Sampling Strategies in Circular A-133 Audits: Ensuring Compliance

WEDNESDAY, DECEMBER 16, 2015, 1:00-2:50 pm Eastern

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Sampling Strategies in Circular A-133 Audits

Dec. 16, 2015

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Sampling requirements of OMB A-133 audits

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

Single Audit Act and Circular A-133

1. 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

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

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

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

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

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.
Attribute sampling

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

<table>
<thead>
<tr>
<th>Significance of Control</th>
<th>Inherent Risk of Compliance Requirement</th>
<th>Minimum Sample Size *</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very significant</td>
<td>Higher inherent risk</td>
<td>60 items</td>
</tr>
<tr>
<td>Very significant</td>
<td>Limited inherent risk</td>
<td>40 items</td>
</tr>
<tr>
<td>Moderately significant</td>
<td>Higher inherent risk</td>
<td>40 items</td>
</tr>
<tr>
<td>Moderately significant</td>
<td>Limited inherent risk</td>
<td>25 items</td>
</tr>
</tbody>
</table>

* Zero deviations expected
Significance of control

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

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

<table>
<thead>
<tr>
<th>Desired Level of Assurance (Remaining Risk of Noncompliance)</th>
<th>Minimum Sample Size *</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>60 items</td>
</tr>
<tr>
<td>Moderate</td>
<td>40 items</td>
</tr>
<tr>
<td>Low</td>
<td>25 items</td>
</tr>
</tbody>
</table>

* Zero deviations expected
Desired level of assurance
(Remaining risk of material noncompliance)

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

<table>
<thead>
<tr>
<th>Frequency and Population Size</th>
<th>Minimum Sample Size *</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quarterly or 4 items</td>
<td>2 items</td>
</tr>
<tr>
<td>Monthly or 12 items</td>
<td>2 to 4 items</td>
</tr>
<tr>
<td>Semimonthly or 24 items</td>
<td>3 to 8 items</td>
</tr>
<tr>
<td>Weekly or 52 items</td>
<td>5 to 9 items</td>
</tr>
<tr>
<td>52 to 250 items</td>
<td>10 % of population</td>
</tr>
</tbody>
</table>

* Small populations are defined as populations of fewer than 250 items
Selecting sample items for testing

Sample selection methods:

I. Random selection

II. Haphazard selection

III. Systematic selection with a random start
Performing the test procedures

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

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

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

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

I. Population = $500,000
II. Sample size of 60 items = $140,000
III. 2 deviations found = $4,000
IV. Ratio = 2.9%
   \[
   \frac{4,000}{140,000}
   \]

I. Likely questioned costs = $14,286
II. Known questioned costs = $4,000
Objectives of A-133 Program Tests

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

“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

Audit of Financial Statements

Compliance Audit
Issues in Application

- 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.
### Comparisons: Controls over Compliance

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

<table>
<thead>
<tr>
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<th>OMB A-133</th>
<th>Financial</th>
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</table>
| **Sampling**     | • Sample sizes are driven by the findings from controls Sizes are 25, 40 and 60.  
                    • Materiality and Tolerable Misstatement of 5% of the program costs underlies the guidance. | • To reduce the overall audit risk to a low level.  
                    • See Risk Model in AAG Audit Sampling.  
                    • No limitation of 60 on substantive tests. |
|                  | • Select large items to audit  
                    • Plan for expected misstatement | • Should select large items  
                    • Should consider expected misstatement |
| **Expand sample if objective not achieved** | Not required (See AAG A-133 Section 11.20) | An option to attain required assurance on the test |
## Comparisons: Compliance Tests

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<tr>
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<th>OMB A-133</th>
<th>Financial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dual Purpose Tests</td>
<td>Can be different programs and compliance controls and compliance</td>
<td>Usually financial controls and substantive</td>
</tr>
<tr>
<td>Results of sample</td>
<td>• Projected (ratio or attribute) to assess the sufficiency of evidence</td>
<td>Projected to assess the sufficiency of evidence to support the auditor’s</td>
</tr>
<tr>
<td></td>
<td>supporting the auditor’s report on program compliance.</td>
<td>opinion.</td>
</tr>
<tr>
<td></td>
<td>• Projected exceptions also are used to determine whether known</td>
<td>Multiple methods of projection permitted (ratio, difference, monetary</td>
</tr>
<tr>
<td></td>
<td>questioned costs should be reported as a finding</td>
<td>unit sampling, etc.)</td>
</tr>
</tbody>
</table>
## Comparisons: Compliance Tests

<table>
<thead>
<tr>
<th>Reporting</th>
<th>OMB A-133</th>
<th>Financial</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>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.</td>
<td>Focus of reporting is on the fairness of the financial statements “as a whole”</td>
</tr>
</tbody>
</table>
Reporting

• 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

• 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.