



# **Enhancing Single Audit Quality - Addressing Common Errors in Testing and Reporting**

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**Presentation by**

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# About Schall & Ashenfarb, CPA's

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Schall & Ashenfarb, CPA's LLC is a New York City based firm that specializes in working with nonprofit organizations. Led by a team of three partners and a staff of approximately 20 CPA's, S&A prides itself on having the hands-on style of a small firm, but with the resources of a larger, regional firm.

S&A audits more than 150 nonprofit organizations each year, and includes prominent clients in the health and human services field, educational groups including private and charter schools, theatres, membership organizations, foundations and religious institutions. The firm specializes in audits of entities that receive federal funds under Part F of the Uniform Guidance (formerly OMB Circular A-133), NYS funds that require audits under U.S. Government Auditing Standards and International Auditing Standards (IAS).

Our audit fees include routine consultations on a year round basis. Our goal is to educate our clients to help them perform to the highest standards. We strive for the best client service possible and promise to return phone calls and e mails the same day, often within the hour. Our education to clients includes frequent newsletters, white papers on industry updates and complimentary seminars with other prominent professionals and government officials.

For a free consultation, feel free to call or e mail

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# Introduction

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- Audit Quality - Recent developments and its impact on the audit practices, and factors that drive audit quality
- Peer Review – Areas of Focus
  - Independence
  - Common Errors
- Steps to Improve Single Audit Quality

# AICPA Enhance Audit Quality Initiative

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- May 2014, EAQ was launched by the AICPA
- In May 2015 the Enhanced Audit Quality – A 6 Point Plan to Improve Audits was published
- The enhanced oversights focus exclusively on must-select engagements which are high risk practice areas
- Determined that Single Audits are a high-risk area



# Enhanced Oversight Reviews

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## Nonconforming Engagements Identified During 2016 partial year review (reviews performed between August 1, 2016 and December 31, 2016)

GAS/Uniform Guidance Engagements			
Number of Must-Select Engagements Performed by Each Firm Selected*	Number of Nonconforming Engagements	Must-Select Audit Engagements Reviewed	Percentage of Engagements Reviewed That Were Identified as Nonconforming
1-2	6	22	27%
3-5	5	11	45%
6-10	2	9	22%
11 or more	1	8	13%
Total	14	50	56%

# Enhanced Oversight Reviews

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## Nonconforming Engagements Identified During 2017

GAS/Uniform Guidance Engagements			
Number of Must-Select Engagements Performed by Each Firm Selected*	Number of Nonconforming Engagements	Must-Select Audit Engagements Reviewed	Percentage of Engagements Reviewed That Were Identified as Nonconforming
1–2	15	28	54%
3–5	7	13	54%
6–10	0	2	0%
11 or more	1	1	100%
Total	23	44	52%

# Does Size Matter?

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- Firms that perform 1 single audit had a **62%** chance of non-conforming audit
- Firms that perform 2 to 10 single audits had a **49%** chance of non-conforming audit
- Firms that perform 11 or more single audits had a **15%** chance of non-conforming audit

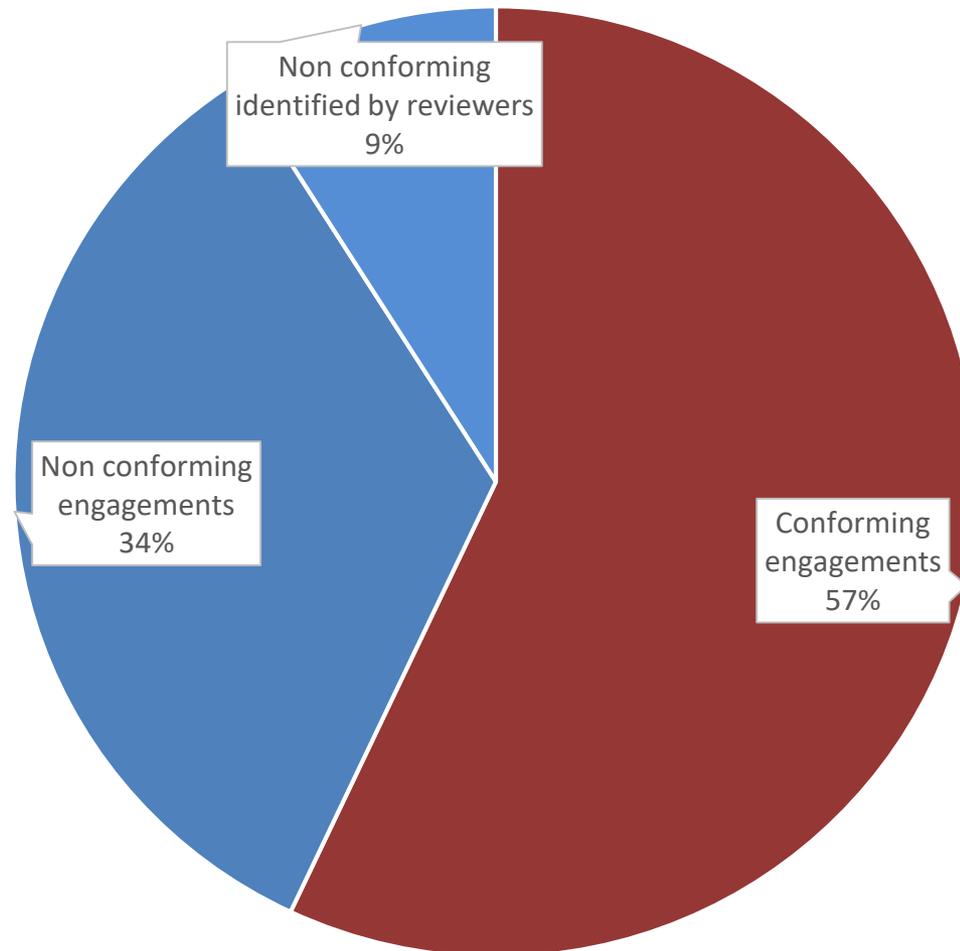
# Does Engagement Partner Experience Matter?

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- If a partner performs one single audit there is a **68%** chance that it will be non-conforming
- If a partner performs between 2 and 10 single audits there is a **44%** chance that it will be non-conforming
- If a partner performs 11 or more single audits, there is a **25%** chance that it will be non-conforming

# Reviewer Performance Improvements

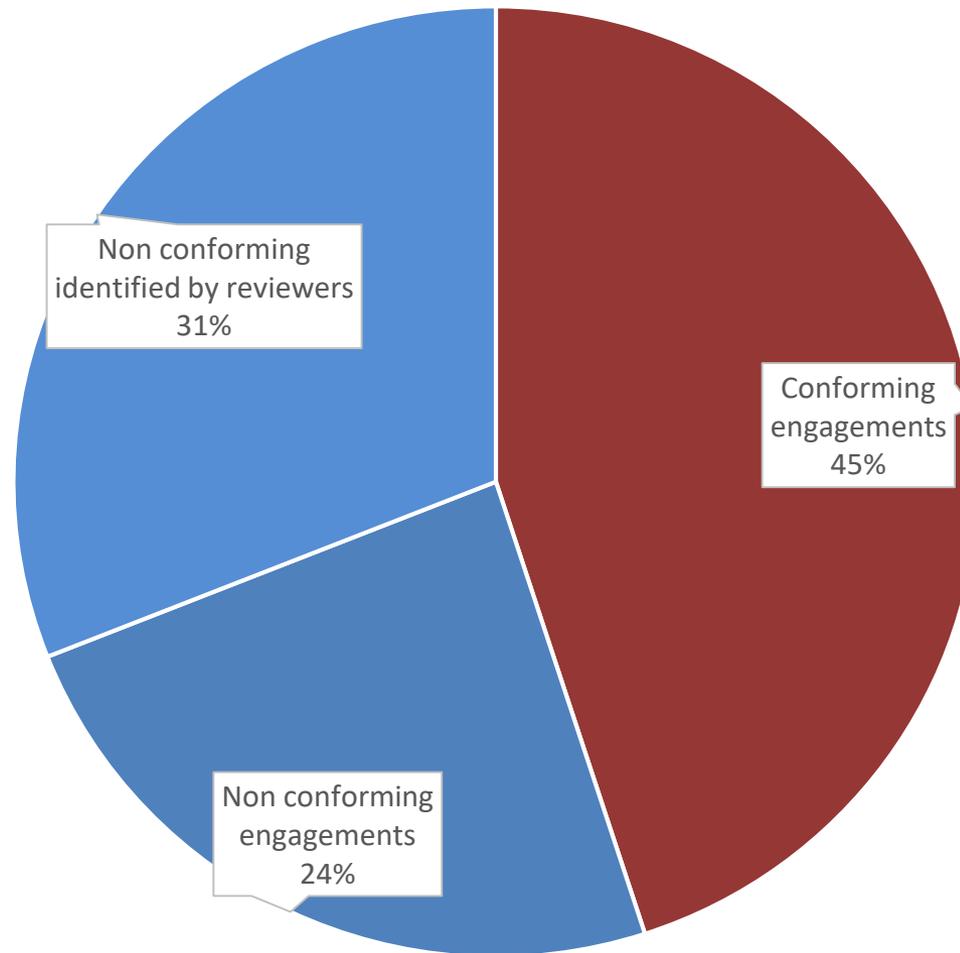
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■ Conforming engagements   ■ Non conforming engagements   ■ Non conforming identified by reviewers

# Reviewer Performance Improvements

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■ Conforming engagements   ■ Non conforming engagements   ■ Non conforming identified by reviewers

# AICPA's Response to Enhanced Oversight Findings

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- Scrutiny of peer reviewers
- Increased focus on quality control systems
- The EAQ Steering Committee identified specific areas of focus for 2019 (as identified on January, 2019 Peer Review Board Open Session Materials):
  - auditing estimates,
  - risk assessment,
  - internal control and documentation.
- Most common material departures from professional standards identified during enhanced oversight reviews are included as emphasis points on recently updated peer review checklists

# Audit Quality Study

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- Uniform Guidance requires a study of audit quality once every six years beginning in 2018
- Purpose is to determine quality of single audits by reviewing a statistically reliable study
- According to FAQ 200.513-1 – the single audit quality study will examine single audits submitted no earlier than 2018; therefore, study likely to take place in 2019 or 2020

# Peer Review

## Common Problem Areas

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- **Consideration of Independence - Yellow Book**
- Schedule of Expenditures of Federal Awards (SEFA)
- Single Audit Planning
- Internal Control Over Compliance
- Compliance Testing
- Reporting

# Yellow Book - Independence

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- The auditor's consideration of independence for nonaudit services should include **ALL** required documented elements (GAS par. 3.59):
  - 1) understanding with the audited entity regarding the nonaudit service;
  - 2) consideration of management's ability to oversee the nonaudit service, including designated individual's skills, knowledge, and experience (SKE);
  - 3) identification of threats that require safeguards (significant threats);and
  - 4) application of safeguards to eliminate or reduce significant threats to an acceptable level

The engagements that fails to document **one or more** of the elements of the independence evaluation required by the 2011 Yellow Book should be considered as nonconforming engagement.

# SEFA

## Common Errors

- **Failure to evaluate and document internal controls** surrounding preparation of SEFA
- **Improper clustering**
- Confusion about subrecipient funding presentation
- Missing footnote disclosure of 10% de minimus indirect cost rate

## Required Actions

- Need to consider IC over accuracy of the expenditure amounts reported in the SEFA and accuracy of the CFDA #. [AAG-GAS 7.31]
- Cluster name and total should be reported on SEFA if at least one program is part of the cluster. [AAG-GAS 7.08]
- Total amount provided to subrecipients from each federal program is required to be presented on the face of SEFA. If no funds provided to subrecipients, no information about subrecipients is required either on the face or in the notes. [AAG-GAS 7.10]
- The note is required regarding whether or not the de minimus indirect cost rate has been elected. [AAG-GAS 7.09]

# Single Audit Planning

## Common Errors

- **No documentation of rationale** for concluding that an applicable compliance requirement was not direct and material and thus not tested

## Required Actions

- Auditor should conclude and document the rationale for determining that compliance requirement was not considered direct and material on the conclusion. [AAG-GAS 10.21]

# Single Audit Planning

## Common Errors

- **Failure to assess risk** of material noncompliance due to **fraud**

## Required Actions

- Compliance engagements are subject to AU-C section 240, Consideration of Fraud in Financial Statements Audit. [AAG-GAS 6.41–.46]
- Focus on fraud risk in relation to material noncompliance or misappropriation of federal funds
- Similar to FS audit approach
- Risk of management override of controls should always be considered

# Single Audit Planning

## Common Errors

- **Failure to test all identified high-risk Type B programs as major programs**

## Required Actions

- At a minimum, the auditor must audit all of the following as major programs (CFR §200.518):
  - All High risk Type A programs
  - All High risk Type B programs
  - Such additional programs as may be necessary to comply with the percentage of coverage rule.

# Single Audit Planning

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- Other common problem areas:
  - No documentation of risk assessment for type B programs
  - Lack of evidence to support "low risk" auditee consideration
  - Missed compliance requirements by using out-of-date Compliance Supplement

# Internal Control Over Compliance

## Common Errors

- **Failure to properly document the understanding of internal controls over each** direct and material compliance requirement for **each** major program:
  - Auditor's documentation of internal control is referenced back to the documentation of controls over the financial statements without direct relationship to the compliance requirement
  - Internal control documentation did not consider the five internal control components for each direct and material compliance requirement
  - Auditor's documentation did not identify the key controls to be tested

## Required Actions

- Controls need to be considered in relation to **each direct and material** compliance requirement for **each major program**
- 5 elements of IC from the COSO framework should be considered
- Obtaining an understanding of internal control includes **design and implementation** of the controls over compliance [AAG-GAS 9.09]
- **Design and implementation** may be performed **concurrently** with a **test of operating effectiveness** but audit documentation should clearly distinguish how procedures accomplished the evaluation of the design/implementation and testing of operating effectiveness [AAG-GAS 9.35]

# Internal Control Over Compliance

## Common Errors

- **Failure to properly document testing of internal controls over each direct and material compliance requirement:**
  - Misconception that a walkthrough of internal controls over financial reporting is sufficient testing to support a low assessed level of control risk
  - Did not test controls because control risk was assessed as high and this was not reported as a significant deficiency or material weakness audit finding
  - Performed “100%” substantive or compliance test instead of testing controls
  - Misunderstood the need to test controls over compliance every year for each major program.

## Required Actions

- AU-C 330 .13-.14 and .31 are not applicable to compliance audit – the use of audit evidence obtained in prior year audits related to testing the operating effectiveness of controls. For UG purposes, controls **should be** tested every year.
- If test of controls are not performed, this would result in a non-conforming engagement for peer review unless the auditor has performed all of the following:
  - Concluded that controls are likely to be ineffective
  - Reported a significant deficiency or material weakness as part of findings
  - Assessed control risk as High
  - Considered additional compliance tests and documented conclusion

# Internal Control Over Compliance

## Common Errors

- **Failure to properly document testing of internal controls over each direct and material compliance requirement (continued):**
  - Insufficient evidence that the firm tested key controls surrounding each major program's direct and material compliance requirement
  - Combined testing of internal controls over all programs without documentation of why such testing was sufficient to support a low assessed level of control risk for each major program
  - Dual purpose testing didn't clearly identify the procedures performed to test operating effectiveness and compliance

## Required Actions

- Consider transaction processing systems and operation of the controls among all major programs, if different, a separate sample needs to be tested [AAG-GAS 11.42]
- Control tests considerations should be distinct from compliance tests considerations even if the tests were accomplished through dual-purpose testing (designing a test of control to be performed concurrently with a test of compliance on the same transaction) [AAG-GAS 9.39]. May be accomplished by adding a narrative, tick marks, attribute descriptions.

# Compliance Testing

## Common Errors

- **No documentation of how sample sizes were determined**

## Required Actions

- Documentation would typically include [AAG-GAS 4.12]:
  - A description of control or type of compliance requirement
  - Consideration of completeness of the population
  - A definition of the deviation and expected deviation rate
  - The chosen sample size and method (random, haphazard, systematic)
  - Specific characteristics of the specific items tested clearly stating internal control vs compliance characteristics in dual testing
  - Evaluation of exceptions
  - Determination of questioned costs
  - Conclusion

# Reporting

## Common Errors

- Deficiencies identified in the management letter but not reported on either Yellow book report or the UG report
- Using incorrect wording on auditors reports
- Not extrapolating results of sampling (known and likely questioned costs >25K)

## Required Actions

- Significant deficiencies and material weaknesses in internal controls over financial reporting, material fraud, abuse or non-compliance must be reported on Yellow Book report as required by GAS. [AAG-GAS 4.12]
- Make sure to trace to the latest available reports to ensure compliance (Chapters 4 and 13 of AICPA Audit Guide – GAS and Single Audits). Consider having a secondary review of all Single Audit reports.
- Auditor should consider the best estimate of total questioned cost. Must report known questioned costs when likely questioned costs are greater than \$25,000 (CFR §200.516 )

# Reporting

## Common Errors

- Not following all required criteria for findings (See Chapter 13 of AICPA Audit Guide GAS and Single Audits)

## Required Actions

- **Federal Awards Criteria**
  - Award and program ID
  - Criteria
  - Condition
  - Cause
  - Effect or potential effect
  - Questioned cost
  - Information to provide a proper perspective
  - Was the audit finding a repeat finding
  - Recommendation
  - View of responsible officials
  - Was a sample statistically valid
- **Yellow Book**
  - Criteria
  - Condition
  - Cause
  - Effect or potential effect
  - Recommendation
  - View of responsible officials

# Reporting

## Common Errors

- Corrective action plan to address each audit finding in the current-year auditor's reports must be prepared by the auditee and must be submitted on the auditee letterhead

## Required Actions

- The corrective action plan must address both financial statement related findings reported on Yellow book report and related to federal awards
- It must also provide [2 CFR 200.511(a) AAG-GAS 13.55]:
  - name(s) of the contact person(s) responsible for corrective action
  - corrective action planned or explanation and specific reasons why the auditee disagrees with the audit finding or believes corrective action is not required
  - anticipated completion date(s) for corrective action

# Reporting

## Common Errors

- Summary schedule of prior audit findings must be prepared by the auditee

## Required Actions

- Prepared by auditee on the auditee's letterhead
- All findings should be reported except those corrected
- When audit findings were fully corrected, the summary schedule need only list the audit findings and state that corrective action was taken.
- When audit findings were not corrected or only partially corrected, the summary schedule of prior audit findings should describe the reasons for a findings recurrence and planned corrective action, and any partial corrective action [2 CFR 200.511(b)(2); AAG-GAS 13.52]

# How to Enhance Audit Quality

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- Only accept engagements you have expertise to perform
- Establish an effective quality control system—similar to clients with strong internal controls
- Provide adequate training for partners, managers, and staff
- Assign staff that are fully trained
- Strongly consider using a pre-issuance, engagement quality control review (EQCR)
- **Use practice aids** (however you need to understand them)

# How to Enhance Audit Quality (continued)

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- Extra-curricula reading (subscribe to professional publications)
- Become a member of the AICPA's GAQC
- Review common audit deficiencies compiled each year by AICPA Peer Review and Professional Ethics Division, updated annual Compliance Supplement, AICPA Risk Alerts and ***Reviewer Alert***
- Have an internal monitoring system that uses published peer review checklists - ***PRP Section 22,100 Supplemental Checklist for Review of Single Audit Engagements***
- **Consider an external monitor of work papers and reports**

# Questions?

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