

# Understanding and Testing Control and Compliance in a Single Audit

UTC4/23/V1

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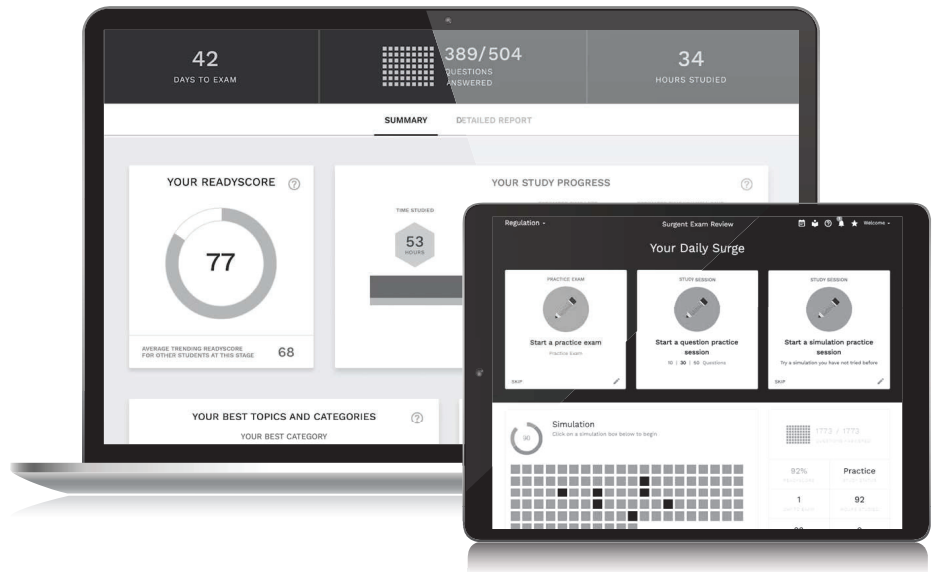
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# ***Table of Contents***

<b>Setting the Perimeter for What We Are Going to Test.....</b>	<b>1</b>
<b>Understanding and Testing Controls in a Single Audit.....</b>	<b>2</b>
<b>Testing Compliance in a Single Audit .....</b>	<b>3</b>
<b>Latest Developments.....</b>	<b>4</b>

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# Setting the Perimeter for What We Are Going to Test

<b>Learning objectives</b>	<b>1</b>
<b>I. What is a single audit?</b>	<b>1</b>
A. The current single audit threshold	1
B. How a single audit differs from a financial statement audit	2
<b>II. The importance of the SEFA and major programs</b>	<b>3</b>
A. Becoming comfortable with the auditee's SEFA	3
1. Exercise 1-1	3
2. How the auditee prepares the SEFA	4
3. How the auditor audits the SEFA	4
B. Properly determining major programs	6
<b>III. Determining the applicable compliance requirements</b>	<b>7</b>
A. What is the Compliance Supplement?	7
B. Exercise 1-2	7
C. The principal compliance requirements	8
D. Exercise 1-3	9
E. Starting with the Supplement's Part 2 – Matrix of Compliance Requirements	10
F. Using the Compliance Supplement – Programs included in the Supplement	11
1. Reviewing the Compliance Supplement's Part 2 – Matrix of Compliance Requirements	11
2. Exercising professional judgment	12
3. Exercise 1-4	13
G. Using the Compliance Supplement – Programs excluded from the Supplement	13
<b>IV. Suggested solutions to exercises</b>	<b>15</b>
A. Suggested solution to Exercise 1-1	15
B. Suggested solution to Exercise 1-2	15
C. Suggested solution to Exercise 1-3	16
D. Suggested solution to Exercise 1-4	17



# Setting the Perimeter for What We Are Going to Test

## Learning objectives


	<p>Upon completing this chapter, you will be able to:</p> <ul style="list-style-type: none"><li>• Succinctly explain what a single audit is and how it differs from a financial statement audit;</li><li>• Perceive the importance of the schedule of expenditures of federal awards and major program determination to a single audit; and</li><li>• Determine the applicable compliance requirements to test in a single audit.</li></ul>
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## I. What is a single audit?

In simple terms, a **single audit** refers to an audit of a nonfederal entity that includes **both** the entity's financial statements **and** federal awards (particularly from a compliance perspective) and is performed under the Uniform Guidance for Federal Awards. The term **single audit** can be a misnomer as due to the requirements and level of effort required it really feels much more like a double or triple audit! However, the term **single audit** essentially refers to the fact that an auditee potentially faces one audit of its federal awards each year (i.e., a single audit) under a unified set of rules. If we did not have the single audit process in place, auditees would likely face a series of audits each year from various federal agencies each of which would be devising its own rules.

### A. The current single audit threshold

Having established what a single audit is, it's only natural to wonder what types of entities are required to undergo a single audit.

	<p><b>The current single audit threshold</b></p> <p>Under the Uniform Guidance for Federal Awards a nonfederal entity (i.e., a state, local government, Indian tribe, institution of higher education, or a not-for-profit that carries out a federal award as a recipient or subrecipient) that <b>expends</b> \$750,000 or more during the nonfederal entity's fiscal year in federal awards must have a single audit or a program-specific audit conducted for that year.</p>
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In the above table, we also refer to a **program-specific audit**. Program-specific audits are somewhat rare and are allowed under the Uniform Guidance for Federal Awards when a nonfederal entity expends federal awards under only one federal program and the auditee is not required to have a financial statement audit. In simple terms, a program-specific audit is a single audit of an entity with only one federal program that is not required to have a financial statement audit. **Note.** In April 2022, limited relief from the single audit requirements was provided for smaller governments receiving funding from the Coronavirus State and Local Fiscal Recovery Funds (CSLFRF) program. For more details, search for "single audit relief provided to certain governments with Treasury COVID-19 funding April 2022 Journal of Accountancy" online.

## B. How a single audit differs from a financial statement audit

We mentioned earlier that a single audit refers to an audit of a nonfederal entity that includes **both** the entity's financial statements **and** federal awards. The following chart illustrates how a single audit differs from a financial statement audit performed under GAAS and the Yellow Book in condensed terms.

How a single audit differs from a financial statement audit in condensed terms			
Core responsibility:	Does the auditor have this responsibility in a GAAS audit?	Does the auditor have this responsibility in a Yellow Book audit?	Does the auditor have this responsibility in a single audit?
Providing an opinion on the financial statements	Yes	Yes	Yes
Reporting (but not opining) on internal control and compliance at the financial statement level	No	Yes	Yes
Providing an AU-C section 725 "in relation to" opinion on the schedule of expenditures of federal awards	No	No	Yes
Performing additional procedures and reporting (but not opining) on internal controls over compliance at the major program level	No	No	Yes
Providing an opinion on compliance for major programs	No	No	Yes

As one would presume based on the prior chart, the additional responsibilities that an auditor has in a single audit means that additional professional literature is required to be applied.

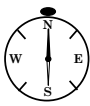
How a single audit differs from a financial statement audit in the professional literature applied			
Professional literature:	Pages of professional literature followed in a GAAS audit?	Pages of professional literature followed in a Yellow Book audit?	Pages of professional literature followed in a single audit?
AICPA AU-C sections (around <b>1,700</b> pages of guidance)	1,700	1,700	1,700
Yellow Book chapters applicable to a financial statement audit (around <b>130</b> pages of guidance)	0	130	130
Single Audit Act Amendments of 1996, Uniform Guidance for Federal Awards, and Compliance Supplement (around <b>1,670</b> pages of guidance)	0	0	1,670
<b>Total pages of professional literature applied</b>	<b>1,700</b>	<b>1,830</b>	<b>3,500</b>

## II. The importance of the SEFA and major programs



Before understanding and testing control and compliance in a single audit, it is essential that the auditor: [1] becomes comfortable with the auditee's schedule of expenditures of federal awards (SEFA); and [2] properly determines major programs.

### A. Becoming comfortable with the auditee's SEFA

Without question, the SEFA is the starting point which sets the direction for a single audit.

	<p style="text-align: center;"><b>The starting point and compass for a single audit</b></p> <p>The SEFA is the critical starting point and compass for the compliance portion of a single audit. The SEFA summarizes the auditee's federal award expenditures and thus provides a basis for planning and conducting the single audit. The compliance portion of a single audit is entirely dependent upon the accuracy of the <b>amounts</b> and <b>programs</b> reported on the SEFA. Besides the auditor's responsibility to issue an opinion on the SEFA, the auditor will use the <b>amounts</b> of expenditures reported on the SEFA to make key decisions regarding the major programs to be audited. The auditor will use the descriptions of the <b>programs</b> included on the SEFA to determine the applicable compliance requirements to test.</p>
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So, why is it so important to properly start the compliance portion of the single audit from the SEFA? Well, as illustrated in the below, if you do not start the audit at the right place you cannot finish the audit at the right place.

What could go wrong?	
	If the expenditures of federal awards are incorrect on the SEFA, major program determination will likely be wrong as the selection of major programs depends on both: (1) the total federal expenditures; and (2) the federal expenditures per program listed on the SEFA.
	If incorrect program numbers and program names are listed on the SEFA, the auditor may be identifying and testing the wrong compliance requirements as the Compliance Supplement's Part 2 - Matrix of Compliance Requirements feeds off of the program numbers listed on the SEFA.








#### 1. Exercise 1-1

Please answer the following question related to the SEFA.

<p style="text-align: center;"><b>I don't have time for this!</b></p> <p>In the current year, the finance director for City X is swamped with day to day activities. She complains that sometimes it takes her a while to put the SEFA together as she first has to analyze the general ledger and make sure that everything was recorded in the proper accounts and then ensure that all the proper amounts and information is included on the SEFA. She asks Auditor Z to analyze the general ledger and prepare the SEFA for her. <b>Are there any issues with this request?</b></p>
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## 2. How the auditee prepares the SEFA

The auditee prepares the SEFA following the detailed guidance provided in the Uniform Guidance for Federal Awards. For example, the Uniform Guidance for Federal Awards provides detailed requirements related to: (1) what should be reported on the SEFA; (2) when expenditures should be reported on the SEFA; (3) the valuation of noncash awards expended; (4) the format of the SEFA; and (5) disclosures that should accompany the SEFA. As we discussed earlier, the compliance portion of a single audit is entirely dependent upon the accuracy of the amounts and programs reported on the SEFA. Errors in the preparation of the SEFA can come back and haunt the audit.











Common SEFA errors that can come back to haunt the audit include...	
	SEFAs not clearly providing the total federal awards expended for each individual federal program;
	SEFAs not being accompanied by any notes (e.g., no description of the significant accounting policies used in preparing the SEFA);
	SEFAs not containing the required information related to the federal agency and pass-through entities, including program numbers or other identifying numbers;
	Programs that are part of a cluster not being shown as such on the SEFA;
	Improper treatment of loan and loan guarantee programs;
	SEFAs containing incorrect program numbers; and
	Research and development programs not being identified as such on the SEFA.

## 3. How the auditor audits the SEFA

As we saw earlier, in a single audit, the auditor provides an AU-C section 725 “in relation to” opinion on the SEFA. We also saw that the auditor will use the amounts and descriptions reported on the SEFA to make key decisions regarding the major programs to be audited and the proper compliance requirements to test. So, just as a builder of a grand building pays special attention to the laying of the cornerstone, the auditor of a single audit pays special attention to the SEFA. Put more bluntly, it is one area of auditing where over-auditing might not be a bad thing.

While this course is not designed to discuss auditing of the SEFA in detail, the following chart discusses some of the more essential aspects of auditing the SEFA.

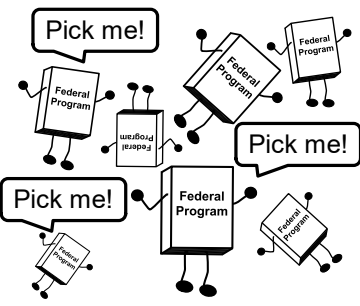


Some of the more essential aspects of auditing the SEFA include...	
	Obtaining an understanding of internal control over the preparation of the SEFA. This would include: (1) the controls over completeness and accuracy; and (2) the controls that ensure program numbers are correct.
	Testing whether the SEFA is complete through various procedures. For example: (1) comparing and reconciling the SEFA directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves; (2) comparing the current SEFA to the prior year SEFA; and (3) observing consistency with other information obtained during the audit.
	Testing the accuracy of the program numbers and names of awarding agencies by comparing them to various sources and other documents. For example: (1) the Compliance Supplement; (2) sam.gov; and (3) the underlying grant records.
	Determining whether the SEFA properly includes direct and indirect costs, and excludes cost sharing or matching amounts.
	Determining whether the SEFA properly measures certain specific items, such as loans and loan guarantees, endowment funds, and noncash assistance.
	Determining whether the form and content of the SEFA complies with the Uniform Guidance for Federal Awards.
	Determining whether the SEFA properly identifies federal awards from pass-through entities.
	Determining whether the notes to the SEFA are adequate.
	Ensuring that clusters of programs are properly reported in the SEFA by reviewing Part 5 – Clusters of Programs of the annual Compliance Supplement.
	Ensuring that adequate management representations regarding the SEFA are obtained.


In the second box above we discuss the importance of comparing and reconciling the SEFA directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves. Related to this, we should note that both the Council of Inspectors General on Integrity & Efficiency checklist for quality control reviews of single audits and the AICPA peer review checklist ask the reviewer to check whether the audit documentation contains evidence that the auditor determined whether the auditee was able to reconcile amounts presented on the SEFA to amounts in the financial statements.

## B. Properly determining major programs

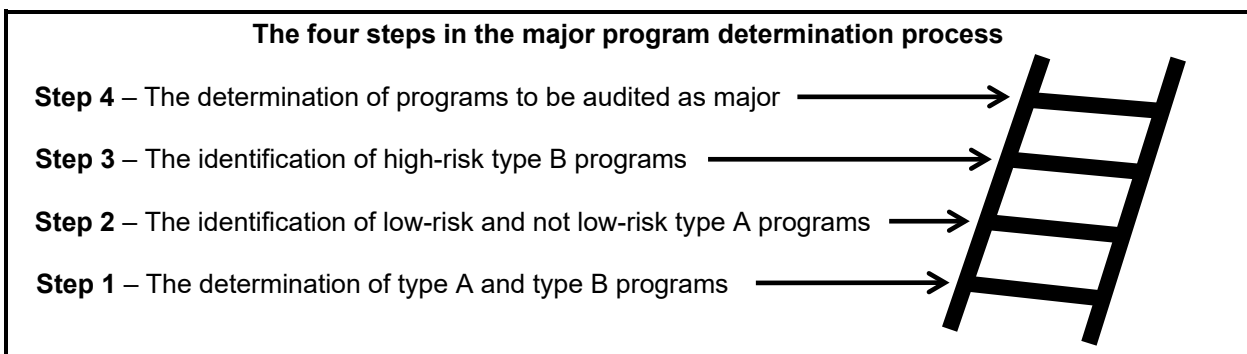
As we saw earlier, in a single audit the auditor will be: (1) performing additional procedures and reporting (but not opining) on internal controls over compliance at the **major program** level; and (2) providing an opinion on compliance for **major programs**. Fortunately, when the Single Audit Act Amendments of 1996 were written (i.e., the law underpinning the single audit process), the United States Congress recognized that requiring auditors to opine on an auditee's compliance for all federal expenditures would be overly time consuming and inefficient. Therefore, the compliance portion of a single audit focuses on the **major programs** of the auditee.

	<p><b>This is why major programs are a big deal</b></p> <p>Major programs are critical to the single audit process as they are the programs for which the auditor will be performing additional internal control work on and ultimately issuing a compliance opinion on as part of the single audit. The term <b>major program</b> refers to a program determined to be major by the auditor by following the four-step major program determination process described in the Uniform Guidance for Federal Awards.</p>
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As discussed in the above, major program determination is an auditor responsibility and not an auditee responsibility. Auditors determine major programs through a four-step process.


	<p><b>What is the four-step major program determination process?</b></p> <p>When performing a single audit, in selecting programs to audit, auditors utilize a complicated four-step major program determination process. The four-step major program determination process is a risk-based approach designed to focus the single audit on higher dollar/higher-risk programs. This risk-based approach incorporates both the risk of the individual program and the risk of the auditee. Under the four-step major program determination process, the auditor: [1] calculates a threshold (based on the amount of federal awards expended) above which programs are designated as <b>type A programs</b> and below which they are designated as <b>type B programs</b>; and [2] follows a prescribed process to assess program risk to identify which programs will be audited as major programs. The requirements for the four-step major program determination process are found in the Uniform Guidance for Federal Awards.</p>
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The following chart provides a high level overview of the four-step major program determination process.




### III. Determining the applicable compliance requirements

Before the auditor can begin understanding and testing control and compliance for major programs, the auditor needs to determine the types of compliance requirements that need to be tested. The starting point for this determination is the annual Compliance Supplement.

	<p style="text-align: center;"><b>And so it begins...</b></p> <p>Once the auditor has become comfortable with the SEFA <b>and</b> has determined major programs, the table is set for the real work (i.e., the work related to understanding and testing control and compliance) in a single audit to begin. This real work will begin by the auditor reviewing the annual Compliance Supplement.</p>
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#### A. What is the Compliance Supplement?

The Office of Management and Budget (OMB) is responsible for coordinating and issuing the annual Compliance Supplement. In the compliance audit portion of a single audit, the applicable compliance requirements are those that may have a **direct and material effect on each major program**. Auditors utilize the Compliance Supplement as the primary tool in determining the compliance requirements that could have a direct and material effect on major programs. **Use of the Compliance Supplement is mandatory.**

	<p style="text-align: center;"><b>Why federal agencies and auditors love the Compliance Supplement</b></p> <p><b>Federal agencies</b> love the Compliance Supplement because: (1) it allows the federal government an opportunity to decree the compliance requirements that they expect to be considered in a single audit; and (2) it enhances consistency in the audits of federal programs. <b>Auditors</b> “love” the Compliance Supplement because: (1) it in large part sets the perimeter for the compliance requirements auditors are expected to test; and (2) it saves auditors time in deducing the compliance requirements to test.</p>
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The Compliance Supplement is issued annually by the OMB in the April to September timeframe at [www.whitehouse.gov/omb/management/office-federal-financial-management/](http://www.whitehouse.gov/omb/management/office-federal-financial-management/).

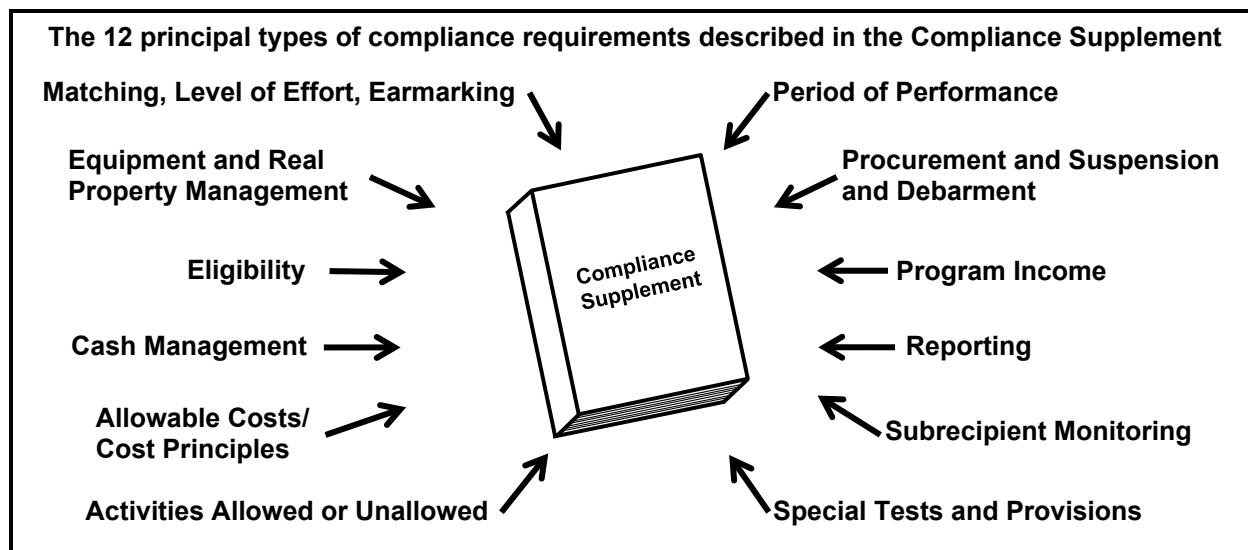
#### B. Exercise 1-2

Please answer the following question related to the Compliance Supplement.

<p style="text-align: center;"><b>How do they do that?</b></p> <p>We just discussed that federal agencies love the Compliance Supplement because it allows the federal government an opportunity to decree the compliance requirements that they expect to be considered in a single audit. <b>How do the federal agencies pick the types of compliance requirements that they expect to be tested?</b></p>
---

## C. The principal compliance requirements

The Compliance Supplement describes 12 principal types of compliance requirements.



Since each federal program operates differently and has different requirements, it can be difficult to get a handle on what each of the 12 types of compliance requirements relates to in a condensed manner. Fortunately, each year Part 3 (primarily), Part 4, and Part 5 of the Compliance Supplement provide detailed descriptions and guidance related to the 12 types of compliance requirements. However, for purposes of this course, the following table attempts to generalize what each of the 12 types of compliance requirements relates to in condensed terms.

Understanding the 12 types of compliance requirements	
<b>Compliance requirement category:</b>	<b>What the compliance requirement relates to in general terms:</b>
<i>Activities Allowed or Unallowed</i>	Did the auditee expend federal awards only on activities that are permitted under federal statutes, regulations, and the terms and conditions of the federal award?
<i>Allowable Costs/Cost Principles</i>	Did the auditee's direct and indirect costs comply with: (1) the specific requirements to be eligible for federal reimbursement; (2) the cost principles contained in Subpart E of the Uniform Guidance for Federal Awards; and (3) the requirements provided in the program legislation, federal awarding agency regulations, and the terms and conditions of the award?
<i>Cash Management</i>	For awards providing advance payments, did the auditee minimize the time between the receipt and use of federal funds? For awards providing funding on a reimbursement basis, were program costs paid for with the auditee's funds before the requested reimbursement?
<i>Eligibility</i>	Did the individuals, groups, or subrecipients to whom the auditee provided financial awards or services meet the required eligibility criteria?

Understanding the 12 types of compliance requirements	
<b>Compliance requirement category:</b>	<b>What the compliance requirement relates to in general terms:</b>
<i>Equipment and Real Property Management</i>	Did the auditee maintain a satisfactory equipment and property management system for its federal award programs and related activities?
<i>Matching, Level of Effort, Earmarking</i>	Did the auditee meet requirements to contribute its own resources to programs in some stated ratio to resources provided by the funding source?
<i>Period of Performance</i>	Did the auditee charge to the federal award only: (1) allowable costs incurred during the period of performance; or (2) costs incurred before the award was made that were authorized by the federal awarding agency or pass-through entity?
<i>Procurement and Suspension and Debarment</i>	Did the auditee: (1) establish and adhere to written procurement procedures that follow applicable federal statutes and the procurement requirements identified in the Uniform Guidance for Federal Awards; and (2) avoid contracts and subawards under covered transactions with parties that are suspended or debarred?
<i>Program Income</i>	Was program income earned during the period of performance recorded and used following the terms and conditions of the award or federal awarding agency regulations?
<i>Reporting</i>	Did the auditee file the required reports and also meet any further requirements that apply to those reports?
<i>Subrecipient Monitoring</i>	Did the pass-through auditee: (1) provide subrecipients with the proper award information and requirements; (2) evaluate each subrecipient's risk of noncompliance to determine the proper monitoring needed; (3) adequately monitor subrecipients; and (4) ensure the accountability of for-profit entities for the use of federal funds provided to them?
<i>Special Tests and Provisions</i>	Did the auditee comply with the specific requirements that are unique to each federal program found in the statutes, regulations, and the provisions of contract or grant agreements pertaining to the program?


## D. Exercise 1-3

Please answer the following question related to the 12 types of compliance requirements.

<p><b>Do some of the 12 types of compliance requirements apply more frequently than others?</b></p> <p>We just briefly reviewed the 12 types of compliance requirements. As federal programs work differently, not all of those compliance requirements apply to all programs. <b>Which of the 12 types of compliance requirements apply more frequently to programs than others?</b></p>
---

## E. Starting with the Supplement's Part 2 – Matrix of Compliance Requirements

Having established that the annual Compliance Supplement describes 12 types of compliance requirements, it is now time for us to look at how the auditor uses the Supplement to determine the types of compliance requirements that need to be tested.




**There are two possible paths for how we will use the Supplement to determine the compliance requirements that need to be tested...**

To determine the direct and material compliance requirements that need to be tested for each major program, the auditor will use the Compliance Supplement. Each year **included in the Supplement** is detailed guidance for determining compliance requirements to be tested for approximately 230 of the largest and/or riskiest federal programs. However, there are more than 1,000 active assistance programs funded by the federal government. So, there are many programs for which detailed guidance is **not included in the Supplement**. For these smaller programs, more generic guidance is provided in the Supplement. The auditor will determine the appropriate path for each major program by looking at the Compliance Supplement's Part 2 – Matrix of Compliance Requirements.

As illustrated in the following chart, the Compliance Supplement's Part 2 – Matrix of Compliance Requirements identifies the approximately 230 federal programs addressed in the Supplement.

**Using the Part 2 – Matrix of Compliance Requirements to determine the right path**


Requirement	A	B	C	E	F	G	H	I	J	L	M	N
	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
Program Number												
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



To determine whether detailed guidance for determining the direct and material compliance requirements to be tested is included in the Compliance Supplement, the auditor will look at the federal program number listed on the SEFA for each major program and then look at the Part 2 – Matrix of Compliance Requirements (see above example from a recent Supplement). If the major program's federal program number **is listed**, the auditor will find detailed guidance for that program **included in the Supplement**. If the major program's federal program number **is not listed**, detailed guidance is **not included in the Supplement** and the auditor will follow the more generic guidance in the Supplement's Part 7 - Guidance For Auditing Programs Not Included In This Compliance Supplement.

## F. Using the Compliance Supplement – Programs included in the Supplement

As discussed in the following, once we have determined that a major program's federal program number is included in the Compliance Supplement, the path to determining the compliance requirements to test becomes clear relatively quickly.



**A relatively quick path to determining the compliance requirements to test**








Once the auditor has determined that a major program is **included in the Supplement**, the path to determining the direct and material compliance requirements to test becomes clear relatively quickly. The auditor will determine the compliance requirements to test for each major program by reviewing the Compliance Supplement's Part 2 – Matrix of Compliance Requirements **and** exercising professional judgment.

### 1. Reviewing the Compliance Supplement's Part 2 – Matrix of Compliance Requirements

The following is an excerpt from a recent Compliance Supplement's Part 2 – Matrix of Compliance Requirements for program number 10.000. The auditor uses this part of the Supplement to identify the types of compliance requirements that the federal agencies typically expect to be tested in a single audit.

**Reviewing the Compliance Supplement's Part 2 – Matrix of Compliance Requirements**







Requirement	A	B	C	E	F	G	H	I	J	L	M	N
	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
Program Number 10.000	Y	Y	Y	N	Y	N	N	N	Y	Y	N	Y



In reviewing the Compliance Supplement's Part 2 – Matrix of Compliance Requirements, the auditor finds the major program's federal program number and examines the corresponding row across the compliance requirements columns. **If the box for a type of compliance requirement contains a "Y"** (see arrows above) it essentially means "Yes" the federal government typically expects that type of compliance requirement to be tested in a single audit of that program. **If the box for type of compliance requirement contains an "N"** it essentially means "No" the federal government typically does not expect that type of compliance requirement to be tested in a single audit of that program.

## 2. Exercising professional judgment

The auditor will determine the compliance requirements to test for each major program by reviewing the Compliance Supplement's Part 2 – Matrix of Compliance Requirements **and** exercising professional judgment. The following chart discusses keys to the auditor's exercising of professional judgment in determining the compliance requirements to test.

Keys to the auditor's exercising of professional judgment in determining the compliance requirements to test include...	
	Even though a "Y" in the Part 2 – Matrix of Compliance Requirements indicates that a compliance requirement is subject to audit, it may not apply to a particular auditee, 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. Auditors will exercise professional judgment (e.g., their understanding of how the program operates at the auditee) in determining which compliance requirements marked "Y" need to be tested at a particular auditee.
	When an "N" appears in the Part 2 - Matrix of Compliance Requirements for a type of compliance requirement, it has been identified by the federal government as not being subject to audit. <b>Auditors are not expected to test requirements that have been noted with an "N."</b> However, the auditor is not prohibited from expanding audit procedures if the terms of a grant award document specify that the additional compliance requirements are material to the administration of the program or if the auditor is aware of additional information that would lead the auditor to believe there are increased risks of fraud, waste, or abuse of federal program funds.
	While the Part 2 – Matrix of Compliance Requirements is the primary guidance for the programs included therein, auditors are required to consider the Supplement <b>and</b> the referenced laws, regulations, and OMB Circulars/Uniform Guidance in determining the compliance requirements subject to the audit that could have both a direct and material effect on the programs.
	The auditor will perform reasonable procedures to ensure that compliance requirements identified as subject to the audit are current and to also determine whether there are any additional provisions of federal awards relevant to the compliance requirements subject to the audit that should be covered by a single audit. Reasonable procedures would be an inquiry of auditee management and a review of the federal awards for the major programs.
	If the Part 2 matrix indicates a "Y" for a particular compliance requirement and the auditor does not test that requirement, the auditor will need to be careful to <b>document</b> why the particular requirement did not have a direct and material effect on the major program being audited (i.e., <b>either</b> the requirement does not apply to the particular auditee <b>or</b> that noncompliance with the requirement could not have a direct and material effect on the program). For peer and quality control review purposes, this documentation needs to be more than just "Not Applicable" or "Immaterial."
	When in doubt regarding the mechanics of a particular compliance requirement and whether it should be tested, Appendix III of the Compliance Supplement provides a listing of federal agency single audit contacts, key management liaisons, and program contacts for each program/cluster included in the Supplement.




### 3. Exercise 1-4

We have been discussing how, for programs included in the Supplement, the auditor will determine the compliance requirements to test for each major program by reviewing the Compliance Supplement's Part 2 – Matrix of Compliance Requirements **and** exercising professional judgment. Please review the following scenarios and indicate whether you believe the auditor should test the compliance requirement.


Should the auditor test the compliance requirement?
<p style="text-align: center;"><b>Scenario 1</b></p> <p>Major Program X had \$800,000 in federal expenditures during the year. The federal expenditures included \$120,000 which was passed-through to subrecipients. The Compliance Supplement's Part 2 matrix row for the program indicates "Y" in the Subrecipient Monitoring column.</p>
<p style="text-align: center;"><b>Scenario 2</b></p> <p>Major Program Y had \$900,000 in federal expenditures during the year. The Compliance Supplement's Part 2 matrix row for the program indicates "Y" in the Procurement and Suspension and Debarment column. Major Program Y made only one small purchase during the year related to that compliance requirement.</p>
<p style="text-align: center;"><b>Scenario 3</b></p> <p>Major Program W had \$1,000,000 in federal expenditures during the year. The award document for Major Program W contained a provision which required Auditee V to provide non-federal contributions toward the program of \$500,000 during the year. The document stated that if Auditee V did not meet the matching provision, Auditee V would be required to return the amount awarded. The Compliance Supplement's Part 2 matrix row for the program indicates "N" in the Matching, Level of Effort, Earmarking column. Major Program W is material to Auditee V's financial statements.</p>

### G. Using the Compliance Supplement – Programs excluded from the Supplement

Each year, there are well over 700 assistance programs currently funded by the federal government for which detailed guidance for determining compliance requirements to be tested is not included in the Compliance Supplement.

	<p style="text-align: center;"><b>A slower path to determining the compliance requirements to test</b></p> <p>To determine the direct and material compliance requirements that need to be tested for programs <b>not included in the Supplement</b>, a little more thought will need to be put into the process. For these smaller programs, the auditor will follow the more generic guidance found in the Supplement's Part 7 - Guidance For Auditing Programs Not Included In This Compliance Supplement.</p>
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While a federal program may have many compliance requirements, normally there are only a few key compliance requirements that could have a direct and material effect on the program. Since the single audit process is not intended to cover every compliance requirement, the auditor's focus must be on the 12 types of compliance requirements contained in the Compliance Supplement.

	<p style="text-align: center;"><b>Following the guidance in Part 7 of the Compliance Supplement</b></p> <p>For federal programs <b>not included in the Supplement</b>, the auditor will use the types of compliance requirements contained in the Compliance Supplement (i.e., the 12 types of compliance requirements discussed earlier) as guidance for identifying the types of compliance requirements to test, and determine the requirements governing the federal program by reviewing the provisions of the federal award, and the laws and regulations referred to in such awards. The Supplement's Part 7 guides auditors through this process.</p>
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Part 7 of the Compliance Supplement provides detailed guidance on the steps to perform to identify the direct and material compliance requirements for a program. The following table summarizes key aspects of that guidance.

In applying Part 7 to determine the compliance requirements to test the auditor should...	
1	<p><b>Identify the program objectives, program procedures, and compliance requirements that are applicable to the federal program.</b> The auditor needs to take time to gain an understanding of how the program works and the types of compliance requirements that apply to it (e.g., by reviewing applicable regulations, reading award documents, and inquiry).</p>
2	<p><b>Determine which of the compliance requirements identified in Step 1 could have a direct and material effect on the major program.</b> Here the auditor could ask questions like: (1) could noncompliance with the requirement result in questioned costs; (2) does the requirement affect a large part of the program; and (3) how concerned would the awarding agency be about noncompliance with the requirement.</p>
3	<p><b>Determine which of the compliance requirements identified in Step 2 are susceptible to testing by the auditor</b> (i.e., the requirements can be evaluated against objective criteria, and the auditor can reasonably be expected to have sufficient basis for recognizing noncompliance).</p>
4	<p><b>Determine which of the 12 types of compliance requirements the compliance requirements identified in Step 3 fall into.</b> For this step, Part 7 suggests preparing a matrix similar to the Part 2 matrix. This creates a connection <b>between</b> the identified compliance requirements of the program <b>to</b> the compliance requirements and related audit objectives in the Supplement's Part 3 - Compliance Requirements.</p>
5	<p><b>For Special Tests and Provisions, determine the applicable audit objectives and audit procedures.</b> Here the auditor will develop audit objectives and audit procedures for each identified Special Test and Provision generally using the guidance contained in the Supplement's Part 3 under Special Tests and Provisions.</p>

## IV. Suggested solutions to exercises

This section contains the suggested solutions to the exercises presented in the chapter.

### A. Suggested solution to Exercise 1-1

#### **I don't have time for this!**

In the current year, the finance director for City X is swamped with day to day activities. She complains that sometimes it takes her a while to put the SEFA together as she first has to analyze the general ledger and make sure that everything was recorded in the proper accounts and then ensure that all the proper amounts and information is included on the SEFA. She asks Auditor Z to analyze the general ledger and prepare the SEFA for her. **Are there any issues with this request?**

Yes. The Uniform Guidance for Federal Awards states that the **auditee** must prepare a SEFA for the period covered by the auditee's financial statements. An auditee unable to prepare the SEFA would serve as a major red flag to the auditor. For example, if the auditee cannot readily determine what the total federal expenditures were during the year and the programs that they related to, how could they possibly determine that they followed the applicable compliance requirements? Also, since the SEFA really sets the perimeter for the audit, as it is where the auditee in essence states "here are all of our federal expenditures for the year that should be included in the single audit," it would be wrong for the auditor to take on this type of auditee responsibility. While the auditor may be needed to provide technical guidance on the nuances of how the SEFA is prepared, the SEFA really needs to be an auditee prepared document.

### B. Suggested solution to Exercise 1-2

#### **How do they do that?**

We just discussed that federal agencies love the Compliance Supplement because it allows the federal government an opportunity to decree the compliance requirements that they expect to be considered in a single audit. **How do the federal agencies pick the types of compliance requirements that they expect to be tested?**

The Uniform Guidance for Federal Awards provides that federal agencies are responsible for annually informing the OMB of any updates needed to the Compliance Supplement and working with the OMB to ensure that the Compliance Supplement focuses the auditor to test the compliance requirements **most likely to cause improper payments, fraud, waste, abuse, or generate audit findings for which the federal awarding agency will take sanctions.**

### C. Suggested solution to Exercise 1-3

**Do some of the 12 types of compliance requirements apply more frequently than others?**

We just briefly reviewed the 12 types of compliance requirements. As federal programs work differently, not all of those compliance requirements apply to all programs. **Which of the 12 types of compliance requirements apply more frequently to programs than others?**

The types of compliance requirements that almost always apply to federal programs include: **activities allowed or unallowed, allowable costs/cost principles, cash management, period of performance, and reporting**. However, it is difficult to generalize as for example, **eligibility** applies to most federal programs which provide benefits, **subrecipient monitoring** applies when federal awards are passed-through, and many programs have **special tests and provisions**. It is important to note that we will soon see that just because a type of compliance requirement applies to a federal program, it does not necessarily mean the auditor will be testing that type of compliance requirement.

## D. Suggested solution to Exercise 1-4

Should the auditor test the compliance requirement?
<p style="text-align: center;"><b>Scenario 1</b></p> <p><b>Major Program X had \$800,000 in federal expenditures during the year. The federal expenditures included \$120,000 which was passed-through to subrecipients. The Compliance Supplement's Part 2 matrix row for the program indicates "Y" in the Subrecipient Monitoring column.</b></p> <p><b>Yes.</b> The auditee has activity related to a compliance requirement and the federal agency has indicated that the requirement is subject to audit for the program. <b>[Note.</b> If only an immaterial amount had been passed-through, the auditor might determine <b>and document</b> that noncompliance with the requirement could not have a direct or material effect on the program and not test the requirement (even though it was identified as subject to audit in the Part 2 matrix).]</p>
<p style="text-align: center;"><b>Scenario 2</b></p> <p><b>Major Program Y had \$900,000 in federal expenditures during the year. The Compliance Supplement's Part 2 matrix row for the program indicates "Y" in the Procurement and Suspension and Debarment column. Major Program Y made only one small purchase during the year related to that compliance requirement.</b></p> <p><b>No.</b> If noncompliance with the requirement could not have a direct and material effect on the program the auditor would not be expected to test the requirement. The auditor would need to document something like "While the Part 2 matrix in the Compliance Supplement identifies Procurement and Suspension and Debarment as being subject to audit for Major Program Y, Auditee Z made only one small purchase during the year that is immaterial overall to the program expenditures. Thus, the Procurement and Suspension and Debarment type of compliance requirement for Major Program Y is not direct and material to Auditee Z."</p>
<p style="text-align: center;"><b>Scenario 3</b></p> <p><b>Major Program W had \$1,000,000 in federal expenditures during the year. The award document for Major Program W contained a provision which required Auditee V to provide non-federal contributions toward the program of \$500,000 during the year. The document stated that if Auditee V did not meet the matching provision, Auditee V would be required to return the amount awarded. The Compliance Supplement's Part 2 matrix row for the program indicates "N" in the Matching, Level of Effort, Earmarking column. Major Program W is material to Auditee V's financial statements.</b></p> <p><b>In the author's opinion, yes.</b> If a program entry in the Part 2 matrix indicates that the Matching, Level of Effort, Earmarking compliance requirement is not subject to the audit and that the grant agreement for that program specifies a certain matching percentage requirement for the same program, then the auditor is typically not expected to consider the grant agreement provisions related to matching in the audit. <b>However,</b> while a requirement may not be subject to the audit for compliance audit purposes, auditors have a responsibility under GAAS and the Yellow Book related to noncompliance with provisions of laws, regulations, contracts, and grant agreements that may have a direct and material effect on the financial statements. In the author's mind, this type of grant award document requirement rises to the level of needing to expand audit procedures to include matching as the terms of the award document specify an additional compliance requirement that is material to the administration of the program.</p>



# Understanding and Testing Controls in a Single Audit


<b>Learning objectives</b>	<b>1</b>
<b>I. Key internal control concepts applied in a single audit</b>	<b>1</b>
<b>A. The Compliance Supplement's Part 6 – Internal Control</b>	<b>2</b>
1. Internal controls over federal awards through the COSO and GAO Green Book lens	2
2. Examples of controls related to the control environment component	3
3. Examples of controls related to the risk assessment component	4
4. Examples of controls related to the control activities component	4
5. Examples of controls related to the information and communication systems component	5
6. Examples of controls related to the monitoring component	5
<b>B. Suggestions for establishing and maintaining controls over federal awards</b>	<b>6</b>
1. Exercise 2-1	7
<b>II. Understanding and testing controls in a single audit</b>	<b>7</b>
<b>A. The auditor's key responsibilities related to internal control</b>	<b>7</b>
1. Exercise 2-2	8
<b>B. Obtaining an understanding of internal control over federal programs</b>	<b>8</b>
1. Exercise 2-3	9
2. Exercise 2-4	10
<b>C. Testing the effectiveness of internal control over federal programs</b>	<b>10</b>
1. Exercise 2-5	12
<b>III. Considering deficiencies in control over compliance</b>	<b>12</b>
<b>A. Applying professional judgment</b>	<b>14</b>
<b>B. Exercise 2-6</b>	<b>14</b>
<b>C. Exercise 2-7</b>	<b>15</b>
<b>IV. Reporting deficiencies in control over compliance</b>	<b>15</b>
<b>V. Tips for staying in good graces with your peer reviewer</b>	<b>16</b>
<b>VI. Suggested solutions to exercises</b>	<b>17</b>
<b>A. Suggested solution to Exercise 2-1</b>	<b>17</b>
<b>B. Suggested solution to Exercise 2-2</b>	<b>18</b>
<b>C. Suggested solution to Exercise 2-3</b>	<b>18</b>
<b>D. Suggested solution to Exercise 2-4</b>	<b>19</b>
<b>E. Suggested solution to Exercise 2-5</b>	<b>19</b>
<b>F. Suggested solution to Exercise 2-6</b>	<b>20</b>
<b>G. Suggested solution to Exercise 2-7</b>	<b>21</b>






# Understanding and Testing Controls in a Single Audit

## Learning objectives

	<p>Upon completing this chapter, you will be able to:</p> <ul style="list-style-type: none"><li>• Understand the key internal control concepts applied in a single audit;</li><li>• Perceive how the auditor obtains an understanding of controls over compliance and then tests the effectiveness of those controls in a single audit; and</li><li>• Explain the identification and reporting of control findings in a single audit.</li></ul>
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### ***1. Key internal control concepts applied in a single audit***

Occasionally, clients forget some of the things that they signed up for when they received federal awards. One of the things that they signed up for was the responsibility to establish and maintain effective internal control over the federal awards they received.


	<p><b>A requirement to establish and maintain effective internal control over federal awards</b></p> <p>The Uniform Guidance for Federal Awards requires an auditee to <b>establish and maintain effective internal control</b> over its federal awards that provides reasonable assurance that the auditee is managing its federal awards in compliance with federal statutes, regulations, and the terms and conditions of the federal awards.</p>
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Auditee management exercises judgment in balancing the cost and benefit of designing, implementing, and operating internal controls. In applying that judgment, management considers both qualitative and quantitative factors, as well as the specific risks of their federal awards and operations (e.g., the risks related to a school breakfast program will be different from the risks related to a transportation infrastructure program). Sometimes auditees struggle in thinking about how internal control over federal awards differs from internal control over the financial statements. The following describes internal control over compliance requirements for federal awards in the single audit environment.

<b>Internal control over compliance requirements for federal awards is a process designed and implemented by the auditee to provide reasonable assurance of the following for federal awards:</b>		
<b>1</b>	<b>2</b>	<b>3</b>
Transactions are properly recorded and accounted for to: (1) permit the preparation of reliable financial statements and federal reports; (2) maintain accountability over assets; and (3) demonstrate compliance with federal statutes, regulations, and the terms and conditions of the federal award.	Transactions are executed in compliance with: (1) federal statutes, regulations, and the terms and conditions of the federal award that could have a direct and material effect on a federal program; and (2) any other federal statutes and regulations identified in the Compliance Supplement.	Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

## A. The Compliance Supplement's Part 6 – Internal Control

Each year, the Compliance Supplement's Part 6 (Internal Control) provides vital guidance related to internal control over compliance requirements for federal awards. This guidance is provided not only for auditors, but it is also provided for auditees. The Compliance Supplement's Part 6 discusses that internal control is not one event or circumstance, but rather a process.

	<p style="text-align: center;"><b>Controls are not a one-off but rather a process</b></p> <p>The Compliance Supplement's Part 6 discusses that internal control is not one event or circumstance, but a dynamic and iterative process – actions that permeate an entity's activities and that are an integral part of the way auditee management runs the entity. Embedded within this process are controls consisting of <b>policies</b> and <b>procedures</b>. <b>Policies</b> reflect auditee management or oversight body statements of what should be done to effect internal control. <b>Procedures</b> consist of actions that implement a policy.</p>
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In discussing internal controls over federal awards, the Compliance Supplement's Part 6 relies heavily on the Committee of Sponsoring Organizations of the Treadway Commission (COSO) integrated framework and the Standards for Internal Control in the Federal Government (GAO Green Book). The Uniform Guidance for Federal Awards also refers to the COSO integrated framework and the GAO Green Book as being best practices related to internal control. **[Important Note.** Shortly after the Uniform Guidance for Federal Awards was issued, the federal agencies put out a document entitled *Uniform Guidance Frequently Asked Questions*. Question 200.303-3 clarified that while auditees must have effective internal control, there is no expectation or requirement that the auditee document or evaluate internal controls prescriptively in accordance with the COSO integrated framework or the GAO Green Book. It also discussed that auditees and their auditors will need to exercise judgment in determining the most appropriate and cost effective internal control in a given environment or circumstance to provide reasonable assurance for compliance with federal program requirements.]

### 1. Internal controls over federal awards through the COSO and GAO Green Book lens

Since the Uniform Guidance for Federal Awards refers to COSO and the GAO Green Book as being best practices related to internal control (i.e., use of these specific frameworks is recommended but not required) we will also look at internal controls through that lens. Both COSO and the GAO Green Book are organized by five components of internal control. COSO identifies 17 principles related to the five components of internal control, each of which has important attributes which explain the principles in greater detail. The GAO Green Book adapts these principles for a government environment. The following table represents a condensed view of the COSO and GAO Green Book components and principles of internal control refined to the single audit environment.




The COSO and GAO Green Book components and principles summarized to the single audit	
Internal control component:	The related 17 principles:
The <b>control environment</b> sets the attitude of the entity, influencing the control mindfulness of its people. It is the foundation for all other components of internal control over compliance, providing discipline and structure.	<ol style="list-style-type: none"><li>1. Demonstrate commitment to integrity and ethical values</li><li>2. Exercise oversight responsibility</li><li>3. Establish structure, responsibility, and authority</li><li>4. Demonstrate commitment to competence</li><li>5. Enforce accountability</li></ol>



The COSO and GAO Green Book components and principles summarized to the single audit	
Internal control component:	The related 17 principles:
<b>Risk assessment</b> is the entity's identification, analysis, and management of risks relevant to the objectives of compliance.	6. Define objectives and risk tolerances 7. Identify, analyze, and respond to risks 8. Assess fraud risk 9. Identify, analyze, and respond to change
<b>Control activities</b> are the policies and procedures that help ensure that management directives are carried out.	10. Design control activities 11. Design activities for the information system 12. Implement control activities
<b>Information and communication systems</b> includes the business processes relevant to compliance. 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 allow personnel to carry out their responsibilities.	13. Use quality information 14. Communicate internally 15. Communicate externally
<b>Monitoring</b> is a process to evaluate the effectiveness of internal control over compliance performance over time.	16. Perform monitoring activities 17. Evaluate issues and remediate deficiencies

To determine if an internal control system is effective, auditee management assesses the design, implementation, and operating effectiveness of the five components and 17 principles. If a principle or component is not effective, or the components are not operating together in an integrated manner, then an internal control system cannot be effective and an adjustment is needed.

## 2. Examples of controls related to the control environment component





The **control environment** sets the attitude of the entity, influencing the control mindfulness of its people. It is the foundation for all other components of internal control over compliance, providing discipline and structure. Internal controls related to the control environment component of the COSO and GAO Green Book frameworks are typically established at the entity-wide level versus at the federal program or type of compliance requirement level. The Compliance Supplement's Part 6 - Internal Control provides approximately 20 illustrative controls related to the control environment component. The following table includes a few of those illustrative controls.

Examples of illustrative controls related to the control environment component from the Compliance Supplement's Part 6	
	Conflict of interest statements are obtained periodically from those charged with governance and key management
	A whistle blower submission process exists to receive and evaluate concerns by employees regarding questionable practices inclusive of issues impacting federal award compliance/noncompliance
	Policies and procedures are in place to ensure that compliance responsibilities are assigned to particular positions

Examples of illustrative controls related to the control environment component from the Compliance Supplement's Part 6	
	Personnel with federal award compliance responsibilities are properly trained on their responsibilities
	Appropriate performance evaluations are provided that establish goals, accountability, and feedback




### 3. Examples of controls related to the risk assessment component

**Risk assessment** is the entity's identification, analysis, and management of risks relevant to the objectives of compliance. Internal controls related to the risk assessment component of the COSO and GAO Green Book frameworks are typically established at the entity-wide level versus at the federal program or type of compliance requirement level. The Compliance Supplement's Part 6 - Internal Control provides approximately 15 illustrative controls related to the risk assessment component. The following table includes a few of those illustrative controls.

Examples of illustrative controls related to the risk assessment component from the Compliance Supplement's Part 6	
	Management identifies key compliance objectives for types of compliance requirements
	Management analyzes and identifies compliance risks
	Management reviews the internal control structure for potential fraud risks
	Management analyzes compliance requirement modifications to properly adjust risk




### 4. Examples of controls related to the control activities component

**Control activities** are the policies and procedures that help ensure that management directives are carried out. Internal controls related to the control activities component of the COSO and GAO Green Book frameworks are typically established at the federal program or type of compliance requirement level. The Compliance Supplement's Part 6 - Internal Control provides approximately **175** illustrative controls related to the control activities component sorted by the type of compliance requirement (e.g., cash management, eligibility, program income). The following table includes a few of those illustrative controls.

Examples of illustrative controls related to the control activities component from the Compliance Supplement's Part 6	
	Related to the <b>eligibility</b> type compliance requirement - Accuracy and completeness of data used to determine eligibility requirements are reviewed and agreed to support as necessary by staff and reviewed by knowledgeable supervisor
	Related to the <b>subrecipient monitoring</b> type compliance requirement - Knowledgeable supervisor reviews subrecipient risk assessments to ensure they address compliance risks and Uniform Guidance requirements and approves individual subrecipient monitoring plans
	Related to the <b>reporting</b> type compliance requirement - Segregation of duties exists between those preparing and those reviewing and filing required reports




## 5. Examples of controls related to the information and communication systems component

**Information and communication systems** includes the business processes relevant to compliance. 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 allow personnel to carry out their responsibilities. Internal controls related to the information and communication systems component of the COSO and GAO Green Book frameworks are typically established at the entity-wide level versus at the federal program or type of compliance requirement level. The Compliance Supplement's Part 6 - Internal Control provides approximately 10 illustrative controls related to the information and communication systems component. The following table includes a few of those illustrative controls.

Examples of illustrative controls related to the information and communication systems component from the Compliance Supplement's Part 6	
	The accounting system provides for separate identification of federal and non-federal transactions
	Relevant internal and external information is communicated and delivered to employees responsible for federal award compliance on a timely basis
	Relevant information is communicated to external parties including subrecipients, vendors, federal granting agencies, and third-party processors on a timely basis


## 6. Examples of controls related to the monitoring component

**Monitoring** is a process to evaluate the effectiveness of internal control over compliance performance over time. Internal controls related to the monitoring component of the COSO and GAO Green Book frameworks are typically established at the entity-wide level versus at the federal program or type of compliance requirement level. The Compliance Supplement's Part 6 - Internal Control provides approximately 10 illustrative controls related to the monitoring component. The following table includes a few of those illustrative controls.




Examples of illustrative controls related to the monitoring component from the Compliance Supplement's Part 6	
	Management monitors the use of effective self-review procedures in critical compliance areas
	Findings, recommendations and other observations by independent auditors, internal auditors, and federal auditors are distributed and reviewed by those individuals responsible for compliance with federal requirements
	Management periodically monitors the corrective action plans related to known noncompliance and control deficiencies and the organization's progress to remediating the findings

## B. Suggestions for establishing and maintaining controls over federal awards

As we have seen, the Uniform Guidance for Federal Awards requires an auditee to establish and maintain effective internal control over its federal awards that provides reasonable assurance that the auditee is managing its federal awards in compliance with federal statutes, regulations, and the terms and conditions of the federal awards. We also discussed that auditee management exercises judgment in balancing the cost and benefit of designing, implementing, and operating internal controls. In applying that judgment, management considers both qualitative and quantitative factors, as well as the specific risks of their federal awards and operations. Sometimes auditees (and auditors) blur the line between a process and a control.

	<p style="text-align: center;"><b>Drawing the line between a process and a control</b></p> <p>Sometimes, the line between <b>how a certain activity is processed</b> and <b>the controls over that process</b> can be blurry and auditees may need help in understanding this distinction. For example, a <b>process</b> could be the steps followed by an individual to determine that an applicant meets the eligibility criteria to receive benefits. However, <b>the controls over that process</b> would be the activities performed to prevent or detect and correct errors in how eligibility determinations are being made (i.e., the review or verification in place to ensure that errors are not occurring in the initial eligibility determinations).</p>
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The Compliance Supplement's Part 6 discusses that controls may be viewed as part of a process and the flow of transactions, but controls need to be separately identified. **When it is difficult to identify the difference between the process and controls, there is often a missing control.** The following chart contains suggestions for how an auditee should establish and maintain internal control over federal awards.

Suggestions for how an auditee should establish and maintain internal control over federal awards	
	<p><b>Consider the process involved and the compliance requirements to which it is subjected.</b> As an example, if the process is charging costs to a federal award, one of the compliance requirements would be that only allowable costs are being charged and cost principles are being followed.</p>
	<p><b>Consider what could go wrong with a process that could cause noncompliance.</b> For example, what could go wrong in the process of charging costs to a federal award that could lead to unallowable costs being charged to the award?</p>
	<p><b>Design, implement, and maintain controls that are responsive to the risk of noncompliance present in the process and what could go wrong.</b> For instance, with regard to the risk of unallowable costs being charged to a federal award, one example control could be having a chart of accounts which segregates unallowable costs/activities into discrete accounts to help ensure they are not coded to federal awards; directly or indirectly.</p>

## 1. Exercise 2-1

Please answer the following questions.

Auditee Z is reviewing the Compliance Supplement's Part 6 and sees discussions that controls are designed to **prevent** or timely **detect** noncompliance. Auditee Z wonders if it would be better for an entity to focus only on **preventive controls** as **detective controls** are allowing noncompliance to occur and catch it afterwards. **How would you answer Auditee Z?**

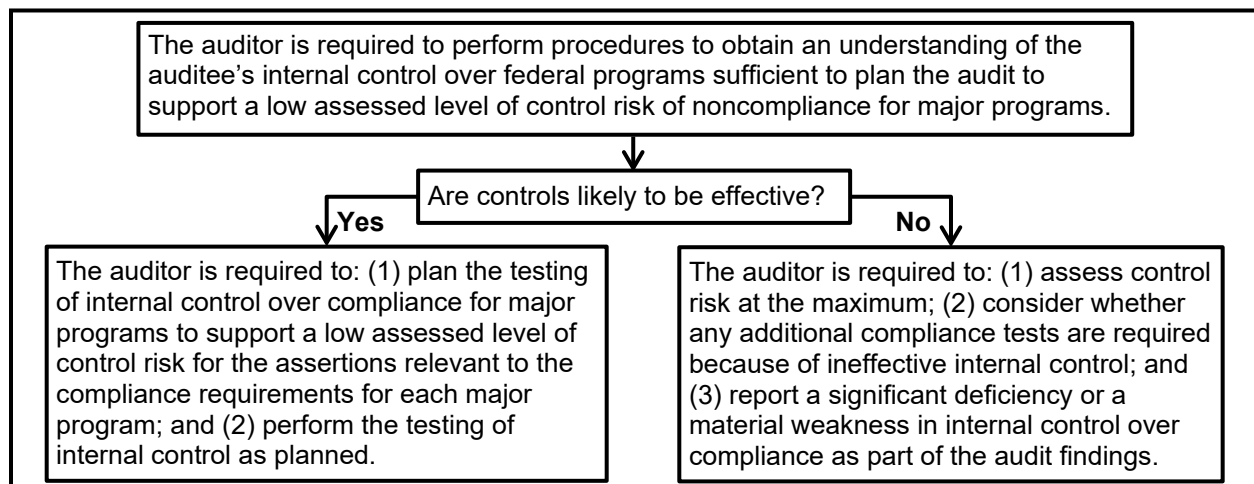
Auditee X believes that taking the time to design and implement controls related to compliance may be time consuming. Auditee X understands that the Compliance Supplement's Part 6 provides helpful guidance related to internal controls and wonders if they could just use the illustrative controls in the Supplement as a checklist for the controls they need. **How would you answer Auditee X?**

## II. Understanding and testing controls in a single audit

Having looked at the auditee's responsibilities to establish and maintain controls related to compliance, it is time for us to now move to the auditor's responsibilities. Once the auditor has determined the applicable compliance requirements that have a direct and material effect on the selected major programs (as discussed earlier in the course), the auditor's attention turns to considering the auditee's internal control over compliance.

### A. The auditor's key responsibilities related to internal control

The following illustration summarizes the auditor's key performance responsibilities related to internal control over compliance under the Uniform Guidance for Federal Awards.



**Important Note.** Please observe the lack of flexibility in the above. In a single audit, we are either required to test the effectiveness of internal control over compliance (i.e., the left box) **or** pursue the course of action shown in the right box.

### 1. Exercise 2-2

Please answer the following question.

Under the Uniform Guidance for Federal Awards, for the direct and material compliance requirements for the selected major programs, the auditor is required to obtain an understanding of internal control, assess risk, and test internal control (unless controls are ineffective in which case we will be reporting a significant deficiency or a material weakness). **Why do you believe that the Uniform Guidance for Federal Awards requires auditors to pay all of this attention to internal control?**


## B. Obtaining an understanding of internal control over federal programs

The following chart discusses key aspects of obtaining an understanding of internal control over compliance for major programs.






Key aspects of obtaining an understanding of internal control over compliance for major programs include...	
✓	The auditor's responsibility to obtain an understanding of internal control over compliance is in relation to each compliance requirement subject to audit that is direct and material for each major program.
✓	Obtaining an understanding of a control includes both <b>evaluating the design of the control</b> (i.e., would the control prevent or detect and correct noncompliance) and <b>determining whether the control has been implemented</b> (i.e., are they using it). Some auditors like to take the approach of thinking what could potentially go wrong with the auditee's adherence to a particular compliance requirement and then trying to identify controls the auditee has in place to prevent that from occurring that are functioning.
✓	The auditor obtains a sufficient understanding about the design and implementation of relevant controls by performing risk assessment procedures (e.g., <b>inquiry of entity personnel, observing the application of a specific control, and inspecting documents and reports</b> ). <b>Note.</b> Under AU-C 315, <i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i> , inquiry alone is not sufficient to evaluate the design of a control and to determine whether it has been implemented.
✓	An auditee may use the same controls for more than one federal program and for similar transactions (e.g., the controls over cash disbursements). Thus, those controls will often provide assurance regarding the achievement of the compliance objectives related to some or all federal program transactions and assets. However, the use of the same controls does not negate the need to gain an understanding for each major program.



Sometimes, in discussing internal control over compliance for major programs, things can get lost in translation between the auditor and auditee. The following chart contains tips for having good communications about internal control over compliance.

	<p><b>Tips for having good communications about internal control over compliance</b></p> <p>In obtaining an understanding of the auditee's internal control over compliance for major programs and its implementation, it may be helpful to speak to the auditee in plain terms and not get hung up in the terminology used in the COSO and GAO Green Book frameworks. For example, if trying to understand the auditee's controls in place over allowable costs/cost principles for a program asking questions like: (1) How do you make sure that only allowable costs have been charged to the program? (2) How do you document that only allowable costs have been charged? and (3) What would you do if you discovered an error?</p>
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To close this section of the course, the following chart illustrates a summarized recipe auditors can follow for obtaining an understanding of internal control over compliance for major programs.

<b>A summarized recipe for obtaining an understanding of internal control over compliance for major programs</b>	
	For each major program, consider the direct and material compliance requirements and how those requirements apply to each major program.
	Consider what could go wrong in each major program that could cause noncompliance with the direct and material compliance requirements and the controls the auditee has developed in response to those risks.
	Perform risk assessment procedures (e.g., inquiry of entity personnel, observing the application of a specific control, and inspecting documents and reports) to obtain a sufficient understanding about the design and implementation of relevant controls.
	If controls are properly designed and implemented, we will move on and test the effectiveness of the controls. If not, we will report a finding.
	Document the above.

### 1. Exercise 2-3

Please answer the following true or false question.

	True or False
<b>1</b> The auditor is also required to obtain an understanding of internal control over compliance for programs that are not considered to be major.	



## 2. Exercise 2-4

Please answer the following question.


Ann Auditor believes that in obtaining an understanding of internal control over compliance she should just look at the auditee's **control activities** and ignore the other COSO and GAO Green Book components (i.e., **control environment**, **risk assessment**, **information and communication systems**, and **monitoring**). Her rationale is that control activities are more observable, concrete and effective. **Does Ann also need to consider the other components of the COSO and GAO Green Book frameworks?**

### C. Testing the effectiveness of internal control over federal programs


As discussed in the following chart, once the auditor has obtained an understanding of internal control over compliance in relation to each compliance requirement subject to audit that is direct and material for each major program, the auditor's attention shifts to making a preliminary assessment regarding the control risk of noncompliance. The **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.

Putting the information gleaned in obtaining an understanding of internal control into use	
	After obtaining an understanding of internal control over compliance for major programs, the auditor makes a preliminary assessment of the 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.
	If the auditor <b>believes</b> a low assessed level of control risk can be supported, the auditor accordingly plans and performs effectiveness testing of the controls. If the auditor <b>does not believe</b> a low assessed level of control risk can be supported, the auditor essentially assesses control risk at the maximum, increases compliance testing, and reports a significant deficiency or material weakness.







In looking at the prior chart, a natural question is “what is a low assessed level of control risk of noncompliance?”

	<b>What is a low assessed level of control risk of noncompliance?</b> Professional standards do not define or quantify a low assessed level of control risk of noncompliance. So, professional judgment is applied in determining the extent of control testing necessary to obtain a low level of control risk of noncompliance. In applying professional judgment, one factor to consider is that this requirement is intended to address federal agencies' desire to know if conditions indicate that auditees <b>have</b> or <b>have not</b> implemented adequate internal control over compliance for federal programs.
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As we have discussed, if the auditor **believes** a low assessed level of control risk can be supported, the auditor accordingly plans and performs effectiveness testing of the controls.

	<p style="text-align: center;"><b>A different level of testing</b></p> <p>Testing the operating effectiveness of controls <b>is different from</b> obtaining an understanding of and evaluating the design and implementation of controls. Obtaining an understanding of and evaluating the design and implementation of controls is more of a one-off type procedure (e.g., we inquired about a control and did one walkthrough). Testing the operating effectiveness of controls typically involves a greater level of test work (e.g., pulling a sample of eligibility determinations and looking for evidence of an approval control being applied).</p>
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The following chart discusses key aspects of planning and performing effectiveness testing of internal control over compliance for major programs.

<b>Key aspects of planning and performing effectiveness testing of internal control over compliance for major programs include...</b>	
	<p>While effectiveness testing involves a different level of test work than obtaining an understanding of controls, similar procedures are used [e.g., inquiries of appropriate auditee personnel (including grant and contract managers); the inspection of documents, reports, or electronic files indicating performance of the control; the observation of the application of the specific controls; and reperformance of the application of the control by the auditor].</p>
	<p>The auditor should obtain evidence that the controls are operating effectively throughout the period of reliance. The auditor considers the frequency of the performance of the control by the auditee and the length of time during the audit period that the auditor is relying on the operating effectiveness of the control (e.g., is it a control applied throughout the year or just at year end).</p>
	<p>Internal controls that address the risks of noncompliance with direct and material types of compliance requirements for major programs should be tested every year in a single audit. This is because the Appendix to AU-C section 935, <i>Compliance Audits</i>, tells us that the provisions in AU-C section 330, <i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i>, that potentially allow for the use of prior internal control testing in a financial statement audit do not apply to a compliance audit.</p>
	<p>If auditors use dual purpose testing [e.g., examining an invoice to determine whether it has been approved (control testing) and whether it provides substantive evidence of an allowable transaction (compliance testing)] it is important that the audit documentation clearly distinguishes the control testing from the compliance testing, along with the results of those tests. Distinctions between control testing and compliance testing may be made through: (1) narratives; (2) tick marks; (3) attribute descriptions; or (4) similar notations.</p>
	<p>The auditor will evaluate whether the tests of controls performed provide (or do not provide) a proper basis for reliance on the controls, whether additional tests of controls are necessary, whether potential control deficiencies need to be reported, and how the remaining risks of noncompliance need to be addressed using substantive procedures.</p>
	<p>Document the above.</p>

## 1. Exercise 2-5

Please answer the following true or false questions.

		True or False
1	Compliance testing alone provides adequate evidence that controls are properly designed, implemented, and operating effectively.	
2	Obtaining an understanding of internal control and testing the effectiveness of internal control assists the auditor in determining the nature, timing, and extent of substantive audit procedures to perform in order to gather evidence related to the opinion on compliance.	

## III. Considering deficiencies in control over compliance


The auditor may identify **deficiencies in internal control over compliance** when: (1) obtaining an understanding of internal control over federal programs; (2) testing the effectiveness of internal control over federal programs, or (3) performing compliance testing.

de-fi-ci-en-cy in in-ter-nal con-trol o-ver com-pli-ance	<p><b>A deficiency in internal control over compliance exists when...</b></p> <p>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.</p>
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For purposes of reporting on internal control over compliance for federal programs, AU-C section 935 contains definitions for the terms *significant deficiency in internal control over compliance* and *material weakness in internal control over compliance*. Those definitions are adjusted somewhat for reporting on internal control over compliance in a single audit as illustrated in the below chart.

Two important internal control definitions in a single audit
<p><b>Significant deficiency in internal control over compliance</b> - 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.</p>
<p><b>Material weakness in internal control over compliance</b> - 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.</p> <p><b>Note.</b> A reasonable possibility exists when the likelihood of an event occurring is either <i>reasonably possible</i> or <i>probable</i> as defined as follows:</p> <p><b>Reasonably possible</b> - The chance of the future event or events occurring is more than remote but less than likely.</p> <p><b>Probable</b> - The future event or events are likely to occur.</p>

As we are weighing internal control over compliance deficiencies on a different scale, certain conditions may be significant deficiencies or material weaknesses in **internal control over compliance** for a major program and not be considered significant deficiencies or material weaknesses in **internal control over financial reporting**.

	<p style="text-align: center;"><b>Using a different scale</b></p> <p>The auditor's determination of whether a deficiency in <b>internal control over compliance</b> is a significant deficiency or material weakness for the purpose of reporting an audit finding is <b>in relation to a type of compliance requirement for a major program</b>. This is a different scale from the one used for evaluating a deficiency in <b>internal control over financial reporting</b> where the auditor is weighing a deficiency <b>in relation to the potential misstatement in the financial statements</b>.</p>
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The auditor evaluates 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 a deficiency depends on the magnitude of potential noncompliance resulting from the deficiency or 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.

	<p style="text-align: center;"><b>Thinking through the potential for noncompliance</b></p> <p>In a single audit, the significance of a deficiency in internal control over compliance depends on the potential for noncompliance, not on whether noncompliance actually has occurred. The absence of identified noncompliance does not provide evidence that identified deficiencies in internal control over compliance are not significant deficiencies or material weaknesses in internal control over compliance.</p>
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Multiple deficiencies that affect the same type of compliance requirement or component of internal control over compliance increase the likelihood of material noncompliance and may, in combination, constitute a significant deficiency or material weakness in internal control over compliance, even though the deficiencies individually may be less severe.

$A + B =$	<p style="text-align: center;"><b>The collective result</b></p> <p>The auditor will determine whether deficiencies that affect the same type of compliance requirement or component of internal control collectively result in a significant deficiency or material weakness in internal control over compliance.</p>
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Management may inform the auditor, or the auditor may otherwise become aware, of the existence of compensating controls that, if effective, may limit the severity of the deficiency and prevent it from being a significant deficiency or material weakness in internal control over compliance. Although the auditor is not required to consider the effects of such compensating controls, the auditor may consider the effects of compensating controls related to a deficiency in operation, provided the auditor has tested the compensating controls for operating effectiveness. Compensating controls do not eliminate the deficiency, but can limit the severity of the deficiency.

## A. Applying professional judgment

The evaluation and classification of a deficiency in internal control over compliance requires a tremendous amount of professional judgment. The following chart provides a simplified checklist to determine whether an identified deficiency is a material weakness in internal control over compliance.

<b>A simplified checklist to determine whether an identified deficiency is a material weakness in internal control over compliance</b> (Note. If the answer to both of the following is “yes” we have a material weakness by definition)		
Yes	No	
<input type="checkbox"/>	<input type="checkbox"/>	Is there a reasonable (i.e., more than remote) possibility that noncompliance with a type of compliance requirement could occur without detection and correction?
<input type="checkbox"/>	<input type="checkbox"/>	Could the noncompliance be material to a type of compliance requirement of a federal program?

If the auditor did not answer “yes” to both of the above, but the auditor believes that the deficiency is important enough to merit attention by those charged with governance we would have a significant deficiency in internal control over compliance. As illustrated below, the AICPA Audit Guide related to performing Yellow Book audits and single audits does provide some helpful benchmarks when it provides three indicators of material weaknesses in internal control over compliance.

The AICPA Audit Guide related to performing Yellow Book audits and single audits provides us with the following three indicators of material weaknesses in internal control over compliance:	
1	Identification of fraud in the major program of any magnitude on the part of senior program management. (Note. For the purposes of evaluating and communicating deficiencies in internal control over compliance, the auditor should evaluate fraud of any magnitude of which he or she is aware on the part of senior program management, including fraud resulting in immaterial noncompliance.)
2	Identification by the auditor of material noncompliance for the period under audit in circumstances that indicate that the noncompliance would not have been detected by the entity’s internal control (e.g., the noncompliance was not initially identified by the entity’s internal control).
3	Ineffective oversight by management, or those charged with governance, over compliance with program requirements where the activity is subject to a type of compliance requirement (e.g., lack of adequate review of federal financial reports prior to submission to the grantor).

## B. Exercise 2-6

Please answer the following question.

<p style="text-align: center;"><b>A tough call</b></p> <p>John is applying his professional judgment in evaluating the severity of a deficiency in internal control over compliance for a major program and is finding it to be a tough call. <b>In addition to the items we have discussed, are there any additional considerations that might help John in making his final determination?</b></p>
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## C. Exercise 2-7

Please answer the following question related to a deficiency in internal control over compliance.

David is performing the single audit of Entity Z in which Program X was selected as a major program. Program X's award requirements include a provision that a quarterly performance report must be filed comparing the actual accomplishments of the program with the goals and objectives for the period (i.e., it is non-financial in nature). In testing internal control and compliance with this requirement David noted a couple of issues. The first issue related to the review of the performance reports. Entity Z's designed control over the quarterly performance report is that the report will be prepared by one employee and reviewed by another employee to ensure the completeness and accuracy of the report prior to submission. However, for two of the four quarterly reports submitted during the year, David determined that the reports had been prepared and submitted by the same employee without any review. Entity Z explained that this occurred due to limited staffing. The second issue related to the documentation supporting the information summarized in the quarterly performance reports. In one of the reports that was prepared and submitted by the same employee, Entity Z did not maintain the documentation supporting the information summarized within the report. Thus, the report could not be reviewed retroactively or verified through audit procedures. Entity Z explained that this occurred due to error. Entity Z had very good support for the other three quarterly reports (which appeared to be in line with the report without support) and David did not observe any other compliance issues with Program X. **How would you initially suggest that David categorize the internal control deficiency? (please circle your response)**




A material weakness in internal control over compliance

A significant deficiency in internal control over compliance

An other deficiency in internal control over compliance (i.e., a deficiency less than a material weakness or significant deficiency that would be communicated to management)




## IV. Reporting deficiencies in control over compliance

Under the Uniform Guidance for Federal Awards, if the auditor determines that a significant deficiency or material weakness in internal control over compliance for a major program exists, the auditor will report a finding. The following chart summarizes key aspects related to reporting these findings.

Key aspects of reporting deficiencies in internal control over compliance	
	The auditor will report any significant deficiencies or material weaknesses in internal control over compliance for a major program in Section III of the schedule of findings and questioned costs. ( <b>Note.</b> If the auditor found any significant deficiencies or material weaknesses in internal control over financial reporting, they would be reported in Section II of the schedule.)
	The auditor will provide the finding in the manner and detail described in the Uniform Guidance for Federal Awards (see 200.516) and the client will respond to the finding.
	The auditor will consider the finding and the client's subsequent efforts to correct the finding in the subsequent audit.

## ***V. Tips for staying in good graces with your peer reviewer***

To close this chapter, the following chart contains three tips for staying in good graces with your peer reviewer when it comes to understanding and testing control in a single audit.

<b>Three tips for staying in good graces with your peer reviewer when it comes to understanding and testing control in a single audit</b>	
	Make sure to document the understanding of internal control over compliance for each major program's compliance requirements subject to audit that are direct and material.
	Make sure to have sufficient appropriate audit evidence regarding the effectiveness testing of controls over compliance for each major program's compliance requirements subject to audit that are direct and material.
	Make sure to document evidence of the effectiveness testing of controls over compliance.



## VI. Suggested solutions to exercises

This section contains the suggested solutions to the exercises presented in the chapter.

### A. Suggested solution to Exercise 2-1

Auditee Z is reviewing the Compliance Supplement's Part 6 and sees discussions that controls are designed to **prevent** or timely **detect** noncompliance. Auditee Z wonders if it would be better for an entity to focus only on **preventive controls** as **detective controls** are allowing noncompliance to occur and catch it afterwards. **How would you answer Auditee Z?**

Sometimes people are confused by the concept of detective controls. Controls 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.

Auditee X believes that taking the time to design and implement controls related to compliance may be time consuming. Auditee X understands that the Compliance Supplement's Part 6 provides helpful guidance related to internal controls and wonders if they could just use the illustrative controls in the Supplement as a checklist for the controls they need. **How would you answer Auditee X?**

The Compliance Supplement's Part 6 discusses that the illustrative controls provided in the Supplement are not intended to be used as a checklist of required internal control characteristics. As we saw earlier, the Uniform Guidance for Federal Awards requires an auditee to **establish and maintain** effective internal control over its federal awards. This is a core auditee responsibility that simply cannot be punted to the Compliance Supplement's Part 6.

## B. Suggested solution to Exercise 2-2

Under the Uniform Guidance for Federal Awards, for the direct and material compliance requirements for the selected major programs, the auditor is required to obtain an understanding of internal control, assess risk, and test internal control (unless controls are ineffective in which case we will be reporting a significant deficiency or a material weakness). **Why do you believe that the Uniform Guidance for Federal Awards requires auditors to pay all of this attention to internal control?**

Traditional audit dogma tells us that we cannot give an opinion on something unless we assess the risk of something. It also tells us that we cannot assess the risk of something unless we understand the inherent risk and control risk involved. Thus, the Uniform Guidance requirements to obtain an understanding of internal control and assess risk aligns with traditional audit thinking. However, the Uniform Guidance goes beyond traditional audit dogma by requiring auditors to **test** the effectiveness of internal control (i.e., not merely obtaining an understanding of it as auditors are required to do for a financial statement audit). The OMB requires effectiveness testing for several reasons including: [1] opining on compliance is more subjective than opining on a quantitative number; [2] auditees are required to establish and maintain effective internal control over compliance for federal awards and the OMB wants auditors to be checking to see if this is actually occurring throughout the audit period; and [3] since the single audit compliance opinions are only for the major programs (rather than all programs) the OMB likely feels that it is important for auditees to take controls seriously.

## C. Suggested solution to Exercise 2-3

True or False	
1	<p>The auditor is also required to obtain an understanding of internal control over compliance for programs that are not considered to be major.</p> <p><b>False.</b> The Uniform Guidance for Federal Awards does not require auditors to obtain an understanding of internal control over compliance for programs that are not considered major.</p>

**Note.** The auditor may choose to do some internal control work as part of the risk assessment process in determining major programs or perhaps for the financial statement audit.

## D. Suggested solution to Exercise 2-4

Ann Auditor believes that in obtaining an understanding of internal control over compliance she should just look at the auditee's **control activities** and ignore the other COSO and GAO Green Book components (i.e., **control environment**, **risk assessment**, **information and communication systems**, and **monitoring**). Her rationale is that control activities are more observable, concrete and effective. **Does Ann also need to consider the other components of the COSO and GAO Green Book frameworks?**

Ann should obtain an understanding of the 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 Compliance Supplement's Part 6 states that all five components of internal control have to be present and functioning for internal control to be designed effectively. Control activities on their own are not an effective system of internal controls as they likely rely on other controls. For example, a management review control generally uses information produced by the entity. Even if that management review control is occurring, it is only effective if there are additional controls over the information used in the review.

## E. Suggested solution to Exercise 2-5

		True or False
1	Compliance testing alone provides adequate evidence that controls are properly designed, implemented, and operating effectively.	<b>False.</b> Testing compliance provides indirect evidence on the effectiveness of controls, but cannot serve as the basis for assessing controls as operating effectively.
2	Obtaining an understanding of internal control and testing the effectiveness of internal control assists the auditor in determining the nature, timing, and extent of substantive audit procedures to perform in order to gather evidence related to the opinion on compliance.	<b>Definitely true!</b>

## F. Suggested solution to Exercise 2-6

### A tough call

John is applying his professional judgment in evaluating the severity of a deficiency in internal control over compliance for a major program and is finding it to be a tough call. **In addition to the items we have discussed, are there any additional considerations that might help John in making his final determination?**

Some additional considerations for John to think through are: (1) how federal agencies may view the severity of the deficiency; (2) the nature of the compliance requirement involved; (3) the vulnerability of the program and compliance requirement to fraud; (4) the subjectivity and complexity involved in meeting the compliance requirement and the level of judgment required in determining noncompliance; (5) the relationship of the control with other controls; (6) the interaction among the deficiencies; (7) the possible future consequences of the deficiency; (8) the program amounts or total of transactions exposed to the deficiency in relation to the compliance requirement; (9) the level of activity related to the compliance requirement exposed to the deficiency in the current period or expected in future periods; and (10) the potential negative publicity or other qualitative factors.

## G. Suggested solution to Exercise 2-7

David is performing the single audit of Entity Z in which Program X was selected as a major program. Program X's award requirements include a provision that a quarterly performance report must be filed comparing the actual accomplishments of the program with the goals and objectives for the period (i.e., it is non-financial in nature). In testing internal control and compliance with this requirement David noted a couple of issues. The first issue related to the review of the performance reports. Entity Z's designed control over the quarterly performance report is that the report will be prepared by one employee and reviewed by another employee to ensure the completeness and accuracy of the report prior to submission. However, for two of the four quarterly reports submitted during the year, David determined that the reports had been prepared and submitted by the same employee without any review. Entity Z explained that this occurred due to limited staffing. The second issue related to the documentation supporting the information summarized in the quarterly performance reports. In one of the reports that was prepared and submitted by the same employee, Entity Z did not maintain the documentation supporting the information summarized within the report. Thus, the report could not be reviewed retroactively or verified through audit procedures. Entity Z explained that this occurred due to error. Entity Z had very good support for the other three quarterly reports (which appeared to be in line with the report without support) and David did not observe any other compliance issues with Program X. **How would you initially suggest that David categorize the internal control deficiency? (please circle your response)**

A material weakness in internal control over compliance

A significant deficiency in internal control over compliance

An other deficiency in internal control over compliance (i.e., a deficiency less than a material weakness or significant deficiency that would be communicated to management)

**Author's Note.** The classification of internal control deficiencies in a compliance audit is **more subjective** than for a financial statement audit as we may encounter instances of noncompliance that are nonmonetary in nature. The Uniform Guidance for Federal Awards requires the auditor to consider material noncompliance in relation to a type of compliance requirement identified in the Compliance Supplement. In this example, the course author would have initially classified this as a significant deficiency in internal control over compliance as for 50% of the year the control was not operating. Reporting was a relevant compliance requirement and the lack of support for one of the reports made it essentially non-auditable (although the other three reports did have reasonable support). **Note.** If David simply cannot determine how an awarding agency may view the severity of the finding, he could consult with the federal agency contact listed in the Compliance Supplement.



# Testing Compliance in a Single Audit


<b>Learning objectives</b>	<b>1</b>
<b>I. Key compliance testing concepts utilized in a single audit</b>	<b>1</b>
A. Exercise 3-1	1
B. Using professional judgment in planning and performing compliance testing	2
C. Materiality concepts applied in planning compliance testing	2
D. Assessing the audit risk of noncompliance	3
1. Exercise 3-2	3
<b>II. Testing compliance in a single audit</b>	<b>4</b>
A. Using the Compliance Supplement's Parts 3, 4, and 5 to test compliance	4
1. Exercise 3-3	4
2. Key concepts related to Part 3 of the Compliance Supplement	5
3. Key concepts related to Part 4 of the Compliance Supplement	5
4. Key concepts related to Part 5 of the Compliance Supplement	6
5. Examples of suggested audit procedures from the Compliance Supplement	6
B. Additional aspects of testing compliance	8
1. Generalities regarding audit evidence	8
2. Exercise 3-4	8
3. Key considerations related to dual purpose testing and sampling	9
4. Exercise 3-5	9
<b>III. Evaluating the results of compliance testing</b>	<b>10</b>
A. Exercise 3-6	11
B. Exercise 3-7	11
C. Exercise 3-8	11
<b>IV. Reporting compliance findings</b>	<b>12</b>
A. Exercise 3-9	13
<b>V. Tips for staying in good graces with your peer reviewer</b>	<b>13</b>
<b>VI. Suggested solutions to exercises</b>	<b>14</b>
A. Suggested solution to Exercise 3-1	14
B. Suggested solution to Exercise 3-2	14
C. Suggested solution to Exercise 3-3	15
D. Suggested solution to Exercise 3-4	15
E. Suggested solution to Exercise 3-5	15
F. Suggested solution to Exercise 3-6	16
G. Suggested solution to Exercise 3-7	16
H. Suggested solution to Exercise 3-8	16
I. Suggested solution to Exercise 3-9	17






# Testing Compliance in a Single Audit

## Learning objectives



	Upon completing this chapter, you will be able to: <ul style="list-style-type: none"><li>• Apply the key compliance testing concepts utilized in a single audit;</li><li>• Perceive how the auditor plans and performs tests of compliance in a single audit; and</li><li>• Explain the identification and reporting of compliance findings in a single audit.</li></ul>
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### ***1. Key compliance testing concepts utilized in a single audit***

When funding leaves Washington, it contains strings (i.e., requirements) attached to it. Washington is naturally curious as to whether the recipients of federal funds are playing by those requirements; therefore, we have the single audit.

	<p><b>There are strings attached to receiving federal funding...</b></p> <p>When auditees receive federal funding, they have to follow the rules related to that funding. More formally said, the auditee is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.</p>
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Earlier in the course, we discussed how the auditor determines the direct and material compliance requirements and the auditor's responsibilities related to understanding and testing internal control over compliance. In a single audit, the auditor also obviously has compliance testing responsibilities beyond those seen in a traditional financial statement audit.

<b>The auditor's key responsibilities related to compliance in a single audit include...</b>	
	Planning and performing the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements that could have a direct and material effect on a major program occurred. This includes examining, on a test basis, evidence about the auditee's compliance with those requirements and performing such other procedures as the auditor considered necessary in the circumstances.
	Expressing an opinion on compliance <b>for each</b> of the auditee's <b>major programs</b> and reporting any related findings (if applicable).

### **A. Exercise 3-1**

Please answer the following true or false question.

		True or False
1	The auditor's responsibilities related to compliance in a single audit are significantly greater than in a Yellow Book audit.	



## B. Using professional judgment in planning and performing compliance testing

Auditors are accustomed to applying professional judgment in all engagements they perform. Planning, conducting, and evaluating the results of compliance testing definitely requires an auditor to exercise professional judgment. The AICPA Audit Guide related to Yellow Book and single audits lists several factors that auditors may consider in applying professional judgment. The following reflects the guidance contained in the Audit Guide.

In using professional judgment in planning, conducting, and evaluating the results of compliance testing, auditors may consider the...	
✓	Assessment of audit risk of noncompliance;
✓	Assessment of materiality;
✓	Evidence obtained from other auditing procedures;
✓	Level of expenditures for the program;
✓	Similarity or dissimilarity of expenditures for the program;
✓	Period of time that the program has operated, or changes in its conditions;
✓	Current and prior auditing experience with the program, particularly findings in previous audits and other evaluations;
✓	Level to which the program is carried out through subrecipients, plus the related monitoring activities;
✓	Level to which the program contracts for goods or services;
✓	Extent to which the program already is subject to program reviews or other forms of independent oversight;
✓	Expectation of compliance or noncompliance with the direct and material compliance requirements;
✓	Level to which computer processing is used to administer the program, plus the complexity of the processing; and
✓	Whether the program has been identified as higher risk in the Compliance Supplement.

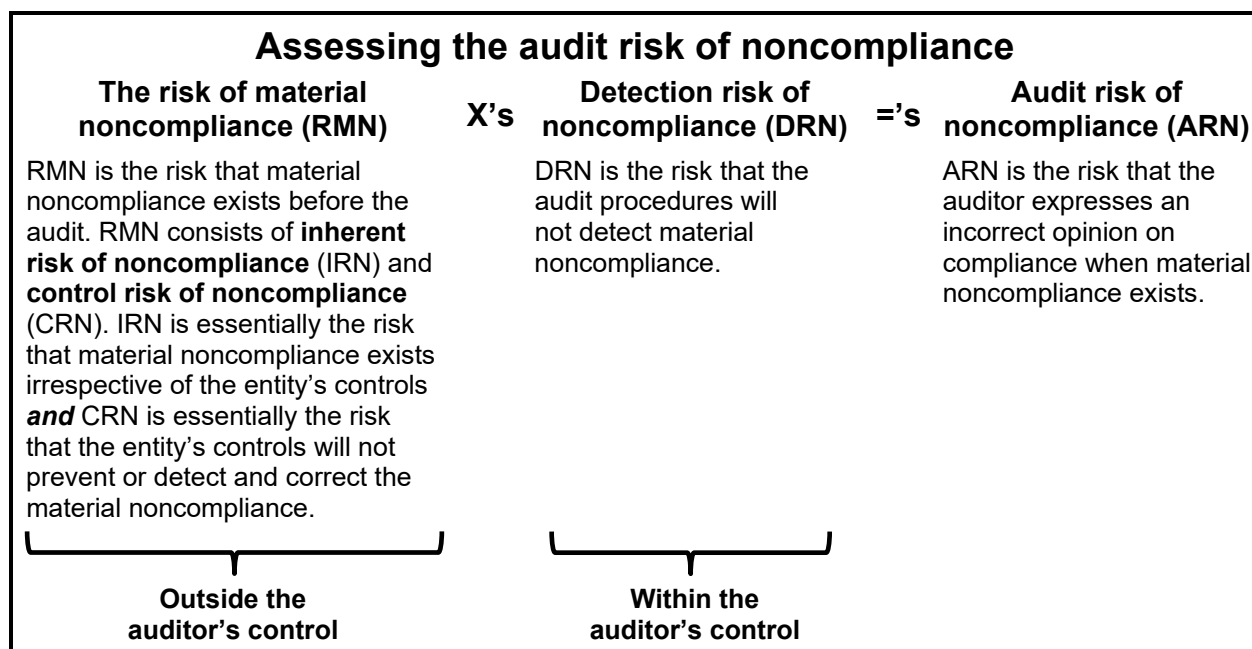
## C. Materiality concepts applied in planning compliance testing

The application of materiality to compliance testing in a single audit differs from the application of materiality in a financial statement audit.

Key materiality concepts applied in planning compliance testing in a single audit	
	In designing audit procedures and developing an opinion on the auditee's compliance with direct and material compliance requirements, the auditor applies the concept of materiality to <b>each major program</b> .
	As it relates to compliance testing, materiality is affected by: [1] the nature of the compliance requirements (which may or may not be quantifiable in monetary terms); [2] the nature and rate of noncompliance identified (particularly as it relates to sampling applications); and [3] qualitative considerations (e.g., the expectations of the entity making the award).

## D. Assessing the audit risk of noncompliance

To provide an opinion on compliance, an auditor obtains sufficient appropriate evidence in support of compliance, thus reducing audit risk of noncompliance to an appropriately low level. Audit risk of noncompliance and materiality, among other matters, need to be considered in tandem for each major program as well as for each direct and material compliance requirement in determining the nature, timing, and extent of compliance testing to be applied. Obtaining an understanding of the major programs, the direct and material compliance requirements, and building upon the information gleaned about the auditee's internal control over compliance establishes a knowledge base. Upon this knowledge base, the auditor plans the compliance audit and applies professional judgment in assessing the **risk of material noncompliance** (see RMN below) and responding to that risk throughout the audit by setting the **detection risk of noncompliance** (see DRN below) to an appropriate level. The overall result is that the **audit risk of noncompliance** (see ARN below) is maintained at the desired low level.



As illustrated in the above, when we are assessing the audit risk of noncompliance, essentially we are trying to determine: [1] where something can go wrong in terms of compliance (i.e., the RMN); and [2] what we are going to do about it in terms of the audit (i.e., setting the DRN to an appropriate level based on our assessment of the RMN).

### 1. Exercise 3-2

Please indicate whether the following statements are true or false.

	True or False
1	Detection risk of noncompliance (DRN) is affected by the nature, timing and extent of the audit procedures that the auditor employs in response to the risk of material noncompliance (RMN).
2	The auditor is required to identify and assess the RMN whether due to fraud or error for each applicable compliance requirement.

## II. Testing compliance in a single audit

After performing risk assessment procedures and assessing the risk of material noncompliance, the auditor will design and perform additional audit procedures, including tests of details to obtain sufficient evidence about the auditee's compliance with each of the direct and material compliance requirements. Risk assessment procedures, tests of controls, and analytical procedures alone **are not sufficient** to address a risk of material noncompliance.

### A. Using the Compliance Supplement's Parts 3, 4, and 5 to test compliance

The key source of guidance for testing compliance in a single audit is the Compliance Supplement's Parts 3, 4, and 5. As illustrated in the following, each of these three parts has a role to play in compliance testing.

Each of the Compliance Supplement's Parts 3, 4, and 5 has role in compliance testing		
Part 3 Compliance Requirements	Part 4 Agency Program Requirements	Part 5 Clusters of Programs
Part 3 contains <b>generic background information</b> for each of the 12 types of compliance requirements. Part 3 also includes audit objectives and suggested audit procedures for the compliance requirements. ( <b>Note.</b> For the Special Tests and Provisions compliance requirement, audit objectives and suggested audit procedures are found in Part 4.)	Part 4 contains <b>unique background information</b> by individual federal program. Part 4 also includes information about compliance requirements <b>specific</b> to a program. For the Special Tests and Provisions compliance requirement, Part 4 contains audit objectives and suggested audit procedures.	In addition to listing clusters of programs, Part 5 provides compliance requirements, audit objectives, and suggested audit procedures for the Research and Development (R&D) and Student Financial Assistance (SFA) clusters.





**Note.** In chapter 1 we discussed program-specific audits, for a program-specific audit performed in accordance with a federal agency's program-specific audit guide (see Appendix VI of the Compliance Supplement), the auditor will follow the guidance in the federal agency's program-specific audit guide.

#### 1. Exercise 3-3

Please review the scenarios below and indicate the primary area in the Compliance Supplement where you would look for suggested audit procedures for testing compliance			
Scenario:	Part 3	Part 4	Part 5
You are auditing program XX.XXX which <b>is not included</b> in the Compliance Supplement. In applying Part 7 of the Compliance Supplement you determined that Program Income is a direct and material compliance requirement for the program.			
You are auditing program 10.553 which <b>is included</b> in the Compliance Supplement and listed as being part of the USDA Child Nutrition Cluster in Part 5 of the Supplement (it is not in the R&D or SFA clusters). You have determined that Special Tests and Provisions is a direct and material compliance requirement for the program and are looking for help in that area.			

## 2. Key concepts related to Part 3 of the Compliance Supplement


As we saw earlier, Part 3 of the Compliance Supplement contains **generic background information** for each of the 12 types of compliance requirements. Part 3 also includes audit objectives and suggested audit procedures for the compliance requirements. (**Note.** For the Special Tests and Provisions compliance requirement, audit objectives and suggested audit procedures are found in Part 4.) The following chart discusses key concepts related to using Part 3 of the Compliance Supplement.



Key concepts related to using Part 3 of the Compliance Supplement	
	The objectives of most compliance requirements for federal programs are generic in nature.
	Part 3's suggested audit procedures are, as the name implies, only suggested. The auditor's judgment will be applied to determine whether Part 3's suggested audit procedures are sufficient to achieve the stated audit objectives and whether additional or alternative procedures are necessary.
	For each program included in the Compliance Supplement, remember to use Part 3 of the Compliance Supplement in tandem with Parts 4 (typically) or 5 (for the R&D or SFA clusters).
	In Part 3, under the Special Tests and Provisions compliance requirement, the Compliance Supplement typically discusses that, both for programs included and not included in the Supplement, the auditor is required to identify any additional compliance requirements which are not based in statute or regulation (e.g., were agreed to as part of audit resolution of prior audit findings), which could be material to a major program. Reasonable procedures to identify such compliance requirements would be inquiry of management and review of the contract and grant agreements pertaining to the program. Any such requirements which may have a direct and material effect on compliance with the requirements of that major program are required to be included in the audit.

We should also mention that in utilizing the Compliance Supplement, the descriptions of the compliance requirements in Parts 3, 4, and 5 are generally a summary of the actual compliance requirements. The auditor is required to refer to the referenced citations (e.g., laws and regulations) for the complete statement of the compliance requirements.

## 3. Key concepts related to Part 4 of the Compliance Supplement




As we saw earlier, Part 4 contains **unique background information** by individual federal program. Part 4 also includes information about compliance requirements **specific** to a program. For the Special Tests and Provisions compliance requirement, Part 4 contains audit objectives and suggested audit procedures. The following chart discusses key concepts related to using Part 4 of the Compliance Supplement.

Key concepts related to using Part 4 of the Compliance Supplement	
	When any of five types of compliance requirements (i.e., Activities Allowed or Unallowed; Eligibility; Matching, Level of Effort, Earmarking; Reporting; and Special Tests and Provisions) is subject to audit and applicable to a program included in the Compliance Supplement, Part 4 <b>always</b> provides additional information specific to the program. For the other seven types of compliance requirements, Part 4 may or may not include information specific to the program.

Key concepts related to using Part 4 of the Compliance Supplement	
	For the Special Tests and Provisions compliance requirement, Part 4 contains suggested audit procedures for compliance testing. For other compliance requirements listed in Part 4 specific to a program (e.g., under the Reporting compliance requirement for a particular program Part 4 often lists various forms used for financial reporting), the auditor will be using Part 3 in developing audit procedures for the specific requirements listed in Part 4. The key takeaway here is that Part 4 is used together with Part 3 and not instead of it.
	The description of program procedures in Part 4 is general in nature. Some programs may operate somewhat differently than described due to: (1) the complexity of governing federal and state laws and regulations; (2) the administrative flexibility afforded nonfederal entities; and (3) the nature, size, and volume of transactions involved. Accordingly, the auditor is required to obtain an understanding of the applicable compliance requirements and program procedures in operation at the auditee to properly plan and perform the audit.

#### 4. Key concepts related to Part 5 of the Compliance Supplement

In addition to listing clusters of programs, Part 5 provides compliance requirements, audit objectives, and suggested audit procedures for the Research and Development (R&D) **and** Student Financial Assistance (SFA) clusters. The following chart discusses key concepts related to using Part 5 of the Compliance Supplement.

Key concepts related to using Part 5 of the Compliance Supplement	
	For the R&D and SFA clusters, Part 5 is the equivalent of Part 4 coverage. Thus, for the Special Tests and Provisions compliance requirement, Part 5 contains suggested audit procedures for compliance testing. For other compliance requirements listed in Part 5 specific to a program, the auditor will be using Part 3 in developing audit procedures for the specific requirements listed in Part 5 (i.e., the auditor will be using Parts 3 and 5 in tandem).
	For the other clusters of programs which are listed in Part 5 (i.e., the non-R&D and non-SFA clusters) the auditor will be using Parts 3 and 4 in tandem in developing audit procedures.
	The auditor is required to refer to the referenced citations (e.g., statutes and regulations) for the complete compliance requirements.

#### 5. Examples of suggested audit procedures from the Compliance Supplement

As a means of illustration, the following chart contains examples of suggested audit procedures from a recent Compliance Supplement for various compliance requirements. **Note.** All of the suggested procedures in the following chart came from Part 3 of the Compliance Supplement except the one for Special Tests and Provisions which came from Part 4.

Examples of suggested audit procedures from a recent Compliance Supplement	
Compliance requirement:	Suggested audit procedure:
Activities Allowed or Unallowed	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.

<b>Examples of suggested audit procedures from a recent Compliance Supplement</b>	
<b>Compliance requirement:</b>	<b>Suggested audit procedure:</b>
Allowable Costs/Cost Principles	Test that direct costs charged to federal awards conformed to any limitations or exclusions set forth in 2 CFR 200, subpart E, (i.e., the Uniform Guidance for Federal Awards cost principles) or in the federal award as to types or amount of cost items.
Cash Management	Select a sample of advance payments and verify that the nonfederal entity minimized the time elapsing between the transfer of funds from the U.S. Treasury or pass-through entity and disbursement by the nonfederal entity.
Eligibility	Select a sample of individuals receiving benefits and perform tests to ascertain if: [1] The required eligibility determinations and redeterminations, (including obtaining any required documentation/verifications) were performed and the individual was determined to be eligible in accordance with the compliance requirements of the program. (Note that some programs have both initial and continuing eligibility requirements and the auditor should design and perform appropriate tests for both. Also, some programs require periodic redeterminations of eligibility, which should also be tested.); [2] Benefits paid to or on behalf of the individuals were calculated correctly and in compliance with the requirements of the program; and [3] Benefits were discontinued when the period of eligibility expired.
Equipment and Real Property Management	Select a sample of equipment transactions acquired under federal awards and test for compliance with the state's policies and procedures for management and disposition of equipment.
Matching, Level of Effort, and Earmarking	Perform tests to verify that the required matching contributions were met.
Period of Performance	For federal awards with performance period ending dates during the audit period, test transactions for costs recorded during the latter part and after the period of performance and verify that the costs had been incurred within the period of performance.
Procurement and Suspension and Debarment	Test a sample of procurements to ascertain if the state's laws and procedures were followed and that the policies and procedures used were the same as for nonfederal funds (2 CFR section 200.317).
Program Income	Perform tests to ascertain if program income was used in accordance with 2 CFR section 200.307(e) and the program requirements set by the federal awarding agency in its regulations and the terms and conditions of the award.
Reporting	Select a sample of reports and perform appropriate analytical procedures and ascertain the reason for any unexpected differences. Examples of analytical procedures include: [1] comparing current period reports to prior period reports; [2] comparing anticipated results to the data included in the reports; and [3] comparing information obtained during the audit of the financial statements to the reports.
Subrecipient Monitoring	Review the pass-through entity's subrecipient monitoring policies and procedures to gain an understanding of the pass-through entity's process to identify subawards, evaluate risk of noncompliance, and perform monitoring procedures based upon identified risks.
Special Tests and Provisions	For CFDA 93.268 Immunization Cooperative Agreements – In order to determine whether the grantee provides oversight of vaccinating providers to ensure that the required information has been recorded for vaccine recipients suggested audit procedures include: [1] determine if the grantee has a written procedure for ensuring that the required information has been recorded for vaccine recipients; [2] determine if the grantee tested a sample of vaccination records to ascertain if the required information was maintained; and [3] determine if the grantee took any follow-up action if the required records and information were not maintained.

## B. Additional aspects of testing compliance

As we have just reviewed, the auditor uses the Compliance Supplement's Parts 3, 4, and 5 to consider the compliance requirements, related audit objectives, and suggested audit procedures to plan and perform tests of compliance. In this section, we will review some additional aspects of testing compliance. Specifically, we will discuss: (1) certain generalities regarding audit evidence; and (2) key considerations related to dual purpose testing and sampling.

### 1. Generalities regarding audit evidence

Professional judgment is essential in 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.

The following contrasts are helpful in establishing a proper combination of procedures to restrict audit risk of noncompliance appropriately:	
>	Evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles.
>	Evidence is more reliable when it exists in documentary form, whether paper, electronic, or other medium (e.g., a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
>	Evidence the auditor obtains directly (e.g., the observation of the application of a control) is more reliable than evidence obtained indirectly or by inference (e.g., inquiring about the application of a control).
>	Evidence that is generated internally is more reliable when the related controls carried out by the auditee are effective.
>	Evidence is more reliable when it is obtained from knowledgeable independent sources outside the auditee.
<b>Note:</b> There can certainly be exceptions to the above contrasts based on the individual situation.	

As the AICPA Audit Guide related to Yellow Book and single audits discusses, in the hierarchy of available audit procedures, those that involve search and verification (e.g., inspection, confirmation, or observation) -- particularly when independent sources outside the auditee are used -- generally are more effective in reducing audit risk of noncompliance than are those involving internal inquiries and comparisons of internal information (e.g., discussions with the individuals responsible for compliance and analytical procedures).

### 2. Exercise 3-4






Please answer the following true or false question.

		True or False
1	In a single audit, compliance testing should include tests of transactions and such other auditing procedures as are necessary to provide the auditor with sufficient evidence to support an opinion on compliance for each major program.	



### 3. Key considerations related to dual purpose testing and sampling

In testing compliance in a single audit, it is not uncommon for the auditor to utilize dual purpose testing particularly when it comes to applying a sampling procedure. For example, using the same sample, an auditor may test whether costs are allowable from a compliance perspective, as well as whether related controls over allowability are working. While the use of dual purpose testing does entail some additional risk and planning, it can be effective if done properly. The following chart discusses several key considerations related to dual purpose testing and sampling.

Key considerations related to dual purpose testing and sampling	
	Essential guidance for using sampling in a single audit is found in Chapter 11 of the AICPA Audit Guide related to Yellow Book and single audits. However, the AICPA Audit Guide related to audit sampling and AU-C section 530, <i>Audit Sampling</i> , also provide vital guidance.
	When using dual purpose sampling to test controls and compliance, the sample needs to allow the auditor to assess the level of control risk as low and also be appropriate for compliance testing purposes. The sample size and sample drawn needs to meet the objectives for both the controls test and the compliance test. Auditors need to be very precise about the control being tested, and in defining the attribute to describe exactly what they want to see is occurring or not occurring.
	In evaluating the results of dual purpose tests, the results should be evaluated separately for the control attributes and the compliance attributes tested. For example, if deviations are encountered in controls testing the auditor evaluates the need for reporting a control deficiency <b>and</b> also considers the impact on compliance testing (e.g., the need to expand compliance testing due to the increased risk posed by the deficiency in internal control over compliance).
	The audit documentation of internal control and compliance tests should be distinguished from one another so there is a clear distinction between the audit objectives and test results for each test so that separate conclusions may be reached on the control attributes and compliance attributes tested.
	Another form of using a sample for multiple purposes is when an auditor attempts to use a single sample for testing for both compliance audit objectives and financial statement audit objectives. This type of sampling involves additional complexities and challenges due to the different objectives and concepts involved. Thus, tread carefully and review related discussions in Chapter 11 of the AICPA Audit Guide related to Yellow Book and single audits.


### 4. Exercise 3-5

Please answer the following true or false question.





		True or False
1	Grace is evaluating the results of a dual purpose sample related to eligibility. In testing a sample of 40 application forms, Grace found that four application forms were not approved by the manager (a key control at the auditee). However, the required eligibility determinations were properly documented on all 40 applications. Grace can ignore the four cases of the control not operating as noncompliance was not observed in the required eligibility determinations.	

### III. Evaluating the results of compliance testing


Performing a single audit includes obtaining reasonable assurance about whether the auditee complied with the direct and material compliance requirements **for each of its major programs**. Thus, the auditor will evaluate the sufficiency and appropriateness of the compliance testing evidence obtained.

	<p><b>In evaluating the results of compliance testing we may encounter findings</b></p> <p>The auditor's tests of compliance with compliance requirements may reveal instances of noncompliance. Instances of noncompliance, among other matters, are referred to as <b>findings</b>. Findings <b>may be of a monetary nature and involve questioned costs</b> (e.g., an auditee erroneously used program funds for non-program purposes) or <b>may be of a nonmonetary nature and not result in questioned costs</b> (e.g., a pass-through entity failed to properly monitor a subrecipient). [Note. In forming an opinion on compliance, the auditor will evaluate likely questioned costs, not just known questioned costs, as well as other material noncompliance that, by its nature, may not result in questioned costs.]</p>
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AU-C section 935, *Compliance Audits*, provides helpful guidance in sizing up whether the auditee has materially complied with the applicable compliance requirements and the AICPA Audit Guide related to Yellow Book and single audits bends that guidance to the single audit as summarized in the following chart.

<b>In sizing up whether an auditee complied with the direct and material compliance requirements in all material respects, the auditor may consider several factors including...</b>	
	The frequency of noncompliance with the direct and material compliance requirements;
	The nature of the noncompliance with the direct and material compliance requirements;
	The adequacy of the entity's system for monitoring compliance with the direct and material compliance requirements and the possible effect of any noncompliance on the entity; and
	Whether any identified noncompliance with the direct and material compliance requirements resulted in likely questioned costs that are material to the federal program.

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

	<p><b>What is material noncompliance?</b></p> <p>In evaluating the results of compliance testing, a <b>material instance of noncompliance</b> is a failure to comply with federal statutes, regulations, or the terms and conditions of the federal award that results in an aggregation of noncompliance (i.e., the auditor's best estimate of the overall noncompliance) that is <b>material to the affected federal program</b> (as the auditor expresses an opinion on each major program). Instances of noncompliance that may not be individually material should be assessed to determine if, in the aggregate, they could have a material effect.</p>
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## A. Exercise 3-6

Please answer the following true or false question.

		True or False
1	Emma Terial is evaluating the results of compliance testing for a major program. The major program was subject to six different types of direct and material compliance requirements. For the Reporting type compliance requirement, Emma found some material noncompliance. However, for the other five types of compliance requirements tested, Emma found no problems. Emma can ignore reporting the material noncompliance in Reporting as following five out of six compliance requirements is not too bad.	

## B. Exercise 3-7

Please answer the following question.

We found this, do we also need to consider that?	
Bill is performing compliance testing on Program X. In testing for Activities Allowed or Unallowed he finds that certain equipment has been charged to Program X. However, the grant agreement for Program X does not allow for program funds to be spent on equipment. <b>Does Bill need to consider whether this noncompliance also represents an internal control deficiency?</b>	









## C. Exercise 3-8

In the following chart are two excerpts from findings auditors have reported in single audits obtained from the Federal Audit Clearinghouse database (<https://facweb.census.gov/>). Please review the condition as described and select how you think the auditor classified the finding based on the limited information provided. [Note. Findings may be classified as more than one type of finding (e.g., both a material noncompliance and a material weakness).]





What do you think the auditor did?			
Scenario:	Material noncompliance	Material weakness	Significant deficiency
"We noted that there was a lack of appropriate and sufficient review and understanding of program requirements, which caused required reporting of financial performance to be filed late, or not filed at all. We noted that Q1 and Q2 reports were not submitted, and Q3 and Q4 reports were submitted after the stated due date." No questioned costs were reported related to the program.			
"During our special tests and provisions testing, we identified five instances where the information included in the income support differed from the information entered by the District." Likely questioned costs of \$996.51 were reported.			

## IV. Reporting compliance findings

In this section, we will discuss the types of compliance findings that the auditor is required to report in a single audit. In a single audit, findings and questioned costs for federal awards are reported in Section III of the Schedule of Findings and Questioned Costs (SFQC). **Note.** Section II of the SFQC reports findings related to the financial statements that are required to be reported in accordance with the Yellow Book.

In Section III of the Schedule of Findings and Questioned Costs (SFQC) the auditor reports the following findings related to federal awards:	
	<b>Material noncompliance related to a major program.</b> <b>Material</b> as being in relation to a type of compliance requirement for a major program identified in the Compliance Supplement.
	<b>Known questioned costs that are greater than \$25,000 for a type of compliance requirement for a major program.</b> <b>Questioned costs</b> are costs that are questioned by the auditor due to a finding: (1) 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; (2) for which the costs, at the time of the audit, are not supported by adequate documentation; or (3) for which the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.
	<b>Known questioned costs when likely questioned costs are greater than \$25,000 for a type of compliance requirement for a major program.</b> <b>Likely questioned costs</b> are developed by extrapolating from audit evidence obtained (e.g., by projecting known questioned costs identified in a sample to the entire population from which the sample was drawn). Auditors are not required to report the likely questioned costs but the known questioned costs (i.e., by reporting the known questioned costs and providing a perspective for the prevalence of the finding the reader of the finding can infer that the likely questioned costs were greater than \$25,000).
	<b>Known questioned costs that are greater than \$25,000 for a federal program that is not audited as a major program.</b> It is unusual for an auditor to discover questioned costs for a program that is not audited as a major program. However, if an auditor does become aware of questioned costs for a non-major program (e.g., as part of audit follow-up or other audit procedures) and the known questioned costs are greater than \$25,000, then the auditor is required to report the finding.
	<b>Significant deficiencies and material weaknesses in internal control over major programs and significant instances of abuse relating to major programs.</b>
	<b>The circumstances concerning why the auditor's report on compliance for each major program is other than an unmodified opinion, unless such circumstances are otherwise reported as audit findings in the SFQC.</b>
	<b>Instances where the results of audit follow-up procedures disclosed that the summary schedule of prior audit findings prepared by the auditee materially misrepresents the status of any prior audit finding.</b>
	<b>Known or likely fraud affecting a federal award unless such fraud is otherwise reported as an audit finding in the SFQC.</b>

The following chart summarizes additional key aspects related to reporting findings from compliance testing. **Note.** Much of the below table is redundant with the guidance we saw in the last chapter when discussing reporting deficiencies in internal control.




Key aspects related to reporting findings from compliance testing	
	The auditor will report any findings related to federal awards in Section III of the schedule of findings and questioned costs. ( <b>Note.</b> If the auditor found any findings related to the financial statements that are required to be reported in accordance with the Yellow Book, they would be reported in Section II of the schedule.)
	The auditor will provide the finding in the manner and detail described in the Uniform Guidance for Federal Awards (see 200.516) and the client will respond to the finding.
	Audit findings (e.g., internal control findings, compliance findings, questioned costs, or fraud) that relate to the same issue should be presented as a single audit finding.
	The auditor will consider the finding and the client's subsequent efforts to correct the finding in the subsequent audit.

### A. Exercise 3-9

So how are things going?			
Below are the four most common types of findings reported in a single audit. For each of the below finding types, please guess the percentage of single audits that are submitted each year (based on a recent year's worth of submissions to the Federal Audit Clearinghouse) with that finding type.			
Questioned costs	Material noncompliance	Material weakness	Significant deficiency
__%	__%	__%	__%

## V. Tips for staying in good graces with your peer reviewer

To close this chapter, the following chart contains three tips for staying in good graces with your peer reviewer when it comes to testing compliance in a single audit.

Three tips for staying in good graces with your peer reviewer when it comes to testing compliance in a single audit	
	Make sure that the audit documentation contains sufficient evidence to support the opinion on compliance for each major program. Take the time to document the individual procedures performed in testing the compliance requirements and the results of those procedures.
	Make sure that the audit documentation includes evidence that the auditor tested the compliance requirements identified as subject to audit in the Compliance Supplement's Part 2 matrix for a major program <b>or</b> explains why certain compliance requirements identified as subject to audit in the Part 2 matrix were determined not to be direct and material to a major program.
	Make sure to maintain and document the nexus between control testing and compliance testing.

## VI. Suggested solutions to exercises

This section contains the suggested solutions to the exercises presented in the chapter.

### A. Suggested solution to Exercise 3-1

		True or False
1	The auditor's responsibilities related to compliance in a single audit are significantly greater than in a Yellow Book audit.	<b>Definitely true!</b> In a single audit, the auditor is actually <b>opining on each major program's compliance with the <u>direct and material compliance requirements applicable to the program</u></b> . In a Yellow Book audit (which is also part of a single audit), the auditor is <b>not opining on compliance</b> but rather the financial statements. Thus, in a Yellow Book audit, the auditor is looking for noncompliance with provisions of laws, regulations, contracts, and grant agreements, <b>which could have a <u>direct and material effect on the financial statements</u></b> .

### B. Suggested solution to Exercise 3-2

		True or False
1	Detection risk of noncompliance (DRN) is affected by the nature, timing and extent of the audit procedures that the auditor employs in response to the risk of material noncompliance (RMN).	<b>True.</b> For example, if problems are found when obtaining an understanding of and testing the effectiveness of the auditee's internal controls over compliance, RMN is going to increase. In response, to reduce DRN to an appropriate level, the auditor may: (1) alter the <b>nature</b> of the procedures performed; (2) adjust the <b>timing</b> of when procedures are performed; and (3) increase the sample size to expand the <b>extent</b> of the items selected for detail testing.
2	The auditor is required to identify and assess the RMN whether due to fraud or error for each applicable compliance requirement.	<b>True.</b> This is specified in AU-C section 935, <i>Compliance Audits</i> .

### C. Suggested solution to Exercise 3-3

Please review the scenarios below and indicate the primary area in the Compliance Supplement where you would look for suggested audit procedures for testing compliance			
Scenario:	Part 3	Part 4	Part 5
You are auditing program XX.XXX which <b>is not included</b> in the Compliance Supplement. In applying Part 7 of the Compliance Supplement you determined that Program Income is a direct and material compliance requirement for the program.	✓		
You are auditing program 10.553 which <b>is included</b> in the Compliance Supplement and listed as being part of the USDA Child Nutrition Cluster in Part 5 of the Supplement (it is not in the R&D or SFA clusters). You have determined that Special Tests and Provisions is a direct and material compliance requirement for the program and are looking for help in that area.		✓	

### D. Suggested solution to Exercise 3-4

	True or False
1 In a single audit, compliance testing should include tests of transactions and such other auditing procedures as are necessary to provide the auditor with sufficient evidence to support an opinion on compliance for each major program.	True.

### E. Suggested solution to Exercise 3-5

	True or False
1 Grace is evaluating the results of a dual purpose sample related to eligibility. In testing a sample of 40 application forms, Grace found that four application forms were not approved by the manager (a key control at the auditee). However, the required eligibility determinations were properly documented on all 40 applications. Grace can ignore the four cases of the control not operating as noncompliance was not observed in the required eligibility determinations.	<b>False.</b> Grace cannot just ignore the control deficiency but needs to evaluate the need for reporting a control deficiency and also consider the impact on compliance testing. 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 and not just whether the auditee complied.

## F. Suggested solution to Exercise 3-6

True or False	
1	<p>Emma Terial is evaluating the results of compliance testing for a major program. The major program was subject to six different types of direct and material compliance requirements. For the Reporting type compliance requirement, Emma found some material noncompliance. However, for the other five types of compliance requirements tested, Emma found no problems. Emma can ignore reporting the material noncompliance in Reporting as following five out of six compliance requirements is not too bad.</p> <p><b>False.</b> For the purpose of reporting an audit finding, the Uniform Guidance for Federal Awards describes the auditor's determination of whether a noncompliance is material as being in relation to a type of compliance requirement for a major program identified in the Compliance Supplement.</p>

## G. Suggested solution to Exercise 3-7

<p align="center"><b>We found this, do we also need to consider that?</b></p> <p>Bill is performing compliance testing on Program X. In testing for Activities Allowed or Unallowed he finds that certain equipment has been charged to Program X. However, the grant agreement for Program X does not allow for program funds to be spent on equipment. <b>Does Bill need to consider whether this noncompliance also represents an internal control deficiency?</b></p> <p>Yes. Bill's observance of noncompliance with Activities Allowed or Unallowed in Program X is also evidence about the auditee's ineffective internal control over that type of compliance requirement (as the auditee's controls did not prevent or detect and correct the noncompliance). Thus, Bill needs to consider whether this noncompliance also represents an internal control deficiency.</p>
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## H. Suggested solution to Exercise 3-8

What do you think the auditor did?			
Scenario:	Material noncompliance	Material weakness	Significant deficiency
"We noted that there was a lack of appropriate and sufficient review and understanding of program requirements, which caused required reporting of financial performance to be filed late, or not filed at all. We noted that Q1 and Q2 reports were not submitted, and Q3 and Q4 reports were submitted after the stated due date." No questioned costs were reported related to the program.	✓	✓	
"During our special tests and provisions testing, we identified five instances where the information included in the income support differed from the information entered by the District." Likely questioned costs of \$996.51 were reported.			✓



## I. Suggested solution to Exercise 3-9

<b>So how are things going?</b>			
Below are the four most common types of findings reported in a single audit. For each of the below finding types, please guess the percentage of single audits that are submitted each year (based on a recent year's worth of submissions to the Federal Audit Clearinghouse) with that finding type.			
<b>Questioned costs</b>	<b>Material noncompliance</b>	<b>Material weakness</b>	<b>Significant deficiency</b>
<b>3.1%</b>	<b>2.7%</b>	<b>4.5%</b>	<b>9.1%</b>



# Latest Developments

This chapter is reserved for additional materials to be added throughout the year as appropriate. As this course went to press there were no latest developments to include.

