, such as the needs and expectations of federal agencies and pass-through entities.

In the compliance audit, the concept of materiality is applied to *each* major program — not to all major programs combined.

For purposes of evaluating the results of compliance testing, a *material instance of noncompliance* is a failure to comply with federal statutes, regulations, and the terms and conditions of the federal award that results in an aggregation of noncompliance (in other words, the auditor's best estimate of the overall noncompliance) that is material to the affected federal program. Instances of noncompliance that individually may not be material should be assessed to determine if, in the aggregate, they could have a material effect.

Because the auditor expresses an opinion on each major program and not on all the major programs combined, reaching a conclusion about whether instances of noncompliance (either individually or in the aggregate) are material to a major program requires consideration of the type and nature of the noncompliance as well as the actual and projected effect on each major program in which the noncompliance was noted. Instances of noncompliance that are material to one major program may not be material to a major program of a different size or nature. In addition, the level of materiality relative to a particular major program can change from one audit to the next.

If the tests of compliance reveal material noncompliance at the major program level, the auditor should consider its effect on the financial statements. The auditor also should consider the cumulative effect of all instances of noncompliance on the financial statements using the materiality level established for the financial statements.

Sufficient appropriate audit evidence

The Uniform Guidance notes that compliance testing must include tests of transactions and such other audit procedures necessary to provide the auditor sufficient appropriate audit evidence to support an opinion on compliance for each major program. Therefore, the auditor should apply procedures that provide reasonable assurance of detecting material noncompliance. The selection and application of procedures that will accumulate evidence that is sufficient and appropriate in the circumstances to provide a reasonable basis for expressing an opinion on compliance requires careful exercise of professional judgment.

A broad array of procedures is available for application in a Uniform Guidance compliance audit. When considering which audit procedures to perform to appropriately restrict audit risk of noncompliance, the auditor should consider the following generalizations (keep in mind that the items are not mutually exclusive and may be subject to important exceptions):

a. Audit evidence is more reliable when it is obtained from knowledgeable independent sources outside the entity.
b. Audit evidence that is generated internally is more reliable when the related controls imposed by the entity are effective.
c. Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
d. Audit evidence is more reliable when it exists in documentary form, whether paper, electronic, or other medium (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
e. Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles.

In the hierarchy of available audit procedures, those that involve search and verification (for example, inspection, confirmation, or observation) — particularly when using independent, third-party sources — generally are more effective at reducing audit risk of noncompliance than are those involving internal inquiries and comparisons of internal information (for example, analytical procedures and discussions with the individuals responsible for compliance).

In a Uniform Guidance compliance audit, an auditor's objective is to accumulate sufficient appropriate audit evidence that limits audit risk of noncompliance to a level that is, in the auditor's professional judgment, appropriately low for the high level of assurance being provided. An auditor should select from all available procedures in any combination that can limit audit risk of noncompliance to an appropriately low level.

For regulatory requirements, an auditor's procedures may include reviewing reports of significant examinations and related communications between regulatory agencies and the entity and, when appropriate, making inquiries of the regulatory agencies, including inquiries about examinations in progress.

Multiple organizational unit considerations

In a Uniform Guidance compliance audit of an auditee that has operations in multiple organizational units (for example, operating units, locations, or branches), the auditor may determine that it is not necessary to test compliance with requirements at every such unit. In making that determination and selecting the units to be tested, the auditor considers the following factors:

a. The degree to which the specified compliance requirements apply at the organizational unit
b. Materiality
c. The degree of centralization of the records
d. The effectiveness of controls, particularly those that affect management's direct control over the exercise of authority delegated to others and management's ability to effectively supervise activities at various locations
e. The nature and extent of operations conducted at the various organizational units
f. The similarity of operations and controls over compliance for different organizational units

Evaluation and reporting of noncompliance

Instances of noncompliance (findings)

An auditor's tests of compliance may disclose instances of noncompliance. The Uniform Guidance refers to these instances of noncompliance, among other matters, as *audit findings*.

> **Key point**
>
> The auditor's determination of whether noncompliance with the provisions of federal statutes, regulations, or the terms and conditions of federal awards is material for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program identified in the *Compliance Supplement*.

Such findings may be of a monetary nature and involve questioned costs or may be nonmonetary and not result in questioned costs. Both GAGAS and the Uniform Guidance specify how certain findings are to be reported.

Furthermore, the auditor should not assume that an instance of fraud or error is an isolated occurrence. Therefore, the auditor should consider how the detection of such noncompliance affects the assessed risks of material noncompliance. Before concluding the audit, the auditor should evaluate whether audit risk of noncompliance has been reduced to an appropriately low level and whether the nature, timing, and extent of the audit procedures need to be reconsidered. The auditor should determine whether sufficient appropriate audit evidence has been obtained to reduce to an appropriately low level the risks of material noncompliance with compliance requirements.

The auditor should relate the evaluation of the compliance testing to other relevant audit evidence when forming a conclusion about compliance as well as internal control over compliance. If compliance testing results in exceptions, the auditor should relate this testing to the results of tests of internal control. A compliance exception is an indicator of a potential deficiency in internal control over compliance.

> **Key point**
>
> Assessing materiality at the appropriate level is critical to the proper evaluation of audit findings.

Findings of noncompliance that cannot be quantified

An auditor may discover instances of noncompliance that cannot be quantified. The auditor's responsibility for reporting those findings can best be described through an example, such as what follows:

> Assume the auditor is auditing a pass-through entity that consistently fails to monitor the activities of its subrecipients as necessary to assure that the subaward is used for authorized purposes. The Uniform Guidance requires the auditor to consider material noncompliance in relation to a type of compliance requirement identified in the *Compliance Supplement*. In this example, subrecipient monitoring is the relevant type of compliance requirement. Because the pass-through entity failed to monitor the activity of its subrecipients, this noncompliance would likely be material in relation to the compliance requirement of subrecipient monitoring. The auditor must report material noncompliance with the provisions of federal statutes, regulations, or the terms and conditions of federal awards related to a major program as audit findings in a schedule of findings and questioned costs. This would be the case even if the auditor finds that the subrecipient actually complied with the terms and conditions of the subaward and achieved performance goals. In addition, the auditor also should consider whether there are significant deficiencies or material weaknesses in internal control over compliance that are required to be reported with respect to subrecipient monitoring. In the example provided, when there is a consistent failure to monitor subrecipients, an internal control over compliance finding would likely be reported.

The effect of questioned costs on the compliance opinion

The Uniform Guidance defines *questioned costs* as costs questioned by the auditor because of an audit finding (*a*) that resulted from a violation or possible violation of a statute, regulation, or the terms and conditions of a federal award, including funds used to match federal funds; (*b*) where the costs, at the time of the audit, are not supported by adequate documentation; or (*c*) where, under the circumstances, the costs incurred appear unreasonable and do not reflect actions of a prudent person.

In evaluating the effect of questioned costs on the opinion on compliance, the auditor considers the best estimate of total costs questioned for each major program (*likely* questioned costs), not just the questioned costs specifically identified (*known* questioned costs). Likely questioned costs are developed by extrapolating from audit evidence obtained, for example, by projecting known questioned costs identified in an audit sample to the entire population from which the sample was drawn. There may be situations in which the auditor considers known questioned costs immaterial but considers likely questioned costs material. In those situations, the auditor should consider the noncompliance to be material (and report an audit finding) or may expand the scope of the Uniform Guidance compliance audit and apply additional audit procedures to further establish the likely questioned costs.

An auditor also must consider known and likely questioned costs when reporting audit findings. Beyond reporting known questioned costs greater than $25,000 for a type of compliance requirement for a major program in the schedule of findings and questioned costs, the auditor also must report known questioned costs when likely questioned costs are greater than $25,000 for a type of compliance requirement for a major program. For example, if the auditor identifies $7,000 in specific questioned costs for a type of compliance requirement for a major program but — based on her evaluation of the effect of questioned costs for that compliance requirement — estimates that total questioned costs are in the $50,000–$60,000 range, the auditor would report a finding that indicates known questioned costs of $7,000.

Federal agency consideration of findings and questioned costs

An auditor's designation of a cost as questioned does not necessarily mean that a federal awarding agency will disallow the cost. In most instances, auditors are unable to determine whether a federal awarding agency or pass-through entity will ultimately disallow a questioned cost because the agency or entity has considerable discretion in those matters.

The Uniform Guidance defines a *management decision* as the federal awarding agency's or pass-through entity's written determination, provided to the auditee, of the adequacy of the auditee's proposed corrective actions to address the findings, based on its evaluation of the audit findings and proposed corrective actions.

A federal awarding agency or pass-through entity responsible for issuing a management decision must do so within six months of acceptance of the audit report by the Federal Audit Clearinghouse (FAC). Management decisions must include the reference numbers the auditor assigned to each audit finding. The federal awarding agency or pass-through entity, in issuing a management decision on whether to disallow the questioned costs, considers their nature and the amounts involved. Most federal awarding agencies have established procedures for appealing and adjudicating questioned costs. Because of the discretion allowed in resolving these matters, all questioned costs are subject to uncertainty regarding their resolution.

Compliance opinion

The auditor should evaluate the sufficiency and appropriateness of the audit evidence obtained. As part of this, the auditor should consider all relevant audit evidence regardless of whether it appears to corroborate or contradict the relevant assertions.

In a Uniform Guidance compliance audit, auditors must report on compliance for each major program. This includes an opinion or modified opinion (or disclaimer of opinion) about whether the auditee complied with federal statutes, regulations, and the terms and conditions of federal awards that could have a direct and material effect on each major program.

In determining whether an auditee complied with the compliance requirements subject to audit that are direct and material, in all material respects, auditors may consider the following factors for each major program:

- The frequency of noncompliance with the compliance requirements subject to audit that are direct and material identified during the compliance audit

- The nature of noncompliance with the compliance requirements subject to audit that are direct and material
- The adequacy of the entity's system for monitoring compliance with compliance requirements subject to audit that are direct and material and the possible effect of any noncompliance on the entity
- Whether any identified noncompliance with the compliance requirements subject to audit that are direct and material resulted in likely questioned costs material to the federal program

The auditor's evaluation of whether the auditee materially complied with the compliance requirements subject to audit that are direct and material includes consideration of any noncompliance the auditor identified, regardless of whether the entity corrected the noncompliance after the auditor brought it to management's attention.

Financial statement effect

The auditor also has the responsibility to assess the effect of noncompliance found — including known and likely questioned costs — against the materiality level established for the basic financial statements. The auditor should consider the effect of (*a*) any contingent liability that may arise from the noncompliance in accordance with applicable FASB or GASB standards and (*b*) for nongovernmental entities, any uncertainty regarding the resolution of instances of noncompliance in accordance with FASB standards.

Knowledge check

2. Which statement regarding materiality in a Uniform Guidance compliance audit is accurate?

    a. Considering materiality in a compliance audit is similar to that in a financial statement audit.
    b. Determining a material instance of noncompliance is in relation to a type of compliance requirement.
    c. Materiality is based on the financial statements.
    d. Materiality is the same for every major program.

Performing follow-up procedures

Auditee responsibilities for audit follow-up and for the summary schedule of prior audit findings

The Uniform Guidance states that an auditee must promptly follow up and take corrective action on audit findings. As part of this required follow-up, the auditee must prepare a summary schedule of prior audit findings. This schedule reports the status of all audit findings included in the prior audit's schedule of findings and questioned costs. It also includes any audit findings reported in the prior audit's summary schedule of prior audit findings that were not identified as either (*a*) fully corrected, (*b*) no longer valid, or (*c*) not warranting further actions.

Under the Uniform Guidance, a valid reason for considering an audit finding as not warranting further action is that all the following have occurred:

- Two years have passed since the audit report in which the finding occurred was submitted to the FAC.
- The federal agency or pass-through entity is not currently following up with the auditee on the audit finding.
- A management decision was not issued.

Auditor responsibilities for follow-up on previously reported audit findings

The Uniform Guidance notes that the auditor must follow up on prior audit findings; perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee; and report, as a current-year audit finding, when the auditor concludes that the auditee's summary schedule of prior audit findings materially misrepresents the status of any prior audit finding. The auditor must perform audit follow-up procedures regardless of whether a prior audit finding relates to a major program in the current year.

Auditor follow-up procedures

To follow up on previous audit findings, the auditor should obtain the auditee's summary schedule of prior audit findings and perform appropriate procedures to determine the status of the audit findings included therein. Although in many cases the procedures performed in the current audit will provide a basis for the auditor to assess the schedule, the auditor may find it necessary to perform procedures directed specifically at the status of prior findings. In these cases, the auditor should consider the following procedures:

- Make inquiries of auditee management and program personnel, including inquiries about the status of corrective actions and estimated completion dates for incomplete actions.
- Review management decisions issued to the auditee by federal awarding agencies or pass-through entities.
- Observe an activity that was redesigned to address a prior-year finding.
- Test similar current-year transactions.

Audit follow-up for findings reported under GAGAS

The summary schedule of prior audit findings the auditee prepares must, as required by the Uniform Guidance, include the status of all findings included in the prior audit's schedule of findings and questioned costs. This includes both audit findings as set forth in 2 CFR 200.516(a) (the compliance audit findings) and findings related to the financial statement audit performed under GAGAS. Technically, the Uniform Guidance limits the auditor's follow-up responsibility to the audit findings in 2 CFR 200.516(a). However, GAGAS requires the auditor to evaluate whether the auditee has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a significant effect on the financial statements. Therefore, performing the follow-up procedures on findings relating to the financial statements is an effective way for an auditor to meet GAGAS follow-up responsibilities.

Consideration of subsequent events

Two types of subsequent events could occur that relate to a Uniform Guidance compliance audit. The first type of events is those that provide additional evidence of conditions extant at the end of the reporting period that affect the auditee's compliance *during* the reporting period. The second type of subsequent events is instances of noncompliance that arose only after the reporting period ended.

The auditor should perform audit procedures up to the date of the auditor's report to obtain sufficient appropriate audit evidence that all subsequent events related to the auditee's compliance during the period covered by the auditor's report on compliance have been identified. The auditor should take into account the auditor's risk assessment when determining the nature and extent of such audit procedures. These procedures should include, but not be limited to, inquiring of management about and considering

- relevant internal auditor's reports issued during the subsequent period,
- other auditor's reports issued during the subsequent period that identify noncompliance,
- reports from federal awarding agencies and pass-through entities issued during the subsequent period related to the auditee's noncompliance, and
- information about the auditee's noncompliance obtained through other professional engagements performed for that entity.

An auditor has no obligation to perform any audit procedures related to the entity's compliance during the period subsequent to that covered by the auditor's report. However, if before the report release date the auditor becomes aware of noncompliance in the period subsequent to that covered by the auditor's report — and this noncompliance is of such a nature and significance that its disclosure is needed to prevent report users from being misled — the auditor should (*a*) discuss the matter with management and, if appropriate, those charged with governance; and (*b*) include an other-matter paragraph in the auditor's report describing the nature of the noncompliance. An example of this would be the discovery of noncompliance subsequent to the audit period, but before the report release date, of such magnitude that it causes the federal awarding agency to stop funding the program.

Knowledge check

3. Which statement regarding audit findings in a Uniform Guidance compliance audit is accurate?

    a. The auditor must stop performing audit procedures when the auditor identifies an audit finding.
    b. Instances of noncompliance are referred to as *audit findings* in the Uniform Guidance.
    c. The Uniform Guidance does not specify how audit findings are to be reported.
    d. Materiality is not a consideration because the Uniform Guidance specifies the audit findings to be reported.

Common deficiencies found in single audits

Common deficiencies related to single-audit engagements include the following:

- Failure to obtain sufficient appropriate audit evidence to support the opinion on major federal programs; the most frequently seen problems concern the following:
  - Inadequate or missing testing of compliance requirements
  - Use of outdated work programs or disclosure checklists that result in audit deficiencies
  - Improper use of dual-purpose testing
  - Inadequately designed procedures
  - Lack of an understanding of the difference between internal control and compliance testing
  - Inappropriate or unsupported sample sizes (or both)
- Failure to calculate materiality for each major program
- Inadequate documentation of procedures performed
- Failure to use or customize an audit program
- Failure to identify and test sufficient and appropriate major programs
- Failure to properly conclude and document either that an applicable compliance requirement does not apply to a particular auditee or that noncompliance with the requirements could not have a direct and material effect on a major program
- Lack of documentation of the consideration of subseqent events related to applicable compliance requirements

Summary

Key foundational points	
1.	The two objectives of the auditor in a single audit are to audit the entity's financial statements and report on the supplementary SEFA and to perform a compliance audit of federal awards. Each objective results in the issuance of certain auditor reports.
2.	Audit risk of noncompliance and materiality, among other matters, need to be considered together for each major program being tested as well as for each compliance requirement subject to audit that is direct and material in determining the nature, timing, and extent of audit procedures and in evaluating the results of those procedures.
3.	The Uniform Guidance states that compliance testing must include tests of transactions and such other audit procedures necessary to provide the auditor sufficient appropriate audit evidence to support an opinion on compliance for each major program.
4.	The auditor's determination of whether noncompliance with the provisions of federal statutes, regulations, or the terms and conditions of federal awards is material for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program identified in the *Compliance Supplement*.

Solutions

Advanced Topics in a Single Audit: Compliance Auditing

Knowledge check solutions

1.

   a. Incorrect. Auditors cannot meet their overall audit objectives without documenting their work.
   b. Incorrect. The opinion on the SEFA is an in-relation-to opinion.
   c. Correct. The auditor should plan the testing of internal control over compliance for major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program.
   d. Incorrect. An oral explanation cannot substitute for written documentation to meet audit objectives.

2.

   a. Incorrect. Considering materiality in a compliance audit is very different than that in a financial statement audit.
   b. Correct. Determining a material instance of noncompliance is in relation to a type of compliance requirement found in the *Compliance Supplement*.
   c. Incorrect. Materiality in the compliance audit is not based on financial statements.
   d. Incorrect. Materiality is not the same for every major program. It is unique to each major program.

3.

   a. Incorrect. The auditor may decide to perform additional audit procedures based on the audit findings they identify.
   b. Correct. Instances of noncompliance are referred to in the Uniform Guidance as *audit findings*.
   c. Incorrect. The Uniform Guidance does specify how certain types of audit findings are to be reported.
   d. Incorrect. Materiality is a consideration when determining whether noncompliance should be reported as an audit finding.

Advanced Topics in a Single Audit: Audit Sampling in a Uniform Guidance Compliance Audit

Learning objectives

- Assess the use of sampling in a Uniform Guidance compliance audit.
- Evaluate guidance and other considerations related to selecting a sample.
- Assess the results of testing as it applies to the Uniform Guidance compliance audit.
- Evaluate what should be documented regarding sampling in a compliance audit.

Audit sampling

Paragraph .05 of AU-C section 530, *Audit Sampling*,[1] defines *audit sampling* as the selection and evaluation of less than 100% of the population of audit relevance such that the auditor expects the items selected (the *sample*) to be representative of the population and, therefore, likely to provide a reasonable basis for conclusions about the population. In other words, audit sampling should provide an auditor with an appropriate basis for making conclusions about a characteristic of a population by examining evidence regarding that characteristic from a subset of the population.

Appendix VII, *Other Audit Advisories*, of the Office of Management and Budget *Compliance Supplement* (*Compliance Supplement*) alerts auditors that AU-C section 530 contains requirements and guidance on sampling and that failure to follow the standards may result in the audit being considered nonconforming. The advisory in Appendix VII also refers auditors to the AICPA Audit Guide titled Government Auditing Standards *and Single Audits* (GAS audit guide) as well as the AICPA Audit Guide *Audit Sampling*.

For more information on sampling in a compliance audit, see chapter 11, "Audit Sampling Considerations of Uniform Guidance Compliance Audits," in the GAS audit guide. That chapter provides considerations in designing an audit approach that includes audit sampling to achieve both compliance and internal control over compliance-related audit objectives in a compliance audit or in a program-specific audit performed in accordance with Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). It builds on the general guidance in AU-C section 530 by providing specific, relevant sampling guidance for single audits or program-specific audits.

An auditor's objectives in a Uniform Guidance compliance audit include reporting on internal control over compliance and expressing an opinion on whether the auditee has complied with federal statutes, regulations, and the terms and conditions of federal awards that may have a direct and material effect on each of its major programs.

The auditor's compliance testing must include tests of transactions and of such other auditing procedures necessary to provide the auditor with sufficient appropriate audit evidence to support the opinion on compliance for each major program. The auditor also must meet the requirements of the Uniform Guidance for testing and reporting on internal control over compliance. Sufficient appropriate audit evidence may be obtained through a variety of procedures. Auditors frequently use audit sampling procedures to obtain such audit evidence.

[1] All AU-C sections can be found in AICPA *Professional Standards*.

Methods of audit sampling

Audit sampling may be applied using a statistical or nonstatistical approach. An excerpt from the introduction to the AICPA Audit Guide *Audit Sampling* states the following:

> When using audit sampling, the auditor chooses between a statistical and a nonstatistical approach to audit sampling. Both methods comply with auditing standards. Statistical methods are drawn from the field of applied statistics and require training and experience in their use. Nonstatistical methods draw on the auditor's experience and professional judgment in selecting items for evidence from populations and evaluating the results. In using statistical sampling, the auditor uses experience and judgment when determining the appropriate selection and evaluation methods provided from the field of applied statistics. It is important to note that nonstatistical sampling methods may use tools from statistical sampling such as random selection of sample items or determining sample size by using statistical sampling tables. A distinguishing element is the evaluation method where statistical methods state a specific numerical sampling risk in inferring the condition of the population from the sample. The differences between these two methods include the different levels of formality in structuring the design and execution of the procedures and the numerical control of and evaluation of sampling risk provided by statistical methods. Both approaches are best carried out by auditors who have training in their use and evaluation. Training in nonstatistical sampling generally provides an overview of statistical principles because those principles are useful in helping the auditor to understand nonstatistical sampling.

Attributes sampling

Attributes sampling is used to reach a conclusion about a population in terms of a rate of occurrence. Its most common use in auditing is to test the rate of deviation from a prescribed control to support the auditor's assessed level of control risk. In attributes sampling, each occurrence of or deviation from a prescribed control is given equal weight in the sample evaluation, regardless of the dollar amount of the transactions. For testing the operating effectiveness of controls that are expected to operate with the same level of consistency, regardless of the size of transactions, attributes sampling is generally the most effective method to apply audit sampling to these tests.

When testing internal control over compliance in a Uniform Guidance compliance audit, the auditor is concerned primarily with rates of deviation from a prescribed control. Similarly, in tests of compliance, the auditor is concerned with whether there is evidence of compliance (that is, the rate and likely magnitude of noncompliance). Therefore, attributes sampling is typically used for tests of controls over compliance and compliance testing in a Uniform Guidance compliance audit.

Sampling in a Uniform Guidance compliance audit

Individually important items

When planning compliance testing for each major program, an auditor may exercise professional judgment to determine which items, if any, represent individually important items that may be individually tested and separated from the remaining population. Items of individual importance may be large, risky, or unusual items or transactions that contain characteristics of a prior compliance finding. Individually important items are those that, standing alone, are significantly different from the remainder of the population (for example, spikes in activity around a certain period, such as journal entries made at the beginning or the close of a federal award).

Although the identification of individually important items is not required by the Uniform Guidance, there are benefits to testing the individually important transactions that exist in a population. Specifically, the application of auditor judgment and experience in examining a population for risky or unusual transactions may

- be more effective in identifying noncompliance than a randomly or haphazardly selected sample,
- reduce detection risk of noncompliance because the items will not be part of the population subject to audit sampling,
- reduce the sample size for the items remaining in the sampling population, or
- eliminate having to sample altogether because it targets those items that have the largest effect on noncompliance.

The following key considerations relate to the testing of individually important items:

- The concept of identifying individually important items and focusing testing on a limited number of large or unusual items relates to compliance testing; it does not relate to testing internal control over compliance.
- A large number of transactions making up a significant percentage of dollars expended or having a significant effect on compliance typically would not represent individually important items because individually important items are usually represented by only a relatively small number of items.
- The identification of individually important items may involve discussions with auditees, analytical procedures such as scanning records, or using computer-assisted auditing techniques.
- The identification of individually important items may not be an efficient method when testing multiple types of compliance requirements at once because an individually important item with respect to a particular type of compliance requirement may not necessarily be an individually important item for another type of compliance requirement.

Defining the population and considering completeness

Proper definition and documentation of the audit objective precedes sampling design and execution. When designing an audit sample, the auditor should consider the purpose of the audit procedure (for example, to determine whether a necessary control was performed effectively or to determine whether a payroll expenditure charged to a federal award was allowable under applicable cost principles) and the characteristics of the population from which the sample will be drawn (for example, all salaried employees or hourly employees).

The auditor should define a population in a manner consistent with the audit objective and the internal control and compliance attributes being tested. It is important to determine that the sampling unit and the population from which units are selected for sampling is appropriate for the specific audit objective because sample results can be appropriately projected only to the population from which the sample was selected.

After the auditor removes transactions tested with nonsampling techniques (for example, individually important items or a subset of items that are tested 100%), the sampling population includes only the items constituting the transactions of interest for an audit objective related to a particular control or type of compliance requirement.

The auditor should select items for the sample in such a way that the auditor can reasonably expect the sample to be representative of the relevant population and likely provide the auditor with a reasonable basis for conclusions about the population. If an initial sample does not contain any items that include an attribute being tested, it may indicate that the sampling population was improperly defined.

The completeness of the population is important because erroneous conclusions could be made about the population if the population actually tested is not the one desired. To verify the completeness of a population, the auditor could, for example, reconcile the population to accounting or other relevant records or to the schedule of expenditures of federal awards. The auditor should develop and perform audit procedures sufficient to conclude that the population includes all the transactions of interest for the specific audit objective.

Sampling units

The sampling unit may be defined by any of the individual elements constituting the population. Each sampling unit constitutes one item in the population. In a Uniform Guidance compliance audit, a sampling unit might be a cash disbursement, student file, refund paid, financial report due during a fiscal year, or a cost transfer made during the year.

The definition of the sampling unit depends on the audit objective and the nature of the audit procedures being applied. For example, a sampling unit for a test of controls related to the activities allowed or unallowed type of compliance requirement may be a payment voucher, a journal entry, or another document that includes evidence of approval or review of the allowability of the expenditure. Each sampling unit may provide evidence of the application of more than one control.

To properly define the sampling unit, it also is important that the auditor determine how the auditee maintains its records (by participant, by program, or by location, for example). Based on the nature of the records, the auditor may then properly design a method to define the sampling unit and identify the sampling population.

Multiple major programs

If the auditee's internal control for a type of compliance requirement is common to more than one major program, the transactions of those programs may be combined into one population for determining sample size and for making sample selections for internal control testing. When an initial sample (one taken from a combined population) does not include items from each major program, the auditor typically uses professional judgment to add items from programs excluded in the initial sample. Note, however, that a sample missing items from a major program might indicate that the source from which the sample is selected (such as a printout or an electronic file) is incomplete.

As an alternative, the auditor could design the initial combined sample to draw items from each major program. For example, imagine that an auditee has common internal controls over the allowable costs and cost principles type of compliance requirement relating to three major programs of similar size. If, in this example, the auditor decides to use a combined sample of 60 items, he may select 20 items from each of the three programs. If the major programs are not of similar size, the sample may be allocated proportionately.

Key point

Experience has shown that it is preferable to select separate samples for compliance testing from each major program because the separate samples provide clear evidence of the compliance tests performed, the results of those tests, and the conclusions reached. Therefore, unlike tests of controls over compliance, compliance testing is typically performed on samples selected with each major program considered a separate population.

When an auditor believes a compliance sample can be selected from a population consisting of multiple major programs, it is important that the auditor document how the results relate to separate programs and how that evidence, together with other audit evidence, is sufficient to support the auditor's opinion on compliance for each major program. Federal quality control reviews have found deficiencies in audits in which auditors used this approach. These deficiencies stem primarily from auditors sampling too few items from each individual major program to support the opinion on compliance.

Multiple organizational units

An auditor might face additional sampling considerations when the auditee operates in multiple organizational units (for example, operating units, locations, or branches). Each organizational unit might maintain separate internal control over compliance that is relevant to the programs or parts of programs the unit administers. In these situations, the auditor should consider the understanding of internal control over compliance to determine whether to define each organizational unit as a separate population.

If controls over compliance or compliance procedures at the various organizational units vary significantly, it may be necessary for each location to be considered a separate population. When transactions relating to types of compliance requirements are processed in organizational units using the same controls or compliance procedures are performed under common oversight and monitoring, it may be feasible for the auditor to obtain sufficient appropriate audit evidence about controls and compliance for major programs by selecting one overall sample across the organizational units (for example, selecting from centralized locations or visiting all organizational units).

Key point

When evaluating whether multiple organizational units use the same controls, *same* does not mean *identical*. The auditor may consider the important elements of a control (such as the control activity and related monitoring) as well as the relative experience and training of each individual who processes or monitors the compliance transaction when determining whether the controls are the same or if they vary significantly.

When it is not feasible to obtain audit evidence centrally or to visit all organizational units but controls or compliance procedures (or both) are the same across organizational units, the auditor generally will select some organizational units from which to obtain audit evidence. In this case, the auditor may consider

- testing the minimum sample size at each significant unit (or more than the minimum sample size, depending on the results of the risk assessment procedures that preceded sampling), or
- varying the selection of less significant organizational units included in the testing from year to year.

Clusters of programs

An audit opinion on a cluster of programs is for the cluster *as a whole* and not for each individual Assistance Listing number or award that makes up the cluster. When sampling involves a cluster of programs, the auditor should consider whether, in the auditor's judgment, sufficient appropriate audit evidence has been gathered for the types of compliance requirements subject to audit that are direct and material relating to the cluster as a whole. A random or haphazard selection of items from the cluster can generally be expected to provide a representative sample.

There might be instances when the initial sample does not appear to be representative because it does not include items relating to certain types of compliance requirements subject to audit that are direct and material for Assistance Listing numbers or awards within the cluster. In this case, determining what additional evidence is needed requires the auditor's professional judgment. Factors the auditor may consider when determining whether to supplement the original sample include the consistency of processing controls over the various programs within the cluster, the volume of transactions and the size of expenditures for a particular program as a component of the overall cluster being tested, the complexity of the compliance requirements, and the past history of compliance. As with other forms of audit testing, the auditor should document the objective of the cluster testing and the sample design.

When auditee records permit, an alternative approach to selecting sample items in a cluster might be for the auditor to analyze the components (for example, expenses) of the cluster transactions and federal awards before selecting the sample. The auditor would then allocate the number of selections from the sample to the transactions or programs in proportion to the overall cluster. The difficulty of this approach depends on how the auditee keeps its records.

Dual-purpose samples for controls and compliance testing

In some circumstances, an auditor might design a test that uses a dual-purpose sample. The most common dual-purpose approach in a Uniform Guidance compliance audit is testing the operating effectiveness of a control and testing whether the auditee complied with relevant federal statutes, regulations, or terms and conditions of federal awards using the same sample. For example, subrecipient monitoring often can be tested with a dual-purpose sample. If the sampling unit is a subrecipient reimbursement request, the documentation might contain evidence of review by the pass-through entity (a signature, for example) and compliance with monitoring activities. When using a dual-purpose sample for internal control and compliance testing, it is important that test objectives align with the same sampling unit and population (that is, the sampled population is appropriate for the tests being applied to it). A sample designed for a dual-purpose test will usually be the larger of the samples that would otherwise have been designed had the control and compliance samples been performed separately.

When testing both the operating effectiveness of a control and whether the auditee complied with a type of compliance requirement, the basis for the auditor's evaluation of the control is the *operation* of the control; it is not based solely on whether the auditee complied. Further, a control that the auditee improperly applies to a transaction does not necessarily lead to noncompliance. Therefore, the auditor might reach different conclusions on controls and compliance for the same sample item (for example, report a significant deficiency or material weakness in internal control over compliance but not a compliance-related audit finding).

In evaluating results of dual-purpose tests, the auditor should separately evaluate findings for the control attributes and the compliance attributes tested. When planning compliance tests, the auditor should use the knowledge obtained of the relevant portions of internal control over compliance to (*a*) identify types of potential noncompliance, to (*b*) consider factors that affect the risk of material noncompliance, and to (*c*) design appropriate tests of compliance. Deviations that result from control tests (including control tests that are part of a dual-purpose sample) may in turn result in a larger compliance sample than originally planned for the related type of compliance requirement. This is because of the increased risk posed by the deficiency in internal control over compliance.

As noted previously, the auditor's documentation of internal control tests should be distinct from the documentation of compliance tests; there must be a clear distinction between the audit objectives and test results for each test to enable separate conclusions on the internal control attributes tested and the compliance attributes tested.

Knowledge checks

1. Which statement about testing individually important items is accurate?

    a. It is used for both internal control and compliance testing.
    b. It is used instead of selecting a sample from the entire population.
    c. It is used to individually test items that are separated from the remaining population.
    d. It is used when numerous items make up a significant part of the population.

2. When testing compliance for multiple major programs, if the initial sample taken from a combined population does not include items from each major program, how should the auditor proceed?

    a. The auditor should ignore the issue because each item had an equal chance to be selected.
    b. The auditor must reselect a new sample.
    c. The auditor should use professional judgment to add items from the programs not represented.
    d. The auditor must change the sampling approach for that testing so that it does not use a combined population.

3. Which is a primary concern when testing internal control over compliance?

    a. The rates of deviation from a prescribed control.
    b. The accuracy of the transaction.
    c. Fraud.
    d. Whether there is noncompliance as a result of discovered control deficiencies.

Sample-size tables

Because the objectives for tests of controls and tests of compliance are different, there are different factors to consider when determining sample sizes; the auditor should therefore consider sample sizes separately for internal control testing and for compliance testing. Audit documentation typically includes the inputs and assumptions for sample sizes to support each sample for every type of compliance requirement subject to audit that is direct and material in which sampling is used.

Inputs and sample sizes for control testing

If the auditor determines that internal control over compliance is effectively designed and implemented, the Uniform Guidance requires that the auditor plan the audit to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program. This requires the auditor to plan to obtain a high level of assurance that controls operate as designed. Therefore, samples for control tests are generally designed to achieve a 90%–95% confidence level (see AICPA Audit Guide *Audit Sampling* for further discussion of confidence levels). Because there are typically few other procedures that provide evidence of the effectiveness of controls, the sample-size table that follows is designed to provide a high level of assurance. This table provides suggested minimum sample sizes for very significant and moderately significant controls with limited-to-higher inherent risk of material noncompliance in a major program. There are only two inputs in this scenario: the significance of the control and its inherent risk of material noncompliance. The auditor should consider compensating, or redundant, controls. If the auditor reduces the significance of a control to moderately significant because there are compensating controls, the auditor must also test the compensating control for operating effectiveness. Inherent risk should match the inherent risk assessment performed in the risk assessment phase of the single audit.

The suggested minimum sample sizes in the "Control testing sample size" table, which follows, are designed to provide sufficient appropriate audit evidence that controls are operating effectively in many Uniform Guidance compliance audit testing situations.[2] However, the auditor should use professional judgment to determine whether a larger sample size is justified to obtain sufficient appropriate audit evidence that controls are functioning in their particular circumstances. For example, there may be additional risks (such as a change in the design of the control or a change in personnel operating the control) or the auditor may expect deviations. It is important to recognize that when controls are not deemed effective, further control testing may not be warranted.

[2] The sample-size tables are taken from chapter 11 of the AICPA Audit Guide Government Auditing Standards *and Single Audits*.

Control testing sample size	
Significance of control and inherent risk of compliance requirement **0 deviations expected**	**Minimum sample size**
Very significant and higher inherent risk	60
Very significant and limited inherent risk or Moderately significant and higher inherent risk	40
Moderately significant and limited inherent risk	25

This table is appropriate for sampling from populations of 250 items or greater.

Inputs and sample sizes for compliance testing

The auditor typically performs a broad array of procedures to provide a reasonable basis for expressing an opinion on compliance for each major program. These other audit procedures typically precede compliance audit sampling. For example, risk assessment procedures usually precede substantive procedures. Similarly, it is common for some controls-related procedures to be conducted prior to compliance testing (such as understanding and testing the control environment). Before designing a compliance audit sample, it is also common for the auditor to consider whether there are individually important items that might be selected for testing prior to selecting a compliance sample. The auditor should consider other audit procedures when determining the appropriate sample size for compliance testing.

The *risk of material noncompliance* consists of inherent risk of noncompliance and control risk of noncompliance. The assurance required from a compliance sample and, therefore, the determination of the minimum compliance sample size, depends on the risk of material noncompliance remaining after other audit procedures have been executed. If the auditor gathers evidence that (*a*) tests of controls show that controls over compliance are effective, (*b*) other audit procedures identify neither instances of noncompliance nor specific heightened risk factors, and (*c*) additional testing via audit sampling is warranted, it is likely that any remaining risk of material noncompliance is low or moderate. Conversely, if tests of controls identify deficiencies in the controls over compliance or if other audit procedures identify instances of noncompliance or specific heightened risk factors, the auditor could assess the remaining risk of material noncompliance as high or moderate.

The auditor may apply the suggested minimum sample sizes in the "Compliance testing sample size" table, which follows, to each compliance requirement subject to audit that is direct and material for each major program. Although these suggested minimum sample sizes often provide the appropriate extent of testing, the auditor may use professional judgment to determine whether larger sample sizes are justified to obtain sufficient appropriate audit evidence in particular circumstances. For example, if there were significant deficiencies or material weaknesses noted with the related controls, the auditor may expand testing to support the conclusion on compliance.

Compliance testing sample size	
Desired level of assurance (remaining risk of material noncompliance) **0 exceptions expected**	**Minimum sample size**
High	60
Moderate	40
Low	25

This table is appropriate for sampling from populations of 250 items or greater.

Testing small populations

Some significant controls or instances of complying with a compliance requirement seldom occur (for example, submitting a required report). The "Small population sample size" table, which follows, provides suggested minimum sample sizes for testing small populations subject to controls and compliance requirements. *Small populations* are defined as populations of fewer than 250 items.

Small population sample size table	
Frequency and population size	**Sample size**
Quarterly (4)	2
Monthly (12)	2–4
Semimonthly (24)	3–8
Weekly (52)	5–9

For populations of 52–250 items, a rule of thumb that some auditors follow is to test a sample of approximately 10% of the population; but sample size is subject to professional judgment and includes risk assessment considerations specific to the engagement.

For more significant controls or for more significant types of compliance requirements, the auditor might determine that an appropriate sample size is on the larger end of the ranges displayed in the sample-size table for small populations.

The auditor may consider the size of the population by reference to the defined sampling unit. For example, in some cases, the auditor might need to consider the populations from several locations or organizational units; if there were weekly controls over the occurrence of expenses at each of 40 departments, the population of weekly expense test controls would be 2,080 (52 × 40); this would not be a small population.

Remember: these tables are based on an expectation of zero exceptions. If your client has a history of noncompliance or findings, these tables will not be sufficient for calculating sample size.

Exercise: Dual-purpose sample size

The auditor is planning to design a test that uses a dual-purpose sample for the allowable costs/cost principles type of compliance requirement. Assume that there

- are three types of expenditures — payroll, direct costs, and transfers;
- is a separate key control for each type of expenditure; and
- is a sample size of 25 for internal control testing and 25 for compliance testing.

What would be the dual-purpose sample size?

Selecting sample items for testing

Once an auditor has identified a population of transactions or items relevant for a control or type of compliance, the auditor may select items for testing from a physical or electronic representation of the population. A printout of expenditures for the period is an example of a physical representation.

The auditor should select items for the sample in such a way that the auditor can reasonably expect the sample to be representative of the relevant population and likely provide the auditor with a reasonable basis for making conclusions about the population. The goal of sample selection (a representative sample) is the same for nonstatistical and statistical sampling alike. For statistical sampling, it is necessary to use an appropriate random sampling method, such as simple random sampling or systematic sampling. In nonstatistical sampling, the auditor uses an approach that approximates random sampling. The *Compliance Supplement* provides specific guidance on sample selection for certain types of major programs.

An overview of selection methods follows. For nonstatistical sampling, the auditor may select the sample using any of the three techniques detailed. For statistical sampling, however, the haphazard selection technique is not appropriate.

Alert —The 2023 *Compliance Supplement*

The 2023 *Compliance Supplement* was not yet available when this course was updated. Therefore, information in this course is based on prior-year supplements. Once the 2023 supplement is issued, auditors should carefully evaluate it for any effect its revisions will have on compliance audits. See the Governmental Audit Quality Center website at https://www.aicpa.org/topic/government for additional information.

Random selection

Random selection means that each sampling item in the population has an equal chance of selection. To perform random selection, the auditor may select a random sample by matching to the population random numbers selected from a random number table or generated with software, such as Microsoft Excel or commercial audit software packages.

Haphazard selection

Haphazard selection is the selection of sampling units with no intentional bias or, put another way, with no special reasoning for including or omitting items from the sample. This technique represents the auditor’s best attempt to use professional judgment in making a random selection, without the use of a structured selection technique (such as random numbers or tables). Haphazard selection does not mean that the auditor samples units carelessly.

The auditor who uses haphazard selection is careful to avoid distorting the sample by selecting, for example, only large, only unusual, only convenient, or only physically small items or by omitting such items as the first or last in the physical representation of the population. The goal is to select a sample without bias. Although haphazard sampling is useful for nonstatistical sampling, it is not appropriate for statistical sampling; this is because with this method the auditor is unable to measure the probability of selecting a combination of sampling units.

Systematic selection with a random start

Systematic selection with a random start determines a uniform interval by dividing the number of physical units in the population by the sample size. The auditor randomly selects a starting point in the first interval. One item is selected at each uniform interval from the starting point throughout the population. For example, if the auditor wishes to select 60 items from a population of 12,000 items, the uniform interval is every 200th item. The auditor randomly selects the first item from within the first interval and then selects every 200th item from the random start.

If the deviation pattern is random, then systematic selection is equivalent to simple random selection. In the absence of a known pattern in the population, it is a practical and efficient alternative to simple random selection, particularly when items are being selected manually from a population.

Evaluating sample results

Evaluating control deviations

The auditor should investigate the nature and cause of control deviations and evaluate any possible effects on the purpose of the audit procedure and on other areas of the audit. The "Control testing sample size" table, found earlier in this course, is based on an expectation of zero deviations. Therefore, when more deviations are encountered than planned for, the auditor has not met the planned audit objective. In other words, although the auditor needs a *tolerance*, or tolerable deviation rate, in order to plan a sample, the observance of a deviation rate as high as the tolerable rate in a sample is not acceptable due to sampling risk.

When a control deviation is identified, the auditor should evaluate its nature and cause to determine whether it signals significant deficiencies or material weaknesses in internal control over compliance.

Calculating the control deviation rate

To calculate the *deviation rate* in a control-test sample, the auditor divides the number of observed deviations by the sample size. For example, if 3 deviations are observed in a sample of 60, the deviation rate is 5% (3/60). The deviation rate in the sample is the auditor's best estimate of the deviation rate in the population from which it was selected. Because the general purpose of testing is to confirm the reliability of the control, it is normal to assume that controls are effective when designing the audit plan. Therefore, deviations observed in the sample are often important to the auditor's compliance testing strategy, depending on the deviation rate and reasons for the deviation.

Considering sampling risk associated with control testing

When evaluating a sample for a test of controls, the auditor should give appropriate consideration to *sampling risk*. This is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. If the estimate of the *population deviation rate* (the sample deviation rate) is less than the tolerable deviation rate for the population, the auditor should consider the risk that such a result might be obtained even if the true deviation rate for the population exceeds the tolerable rate for the population.

If an auditor performs a statistical sampling application, the auditor might use a table or computer program to help measure the allowance for sampling risk. If the auditor performs a *nonstatistical* sampling application, sampling risk might not be directly measurable. However, when the rate of deviation identified in the sample exceeds the expected population deviation rate used in designing the sample (which is zero in the "Control testing sample size" table), it is generally appropriate for the auditor to conclude that sample results do not support the planned assessed level of control risk of noncompliance.

The "Control testing sample size" table is based on an expectation of zero deviations. When more deviations are encountered than planned for, the auditor has not met the planned audit objective and there is likely to be an unacceptably high risk that the true deviation rate in the population exceeds the tolerable rate due to sampling risk. In such a circumstance, after considering the reasons for the control deviations and the number of them identified, the auditor might conclude that it is appropriate to expand the test or perform other tests to include sufficient additional items to reduce control risk to an acceptable level. Rather than testing additional items, however, it is often more efficient in a Uniform Guidance compliance audit to report a deficiency in internal control over compliance and, when testing compliance, to increase the auditor's assessed level of remaining risk of material noncompliance and increase the extent of compliance testing to reflect the change in the control risk of noncompliance assessment.

Assessing the potential magnitude of a deficiency in internal control over compliance

If the auditor finds deviations, a determination about whether they are deficiencies in internal control over compliance must be made and, if so, whether those deficiencies are material weaknesses, significant deficiencies, or just deficiencies in internal control over compliance. AU-C section 265*, Communicating Internal Control Related Matters Identified in an Audit*, requires the auditor to consider the likelihood and magnitude of deficiencies individually or in combination.

Reaching an overall conclusion on tests of controls

The auditor must exercise professional judgment when reaching an overall conclusion on the effect that the evaluation of the sample results will have on the assessed level of control risk of noncompliance, the risks of material noncompliance, and, therefore, on the nature, timing, and extent of planned compliance tests. If the sample results, along with other relevant audit evidence, support the planned low assessed level of control risk of noncompliance, the auditor may have no need to modify planned compliance tests. If a low assessed level of control risk of noncompliance is not supported, the auditor should consider either performing further tests of other controls that could result in supporting the planned level of control risk of noncompliance or increasing the assessed level of control risk of noncompliance and altering the nature, timing, or extent of the planned compliance tests accordingly.

Evaluating compliance exceptions

Exceptions the auditor observes in a sample are important to his compliance testing strategy; he should evaluate the exceptions to determine whether to report findings of material noncompliance. Further, compliance findings may affect the opinion on the auditee's compliance with compliance requirements that could have a direct and material effect on major programs. Whether the sample is statistical or nonstatistical, the auditor should evaluate the nature and cause of the noncompliance to reach an overall conclusion on compliance with a particular type of compliance requirement.

Calculating the compliance exception rate or likely questioned costs

For nonmonetary compliance attributes, calculating the exception rate in the compliance test sample requires the auditor to divide the number of observed exceptions by the sample size. For example, if 3 exceptions are observed in a sample of 60, the exception rate is 5% (3/60). The exception rate in the sample generally is the auditor's best estimate of the exception rate in the population from which it was selected.

Although compliance testing in a Uniform Guidance compliance audit often involves monetary amounts, the focus of the testing is on whether there is evidence of compliance to support the auditor's opinion on compliance. Additionally, when noncompliance related to monetary transactions of a program is discovered, the Uniform Guidance requires the auditor to determine and report known questioned costs and estimate likely questioned costs associated with the audit finding. The estimation of likely questioned costs may require the projection of sample results to determine the effect on the auditor's opinion on compliance and whether an audit finding is required to be reported in the schedule of findings and questioned costs. The auditor is not required to expand testing to definitively determine the total questioned costs; there is no requirement in the Uniform Guidance to report an exact amount or a statistical projection of likely questioned costs. Rather, the Uniform Guidance requires the auditor to consider the effect of likely questioned costs on the auditor's opinion on compliance and to include an audit finding when her estimate of likely questioned costs exceeds $25,000.

As noted previously, the auditor should evaluate the finding to calculate an estimate of likely questioned costs in order to determine whether likely questioned costs exceed $25,000. For example, the auditor specifically identifies $7,000 in known questioned costs for a type of compliance requirement but, based on his projection of the exception to the population, develops an estimate that total likely questioned costs are approximately $60,000. In that case, based on the $60,000 of likely questioned costs, the auditor must report an audit finding that identifies known questioned costs of $7,000. If likely questioned costs exceed program materiality, the auditor may consider modifying the audit opinion on compliance for that program.

Two approaches are commonly used to project compliance results to a monetary population. First, if the monetary compliance exceptions are 100% errors (for example, the entire sampling unit contains all allowable or unallowable costs) from a population of similarly sized transactions, the auditor can apply the same exception rate technique discussed previously for nonmonetary compliance attributes to the population of dollars to estimate likely questioned costs. For example, if 3 exceptions are observed in a sample of 60, the exception rate is 5% (3/60). Assuming the three exceptions were 100% errors, and the population is made up of homogeneous transactions, the 5% exception rate would be applied to the total population monetary value to estimate likely questioned costs. Continuing the example, if the total value of the sampling population was $1 million, then likely questioned costs would be $50,000.

The second approach applies the noncompliance or questioned cost rate of dollar noncompliance observed in the sample to the population. For example, an auditor might have selected a sample that adds up to $15,000 and observed known questioned costs of $450, or 3% of the recorded amount of the expenditures tested. If the total recorded amount in the expenditures population is $1 million, then likely questioned costs would be $30,000 ($1,000,000 × 3%). This approach is especially useful when a sampling unit is found to be only partially incorrect.

Considering sampling risk associated with compliance testing

When evaluating a sample for a test of compliance, the auditor should give appropriate consideration to sampling risk. If the estimate of the population exception rate (the sample exception rate) for nonmonetary attributes is less than the tolerable exception rate for the population, or if the estimate of likely questioned costs is less than tolerable error for a monetary population, the auditor might consider the risk that such a result could be obtained even if the true exception rate or questioned costs for the population exceeds the tolerable rate or tolerable error, respectively, for the population.

If the auditor performs a statistical sampling application, the auditor might use a table or computer program to help measure the allowance for sampling risk. If the auditor performs a *nonstatistical* sampling application, sampling risk may not be directly measurable. However, when the rate of exceptions or likely questioned costs identified in the sample exceeds the expected exception rate used in designing the sample (which is zero in the "Compliance testing sample size" table), it is generally appropriate for the auditor to conclude that sample results do not support an acceptable level of compliance.

As already noted, the "Compliance testing sample size" table is based on an expectation of zero exceptions. When more exceptions are encountered than planned for, the auditor has not met the planned audit objective and there is likely to be an unacceptably high risk that the true exception rate in the population exceeds the tolerable rate due to sampling risk. In such a circumstance, after considering the reasons for the compliance exceptions and the number and magnitude of exceptions identified, the auditor may conclude that it is appropriate to expand testing or perform other tests to include sufficient additional items to reduce the risk of material noncompliance to an acceptable level. Alternatively, rather than expand the scope of testing to improve the precision of the projected error, the auditor might consider it prudent to report the exceptions as an audit finding and evaluate the effect that the sample result has on the assessed level of risk of material noncompliance and the overall compliance opinion.

In evaluating whether an exception is a finding, it is particularly important to consider sampling risk when the projected likely questioned cost is close to the reporting threshold of $25,000. The auditor would generally conclude that there is an unacceptable risk that the true questioned costs exceeds the reporting threshold. Even when the projected likely questioned costs are considerably less than the reporting threshold, the auditor should consider the risk that such a result might be obtained even though the true questioned costs for the population exceeds the reporting threshold (allowance for sampling risk). The smaller the sample, the greater the associated uncertainty or sampling risk associated with that sample.

Effect of compliance testing results on internal control results reporting

The auditor should relate the evaluation of the compliance testing sample to other relevant audit evidence when forming a conclusion about compliance and internal control over compliance. If compliance testing results in exceptions, the auditor should relate this testing to the results of tests of internal control. A compliance exception indicates a potential deficiency in internal control over compliance.

Reaching an overall conclusion on tests of compliance

The auditor must exercise professional judgment when reaching an overall conclusion about the effect that the evaluation of the sample results has on the assessed level of risk of material noncompliance and, therefore, on the overall Uniform Guidance compliance audit opinion. If the sample results, along with other relevant audit evidence, support other than an unmodified opinion, the auditor should modify the opinion accordingly.

For nonmonetary compliance attributes (for example, a report is submitted on a timely basis), the auditor should document noted exceptions and consider the guidance contained in the Uniform Guidance to determine whether the finding should be included in the schedule of findings and questioned costs. For monetary attributes, the auditor also should document noted exceptions (and any related questioned costs); if known or likely questioned costs exceed $25,000, the auditor must report the audit finding.

When the auditor finds a compliance exception that by itself does not meet the criteria of an audit finding, the auditor typically gains assurance that the exception may indeed be omitted from the schedule of findings and questioned costs. Although the Uniform Guidance does not require the auditor to expand a sample in the case of exceptions, there may be additional procedures performed to support the conclusion that the exception is not a finding (for example if the questioned costs are close to but under the reporting threshold of $25,000). In all cases when an initial exception is determined not to be an audit finding, the auditor should document the rationale for omitting the exception from the schedule of findings and questioned costs.

Documentation

As noted in AU-C section 935, *Compliance Audits*, the auditor should document responses to the assessed risks of material noncompliance, the procedures performed to test compliance with applicable compliance requirements, and the results of those procedures, including any tests of controls over compliance. The form and extent of documentation related to sampling are influenced by numerous factors; these factors might include the size and complexity of the auditee, the nature and complexity of the auditee's internal control over compliance, the nature and complexity of the compliance requirements, and the auditee's past experience relative to compliance.

Examples of items that the auditor typically documents include the following:

- A description of the control or type of compliance requirement being tested
- A definition of the population and the sampling unit, including how the auditor considered the completeness of the population
- A definition of the deviation or exception condition
- The desired confidence or assurance level, the tolerable deviation or exception rate, and the expected population deviation or exception rate
- The chosen sample size
- The sample selection method used (as in, random, haphazard, or systematic)
- The selected sample items, which would include identifying characteristics of the specific items tested, clear documentation to support both controls and compliance testing when dual-purpose testing is applied, and resolution of any documents that cannot be located
- An evaluation of the sample, including the following:
  - The number of deviations or exceptions found in the sample
  - Important qualitative aspects of the deviations or exceptions
  - The projected population deviation or exception rate
  - A determination of whether sample results support the test objective
  - The effect of the evaluation on other audit procedures (for example, if tests of controls do not allow the auditor to support a low assessed level of control risk of noncompliance for major programs, consideration of the effect on subsequent tests of compliance)
  - The auditor's determination of known questioned costs and estimate of likely questioned costs
  - A determination whether observed deviations or exceptions require the auditor to modify the auditor's opinion on compliance or will result in a finding and, if not, how the auditor considered sampling risk
- Any qualitative factors considered significant in making the sampling, selections, assessments, and judgments, which may include multiple major programs, multiple organizational units, clusters, or other factors
- A summary of the overall conclusion (if not evident from the results)

Knowledge checks

4. Which is **not** accurate regarding methods of sampling?

    a. In nonstatistical sampling, the auditor uses a sample selection approach that approximates a random sampling approach.
    b. For statistical sampling, it is not necessary to use an appropriate random sampling method, such as simple random sampling or systematic sampling.
    c. Haphazard selection is the selection of sampling units without any intentional bias or, put another way, without any special reasoning for including or omitting items from the sample.
    d. Random selection provides an equal chance of selection to each sampling item in the population.

5. Which statement accurately reflects auditor considerations when reaching a conclusion on internal control and compliance testing?

    a. A control deficiency found that is a material weakness will result in a modified opinion on a major program.
    b. Some deviations are expected when using the sample-size tables.
    c. Control deficiencies identified are required to have questioned costs reported based on the type of control.
    d. Zero deviations are expected when using the sample-size tables.

Common deficiencies found in single audits

Common deficiencies related to sampling in a single audit include the following

- Failure to adequately document sampling methodology
- Failure to document the adequacy of the planned sample size for a test of controls over compliance to achieve a low level of control risk
- Failure to document the testing of controls and compliance for the relevant assertions related to each applicable compliance requirement with a direct and material effect for the major program, including insufficient documentation and improper usage of dual-purpose testing

Summary

Key foundational points	
1.	Audit sampling should provide an auditor with an appropriate basis for making conclusions about a characteristic of a population by examining evidence regarding that characteristic from a subset of the population.
2.	AU-C section 530 contains guidance regarding the use of sampling. Chapter 11 of the GAS audit guide applies guidance found in AU-C section 530 to a single audit.
3.	When a control deviation is identified, the auditor should evaluate its nature and cause to determine whether it signals significant deficiencies or material weaknesses in internal control over compliance.
4.	The form and extent of documentation related to sampling are influenced by numerous factors; these factors might include the size and complexity of the auditee, the nature and complexity of the auditee's internal control over compliance, the nature and complexity of the compliance requirements, and the auditee's past experience relative to compliance.

Solutions

Advanced Topics in a Single Audit: Audit Sampling in a Uniform Guidance Compliance Audit

Exercise solution: Dual-purpose sample size

The size of a sample designed for dual purposes should be the larger of the samples that would otherwise have been designed if the control and compliance samples were performed separately. In this case, the dual-purpose sample size would be 75, determined as follows:

For control testing:	For compliance testing:
3 key controls	1 compliance requirement
25 per each control	25 per requirement
Total is 75	Total is 25

Knowledge check solutions

1.

   a. Incorrect. Testing individually important items is appropriate for compliance testing only.
   b. Incorrect. The testing of individually important items is one method of testing compliance. Often the remaining population is tested using another method.
   c. Correct. When testing individually important items, those items are separated from the rest of the population.
   d. Incorrect. The testing of individually important items is typically not appropriate when numerous items make up a significant part of the population.

2.

a. Incorrect. The auditor should not ignore the issue because evidence is needed regarding compliance for each major program.
b. Incorrect. The auditor is not required to reselect a new sample. However, steps should be taken to ensure each major program is being tested for compliance.
c. Correct. The auditor typically will exercise professional judgment to add items from any programs not represented.
d. Incorrect. It is not required that the sampling approach be changed so that the testing does not use a combined population. However, the auditor should ensure that all major programs are tested.

3.

a. Correct. When testing internal control over compliance, the auditor is primarily concerned about the rates of deviation from a prescribed control.
b. Incorrect. The accuracy of the transaction would provide information regarding compliance, not internal control over compliance.
c. Incorrect. The presence of fraud would be an indicator of noncompliance, not internal control over compliance.
d. Incorrect. Although noncompliance discovered during testing provides the auditor with information relevant to the compliance audit, any noncompliance found is not the objective of testing internal control over compliance.

4.

a. Incorrect. In nonstatistical sampling, the auditor uses a sample selection approach that approximates a random sampling approach.
b. Correct. In statistical sampling, it is necessary to use an appropriate random sampling method, such as simple random sampling or systematic sampling.
c. Incorrect. Haphazard selection is the selection of sampling units without any intentional bias; that is, without any special reasoning for including or omitting items from the sample.
d. Incorrect. Random selection provides an equal chance of selection to each sampling item in the population.

5.

a. Incorrect. A control deficiency found that is a material weakness may indicate noncompliance. However, there may be no noncompliance even with a material weakness in internal control.
b. Incorrect. Sample-size tables are not based on an expectation of some deviations.
c. Incorrect. Compliance exceptions, not control deficiencies, result in questioned costs.
d. Correct. The sample-size tables are based on an expectation of zero deviations. The auditor would take this into consideration when evaluating sampling results.

Advanced Topics in a Single Audit: Pass-Through Entities and Subrecipients

Learning objectives

- Assess whether an entity is a subrecipient or a contractor.
- Identify a pass-through entity's responsibilities for subrecipient monitoring.
- Evaluate the effect of insufficient subrecipient monitoring in a Uniform Guidance compliance audit.

Pass-through entities, subrecipients, and contractors

Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), applies both to recipients expending federal awards received directly from federal awarding agencies and to subrecipients expending federal awards received from a pass-through entity. Accordingly, recipients and subrecipients that expend $750,000 or more in federal awards must have a single or program-specific audit in accordance with the Uniform Guidance.

Many nonfederal entities receiving federal awards make pass-through payments of federal awards (subawards) to other entities that are considered subrecipients. Pass-through entities are responsible for ensuring that subrecipients expend awards in compliance with applicable federal statutes, regulations, and the terms and conditions of federal awards.

Depending on the substance of its agreements with federal awarding agencies and pass-through entities, a nonfederal entity may receive federal funds concurrently as a recipient, a subrecipient, or a contractor. Therefore, , a pass-through entity must make case-by-case determinations about whether each agreement it makes for the disbursement of federal program funds casts the party receiving the funds as a subrecipient or a contractor. In addition, the federal awarding agency might supply — and require recipients to comply with — additional guidance to support this determination provided that guidance does not conflict with the Uniform Guidance. Responsibilities for compliance with federal program requirements and the compliance requirements subject to audit that are direct and material to be tested by the auditor can differ significantly depending on whether the entity is a pass-through entity, a subrecipient, or a contractor. Guidance on distinguishing between a subrecipient and a contractor can be found in the Uniform Guidance at 2 CFR 200.331 of Subpart D, "Post Federal Award Requirements."

Payments received by a contractor for goods or services provided in connection with a federal program are not considered federal awards. In addition, the Uniform Guidance states that Medicaid payments to a subrecipient for providing patient-care services to Medicaid-eligible individuals are not considered federal awards expended under the Uniform Guidance unless a state requires the funds to be treated as federal awards because reimbursement is on a cost-reimbursement basis.

The Uniform Guidance states that in determining whether an agreement between a pass-through entity and another nonfederal entity casts the latter as a subrecipient or a contractor, the substance of the relationship is more important than the form of the agreement. All the characteristics listed in the following paragraphs may not be present in all cases; the pass-through entity must use judgment in classifying each agreement as either a subaward or a procurement contract. In some cases, it might be difficult for the pass-through entity to determine whether a relationship with an entity is that of a subrecipient or a contractor. The federal cognizant agency for audit, the oversight agency for audit, or the federal awarding agency may assist the pass-through entity in making such determinations.

Subrecipient and contractor determinations

The following are characteristics of a federal award versus a payment for goods and services, as set forth by the Uniform Guidance.

Federal award

Characteristics indicative of a federal award received by a subrecipient are when the nonfederal entity

1. determines who is eligible to receive what federal financial assistance;
2. has its performance measured in relation to whether federal program objectives are met;
3. is responsible for programmatic decision-making;
4. is responsible for adherence to applicable federal program requirements specified in the federal award; and
5. uses the federal funds in accordance with its agreement to carry out a program for a public purpose specified in authorizing statutes rather than to provide goods or services for the benefit of the pass-through entity.

Payment for goods and services

Characteristics indicative of a procurement relationship between the nonfederal entity and a contractor are when the entity receiving the federal funds

1. provides the goods and services within normal business operations;
2. provides similar goods or services to many different purchasers;
3. normally operates in a competitive environment;
4. provides goods or services ancillary to the operation of the federal program; and
5. is not subject to compliance requirements of the federal program as a result of the agreement, though similar requirements may apply for other reasons.

Examples of subrecipients and contractors

Pass-through entity and subrecipient

Following are examples of a typical relationship between a pass-through entity and a subrecipient:

- A state department of education (pass-through entity) receives a federal award and is responsible for administering and disbursing the federal award to local school districts (subrecipients) according to a formula or on some other basis.
- A regional planning commission (pass-through entity) receives a federal award for the provision of food for elderly and low-income individuals, and the commission disburses the award to not-for-profit (NFP) entities (subrecipients) to support their feeding programs.
- A university (pass-through entity) receives a federal award and disburses the award to a governmental hospital (subrecipient) to conduct research.
- A state arts commission (pass-through entity) receives a federal award and disburses the award to an NFP theater group (subrecipient) to support a summer arts series.

Recipient and contractor

Following are examples of a typical relationship between a recipient and a contractor:

- A local government (recipient) receives a federal award to provide mental health services in a designated area. Some of the funds are paid to a construction company (contractor) to repair a leaky roof.
- A county (recipient) receives a federal award to operate a Head Start program and pays an NFP entity (contractor) to provide temporary clerical services.
- An NFP organization (recipient) receives a federal award to run a preschool and pays a medical doctor (contractor) to perform health screening on a per-student basis.
- An NFP organization (recipient) receives a federal award to operate a child care center and pays an NFP clinic (contractor) to perform physical exams.

Entity is both a subrecipient and a pass-through entity

Instances occur in which an entity can be both a subrecipient and a pass-through entity, as shown in the following examples:

- A local government receives a subaward from a state government agency (the local government is a subrecipient) and in turn passes through a portion of the federal award to an NFP entity (the local government is also a pass-through entity) to administer a federal program.
- An NFP area agency receives a subaward from a state (the NFP area agency is a subrecipient) and further passes through a portion of the federal award to a for-profit health care provider (the NFP area agency also is a pass-through entity).

Knowledge check

1. Which situation best indicates the existence of a subrecipient relationship?

    a. The entity receiving the federal funding provides the goods and services within normal business operations.
    b. The entity receiving the federal funding operates in a competitive environment.
    c. The entity receiving the federal funding provides a service ancillary to the federal program.
    d. The entity receiving the federal funding is responsible for programmatic decision-making.

Planning considerations — Pass-through entities

Effect of pass-through federal awards on major program determination

The determination of when a federal award is expended must be based on when the activity related to the award occurs. With respect to federal awards provided by a pass-through entity to subrecipients, federal awards are deemed expended by the pass-through entity when the funds are disbursed to subrecipients, regardless of when subrecipients expend the federal funds. Accordingly, the amount of federal funds disbursed to subrecipients must be included in the total expenditures of federal awards of the pass-through entity and in the determination of the pass-through entity's major programs.

Subrecipient or contractor determination

As part of a Uniform Guidance compliance audit, the pass-through entity auditor considers whether the auditee's subrecipient and contractor determinations comply with the Uniform Guidance when testing subrecipient monitoring and the total amounts provided to subrecipients from each federal program on the schedule of expenditures of federal awards (SEFA).

Materiality

An auditor's consideration of materiality is a matter of professional judgment and is influenced by the auditor's perception of the needs of a reasonable person who will rely on the auditor's work. A comparison of the amount of federal funds passed through to subrecipients with the total amount of expenditures for each individual major program or cluster can help the auditor determine whether the pass-through amount is direct and material. When subrecipient monitoring is subject to audit and the amount of federal funds passed through to subrecipients is either quantitatively or qualitatively material in relation to the major program being audited, the auditor is required to test subrecipient monitoring for the program. Some federal programs are designed in such a manner that subrecipient expenditures are intended to be material to the pass-through entity's award. For example, the Community Services Block Grant requires a state to subaward at least 90% of the state's award.

Pass-through entity request for a program to be audited as a major program

When a subrecipient is required to have a single audit, the Uniform Guidance permits the pass-through entity to request that a subrecipient's program be audited as a major program in lieu of the pass-through entity conducting or arranging for additional audits. When a pass-through entity makes such a request, it must pay the full incremental cost for such an audit.

Performing and reporting on the audit

Auditor's consideration of a pass-through entity's subrecipient monitoring

Subrecipient monitoring is 1 of the 12 types of compliance requirements included in the Office of Management and Budget *Compliance Supplement* (*Compliance Supplement*). As part of the Uniform Guidance compliance audit, the auditor of the pass-through entity tests and reports on subrecipient monitoring when federal awards passed through to subrecipients are subject to audit and direct and material to a major program.

The auditor must perform procedures to obtain an understanding of internal control over federal programs that is sufficient to plan the audit of the pass-through entity to support a low assessed level of control risk of noncompliance for major programs. As part of this, the auditor should consider the pass-through entity's internal control over compliance used to monitor subrecipients and plan the testing of internal control to support a low assessed level of control risk for subrecipient monitoring.

Tests of internal control over compliance related to subrecipient monitoring may include inquiry; observation and inspection of documentation; or a reperformance by the auditor of some of or all the pass-through entity's monitoring activities. The nature and extent of tests the auditor performs vary depending on the auditor's assessment of inherent risk of noncompliance, understanding of the internal control over compliance, materiality, and professional judgment. The results of the auditor's tests of internal control over compliance assist in determining the nature, timing, and extent of the tests of subrecipient monitoring compliance.

An understanding of the pass-through entity requirements found in the Uniform Guidance and the related information in the *Compliance Supplement* will assist the auditor in designing appropriate tests of the pass-through entity's monitoring of subrecipients. The subrecipient monitoring compliance requirement section in Part 3, "Compliance Requirements," of the *Compliance Supplement* notes that the pass-through entity must

- clearly identify to the subrecipient
  - the award as a subaward at the time of subaward by providing the information described in 2 CFR 200.332(a)(1);
  - all requirements imposed by the pass-through entity on the subrecipient so that the federal award is used in accordance with federal statutes, regulations, and the terms and conditions of the award; and
  - any additional requirements that the pass-through entity imposes on the subrecipient in order for the pass-through entity to meet its own responsibility for the federal award (for example, financial, performance, and special reports).
- evaluate each subrecipient's risk of noncompliance for purposes of determining the appropriate subrecipient monitoring related to the subaward.
- monitor the activities of the subrecipient as necessary to ensure that the subaward is used for authorized purposes, complies with the terms and conditions of the subaward and achieves performance goals.

- Some federal awards may be passed through to for-profit entities. For-profit subrecipients are accountable to the pass-through entity for the use of the federal funds provided. Because the Uniform Guidance audit requirements are not applicable to for-profit subrecipients, the pass-through entity is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients for the subaward. The agreement with the for-profit subrecipient must describe applicable compliance requirements and the for-profit subrecipient's compliance responsibility. Methods to ensure compliance for federal awards made to for-profit subrecipients may include pre-award audits, monitoring during the agreement, and post-award audits.

Evaluation of audit findings

Pass-through entities must identify the total amount provided to subrecipients from each federal program in the SEFA. If a pass-through entity is unable to identify amounts provided to subrecipients, the auditor should consider whether a significant deficiency or material weakness in internal control over compliance should be reported. The auditor also should consider whether material noncompliance for subrecipient monitoring has occurred.

The Uniform Guidance requires the auditor to consider an audit finding in relation to the type of compliance requirement (subrecipient monitoring, in this case) identified in the *Compliance Supplement*, regardless of whether the finding can be quantified. The auditor's responsibility for reporting such findings is best described with an example, such as the following:

> Assume that the auditor is auditing a pass-through entity that consistently fails to monitor the activities of its subrecipients as necessary to ensure that the subaward is used for authorized purposes. In this example, subrecipient monitoring is the relevant type of compliance requirement. Because the pass-through entity failed to monitor the activity of its subrecipients, this noncompliance is likely material in relation to the compliance requirement of subrecipient monitoring. The auditor must report material noncompliance with the provisions of federal statutes, regulations, or the terms and conditions of federal awards related to a major program as audit findings in a schedule of findings and questioned costs. This would be the case even if it is found that the subrecipient actually complied with the terms and conditions of the subaward and achieved performance goals. The auditor also should consider whether significant deficiencies or material weaknesses in internal control over compliance exist that require reporting with respect to subrecipient monitoring. In this example — a consistent failure to monitor subrecipients — that would likely be the case.

When the subrecipient monitoring system is insufficient

The auditor may determine that the pass-through entity's subrecipient monitoring system is not sufficient to ensure the subrecipient's compliance with federal statutes, regulations, and terms and conditions of federal awards. The auditor must report significant deficiencies and material weaknesses in internal control over major programs or significant instances of abuse relating to major programs.

The effect of the noncompliance on the opinion on compliance for major programs is primarily a function of the pervasiveness of the lack of monitoring and the materiality of subrecipient funding to a program.

For example, if the pass-through entity did not perform subrecipient-monitoring procedures and 90% of the program was passed through to subrecipients, an opinion modification would likely be warranted. This would likely be the case even if the scope of the audit is expanded to include additional auditing procedures to determine that the subrecipients actually complied with laws and regulations.

The pass-through entity may ask the auditor to perform additional procedures beyond the scope of the Uniform Guidance compliance audit to determine whether the subrecipient is in compliance with one or more compliance requirements (such as conducting tests of records for eligibility at the subrecipient's site). Such additional procedures are generally performed as a separate engagement and would be insufficient to remedy an internal control deficiency or noncompliance of the pass-through entity's subrecipient monitoring system; however, the additional procedures may provide evidence about whether subrecipient noncompliance could affect the pass-through entity's own records and, if the subrecipient disclosed material noncompliance (for example, with eligibility), that may strengthen the effect in a finding of noncompliance of the pass-through entity's monitoring system.

The auditor also should consider any implications of an insufficient subrecipient monitoring system on the opinion on the financial statements. If amounts passed through to subrecipients are considered material to the financial statements of the pass-through entity, the auditor should determine whether the report on the financial statements should be modified. Factors to consider in making such a determination include any audit evidence available to the auditor (such as subrecipients' Uniform Guidance compliance audit reports and other financial reports that may have been submitted to the pass-through entity or obtained by the pass-through entity from the FAC) that might indicate that the subrecipients administered the program in compliance with laws and regulations. Further, the auditor should consider whether it is necessary to report an internal control or compliance finding in the report issued to meet the requirements of *Government Auditing Standards*.

Effect of subrecipients' noncompliance on the pass-through entity's report

The instances of noncompliance reported in subrecipients' audit reports are not required to be included in the pass-through entity's audit report. As noted previously, however, the auditor of the pass-through entity should consider the effects of reported instances of subrecipient noncompliance. These could indicate weaknesses in the pass-through entity's subrecipient monitoring system that might need to be reported.

Adjustment of pass-through entity financial records and reports

Questioned costs at the subrecipient level found to be unallowable by the pass-through entity might require the pass-through entity to adjust its financial records and its federal expenditure reports. Total allowable program costs that exceed required expenditure levels and individual program requirements regarding the timing of claims affect whether the pass-through entity will need to reflect a liability to the awarding agency in its financial statements. As part of the finding-resolution process, the pass-through entity should estimate total unallowable costs associated with each subrecipient finding and consider the need to adjust financial records and federal expenditure reports. The auditor should consider the pass-through entity's failure to make needed adjustments to its records and federal reports when forming an opinion on the financial statements and on compliance for major programs.

Unallowable audit costs

For subrecipients that expend less than $750,000 in federal awards annually, the cost of any audits or attestation engagements (other than agreed-on procedures engagements arranged and paid for by a pass-through entity) is not an allowable cost and, therefore, may not be charged to any federal award. Accordingly, the Uniform Guidance forbids the cost of a financial statement audit conducted in accordance with generally accepted auditing standards or *Government Auditing Standards* to be charged (by either a pass-through entity or subrecipient) to federal awards for a subrecipient that annually expends less than $750,000 in federal awards.

Knowledge checks

2. What is a result when questioned costs at the subrecipient level are found to be unallowable?

    a. The pass-through entity is required to adjust its financial statements for any questioned costs.
    b. The pass-through entity is required to remit funds in the amount of questioned costs to the awarding agency.
    c. The auditor should consider the impact on the compliance opinion but not the financial statement opinion when the auditee does not make needed adjustments.
    d. The auditor should consider the impact on both the financial statement opinion and the compliance opinion when the auditee does not make needed adjustments.

3. Which is required regarding material noncompliance for subrecipient monitoring?

    a. The Uniform Guidance requires the auditor to consider the audit finding in relation to the total amount of the federal funding passed through to subrecipients.
    b. The auditor must report an audit finding related to subrecipient monitoring only if questioned costs are identified.
    c. The auditor must report material noncompliance related to a major program as audit findings in a schedule of findings and questioned costs.
    d. The Uniform Guidance requires the auditor to consider whether an instance of noncompliance has occurred if the auditee is unable to identify amounts provided to subrecipients. The auditor does **not** need to consider whether there is a deficiency in internal control.

Other considerations

Contractor compliance considerations

Auditee responsibilities

The Uniform Guidance provides that, in most cases, the auditee's compliance responsibility for contractors is only to ensure that the procurement, receipt, and payment for goods and services comply with federal statutes, regulations, and the terms and conditions of federal awards. Federal award compliance requirements normally do not pass through to a contractor; however, the auditee is responsible for ensuring compliance for procurement transactions that are structured such that the contractor is responsible for program compliance or the contractor's records must be reviewed to determine program compliance.

Furthermore, when an auditee engages a contractor to perform work related to compliance with federal awards, the auditee may assign tasks related to compliance to the contractor. For example, an auditee may engage a contractor to collect information the auditee uses to make eligibility determinations and maintain a system to support eligibility determinations and store related data. Using the contractor for this purpose does not relieve the auditee of its responsibility for ensuring compliance for eligibility related to federal awards.

Auditor's responsibilities

The Uniform Guidance provides guidance that when contractors are responsible for program compliance and the procurement transactions relate to a major program, the scope of the audit must include determining whether contractor transactions comply with federal statutes, regulations, and the terms and conditions of federal awards if such transactions are material to a major program of the auditee.

In such a case, the auditor would normally evaluate a contractor's compliance by reviewing the auditee's records and the results of the auditee's procedures for ensuring compliance by the contractor. When the auditor cannot obtain sufficient assurance of compliance from reviewing the auditee's records and procedures, a deficiency in internal control over compliance exists. The auditor should evaluate the severity of each deficiency in internal control over compliance identified during the audit to determine whether the deficiency, individually or in combination, is a significant deficiency or material weakness in internal control over compliance. The auditor also should perform additional procedures to determine compliance. These procedures could include testing the contractor's records or obtaining reports on compliance procedures performed by the contractor's independent auditor.

Before the auditor undertakes a single or program-specific audit, it is important for the auditor to understand the nature of the auditee's contractor relationships; whether the contractors are responsible for program compliance; the auditee's procedures for ensuring contractor compliance; and whether it will be necessary for the auditor to test contractor records.

For-profit subrecipients

The auditor's responsibilities related to for-profit subrecipients are similar to those of NFP subrecipients. Because the Uniform Guidance does not require for-profit subrecipients to have an audit, the risk of noncompliance is different from that of a subrecipient that *is* required to have an audit under the Uniform Guidance.

Foreign public entities and foreign organizations

The audit requirements found in Subpart F, "Audit Requirements," of the Uniform Guidance do not apply to foreign public entities or foreign organizations expending federal awards received either directly as a recipient or indirectly as a subrecipient. Therefore, responsibilities that a pass-through entity and its auditor have for a foreign public entity or foreign organization are the same as those for a for-profit subrecipient.

Subrecipient's indirect cost rate

A pass-through entity is required to include an approved federally recognized indirect cost rate negotiated between the subrecipient and the federal government. If no approved rate exists, the pass-through entity must determine the appropriate rate in collaboration with the subrecipient, which is either of the following:

- The negotiated indirect cost rate between the pass-through entity and the subrecipient, which can be based on a prior negotiated rate between a different pass-through entity and the same subrecipient. If basing the rate on a previously negotiated rate, the pass-through entity is not required to collect information justifying this rate but may elect to do so.
- The *de minimis* indirect cost rate.
    - The pass-through entity must not require use of a *de minimis* indirect cost rate if the subrecipient has a federally approved rate. Subrecipients can elect to use the cost allocation method to account for indirect costs in accordance with the Uniform Guidance.

An exception may apply when a federal awarding agency uses a different rate for a class of federal awards; when a federal statute or regulation requires a different rate for that award; or when a deviation is approved by the head of the federal awarding agency.

Summary

Key foundational points	
1.	The Uniform Guidance states that in determining whether an agreement between a pass-through entity and another nonfederal entity casts the latter as a subrecipient or a contractor, the substance of the relationship is more important than the form of the agreement.
2.	Pass-through entities are responsible for ensuring that subrecipients expend awards in compliance with federal statutes, regulations, and the terms and conditions of federal awards.
3.	If the auditor determines that the pass-through entity's subrecipient monitoring system is not sufficient to ensure the subrecipient's compliance with federal statutes, regulations, and terms and conditions of federal awards, the auditor must report significant deficiencies and material weaknesses in internal control over major programs or significant instances of abuse relating to major programs.

Solutions

Advanced Topics in a Single Audit: Pass-Through Entities and Subrecipients

Knowledge check solutions

1.

   a. Incorrect. A subrecipient relationship is not indicated when the entity receiving the funding provides the goods and services within normal business operations.
   b. Incorrect. A subrecipient relationship is not indicated when the entity receiving the funding operates in a competitive environment.
   c. Incorrect. A subrecipient relationship is not indicated when service provided by the entity is ancillary to the federal program.
   d. Correct. A subrecipient relationship exists where the entity receiving the funding has responsibility for programmatic decision-making.

2.

   a. Incorrect. The pass-through entity may need to adjust its financial statements depending on materiality and other considerations. However, it is not a given in all circumstances.
   b. Incorrect. The pass-through entity may need to remit the funds to the awarding agency. However, it is not a given in all circumstances.
   c. Incorrect. When the auditee does not make needed adjustments, the auditor should consider the impact on compliance opinion, but other considerations are needed.
   d. Correct. The auditor should consider the impact on both the financial statement opinion and the compliance opinion when the auditee does not make needed adjustments for costs found to be unallowable.

3.

a. Incorrect. Audit findings are required to be considered in relation to the type of compliance requirement, such as subrecipient monitoring, not in relation to the total amount of the federal funding passed through to subrecipients.
b. Incorrect. The auditor reports an audit finding related to subrecipient monitoring when it is considered material to that compliance requirement, not only if questioned costs are identified.
c. Correct. The auditor must report material noncompliance related to a major program as audit findings in a schedule of findings and questioned costs.
d. Incorrect. If the auditee is unable to identify amounts provided to subrecipients, the auditor should consider whether an instance of noncompliance has occurred and whether there is a deficiency in internal control.

Advanced Topics in a Single Audit: Reporting in a Uniform Guidance Compliance Audit

Learning objectives

- Distinguish the reports required to be issued in a single audit.
- Categorize the requirements related to preparing a schedule of findings and questioned costs.
- Identify what should be reported as a finding.
- Evaluate the elements of a finding.
- Recognize issues related to the auditor's reporting responsibilities when performing a Uniform Guidance compliance audit.

Reporting requirements under the Uniform Guidance

The auditor's reporting responsibilities in a single audit are driven by the following three levels of auditing standards and requirements:

- Generally accepted auditing standards (GAAS)
- *Government Auditing Standards* (Yellow Book)
- Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance)

These standards and requirements expand the level of auditor responsibility from reporting on an auditee's financial statements to also reporting on internal control and on compliance.

Auditor's reports

In an audit performed under the Uniform Guidance, the auditor's reports must include the following:

- An opinion (or disclaimer of opinion) as to whether the financial statements of the auditee are presented fairly in all material respects in accordance with generally accepted accounting principles (GAAP) (or a special purpose framework such as cash, modified cash, or regulatory as required by state law). The auditor must also decide whether the schedule of expenditures of federal awards (SEFA) is stated fairly in all material respects in relation to the auditee's financial statements as a whole.
- A report on internal control over financial reporting and compliance with provisions of laws, regulations, contracts, and award agreements, noncompliance with which could have a material effect on the financial statements. This report must describe the scope of testing of internal control and compliance and the results of the tests and, where applicable, refer to the separate schedule of findings and questioned costs.
- A report on compliance for each major program and on internal control over compliance. This report must describe the scope of testing of internal control over compliance; include an opinion (or disclaimer of opinion) as to whether the auditee complied with federal statutes, regulations, and the terms and conditions of federal awards that could have a direct and material effect on each major program; and refer to the separate schedule of findings and questioned costs.
- A schedule of findings and questioned costs.

The following table, “Reporting in Single Audits,” provides a matrix depicting the auditor’s reports in a single audit required by GAAS, *Government Auditing Standards*, and the Uniform Guidance.

Reporting in Single Audits			
	Required by		
Report	*GAAS*	*Government Auditing Standards*	Uniform Guidance
Opinion (or disclaimer of opinion) on financial statements and supplementary schedule of expenditures of federal awards	X	X	X
Report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements		X	X
Report on compliance and internal control over compliance for *each* major federal program (this report includes separate opinions [or disclaimers of opinion] on each major program’s compliance)			X
Schedule of findings and questioned costs			X

The AICPA Audit Guide Government Auditing Standards *and Single Audits* includes the basic elements for the auditor’s combined report on compliance and internal control over compliance in accordance with the Uniform Guidance. The guide also includes examples of the various reports that are issued to comply with *Government Auditing Standards* and the Uniform Guidance. The Governmental Audit Quality Center has posted excerpts of these illustrative reports at https://www.aicpa.org/resources/article/governmental-illustrative-auditors-reports.

Data collection form

COVID-19 Considerations

To maximize the transparency and accountability of COVID-19-related award expenditures, appendix VII, “Other Audit Advisories,” of the *Compliance Supplement* notes that nonfederal entities should separately identify COVID-19 expenditures on the data collection form (Form SF-SAC). This includes both existing programs with incremental COVID-19 funding and the new COVID-19-only programs. This may be accomplished by identifying COVID-19 expenditures on the data collection form (Form SF-SAC) on a separate row by Assistance Listing number with “COVID-19” as the first characters in Part II, Item 1c, “Additional Award Information.”

	a	b	c	d	e	f	g	h
	Assistance Listing #	Assistance Listing #						
Row Number (auto-generated)	Federal Awarding Agency Prefix	Assistance Listing Three-Digit Extension	Additional Award Identification	Federal Program Name	Amount Expended	Cluster Name	Federal Program Total (auto-generated)	Cluster Total (auto-generated)
					($)		($)	($)
1	93	558		TEMPORARY ASSISTANCE FOR NEEDY FAMILIES	$3,000,000.00		$4,000,000.00	
2	93	558	COVID-19	COVID-19 – TEMPORARY ASSISTANCE FOR NEEDY FAMILIES	$1,000,000.00		$4,000,000.00	
				Total Federal Awards Expended =	$4,000,000.00			

Practice issue

The U.S. Department of Education (ED) sent a memo to grant recipients explaining how ED programs that use alpha characters to identify subprograms within an Assistance Listing (such as the Education Stabilization Fund) are to be reported on the SEFA and the data collection form (Form SF-SAC). ED posted this downloadable memo at **https://www2.ed.gov/about/offices/list/ofo/docs/final-memo-to-grantees-regarding-subprogram-aln-identification.docx**. The ED memo says that the guidance in the memo is effective for all single audit submissions that include ED programs on or after Monday, August 9, 2021.

The Uniform Guidance requires the auditee to submit a data collection form (Form SF-SAC) that states whether the audit was completed in accordance with the Uniform Guidance and provides information about the auditee, its federal programs, and the results of the audit.

The auditee completes the data collection form online (through the Federal Audit Clearinghouse [FAC] website at https://facweb.census.gov) and electronically certifies it (via an online signature) upon submission.

Practice issue

Effective October 2023, the location of the Clearinghouse will move to the General Services Administration (GSA). At that time, all reports with fiscal year ends beginning in 2023 will be required to submitted through the new FAC hosted by GSA. Once operational, the website for filing data collection forms through the GSA will be https://www.fac.gov/.

The auditee certification statement must be signed by a senior level representative of the auditee (for instance, state controller, director of finance, chief executive officer, or chief financial officer) and indicate, at a minimum, that (1) the reporting package does not include protected personally identifiable information (PII); (2) the reporting package does not include business identifiable information; (3) the auditee complied with applicable requirements; (4) the data were prepared in accordance with the requirements (and the instructions accompanying the form); (5) all information is included and it is accurate and complete; (6) the auditee engaged an auditor to perform an audit in accordance with the audit requirements of the Uniform Guidance and for the period described in the data collection form; (7) the auditee ensured the auditor completed such audit and issued the signed audit report, which states that the audit was conducted in accordance with the audit requirements of the Uniform Guidance; and (8) the FAC is authorized to make the reporting package and the data collection form publicly available on a website. (Certain Indian tribes and tribal organizations may opt not to authorize the FAC to make the reporting package publicly available.)

Key point

The preparation of the auditee portion of the data collection form is a management responsibility. There are auditor independence considerations under *Government Auditing Standards* and GAAS when the auditor is performing the single audit and prepares the auditee portion of the data collection form. The auditor should assess the impact that providing this nonaudit service has on independence and respond to any identified threats to independence using the conceptual framework in *Government Auditing Standards*.

In addition, the auditor must complete the applicable data elements of the data collection form online (for example, auditor contact information and information on the results of the financial statement audit and the compliance audit of federal programs under the Uniform Guidance) and electronically sign an auditor statement provided on the form. The auditor statement indicates, at a minimum, the source of the information included in the form, the auditor's responsibility for the information, that the form is not a substitute for the reporting package, and that the content of the form is limited to the collection of information prescribed by the Office of Management and Budget (OMB). The date the auditor signs the statement indicates the completion date of the form as it relates to the auditor. The wording of the auditor's statement section of the data collection form indicates that no additional procedures were performed since the date of the audit reports. This wording releases the auditor from any subsequent-event responsibility with regard to the timing of the completion of the form and the completion of the audit.

Under the Uniform Guidance, unless restricted by federal statutes or regulations, the auditee must make copies of the reporting package available for public inspection. The data collection form and reporting package are available for public inspection through the FAC. Auditees and auditors must ensure that their respective parts of the reporting package do not include protected PII.

If the auditee or auditor revises a previous submission or other communication made to the FAC, such changes are done on the FAC website. See the FAC website for the most current information on the process for situations in which there are revisions to the form or other communication, including instructions for submitting those revisions to the FAC.

Reporting package

The auditee must electronically submit to the FAC the data collection form and the reporting package. The reporting package must include:

- Financial statements and a supplementary schedule of expenditures of federal awards
- Auditor's reports
- A summary schedule of prior audit findings
- A corrective action plan

After the data collection form is completed and the reporting package is uploaded by the auditee to the FAC website, certification by the auditee and a signature by the auditor on the auditor statement completes the submission. The auditee must submit the data collection form and the reporting package within the earlier of 30 days after the receipt of the auditor's reports or 9 months after the end of the audit period.

Schedule of findings and questioned costs

The Uniform Guidance requires the auditor to prepare a schedule of findings and questioned costs. This schedule is required to contain the following:

1. A summary of the auditor's results, which must include the following:
   a. The type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP (that is, unmodified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).
   b. Where applicable, a statement that significant deficiencies or material weaknesses in internal control were disclosed by the audit of the financial statements.
   c. A statement as to whether the audit disclosed any noncompliance that is material to the financial statements of the auditee.
   d. Where applicable, a statement that significant deficiencies or material weaknesses in the internal control over major programs were disclosed by the audit.
   e. The type of report the auditor issued on compliance for major programs (that is, unmodified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).
   f. A statement on whether the audit disclosed any audit findings that the auditor is required to report.
   g. An identification of major programs (in the case of a cluster of programs, only the cluster name as shown on the SEFA is required).
   h. The dollar threshold used to distinguish between type A and type B programs.
   i. A statement on whether the auditee qualified as a low-risk auditee.
2. Findings relating to the financial statements that are required to be reported in accordance with *Government Auditing Standards*.
3. Findings and questioned costs for federal awards, which must include audit findings as defined in 2 CFR 200.516(a); this section of the schedule must include the following:
   a. Audit findings (for example, internal control findings, compliance findings, questioned costs, or fraud) that relate to the same issue must be presented as one finding. When practical, audit findings should be organized by federal agency or pass-through entity.
   b. Audit findings that relate to both the financial statements and the federal awards must be reported in both sections of the schedule. However, the reporting in one section of the schedule may be in summary form with a reference to a detailed reporting in the other section of the schedule. For example, a material weakness in internal control that affects the auditee as a whole, including its federal awards, would usually be reported in detail in the section of the schedule of findings and questioned costs related to the financial statements, with a summary identification and reference given in the section related to federal awards. Conversely, a finding of noncompliance with a federal program law that also is material to the financial statements would be reported in detail in the federal awards section of the schedule, with a summary identification and reference given in the financial statement section.

Reporting findings in a Uniform Guidance compliance audit

The following table summarizes the requirements related to reporting findings in a Uniform Guidance compliance audit report. Also included in this table are items that, although not required to be reported under the Uniform Guidance, may be communicated under the guidance in AU-C section 260, *The Auditor's Communication With Those Charged With Governance*, and AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit*, as part of the compliance audit.

	Schedule of findings and questioned costs	Communicate in writing or orally
Findings related to the financial statements required to be reported in accordance with *Government Auditing Standards*	X	
Matters reported in a Uniform Guidance audit:		
Deficiencies in internal control:		
Significant deficiencies in internal control over compliance with a type of compliance requirement for a major program	X	
Material weaknesses in internal control over compliance with a type of compliance requirement for a major program	X	
Other deficiencies in internal control over compliance that are not significant deficiencies or material weaknesses required to be reported but, in the auditor's judgment, are of sufficient importance to be communicated to management[1]		X
Noncompliance with federal statutes, regulations, or the terms and conditions of federal awards related to a major program		
That is material in relation to a type of compliance requirement for a major program identified in the OMB *Compliance Supplement*	X	
That does not meet the criteria for reporting under the Uniform Guidance but, in the auditor's judgment, is of sufficient importance to communicate to management or those charged with governance[2]		X

	Schedule of findings and questioned costs	Communicate in writing or orally
Questioned costs		
Known questioned costs that are greater than $25,000 for a type of compliance requirement for a major program	X	
Known questioned costs when likely questioned costs are greater than $25,000 for a type of compliance requirement for a major program	X	
Known questioned costs that are greater than $25,000 for a program that is not audited as a major program	X	
Fraud		
Known or likely fraud affecting a federal award	X	
Abuse[3]		
Significant instances of abuse relating to major programs; that is, abuse that is either quantitatively or qualitatively material to a major program	X	
Other audit findings		
Circumstances concerning why the auditor's report on compliance for each major program is other than unmodified, unless such circumstances are otherwise reported as an audit finding in the schedule of findings and questioned costs.	X	
Instance when the results of audit follow-up procedures disclosed that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding	X	
Other findings or issues arising from the compliance audit that are not otherwise required to be reported but are, in the auditor's professional judgment, significant and relevant to those charged with governance		X

[1] For major programs, the threshold for reporting deficiencies, or a combination of deficiencies, in internal control over compliance as significant deficiencies or material weaknesses and the threshold for reporting as other matters noncompliance with federal statutes, regulations, and the terms and conditions of a federal award is in relation to a type of compliance requirement identified in the OMB *Compliance Supplement* (*Compliance Supplement*).Generally, this reporting level is lower than financial statement materiality and the materiality level used for the opinion on a major program. Even given this lower reporting threshold, there may be instances in which the auditor deems it appropriate to communicate to management internal control deficiencies or noncompliance that is not otherwise required to be reported.

[2] See note 1.

[3] Situations or transactions involving federal awards that might otherwise appear to constitute abuse, instead, generally are instances of noncompliance. However, there may be isolated situations or transactions involving federal awards that the auditor becomes aware of that do constitute abuse.

Knowledge check

1. Which information is required to be included in the "Summary of auditor's results" component of the schedule of findings and questioned costs?

    a. Findings related to the financial statements that are required to be reported in accordance with *Government Auditing Standards*.
    b. A statement on whether the auditee qualified as a low-risk auditee.
    c. A statement on whether the findings and questioned costs for federal awards relate to the same issue if presented as one finding.
    d. Findings related to both the financial statements and the federal awards.

Communicating other findings to management

The schedule of findings and questioned costs must include all audit findings required to be reported under the Uniform Guidance. A separate written communication (such as a communication sometimes referred to as a *management letter*) may not be used to communicate such matters to the auditee in lieu of reporting them as audit findings in accordance with the Uniform Guidance. When there are other matters that do not meet the Uniform Guidance requirements for reporting but, in the auditor's judgment, warrant the attention of those charged with governance, they should be communicated in writing or orally. If such a communication is provided in writing to the auditee, there is no requirement for that communication to be referenced in the Uniform Guidance compliance report.

Knowledge check

2. Which is required to be reported as an audit finding?

    a. All deficiencies in internal control over compliance.
    b. Any instance of abuse.
    c. Known or likely fraud.
    d. Noncompliance with federal statutes, regulations, or the terms and conditions of federal awards that is material in relation to the SEFA.

Summary schedule of prior audit findings and corrective action plan

The auditee is responsible for follow-up and corrective action on findings relating to federal awards and the financial statements. As part of this responsibility, the auditee must prepare a summary schedule of prior audit findings. The auditee is not required to prepare a summary schedule of prior audit findings if there are no matters reportable therein. The auditee also must prepare, in a document separate from the auditor's findings, a corrective action plan that addresses each of the current-year audit findings.

Summary schedule of prior audit findings

The summary schedule of prior audit findings and the corrective action plan, both of which are part of the reporting package, must include the reference numbers the auditor assigned to audit findings in the schedule of findings and questioned costs. Because the summary schedule of prior audit findings may include audit findings from multiple years, it must include the fiscal year in which the finding initially occurred.

The summary schedule of prior audit findings must report the status of all audit findings — which encompass those defined in 2 CFR 200.516(a) — included in the prior audit's schedule of findings and questioned costs. The summary schedule also must include audit findings reported in the prior audit's summary schedule of prior audit findings unless those audit findings are listed as corrected, no longer valid, or not warranting further action. For fully corrected audit findings, the schedule need only list the audit findings and state that corrective action was taken. For uncorrected or partially corrected audit findings, the schedule must describe the reasons for the audit finding's recurrence and planned corrective action and any partial corrective action taken. When the corrective action taken is significantly different from corrective action previously reported in a corrective action plan or in the federal agency's or pass-through entity's management decision, the summary schedule must provide an explanation.

The auditor must follow up on prior audit findings; perform procedures to assess the reasonableness of the summary schedule of prior audit findings that the auditee prepared in accordance with the Uniform Guidance; and report, as a current-year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding. The auditor must perform audit follow-up regardless of whether a prior audit finding relates to a major program in the current year.

In accordance with 2 CFR 200.511, the summary schedule of prior audit findings also must include findings relating to the financial statements, which also are required to be reported in accordance with *Government Auditing Standards*. Although the Uniform Guidance technically limits the auditor's follow-up responsibility to audit findings in 2 CFR 200.516(a), *Government Auditing Standards* requires that the auditor evaluate whether the auditee has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a significant effect on the financial statements or other data significant to the audit objectives. Therefore, performing the auditor follow-up procedures on findings that relate to the financial statements is an effective way to meet the follow-up responsibilities under *Government Auditing Standards*.

Corrective action plan

The auditee must prepare, in a document separate from the schedule of findings and questioned costs, a corrective action plan to address each audit finding included in the current-year auditor's report. The corrective action plan must address both findings relating to federal awards and findings related to the financial statements required to be reported in accordance with *Government Auditing Standards*. It must also provide the name(s) of the contact person(s) responsible for corrective action, the corrective action planned for each audit finding (referred to by the auditor-assigned reference number), and the anticipated completion date. If the auditee disagrees with a finding or believes corrective action is not required, the plan must contain an explanation and specific reasons the auditee disagrees with that particular audit finding. The auditor might find the auditee's prior-year corrective action plan — along with the summary schedule of prior audit findings — useful when following up because it may provide a preliminary indication of the corrective steps planned by the auditee.

Although it is the auditee's responsibility to prepare the corrective action plan, the auditee may want to separately engage the auditor to help develop appropriate corrective actions in response to audit findings. In such circumstances, the auditor should consider the *Government Auditing Standards* independence guidance prior to agreeing to perform the nonaudit service.

Key point

The Uniform Guidance requires the auditee to prepare a summary schedule of prior audit findings (summary schedule) and, when there are findings, a corrective action plan. These two documents are required to be included in the reporting package submitted to the FAC. Note that the inclusion of the summary schedule and corrective action plan in the reporting package is considered neither "other information" under AU-C section 720, *The Auditor's Responsibilities Relating to. Other Information Included in Annual Reports,* nor "supplementary information" under AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole* because it does not fit the criteria for such in either AU-C section.

The auditor has sole responsibility for creating the schedule of findings and questioned costs. Auditors are further required to present the views of responsible officials within the detail of any audit findings listed in this schedule.

The Uniform Guidance requires the auditee to prepare a summary schedule of prior audit findings and a corrective action plan. These two documents are solely auditee responsibilities.

It is important that these responsibilities remain with the appropriate party. For example, the auditor's inclusion of the views of responsible officials in the detail of an audit finding on the schedule of findings and questioned costs does not meet the Uniform Guidance requirement for the auditee to prepare a corrective action plan.

Elements of a finding

> **COVID-19 Considerations**
>
> Appendix VII of the *Compliance Supplement* states that auditors should include the COVID-19 identification for audit findings that are applicable to programs that are entirely COVID-19 funded or existing programs with COVID-19 funding. See appendix VII of the *Compliance Supplement* for more details.

According to 2 CFR 200.516(b), audit findings must be presented in sufficient detail and clarity for the auditee to prepare and implement a corrective action plan and for federal agencies and pass-through entities to arrive at a management decision. Audit findings must include the following specific information, as applicable:

a. Identification of the federal program and specific federal award, including
   i. the Assistance Listing title and number,
   ii. the federal award identification number and year,
   iii. the name of the federal agency, and
   iv. the name of the pass-through entity (if applicable).

   When information such as the Assistance Listing title and number or the federal award identification number is unavailable, the auditor must provide the best available information to describe the federal award.

b. The criteria or specific requirements the audit finding is based on, including the federal statutes, regulations, or terms and conditions of the federal awards.
c. The condition found, including facts that support the deficiency identified in the finding.
d. A statement of cause that identifies the reason or explanation for the condition or factors responsible for the difference between the situation that exists (the *condition*) and the required or desired state (the *criteria*); this also might serve as a basis for recommendations for corrective action.
e. The possible asserted effect to provide sufficient information to the auditee and federal agency, or pass-through entity in the case of a subrecipient, to permit them to determine the cause and effect to facilitate prompt and proper corrective action. A statement of the effect or potential effect should provide a clear, logical link to establish the impact or potential impact of the difference between the condition and the criteria.
f. Identification of questioned costs and how they were computed. Known questioned costs must be identified by applicable Assistance Listing number and applicable federal award identification number.
g. Information to provide a proper perspective for judging the prevalence and consequences of the audit findings (for example, whether the audit findings represent an isolated instance or a systemic problem). When appropriate, the instances identified must be related to the universe and the number of cases examined and be quantified in terms of the dollar value. The auditor should report whether the sampling was a statistically valid sample.
h. Identification of whether the audit finding was a repeat of a finding in the immediately prior audit and, if so, any applicable prior-year audit finding numbers.
i. Recommendations to prevent future occurrences of the deficiency identified in the audit finding.
j. Views of responsible officials of the auditee.
k. Reference numbers.

Audit findings related to federal awards also should meet the presentation requirements of *Government Auditing Standards*.

Key point

If the auditor reported a finding in the prior-year audit (i.e., 20X1-002) and this year it is a repeat finding, the auditor should number the current-year finding 20X2-XXX. The auditor should note the prior-year finding number, 20X1-002, in the finding detail.

Other reporting considerations

Dating the auditor's reports

Report on compliance with requirements that could have a direct and material effect on each major program and on internal control over compliance

The auditor's report on compliance and on internal control over compliance related to major programs that the Uniform Guidance requires carries the same date as that of a financial statement report when the audit procedures performed to satisfy Uniform Guidance requirements are completed along with the procedures performed on the financial statements. However, when some audit procedures performed to satisfy Uniform Guidance requirements are completed subsequent to the procedures performed on the financial statements, the report on compliance for each major program and report on internal control over compliance should carry a later date (that is, when the auditor has obtained sufficient appropriate audit evidence to support the report on the audit of compliance). The auditor should adapt and apply applicable requirements and guidance from AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*, to perform subsequent-events procedures from the date of the report on the financial statements to the date of the report on the Uniform Guidance compliance audit.

Option to include reporting on the SEFA

The recommended approach to reporting on the SEFA is to include it in the report on the financial statements. In certain circumstances (for example, when the SEFA is presented in a separate single audit reporting package), the auditor's report on the SEFA may be incorporated into the Uniform Guidance compliance audit reporting. Because of the added nuance when including the SEFA reporting in the Uniform Guidance compliance report, it might help the auditor to review the illustrative auditor's reports available in AICPA Audit Guide Government Auditing Standards *and Single Audits*, which show how to incorporate the SEFA reporting into the Uniform Guidance compliance report.

As it relates to dating the SEFA, paragraph .12 of AU-C section 725 states that the date of the auditor's report on supplementary information in relation to the financial statements as a whole should not be earlier than the date on which the auditor completed the procedures required in paragraph .07 of AU-C section 725. Therefore, the date of the auditor's report on the SEFA may be the same as that on the financial statement report or it may carry a later date. In no case would the date of the in-relation-to opinion on the SEFA be earlier than the date of the financial statement report.

When the procedures AU-C section 725 requires are completed on a date earlier than that of the auditor's "Report on Compliance for Each Major Federal Program," the auditor would dual-date the auditor's report on the SEFA, using the following illustrative wording:

> [Date], except for our report on the Schedule of Expenditures of Federal Awards, for which the date is [date the in-relation-to procedures completed].

When the audit of federal awards does not encompass the entirety of the auditee's operations

When the audit of federal awards does not encompass the entirety of the auditee's operations expending federal awards, the auditor should identify operations not included in a separate paragraph that follows the first paragraph of the introductory section of the report on compliance for each major program. An example of such a paragraph follows:

> Example Entity's basic financial statements include the operations of the [identify organizational unit, such as a governmental component unit, an operating unit, or a department], which expended [include dollar amount, if known] in federal awards which is not included in Example Entity's schedule of expenditures of federal awards during the year ended June 30, 20X1. Our audit, described below, did not include the operations of [identify organizational unit] because [state the reason for the omission, such as the organizational unit engaged other auditors to perform an audit of compliance].

The implementing regulations of federal awarding agencies may define the auditee differently than does GAAP

The regulations implementing the Uniform Guidance may define the entity to be audited for single audit purposes differently than how it would be defined under GAAP. For example, FASB *Accounting Standards Codification* (ASC) 958-810 requires presentation of consolidated financial statements when one not-for-profit (NFP) entity (the parent) controls the voting majority of the board and has an economic interest in another NFP entity. If the regulations of the federal agency that provides federal awards to the parent define the entity for single audit purposes to consist of only the parent, then audited parent-only financial statements (instead of consolidated financial statements) should be submitted to comply with these regulations. If the NFP entity's consolidated financial statements are not also prepared as required by GAAP, a modified opinion due to a material departure from GAAP on the parent-only financial statements may be required. AU-C section 705, *Modification to the Opinion in the Independent Auditor's Report*, and various AICPA Audit and Accounting Guides, including *Not-for-Profit Entities*, *State and Local Governments*, and *Health Care Entities*, provide guidance on reporting when there is a departure from GAAP.

Issuing an opinion on the SEFA under AU-C Section 805 when the auditor is engaged to perform only the compliance audit under the Uniform Guidance

In some instances, the auditor may be engaged to issue a stand-alone opinion on the SEFA, either as part of the report issued to meet the requirements of the Uniform Guidance or separately. It is important to note that when an auditor is engaged to perform only the compliance audit required under the Uniform Guidance — and not the financial statement audit — the auditor may not issue an in-relation-to opinion. When this occurs, the auditee may consider engaging the auditor to issue an opinion on the SEFA under AU-C section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*. Although this engagement would be performed under

Government Auditing Standards, because the SEFA (the financial statement) presents only the activities of the federal programs, the auditor is not required to issue a separate report on internal control over financial reporting and on compliance with provisions of laws, regulations, contracts, and grant agreements to meet the reporting requirements of *Government Auditing Standards*. However, the auditor always has the option of issuing a separate *Government Auditing Standards* report.

Reissuing the Uniform Guidance compliance report

If an auditor reissues the Uniform Guidance compliance report, the reissued report should include a paragraph within the report's other-matters section stating that it replaces a previously issued report and describes why the report is being reissued and lists any changes to the previously issued report. Examples of situations that may compel the auditor to reissue the Uniform Guidance compliance report are (*a*) a quality control review performed by a governmental agency indicates that the auditor did not test a compliance requirement subject to audit that is direct and material and (*b*) the auditor discovered subsequent to the date of the compliance report that the entity had another major program required to be tested.

If the auditor performs additional procedures to obtain sufficient appropriate audit evidence for all the major programs reported on, the auditor should revise the report date to reflect the date the auditor obtained sufficient appropriate audit evidence regarding the events that caused the auditor to perform new procedures. If, however, the auditor performs additional procedures to obtain sufficient appropriate audit evidence for only *some* of the major programs reported on, the auditor should dual-date the report with the report date revised to reflect the date the auditor obtained sufficient appropriate audit evidence regarding the major programs affected by the circumstances and referencing the major programs for which additional audit procedures have been performed. Reissuance of an auditor-prepared document required by the Uniform Guidance that is incorporated by reference into the auditor's report (for example, the schedule of findings and questioned costs) is considered a reissuance of the auditor's report.

If a single audit report is reissued and the data collection form (DCF) has been submitted already, an amended DCF must be submitted to the Federal Single Audit Clearinghouse. Guidance on how the submission should be completed is available on the Clearinghouse website.

Desk and on-site reviews

In addition to the quality control requirements set forth in *Government Auditing Standards*, cognizant agencies for audit have implemented procedures for evaluating the quality of audits. These procedures include both desk reviews and on-site reviews. (The oversight agencies for audit also may perform these reviews.) As part of the cognizant agencies' evaluation of the completed reports of such engagements and, as required by the Uniform Guidance, the supporting audit documentation must be made available on request by the representative of the federal agency. Audit documentation typically is reviewed at a location agreed on by the cognizant agency for audit and the independent auditor.

Whenever a review of the audit report or audit documentation discloses an inadequacy, the audit firm is contacted for corrective action. When major inadequacies are identified and the representative of the cognizant agency for audit determines that the audit report and its documentation are substandard, cognizant agencies may take further steps. In such cases of the audit found to be substandard by the federal agency, the matter may be submitted to state boards of public accountancy or the AICPA's Professional Ethics Division.

Required government-wide evaluation of single audit quality

The Uniform Guidance provides that a government-wide audit quality project must be performed once every six years or at such other interval as the OMB determines; the Uniform Guidance also requires that the results of these government-wide evaluations be made public. This project is to be led by an OMB-designated federal agency along with cooperation and support of cognizant agencies for audit. The government-wide project can rely on the current and ongoing quality control review work performed by the agencies, state auditors, and professional audit associations. The purpose of the project is to determine the quality of single audits by providing a reliable estimate of the extent to which single audits conform to applicable requirements, standards, and procedures. Recommendations will be made to address noted quality issues, including recommendations for any changes to applicable requirements, standards, and procedures that the project's results indicate.

Review of audit documentation

In a single audit performed under *Government Auditing Standards*, the auditor is required to document that, before the report release date, supervisory review of the evidence that supports the findings and conclusions contained in the auditor's report has occurred.

Based on the number and types of deficiencies found in single audits, the supervisory review should place special emphasis on areas where audit deficiencies often occur. The reviewer could check these problem areas and bear in mind that they might not be areas typically checked in a supervisory review of the audit documentation in a single audit. For areas to focus on, see the section "Common Deficiencies Found in Single Audits."

Knowledge check

3. Which is a requirement when reporting on a Uniform Guidance compliance audit?

    a. Except in the case of a reissued report, the auditor's report on compliance and internal control over compliance should carry the same date as the report on the financial statements.
    b. In a single audit performed under *Government Auditing Standards*, the auditor is required to document that, after the report release date, supervisory review of the evidence that supports the findings and conclusions contained in the auditor's report has occurred.
    c. Whenever a desk or on-site review of the audit report or audit documentation discloses an inadequacy, the auditor should contact the auditee for corrective action.
    d. When an auditor is engaged to perform only the compliance audit required under the Uniform Guidance, the auditor may not issue an in-relation-to opinion.

Common deficiencies found in single audits

Common deficiencies related to reporting in a single audit include the following:

- Financial statement report. Failure to include all of the required elements of professional standards in the Independent Auditor's Report, including the following omissions: (1) reference to the engagement being performed in accordance with *Government Auditing Standards*; (2) identification of the governmental entity's major funds and opinion units presented; (3) addressing supplemental information and required supplemental information; (4) reference to prior-year financial statements when comparative years are presented; and (5) reference to the Yellow Book Internal Control report.
- *Government Auditing Standards* report. Failure to include all required elements of professional standards in the auditor's report on internal control over financial reporting and on compliance and other matters, including (1) omitted "Independent" from report title; (2) omitted or incorrectly referenced material weaknesses or significant deficiencies included in the schedule of findings and questioned costs — indication that there were no significant deficiencies identified; (3) omitted a clause stating that the entity's responses were not audited and that the auditor expresses no opinion on those responses; and (4) omitted purpose alert.
- The auditor did not properly date the audit report. This usually occurs because the auditor reissued the report as a result of additional disclosures or audit procedures but failed to dual-date or redate the report. There have also been instances in which the auditor dated the report before obtaining sufficient evidence.
- The auditor's report did not contain an appropriate indication of the character of the examination and the degree of responsibility taken with respect to the required supplementary information or supplementary information accompanying the basic financial statements other than with respect to the SEFA.
- Auditors did not comply with AU-C section 265 in wording their reports. The definitions of *control deficiencies*, *significant deficiencies*, and *material weaknesses* used language in superseded guidance.
- The auditor's report on compliance and on internal control over financial reporting based on an audit of financial statements performed in accordance with *Government Auditing Standards* failed to describe the auditor's departure from the standard unmodified opinion on the financial statements.
- The auditor did not report audit findings in the schedule of findings and questioned costs with (*a*) all of the required elements, (*b*) the specific federal award identification including Assistance Listing number, (*c*) the name of the federal agency, (*d*) the reference number or any other required component of a finding, or (*e*) a combination of any of these items.
- The auditor failed to properly and consistently report the results of the single audit between the auditor's reports, the schedule of findings and questioned costs, and the data collection form, including major program determination and threshold, low-risk auditee status, and evaluation of findings.
- The auditor failed to undergo a peer review as required by state board or *Government Auditing Standards* requirements (or both) or by the requirements of the AICPA or state CPA society (or both).
- The auditor failed to submit timely the data collection form (Form SF-SAC) to the FAC for the current-year audit.

Summary

Key foundational points	
1.	The auditor's reporting responsibilities in a single audit are driven by three levels of auditing standards and requirements: GAAS, *Government Auditing Standards*, and the Uniform Guidance. These standards and requirements expand the level of auditor responsibility from reporting on an auditee's financial statements to also reporting on internal control and on compliance.
2.	The Uniform Guidance states that the auditor must prepare a schedule of findings and questioned costs, which must include the following three components: *a.* A summary of the auditor's results *b.* Findings relating to the financial statements that are required to be reported in accordance with *Government Auditing Standards* *c.* Findings and questioned costs for federal awards
3.	The Uniform Guidance provides requirements related to reporting findings in a Uniform Guidance compliance audit report. Although not required to be reported under the Uniform Guidance, additional items may be communicated under the guidance in AU-C section 260 and AU-C section 265 as part of the compliance audit.
4.	Audit findings must be presented in detail sufficient for the auditee to prepare and implement a corrective action plan and for federal agencies and pass-through entities to arrive at a management decision.
5.	Auditors have many other reporting considerations related to their responsibilities when performing a Uniform Guidance compliance audit.

Exercise: Audit report wording

For each of the following, identify which report the language was derived from. Choices are *financial statement opinion*, Government Auditing Standards *report*, *Uniform Guidance compliance report*, or *schedule of findings and questioned costs*.	
Example: A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis.	Uniform Guidance compliance report
As part of obtaining reasonable assurance about whether the City of Selena'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.	
In accordance with *Government Auditing Standards*, we have also issued our report dated June 15, 20XX, on our consideration of the City of Selena's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.	
In our opinion, the City of Selena complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 20XX.	
Management is responsible for compliance with the requirements referred to above and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules and provisions of contracts or grant agreements applicable to the City of Selena’s federal programs.	
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.	

Exercise: Audit report wording (continued)

This was reported as finding 20XX-001 in the prior year.	
We conducted our audit in accordance with 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.	
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 the City of Selena, as of and for the year ended June 30, 20XX, and the related notes to the financial statements, which collectively comprise the City of Selena's basic financial statements, and have issued our report thereon dated August 15, 20XX.	

Solutions

Advanced Topics in a Single Audit: Reporting in a Uniform Guidance Compliance Audit

Exercise solution: Audit report wording

For each of the following, identify which report the language was derived from. Choices are Uniform Guidance compliance report, *Government Auditing Standards* report, financial statement opinion, or schedule of findings and questioned costs.	
Example: A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis.	Uniform Guidance compliance report
As part of obtaining reasonable assurance about whether the City of Selena'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.	*Government Auditing Standards* report
In accordance with *Government Auditing Standards*, we have also issued our report dated June 15, 20XX, on our consideration of the City of Selena's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.	Financial statement opinion
In our opinion, the City of Selena complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 20XX.	Uniform Guidance compliance report

Exercise solution: Audit report wording (continued)

Management is responsible for compliance with the requirements referred to above and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules and provisions of contracts or grant agreements applicable to the City of Selena's federal programs.	Uniform Guidance compliance 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.	*Government Auditing Standards* report
This was reported as finding 20XX-001 in the prior year.	Schedule of findings and questioned costs
We conducted our audit in accordance with 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.	Financial statement opinion
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 the City of Selena, as of and for the year ended June 30, 20XX, and the related notes to the financial statements, which collectively comprise the City of Selena's basic financial statements, and have issued our report thereon dated August 15, 20XX.	*Government Auditing Standards* report

Knowledge check solutions

1.

   a. Incorrect. Findings related to the financial statements that are required to be reported in accordance with *Government Auditing Standards* are not included in this component.
   b. Correct. A statement on whether the auditee qualified as a low-risk auditee is included in the summary of auditor's results component.
   c. Incorrect. A statement on whether findings and questioned costs for federal awards relate to the same issue if presented as one finding are not included in this component.
   d. Incorrect. Findings related to both the financial statements and the federal awards are not included in this component.

2.

   a. Incorrect. Not all deficiencies in internal control over compliance are required to be reported as an audit finding.
   b. Incorrect. All instances of abuse are not required to be reported as a finding.
   c. Correct. Known or likely fraud is required to be reported as a finding.
   d. Incorrect. Noncompliance with federal statutes, regulations, or the terms and conditions of federal awards related to a major program that is material in relation to a type of compliance requirement for a major program, not the SEFA, must be reported as a finding.

3.

   a. Incorrect. The auditor's report on compliance and internal control over compliance will carry the same date as the report on the financial statements only if that date is the date on which the auditor obtained sufficient appropriate audit evidence on compliance and internal control over compliance.
   b. Incorrect. Supervisory review of the evidence that supports the findings and conclusions contained in the auditor's report should occur before the report release date.
   c. Incorrect. Whenever a desk or on-site review of the audit report or audit documentation discloses an inadequacy, the audit firm, not the auditee, is contacted for corrective action.
   d. Correct. When an auditor is engaged to perform only the compliance audit required under the Uniform Guidance — and not the financial statement audit — the auditor may not issue an in-relation-to opinion.

Exempt Organizations Glossary

Governmental terminology

accounting system. The methods and records established to identify, assemble, analyze, classify, record, and report a government's transactions and to maintain accountability for the related assets and liabilities.

accrual basis of accounting. The recording of financial effects on a government of transactions and other events and circumstances that have consequences for the government in the periods in which those transactions, events, and circumstances occur, rather than only in the periods in which cash is received or paid by the government.

ad valorem tax. A tax based on value (such as a property tax).

advance from other funds. An asset account used to record noncurrent portions of a long-term debt owed by one fund to another fund within the same reporting entity. See due to other funds and interfund receivable/payable.

advanced refunding. When governments place the proceeds of a new debt with an escrow agent to invest until they are needed to pay the principal and interest of the old debt.

appropriation. A legal authorization granted by a legislative body to make expenditures and to incur obligations for specific purposes. An appropriation is usually limited in the amount and time it may be expended.

assigned fund balance. A portion of fund balance that includes amounts that are constrained by the government's intent to be used for specific purposes, but that are neither restricted nor committed.

availability payment arrangement (APA). An arrangement in which a government compensates an operator for activities that may include designing, constructing, financing, maintaining, or operating an underlying nonfinancial asset for a period of time in an exchange or exchange-like transaction.

available appropriation. Amount of the current appropriation remaining to be committed or spent.

basis of accounting. A term used to refer to when revenues, expenditures, expenses, and transfers, and related assets and liabilities are recognized in the accounts and reported in the financial statements. Specifically, it relates to the timing of the measurements made, regardless of the nature of the measurement. See accrual basis of accounting, cash basis of accounting, and modified accrual basis of accounting.

blending. Combines the financial information of the component unit with the existing funds of the primary government in the financial statements.

bond. A written promise to pay a specified sum of money (the face value or principal amount) at a specified date or dates in the future (the maturity dates[s]), together with periodic interest at a specified rate. Sometimes, however, all or a substantial part of the interest is included in the face value of the security. The difference between a note and bond is that the latter is issued for a longer period and requires greater legal formality.

business type activities. Those activities of a government carried out primarily to provide specific services in exchange for a specific user charge.

budgetary comparison schedules. Schedules that are reported as part of required supplementary information (RSI). RSI is unaudited information included with governmental financial statements.

capital grants. Grants restricted by the grantor for the acquisition or construction, or both, of capital assets.

capital projects fund. A fund used to account for and report financial resources that are restricted, committed, or assigned to expenditures for capital outlays, including the acquisition or construction of capital facilities and other capital assets. Capital project funds exclude those types of capital-related outflows financed by proprietary funds or for assets that will be held in trust for individuals, private organizations, or other governments.

cash basis of accounting. A basis of accounting that requires the recognition of transactions only when cash is received or disbursed.

committed fund balance. A portion of fund balance that includes amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the government's highest level of decision-making authority.

Compliance audit. An attest engagement that is performed in accordance with AU-C section 935, Compliance Audits. When a compliance audit performed in accordance with AU-C section 935 also includes separate reporting under AU-C section 725, Supplementary Information in Relation to the Financial Statements as a Whole, or 805, Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement, this definition also extends to the audit of the schedule or statement that will accompany the AU-C section 935 report.

Compliance audit client. An entity with respect to which a compliance audit is performed. When an entity meets the definition of a compliance audit client, the "Client Affiliates" interpretation [1.224.010] and the "State and Local Government Client Affiliates" interpretation [1.224.020] do not apply.

conduit debt obligation. A debt instrument issued in the name of a state or local government (the issuer) that is for the benefit of a third party primarily liable for the repayment of the debt instrument (the third-party obligor). A conduit debt obligation meets all the specific criteria.

consumption method. The method of accounting that requires the recognition of an expenditure or expense as inventories are used.

contributed capital. Contributed capital is created when a general capital asset is transferred to a proprietary fund or when a grant is received that is externally restricted to capital acquisition or construction. Contributions restricted to capital acquisition and construction and capital assets received from developers are reported in the operating statement as a separate item after nonoperating revenues and expenses.

current refunding. When governments use the proceeds of new debt to immediately pay the old debt

custodial fund. A fiduciary fund used to account for financial resources not administered through a trust or equivalent arrangement meeting specified criteria, and that are not required to be reported in a pension (and other employee benefit) trust fund, investment trust fund, or private-purpose trust fund.

debt service fund. A fund used to account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest. Debt service funds should be used to report resources if legally mandated. Financial resources that are being accumulated for principal and interest maturing in future years should also be reported as debt service funds.

deferred inflow of resources. An acquisition of net assets by a government that is applicable to a future reporting period.

deferred outflow of resources. A consumption of net asset by a government that is applicable to a future reporting period.

deficit. (*a*) The excess of the liabilities of a fund over its assets. (*b*) The excess of expenditures over revenues during an accounting period or, in the case of proprietary funds, the excess of expenses over revenues during an accounting period.

derived tax revenues. Taxes assessed on exchange transactions. For example, sales tax imposed on sales transactions and income tax imposed on earnings are derived tax revenues.

disbursement. A payment made in cash or by check. Expenses are only recognized at the time physical cash is disbursed.

due from other funds. A current asset account used to indicate an account reflecting amounts owed to a particular fund by another fund for goods sold or services rendered. This account includes only short-term obligations on an open account, not interfund loans.

due to other funds. A current liability account reflecting amounts owed by a particular fund to another fund for goods sold or services rendered. This account includes only short-term obligations on an open account, not interfund loans.

enabling legislation. Legislation that authorizes a government to assess, levy, charge, or otherwise mandate payment of resources from external resource providers and includes a legally enforceable requirement that those resources be used for the specific purposes stipulated in the legislation.

encumbrances. Commitments related to unperformed (executory) contracts for goods or services. Used in budgeting, encumbrances are not generally accepted accounting principles (GAAP) expenditures or liabilities but represent the estimated amount of expenditures that will ultimately result if unperformed contracts in process are completed.

enterprise fund. A fund established to account for operations financed and operated in a manner similar to private business enterprises (such as gas, utilities, transit systems, and parking garages). Usually, the governing body intends that costs of providing goods or services to the general public be recovered primarily through user charges.

expenditures. Decreases in net financial resources. Expenditures include current operating expenses requiring the present or future use of net current assets, debt service and capital outlays, intergovernmental grants, entitlements, and shared revenues.

expenses. Outflows or other consumption of assets or incurrences of liabilities, or a combination of both, from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations.

extraordinary item. A transaction or event that is both unusual in nature and infrequent in occurrence.

fiduciary fund. A fund that reports fiduciary activities meeting the criteria in paragraphs 6–11 of GASB Statement No. 84, *Fiduciary Activities*. Financial reporting is focused on reporting net position and changes in net position.

financial information system (FIS). A system that aggregates source data underlying the financial statements or generates information that is significant to either the financial statements or financial processes as a whole.

flow of current financial resources. Measurement focus used by governmental funds.

flow of economic resources. Measurement focus used by proprietary funds.

fund. A fiscal and accounting entity with a self-balancing set of accounts in which cash and other financial resources, all related liabilities and residual equities, or balances, and changes therein, are recorded and segregated to carry on specific activities or attain certain objectives in accordance with special regulations, restrictions, or limitations.

fund balance. The difference between fund assets and fund liabilities of the generic fund types within the governmental category of funds.

fund financial statements. Each fund has its own set of self-balancing accounts and fund financial statements that focus on information about the government's governmental, proprietary, and fiduciary fund types.

fund type. The 11 generic funds that all transactions of a government are recorded into. The 11 fund types are as follows: general, special revenue, debt service, capital projects, permanent, enterprise, internal service, private-purpose trust, pension (and other employee benefit) trust, investment trust, and custodial.

GASB. The Governmental Accounting Standards Board (GASB), organized in 1984 by the Financial Accounting Foundation (FAF) to establish standards of financial accounting and reporting for state and local governmental entities. Its standards guide the preparation of external financial reports of those entities.

general fund. The fund within the governmental category used to account for all financial resources, except those required to be accounted for in another governmental fund.

general-purpose governments. Governmental entities that provide a range of services, such as states, cities, counties, towns, and villages.

governmental accounting. The composite activity of analyzing, recording, summarizing, reporting, and interpreting the financial transactions of governments.

governmental activities. The activities that occur in a government organization related to the acquisition, use, and balances of spendable financial resources and related current liabilities, except for those activities accounted for as business-type or fiduciary activities.

government acquisitions. Transactions in which a government acquires another entity, or its operations, in exchange for significant consideration.

governmental funds. Funds used to account for the acquisition, use, and balances of spendable financial resources and the related current liabilities, except those accounted for in proprietary funds and fiduciary funds. Essentially, these funds are accounting segregations of financial resources. Spendable assets are assigned to a particular government fund type according to the purposes for which they may or must be used. Current liabilities are assigned to the fund type from which they are to be paid. The difference between the assets and liabilities of governmental fund types is referred to as fund balance. The measurement focus in these fund types is on the determination of financial position and changes in financial position (sources, uses, and balances of financial resources), rather than on net income determination.

government mandated non-exchange transactions. Resources provided by a higher-level government with the requirement that they be used for a purpose established by the higher-level government.

government mergers. Combinations of legally separate entities without the exchange of significant consideration. This statement requires the use of carrying values to measure the assets and liabilities in a government merger and certain transfers of operations.

government-wide financial statements. Highly aggregated financial statements that present financial information for all assets (including infrastructure capital assets), liabilities, and net assets of a primary government and its component units, except for fiduciary funds. The government-wide financial statements use the economic resources measurement focus and accrual basis of accounting.

infrastructure assets. Long-lived capital assets that normally are stationary in nature and can be preserved for a significantly greater number of years than most capital assets. Examples of infrastructure assets are roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems. Buildings, except those that are an ancillary part of a network of infrastructure assets, are not considered infrastructure assets.

interfund receivable/payable. Activity between funds of a government reflecting amounts provided with a requirement for repayment, or sales and purchases of goods and services between funds approximating their external exchange value (also referred to as interfund loans or interfund services provided and used).

interfund transfers. All transfers, such as legally authorized transfers from a fund receiving revenue to a fund through which the resources are to be expended, where there is no intent to repay. Interfund transfers are recorded on the operating statement.

internal service fund. A generic fund type within the proprietary category used to account for the financing of goods or services provided by one department or agency to other departments or agencies of a government, or to other governments, on a cost-reimbursement basis.

Investment. As defined by the GASB Statement No. 72, *Fair Value Measurement and Application*, an investment is a security or other asset held primarily for the purpose of income or profit.

investment trust fund. A generic fund type within the fiduciary category used by a government in a fiduciary capacity, such as to maintain its cash and investment pool for other governments.

landfill closure and post-closure care. Certain significant costs related to closing a landfill and monitoring the closed landfill accounted for by governments in an enterprise fund.

lease. A contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction.

major funds. A government's general fund (or its equivalent), other individual governmental type, and enterprise funds that meet specific quantitative criteria, and any other governmental or enterprise fund that a government's officials believe is particularly important to financial statement users.

major fund approach. Presents information about the largest, most important funds separately and combines information about the other funds into a single column, enables financial statement users to focus on the government's most important funds.

management's discussion and analysis. Management's discussion and analysis, or MD&A, is required supplementary information that introduces the basic financial statements by presenting certain financial information as well as management's analytical insights on that information.

measurement focus. The accounting convention that determines (*a*) which assets and which liabilities are included on a government's balance sheet and where they are reported, and (*b*) whether an operating statement presents information on the flow of financial resources (revenues and expenditures) or information on the flow of economic resources (revenues and expenses).

modified accrual basis of accounting. The basis of accounting adapted to the governmental fund type measurement focus. Revenues and other financial resource increments are recognized when they become both *measurable* and *available to finance expenditures of the current period*. *Available* means collectible in the current period or soon enough thereafter to be used to pay liabilities of the current period. Expenditures are recognized when the fund liability is incurred and expected to be paid from current resources, except for (*a*) inventories of materials and supplies that may be considered expenditures either when purchased or when used, and
(*b*) prepaid insurance and similar items that may be considered expenditures either when paid for or when consumed. All governmental funds are accounted for using the modified accrual basis of accounting in fund financial statements.

modified approach. Rules that allow infrastructure assets that are part of a network or subsystem of a network not to be depreciated as long as certain requirements are met.

more than likely. A likelihood of more than 50%.

net position. The residual of all other elements presented in a statement of financial position.

net investment in capital assets. A component of net position that consists of capital assets and net of accumulated depreciation, reduced by the outstanding balances of bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

nonexchange transactions. Transactions that do not involve an exchange of value.

nonfinancial nature. In the context of GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets,* an asset with a nonfinancial nature is one that is not in a monetary form similar to cash and investment securities and that represents neither a claim or right to assets in a monetary form similar to receivables nor a prepayment for goods or services.

nonreciprocal interfund activity. Transfers and reimbursements for interfund transactions.

nonspendable fund balance. The portion of fund balance that includes amounts that cannot be spent because they are either (*a*) not in spendable form or (*b*) legally or contractually required to be maintained intact.

Operational accountability. The provision of information about the results of operations and the financial condition of the overall government. The fund financial statements are used to address fiscal accountability.

parity bond. A bond with equal rights to the collateral as other bonds issued under a common bond indenture.

pension (and other employee benefit) trust fund. A trust fund used to account for a public employees retirement system, OPEB plan, or other employee benefits other than pensions that are administered through trusts that meet specified criteria. Pension (and other employee benefit) trust funds use the accrual basis of accounting and the flow of economic resources measurement focus.

permanent fund. A generic fund type under the governmental category used to report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting government's programs and, therefore, are for the benefit of the government or its citizenry. (Permanent funds do not include private-purpose trust funds, which should be used when the government is required to use the principal or earnings for the benefit of individuals, private organizations, or other governments).

potential component unit. When a special-purpose government does not meet all the criteria that defines a primary government, it becomes a *potential component unit* of a primary government. To be classified as a component unit of a primary government, a special-purpose government must first be a legally separate entity.

primary government. The core of the financial reporting entity. All state and general-purpose local governments meet the definition of a *primary government*.

private purpose trust fund. A general fund type under the fiduciary category used to report resources held and administered by the reporting government acting in a fiduciary capacity for individuals, other governments, or private organizations.

proprietary funds. The government category used to account for a government's ongoing organizations and activities that are similar to those often found in the private sector (these are enterprise and internal service funds). All assets, liabilities, equities, revenues, expenses, and transfers relating to the government's business and quasi-business activities are accounted for through proprietary funds. Proprietary funds should apply all applicable GASB pronouncements and those GAAP applicable to similar businesses in the private sector, unless those conflict with GASB pronouncements. These funds use the accrual basis of accounting in conjunction with the flow of economic resources measurement focus.

public-private and public-public partnership (PPP). An arrangement in which a government (the transferor) contracts with an operator to provide public services by conveying control of the right to operate or use a nonfinancial asset, such as infrastructure or other capital asset (the underlying PPP asset), for a period of time in an exchange or exchange-like transaction.

purchases method. The method under which inventories are recorded as expenditures when acquired.

reciprocal interfund activity. Loans and services provided and used in interfund transactions.

reporting entity. The primary government and its component units.

restricted net position. Used when constraints are placed on net position. The constraints can be either externally imposed (for example, debt covenants or grantor restrictions) or imposed by constitutional provisions or enabling legislation. In cases where there are endowment-type funds, two components of restricted net position should be displayed: expendable and nonexpendable net position.

restricted fund balance. Portion of fund balance that reflects constraints placed on the use of resources (other than nonspendable items) that are either (*a*) externally imposed by a creditor, such as through debt covenants, grantors, contributors, or laws or regulations of other governments or (*b*) imposed by law through constitutional provisions or enabling legislation.

required supplementary information. GAAP specify that certain information be presented as required supplementary information, or RSI.

revenues or other financing sources, Inflows of current financial resources.

revenues or gains. Inflows of economic resources for proprietary funds.

service concession arrangement (SCA). A PPP arrangement between a transferor and an operator in which all the following criteria are met:

a. The transferor conveys to the operator the right and related obligation to provide public services through the use and operation of an underlying PPP asset in exchange for significant consideration, such as an upfront payment, installment payments, a new facility, or improvements to an existing facility.
b. The operator collects and is compensated by fees from third parties.
c. The transferor determines or has the ability to modify or approve which services the operator is required to provide, to whom the operator is required to provide the services, and the prices or rates that can be charged for the services.
d. The transferor is entitled to significant residual interest in the service utility of the underlying PPP asset at the end of the arrangement.

short-term lease. A lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. Lessees and lessors should recognize short-term lease payments as outflows of resources or inflows of resources, respectively, based on the payment provisions of the lease contract.

special-purpose governments. Legally separate entities that perform only one activity or a few activities, such as cemetery districts, school districts, colleges and universities, utilities, hospitals and other health care organizations, and public employee retirement systems.

special item. A significant transaction or event within the control of management that is either unusual in nature or infrequent in occurrence.

special revenue fund. A fund that must have revenue or proceeds from specific revenue sources that are either restricted or committed for a specific purpose other than debt service or capital projects. This definition means that in order to be considered a special revenue fund, there must be one or more revenue sources upon which reporting the activity in a separate fund is predicated.

state and local government client affiliates. An affiliate of a financial statement attest client exists in all the following situations:

i. The entity is included in the financial statement attest client's financial statements and the member or member's firm does not make reference to another auditor's report on the entity.
ii. The entity is included in the financial statement attest client's financial statements, the member or member's firm makes reference to another auditor's report on the entity, and

(1) the entity is material to the financial statement attest client's financial statements as a whole and
(2) the financial statement attest client has more than minimal influence over the entity's accounting or financial reporting process. There is a rebuttable presumption that the financial statement attest client has more than minimal influence over the accounting or financial reporting process of funds and blended component units.

iii. The entity is a material excluded entity, and the financial statement attest client has more than minimal influence over the entity's accounting or financial reporting process. A material excluded entity is an entity that is required under the applicable financial reporting framework to be included in the financial statements of the financial statement attest client but is, nevertheless, excluded by the financial statement attest client and is material to the financial statement attest client's financial statements as a whole. There is a rebuttable presumption that the financial statement attest client has more than minimal influence over the accounting or financial reporting process of funds and blended component units.

iv. The investor, which is either the financial statement attest client or an affiliate as defined in item (i) of this definition, has an investment in an investee when the investor either
(1) controls the investee, unless the investment in the investee is trivial and clearly inconsequential to the financial statement attest client's financial statements as a whole, or
(2) has significant influence over the investee and the investment in the investee is material to the financial statement attest client's financial statements as a whole.

statement of activities. Reports the results of operations for the government. Program revenues are normally reported in the statement of activities using the following three separate columns: Charges for services, operating grants and contributions, and capital grants and contributions.

statement of net position. A balance sheet in that it reports assets plus deferred outflows of resources, liabilities plus deferred inflows of resources, and net position for the government.

subscription-based information technology arrangement (SBITA). A contract that conveys control of the right to use another party's (a SBITA vendor's) information technology (IT) software, alone or in combination with tangible capital assets (the underlying IT assets), as specified in the contract for a period of time in an exchange or exchange-like transaction.

unassigned fund balance. Residual classification for the general fund. This classification represents fund balance that has not been assigned to other funds and has not been restricted, committed, or assigned to specific purposes within the general fund. The general fund should be the only fund that reports a positive unassigned fund balance amount. In other funds, if expenditures incurred for specific purposes exceeded the amounts restricted, committed, or assigned to those purposes, it may be necessary to report a negative unassigned fund balance.

unrestricted fund balance. The total of committed fund balance, assigned fund balance, and unassigned fund balance.

unrestricted net position. Includes all other net position not included in net investment in capital assets or restricted net position. Unlike fund balance, designations of unrestricted net position should not be reported on the face of the financial statements.

voluntary nonexchange transaction. Resources provided by legislative or contractual agreements (other than exchange) entered into willingly by the parties.

Not-for-profit terminology

Agency transactions. A type of exchange transaction in which the reporting organization acts as an agent, trustee, or intermediary for another party that may be a donor or done..

board-designated endowment fund. An endowment fund created by a not-for-profit entity's governing board by designating a portion of its net assets without donor restrictions to be invested to provide income for a long, but not necessarily specified, period. In rare circumstances, a board-designated endowment fund also can include a portion of net assets with donor restrictions. For example, if a not-for-profit is unable to spend donor-restricted contributions in the near term, then the board sometimes considers the long-term investment of these funds.

board-designated net assets. Net assets without donor restrictions subject to self-imposed limits by action of the governing board. Board-designated net assets may be earmarked for future programs, investment, contingencies, purchase or construction of fixed assets, or other uses. Some governing boards may delegate designation decisions to internal management. Such designations are considered to be included in board-designated net assets.

charitable lead trust. A trust established in connection with a split-interest agreement in which the not-for-profit entity receives distributions during the agreement's term. Upon termination of the trust, the remainder of the trust assets are paid to the donor or to third-party beneficiaries designated by the donor.

charitable remainder trust. A trust established in connection with a split-interest agreement in which the donor or a third-party beneficiary receives specified distributions during the agreement's term. Upon termination of the trust, a not-for-profit entity receives the assets remaining in the trust.

collections. Works of art, historical treasures, or similar assets that are (*a*) held for public exhibition, education, or research in furtherance of public service, rather than financial gain; (*b*) protected, kept unencumbered, cared for, and preserved; and (*c*) subject to an organizational policy that requires the proceeds of items that are sold to be used to acquire other items for collections, direct care of existing collections, or both.

conditional promise to give. A promise to give that is subject to a donor-imposed condition.

contribution. An unconditional transfer of cash or other assets, as well as unconditional promises to give, to an entity or a reduction, settlement, or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner.

Contributions (nonreciprocal) transactions. Inflows from an unconditional transfer of assets, as well as unconditional promises to give, or reduction, settlement, or cancellation of debt in a voluntary nonreciprocal transfer by an entity other than an owner.

costs of joint activities. Costs incurred for a joint activity. Costs of joint activities may include joint costs and costs other than joint costs. *Costs other than joint costs* are costs that are identifiable with a particular function, such as program, fund-raising, management and general, and membership development costs.

donor-imposed condition. A donor stipulation (donors include other types of contributors, including makers of certain grants) that represents a barrier that must be overcome before the recipient is entitled to the assets transferred or promised. Failure to overcome the barrier gives the contributor a right of return of the assets it has transferred or gives the promisor a right of release from its obligation to transfer its assets.

donor-imposed restriction. A donor stipulation (*donors* include other types of contributors, including makers of certain grants) that specifies a use for the contributed asset that is more specific than broad limits resulting from the nature of the organization, the environment in which it operates, and the purposes specified in its articles of incorporation or bylaws, or comparable documents for an unincorporated association. A restriction on an organization's use of the asset contributed may be temporary in nature or perpetual in nature.

donor-restricted endowment fund. An endowment fund that is created by a donor stipulation (*donors* include other types of contributors, including makers of certain grants) that requires investment of the gift in perpetuity or for a specified term. Some donors or laws may require that a portion of income, gains, or both be added to the gift and invested subject to similar restrictions.

donor-restricted support. Donor-restricted revenues or gains from contributions that increase net assets with donor restrictions (*donors* include other types of contributions, including makers of certain grants).

economic interest. A not-for-profit entity's interest in another entity that exists if any of the following criteria are met: (*a*) The other entity holds or uses significant resources that must be used for the purposes of the not-for-profit entity, either directly or indirectly, by producing income or providing services, or (*b*) the not-for-profit entity is responsible for the liabilities of the other entity.

endowment fund. An established fund of cash, securities, or other assets that provides income for the maintenance of a not-for-profit entity. The use of the assets of the fund may be with or without donor-imposed restrictions. Endowment funds generally are established by donor-restricted gifts and bequests to provide a source of income.

Exchange (reciprocal) transactions. Inflows from exchange transactions arise when both parties receive goods and services of commensurate value.

functional expense classification. A method of grouping expenses according to the purpose for which the costs are incurred. The primary functional classifications of a not-for-profit entity are program services and supporting activities.

fund A fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations

fundraising activities. Activities undertaken to induce potential donors to contribute money, securities, services, materials, facilities, other assets, or time.

funds functioning as endowment. Net assets without donor restrictions (*donors* include other types of contributors, including makers of certain grants) designated by an entity's governing board to be invested to provide income for generally a long, but not necessarily specified, period.

gifts in kind. Noncash assets received by some NFP entities.

joint activity. An activity that is part of the fund-raising function and has elements of one or more other functions, such as programs, management and general, membership development, or any other functional category used by the entity.

joint costs. The costs of conducting joint activities that are not identifiable with a particular component of the activity.

management and general activities. Supporting activities that are not directly identifiable with one or more programs, fund-raising activities, or membership development activities.

Membership development activities. Activities that include soliciting for prospective members and membership dues, membership relations, and similar activities.

natural expense classification. A method of grouping expenses according to the kinds of economic benefits received in incurring those expenses. Examples of natural expense classifications include salaries and wages, employee benefits, professional services, supplies, interest expense, rent, utilities, and depreciation.

net assets. The excess or deficiency of assets over liabilities of a not-for-profit entity, which is divided into two mutually exclusive classes according to the existence or absence of donor-imposed restrictions.

net assets with donor restrictions. The part of net assets of a not-for-profit entity that is subject to donor-imposed restrictions (*donors* include other types of contributors, including makers of certain grants).

net assets without donor restrictions. The part of net assets of a not-for-profit entity that is not subject to donor-imposed restrictions (*donors* include other types of contributors, including makers of certain grants).

Other inflows. Resources NFPs receive from other activities, such as investment activities.

programmatic investing. The activity of making loans or other investments that are directed at carrying out a not-for-profit entity's purpose for existence, rather than investing in the general production of income or appreciation of an asset (for example, total return investing). An example of programmatic investing is a loan made to lower-income individuals to promote home ownership.

promise to give. A written or oral agreement to contribute cash or other assets to another entity. A promise to give may be either conditional or unconditional.

underwater endowment fund. A donor-restricted endowment fund for which the fair value of the fund at the reporting date is less than either the original gift amount or the amount required to be maintained by the donor or by law that extends donor restrictions.

Single audit and Yellow Book terminology

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.

agreed-upon procedures engagement. Consists of auditors performing specific procedures on subject matter or an assertion and reporting findings without providing an opinion or a conclusion on it.

attestation engagements. Attestation engagements concern examining, reviewing, or performing agreed-upon procedures on a subject matter or an assertion about a subject matter and reporting on the results.

audit objectives. What the audit is intended to accomplish. They identify the audit subject matter and performance aspects to be included. Audit objectives can be thought of as questions about the program that the auditors seek to answer based on evidence obtained and assessed against criteria. Audit objectives may also pertain to the current status or condition of a program.

audit procedures. The specific steps and tests auditors perform to address the audit objectives.

audit risk. The possibility that the auditors' findings, conclusions, recommendations, or assurance may be improper or incomplete. The assessment of audit risk involves both qualitative and quantitative considerations.

bias threat. The threat that an auditor will, as a result of political, ideological, social, or other convictions, take a position that is not objective.

cause. The factor or factors responsible for the difference between the condition and the criteria, which may also serve as a basis for recommendations for corrective actions.

compliance supplement. A document issued annually in the spring by the OMB to provide guidance to auditors.

condition. A situation that exists. The condition is determined and documented during the engagement.

criteria. Laws, regulations, contracts, grant agreements, standards, measures, expected performance, defined business practices, and benchmarks against which performance is compared or evaluated. Criteria identify the required or desired state or expectation with respect to the program or operation. Criteria provide a context for evaluating evidence and understanding the findings, conclusions, and recommendations in the report.

data collection form. A form submitted to the Federal Audit Clearinghouse that provides information about the auditor, the auditee and its federal programs, and the results of the audit.

effect or potential effect. The outcome or consequence resulting from the difference between the condition and the criteria.

familiarity threat. The threat that aspects of a relationship with management or personnel of an audited entity, such as a close or long relationship, or that of an immediate or close family member, will lead an auditor to take a position that is not objective.

federal financial assistance. Assistance that nonfederal entities receive or administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance, but does not include amounts received as reimbursement for services rendered to individuals in accordance with guidance issued by the director.

financial audits. Financial audits are primarily concerned with providing reasonable assurance about whether financial statements are presented fairly, in all material respects, in conformity with GAAP or with a comprehensive basis of accounting other than GAAP.

GAGAS. Generally accepted government auditing standards issued by the GAO. They are published as *Government Auditing Standards*, also commonly known as the Yellow Book.

GAO. The United States Government Accountability Office. Among its responsibilities is the issuance of GAGAS.

independence in appearance. The absence of circumstances that would cause a reasonable and informed third party to reasonably conclude that the integrity, objectivity, or professional skepticism of an audit organization or member of the engagement team had been compromised.

independence in mind. The state of mind that permits the conduct of an engagement without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

management participation threat. The threat that results from an auditor’s taking on the role of management or otherwise performing management functions on behalf of the audited entity, which will lead an auditor to take a position that is not objective.

OMB. The Office of Management and Budget. The OMB assists the President in the development and implementation of budget, program, management, and regulatory policies.

pass-through entity. A nonfederal entity that provides federal awards to a subrecipient to carry out a federal program.

performance audits. Performance audits entail an objective and systematic examination of evidence to provide an independent assessment of the performance and management of a program against objective criteria as well as assessments that provide a prospective focus or that synthesize information on best practices or cross-cutting issues.

period of professional engagement. The period beginning when the auditors either sign an initial engagement letter or other agreement to conduct an engagement or begin to conduct an engagement, whichever is earlier. The period lasts for the duration of the professional relationship — which, for a recurring engagement, could cover many periods — and ends with the formal or informal notification, either by the auditors or the audited entity, of the termination of the professional relationship or with the issuance of a report, whichever is later.

presumptively mandatory requirements. Auditors and the audit organization must comply in all cases in which such a requirement is relevant, except in rare circumstances.

professional judgment. Use of the auditor's professional knowledge, skills, and abilities, in good faith and with integrity, to diligently gather information and objectively evaluate the sufficiency and appropriateness of evidence. Professional judgment includes exercising reasonable care and professional skepticism.

program-specific audit. A compliance audit of one federal program.

safeguards. Actions or other measures, individually or in combination, that auditors and the audit organization take that effectively eliminate threats to independence or reduce them to an acceptable level.

self-interest threat. The threat that a financial or other interest will inappropriately influence an auditor's judgment or behavior.

self-review threat. The threat that an auditor or audit organization that has provided nonaudit services will not appropriately evaluate the results of previous judgments made or services provided as part of the nonaudit services when forming a judgment significant to an engagement.

significance. The relative importance of a matter within the context in which it is being considered, including quantitative and qualitative factors. In performance audit requirements, the term *significance* is comparable to the term *material* as used in the context of financial statement engagements.

single audit. An audit of a nonfederal entity that includes the entity's financial statements and federal awards.

single audit guide. This AICPA Audit Guide, formally titled Government Auditing Standards *and Single Audits*, is the former Statement of Position (SOP) 98-3, *Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards*. The single audit guide provides guidance on the auditor's responsibilities when conducting a single audit or program-specific audit in accordance with the Single Audit Act, GAGAS, and the Uniform Guidance.

specialist. An individual or organization possessing special skill or knowledge in a particular field other than accounting or auditing that assists auditors in conducting engagements. A specialist may be either an internal specialist or an external specialist.

structural threat. The threat that an audit organization's placement within a government entity, in combination with the structure of the government entity being audited, will affect the audit organization's ability to perform work and report results objectively.

subrecipient. A nonfederal entity that receives federal awards through another nonfederal entity to carry out a federal program but does not include an individual who receives financial assistance through such awards.

undue influence threat. The threat that influences or pressures from sources external to the audit organization will affect an auditor's ability to make objective judgments.

Uniform Guidance. Formally known as Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*. The Uniform Guidance sets forth the requirements for the compliance audit portion of a single audit.

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.

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