You Got This: An Introduction to Yellow Book and Single Audits

YGT4/26/V1

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Contents for Today's Course

- Section 1 – What Yellow Book Financial Audits Do and Do Not Include
- Section 2 – The Yellow Book Auditor Qualification Requirements
- Section 3 – The Additional Performance and Reporting Requirements for a Yellow Book Financial Audit
- Section 4 – Key Things to Know Going Into the Single Audit
- Section 5 – The SEFA Drives Major Program Determination; Major Program Determination Drives What We Are Going to Audit
- Section 6 – Understanding and Testing Controls and Compliance
- Section 7 – Reporting Findings and Audit Reporting

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Section 1

What Yellow Book Financial Audits Do and Do Not Include

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Section 1 – Learning Objectives

- Our objectives for this section are to:
  - Understand what the Yellow Book is and where you can find it
  - Recognize when the Yellow Book standards apply
  - Differentiate the various types of engagements covered by the Yellow Book
  - Explain how the Yellow Book relates to other professional standards
  - Understand key Yellow Book terminology
  - See the "big picture" of what a Yellow Book audit is really all about

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What is the Yellow Book?

- The term **Yellow Book** refers to a set of standards issued by the Government Accountability Office (GAO)
  - The GAO is a federal agency that works for the U.S. Congress
- The Yellow Book is formally referred to by the terms **Government Auditing Standards** (GAS) or **Generally Accepted Government Auditing Standards** (GAGAS)
- When the original version of the standards was issued in 1972, a bright yellow cover was used for the printed document, and the nickname **Yellow Book** has since been used conversationally when referring to the standards
  - Basically, the acronym GAS sounded the same as the AICPA's GAAS and GAGAS just sounded bad, so people started saying Yellow Book
  - In audit reporting, the more formal **Government Auditing Standards** terminology is used

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Where Can You Find the Yellow Book?

- The Yellow Book has gone through several revisions over the years
- The most recent Yellow Book revision was issued in 2024 and represents the 9th revision of the standards
- The 2024 Yellow Book revision is available at www.gao.gov

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When Do You Have to Follow the Yellow Book?

- The Yellow Book does not have the authority to require its application
- Things outside the Yellow Book require its application, including
  - **Federal laws and regulations** (e.g., the Single Audit Act Amendments of 1996, Uniform Guidance for Federal Awards, and HUD Consolidated Audit Guide require application of the Yellow Book)
  - **Contracts and grant agreements** (e.g., a grant received by a government or not-for-profit may require a Yellow Book audit)
  - **Other things** (e.g., state and local laws and regulations, policies, and more)
- So, it's really a matter of knowing your clients [governments, not-for-profits (NFPs) and even some for-profits] and the types of audit requirements and policies they are subject to

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The Various Types of Engagements Covered by the Yellow Book Include…

- **Financial audits**
  - By far, financial audits are the most common type of Yellow Book engagement performed and the focus of this course
- **Attestation engagements** (including examination engagements, review engagements, agreed-upon procedures engagements) and **reviews of financial statements**
  - These Yellow Book engagements are somewhat rare
- **Performance audits**
  - Performance audits are often economy and efficiency type audits and are typically performed by government/internal auditors

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Depending Upon the Type of Engagement You Are Performing, Different Chapters of the Yellow Book Apply

Chapter of the Yellow Book:	For **financial audits** auditors apply:	For **attestation engagements** and **f/s reviews** auditors apply:	For **performance audits** auditors apply:
Chapter 1: Foundation and Principles for the Use and Application of Government Auditing Standards	✓	✓	✓
Chapter 2: General Requirements for Complying with Government Auditing Standards	✓	✓	✓
Chapter 3: Ethics, Independence, and Professional Judgment	✓	✓	✓
Chapter 4: Competence and Continuing Professional Education	✓	✓	✓
Chapter 5: Quality Management, Engagement Quality Reviews, and Peer Review	✓	✓	✓
Chapter 6: Standards for Financial Audits	✓		
Chapter 7: Standards for Attestation Engagements and Reviews of Financial Statements		✓	
Chapter 8: Fieldwork Standards for Performance Audits			✓
Chapter 9: Reporting Standards for Performance Audits			✓

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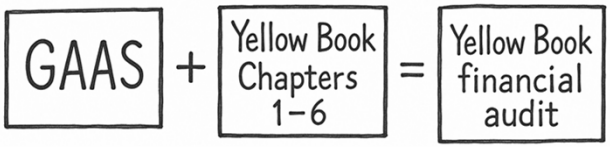
How the Yellow Book Relates to Other Standards

For financial audits, the Yellow Book incorporates by reference the AICPA SASs, **so auditors do everything GAAS requires plus the requirements in Chapters 1-6 of the Yellow Book**. Similar concepts apply to Yellow Book attestation engagements and reviews of financial statements



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Key Yellow Book Terminology

The Yellow Book utilizes the concept of identifying requirements via the use of the terms **should** (representing presumptively mandatory requirements) and **must** (representing unconditional requirements). The requirements are differentiated from application guidance by borders surrounding the text. Auditors are required to understand **the entire text of the applicable chapters** of the Yellow Book.

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Example of the Bordered Requirement Format

Provision of Nonaudit Services to Audited Entities

Requirement: Nonaudit Services

3.64 Before auditors agree to provide a nonaudit service to an audited entity, they should determine whether providing such a service would create a threat to independence, either by itself or in aggregate with other nonaudit services provided, with respect to any GAGAS engagement they conduct.

Application Guidance: Nonaudit Services

3.65 Auditors have traditionally provided a range of nonaudit services that are consistent with their skills and expertise. Providing nonaudit services

Page 43 GAO-24-106786 Government Auditing Standards

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Key Yellow Book Terminology

The Yellow Book defines an **auditor** as being **an individual assigned to planning, directing, performing engagement procedures, or reporting on Yellow Book engagements regardless of job title**. Therefore, individuals who may have the title auditor, information technology auditor, analyst, practitioner, evaluator, inspector, or other similar titles are considered auditors under the Yellow Book.

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Why the Yellow Book Definition of an Auditor is Important…

- The Yellow Book contains requirements related to auditor qualifications. These requirements apply to essentially everyone working on the audit regardless of title or whether they are licensed CPAs yet. For example,
  - Chapter 3 of the Yellow Book states that "In all matters relating to the GAGAS engagement, **auditors** and audit organizations must be independent from an audited entity."
  - With limited exceptions, the 24-hour Yellow Book CPE requirement found in Chapter 4 of the Yellow Book applies to all auditors working on Yellow Book engagements

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The "Big Picture" of What a Yellow Book Audit is Really All About

If one were to try to briefly describe what the Yellow Book is really all about, the two overall themes would be…

Auditor qualifications

The Yellow Book contains requirements and guidance dealing with ethics, independence, professional judgment, competence (including CPE), quality management, and peer review. **Simply put, the Yellow Book holds auditors to a higher level in terms of their qualifications.**

Transparency in reporting

The Yellow Book contains performance and reporting standards. Transparency is emphasized in the reporting standards (e.g., as part of a financial audit, an auditor will also be reporting on internal control and compliance with provisions of laws, regulations, contracts, or grant agreements regardless of whether they identify internal control deficiencies or instances of noncompliance). **Simply put, the Yellow Book provides for more transparency in the reporting process.**

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Exercise 1

NFP X is required to have a Yellow Book audit of its financial statements. Is this a **compliance audit**?

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Solution to Exercise 1

No. The AICPA defines a **compliance audit** as being a program-specific audit or an organization-wide **audit of an entity's compliance with applicable compliance requirements**. AU-C section 935, *Compliance Audits*, states that it applies when an auditor performs a compliance audit in accordance with **all** of the following: (1) GAAS; (2) the Yellow Book financial auditing standards; **and** (3) **a governmental audit requirement that requires the auditor to express an opinion on compliance.**

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Expanding Upon the Last Slide

- The standard wording in a Yellow Book financial statement audit opinion discusses that a Yellow Book financial audit involves more transparency but is not a compliance audit when it states
  - In accordance with *Government Auditing Standards*, **we have also issued our report dated [date of report] on our consideration of the [Entity]'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters**. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, **and not to provide an opinion on the effectiveness of the [Entity]'s internal control over financial reporting or on compliance**. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering [Entity]'s internal control over financial reporting and compliance.

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An Example of an Entity Having a Compliance Audit

Let's say a different entity, NFP Z, is required to have a single audit. NFP Z would be undergoing a compliance audit as the auditor will be expressing an opinion on the financial statements under GAAS and the Yellow Book **while also** expressing an opinion(s) on compliance under the Uniform Guidance for Federal Awards (following GAAS, the Yellow Book, and the Uniform Guidance).

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A Final Comparison of a Yellow Book Financial Statement Audit Versus a Compliance Audit Using the Two NFPs We've Just Discussed

NFP X – The Yellow Book financial statement audit will involve:

- Providing a GAAS and Yellow Book audit opinion on the f/s
- The Yellow Book reporting (but not opining) on internal control and compliance at the f/s level

NFP Z – The single audit will involve:

- **Everything on the left**
- Providing an AU-C section 725 "in relation to" opinion on the SEFA
- Performing additional procedures and reporting (but not opining) on internal controls over compliance at the major program level
- Providing an **opinion on compliance for each major program**

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Section 2

The Yellow Book Auditor Qualification Requirements

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Section 2 – Learning Objectives

- Our objectives for this section are to:
  - Understand the Yellow Book guidance related to ethics and independence
  - Recognize the Yellow Book CPE requirements and when they apply
  - Understand key concepts related to the Yellow Book quality management, engagement quality review, and peer review requirements
  - See the "big picture" of what the Yellow Book auditor qualification requirements are all about

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The Yellow Book Ethical Principles for Auditors

- Chapter 3 of the Yellow Book discusses **ethics**, **independence**, and **professional judgment**
- The Yellow Book's **ethical principles** contain no should or must-level requirements
- The approximately 1,000-word discussion on ethics primarily serves as a foundation from which the Yellow Book independence requirements are built (i.e., it helps us get a feel for where the GAO is coming from)

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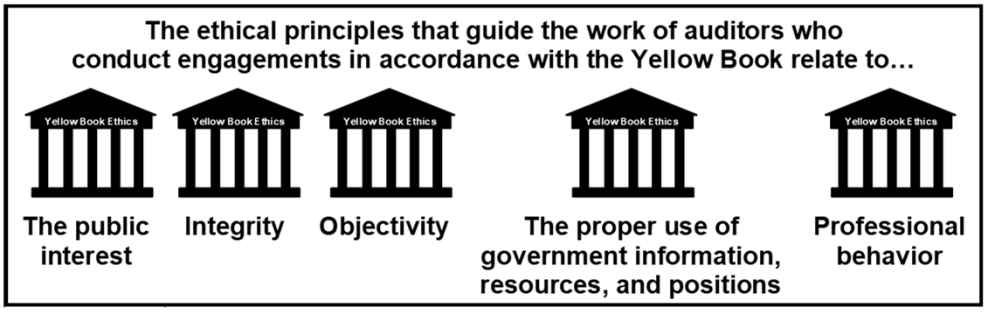
The Yellow Book Ethical Principles for Auditors



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Excerpts From the Yellow Book Ethical Principles for Auditors

- A distinguishing mark of an auditor is acceptance of responsibility to serve **the public interest**
- Acting with **integrity** means that auditors place priority on their responsibilities to the public interest
- Maintaining **objectivity** includes a continuing assessment of relationships with audited entities and other stakeholders in the context of the auditors' responsibility to the public

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Excerpts From the Yellow Book Ethical Principles for Auditors

- **Government information, resources, and positions** are to be used for official purposes and not inappropriately for the auditors' personal gain
- **Professional behavior** includes auditors putting forth an honest effort in performing their duties in accordance with the relevant technical and professional standards

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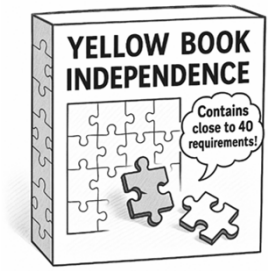
Independence

The Yellow Book contains a strong emphasis on the independence of both the auditor and the audit organization. In fact, approximately 30 pages are devoted to the topic, which is more than the Yellow Book devotes to the topic of performing and reporting on financial audits. At times, the independence guidance can be somewhat puzzling.



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The Yellow Book's Discussion of Independence Consists of Four Interrelated Sections, Providing…

	General requirements and application guidance;
	Requirements for and guidance on a **conceptual framework** for making independence determinations based on facts and circumstances that are often unique to specific environments;
	Requirements for and guidance on independence for auditors providing **nonaudit services**, including identification of specific nonaudit services that always impair independence and others that would not normally impair independence; and
	Requirements for and guidance on **documentation** necessary to support adequate consideration of auditor independence.

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General Independence Requirements (i.e., the First Interrelated Section)

The general independence requirements are overarching in nature (e.g., the Yellow Book specifies that auditors and audit organizations are required to avoid situations that could lead reasonable and informed third parties to conclude that the auditors and audit organizations are not independent) and they also specify the period of time for which independence is required

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An Unconditional Requirement To Be Independent From an Audited Entity…

In all matters relating to the Yellow Book engagement, auditors **and** audit organizations are required to be independent from an audited entity. Independence consists of both ***independence of mind*** and ***independence in appearance***.

Independence	=	**Independence of mind**	+	**Independence in appearance**
		The state of mind that permits the conduct of an engagement without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.		The absence of circumstances that would cause a reasonable and informed third party to reasonably conclude that the integrity, objectivity, or professional skepticism of an audit organization or member of the engagement team had been compromised.

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The Time Period During Which Independence is Required

The Yellow Book requires auditors and audit organizations to be independent from an audited entity during: (1) any period of time that falls within the period covered by the financial statements or subject matter of the engagement; **and** (2) the period of professional engagement. The period of professional engagement begins when the auditors either sign an initial engagement letter or agreement to conduct an engagement or begin to conduct an engagement, whichever is earlier. The period lasts for **the duration of the professional relationship** (which, for recurring engagements, could cover many periods) and ends with the formal or informal notification, either by the auditors or the audited entity, of the termination of the professional relationship or with the issuance of a report, whichever is later.

Note. Paragraphs 3.66 and 3.67 of the Yellow Book provide two isolated exceptions to the above requirement

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The Conceptual Framework Approach to Independence (i.e., the Second Interrelated Section)

Many different circumstances, or combinations of circumstances, are relevant in evaluating threats to independence. Therefore, the Yellow Book provides a **principles-based** conceptual framework that auditors use to identify, evaluate, and apply safeguards to address threats to independence. The framework can be applied to many variations in circumstances that create threats to independence and allows auditors to address threats to independence that result from activities that are not specifically prohibited by the Yellow Book

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Auditors Are Required To Apply the Conceptual Framework at the Audit Organization, Engagement Team, and Individual Auditor Levels To…

1		2
Identify threats to independence *and* evaluate the significance of the threats identified both individually and in the aggregate	**and**	**Apply safeguards as necessary to eliminate the threats or reduce them to an acceptable level**

The Application of the Conceptual Framework Is a Continuous Process

Auditors are required to reevaluate threats to independence, including any safeguards applied, **whenever** the audit organization or the auditors become aware of **new information or changes in facts and circumstances** that could affect whether a threat has been eliminated or reduced to an acceptable level. Situations that **may** create threats to independence can occur at any time during the relationship with the client (e.g., the start of a new engagement, the assignment of new personnel to an ongoing engagement, and acceptance of a nonaudit service for an audited entity).

Auditors Are Required To Evaluate Seven Broad Categories of Threats to Independence When Applying the Conceptual Framework

	Self-interest threat is the threat that a financial or other interest will inappropriately influence an auditor's judgment or behavior. For example, a firm having undue dependence on income from a particular audited entity **or** a member of the audit team entering into employment negotiations with an audited entity.
	Self-review threat is the threat that an auditor or audit organization that has provided nonaudit services will not appropriately evaluate the results of previous judgments made or services provided as part of the nonaudit services when forming a judgment significant to a Yellow Book engagement. For example, a firm having prepared the original data used to generate records that are the subject matter of the engagement **or** providing a service for an audited entity that directly affects the subject matter information of the engagement.

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Auditors Are Required To Evaluate Seven Broad Categories of Threats to Independence When Applying the Conceptual Framework

	Bias threat is the threat that an auditor will, as a result of political, ideological, social, or other convictions, take a position that is not objective. For example, a member of the engagement team having biases associated with political, ideological, or social convictions that result from membership or employment in, or loyalty to, a particular type of policy, group, entity, or level of government that could affect the auditor's objectivity.
	Familiarity threat is the threat that aspects of a relationship with management or personnel of an audited entity, such as a close or long relationship, or that of an immediate or close family member, will lead an auditor to take a position that is not objective. For example, a member of the engagement team having a close or immediate family member who is a principal or senior manager of the audited entity **or** senior engagement personnel having a long association with the audited entity.

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Auditors Are Required To Evaluate Seven Broad Categories of Threats to Independence When Applying the Conceptual Framework

	Undue influence threat is the threat that influences or pressures from sources external to the audit organization will affect an auditor's ability to make objective judgments. For example, a threat of replacing an auditor based on a disagreement with the contents of an audit report, the auditors' conclusions, or the application of an accounting principle or other criteria **or** unreasonable restrictions on the time allowed to complete an engagement or issue the report.
	Management participation threat is the threat that results from an auditor's taking on the role of management or otherwise performing management functions on behalf of the audited entity, which will lead an auditor to take a position that is not objective. For example, an auditor preparing management's corrective action plan to deal with deficiencies detected in the engagement.

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Auditors Are Required To Evaluate Seven Broad Categories of Threats to Independence When Applying the Conceptual Framework

	Structural threat is the threat that an audit organization's placement within a government entity, in combination with the structure of the government entity being audited, will affect the audit organization's ability to perform work and report results objectively. Structural threats primarily relate to auditors working for a government (e.g., a state auditor) or internal auditors. For example, a state auditor auditing the governor's office may have a structural threat.

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Once a Potential Threat to Independence Has Been Identified, It Needs to Be Evaluated

⚖	Threats to independence are evaluated both individually and in the aggregate.
⚖	Evaluating the significance of a threat involves professional judgment. A threat to independence is not at an acceptable level if it either: [1] could affect the auditors' ability to conduct an engagement without being affected by influences that compromise professional judgment; or [2] could expose the auditors or audit organization to circumstances that would cause a reasonable and informed third party to conclude that the integrity, objectivity, or professional skepticism of the audit organization, or an auditor, had been compromised.
⚖	Auditors are required to determine whether identified threats to independence are at an acceptable level or have been eliminated or reduced to an acceptable level, considering both qualitative and quantitative factors to determine the significance of a threat.

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After the Auditor Has Identified and Evaluated Threats to Independence, the Next Step Is To Consider the Application of Safeguards

Safeguards are actions or other measures, individually or in combination, that auditors and audit organizations take that effectively eliminate threats to independence or reduce them to an acceptable level. **When auditors determine that threats to independence are not at an acceptable level, they are required to determine whether appropriate safeguards can be applied to eliminate the threats or reduce them to an acceptable level.** In some cases, multiple safeguards may be necessary to address a threat.

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Examples of Safeguards Provided in the Yellow Book Include…

	Consulting an independent third party, such as a professional organization, a professional regulatory body, or another auditor to discuss engagement issues or assess issues that are highly technical or that require significant judgment.
	Involving another audit organization to perform or re-perform part of the engagement.
	Having an auditor who was not a member of the engagement team review the work performed.

Examples of Safeguards Provided in the Yellow Book Include…

	Removing an auditor from an engagement team when that auditor's financial or other interests or relationships pose a threat to independence.
	With regard to threats to independence related to nonaudit services taking actions such as: (1) not including individuals who provided the nonaudit service as engagement team members; (2) having another auditor, not associated with the engagement, review the engagement and nonaudit work as appropriate; (3) engaging another audit organization to evaluate the results of the nonaudit service; or (4) having another audit organization re-perform the nonaudit service to the extent necessary to enable that other audit organization to take responsibility for the service.

An Important Documentation Requirement Related to Safeguards

In cases where auditors determine that threats to independence require the application of safeguards, they are required to **document the threats identified and the safeguards applied** to eliminate or reduce the threats to an acceptable level.

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What if Safeguards Cannot Be Applied or Are Not Enough?

Auditors are required to conclude that independence is impaired if no safeguards have been effectively applied to eliminate an unacceptable threat or reduce it to an acceptable level. When this occurs, auditors are required to: (1) decline to accept an engagement; or (2) terminate an engagement in progress (except in very limited circumstances relating to auditors working within the government discussed in paragraphs 3.25 or 3.84 of the Yellow Book).

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What Drives the Determination of When Independence Is Impaired?

Whether independence is impaired depends on the nature of the threat, whether the threat is of such significance that it would compromise an auditor's professional judgment or create the appearance that the auditor's integrity, objectivity, or professional skepticism may be compromised, and the specific safeguards applied to eliminate the threat or reduce it to an acceptable level.

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Exercise 2

Anne Auditor believes that a significant self-review threat exists related to a Yellow Book client. Basically, her firm prepares the financial statements for the client and then audits them. Anne believes the client possesses suitable skill, knowledge, or experience (SKE) to oversee the service **and** the controller reviews the drafted financial statements using a checklist provided by Anne. **Can Anne document the presence of SKE and client's completion of a checklist as being safeguards to reduce the self-review threat to an acceptable level?**

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Solution to Exercise 2

No. While Anne is correct that a significant threat exists, there are two problems here. The **first problem** is that the presence of SKE under the Yellow Book is not a safeguard but rather a requirement that must be satisfied for the auditor to be able to perform a nonaudit service in the first place (**Note**. We will soon see this in the course). The **second problem** is that under the Yellow Book, safeguards are defined as actions that auditors and audit organizations take instead of actions the client takes (**Note**. The Yellow Book does not have the concept of partial safeguards implemented by the client that the AICPA rules have). **In Exercise 3, we will work through the types of safeguards that Anne should typically apply in this situation**.

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Before Leaving Our Discussion of the Conceptual Framework…

We should also mention that the Yellow Book provides additional tailored guidance for audit organizations in government entities (e.g., a state auditor) and internal auditors. This guidance is found in paragraphs 3.52 to 3.58 of the Yellow Book.

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The Provision of Nonaudit Services to Audited Entities (i.e., the Third Interrelated Section)

As we just reviewed, the Yellow Book provides a **principles-based** conceptual framework that auditors use to identify, evaluate, and apply safeguards to address threats to independence. The Yellow Book also contains guidance and requirements **specific to evaluating threats to independence related to nonaudit services that auditors provide to audited entities.**

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The Provision of Nonaudit Services to Audited Entities (i.e., the Third Interrelated Section)

The guidance and requirements related to nonaudit services builds onto the principles-based conceptual framework and is in part more **rules-based** (e.g., it enumerates specific nonaudit services that always impair auditor independence with respect to audited entities and that auditors are prohibited from providing to audited entities). The guidance includes discussions related to **the provision of nonaudit services to audited entities in general** and **the consideration of specific nonaudit services.**

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The Provision of Nonaudit Services to Audited Entities in General

Providing nonaudit services to audited entities may create threats to independence

Before auditors agree to provide a nonaudit service to an audited entity, they are required to determine whether providing such a service would create a threat to independence, either by itself or in aggregate with other nonaudit services provided, with respect to any Yellow Book engagement they conduct.

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Certain Routine Activities Are Not Considered To Be Nonaudit Services (i.e., This Is Good News!)

	Routine activities that auditors perform related directly to conducting an engagement, such as providing advice and responding to questions as part of an engagement, are **not** considered nonaudit services under the Yellow Book. Such routine activities generally involve providing advice or assistance to the audited entity on an informal basis as part of an engagement.
	Routine activities directly related to an engagement may include: (1) providing advice to the audited entity on an accounting matter as an ancillary part of the overall financial audit; (2) providing advice to the audited entity on routine business matters; (3) educating the audited entity about matters within the technical expertise of the auditors; and (4) providing information to the audited entity that is readily available to the auditors, such as best practices and benchmarking studies. **Note.** Paragraph 3.72 of the Yellow Book discusses additional services that government audit organizations may provide.

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However, the Yellow Book Warns Us That Certain Services Are Not Routine Activities (i.e., This Is the Bad News!)

Activities such as **financial statement preparation, cash-to-accrual conversions, and reconciliations** are considered nonaudit services under the Yellow Book, not routine activities related to the performance of an engagement, and are evaluated using the conceptual framework and independence guidance contained in the Yellow Book.

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A Key Concern Related to Performing Nonaudit Services Is the Potential Management Participation Threat That May Be Created

Before auditors agree to provide nonaudit services to an audited entity that the audited entity's management requested and that could create a threat to independence, either by themselves or in aggregate with other nonaudit services provided, with respect to any Yellow Book engagement they conduct, auditors are required to determine that the audited entity has designated an individual who possesses suitable **skill, knowledge, or experience (SKE)** and that the individual understands the services to be provided sufficiently to oversee them.

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A Key Concern Related to Performing Nonaudit Services Is the Potential Management Participation Threat That May Be Created

	Although the responsible individual in management is required to have sufficient expertise to oversee the nonaudit services, management is **not** required to possess the expertise to perform or re-perform the services. Indicators of management's ability to effectively oversee the nonaudit service include management's ability to determine the reasonableness of the results of the nonaudit services provided and to recognize a material error, omission, or misstatement in the results of the nonaudit services provided.
	In cases where the audited entity is unable or unwilling to assume these responsibilities, auditors are required to conclude that the provision of these services is an impairment to independence.

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An Important Documentation Requirement Related to SKE and the Provision of Nonaudit Services

	The Yellow Book requires auditors to document consideration of management's ability to effectively oversee nonaudit services to be provided. **Note**. The requirement to document SKE is not found in the AICPA standards (i.e., the AICPA standards require SKE to be present but do not require documentation of the assessment)

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When Performing Nonaudit Services Do Not Take on Management Responsibilities

The Yellow Book requires auditors to conclude that management responsibilities that the auditors perform for an audited entity are impairments to independence. The Yellow Book considers the following to be management responsibilities:
Setting policies and strategic direction for the audited entity;
Directing and accepting responsibility for the actions of the audited entity's employees in the performance of their routine, recurring activities;
Providing services that are intended to be used as management's primary basis for making decisions that are significant to the subject matter of the engagement;
Serving as a voting member of an audited entity's management committee or board of directors;
Having custody of an audited entity's assets;
Reporting to those charged with governance on behalf of management;
Deciding which of the audit organization's or outside third party's recommendations to implement;
Accepting responsibility for the management of an audited entity's project;
Developing an audited entity's performance measurement system when that system is material or significant to the subject matter of the engagement; and
Accepting responsibility for designing, implementing or maintaining internal control.

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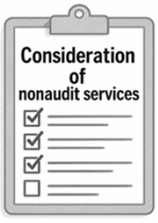
So, What's Our Thought Process When We Have Performed a Nonaudit Service?

If auditors provided a nonaudit service in the period to be covered by the engagement,[1] they are required to: (1) determine if the Yellow Book expressly prohibits the nonaudit service; (2) if audited entity management requested the nonaudit service, determine whether the SKE of the individual responsible for overseeing the nonaudit service was sufficient; **and** (3) determine whether a threat to independence exists and address any threats noted in accordance with the conceptual framework.

[1]The Yellow Book also has discussions regarding how previous nonaudit services may impact independence



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Another Important Documentation Requirement Related to the Provision of Nonaudit Services

In connection with nonaudit services, auditors are required to establish and document their understanding with the audited entity's management or those charged with governance, as appropriate, regarding: [1] the objectives of the nonaudit service; [2] the services to be provided; [3] the audited entity's acceptance of its responsibilities (i.e., assuming all management responsibilities; overseeing the services, by designating an individual, preferably within senior management, who possesses SKE; evaluating the adequacy and results of the services provided; and accepting responsibility for the results of the services); [4] the auditors' responsibilities; and [5] any limitations on the provision of nonaudit services.

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The Consideration of Specific Nonaudit Services

We discussed earlier that the guidance and requirements related to nonaudit services is in part more **rules-based**. This will become apparent as we look at the guidance related to the consideration of specific nonaudit services. Auditors may be able to provide nonaudit services in these broad areas without impairing independence if: [1] the nonaudit services are not expressly prohibited by the Yellow Book; [2] the auditors have determined that the general requirements for providing nonaudit services we have been discussing have been met; and [3] any significant threats to independence have been eliminated or reduced to an acceptable level through the application of safeguards.

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The Specific Nonaudit Services Discussed in the Yellow Book Relate to Six Broad Areas

- Preparing accounting records and financial statements
- Internal audit assistance services provided by external auditors
- Internal control evaluation as a nonaudit service
- Information technology services
- Appraisal, valuation, and actuarial services
- Other nonaudit services

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Preparing Accounting Records and Financial Statements

The overall theme is that management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, even if the auditor assisted in drafting those financial statements. Consequently, an auditor accepting responsibility for the preparation and fair presentation of financial statements that the auditor will subsequently audit or that will otherwise be the subject matter of an engagement would impair the auditor's independence.

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Preparing Accounting Records and Financial Statements

Auditors are required to conclude that the following services involving preparation of accounting records impair independence with respect to an audited entity:	
👎	Determining or changing journal entries, account codes or classifications for transactions, or other accounting records for the entity without obtaining management's approval;
👎	Authorizing or approving the entity's transactions; and
👎	Preparing or making changes to source documents without management approval. Source documents include those providing evidence that transactions have occurred (e.g., purchase orders, payroll time records, customer orders, and contracts). Such records also include an audited entity's general ledger and subsidiary records or equivalent.

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Preparing Accounting Records and Financial Statements

✏	Auditors are required to conclude that preparing financial statements in their entirety from a client-provided trial balance or underlying accounting records creates **significant threats** to auditors' independence, and are required to document the threats and safeguards applied to eliminate and reduce threats to an acceptable level in accordance with the conceptual framework or decline to provide the services.

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Exercise 3

In Exercise 2 we met Anne Auditor who has properly identified a significant self-review threat. Anne's firm prepares the financial statements for a client and then audits them. Anne has documented the understanding with the client regarding the nonaudit service, the client's SKE, and the significant threat of preparing the financial statements. **Anne is trying to develop and document a safeguard to reduce the significant threat to an acceptable level. Do you have any ideas?**

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Solution to Exercise 3

Typically, in this scenario, one of the following safeguards is documented and applied: (1) not including individuals who prepared the financial statements as audit team members; **or** (2) if the audit team prepared the financial statements, having an auditor who was not a member of the audit team review the work performed

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Preparing Accounting Records and Financial Statements

Auditors are required to identify as threats to independence any other services related to preparing accounting records and financial statements including: (1) recording transactions for which management has determined or approved the appropriate account classification, or posting coded transactions to an audited entity's general ledger; (2) preparing certain line items or sections of the financial statements based on information in the trial balance; (3) posting entries that an audited entity's management has approved to the entity's trial balance; and (4) preparing account reconciliations that identify reconciling items for the audited entity management's evaluation. In addition to identifying these threats, auditors are also required to evaluate the significance of the threats created and document the evaluation. **Note.** As a reminder, when an auditor determines that the application of safeguards is needed under the conceptual framework the auditor is also required to document the safeguards applied.

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Preparing Accounting Records and Financial Statements

When exercising professional judgment in evaluating whether the services discussed in the prior slide are significant threats, relevant factors to consider include: (1) the extent to which the outcome of the service could have a material effect on the financial statements; (2) the degree of subjectivity involved in determining the appropriate amounts or treatment for those matters reflected in the financial statements; and (3) the extent of the audited entity's involvement in determining significant matters of judgment. Merely providing clerical assistance, such as typing, formatting, printing, and binding financial statements, is unlikely to be a significant threat.

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Internal Audit Assistance Services Provided by External Auditors

Auditors are required to conclude that the following activities impair an external auditor's independence with respect to an audited entity: (1) setting internal audit policies or the strategic direction of internal audit activities; (2) performing procedures that form part of the internal control, such as reviewing and approving changes to employee data access privileges; and (3) determining the scope of the internal audit function and resulting work.

Internal Control Evaluation as a Nonaudit Service

When providing separate evaluations as nonaudit services, auditors are required to evaluate the significance of the threat created by performing separate evaluations and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level. Factors relevant to evaluating the significance of any threats created by providing separate evaluations as a nonaudit service include the frequency of the separate evaluations and the scope or extent of the controls (in relation to the scope of the engagement conducted) being evaluated. Auditors are required to conclude that providing or supervising ongoing monitoring procedures over an entity's system of internal control impairs independence because the management participation threat created is so significant that no safeguards could reduce the threat to an acceptable level.

Information Technology (IT) Services

Auditors are required to conclude that providing IT services to an audited entity that relate to the period under audit impairs independence if those services include: (1) designing or developing an audited entity's financial information system or other IT system that will play a significant role in the management of an area of operations that is or will be the subject matter of an engagement; (2) making other than insignificant modifications to source code underlying an audited entity's existing financial information system or other IT system that will play a significant role in the management of an area of operations that is or will be the subject matter of an engagement; (3) supervising audited entity personnel in the daily operation of an audited entity's information system; or (4) operating an audited entity's network, financial information system, or other IT system that will play a significant role in the management of an area of operations that is or will be the subject matter of an engagement.

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Appraisal, Valuation, and Actuarial Services

Auditors are required to conclude that independence is impaired if an audit organization provides appraisal, valuation, or actuarial services to an audited entity when: (1) the services involve a significant degree of subjectivity; and (2) the results of the service, individually or when combined with other valuation, appraisal, or actuarial services, are material to the audited entity's financial statements or other information on which the audit organization is reporting.

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Other Nonaudit Services

Auditors are required to conclude that providing certain other nonaudit services impairs an external auditor's independence with respect to an audited entity. These activities include: [1] advisory service; [2] benefit plan administration; [3] business risk consulting; [4] executive or employee recruiting; and [5] investment advisory or management. For more information, see paragraph 3.106 of the Yellow Book.

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Independence Documentation (i.e., the Fourth Interrelated Section)

Under the Yellow Book auditors are required to document the following where applicable:	
✎	The threats to independence that require the application of safeguards, along with the safeguards applied, in accordance with the conceptual framework. **Note.** This would include the guidance related to the preparation of financial statements in their entirety from a client-provided trial balance or underlying accounting records.
✎	The consideration of audited entity management's ability to effectively oversee a nonaudit service to be provided by the auditor.
✎	The auditor's understanding with an audited entity for which the auditor will provide a nonaudit service.
✎	The evaluation of the significance of the threats created by providing other services related to preparing accounting records and financial statements.
✎	The safeguards discussed in paragraphs 3.52 through 3.56 of the Yellow Book if an audit organization is structurally located within a government entity (e.g., a state auditor) and is considered structurally independent based on those safeguards.

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Professional Judgment

- As we discussed earlier, Chapter 3 of the Yellow Book discusses **ethics**, **independence**, and **professional judgment**
- By far, the independence requirements take up more bandwidth than any other topic
- In terms of **professional judgment**, the Yellow Book requires auditors to use professional judgment in planning and conducting the engagement and in reporting the results. **Note**. This is the only requirement related to professional judgment.

Competence & CPE

- Chapter 4 of the Yellow Book discusses **competence** and **CPE**
- Since the vast majority of the approximately 20-page chapter is devoted to **CPE** we will focus our attention there
  - The **competence** guidance primarily relates to ensuring that the audit team collectively has the competence to perform the engagement **and** the individual team members have the competence to perform their assigned duties
- The **CPE** requirements have always been a key focus of the Yellow Book as the GAO wants auditors to be current and competent in this unique area of auditing

The CPE Requirements Are in Part Tailored to the Individual Auditor and the Role(s) That He/She Performs During a Yellow Book Engagement

- The Yellow Book defines the following roles
  - **Planning** - Determining engagement objectives, scope, and methodology; establishing criteria to evaluate matters subject to audit; or coordinating the work of the other audit organizations. This definition excludes auditors whose role is limited to gathering information used in planning the engagement.
  - **Directing** - Supervising the efforts of others who are involved in accomplishing the objectives of the engagement or reviewing engagement work to determine whether those objectives have been accomplished
  - **Reporting** - Determining the report content and substance or reviewing reports to determine whether the engagement objectives have been accomplished and the evidence supports the report's technical content and substance prior to issuance. This includes signing the report
  - **Performing engagement procedures** - Performing tests and procedures necessary to accomplish the engagement objectives in accordance with the Yellow Book

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The Yellow Book CPE Requirements Have Two Components

Auditors who plan, direct, perform engagement procedures for, or report on an engagement conducted in accordance with the Yellow Book are required to develop and maintain their professional competence by completing at least **80 hours** of CPE in every 2-year period as follows:

24-hours	+	**56-hours**	=	**80-hours**
In subject matter directly related to the government environment, government auditing, or the specific or unique environment in which the audited entity operates.		In subject matter that directly enhance auditors' professional expertise to conduct engagements.		

Two key points about the above: (1) auditors are required to complete at least 20 hours of CPE in each year of the 2-year periods; and (2) we will soon see that certain auditors are exempt from all or some of the CPE requirements.

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Exemptions From All or Some of the Yellow Book CPE Requirements

	Auditors **are exempted from the 56-hour CPE requirement, but not the 24-hour requirement**, if they: (1) charge less than 20 percent of their time annually to engagements conducted in accordance with the Yellow Book; **and** (2) are only involved in performing engagement procedures, **but not involved in planning, directing, or reporting on the engagement**.
	**Note.** The 20 percent may be based on historical or estimated charges in a year, provided that the audit organization has a basis for this determination and monitors actual time. For auditors who change status such that they are charging more than 20 percent of their time annually to engagements under the Yellow Book, the audit organization may prorate the required CPE hours similar to when auditors are assigned to Yellow Book engagements after the beginning of a 2-year CPE measurement period.

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Exemptions From All or Some of the Yellow Book CPE Requirements

	**Nonsupervisory auditors who charge less than 40 hours of their time annually to engagements conducted in accordance with the Yellow Book** are exempted from **both the 24-hour and 56-hour CPE requirements**.
	College and university students employed on a temporary basis for a limited period of time (e.g., an internship of limited duration) or enrolled in a formal program sponsored by the college or university for a specific period of employment (e.g., a term or semester) **are exempted from the CPE requirements**.

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Exemptions From All or Some of the Yellow Book CPE Requirements

Employees or contract employees performing support services within the audit organization, such as individuals who are assigned to positions in budgeting, human resources, training, and administrative functions, and who **do not conduct engagement activities are not auditors subject to the Yellow Book CPE requirements**. Employees or contract employees who assist in the engagement by performing support services, such as performing background research, data entry, writing and editing assistance, proofreading, or report production and distribution **are not auditors subject to the Yellow Book CPE requirements**.

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Exemptions From All or Some of the Yellow Book CPE Requirements

The audit organization, at its discretion, may grant exemptions from **a portion of** the CPE requirement in the event of extended absences or other extenuating circumstances if situations such as the following prevent auditors from fulfilling those requirements **and conducting engagements**: (1) ill health; (2) maternity or paternity leave; (3) extended family leave; (4) sabbaticals; (5) leave without pay absences; (6) foreign residency; (7) military service; and (8) disasters. **However, the audit organization may not grant exceptions for reasons such as workload, budget, or travel constraints.**

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Looking More Closely at the 24-hour CPE Requirement

- As we saw earlier, under the 24-hour CPE requirement, auditors obtain in every two-year period, 24 hours in subject matter directly related to the government environment, government auditing, or the specific or unique environment in which the audited entity operates
- CPE used to fulfill the 24-hour requirement may be taken at any time during the 2-year measurement period
- Auditors may consider probable future engagements to which they may be assigned when selecting specific CPE subjects
- **If an auditor takes more than 24 hours in courses which satisfy the 24-hour requirement the excess could be used toward satisfying the 56-hour requirement**

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Examples of Subject Matters That Qualify Toward the 24-hour Requirement

- 4.23 of the Yellow Book provides over 20 examples of subject matters that qualify toward the 24-hour requirement. However, in practice, most of the courses taken relate to
  - The Yellow Book
  - Single auditing
  - HUD auditing
  - SAS based and focused auditing courses
  - GASB accounting
  - NFP accounting and auditing
  - Government and NFP fraud
  - NFP taxation

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Looking More Closely at the 56-hour CPE Requirement

- As we saw earlier, under the 56-hour CPE requirement, auditors obtain in every two-year period, 56 hours in subject matter that directly enhance auditors' professional expertise to conduct engagements
- 4.24 of the Yellow Book provides over 10 very broad examples of subject matters that qualify toward the 56-hour requirement. A few examples of courses that could qualify are:
  - Accounting courses
  - State ethics courses
  - Most soft skills courses (e.g., leadership, communication)
  - IT and software applications used in conducting engagements
  - Taxation courses relevant to audits (e.g., corporate taxation courses if you audit corporations)

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The Yellow Book Specifies Certain Topics/Activities That Do Not Qualify Toward Either the 24- or 56-hour Requirement Including…

- **Taxation not related to the subject matter of audit engagements (e.g., individual taxation courses, taxation strategy courses)**
- **Personal financial planning and investment**
- **Estate planning**
- **Retirement planning**
- Practice management
- On-the-job training
- Programs that are designed for general personal development (e.g., résumé writing, improving parent-child relations)
- Programs that demonstrate office equipment or software that is not used in conducting engagements

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The Yellow Book Specifies Certain Topics/Activities That Do Not Qualify Toward Either the 24- or 56-hour Requirement Including…

- Programs that provide training on the audit organization's administrative operations
- Business sessions at professional organization conferences, conventions, and meetings that do not have a structured educational program with learning objectives
- Conducting external quality reviews
- Sitting for professional certification examinations
- Basic or elementary courses in subjects or topics in which auditors already have the knowledge and skills being taught
  - **However, basic or elementary courses are acceptable in cases where they are deemed necessary as "refresher" courses to enhance the auditors' proficiency to conduct audits and attestation engagements**

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A Documentation Requirement Related to CPE

The audit organization is required to maintain documentation of each auditor's CPE. **Note.** Paragraphs 4.50 to 4.53 of the Yellow Book provide suggested application guidance for monitoring and documenting compliance with the CPE requirements.

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Chapter 4 of the Yellow Book Provides Additional CPE Guidance in Several Areas Including…

- How firms establish a two-year measurement period
- How to handle the addition of staff to Yellow Book engagement teams or changes in roles within the two-year measurement period (i.e., the proration rules)
- What to do when auditors do not complete the required hours within the two-year measurement period
- Guidance for types of educational activities that count for CPE and the measurement of hours
- Guidance related to internal specialists

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Quality Management, Engagement Quality Reviews, and Peer Review

- Chapter 5 of the Yellow Book discusses **quality management**, **engagement quality reviews**, and **peer review**
- When looking at Chapter 5, it is important to remember that the Yellow Book is used by many different types of auditors. For example,
  - CPA firms
  - Auditors working within government
  - Internal auditors
  - International auditors
- Some auditors, such as CPA firms, are already subject to quality management and peer review requirements. Other auditors are not.

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Since This is an Introduction to Yellow Book Course, Going In-depth Into Chapter 5 is Not the Best Use of Our Time. However, We Did Want To Make the Following Points…

- When looking at Chapter 5, keep in mind that the GAO did not want audit organizations already subject to one set of recognized quality management or peer review standards (e.g., the AICPA requirements) to also have to comply with an entirely different set of standards just because of the Yellow Book
- For recognized standards (e.g., the AICPA requirements), Chapter 5 adds certain guidance/requirements. For example,
  - Paragraph 5.07 provides key quality management applicability guidance for CPA firms subject to the AICPA requirements
  - Paragraph 5.162 requires one or more Yellow Book engagements to be included in a peer review
- For auditors not covered by recognized standards, the guidance in Chapter 5 is more extensive

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Section 3

The Additional Performance and Reporting Requirements for a Yellow Book Financial Audit

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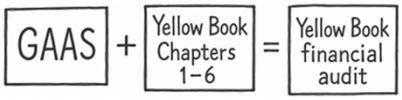
Section 3 – Learning Objectives

- Our objectives for this section are to:
  - Understand the key Yellow Book guidance related to performing a financial audit
  - Recognize the key Yellow Book reporting requirements
  - See the "big picture" of what a Yellow Book financial audit is all about

Performing a Yellow Book Financial Audit

- As discussed earlier, if one were to try to briefly describe what the Yellow Book is really all about, the two overall themes would be **auditor qualifications** and **transparency in reporting**
- In this section, we will see that Chapter 6 of the Yellow Book contains additional **performance** and **reporting** standards for financial audits that increase transparency in reporting
  - It is important to remember that the Chapter 6 performance and reporting standards are applied in addition to GAAS and the Yellow Book auditor qualification standards (discussed in the previous section)



The Additional Performance and Reporting Requirement Areas for a Yellow Book Financial Audit

	Performance requirements		Reporting requirements
1	Compliance with standards	10	Reporting the auditors' compliance with the Yellow Book
2	Licensing and certification	11	**Reporting on internal control, compliance, and instances of fraud** ♀
3	Auditor communication	12	**Presenting findings in the audit report** ♀
4	Results of previous engagements	13	Reporting findings directly to parties outside the audited entity
5	Investigations or legal proceedings	14	**Obtaining and reporting the views of responsible officials** ♀
6	**Noncompliance with laws, regulations, contracts, and grant agreements** ♀	15	Reporting confidential or sensitive information
7	**Findings** ♀	16	Distributing reports
8	Audit documentation		
9	Availability of individuals and documentation		

♀ These additional performance and reporting requirement areas are the most significant as they expand: (1) the auditor's AU-C section 250 responsibilities; (2) the reporting related to internal control and compliance; and (3) where and how findings are reported

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The Five Game Changers

- Several of the sixteen requirement areas shown on the prior slide are relatively short and not complex. However, the following five areas are more involved and meaningful. Thus, in this introductory course, we will focus on
  - Noncompliance with laws, regulations, contracts, and grant agreements
  - Findings
  - Reporting on internal control, compliance, and instances of fraud
  - Presenting findings in the audit report
  - Obtaining and reporting the views of responsible officials

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Noncompliance With Laws, Regulations, Contracts, and Grant Agreements

- Government programs are subject to provisions of many laws, regulations, contracts, and grant agreements that can have an impact on an audit
- The Yellow Book uses AU-C section 250 as a foundation and builds upon its requirements
- AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, discusses two categories of laws and regulations that the auditor is concerned with and distinguishes the auditor's responsibilities regarding compliance between the two categories

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The Two AU-C Section 250 Categories of Laws and Regulations That the Auditor Is Concerned With

For…	The auditor has a requirement to…
Provisions of laws and regulations generally recognized to **have a direct effect** on the determination of material amounts and disclosures in the financial statements	Obtain sufficient appropriate audit evidence regarding material amounts and disclosures in the financial statements that are determined by the provisions of those laws and regulations.
Provisions of laws and regulations **that do not have a direct effect** on the determination of amounts and disclosures in the financial statements but compliance with which may be fundamental to the operating aspects of the entity, the entity's ability to continue operating, or necessary for the entity to avoid material penalties	Perform procedures that may identify instances of noncompliance with other laws and regulations that may have a material effect on the financial statements including: (1) inquiring of management and, when appropriate, those charged with governance about whether the entity is in compliance with such laws and regulations; **and** (2) inspecting correspondence with the relevant licensing or regulatory authorities.

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With Regard to Noncompliance, the Yellow Book Builds Upon AU-C Section 250

Under the Yellow Book, auditors are required to extend the AICPA requirements concerning consideration of noncompliance with laws and regulations **to include consideration of noncompliance with provisions of contracts and grant agreements**

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Exercise 4

For a Yellow Book financial statement audit, the auditor is going to obtain an understanding of the provisions of laws, regulations, contracts, and grant agreements relevant to the entity, and how the entity is complying with them. The auditor will perform procedures that may identify instances of noncompliance with provisions of laws, regulations, contracts, and grant agreements that may have a material effect on the financial statements. **What are some example procedures that may assist an auditor in assessing management's identification of these compliance requirements and in obtaining an understanding of their possible effects on the financial statements?**

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Solution to Exercise 4

Example procedures could include things like:	
1.	If you have previously audited the entity, considering the knowledge about the compliance requirements the entity faces that you have gained from prior audits.
2.	Discussing the compliance requirements that the entity faces with their financial management, grant administrators, and legal counsel.
3.	Reviewing relevant portions of any directly related agreements (e.g., grant and debt agreements).
4.	Gaining an understanding from management of the sources of revenue, reviewing any related agreements (e.g., grant and debt agreements), and inquiring about the applicability of any overall governmental regulations to the accounting for the revenue.
5.	Obtaining copies of, and reviewing relevant sections of, laws and regulations concerning the entity. Sections of such documents relating to financial reporting, investments, debt, taxation, budget, and appropriation and procurement matters may be particularly important.

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Solution to Exercise 4

Example procedures could include things like:	
6.	Reviewing the minutes of the entity's governing body for information about contracts and grant agreements that have a material effect on the financial statements.
7.	Inquiring of the appropriate audit oversight organization regarding the compliance requirements applicable to entities within their jurisdiction, including statutes and reporting requirements.
8.	Reviewing information about applicable federal and state program compliance requirements (e.g., information in the OMB Compliance Supplement, federal audit guides, and state and local policies and procedures).
9.	Inquiring of finance personnel or program administrators from which the entity receives grants regarding restrictions, limitations, terms, and conditions under which the grants were provided. Administrators may be helpful in identifying compliance requirements that they may identify separately or publish in an audit guide.
10.	Staying vigilant to the possibility that other procedures performed during the audit may bring instances of noncompliance to the auditor's attention.

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Findings

- The Yellow Book performance requirements related to **findings** primarily address: (1) **the development of certain required elements of findings**; and (2) **considering whether identified findings or other matters are internal control deficiencies**
- Of the above two areas, **the development of certain required elements of findings** is the more significant area as the second area (**considering whether identified findings or other matters are internal control deficiencies**) comes more inherently to auditors

The Development of Certain Required Elements of Findings

- Under the Yellow Book, a **finding** may involve: (1) a deficiency in internal control; (2) noncompliance with provisions of laws, regulations, contracts, or grant agreements; or (3) instances of fraud
- To be precise, we will soon see that the following findings will be reported
  - **Significant deficiencies** or **material weaknesses**
  - **Material noncompliance**
  - **Material fraud**
- Because the above findings will be formally reported, **the Yellow Book requires that findings be developed in a uniform manner** so they can be reported in a uniform manner

The Four Elements of a Finding

- In a Yellow Book financial audit, findings consist of four elements

Criteria + Condition + Cause + Effect or potential effect = Finding

- The Yellow Book also defines each of the four elements

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The Four Elements of a Finding

For inclusion in findings, **criteria** may include the laws, regulations, contracts, grant agreements, standards, measures, expected performance, defined business practices, and benchmarks against which performance is compared or evaluated. Criteria identify the required or desired state or expectation with respect to the program or operation. Criteria provide a context for evaluating evidence and understanding the findings, conclusions, and recommendations in the report. In a financial audit, the applicable financial reporting framework, such as GAAP, represents one set of criteria.
A **condition** is a situation that exists. The condition is determined and documented during the audit.

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The Four Elements of a Finding

The **cause** is the factor or factors responsible for the difference between the condition and the criteria, and may also serve as a basis for recommendations for corrective actions. Common factors include poorly designed policies, procedures, or criteria; inconsistent, incomplete, or incorrect implementation; or factors beyond the control of program management. Auditors may assess whether the evidence provides a reasonable and convincing argument for why the stated cause is the key factor contributing to the difference between the condition and the criteria.
The **effect or potential effect** is the outcome or consequence resulting from the difference between the condition and the criteria. When the audit objectives include identifying the actual or potential consequences of a condition that varies (either positively or negatively) from the criteria identified in the audit, effect is a measure of those consequences. Effect or potential effect may be used to demonstrate the need for corrective action in response to identified problems or relevant risks.

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Considering Whether Identified Findings or Other Matters Are Internal Control Deficiencies

- Regardless of the type of finding identified (e.g., material noncompliance with a contract or grant agreement), the root cause of a finding may relate to an underlying control deficiency
- **The Yellow Book requires auditors to also consider the existence of internal control deficiencies in their evaluation of identified findings when developing the cause element of the identified findings**

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Reporting on Internal Control, Compliance, and Instances of Fraud

- **The Yellow Book requires auditors to report on internal control and compliance with provisions of laws, regulations, contracts, or grant agreements** regardless of whether they identify internal control deficiencies or instances of noncompliance
  - When comparative financial statements are presented, this reporting relates only to the most recent reporting period included
  - The Yellow Book itself does not contain report illustrations of this additional reporting; rather, it is the AICPA (www.aicpa.org/gaqc) that does this
  - The AICPA refers to this report as the *Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards*
  - The audit report on the financial statements will refer to this report

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Reporting on Internal Control, Compliance, and Instances of Fraud

- The following excerpts from an AICPA illustrative report on internal control over financial reporting and on compliance and other matters help describe the scope of a Yellow Book audit
  - In planning and performing our audit of the financial statements, we considered the [Entity]'s internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, **but not for the purpose of expressing an opinion on the effectiveness of the [Entity]'s internal control. Accordingly, we do not express an opinion on the effectiveness of the [Entity]'s internal control.**
  - As part of obtaining reasonable assurance about whether the [Entity]'s financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. **However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.**

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Reporting on Internal Control, Compliance, and Instances of Fraud

- The Yellow Book requires the following **findings** to be **reported:**
  - Any **significant deficiencies** or **material weaknesses** in internal control over financial reporting identified by the auditor
  - **Noncompliance with provisions of laws, regulations, contracts, or grant agreements that has a material effect on the financial statements** or other financial data significant to the audit objectives
  - **Fraud that is material, either quantitatively or qualitatively, to the financial statements** or other financial data significant to the audit objectives
- The above findings can be presented in the report on internal control over financial reporting and on compliance and other matters **or**, as more frequently seen, the report can refer to a separate schedule that presents the findings (e.g., a schedule of findings and responses **or** a schedule of findings and questioned costs)
- The Yellow Book has communication requirements for lower-level findings

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Presenting Findings in the Audit Report

- When reporting findings
  - The auditor will include the **criteria**, **condition**, **cause**, and **effect or potential effect** (i.e., the four elements of a finding)
  - The findings should be written in a manner that provides a perspective by describing the nature and extent of the issues being reported and the extent of the work performed that resulted in the finding
  - Auditors will provide **recommendations** for corrective action as part of the finding
  - Findings need to be assigned a reference number consisting of the fiscal year being audited as the first four digits of each reference number, followed by a three-digit numeric sequence (e.g., 2026-001, 2026-002, etc.)
  - The findings will include the **views of responsible officials** (see next slide)

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Obtaining and Reporting the Views of Responsible Officials

- The Yellow Book requires auditors to obtain and report the **views of responsible officials** of the audited entity concerning the findings, conclusions, and recommendations in the audit report, as well as any planned corrective actions
- Related to obtaining and reporting the views of responsible officials, the Yellow Book provides guidance for when:
  - The client responds in writing
  - The client responds orally
  - The client disagrees with the finding
  - The client fails to provide a response

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An Example Yellow Book Finding

Schedule of Findings and Responses
Year Ended June 30, 2023

Finding 2023-001: Financial Accounting Closing Procedures

Material Weakness

Criteria: The objective of effective internal controls over financial reporting is to prevent or detect and correct material misstatements (caused by error or fraud) in a timely manner and permit the timely preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

Condition: During the audit for the year ended June 30, 2023, errors were identified in the balances provided for certain accounts, including accounts receivable, deferred revenue, stormwater revenue, and lease related assets and liabilities.

Effect: Inaccurate reconciliation of certain asset and liability accounts resulted in the identification of material adjusting journal entries during the audit process to correct improperly reported balances.

Cause: The Town did not follow proper review and reconciliation processes for certain balance sheet accounts.

Recommendation: We recommend that management conducts a thorough review of all balance sheet accounts, across funds, to ensure that the trial balances provided for audit do not contain material errors.

Views of Responsible Officials: We agree with the finding, and plan to work with the Town Council to develop an appropriate response to ensure the accuracy of future financial reporting. The Town intends to formalize a plan, to be submitted to the Local Government Commission, by March 1, 2024.

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What Have We Seen So Far?

- The Yellow Book does indeed hold auditors to a higher level in terms of their qualifications (e.g., through the independence, CPE, and peer review requirements)
- The Yellow Book does indeed provide for more transparency in the reporting process as findings are reported rather than merely communicated to the client

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Section 4

Key Things To Know Going Into the Single Audit

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Section 4 – Learning Objectives

- Our objectives for this section are to:
  - Understand what a single audit is and where you can find key guidance
  - Explain how a single audit involves three levels of requirements
  - Recognize when a single audit is required
  - Understand common single audit terminology

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Why Do We Have Single Audits?

- Federal money is the American taxpayers' money
- The federal government has a fiduciary responsibility to ensure that federal funds are spent in accordance with how America's elected representatives have voted to spend the funds
- Single audits are **the primary tool** federal agencies and pass-through entities use to provide oversight for federal awards made to nonfederal entities
- To some degree, single audits also reduce the audit burden on nonfederal entities receiving federal awards
  - If a uniform single audit process were not in place, federal agencies would likely require nonfederal entities to periodically undergo multiple audits for the different types of federal awards they receive from different federal agencies (e.g., a small city might be required to have separate audits by HUD, EPA, DOJ, DOT, DHS, and others)

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The Single Audit Act Amendments of 1996

- Since the single audit is such an important tool in the federal government's fiduciary oversight of the taxpayers' money, the United States Congress set into law certain key requirements for the single audit in the Single Audit Act Amendments of 1996
  - For being a law, the Single Audit Act Amendments of 1996 are relatively short consisting of only ten pages!
- One reason that the law is so short is that it charges the Office of Management and Budget (**OMB**) to prescribe the detailed guidance to implement the law (e.g., the **Uniform Guidance for Federal Awards** and **annual Compliance Supplement**)

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Under the Single Audit Framework Established in the Single Audit Act Amendments of 1996, the Auditor Will…

	Determine whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP).
	Determine whether the SEFA is presented fairly in all material respects in relation to the financial statements taken as a whole.
	With respect to internal controls pertaining to the compliance requirements for each major program: (1) obtain an understanding of such internal controls; (2) assess control risk; and (3) perform tests of controls unless the controls are deemed to be ineffective.
	Determine whether the nonfederal entity has complied with federal statutes, regulations, and the terms and conditions of federal awards that could have a direct and material effect on each major program.

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A Couple of Additional Points About the Single Audit Framework

- The Single Audit Act Amendments of 1996 **require that the audit be performed in accordance with the Yellow Book**
  - Thus, the single audit will also incorporate the financial statement level internal control and compliance requirements found in the Yellow Book
- The Single Audit Act Amendments of 1996 provide that a nonfederal entity that expends awards under only one federal program and is not subject to statutes, regulations, or the terms and conditions of federal awards that require a financial statement audit of the nonfederal entity, may elect to have a **program-specific audit**
  - Program-specific audits are also performed under the Uniform Guidance for Federal Awards (a helpful resource is Chapter 14 of the AICPA Yellow Book and Single Audit Guide)

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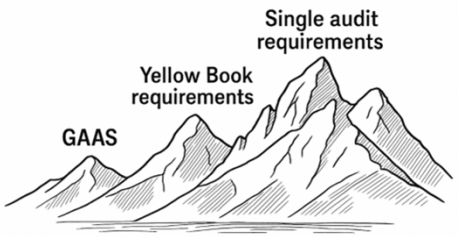
Single Audits Involve Three Levels of Requirements

The Single Audit Act Amendments of 1996 require that the audit be performed in accordance with the Yellow Book. The Yellow Book requires auditors performing financial audits in accordance with the Yellow Book to comply with GAAS. So, **in a single audit, we are applying three levels of requirements which increase the responsibilities and reporting deliverables** as shown on the next slide



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How Does a Single Audit Differ From a Financial Statement Audit?

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**

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The Uniform Guidance for Federal Awards

- As discussed earlier, the OMB issues the detailed implementation guidance on how to perform a single audit. The two primary sources of guidance are the **Uniform Guidance for Federal Awards** and the annual **Compliance Supplement**
  - Both documents can be found at the Federal Audit Clearinghouse (FAC) website (www.fac.gov) under the "Policy & Compliance" tab
- The Uniform Guidance for Federal Awards has been revised and amended over the years with the most recent significant revision occurring in 2024
- In audit reporting the Uniform Guidance for Federal Awards is more formally referred to as Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*

SURGENT ACCOUNTING & FINANCIAL EDUCATION

How Is the Uniform Guidance for Federal Awards Organized?

The organization of the Uniform Guidance for Federal Awards					
Subpart A - Acronyms and Definitions (§200.00 - §200.1)	**Subpart B - General Provisions (§200.100 - §200.113)**	**Subpart C - Pre-Federal Award Requirements and Contents of Federal Awards (§200.200 - §200.216)**	**Subpart D - Post Federal Award Requirements (§200.300 - §200.346)**	**Subpart E - Cost Principles (§200.400 - §200.476)**	**Subpart F - Audit Requirements (§200.500 - §200.521)**
⬆	⬆	⬆	⬆	⬆	⬆
Contains acronyms and definitions used in administrative requirements, cost principles, and audit requirements.	Contains some broad overall guidance (e.g., effective dates)	Contains administrative requirements		Contains cost principles	Contains audit requirements

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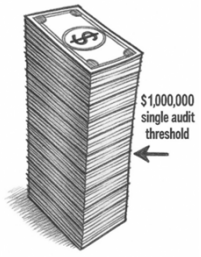
When Is a Single Audit Required Under the Uniform Guidance for Federal Awards?

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 **expends $1,000,000** or more during the nonfederal entity's fiscal year in federal awards must have a single audit or program-specific audit conducted for that year. (**Note**. For audits of years ending before 9/30/25 a lower threshold applied)



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Key Terminology Used in Single Auditing

- **Single audit** - an audit of a nonfederal entity that includes both the entity's financial statements **and** federal awards (particularly from a compliance perspective)
- **Program-specific audit** - an audit of a nonfederal entity that occurs when an auditee expends federal awards under only one federal program and the auditee is not required to have a financial statement audit
- **Nonfederal entity** - a state, local government, Indian tribe, institution of higher education, or a not-for-profit that carries out a federal award as a **recipient** (an entity receiving an award directly from a federal agency) or **subrecipient** (an entity receiving an award from a pass-through entity)

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Key Terminology Used in Single Auditing

- **Pass-through entity** - a nonfederal entity that provides federal awards to a subrecipient to carry out a federal program
- **Federal financial assistance** - assistance that nonfederal entities receive or administer in the form of grants, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance, but does not include amounts received as reimbursement for services rendered to individuals in accordance with guidance found in the Uniform Guidance for Federal Awards

SURGENT ACCOUNTING & FINANCIAL EDUCATION

Key Terminology Used in Single Auditing

- **Federal award** - federal financial assistance and federal cost-reimbursement contracts that nonfederal entities receive directly from federal awarding agencies **or** indirectly from pass-through entities. Expenditures of federal awards are reported in the **schedule of expenditures of federal awards (SEFA)**
- **Major program** - a program determined to be major by the auditor following the four-step major program determination process in the Uniform Guidance for Federal Awards
- **Cluster of programs** - a grouping of closely related federal programs that have similar compliance requirements

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Key Terminology Used in Single Auditing

- **Assistance Listing number (ALN)** - the number assigned to a federal program (sam.gov). In the past, ALNs were referred to as CFDA numbers
- **Compliance Supplement** - the annual document issued by the OMB utilized for the compliance audit
- **Federal Audit Clearinghouse (FAC)** - an office within the General Services Administration which receives single audit submissions and makes them available to awarding entities and the public
- **Reporting package** - the auditee's submission to the FAC (along with the data collection form) at the completion of the audit that includes: (1) the financial statements and SEFA; (2) the auditor's reports; (3) a corrective action plan; and (4) a summary schedule of prior audit findings

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Key Terminology Used in Single Auditing

- **Data collection form** - a submission (Form SF-SAC) to the FAC at the completion of the audit
- **Corrective action plan (CAP)** - an auditee prepared document that addresses each finding in the current year audit reports
- **Summary schedule of prior audit findings** - an auditee prepared document which reports the status of findings in the prior audit
- **Schedule of findings and questioned costs (SFQC)** - an auditor prepared document which conveys: (1) a summary of the auditor's results; (2) findings related to the financial statements that are required to be reported under the Yellow Book; and (3) findings and questioned costs for federal awards

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Key Resources Used in Performing a Single Audit

- In addition to the Uniform Guidance for Federal Awards and annual Compliance Supplement (both available at www.fac.gov) key single auditing resources include
  - The FAC website (www.fac.gov) is where single audits are ultimately submitted, and also a searchable repository of single audits performed on entities across the U.S.
  - The Council on Federal Financial Assistance (www.coffa.gov) provides a wealth of information regarding the single audit process
  - The AICPA's Governmental Audit Quality Center (www.aicpa.org/gaqc) provides a good deal of implementation guidance including the AICPA Yellow Book and Single Audit Guide
  - The OMB (www.whitehouse.gov/omb/)
  - The GAO (www.gao.gov) is responsible for the Yellow Book itself
  - The Council of the Inspectors General on Integrity and Efficiency (www.ignet.gov)

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Three More Items We Need To Know Upfront: The Timeliness of the Audit Submission Is a Major Issue to the Federal Agencies

- The Uniform Guidance for Federal Awards requires auditees to ensure that the single audit is properly performed and submitted when due
- The audit must be submitted to the FAC within 30 calendar days after the auditee receives the auditor's report(s) **or** nine months after the end of the audit period (**whichever is earlier**)
- An auditee's failure to meet the submission deadline will impact its ability to qualify as a low-risk auditee in future audits (i.e., the auditee may undergo additional audit work in the future)

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Three More Items We Need To Know Upfront: The Role of AU-C Section 935 in a Single Audit

- AU-C section 935, *Compliance Audits*, assists the auditor in understanding how the OMB's requirements, the Yellow Book's requirements, and GAAS all interrelate and build upon each other in a compliance audit
- AU-C section 935 addresses the application of GAAS in compliance auditing (e.g., the compliance audit portion of a single audit)
- AU-C section 935 does not apply to the financial statement audit component of a single audit

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Three More Items We Need To Know Upfront: When It Comes to Single Auditing, Don't Be Afraid To Ask for Help

- Each year, **Part 8 Appendix III of the Compliance Supplement contains a listing of federal agency single audit contacts, key management liaisons, and program contacts.** These contacts are listed to assist auditors with questions.
- Pass-through entities can also be a helpful resource

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Section 5

The SEFA Drives Major Program Determination; Major Program Determination Drives What We Are Going To Audit

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Section 5 – Learning Objectives

- Our objectives for this section are to:
  - Appreciate the critical nature of the SEFA
  - Explain the auditor's responsibilities related to the SEFA
  - See the importance of the major program determination process
  - Recognize key aspects of the major program determination process
  - Understand how the auditor determines the direct and material compliance requirements to test for each major program

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The Auditee's Core Responsibilities Related to the SEFA

- The Uniform Guidance for Federal Awards requires the **auditee** to
  - **Identify all federal awards received and expended and the federal programs under which they were received**. Federal program and award identification includes as applicable: (1) the Assistance Listing title and number, (2) the award number and year; (3) the name of the federal agency; and (4) the name of the pass-through entity and the identifying award number assigned by the pass-through entity. **Note**. This information enables the auditee to reconcile amounts presented in the financial statements to related amounts in the SEFA
  - **Prepare the SEFA**
    - The information in the SEFA is required to relate to the same period as the financial statements

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Exercise 5

If an auditee struggles in preparing its SEFA, is that potentially a red flag to the auditor?

Solution to Exercise 5

Yes. While auditees may need assistance in formatting and nuances of the SEFA, the actual preparation of the SEFA is a core auditee responsibility. The SEFA is essentially where the auditee says, “here are all of the federal expenditures for the year that should be included in the single audit by program”. If an auditee cannot readily determine what the federal expenditures were during the year and the programs they related to, how can they possibly tell us that they followed the applicable compliance requirements?

Expanding Upon the Last Slide

- **The SEFA drives major program determination and major program determination drives what we are going to audit.** Thus, errors in preparing the SEFA can have significant ramifications on the audit
  - If incorrect **amounts** for the individual programs or in total appear on the SEFA, major program determination will likely be incorrect
  - If incorrect **program** numbers and names appear on the SEFA, the auditor will likely be identifying and testing the wrong compliance requirements

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How the Auditee Prepares the SEFA

- The auditee prepares the SEFA following the detailed guidance provided in the Uniform Guidance for Federal Awards
- The Uniform Guidance for Federal Awards provides detailed requirements related to:
  - **What** should be reported on the SEFA
  - **When** expenditures should be reported on the SEFA
    - For example, special rules apply to loan and loan guarantee programs
  - The **valuation** of noncash awards expended
    - For example, guidance is provided for food commodities and donated property
  - The **format** of the SEFA
  - **Disclosures** that should accompany the SEFA

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The Key Components of the SEFA

	The SEFA will include the total federal awards expended (in both cash and noncash assistance) for the period covered by the auditee's financial statements and…
1	List the individual federal programs by federal agency. For a cluster of programs, the SEFA will provide the cluster name, list the individual federal programs within the cluster of programs, and provide the applicable federal agency name. For research and development, total federal awards expended will be shown either by individual federal award or by federal agency and major subdivision within the federal agency.
2	Provide the name of the pass-through entity and identifying number assigned by the pass-through entity for federal awards received as a subrecipient.
3	Provide the total federal awards expended for each individual federal program and the Assistance Listing number (or other identifying number when the Assistance Listing information is not available). If a cluster of programs is present, the SEFA also needs to provide the total federal awards expended for the cluster.
4	Give the total amount provided to subrecipients from each federal program.
5	Include accompanying notes describing: (1) the significant accounting policies used in preparing the SEFA; (2) whether or not the auditee elected to use the de minimis indirect cost rate contained in the Uniform Guidance for Federal Awards; and (3) the balances of loans or loan guarantee programs outstanding at the end of the audit period for loan or loan guarantee programs described in §200.502 of the Uniform Guidance for Federal Awards.

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An Illustrative SEFA

City of Sugar Land, Texas
Schedule of Expenditures of Federal Awards
For the Fiscal Year Ended September 30, 2024

Federal Grantor/ Pass-Through Grantor Program Title	Federal Assistance Listing Number	Pass-Through Entity Identifying Number	Total Federal Expenditures
U.S. DEPARTMENT OF JUSTICE			
Direct Programs:			
Bulletproof Vest Partnership Program:			
Bulletproof Vests	16.607	n/a	$ 4,417
TOTAL U.S. DEPARTMENT OF JUSTICE			4,417
U.S. DEPARTMENT OF TRANSPORTATION			
Passed through Texas Department of Transportation:			
Highway Safety Cluster:			
STEP Speed Comprehensive	20.600	587EGF6102	33,924
STEP CIMV	20.600	587XXEGF6102	10,947
Total Highway Safety Cluster			44,871
TOTAL U.S. DEPARTMENT OF TRANSPORTATION			44,871
U.S. DEPARTMENT OF THE TREASURY			
Direct Programs:			
Coronavirus State and Local Fiscal Recovery Funds:			
COVID-19: American Rescue Plan Act of 2021 - State and Local Fiscal Recovery	21.027	n/a	3,438,072
TOTAL U.S. DEPARTMENT OF THE TREASURY			3,438,072
U.S. DEPARTMENT OF HOMELAND SECURITY			
Passed Through Texas Office of the Governor - Homeland Security Grants Division:			
Homeland Security Grant Program-FY2023 Urban Area Security Initiative-CyberSecurity	97.067	EMW-2023-SS-00025	17,671
Homeland Security Grant Program-FY2024 Urban Area Security Initiative-Vehicle Barricade	97.067	EMW-2023-SS-00025	140,526
Total 97.067			158,197
TOTAL U.S. DEPARTMENT OF HOMELAND SECURITY			158,197
TOTAL EXPENDITURES OF FEDERAL AWARDS			$ 3,645,557

See accompanying Notes to the Schedule of Expenditures of Federal Awards.

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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.

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How the Auditor Audits the SEFA

Under the Uniform Guidance for Federal Awards, 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.

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Under AU-C Section 725 Auditors Provide an "In Relation To" Opinion on the SEFA Using Wording Such As…

The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. **The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America.** In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects **in relation to** the financial statements as a whole.

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Some of the More Essential Aspects of Auditing the SEFA Include…

- Obtaining an understanding of the internal controls over the preparation of the SEFA
  - How does the auditee ensure the SEFA is complete and accurate?
  - How does the auditee ensure the ALNs are correct?
- Testing the **completeness** of the SEFA
  - 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
  - Comparing the current SEFA to the prior year SEFA
  - Comparing consistency of the SEFA to other information obtained during the audit

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Some of the More Essential Aspects of Auditing the SEFA Include…

- Testing the **accuracy/valuation** of the SEFA
  - Comparing the listed program numbers and names of awarding agencies to award documents, grant records, Compliance Supplement, sam.gov, etc.
  - Determining whether the SEFA properly identifies pass-through awards
  - Determining whether the SEFA properly includes direct and indirect costs, and excludes cost sharing of matching amounts
  - Determining whether the SEFA properly measures certain unique items like loans and loan guarantees, noncash assistance, etc.
  - Ensuring that clusters of programs are properly reported in the SEFA by reviewing Part 5 – Clusters of Programs in the annual Compliance Supplement

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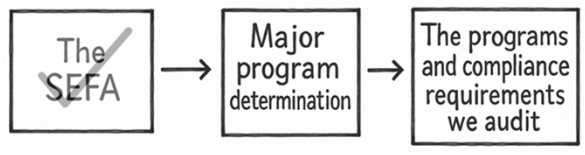
Some of the More Essential Aspects of Auditing the SEFA Include…

- Testing the **presentation and disclosure** of the SEFA
  - Determining whether the form and content of the SEFA complies with the Uniform Guidance for Federal Awards
  - Determining whether the notes to the SEFA are adequate
- Ensuring that adequate management representations regarding the SEFA are obtained

SURGENT ACCOUNTING & FINANCIAL EDUCATION

It's Time To Select Major Programs!

- As we discussed earlier, **the SEFA drives major program determination and major program determination drives what we are going to audit**
- Thus, once the auditor has become comfortable with the SEFA, it's time to determine major programs



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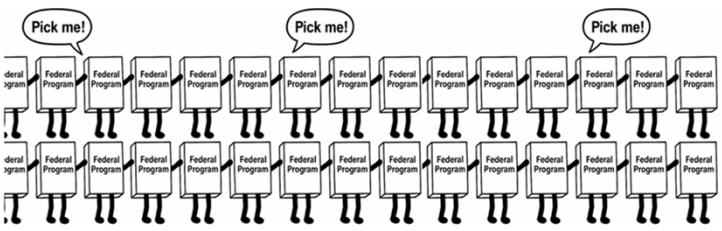
Why Are Major Programs Such a Big Deal?

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 **major program** 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.**



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The Four-Step Major Program Determination Process Described in the Uniform Guidance for Federal Awards

- In theory, the four-step major program determination process is a risk-based approach that focuses the single audit on higher dollar/higher-risk programs
  - The process is very rules and terminology driven
  - The process sometimes yields unexpected results
- Under the four-step process, the auditor
  - Calculates a threshold (based on the total federal awards expended) above which programs are called **type A programs** and below which they are called **type B programs**; and
  - Follows a prescribed process to assess program risk to identify which programs will be audited as major programs

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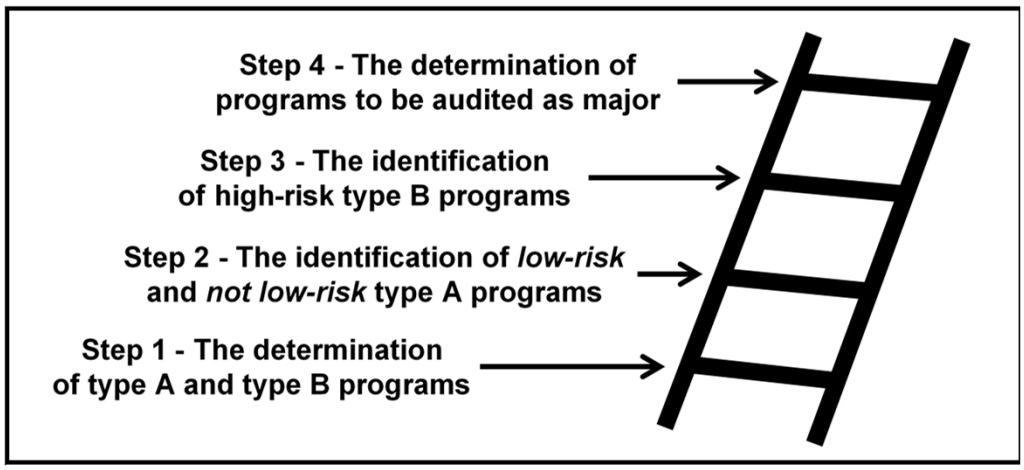
The Four Steps in the Major Program Determination Process



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A Few Points About Step 1

- In Step 1 auditors classify programs as being either **type A programs** or **type B programs** using a sliding-scale threshold provided in the Uniform Guidance for Federal Awards
- For purposes of determining major programs, federal awards with the same ALN are considered as one program and a cluster of programs is also considered as one program
- Special rules may apply to auditees with large loan programs
- Auditors will report the threshold utilized in the SFQC

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A Few Points About Step 2

- In Step 2 auditors assess the risk of **each type A program**
  - Programs are classified as either **low-risk** or **not low-risk** using criteria provided in the Uniform Guidance for Federal Awards
  - Programs with certain prior audit findings or not recently audited will be deemed **not low-risk**
  - Auditors **do not** consider inherent risk
  - All **not low-risk type A programs will be audited as major programs in the current year**
  - **Low-risk type A programs** may still be audited as major programs if selected in Step 4 of the process
  - The number of low-risk type A programs is important for performing Step 3 of the process

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A Few Points About Step 3

- In Step 3 auditors look at the **type B programs**
  - **In some scenarios auditors get to skip step 3**
  - Auditors typically assess the risk of **some** of the **type B programs** using criteria provided in the Uniform Guidance for Federal Awards
  - Special rules exist to keep auditors from having to look at very small programs
  - If type B programs are assessed as being **high-risk, they will be audited as major programs in the current year**
  - Auditors **do** consider inherent risk

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A Few Points About Step 4

- In Step 4, auditors finish the process of determining the major programs to be audited in the current year
  - All of the **not low-risk type A programs** identified in Step 2 will be audited as major programs
  - All of the **high-risk type B programs** identified in Step 3 will be audited as major programs
  - Auditors then apply a **percentage-of-coverage rule** described in the Uniform Guidance for Federal Awards that potentially requires additional programs to be audited as major programs
    - The percentage-of-coverage rule sets a minimum percentage of federal expenditures that must be audited as major programs
    - The percentage utilized in applying the rule will be driven based on whether the auditee is classified as being either a **low-risk auditee** or **non-low-risk auditee** using provided criteria
    - Auditors will report whether the auditee was a low-risk auditee in the SFQC

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Exercise 6

How do federal agencies, pass-through entities, and other report users know the specific programs that the auditor selected as major in the current year?

Solution to Exercise 6

- We will see later that the auditor issues a report on compliance and internal control over compliance as part of the single audit. In that report, the auditor will opine on the compliance requirements that could have a direct and material effect on **each major program.**
- That report generally **does not** identify the specific federal programs that were audited as major programs. **Instead**, that report refers report users to the **listing of the major programs included in the summary of auditor's results section of the SFQC.**
  - The exception to the above is when the auditor is modifying the compliance opinion for one or more major programs in which case the report will identify those precise programs

Let's Determine the Compliance Requirements To Test!

- As we discussed, **the SEFA drives major program determination and major program determination drives what we are going to audit**
- Thus, once the auditor has become comfortable with the SEFA and selected the major programs, **the auditor looks at those major programs and determines the related compliance requirements to test (i.e., the direct and material compliance requirements)**

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Looking at the Major Programs and Determining the Compliance Requirements To Test

- 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
- **Thus, auditors look at the major programs they selected in the four-step major program determination process and then use the annual Compliance Supplement to determine the compliance requirements to test**
  - Use of the Compliance Supplement is mandatory, and auditors must use the Supplement for the appropriate year

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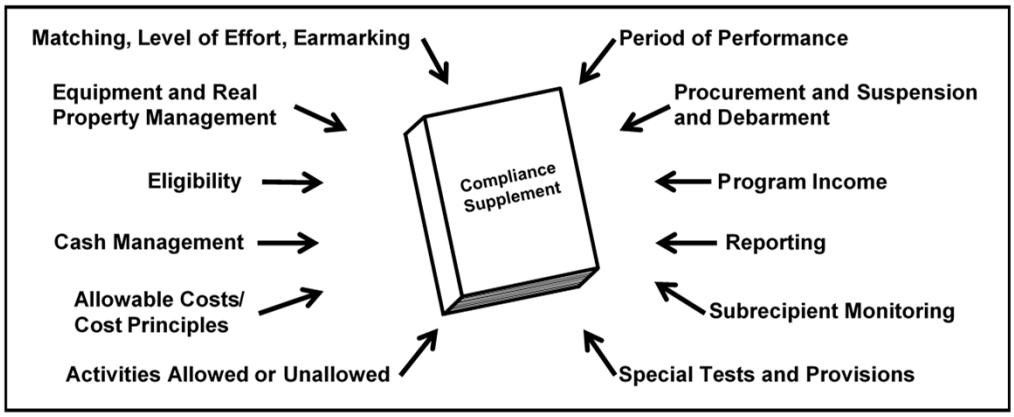
The Compliance Supplement Describes 12 Principal Types of Compliance Requirements



There Are Two Possible Paths to Using the Compliance Supplement To Determine the Types of Compliance Requirements To Test

Federal programs included in the Compliance Supplement

- For approximately 200 of the largest and/or riskiest programs, specific guidance for determining the compliance requirements to be tested is provided in the **Compliance Supplement's Part 2 - Matrix of Compliance Requirements**

Federal programs not included in the Compliance Supplement

- For hundreds of smaller programs not included in the Part 2 – Matrix of Compliance Requirements, auditors will follow more generic guidance provided in the **Compliance Supplement's Part 7 – Guidance For Auditing Programs Not Included In This Compliance Supplement**

How Does the Auditor Know Which Path To Take?

To determine whether specific guidance for determining the compliance requirements to test is included in the Compliance Supplement, the auditor will look at a major program's ALN listed on the SEFA and then look at the Part 2 – Matrix of Compliance Requirements. If the ALN is listed in Part 2 (as ALN 81.042 is in the below illustration), the auditor will find specific guidance for that program in the Supplement. If an ALN is not listed, the auditor follows Part 7 - Guidance For Auditing Programs Not Included In This Compliance Supplement

Requirement	A	B	C	E	F	G	H	I	J	L	M	N
Program Number	Activities Allowed or Unallowed	Allowable Costs/Cost Principles	Cash Management	Eligibility	Equipment Real Property Management	Matching, Level of Effort, Earmarking	Period of Performance	Procurement Suspension & Debarment	Program Income	Reporting	Subrecipient Monitoring	Special Tests and Provisions
81.042	Y	Y	N	Y	N	N	N	Y	N	Y	Y	N

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Using the Compliance Supplement - Programs Included in the Supplement

- If 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

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Using the Compliance Supplement - Programs Included in the Supplement

- In reviewing the Compliance Supplement's Part 2 – Matrix of Compliance Requirements, the auditor finds the major program's ALN and examines the corresponding row across the compliance requirements columns
  - If the box for a type of compliance requirement contains a "**Y**" (see next slide) 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

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Using the Compliance Supplement - Programs Included in the Supplement

In the below illustration, by placing a "Y" under a compliance requirement, the Supplement is essentially telling the auditor that the government typically expects that compliance requirement to be tested as it normally is direct and material to ALN 81.042

Requirement	A	B	C	E	F	G	H	I	J	L	M	N
Program Number	Activities Allowed or Unallowed	Allowable Costs/Cost Principles	Cash Management	Eligibility	Equipment Real Property Management	Matching, Level of Effort, Earmarking	Period of Performance	Procurement Suspension & Debarment	Program Income	Reporting	Subrecipient Monitoring	Special Tests and Provisions
81.042	Y	Y	N	Y	N	N	N	Y	N	Y	Y	N

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Using the Compliance Supplement - Programs Included in the Supplement

- The auditor also exercises **professional judgment** in determining the compliance requirements to test
  - Even though a "Y" appears in the Part 2 – Matrix of Compliance Requirements for a given ALN, 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. If the auditor does not test that requirement, the auditor will need to document why the requirement did not have a direct and material effect on the major program being audited
  - Parts 1 & 2 of the Compliance Supplement provide important additional guidance related to the application of professional judgment in determining the compliance requirements to test

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Using the Compliance Supplement – Programs Not Included in the Supplement

- For hundreds of smaller programs not included in the Part 2 – Matrix of Compliance Requirements, auditors will follow more generic guidance provided in **Part 7 – Guidance For Auditing Programs Not Included In This Compliance Supplement**
  - The Part 7 guidance includes a five-step process for auditors to identify the compliance requirements to test
- 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

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It's Time To Understand and Test Controls and Compliance!

- As we have seen, the SEFA drives major program determination and major program determination drives what we are going to audit
- Once the auditor has looked at the major programs and **determined the related compliance requirements to test (i.e., the direct and material compliance requirements), it becomes time to understand and test controls and compliance!**

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Section 6

Understanding and Testing Controls and Compliance

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Section 6 – Learning Objectives

- Our objectives for this section are to:
  - Understand key internal control concepts applied in a single audit
  - Perceive key compliance testing concepts utilized in a single audit
  - See the types of control and compliance findings that may be reported in a single audit

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Remember This Slide From Earlier? We're About To Start Working on the Bottom Right Responsibilities

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

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The Auditee's Core Responsibilities Related to Internal Control Over Compliance

The Uniform Guidance for Federal Awards **requires** that recipients and subrecipients receiving federal awards **establish**, **document** and **maintain** effective **internal control over the federal awards** that provides reasonable assurance that the recipient or subrecipient is managing the federal awards **in compliance with** federal statutes, regulations, and the terms and conditions of the federal awards

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Internal Controls Over Compliance Are Not a One-size-fits-all Concept

- Auditee management exercises judgment in balancing the cost and benefit of designing, implementing, and operating internal controls over compliance. 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)
- The **Compliance Supplement's Part 6 – Internal Control** provides invaluable guidance to auditees and auditors in terms of thinking about controls from a compliance perspective

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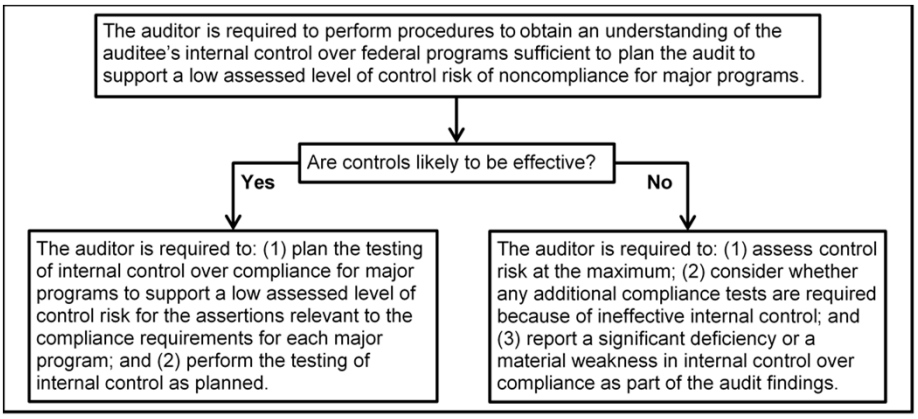
Understanding and Testing Controls in a Single Audit

- Having briefly looked at the **auditee's** responsibilities to establish, document 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 in the previous section), the auditor's attention turns to understanding and testing controls over compliance

Understanding and Testing Controls in a Single Audit

- **For each major program**, the auditor will perform risk assessment procedures to obtain a sufficient understanding of the compliance requirements subject to audit that are direct and material and **the entity's internal control over compliance with those compliance requirements**
- While auditors **will not be opining** on internal control over compliance in a single audit, they **will be performing effectiveness testing of these controls and reporting on them**

Understanding and Testing Controls in a Single Audit



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

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Understanding and Testing Controls in a Single Audit

- The AICPA Audit Guide related to Yellow Book and Single Audits provides helpful guidance related to understanding and testing controls in a single audit
- Testing the operating effectiveness of controls **is different from** 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)

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Understanding and Testing Controls in a Single Audit

- The auditor should obtain evidence that the controls are operating effectively throughout the period of reliance
  - Some controls are applied throughout the year
  - Other controls may just apply at year end
- Under AU-C section 935, *Compliance Audits*, controls related to direct and material compliance requirements for major programs should be tested every year in a single audit
- 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

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Exercise 7

Does compliance testing alone provide adequate evidence that controls are properly designed, implemented, and operating effectively?

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Solution to Exercise 7

No. Testing compliance provides indirect evidence on the effectiveness of controls, but cannot serve as the basis for assessing controls as operating effectively.

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Considering Deficiencies in Internal Control Over Compliance

- The auditor may identify deficiencies in internal control over compliance when
  - Obtaining an understanding of internal control over federal programs
  - Testing the effectiveness of internal control over federal programs
  - Performing compliance testing
- 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**

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Considering Deficiencies in Internal Control Over Compliance

- The determination of whether a deficiency is a **significant deficiency** or **material weakness** for the purpose of reporting a finding is in relation to a type of compliance requirement **for a major program**
  - A **material weakness** in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with **a type of compliance requirement** of **a federal program** will not be prevented or detected and corrected on a timely basis
  - A **significant deficiency** in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with **a type of compliance requirement** of **a federal program** that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance

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The AICPA Audit Guide Related to Yellow Book and Single Audits Provides 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.
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.
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).

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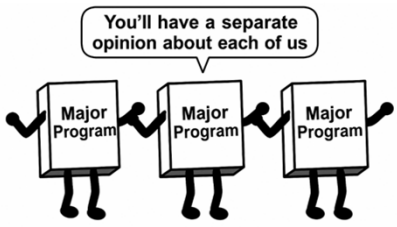
The Auditee's Core Responsibilities Related to Compliance

When auditees receive federal funding, they must follow the rules related to that funding. More formally said, the auditee is responsible for complying with federal statutes, regulations, and the terms and conditions of the federal awards it receives

Testing Compliance in a Single Audit

- Having briefly looked at the **auditee's** responsibilities related to compliance, let's now move to the **auditor's** responsibilities
- Ultimately, at the end of the single audit, the auditor will be responsible for **providing an opinion** on the auditee's compliance with the types of compliance requirements identified as subject to audit in the OMB Compliance Supplement that could have a direct and material effect **on each of the auditee's major federal programs**



Testing Compliance 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 **each major program**
- 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)

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Testing Compliance in a Single Audit

- The AICPA Audit Guide related to Yellow Book and Single Audits **and** AU-C section 935 provide vital guidance related to testing compliance. This guidance
  - Assists in broad areas like planning and performing compliance testing in general
  - Assists in specific areas like determining materiality, risk assessment, audit sampling, dual-purpose testing, etc.
- For this introductory course, we want to focus on the key role that the Compliance Supplement plays in compliance testing

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Testing Compliance in a Single Audit

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 **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.)	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.	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.

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Testing Compliance in a Single Audit

- Key concepts related to using Part 3 of the Compliance Supplement include
  - 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)

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Testing Compliance in a Single Audit

- Key concepts related to using Part 3 of the Compliance Supplement include
  - 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

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Testing Compliance in a Single Audit

- Key concepts related to using Part 4 of the Compliance Supplement include
  - 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 **always** 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

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Testing Compliance in a Single Audit

- Key concepts related to using Part 4 of the Compliance Supplement include
  - 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.**

Testing Compliance in a Single Audit

- Key concepts related to using Part 4 of the Compliance Supplement include:
  - The description of program procedures in Part 4 is general in nature. Some programs may operate somewhat differently than described due to:
    - The complexity of governing federal and state laws and regulations
    - The administrative flexibility afforded nonfederal entities
    - 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

Testing Compliance in a Single Audit

- Key concepts related to using Part 5 of the Compliance Supplement include:
  - 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

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Testing Compliance in a Single Audit

- To provide a feel for the guidance provided, the below are examples of suggested audit procedures from a recent Compliance Supplement
  - Related to **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
  - Related to **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

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Exercise 8

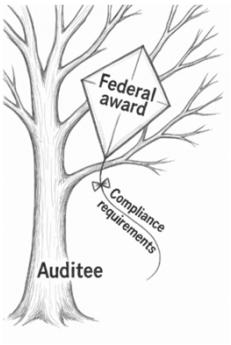
In performing tests of compliance, auditors may identify instances of noncompliance. Could such findings be nonmonetary in nature?

Solution to Exercise 8

Yes! Findings may be of a **monetary nature and involve questioned costs** (e.g., an auditee erroneously used program funds for non-program purposes) **OR** may be of a **nonmonetary nature and not result in questioned costs** (e.g., a pass-through entity failed to properly monitor a subrecipient)

Considering Findings Related to Compliance

- As we saw earlier, auditors may determine that a **significant deficiency** or **material weakness** in internal control over compliance exists in which case they **will report a finding**
- Auditors may also determine that findings related to compliance issues exist that will be reported



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Compliance Findings That Get Reported

- **Material noncompliance related to a major program**
  - Material for the purpose of reporting an audit finding is in relation to **a type of compliance requirement** for **a major program** identified in the Compliance Supplement
- **Known questioned costs** when either known **or** likely questioned costs **are greater than $25,000** for **a type of compliance requirement** for **a major program**
- Known questioned costs greater than $25,000 for a federal program that **is not audited as a major program**

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Compliance Findings That Get Reported

- The circumstances concerning why the auditor's report on compliance for each major program is other than an unmodified opinion
- Known or likely fraud affecting a federal award
- 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

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Section 7

Reporting Findings and Audit Reporting

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Section 7 – Learning Objectives

- Our objectives for this section are to:
  - Understand the critical nature of the schedule of findings and questioned costs (SFQC)
  - Review **what** findings get reported, **where** findings get reported, and **how** findings get reported in a single audit
  - Explain other key aspects of single audit reporting

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The Schedule of Findings and Questioned Costs (SFQC)

- The reporting of findings and audit reporting in a single audit is involved. One of the most critical elements of this reporting is the SFQC.
- The SFQC consists of three sections:
  - **Section I** - A summary of the auditor's results including
    - Information about how the audit went
    - Identification of the major programs audited
    - Certain key aspects of the major program determination process
  - **Section II** - Any reportable Yellow Book financial statement findings
  - **Section III** - Any reportable federal award findings

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Example SFQC For an Entity Without Any Findings

Nonprofit J
Schedule of Findings and Questioned Costs
Year Ended June 30, 202X

I. Summary of Auditor's Results

Financial Statements

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP: **Unmodified opinion**

Internal control over financial reporting:

- Material weakness(es) identified? ___ Yes _X_ No
- Significant deficiency(ies) identified? ___ Yes _X_ None Reported

Noncompliance material to financial statements noted? ___ Yes _X_ No

Federal Awards

Internal control over major federal programs:

- Material weakness(es) identified? ___ Yes _X_ No
- Significant deficiency(ies) identified? ___ Yes _X_ None Reported

Type of auditor's report issued on compliance for major federal programs: **Unmodified opinion**

- Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? ___ Yes _X_ No

Identification of major federal programs: Assistance Listing 17.264 National Farmworker Jobs Program

Dollar threshold used to distinguish between type A and type B programs: $1,000,000

Auditee qualified as low-risk auditee? ___ Yes _X_ No

II. Findings Relating to the Financial Statement Audit as Required to be Reported in Accordance with Generally Accepted Government Auditing Standards

None Reported.

III. Findings and Questioned Costs for Federal Awards

None Reported.

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Section I of the SFQC

- Section I of the SFQC provides a summary of the auditor's results including:
  - The type of opinion issued on the financial statements;
  - Whether the Yellow Book audit identified any significant deficiencies, material weaknesses, or material noncompliance at the financial statement level;
  - Whether the compliance audit identified any significant deficiencies or material weaknesses in the internal control over major programs;
  - The type of report the auditor issued on compliance for major programs;
  - Whether the audit disclosed any reportable findings;
  - The major programs audited;
  - The threshold used to distinguish between type A and type B programs; and
  - Whether the auditee qualified as a low-risk auditee

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Section II of the SFQC

- Section II of the SFQC reports the **Yellow Book findings related to the financial statements** including:
  - **Significant deficiencies** and/or **material weaknesses**
  - **Material noncompliance**
  - **Material fraud**
- The Yellow Book findings should include all the elements required by the Yellow Book (i.e., criteria, condition, cause, effect or potential effect, recommendation, and views of responsible officials)
- Findings need to be assigned a reference number consisting of the fiscal year being audited as the first four digits of each reference number, followed by a three-digit numeric sequence (e.g., 2026-001, 2026-002, etc.)

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Section III of the SFQC

- Section III of the SFQC reports the **federal award findings** including:
  - **Significant deficiencies** and/or **material weaknesses in internal control over major programs**
  - **Material noncompliance related to a major program**
  - **Known questioned costs** when either known **or** likely questioned costs **are greater than $25,000** for **a type of compliance requirement** for **a major program**
  - Known questioned costs greater than $25,000 for a federal program that **is not audited as a major program**
  - The circumstances concerning why the auditor's report on compliance for each major program is other than an unmodified opinion
  - Known or likely fraud affecting a federal award
  - 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

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Section III of the SFQC

- In reporting a **federal award finding** in Section III of the SFQC auditors will include:
  - The federal program and specific federal award identification, including the Assistance Listing title and number, federal award identification number and year, the name of the federal agency, and name of the applicable pass-through entity. When information, such as the Assistance Listing title and number or federal award identification number, is unavailable, the auditor will provide the best information available to describe the federal award
  - The **criteria** or specific requirement for the audit finding (e.g., the specific federal statute, regulation, or term and condition of the federal award). The criteria or specific requirement provides a context for evaluating evidence and understanding findings. The criteria should generally identify the required or desired state or expectation with respect to the program or operation

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Section III of the SFQC

- In reporting a **federal award finding** in Section III of the SFQC auditors will include:
  - The **condition** found, including facts that support the deficiency identified in the audit finding
  - A statement of **cause** that identifies the reason or explanation for the condition or the factors responsible for the difference between the situation that exists (condition) and the required or desired state (criteria), which may also serve as a basis for recommendations for corrective action
  - The possible asserted **effect** to provide sufficient information to the auditee and federal agency or pass-through entity to permit them to determine the cause and effect to facilitate prompt and proper corrective action. A statement of the effect or potential effect should provide a clear, logical link to establish the impact or potential impact of the difference between the condition and the criteria

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Section III of the SFQC

- In reporting a **federal award finding** in Section III of the SFQC auditors will include:
  - The identification of known **questioned costs**, by applicable Assistance Listing number(s) and federal award identification number(s), and how these questioned costs were computed
  - When there are known questioned costs, but the dollar amount is undetermined or not reported, a description of why the dollar amount was undetermined or otherwise could not be reported
  - Information to provide proper **perspective** for evaluating the prevalence and consequences of the audit finding (e.g., whether the audit finding represents an isolated instance or a systemic problem). Where appropriate, instances identified will be related to the universe and the number of cases examined and be quantified in terms of dollar value. In addition, the audit finding should indicate whether the sampling was a statistically valid sample

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Section III of the SFQC

- In reporting a **federal award finding** in Section III of the SFQC auditors will include:
  - The identification of whether the audit finding is a repeat of a finding in the immediately prior audit. The audit finding will identify the applicable prior year audit finding reference numbers in these instances
  - **Recommendations** to prevent future occurrences of the deficiency identified in the audit finding
  - **Views of responsible officials** of the auditee
  - Findings need to be assigned a reference number consisting of the fiscal year being audited as the first four digits of each reference number, followed by a three-digit numeric sequence (e.g., 2026-001, 2026-002, etc.)

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Example Reporting of a Federal Award Finding

Schedule of Findings and Questioned Costs (Continued)

Year Ended June 30, 2024

Section III - Federal Program Audit Findings

Reference Number	Finding	Questioned Costs
2024-001	**Assistance Listing Number, Federal Agency, and Program Name** - 10.553 and 10.555, U.S. Department of Agriculture, Child Nutrition Cluster **Federal Award Identification Number and Year** - 241960 and 241970 **Pass-through Entity** - Michigan Department of Education **Finding Type** - Significant deficiency **Repeat Finding** - No **Criteria** - The Academy must submit monthly claims for reimbursement for meals served to eligible students within 60 days following the last day of the month covered by the claim (7 CFR sections 210.8, 220.11, 215.10, and 225.15 (c)). Upon preparation of meal reimbursement claims, the Academy is required to have controls in place to ensure the accuracy of the request for reimbursement. **Condition** - The Academy does not currently have a control in place where a review of the meal counts entered into the Michigan Nutrition Data (MiND) system takes place, which could result in incorrect reporting of the number of free and reduced priced meals, which could result in the Academy being reimbursed an incorrect amount by the Michigan Department of Education. **Questioned Costs** - None **Context** - Monthly reimbursement claim requests do not have evidence of a second review. However, monthly claim requests are supported by underlying detail from the point-of-sale system. **Cause and Effect** - The absence of a secondary review comparing meal data from the Academy's meal tracking point-of-sale system to the inputs into the MiND system resulted in the Academy being reimbursed for inaccurate amounts. **Recommendation** - The Academy should implement a control where the monthly reimbursement request is reviewed and approval is documented to ensure the submission is mechanically accurate and that it agrees with the Academy's internal meal claims data report. **Views of Responsible Officials and Corrective Action Plan** - The Academy agrees with the recommendation and intends to implement the related procedures.	None

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Other Key Aspects of Single Audit Reporting

- Under the Uniform Guidance for Federal Awards, the auditor reporting will include:
  - An opinion on the financial statements under GAAS and the Yellow Book
    - This would also include the in relation to reporting on the SEFA
  - The Yellow Book reporting on internal control over financial reporting and on compliance and other matters
  - The Uniform Guidance for Federal Awards reporting on compliance for each major federal program and report on internal control over compliance
  - The SFQC
- The **AICPA** (www.aicpa.org/gaqc) provides critical guidance, **options** (e.g., options related to where the SEFA reporting occurs), and **illustrations** related to each of the reporting elements discussed above

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Other Key Aspects of Single Audit Reporting

- Single audits are submitted electronically to the FAC website (fac.gov) and include:
  - The financial statements and SEFA
  - The auditor reporting discussed on the prior slide
  - A **summary schedule of prior audit findings**
  - A **corrective action plan**
- The above elements are referred to as the **reporting package**. The auditee and auditor also complete a **data collection form** to complete the submission
  - Information on the data collection form and submission process is available at the FAC website

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Other Key Aspects of Single Audit Reporting

- On the prior slide we mentioned the **summary schedule of prior audit findings** and **corrective action plan**
- The **auditee** is responsible for follow-up and corrective action on findings relating to federal awards **and** the financial statements
  - The auditee will prepare a **summary schedule of prior audit findings** related to findings from the prior audit
    - The auditor is required to perform procedures to assess the reasonableness of the summary schedule of prior audit findings
    - The auditee is not required to prepare a summary schedule of prior audit findings if there are no matters reportable therein
  - The auditee will prepare, in a document separate from the auditor's findings, a **corrective action plan** that addresses **each** of the current-year audit findings

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What Have We Seen?

- As we said earlier, federal money is the American taxpayers' money and single audits are the primary tool to ensure that federal funds are spent in accordance with how America's elected representatives have voted to spend the funds
- At first glance, the application of GAAS, the Yellow Book, and single audit requirements at one auditee can seem daunting. However, after getting comfortable with the terminology, uniqueness (e.g., the SEFA and major program determination), and compliance auditing concepts, single audits are not as steep of a climb as they may initially appear!

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Thank you!

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