

Single Audit Workshop

May 14, 2024

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

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Learning Objectives

1. Recall the steps in Major Program Determination
2. Contrast tests of controls and tests of compliance
3. Describe the considerations for direct & material determinations
4. Perform compliance testing in conformance with the Uniform Guidance
5. Identify internal controls over compliance that will support the ESSER program
6. Describe best practices in documenting compliance testing



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Single Audit Workshop



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Steps in a Single Audit

- Identify Compliance Requirements per Compliance Supplement
- Determine Whether Direct and Material
- Perform Risk Assessment Procedures
 - Including Fraud Risk

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Steps in a Single Audit Cont'd

- Perform Inherent Risk Assessment
- Determine PRELIMINARY Control Risk Assessment
 - Document design and conclusions reached
- Perform Tests of Controls
 - Determine Sample Size for Control Testing
 - Document operating effectiveness tests & conclusions reached

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Steps in a Single Audit Cont'd

- Determine FINAL Control Risk Assessment
 - Assess magnitude of any findings and report
 - DOCUMENT changes and reasons for change
- Use IR & CR Assessments to determine Risk of Material Noncompliance

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Steps in a Single Audit Cont'd

- Perform Tests of Compliance
 - Consider impact of multiple tests on remaining risk of noncompliance
 - Determine Sample Size
 - Perform testing & evaluate compliance exceptions
 - Calculate Compliance Exception Rate or Likely Questioned Costs
- Reach an Overall Conclusion on Tests of Compliance

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Steps in a Single Audit Cont'd

- Single Audit Reporting
 - Report on Compliance for Each Major Program
 - Report on Internal Control Over Compliance
 - Report on SEFA
- Yellow Book Report
 - Report on Internal Controls Over Financial Reporting and on Compliance and Other Matters
- Financial Statement Audit Report

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Before You Begin

- It is important that you know your Assistance Listing Number (formerly CFDA number) inside and out!
 - Objective
 - Procedures
 - Funding

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Step 1: Applicable

- Review actual grant agreement
- Review Compliance Supplement Part 2: The Matrix

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How Do I Know What to Test?

- Determine applicability of compliance requirements
 - Part 2 of the Compliance Supplement – Matrix of Compliance Requirements
 - Which are “subject to audit”
 - Review contracts and grant agreements
 - Discuss with appropriate individuals within the auditee organization

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Matrix of Compliance Requirements

Requirement	A	B	C	E	F	G	H	I	J	L	M	N
Program Number	Activities Allowed or Unallowed	Allowable Costs/Cost Principles	Cash Management	Eligibility	Equipment Real Property Management	Matching, Level of Effort, Earmarking	Period of Performance	Procurement Suspension & Debarment	Program Income	Reporting	Subrecipient Monitoring	Special Tests and Provisions
10.000	Y	Y	Y	N	Y	N	N	N	Y	Y	N	Y
10.500	Y	Y	N	N	N	Y	Y	N	N	Y	Y	N
10.511	Y	Y	Y	N	Y	Y	N	N	N	Y	N	N
10.512	Y	Y	Y	N	Y	Y	N	N	N	Y	N	N
10.514	Y	Y	Y	N	N	N	N	N	N	Y	Y	N
10.515	Y	Y	Y	N	N	N	N	N	N	Y	Y	N
10.516	Y	Y	Y	N	Y	N	N	N	N	Y	Y	N
10.517	Y	Y	Y	N	Y	N	N	N	N	Y	Y	N
10.520	Y	Y	Y	N	Y	N	N	N	N	Y	Y	N
10.521	Y	Y	Y	N	Y	N	N	N	N	Y	Y	N
10.551/10.561	Y	Y	N	N	N	Y	N	Y	N	N	Y	Y
10.553/10.555/10.556/10.559	Y	Y	Y	Y	N	N	N	Y	Y	N	N	Y
10.557	Y	Y	Y	Y	N	N	Y	Y	N	N	N	N
10.558	Y	Y	Y	Y	N	N	N	Y	N	N	Y	Y

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Compliance Requirements



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Activities Allowed or Unallowed (A)

- Specifies the activities that can or cannot be funded under a specific program and how they are calculated and supported
- Unique to each Federal program and are found in the laws, regulations, and the provisions of contract or grant agreements pertaining to the program

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Allowable Costs / Cost Principles (B)

- Specifies the costs that can and cannot be funded under a specific program and how they are calculated and supported

In accordance with required guidance:

- CFR 200 Subpart E
- Prior OMB Circulars
- Terms specified in the grant agreement

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Allowable Costs / Cost Principles (A/B)

To be allowable, a cost must:

- Be necessary and reasonable for the performance of the Federal award and be allocable thereto.
- Conform to any limitations or exclusions set forth in these principles or in the Federal award as to types or amount of cost items.
- Be consistent with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity.
- Be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- Be determined in accordance with GAAP (with certain exceptions for state and local governments and Indian tribes).
- Not be included as a cost or used to meet cost sharing or matching requirements of any other federally-financed program in either the current or a prior period.
- Be adequately documented.
- Cost must be incurred during the approved budget period.

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Cash Management (C)

- Reimbursement Basis
 - Program costs must be incurred by the entity prior to requesting reimbursement
- Advance Payments
 - Recipients must follow procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement

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Eligibility (E)

- Participants meet the program criteria to receive grant funding
- The specific requirements for eligibility are unique to each Federal program
 - The requirements are found in the laws, regulations, and the provisions of contracts and grant agreements

Equipment and Real Property Management (F)

- Management, use and disposal of equipment or real property
- Requirements for equipment and real property are contained in UG, program legislation, Federal awarding agency regulations, and the terms and conditions of the award

Matching, Level of Effort, Earmarking (G)

- Matching
 - Required cost share
- Level of effort
 - Required participation from period to period
- Earmarking
 - Setting aside funding for specified activities

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Period of Performance (H)

- The total estimated time interval between the start of an initial Federal award and the planned end date, which may include one or more funded portions, or budget periods

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Procurement and Suspension and Debarment (I)

- Procurement
 - Five methods of procurement
 - Micro-purchase
 - Small Purchase
 - Sealed Bids
 - Proposals
 - Noncompetitive Procurement

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Procurement and Suspension and Debarment (I) Cont'd

- Suspension and Debarment
 - Prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred or whose principals are suspended or debarred

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Program Income (J)

- Income generated by Federal funds are used for program expenditures
- May be used in 3 ways:

Deduction

Addition

Cost Sharing
or Matching

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Reporting (L)

- Reporting Requirements
 - Financial
 - Performance
 - FFATA
 - Special

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Sub-recipient Monitoring (M)

- Identification of the award as a subaward
- Evaluate risk
- Monitoring pass-through funding
- Ensure accountability

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Step 2: Identifying D&M CRs

- Use professional judgment to determine which of the compliance requirements may have a direct and material effect on each major program

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Considerations

- Consider both qualitative and quantitative factors
 - Auditor judgment
 - Experience
 - Accepted risk
 - Industry expectation

Direct & Material

- Noncompliance could result in being denied reimbursement of program expenditures or having to refund federal monies or make other restitution in an amount that would be material to the major program
- **DOCUMENT** this consideration and results
 - N/A or Not D&M is not enough
 - Inquiry alone is not enough

Step 3: Risk Assessment Procedures

- 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

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Fraud Risk Assessment

- Assess the risks of material noncompliance with a major program's compliance requirements occurring due to fraud
- Document specific fraud risks
 - Management override of controls

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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

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Considerations

- Audit risk of noncompliance and materiality need to be considered together for each major program being audited as well as for each direct and material compliance requirement in determining the nature, timing, and extent of audit procedures and in evaluating the results of those procedures

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Risk of Material Noncompliance

$$\text{RMNC} = \text{IRNC} \times \text{CRNC}$$

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Risk of Material Noncompliance Cont'd

- Inherent Risk of Noncompliance
 - The susceptibility of a major program's compliance requirement to noncompliance that could be material, either individually or when aggregated with other instances of noncompliance, before consideration of any related controls over compliance

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Risk of Material Noncompliance Cont'd

- Control Risk of Noncompliance
 - 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

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Step 4 - Inherent Risk Factors

- Factors that may suggest higher inherent risk of noncompliance include the following:

Criteria for identifying and assessing RMNC identified by the gov't audit requirement & related communications from oversight orgs or regulators

The complexity of the applicable compliance requirements

The susceptibility of the applicable compliance requirements to noncompliance

The length of time the entity has been subject to the applicable compliance requirements

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Step 4 - Inherent Risk Factors Cont'd

The auditor's observations about how the entity has complied with the applicable compliance requirements in prior years

The potential effect on the entity of noncompliance with the applicable compliance requirements

The degree of judgment involved in adhering to the compliance requirements

The auditor's assessment of the risks of material misstatement in the financial statement audit

Step 5: ICOC Assessment

- What is Internal Controls over Compliance?
 - A process—effected by an entity's management and other personnel—designed to provide reasonable assurance regarding the achievement of the objectives for federal programs

Objective 1

- Transactions are properly recorded and accounted for to:
 - Permit the preparation of reliable financial statements and federal reports;
 - Maintain accountability over assets; and
 - Demonstrate compliance with laws, regulations, and other compliance requirements;

Objective 2

- Transactions are executed in compliance with:
 - Laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on a federal program; and
 - Any other laws and regulations that are identified in the compliance supplement; and

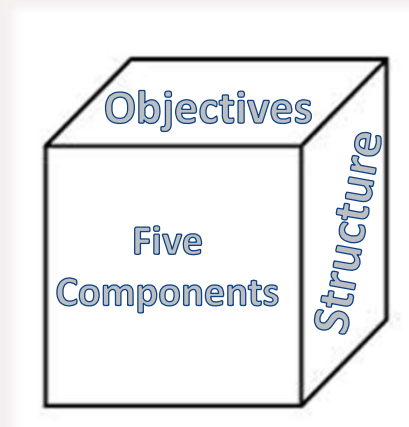
Objective 3

- Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition

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COSO Cube

- Objectives
- Components
- Organizational Structure



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What is a Control?

- Process
 - Procedures that originate, transfer or change data
 - Can introduce errors
 - Example: Employees complete their timesheets
- Controls
 - Procedures designed to prevent, detect and correct errors resulting from processing of accounting information
 - Cannot generate errors
 - Example: Project manager approves timesheets

Control Risk

- 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

Process

- Not a serial process but a dynamic and integrated process
- Each organization implements internal controls differently
- Must be able to adapt to changing business and operating environments
- More than just policies and procedures
 - Requires use of judgment

Effected by People

- Management and boards of directors use of judgment to determine how much control is enough
- Management, internal auditors, other personnel apply judgment as they monitor and assess the effectiveness of the system of internal control
- Not merely about policy and procedure manuals, systems, and forms

Reasonable Assurance

- Does not provide absolute assurance
- Limitations of internal controls
 - Collusion
 - Management override
 - External events beyond the organizations control
 - Bad judgments or decisions

Design

- Perform risk assessment procedures to obtain an understanding of the entity's internal control over compliance which includes an evaluation of the design of controls and whether the controls have been implemented

Design Cont'd

- The auditor should obtain an understanding of the five components of internal control sufficient to assess the risks of material noncompliance with each direct and material compliance requirement for each major program
 - Each major program
 - Each direct & material compliance requirement
 - Each of the 5 elements of COSO

COSO Components - Adapted

- Control Environment
 - Sets the tone of the entity, influencing the control consciousness of its people
 - It is the foundation for all other components of internal control over compliance, providing discipline and structure

COSO Components - Adapted Cont'd

- Risk Assessment
 - The entity's identification, analysis, and management of risks relevant to the objectives of the compliance audit
 - If the risk assessment process is appropriate to the circumstances, including the nature, size, and complexity of the entity, it assists the auditor in identifying risks of material noncompliance

COSO Components - Adapted Cont'd

- Information and Communication Systems
 - Includes the business processes relevant to compliance with the applicable compliance requirements. It consists of procedures and records designed and established to support the identification, capture, and exchange of information related to compliance in a form and time-frame that enable people to carry out their responsibilities

COSO Components - Adapted Cont'd

- Control Activities
 - The policies and procedures that help ensure that management directives are carried out
- Monitoring
 - A process to assess the effectiveness of internal control over compliance performance over time

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COSO 2013



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Control Environment

1. The organization demonstrates a commitment to integrity and ethical values
2. The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control
3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives
4. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives
5. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives

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Risk Assessment

6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives
7. The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed
8. The organization considers the potential for fraud in assessing risks to the achievement of objectives
9. The organization identifies and assesses changes that could significantly impact the system of internal control

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Control Activities

10. The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels
11. The organization selects and develops general control activities over technology to support the achievement of objectives
12. The organization deploys control activities through policies that establish what is expected and procedures that put policies into place

Information & Communication

13. The organization obtains or generates and uses relevant, quality information to support the functioning of internal control
14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control
15. The organization communicates with external parties regarding matters affecting the functioning of internal control

Monitoring

16. The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning
17. The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate

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Let's Do An Exercise



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Allowable Costs

- Control Objective
 - To provide reasonable assurance that the costs of goods and services charged to Federal awards are allowable and in accordance with the applicable cost principles

Cash Management

- Control Objective
 - To provide reasonable assurance that the
 - Drawdown of Federal cash is only for immediate needs
 - Reimbursement is requested only after costs have been incurred
 - Recipients limit payments to subrecipients to immediate cash needs

Preliminary Assessment

- 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 direct and material compliance requirements for major programs
- The auditor's basis for judgment of the assessed level of control risk of noncompliance should be documented to support the decisions made

Step 6: Testing Operating Effectiveness

- The auditor should 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
- Testing the operating effectiveness of controls is different from obtaining an understanding of and evaluating the design and implementation of controls

Extent of Testing of ICOC

- 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 is relying on the operating effectiveness of the control
- The **expected deviation** from the control
- The **relevance and reliability** of the audit evidence to be obtained 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

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Sampling Overview



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Sampling Defined

“The selection and evaluation of less than 100 percent of the population of audit relevance such that the auditor expects the items selected (the sample) to be representative of the population and, thus, likely to provide a reasonable basis for conclusions about the population”

– AU-C 530

What is NOT sampling?

- Inquiry and observation
- Analytical procedures
- Procedures applied to every item in population
- Tests of Automated IT controls

Non-Statistical vs. Statistical Samples

- Both comply with auditing standards
- Statistical samples rely on statistics
- Non-statistical rely on professional judgment

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Requirements That Apply to All Single Audit Samples

- Planning
 - Determine Audit Objective
 - Define the Population
 - Define Sampling Unit
- Selection
 - Representative Selection
- Evaluation
 - Calculate Deviation Rates
 - Project Sample Results

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Purpose of Single Audit Samples

- Tests of controls (TOC) provide evidence about the effectiveness of the design, implementation, or operation of controls and policies in preventing or detecting material noncompliance
 - Objective: Rates of deviations from a prescribed control

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Purpose of Single Audit Samples Cont'd

- Compliance testing provides evidence about an auditee's ability to adhere to the direct & material compliance requirements of its major programs
 - Objective: Rates and potential magnitude of noncompliance

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Population Considerations

- Identify & document testing objective
 - Different objectives for tests of control and compliance
 - Utilize the Compliance Supplement
- Be sure to test for population completeness
 - Perform reconciliation to the SEFA
 - Compare to other accounting records

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Population Considerations Cont'd

- Population may not consist of accounting records
 - i.e. eligibility files
- Centralization vs. Decentralization
 - Timesheets approved separately by different departments
 - Transaction processing and the operation of related controls are decentralized
 - Goal is representative sample

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Population Considerations Cont'd

- Understand the characteristics of the population
 - Identify the sampling unit (cash disbursements, eligibility files, expenditures, refund paid, financial reports, cost transfers)
 - Remove individually important items
 - Does each transaction or instance of the control have an equal opportunity of being selected?

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Multi-component Populations

- How does each component maintain internal controls?
 - Independently/centrally
- Consider separate populations
 - Locations, programs
- Clusters

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Controls vs. Compliance

- Properly identify the universe of transactions
 - Auditor's opinion is on EACH major program
 - For controls testing, it's may be OK to test across programs
 - For compliance testing, treat each major program as a separate population

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Example

- An auditee has common internal controls over the Allowable Costs/Cost Principles relating to 3 major programs
- Sample size
 - Combined population - 60 items
- Selection
 - Similar size programs - 20 items from each of the 3 major programs
 - Dissimilar size programs - Allocate proportionately

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Controls Testing

- Required to obtain high assurance (CR = Low)
 - High Assurance = 90-95% confidence
 - Plan for zero exceptions
 - Sampling requires “tolerance” for deviations (5 to 10%)
- Use auditor’s judgment
 - May need to test more than the minimum

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Controls Testing & Compliance

- Must plan tests of controls to obtain an understanding of internal control over federal programs sufficient to plan the compliance audit to support a low assessed level of control risk of noncompliance for major programs
- While the planned tests must be performed, the Uniform Guidance does not require that a low level of assessed control risk of noncompliance be achieved

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Inputs for Control Testing

- Significance of Control
- Inherent Risk

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Control Testing Sample Sizes

Significance of Control	Inherent Risk	Minimum Sample Size (0 deviations expected)
Very Significant	Higher Inherent Risk	60
Very Significant	Limited Inherent Risk	40
Moderately Significant	Higher Inherent Risk	40
Moderately Significant	Limited Inherent Risk	25

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What about Smaller Populations?

Frequency and/or Population Size	Sample Size
Quarterly (4)	2
Monthly (12)	2-4
Semimonthly (24)	3-8
Weekly (52)	5-9

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Performing Procedures

- Evidence of who, when, what
- Procedures include:
 - **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
 - **Reperformance** of the application of the controls by the auditor
- Generally involves combination of procedures
- Inquiry alone is not sufficient

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Step 7: Final Control Assessment

- Evaluate whether the assessment of the risk of material noncompliance of the relevant compliance requirements remain appropriate
 - May cause the auditor to modify the nature, timing, or extent of other planned audit procedures
 - IF you are not able to support a low assessed level of control risk of noncompliance you are NOT required to expand the testing of internal control over compliance for that compliance requirement

Deficiency

- 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

Significant Deficiency

- A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance

Material Weakness

- A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected and corrected on a timely basis

Risk Factors

The factors include:

- Nature of the type of compliance requirement involved
- Susceptibility of the program and related types of compliance requirements to fraud
- Subjectivity and complexity involved in meeting the compliance requirement, and the extent of judgment required in determining noncompliance.
- Interaction or relationship of the control with other controls
- Interaction among the deficiencies.
- Possible future consequences of the deficiency

Magnitude

- The evaluation of deficiencies in internal control over compliance includes the magnitude of potential noncompliance

The factors may include:

- Program amounts or total of transactions exposed to the deficiency, in relation to the type of compliance requirement
- Volume of activity related to the compliance requirement exposed to the deficiency in the current period or expected in future periods
- Adverse publicity or other qualitative factors

Indicators

- Indicators of material weaknesses in internal control over compliance include
 - Identification of fraud (of any magnitude) in the major program of any magnitude on the part of senior program management
 - Identification by the auditor of material noncompliance
 - IF the noncompliance was not initially identified by the entity's internal control
 - Ineffective oversight by management, or those charged with governance
 - For example, lack of adequate review of federal financial reports prior to submission to the grantor

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Deficiencies in Design

- Inadequate design of controls over activities subject to a type of compliance requirement
- Inadequate design of controls over complex types of compliance requirements
- Insufficient control consciousness within the entity
- Absent or inadequate segregation of duties
- Inadequate design of IT controls
- Employees or management who lack the qualifications and training to fulfill their assigned functions
- Inadequate design of monitoring controls
- Absence of an internal process to report deficiencies in internal control over compliance to management

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Deficiencies in Operations

- Failure in the operation of effectively designed controls over a type of compliance requirement
- Failure of the information and communication component of internal control over compliance to provide complete and accurate output because of deficiencies in timeliness, completeness, or accuracy of information related to compliance
- Misrepresentation by entity personnel to the auditor
- Management override of controls
- Failure of an application control caused by a deficiency in the design or operation of an IT general control
- An observed deviation rate that exceeds the number of deviations expected by the auditor in a test of the operating effectiveness of a control

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Documentation Requirements

- Key elements of the understanding obtained regarding each of the aspects of the entity and its environment
 - Assessment of the risks of material noncompliance,
 - Sources of information from which the understanding was obtained;
 - Risk assessment procedures performed
- The identified and assessed risks of material noncompliance
- The risks identified and related controls about which the auditor has obtained an understanding as a result of the requirements

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Testing Compliance vs. Testing ICOC

- Simply testing compliance does not provide evidence that controls are appropriately designed or operating effectively

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Design vs. Operation

- Test of **design** and implementation
 - Walkthrough our understanding
 - Conclusion: Control has been properly designed and implemented
- Test of **effectiveness**
 - Test key control attributes
 - Conclusion: Control is effective

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Step 8: Risk of Noncompliance

- Compliance testing includes tests of transactions and such other auditing procedures necessary to provide the auditor with sufficient evidence to support an opinion on compliance
- Serves to limit detection risk of noncompliance

Use of ICOC

- The auditor may use evidence gained from the tests of controls relevant to compliance requirements to determine the nature, timing, and extent of the testing required to express an opinion on compliance with requirements that have a direct and material effect on major federal program

Impact of Control Testing

- If the auditor gathers evidence that controls over compliance are effective through tests of controls, and other audit procedures do not identify instances of noncompliance or identify specific heightened risk factors
 - It is likely the remaining risk of material noncompliance would be low or moderate

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Impact of Control Testing Cont'd

- Conversely, if tests of controls identify weaknesses in the controls over compliance, or other audit procedures identify instances of noncompliance or identify specific heightened risk factors
 - May lead to assessment that the risk of material noncompliance is high or moderate

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Desired Level Of Assurance

- The risk of material noncompliance consists of inherent risk of noncompliance and control risk of noncompliance
- The assurance required from a compliance sample depends on the risk of material noncompliance remaining after other audit procedures
 - Risk assessment procedures
 - Substantive analytical procedures
 - Tests of individually important items

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Step 9: Compliance Testing

- Design and perform substantive procedures for all relevant assertions related to the direct and material compliance requirements 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

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Audit Risk of Noncompliance

- The auditor should obtain sufficient appropriate audit evidence in support of compliance in order to reduce the risk of noncompliance to acceptable low level
- In order to determine the nature, timing, and extent of tests to perform, the auditor should exercise professional judgment regarding the appropriate level of detection risk of noncompliance to accept
- Consider
 - Audit Risk of noncompliance
 - Materiality

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Inputs for Compliance Testing

- Desired Level of Assurance
- Remaining Risk of Noncompliance

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Impact on Sample Size

Desired Level of Assurance (Remaining Risk of Material Noncompliance)	Minimum Sample Size (0 Exceptions expected)
High	60
Moderate	40
Low	25

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What about Smaller Populations?

Frequency and/or Population Size	Sample Size
Quarterly (4)	2
Monthly (12)	2-4
Semimonthly (24)	3-8
Weekly (52)	5-9

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Compliance Supplement

- Contains suggested audit procedures

Suggested Audit Procedures – Compliance

1. Identify the types of activities which are either specifically allowed or prohibited by the laws, regulations, and the provisions of contract or grant agreements pertaining to the program.
2. When allowability is determined based upon summary level data, perform procedures to verify that:
 - a. Activities were allowable.
 - b. Individual transactions were properly classified and accumulated into the activity total.
3. When allowability is determined based upon individual transactions, select a sample of transactions and perform procedures to verify that the transaction was for an allowable activity.
4. The auditor should be alert for large transfers of funds from program accounts which may have been used to fund unallowable activities.

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Materiality

- Materiality is affected by
 - Nature of the compliance requirement
 - May not be quantifiable in monetary terms
 - Nature and frequency of noncompliance identified
 - Sampling Risk
 - Qualitative considerations
 - Needs and expectations of federal agencies and pass-through entities

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Materiality Cont'd

- Apply concept of materiality to each major program taken as a whole, rather than all major programs combined
- Definition of a material instance of noncompliance
 - A failure to follow requirements, or a violation of prohibitions, established by law, regulation, contract, or grant agreement that results in an aggregation of noncompliance that is material to the affected federal program
 - Auditor's best estimate of the overall noncompliance

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Preference in Evidence

- Obtained from knowledgeable independent sources outside the entity
- Audit evidence that is generated internally is more reliable when the related controls are effective
- Obtained directly by the auditor
- Exists in documentary form, whether paper, electronic, or other medium
- Original documents are more reliable than photocopies or facsimiles

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Noncompliance

- May identify instances of noncompliance
 - These instances of noncompliance are referred to as “findings”
- May be of a monetary nature and involve questioned costs or may be nonmonetary and not result in questioned costs
- The auditor should not assume that an instance of fraud or error is an isolated occurrence

Step 10: Overall Conclusion on Compliance

- Auditor must opine on whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on each major program

Considerations

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

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Questioned Costs

- Resulted from a **violation** or possible violation of a provision of a law, regulation contract, grant, cooperative agreement etc.
- Not supported by adequate **documentation**
- Appear **unreasonable** and do not reflect the actions a prudent person would take in the circumstances

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Step 11: Reporting

- Report on Financial Statements
- Report on SEFA
- Yellow Book Report
- Report on Major Programs
 - Schedule of Findings & Questioned Cost

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Reporting Package

- | | |
|---|---|
| <ul style="list-style-type: none"> • Auditor's report on FS • Auditor's in-relation-to reporting on SEFA • Auditee's FS • Auditee's SEFA • Yellow Book Report <ul style="list-style-type: none"> • Compliance • Internal Control • Financial Reporting | <ul style="list-style-type: none"> • Auditor's report on compliance and internal control over compliance – major programs • Auditor's schedule of findings and questioned costs • Auditee's summary schedule of prior audit findings • Auditee's corrective action plan |
|---|---|

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Wrap Up



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What Questions Do You Have?



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Content last reviewed: 4/29/24

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