

*Presenting a live 110-minute teleconference with interactive Q&A*

# Sampling Strategies for Circular A-133 Audits: Ensuring Compliance and Internal Controls

Selecting a Methodology, Developing an Audit Sampling Plan,  
and Understanding Deviations and Exceptions Analysis

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THURSDAY, JANUARY 16, 2014

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

Collette Cummins, CPA, Managing Director, Auditing Methodologies, Grant Thornton, Chicago  
Lynford Graham, CPA, Ph.D., CFE, Bentley University, Waltham, Mass.

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# Sampling Strategies for Circular A-133 Audits: Ensuring Compliance and Internal Controls

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Jan. 16, 2014

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Lynford Graham, Bentley University  
[lgrahamcpa@verizon.net](mailto:lgrahamcpa@verizon.net)

Collette Cummins, Grant Thornton  
[Collette.Cummins@us.gt.com](mailto:Collette.Cummins@us.gt.com)

# Today's Program

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Sampling Requirements of OMB A-133 Audits

*[Collette Cummins]*

Slide 7 - Slide 33

Comparison to Financial Statement Audit Sampling

*[Lynford Graham]*

Slide 34 - Slide 39

# Sampling requirements of OMB A-133 audits

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- I. Overview of A-133 requirements**
- II. Sample planning considerations**
- III. Minimum sample sizes**
- IV. Performing test procedures**
- V. Evaluating sample results**

# Overview

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## Single Audit Act and Circular A-133

- I. Require entities that expend more than \$500,000 in federal awards or grants in a fiscal year to have a single or program-specific audit which includes:
  - A. Audit of the financial statements and reporting on the schedule of expenditures of federal awards (SEFA)
  - B. Compliance audit of federal awards



# Overview

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## Objectives of a compliance audit of federal awards

- I.** Obtain an understanding of the internal control over compliance for each major program
- II.** Assess the control risk of noncompliance
- III.** Perform tests of those controls (unless the controls are deemed ineffective)
- IV.** Determine whether the auditee has complied with laws, regulations and provisions of contracts or grant agreements pertaining to federal awards that may have a direct and material effect on each of its major programs

# Overview

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- Step 1:** Identify federal awards
- Step 2:** Determine major programs to be audited
- Step 3:** Identify direct and material compliance requirements for each major program
- Step 4:** Perform risk assessment procedures
- Step 5:** Perform tests of controls and audit compliance

# Types of audit procedures

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- I. Inquiry and observation
- II. Analytical procedures
- III. Test every item in population
- IV. Test individually important items
- V. Test a sample of items from the population

# Planning considerations for sampling

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- I. Determine objectives of test**
- II. Define the population**
- III. Consider completeness of the population**
- IV. Define the sampling unit**
- V. Define control deviation or compliance exception**
- VI. Determine sample size**

# Sampling efficiency tips

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- I. Dual purpose testing – combining tests of controls over compliance and compliance testing**
- II. Combining tests of same control over compliance and/or same compliance requirement across multiple major programs**
- III. Combining tests of controls over compliance and/or compliance testing across multiple organizational units**
- IV. Tip – pre-map common controls (entity and application level) and compliance controls to various programs and financial audit test objectives. Avoid redundant and contradictory work papers.**

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# Attribute sampling

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- I.** Used to reach a conclusion about a population in terms of rate of occurrence
- II.** Conclusion is pass/fail not a conclusion about the monetary amount
- III.** Each transaction is given equal weight, regardless of size of transaction
- IV.** Number of transactions has little effect on sample sizes (with populations greater than 250 items)

# Control testing sample size table

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<b>Significance of Control</b>	<b>Inherent Risk of Compliance Requirement</b>	<b>Minimum Sample Size *</b>
Very significant	Higher inherent risk	60 items
Very significant	Limited inherent risk	40 items
Moderately significant	Higher inherent risk	25 items
Moderately significant	Limited inherent risk	25 items

\* Zero deviations expected



# Significance of control

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Considerations to determine significance of control:

- I.** Potential magnitude of noncompliance if the control were to fail
- II.** Higher and more pervasive the risk relating to the control objective
- III.** Whether the program is identified as higher risk in the compliance supplement
- IV.** Single control or multiple controls necessary to achieve the control objective

# Inherent risk

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Factors that may suggest higher inherent risk:

- I. New program with little history
- II. Complex processing (e.g., nonroutine, nonsystematic, manual or judgmental)
- III. Very high volume of activity
- IV. Substantial change in policies, processes or personnel
- V. Program identified as higher risk in the Compliance Supplement

# Compliance testing sample size table

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Desired Level of Assurance (Remaining Risk of Noncompliance)	Minimum Sample Size *
High	60 items
Moderate	40 items
Low	25 items

\* Zero deviations expected

# Desired level of assurance (Remaining risk of material noncompliance)

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## Considerations:

- I.** Importance of compliance requirement
- II.** Inherent risk of noncompliance factors
- III.** Risk of fraud
- IV.** Results of related control testing
- V.** Other audit procedures performed (e.g., testing individually important items, analytical procedures)

# Small population sample size table

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Frequency and Population Size	Minimum Sample Size *
Quarterly or 4 items	2 items
Monthly or 12 items	2 to 4 items
Semimonthly or 24 items	3 to 8 items
Weekly or 52 items	5 to 9 items
52 to 250 items	10 % of population

\* Small populations are defined as populations of fewer than 250 items

# Selecting sample items for testing

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## Sample selection methods:

**I.** Random selection

**II.** Haphazard selection

**III.** Systematic selection with a random start

# Performing the test procedures

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- I. Voided documents**
- II. Unused or inapplicable documents**
- III. Mistakes in estimating population sequences**
- IV. Stopping the test before completion**
- V. Inability to examine selected items**

# Performing the test procedures

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- I. Identify control deviations and compliance exceptions**
- II. Investigate and understand the nature and cause of control deviations and compliance exceptions**
- III. Determine if additional testing is required**



# Evaluating sample results for control deviations

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- I. Calculating the control deviation rate**
- II. Considering sampling risk associated with control testing**
- III. Assessing the potential magnitude of a deficiency in internal control over compliance**
- IV. Reaching an overall conclusion on tests of controls**

# Evaluating sample results for compliance exceptions

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- I. Calculating the compliance exception rate or likely questioned costs**
- II. Considering sampling risk associated with compliance testing**
- III. Effect of compliance testing results on internal control results reporting**
- IV. Reaching an overall conclusion on tests of compliance**

# Evaluation example

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- I. Population = \$500,000**
- II. Sample size of 60 items = \$140,000**
- III. 2 deviations found = \$4,000**
- IV. Ratio = 2.9%**

$$\text{\$4,000} / \text{\$140,000}$$

- I. Likely questioned costs = \$14,286**
- II. Known questioned costs = \$4,000**

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# Objectives of A-133 Program Tests

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## **For Controls**

OMB Circular A-133 §.500(c)(2) provides that, generally, the auditor shall plan the testing of internal control over major programs to support a low level of assessed control risk for the assertions relevant to the compliance requirements for each major program, and perform that testing as planned.

## **For Compliance (Substantive)**

**Objective is compliance with laws, regulations, and the provisions of contracts or grant agreements**

A-133 Section 500 (d) (1)

# Financial Audits

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**“The purpose of an audit is to provide financial statement users with an opinion by the auditor on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework, which enhances the degree of confidence that intended users can place in the financial statements.”**

**AU-C Section 200. Paragraph 3**

# Sampling Guidance in Single Audits



# Issues in Application

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- **Confusion: applying A-133 sampling guidance in the financial portion of the Single and other audits.**
- **Use of fixed sample sizes of 25, 40 and 60 in financial statement audits.**
- **Many elements of 2012 AAG *Audit Sampling* apply to A-133. Not enumerated in the guidance nor fully referenced to the AAG.**



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# Comparisons : Controls over Compliance

	OMB A-133	Financial
Understanding Controls	Controls over compliance	Controls over financial reporting
Test for high reliance	Required, unless controls are obviously not in place	Optional , depends on audit strategy
Controls to test	14 defined attributes that may apply to specific program	Controls over financial reporting based on risk and materiality considerations
Extent of Testing	High reliance based on defined inherent risks. Sizes 25, 40, 60.	A continuum based on degree of reliance and sampling parameters: risk, tolerable and expected rate.
Consider Expected Deviations	Not required in planning	Consider in planning

# Comparisons: Compliance Tests

	OMB A-133	Financial
Sampling	<ul style="list-style-type: none"> <li>• Sample sizes are driven by the findings from controls Sizes are 25, 40 and 60.</li> <li>• Materiality and Tolerable Misstatement of 5% of the program costs underlies the guidance.</li> </ul>	<ul style="list-style-type: none"> <li>• To reduce the overall audit risk to a low level.</li> <li>• See Risk Model in AAG Audit Sampling.</li> <li>• No limitation of 60 on substantive tests.</li> </ul>
<ul style="list-style-type: none"> <li>• Select large items to audit</li> <li>• Plan for expected misstatement</li> </ul>	Not required (See AAG A-133 Section 11.20)	<ul style="list-style-type: none"> <li>• Should select large items</li> <li>• Should consider expected misstatement</li> </ul>
Expand sample if objective not achieved	Not required	An option to attain required assurance on the test

# Comparisons : Compliance Tests

	OMB A-133	Financial
Dual Purpose Tests	Can be different programs <b>and</b> compliance controls <b>and</b> compliance	Usually financial controls and substantive
Results of sample	<ul style="list-style-type: none"> <li>Projected (ratio or attribute) to assess the sufficiency of evidence supporting the auditor's report on program compliance.</li> <li>Projected exceptions also are used to determine whether known questioned costs should be reported as a finding</li> </ul>	<p>Projected to assess the sufficiency of evidence to support the auditor's opinion.</p> <p>Multiple methods of projection permitted (ratio, difference, monetary unit sampling, etc.)</p>

# Comparisons : Compliance Tests

	OMB A-133	Financial
Reporting	Each major program requires an auditor opinion, and may require the application of separate tests of controls over compliance and compliance when reaching opinions and identifying reportable issues for the various programs.	Focus of reporting is on the fairness of the financial statements “as a whole”

# Reporting

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- Controls over compliance
  - Deviations will increase compliance sampling (e.g., 40 or 60)
  - Deviations (& misstatements) imply control deficiencies
  - Report Significant Deficiencies and Material Weaknesses
- Compliance
  - Report known compliance misstatement if factual (known) and projected (ratio or attribute methods) > \$10,000
  - Example: If projected misstatement is \$20,000
    - Report the factual amount of \$200.

# Some Observations

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- 2009 sampling guidance triggered by 2007 GAO samples of 208 A-133 engagements for audit quality. Results were poor.
- Expect another sample of A-133s soon by GAO to measure compliance with guidance
- After December 15, 2014. COSO is updated.
  - Five components
  - Seventeen principles - satisfy all for effective controls
  - Integrated application
- Confusion of guidance with Financial Reporting could impact peer reviews, inspections and litigation exposure.