

**U.S. Department of Housing and Urban Development  
Office of the Inspector General**

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**SPECIAL ATTENTION OF:**

Title II and I Mortgagees; Lenders;  
Loan Management Branch Chiefs;  
Ginnie Mae Issuers; Multifamily Owners &  
Management Agents; Multifamily Hospital  
Program Owners & Management Agents

**TRANSMITTAL**

**Handbook No:** 2000.04, REV-2, CHG-10

**Chapter Number:** 1

**Issued:** April 2011

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1. This transmits Handbook 2000.04, REV-2, CHG-10, Chapter 1, Consolidated Audit Guide for Audits of HUD Programs, HUD – General Audit Guidance, and Appendix A, Attribute Sampling.
  
2. **Summary:** The Office of the Inspector General (OIG) is in the process of updating the handbook and will release each chapter as it is completed. When all of the individual chapters of the audit guide are revised, they will be consolidated into a revised audit guide and issued as Handbook No. 2000.04, REV-3.

This handbook chapter is a change to Handbook 2000.04, REV-2, chapter 1, dated December 2001. A change was necessary to conform to information included in the latest updated chapters. Information was added to meet current requirements of the Government Auditing Standards, Office of Management and Budget Circular A-133 (A-133) requirements, new and updated American Institute of Certified Public Accountants standards, items to be included in the engagement letter on all audits of U.S. Department of Housing and Urban Development (HUD) programs, and a requirement that if the auditor engagement is terminated by the client or if the auditor withdraws from the engagement, the auditor must notify OIG and the HUD servicing program office in writing providing a detailed explanation. This chapter serves as a reference to assist the independent auditor in performing program-specific audits of profit-motivated sponsors (for-profit entities) for certain HUD and Government National Mortgage Association (Ginnie Mae) programs.

Appendix A, which was an attachment to chapter 3, dated July 2008, and is now applicable to all audits performed of HUD programs using this audit guide, is to be filed at the end of the guide. The appendix in chapter 3 will be removed, and the related wording in chapter 3 will be modified when all chapters are consolidated into a revised audit guide and issued as Handbook No. 2000.04, REV-3

### 3. Significant Changes:

- a. Paragraph 1-2 allows this guide to be used as a program-specific audit guide for audits of not-for-profit sponsors or entities covered by A-133; however, the auditor is to follow A-133 reporting and major program determination requirements.
- b. Paragraph 1-4 displays the value to be used in making major program determinations for each program covered by this guide.
- c. Paragraph 1-5 requires attribute sampling as the appropriate sampling methodology for use in auditing all programs in all chapters of this guide. Minimum sample sizes are established and are mandatory to provide sufficient audit evidence and adequate audit coverage.
- d. Paragraph 1-6 requires the auditor, if he/she becomes aware of illegal acts or fraud that has occurred or is likely to occur, to telephonically contact the HUD OIG single audit coordinator to discuss his/her findings.
- e. Paragraph 1-7 requires information to be included in engagement letters for all audits of HUD programs so that the auditor and the client are in agreement and the client grants permission for the auditor to obtain information from the prior auditor and report fraud as provided for in the HUD audit guide. The following explains the information required in selected paragraphs:
  - 1) Paragraph 1-7A provides mandatory information that must be included in the engagement letter so that the auditor and the client are in agreement as to methodology to be used in conducting the audit, reporting requirements, reporting of fraud, key target dates, and access to working papers and auditee's documentation.
  - 2) Paragraph 1-7F provides that the current auditor should contact the prior auditor to gain an understanding of any unreported information that may have an effect on the current audit.
  - 3) The remaining planning information in paragraph 1-7 was contained in the prior version of chapter 1 and is now separated into four sections, labeled B. Testing, C. Reporting, D. Management Representations, and E. Audit Documentation.
  - 4) Paragraph 1-8 was added to provide the HUD contact points for each audit guide chapter that are to be notified should the auditor, performing an audit covered by the specific chapter, withdraw or be terminated from the engagement.

- 5) Paragraph 1-10 was added to advise auditors and clients that either HUD OIG or the Office of Public and Indian Housing's Real Estate Assessment Center can perform quality control reviews of audits conducted using this audit guide and the action(s) that can be taken if the reviewer finds the audit report and audit documentation to be substandard or contain major inadequacies.
- f. Appendix A, Attribute Sampling, applies to all audits performed using this audit guide, provides the sampling methodology to be used, and establishes minimum sample sizes.

**4. Filing Instructions:**

The issuance of this chapter cancels chapter 1, dated December 2001.

<b>Remove</b>	<b>Insert</b>
Chapter 1, dated December 2001	Chapter 1, dated April 2011
	Appendix A, dated April 2011

**5. Effective Date:**

This chapter is effective and can be used upon issuance. The requirements in this chapter shall apply to audits of entities with fiscal years ending on or after September 30, 2011.



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## CHAPTER 1. GENERAL AUDIT GUIDANCE

- 1-1. **Purpose.** This guide is to assist the independent auditor (auditor) in performing program-specific audits of profit-motivated sponsors (for-profit entities) and not-for-profit sponsors for certain U.S. Department of Housing and Urban Development (HUD) housing and Government National Mortgage Association (Ginnie Mae) programs. These audits must be performed in accordance with the standards for financial audits as promulgated by the American Institute of Certified Public Accountants (AICPA) professional standards (generally accepted auditing standards or GAAS) including Statement on Auditing Standards (SAS) No. 117, Compliance Audits, issued by the AICPA Auditing Standards Board, and government auditing standards (generally accepted government auditing standards or GAGAS), issued by the Comptroller General of the United States.

The objectives of a HUD program-specific audit are to assist HUD program managers in determining whether the auditee has complied with all of the requirements of the program as well as ensuring that the related Federal funds are correctly utilized. Such audits begin with a financial audit to determine that the related financial statements are reported in accordance with generally accepted accounting principles. Additionally, audits performed in accordance with this guide require an increased review of the system of internal control to (1) provide relevant and reliable financial data and reports; (2) provide reasonable assurance that the auditee is managing HUD programs in compliance with applicable laws and regulations; (3) safeguard assets; and (4) promote economic, efficient, and effective resource management and delivery of authorized services to the designated target population. Lastly, these program-specific audits require that the auditor perform specific procedures that enable the auditor to opine on whether the client has complied with the requirements of the HUD program. HUD program audit reports are a primary tool used by program managers to meet their stewardship responsibilities in overseeing these HUD programs and assuring the integrity of Federal funds. Program managers, with the assistance of the HUD Office of Public and Indian Housing's Real Estate Assessment Center (PIH-REAC), the Departmental Enforcement Center (DEC), and the Office of General Counsel, must act upon the areas of noncompliance and internal control weaknesses noted in these reports. To be of value, these reports must contain adequate information to give reported matters perspective and allow the managers to take necessary corrective action.

Another objective of this guide is to provide auditors of for-profit program participants with guidance in performing yearly audits required by their agreements with HUD. While use of this guide is mandatory for audits of all for-profit participants, this guide is not intended to be a complete manual of audit procedures. The guide is not intended to cover all situations that may exist or replace the auditor's judgment of audit work required to meet GAAS and/or GAGAS. It is meant to supplement those standards with information specific to HUD program audits. Suggested audit procedures contained herein might not cover all circumstances or conditions encountered in a particular audit. The auditor should use professional judgment to tailor the procedures so that the audit objectives may be achieved. However, auditors must address all applicable compliance requirements in this guide. If the

auditor determines that certain procedures will not to be performed, the rationale for the exclusion must be explained in detail and documented in the audit documentation in support of the auditor's report, and an appropriate qualification to the auditor's opinion may be required.

This guide is divided into eight chapters. This chapter, chapter 1, documents the purpose, background, and requirements for the performance of HUD program audits. It also includes other matters the auditor should consider in preparing for the audit. Chapter 2 contains the reporting requirements. Both chapters 1 and 2 apply to all audits covered by this guide. Each of the remaining chapters contains procedures for auditing compliance with specific HUD programs' requirements.

Chapters 3 through 8 contain references to relevant program requirements, etc., that were in effect at the time each chapter was issued. PIH-REAC also developed guidelines for the reporting of the audit results in an electronic system. Such guidance requires an additional engagement, and those requirements are known as Uniform Financial Reporting Standards (UFRS) regulations. Program participants and auditors can obtain a copy of PIH-REAC's UFRS guidance from the HUD PIH-REAC Web site at

**<http://www.hud.gov/reac/products/prodmf.html>**.

Use of the UFRS guide is mandatory for all engagements covered under HUD's UFRS regulations (24 CFR (Code of Federal Regulations) Part 5, Subpart H).

Because program requirements are subject to change, it is important that the auditor ensure that the list of the audit procedures to be used for his/her specific audit is complete and applicable to the period being audited. If additional requirements are identified or program requirements are not applicable to a certain period covered by the audit, audit procedures in this guide should be adjusted accordingly, and those adjustments should be documented in the audit documentation. Federal rules, regulations, and other guidance should be followed, and procedures in this guide should be modified to test compliance with those rules, regulations, and guidance. Examples of such guidance include the issuance of information in mortgage letters or housing notices.

Auditors are required to submit the results of their audits to HUD. If any single audit (entitywide or program-specific), conducted in accordance with Office of Management and Budget Circular A-133 (A-133), includes any HUD program, the data collection form and reporting package must be submitted to the Federal clearinghouse as provided for in A-133.

Any management letter must be submitted directly to the HUD office providing funding/services to the auditee as part of the reporting process. When reporting through an electronic system is available, such management letter should be included in the filing. When electronic filing is not available, management letters should be sent to the local program office in hardcopy format. The auditor should determine the program office

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responsible for monitoring the auditee from the review of correspondence during the audit and in discussion with the client.

If a HUD program-specific audit is performed as provided for in paragraph 1-2, below, or if the A-133 Compliance Supplement does not include the program that is being audited, the auditor may establish an audit program using this guide. This guidance is in keeping with part 7 of the A-133 Compliance Supplement, which is to be used when a program is not in the supplement. Part 7 provides information on how to identify compliance requirements. Paragraph 1.d states, "If there is a program-specific audit guide or other audit guidance issued by the Federal agency's Office of Inspector General (OIG), the auditor may wish to consider this guidance in identifying the program objectives, program procedures, and compliance requirements." If the A-133 auditor elects to use another source to identify program-specific requirements, such as a third-party audit guide service, the auditor must ensure that all of the requirements of this guide are included in the final audit program. If this guide is used to fulfill the A-133 requirements, either as a program-specific audit or in building a program in accordance with part 7, the single audit report package must be submitted directly to both HUD and the clearinghouse as stated in chapter 2, paragraph 2-3, of this guide. Also, the submission to the Federal clearinghouse does not remove the requirement for the electronic submission to HUD.

Auditors should also note that many program audit reports and related information about the audit and/or the auditee must also be electronically submitted to HUD. Please refer to the information on HUD PIH-REAC's Web site referenced above for a detailed discussion on HUD's electronic submission reporting requirements for multifamily program participants (refer to 24 CFR Part 5, Subpart H). Electronic submission to HUD does not remove the requirement for the submission of the single audit package to the Federal clearinghouse.

If the auditor desires technical assistance pertaining to HUD programs, their regulations, or operations, the auditor should contact the particular HUD headquarters or field program office contact person/office listed in the applicable chapter or contact the office providing funding/services to the auditee. A list of local and State offices is available on the Internet at the following Web site:

<http://www.hud.gov/localoffices.cfm>.

- 1-2. Use of Guide as a Program-Specific Guide.** This guide shall be used in performing program-specific audits of not-for-profit sponsors or entities covered by A-133. Paragraph 235(a) states, "When an auditor decides to perform a program specific audit, the auditor should contact the Office of Inspector General of the Federal agency to determine whether such a guide is available. When a current program-specific audit guide is available, the auditor shall follow GAGAS and the guide when performing a program-specific audit." When it is decided that a program-specific audit is to be performed to satisfy A-133 requirements, the engagement letter is to be modified to state that the auditor shall comply with the requirements of Handbook 2000.04. Also, since the guide does not contain all of

the requirements of A-133, the engagement letter should state that the auditor must follow the requirements of section 235 of A-133 and that the illustrative auditor reporting in chapter 2 of the guide must be modified to conform to A-133 requirements; otherwise, unless both the reporting requirements of paragraph 235(c) and chapter 2 of this guide are to be followed, the audit report will not be accepted by the Federal clearinghouse or by HUD to fulfill the A-133 or HUD program reporting requirements.

- 1-3. Auditor Qualifications.** An auditor must meet the auditor qualifications requirements as contained in GAGAS, including the qualifications relating to independence and continuing professional education. Additionally, the audit organization is to meet the quality control standards of GAGAS. Further, GAGAS requires audit organizations to make their peer reports available to the public and specifically requires that they are to be provided to the client. It is not necessary to submit the report to the servicing HUD program office, DEC, or HUD OIG unless requested to do so by representatives of those offices or specifically required to do so in other chapters of this guide.

The standards on auditor qualifications in GAGAS require that accountants and accounting firms comply with the applicable provisions of the public accountancy laws and rules of the jurisdictions in which they are licensed and where the audit is being conducted. If the auditee is located in a State outside the home State of the auditor and the auditor performs substantial fieldwork in the auditee's State, the auditor should document his/her compliance with public accountancy laws of that State regarding licensing in the audit documentation. This guide does not impose additional licensing requirements beyond those established by the individual State boards of accountancy (although some States allow temporary practice without a license).

Chapter 3 of GAGAS sets forth the general standards for ensuring the credibility of auditors' results. Paragraph 3.03 states that matters relating to the audit work, the audit organization, and the individual auditor, whether government or public, should be free, both in fact and appearance, from personal, external, and organizational impairments to independence. To perform any of the audits covered by this guide, the auditor must be independent and follow the principles stated in chapter 3 of GAGAS.

Refer to HUD Handbooks 4060.1, 4370.2, and 4470.1 regarding any additional HUD requirements placed on the auditor's relationship with the mortgagor and/or general contractor.

- 1-4. Audit Scope and Approach.** The audit should be sufficiently comprehensive in scope to permit an expression of opinion on the financial statements and in-relation-to opinion on the supplemental data of the HUD-assisted activity.

The opinion on the financial statements should state whether the basic financial statements present fairly, in all material respects, the financial position of the auditee as of the date of the financial statements and the results of its operations and its equity and cash flows for the period then ended in accordance with accounting principles generally accepted in the

United States of America. In addition, the in-relation-to opinion should state that the supplemental data have been subjected to the audit procedures applied in the audit of the basic financial statements and whether the data are fairly stated in all material respects in relation to the financial statements taken as a whole.

GAGAS indicates that the auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risk of material misstatement of the financial statements, whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. GAGAS expands on this requirement to include requirements regarding the reporting of internal control over financial reporting as part of planning and performing the audit and reporting on internal controls. Section 1-9 of this guide expands those requirements. The auditor should report on compliance and other matters and on internal controls over financial reporting in accordance with chapter 2 of the guide.

As part of planning and performing the financial statement audit, under GAGAS, the auditor is required to test and report on the auditee's compliance with applicable HUD laws and regulations regardless of the amount of Federal financial assistance. The auditor is to consider compliance and other matters which could have a direct and material effect on the financial statement amounts as well as the auditee's internal control over financial reporting. This guide further enhances this requirement such that the auditor's report on compliance should include an opinion on the auditee's compliance with specific requirements applicable to each of its major programs. Reporting requirements are discussed further in chapter 2. The auditor should use the information in the following table to determine whether a program(s) is considered to be a major program for the type of audit being performed using a specific audit guide chapter. A major program is defined as an individual assistance program or a group of programs in a category of Federal financial expenditures, which is equal to or exceeds the amount shown in the following table during the applicable year or a project that has an outstanding HUD-insured or HUD-guaranteed loan balance, which is equal to or exceeds the amount shown in the table as of the reporting date.

<b>Values to be used in making major program determinations when using this audit guide</b>	
<b>Chapter number</b>	<b>Dollar value of expenditures or outstanding loans to be used in determining a major program</b>
3	\$500,000
4	\$500,000
5	No major program designation needed
6	No dollar amount/any client with a servicing portfolio
7	\$2,000,000
8	\$2,000,000

**Note:** When an aggregate of a mortgagee's Federal Housing Administration (FHA)-insured loans, originated and/or serviced, exceeds \$2 million during the period under audit, those loans are considered to be a major program.

A Ginnie Mae issuer with a servicing portfolio and any remaining principal balance, as of the reporting date, is also considered a major program.

Although projects, lenders, and/or issuers with HUD-assisted activity of less than the amounts contained above for the period under audit will be considered nonmajor programs, the auditor must still test and report on the entity's compliance with specific requirements. However, such work may be reduced in scope as the auditor is not required to opine on the client's compliance. The auditor's report on compliance with nonmajor programs is described in chapter 2.

HUD requires the reporting of all compliance violations and an identification of total questioned cost for each finding as a result of noncompliance. HUD requires that all instances of noncompliance with any HUD requirement or regulation, material weakness in internal control, all instances of fraud or illegal acts, and contract violations be reported as findings in the audit report. Noncompliance, deficiencies, and instances of violations that were corrected during the audit, after the fiscal year under audit, or before the issuance of the audit report must be included in the report as resolved findings. Audit finding sections are also included in chapter 2 and in chapters 3 through 8 of this guide in the event that the auditor following the audit steps in a specific chapter does not refer to chapter 2. The criteria for reporting findings vary among programs. Please refer to the finding sections in the program chapters for any specific detailed information the program may have on reporting of noncompliance.

- 1-5. Sample Selection.** According to GAGAS, the third fieldwork standard for financial audits states:

The auditor must obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit.

Audit sampling, when properly applied, can provide sufficient appropriate evidence to support the audit opinion.

Audit sampling is defined as the application of an audit procedure to less than 100 percent of the items within an account balance or class of transactions for the purpose of evaluating some characteristic of the balance or class. There are two general approaches to audit sampling: nonstatistical and statistical. Both approaches require the auditor to use professional judgment in planning, performing, and evaluating a sample and in relating the audit evidence produced by the sample to other audit evidence when forming a conclusion about the related account balance or class of transactions.

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It is important that the sample selected be representative of the population. The size of a sample necessary to provide sufficient audit evidence depends on both the objectives and the efficiency of the sample. Because of the previous inconsistency in the application of the sampling process in auditing HUD programs, OIG convened a panel consisting of representatives from OIG, PIH-REAC, AICPA, and several auditing firms with significant HUD experience to discuss the issue and potential solutions. Based on the feedback from that panel, OIG initially decided and all participants agreed that attribute sampling is the appropriate sampling methodology for use in auditing programs using this guide to provide consistency and ensure adequate coverage to support the audit opinions rendered. This sampling requirement was initially included as a requirement only in chapter 3, issued July 2008, and has since been endorsed by AICPA in its Audit Guide, Government Auditing Standards and A-133 Audits. Therefore, HUD now requires that attribute sampling be used for all audits performed using all chapters of this guide. Appendix A to chapter 3 is now an appendix A to this guide and applies to all chapters. It is transmitted with this chapter for practitioners' reference and use.

Also in this guide, the attribute sampling method for selecting a sample is to be used to test compliance and for testing of controls, whenever a statement is made that a sample is to be selected. The attached appendix A provides additional information on attribute sampling and minimum sample sizes. The sample sizes stated in appendix A are mandatory and are to be the minimum sample sizes to be used for all testing.

- 1-6. Matters Requiring Immediate Action.** The auditor should specifically assess the risk of material misstatement of the financial statements due to fraud and should consider that assessment in designing the audit procedures to be performed. In making this assessment, the auditor should consider fraud risk factors contained in AICPA statements on auditing standards.

Normally, an audit in accordance with GAGAS does not include audit procedures specifically designed to detect illegal acts. However, procedures applied for the purpose of forming an opinion on the financial statements or on compliance may bring possible illegal acts to the auditor's attention. According to GAGAS, fraud is a type of illegal act involving the obtaining of something of value through willful misrepresentation. Fraud/illegal acts include, but are not limited to theft of program/project funds or assets, unauthorized loans of program/project funds, payment of nonproject/nonprogram expenses, bid rigging, and false claims.

If the auditor becomes aware of illegal acts or fraud that has occurred or is likely to have occurred, the auditor should telephonically advise the HUD OIG single audit coordinator (215-430-6733) of his/her findings and provide an oral briefing on the conditions noted. Discussions will center on the suggested material to be included in the audit report, whether a special report on fraud and/or illegal acts needs to be issued, and the suggested documentation that needs to be transmitted to the single audit coordinator outside any issued audit product or report. Refer to chapter 2, paragraph I, for additional information.

**1-7. Planning the Audit.**

**A. Engagement Letter.** A written letter of engagement between the auditee and the auditor is required and shall contain the following mandatory information:

1. That the audit is to be performed in accordance with GAAS; GAGAS; and HUD's audit guide, HUD Handbook 2000.04, dated 2010 (when REV-3 is issued, the auditor is to use the actual issuance date of REV-3).
2. The date the audit report will be delivered to the auditee.
3. That the auditor is required to provide the HUD Secretary or his/her designee, the HUD Inspector General, and the U.S. Government Accountability Office (GAO) or their representatives access to audit documentation or any other documents needed to review the audit (hardcopy or electronic). Access to audit documentation by HUD and GAO representatives includes making necessary photocopies of any or all of the hardcopy audit documentation or any other documents and/or electronic copies of any electronic audit documentation or any other electronic documents.
4. That if the auditor becomes aware of illegal acts or fraud that has occurred or is likely to occur, the auditor is required to bring such acts to the attention of the appropriate level of management, even if the matter is considered inconsequential. In addition, as required in chapter 1, paragraph 1-6, of this audit guide, the auditor is required to telephonically contact the HUD single audit coordinator to discuss the conditions noted. Based on that discussion, the auditor will be requested to prepare a written report on all known or likely illegal acts or fraud. Acceptance of the engagement letter grants the auditor permission to make the telephone contact with the HUD single audit coordinator and discuss the conditions noted.
5. That if the program being audited requires electronic submission of the financial and compliance data to HUD, the responsibilities of the auditor and the client should be included as follows:
  - a. The client is responsible to make the electronic submission to HUD.
  - b. The auditor under a separate agreed-upon procedure review is responsible to ensure that the data submitted are accurate and agree with the client's hardcopies of the supporting documentation. Also, the letter should specify whether the agreed-upon procedure engagement is a part of this engagement or will be a separate engagement.
6. A description of the:
  - a. Scope of the planned audit.

- b. Contents of the report and that the report will meet the requirements of this audit guide and A-133 if the report is to satisfy both requirements.
7. Permission for the auditor to review the prior auditor's audit documentation files (working papers) supporting the prior audit and for the auditor to discuss any matters with the prior auditor that may not be adequately explained or documented in the audit documentation or any preexisting condition the auditor notes in his/her review that was not in the prior audit report.
8. A list of the information the auditor wants the auditee to provide for the audit and the requested delivery date of those items.

Note that it is the auditee's responsibility to ensure that the audit is completed within the time requirements set forth in its contracts/agreements with HUD and that the conditions stated in the engagement letter are met. Extensions to the date the reports are due to HUD will not be granted. Delays caused by the auditee should become the basis of an audit finding.

**B. Testing.** Generally, the auditor should use professional judgment to determine the extent of testing necessary to support his/her opinion on the auditee's financial statements and to report on the auditee's internal controls and on compliance with applicable laws and regulations. However, the minimum sample requirements stated in appendix A are the smallest sample sizes that can be used for each of the three areas (financial, compliance, and controls) to be tested. One sample is not to be used for all three areas to be tested; each area is to have its own sample to meet the audit objective of that area. Regardless of the amount of funds expended, each of the applicable compliance requirements contained in this guide must be addressed regardless of the amount of Federal financial assistance. If for any reason the auditor decides not to perform detailed testing of a particular compliance requirement, the reasons must be explained in detail and documented in the audit documentation, and an appropriate qualification to the auditor's opinion may be required. A testing plan is included in chapter 3, which may be used when an owner or management agent has many HUD-assisted projects. It provides for sampling of certain described compliance requirements on a consolidated basis. Use of that method must be agreed to by the owner. Also, all other compliance requirements are to be tested separately for each individual project, even when the project is owned or managed by an entity that owns or manages multiple HUD-assisted projects. When there are many projects/programs involved, each is to be considered a universe unto itself, and the sampling guidance is to be followed for each project separately. Sample sizes and sample methodology contained in appendix A must be followed. There have been various interpretations of the wording in chapter 3 by some auditors to reduce the amount of sampling required. Each project is to be considered as its own universe rather than the interpretation by some auditors that all projects constitute one universe for determination of sample size, except for certain compliance requirements that are permitted to be audited on a consolidated basis as defined in chapter 3, paragraph 3-1.

**C. Reporting.** All material instances of noncompliance or compliance violations identified by the auditor must be reported as a finding, even in those cases in which corrective action was taken by the auditee after the audit period. For guidance, consult the particular program chapter. The schedule of findings and questioned costs (chapter 2, example F) contains all of the information required to be included in a finding as applicable based on the deficiency being reported. Please refer to chapter 2 for further guidance.

Unless specified elsewhere in this guide, the financial and compliance data required to be submitted to HUD, by both for-profit and nonprofit owners, must be the audited financial statements and data.

**D. Management Representations.** The auditor is required to obtain written representation from management that includes matters concerning compliance with program laws and regulations that have a material effect on the financial statements and each HUD-assisted program and all compliance violations or issues regardless of their materiality, as well as management's responsibilities to establish and maintain effective control over financial reporting and internal control over compliance.

**E. Audit Documentation.** The auditor shall retain audit documentation (previously referred to as audit working papers) and reports for a minimum of 6 years from the submission of the audit report to HUD, unless the auditor is notified in writing by HUD or GAO to extend the retention period. A hardcopy of the bound audit report with the original auditor's signature is to be included as a part of the audit documentation. When an auditor becomes aware that HUD or the auditee is contesting an audit finding in the report, the auditor shall contact the single audit coordinator for further guidance regarding the length of time the related audit documentation should be held before destruction of that audit documentation and report.

**F. Communication With Prior Auditor.** It is important that the auditor gain an understanding of the auditee and its overall operations. The auditor should contact the prior auditor to gain an understanding of (1) conditions that exist that may not have been included in the audit report or other audit correspondence, (2) reasons why the auditor is not performing the current audit, (3) an understanding of any condition that may not have been reported or documented in the audit documentation, and (4) any other matter that may have an effect on the current audit.

**1-8. Withdrawal From or Termination of an Engagement.** On occasion an auditor's engagement may be terminated by the client or he/she may withdraw from the engagement. This termination or withdrawal could occur for a number of reasons. When this happens, the auditor is to advise the OIG single audit coordinator and the HUD servicing program office in writing. The written notification (letter or report) is to provide a detailed explanation for the withdrawal or termination. It should also provide information of any potential illegal acts or fraud that the auditor may have observed, should that be the basis of

the termination of the engagement. Also, if illegal acts or fraud that may exist is the reason, the auditor is to follow the guidance in paragraph 1-6, page 1-7 of this chapter. The following are the offices that are to be notified based on the audit guide chapter being used to audit the HUD-funded activity.

Program audited based on audit guide chapter no.	Position of person to be contacted
3	Director, Office of Asset Management
4	Director, Section 242 Hospital Program, Office of Insured Healthcare Facilities
5	Deputy Assistant Secretary for Multifamily Housing
6	Executive Vice President of Ginnie Mae
7 & 8	Director, Office of Lender Approval and Recertification Division, and the branch chief
3 through 8	HUD OIG Single Audit Coordinator

- 1-9. Consideration of Internal Controls and Compliance.** Overall guidance for the consideration of internal controls, testing, and reporting requirements for Federal financial assistance programs is provided in GAGAS.

GAGAS requires that a sufficient understanding of internal controls be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed. In fulfilling the audit requirement relating to an understanding of internal controls and assessing the level of control risk, the auditor should follow, at a minimum, the guidance contained in AICPA SAS No. 109, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement. In addition, when auditing HUD programs, the auditor should perform tests of controls to evaluate the effectiveness of the design and operation of internal controls in preventing or detecting material noncompliance with the requirements of the HUD-assisted programs. The auditor should perform these procedures regardless of whether the auditor assesses the internal control risk to be below the maximum. The steps performed and conclusions reached should be clearly stated in the audit documentation. The audit documentation should clearly demonstrate the auditor's understanding and assessment of control risk related to internal controls over compliance established for HUD-assisted activities. Tests may be omitted only in areas in which internal controls are likely to be ineffective in preventing or detecting noncompliance; in which case, instances of the deficiencies are to be reported as findings.

- 1-10. Quality Control Review of Audits.** HUD OIG and PIH-REAC have implemented procedures for evaluating audits performed by non-Federal auditors. As part of this evaluation of completed audits, the supporting audit documentation shall be made available upon request by OIG or PIH-REAC. To facilitate these requests, the transmittal letter of the audit report should include the name, firm address, and telephone number of the audit partner on the engagement; the partner's Federal employer identification number; and the

State licensing number and certification number of the attesting certified public accountants.

Whenever OIG's or PIH-REAC's evaluation of an audit report or audit documentation discloses inadequacies, the auditor may be asked to take corrective action. If OIG or PIH-REAC determines that the audit report or the audit documentation are substandard or contain major inadequacies, OIG or PIH-REAC may also consider any or all of the following actions: (1) filing a complaint against the auditor with AICPA and/or the appropriate State board of accountancy, (2) making a referral to DEC to suspend or debar the auditor from further participation in Federal programs, or (3) referring the case to the Department of Justice for possible civil or criminal prosecution.

**1-11. Corrective Action Plan.** To assist HUD in resolving instances of noncompliance and material weaknesses in internal controls identified by the auditor, the auditee is required to submit a corrective action plan (CAP) with the auditor's report on HUD-assisted programs. Refer to chapter 2 for guidance on the preparation and submission of the CAP. Please note that in the CAP, the auditee must describe the corrective action taken or planned in response to findings identified by the auditor. In addition, the auditee must comment on the status of corrective action taken on prior findings. The submission of the CAP is considered a necessary part of the audit requirement for audits of all HUD programs and must be submitted to HUD together with the auditor's reports and audited financial statements. HUD-required audit reports submitted without a CAP are considered incomplete. Any HUD-required report which is incomplete and not corrected by the submission deadline shall be considered delinquent. Additional guidance concerning the CAP is contained in chapter 2 of this guide.

**1-12. Fair Housing and Nondiscrimination.** When performing compliance work in the fair housing and nondiscrimination area, the following references should be used: HUD Handbook 8004.1, Consolidated Civil Rights Monitoring Requirements for Section 8; 24 CFR Parts 1 (Title VI of the Civil Rights Act, Americans with Disabilities Act, and others) and 8 (Section 504 of the Rehabilitation Act), both of which are applicable to all HUD-assisted housing; and 24 CFR Part 100. The Fair Housing Act prohibits discrimination based on race, color, religion, national origin, sex, familial status, or disability in all aspects of the sale or rental of a dwelling (familial status refers to family composition, such as number and ages of children). The prohibitions extend to actions which have disparate impacts because of any of the prohibited bases. The Fair Housing Act applies to all housing in the Nation. However, Title VI and the Fair Housing Act requirements may not apply in certain cases in which Indian tribes are receiving HUD assistance.

## Appendix A

### Attribute Sampling

This appendix applies to all chapters in this audit guide.

When planning to test a particular sample of transactions, the auditor should consider the specific audit objective to be achieved and should determine whether the audit procedure or combination of procedures to be applied will achieve that objective. The size of a sample necessary to provide sufficient evidential matter depends on both the objectives and the efficiency of the sample. As noted in section 1-7C of chapter 1, all material instances of noncompliance, including those identified through sampling, must be reported as findings in the audit report.

#### **Determining Test Objective, Defining the Population, and Defining an Exception.**

Before beginning testing, the auditor must understand and document what attribute and/or assertions are being tested. The auditor needs to identify and document the appropriate population and should also perform procedures (e.g., reconciliations, inquiry) to ensure that the population from which the samples are selected is complete.

Each compliance requirement selected for testing should be considered a separate population, and samples should be selected accordingly. The sample selected could possibly be used to test multiple attributes within each compliance requirement. Additionally, auditors must assess the control environment at entities with multiple locations. If controls at the different locations are significantly different, each location must be considered a separate population.

The auditor must document the “sampling unit,” which is the individual item subject to sampling in the population (i.e., reconciliations, loan files, cash disbursements, cash receipts, etc.).

When selecting the sample of individual items, auditors must ensure that the sample is representative of the universe for the compliance requirement being tested.

The auditor should also clearly define what would be considered an exception. A single exception would indicate noncompliance, subject to further determination of materiality necessary to determine the required method of reporting.

#### **A. Determining the Sample Size.**

To determine attribute testing sample sizes, the auditor needs to determine the value for three inputs: desired confidence level, tolerable exception rate, and expected exception rate. The compliance table sample size is based on the following expectations.

1. **Desired Confidence.** Auditors should obtain a high degree of assurance by using a confidence level of 90, 95, or 99 percent.
2. **Tolerable Exception Rate.** A 5-10 percent exception rate is acceptable.
3. **Expected Exception Rate.** No exceptions should be accepted.
4. **Materiality.** Using attribute testing, monetary materiality, or tolerable misstatement is not a necessary input for determining sample size.

**B. Sample Size Table.** Using the preferences above and an attribute sampling software program, if a high level of assurance is defined as 90 percent confidence and tolerable exception rate is 5 or 10 percent with an expectation of zero exceptions, the sample size is 48 or 23 (respectively for 5 and 10 percent exception rates), which is rounded to 50 and 25 below. Similarly, using 95 percent confidence, zero exceptions, and a 5 or 10 percent tolerable exception rate, the sample size is 64 or 32, which is rounded to 65 and 35 below.

**Compliance sample size table**

<b>Importance/significance of the attribute being tested</b>	<b>Confidence level</b>	<b>Tolerable rate</b>	<b>Minimum sample size for populations over 200</b>
Low	90%	5%	50
Low	90%	10%	25
High	95%	5%	65
High	95%	10%	35

This table is illustrative but does not replace professional judgment. As noted in the table, these are minimum sample sizes, and there may be many situations in which the auditor should also consider qualitative factors when determining sample size. Such qualitative factors may include but are not limited to

- (1) First year the auditor audited an entity.
- (2) Larger, decentralized entities.
- (3) High number of findings in the past.
- (4) Significant deficiencies or material weaknesses in the past.
- (5) Poor internal controls.
- (6) Extremely high volume of activity in a particular compliance requirement.
- (7) High project employee turnover in a particular area or department.

If the initial sample does not include a particular attribute being tested, typically there would be a need to have additional items included in the sample to address just that specific attribute.

Each compliance test performed should be evaluated separately for purposes of determining sample size. Judgment should be used to determine what tests are considered low risk and which are considered high risk. When making the determination of high or low risk, it will be important to understand the population.

**C. Populations of 200 or Fewer Items.** When performing compliance testing of populations of fewer than 200 items, the following guidance is provided. Generally examine at least

- (1) 20 items when the population being tested contains between 100 and 199 items,
- (2) 10 items when the population being tested contains between 50 and 99 items,
- (3) 5 items when the population being tested contains between 20 and 49 items,  
and
- (4) Fewer than 5 items for smaller populations.

As noted above, these are suggested minimum sample sizes, and there may be quantitative factors used to determine the sample size to be used.

**D. Testing and Evaluating Results.** The sample sizes in the table above are based on an expectation of no exceptions. If the testing performed discovers no exceptions, the auditor has achieved a high degree of confidence that the attribute/assertion is performed at an acceptable level.

If there are observed exceptions, the auditor should investigate the nature and cause of the exceptions to determine whether the exceptions are immaterial or material compliance findings, significant deficiencies, or material weaknesses in internal control. It is not necessary to expand testing when exceptions are found. All exceptions must be reported. Refer to paragraph 1-7C and chapter 2 for reporting requirements using this audit guide.

In cases in which an exception is found, the auditor must determine whether the individual exception is material enough to include or is a compliance violation that must be included in the report. If it is determined that an exception is not material enough to report and is not a compliance issue that must be reported as a finding, the auditor may want to apply additional procedures to evaluate the magnitude of the exception.

The auditor should consider whether the lack of an effective internal control constitutes a significant deficiency or a material weakness and document the basis for an unqualified opinion if a finding is determined to be a significant deficiency or material weakness.

**E. Work Paper Documentation Needed.** Documentation of sampling procedures must include the test objective, the definition of an exception, a description of the population tested and the sampling unit, the confidence level, the significance of the attribute, the sample size, and the results of testing.

F. **Technical Assistance Available.** Technical guidance on audit sampling is available in the following documents:

**SAS No. 39.** Audit Sampling (AICPA)

**SAS No 111.** Amendment to **SAS No. 39**, Audit Sampling (AICPA, Professional Standards, vol. 1, AU sec. 350), as amended

**AICPA Audit Guide.** Audit Sampling, New Edition as of April 1, 2001

**AICPA Audit Guide.** Government Auditing Standards

**SAS No. 74.** Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance (AICPA, Professional Standards, vol. 1, AU sec. 801)

Pacific Islands, any instrumentality thereof, any multi-State, regional, or interstate entity which has governmental functions, and any Indian tribe as defined in this section.

Student Financial Aid (SFA) includes those programs of general student assistance, such as those authorized by Title IV of the Higher Education Act of 1965, as amended, (20 U.S.C. 1070 et seq.) which is administered by the U.S. Department of Education, and similar programs provided by other Federal agencies. It does not include programs which provide fellowships or similar Federal awards to students on a competitive basis, or for specified studies or research.

Subrecipient means a non-Federal entity that expends Federal awards received from a pass-through entity to carry out a Federal program, but does not include an individual that is a beneficiary of such a program. A subrecipient may also be a recipient of other Federal awards directly from a Federal awarding agency. Guidance on distinguishing between a subrecipient and a vendor is provided in §     .210.

Types of compliance requirements refers to the types of compliance requirements listed in the compliance supplement. Examples include: activities allowed or unallowed; allowable costs/cost principles; cash management; eligibility; matching, level of effort, earmarking; and, reporting.

Vendor means a dealer, distributor, merchant, or other seller providing goods or services that are required for the conduct of a Federal program. These goods or services may be for an organization's own use or for the use of beneficiaries of the Federal program. Additional guidance on distinguishing between a subrecipient and a vendor is provided in §     .210.

#### **Subpart B--Audits**

##### **§     .200     **Audit requirements.****

(a) Audit required. Non-Federal entities that expend \$300,000 (*\$500,000 for fiscal years ending after December 31, 2003*) or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part. Guidance on determining Federal awards expended is provided in §     .205.

(b) Single audit. Non-Federal entities that expend \$300,000 (*\$500,000 for fiscal years ending after December 31, 2003*) or more in a year in Federal awards shall have a single audit conducted in accordance with §     .500 except when they elect to have a program-specific audit conducted in accordance with paragraph (c) of this section.

(c) Program-specific audit election. When an auditee expends Federal awards under only one Federal program (excluding R&D) and the Federal program's laws, regulations, or grant agreements do not require a financial statement audit of the auditee, the auditee may elect to have a program-specific audit conducted in accordance with §     .235. A program-specific audit may not be elected for R&D unless all of the Federal awards expended were received from the same Federal agency, or the same Federal agency and the same pass-through entity, and that Federal agency, or pass-through entity in the case of a subrecipient, approves in advance a program-specific audit.

(d) Exemption when Federal awards expended are less than \$300,000 (*\$500,000 for fiscal years ending after December 31, 2003*). Non-Federal

(b) Unallowable costs. A non-Federal entity shall not charge the following to a Federal award:

(1) The cost of any audit under the Single Audit Act Amendments of 1996 (31 U.S.C. 7501 et seq.) not conducted in accordance with this part.

(2) The cost of auditing a non-Federal entity which has Federal awards expended of less than \$300,000 (*\$500,000 for fiscal years ending after December 31, 2003*) per year and is thereby exempted under **§\_\_.200(d)** from having an audit conducted under this part. However, this does not prohibit a pass-through entity from charging Federal awards for the cost of limited scope audits to monitor its subrecipients in accordance with **§\_\_.400(d)(3)**, provided the subrecipient does not have a single audit. For purposes of this part, limited scope audits only include agreed-upon procedures engagements conducted in accordance with either the AICPA's generally accepted auditing standards or attestation standards, that are paid for and arranged by a pass-through entity and address only one or more of the following types of compliance requirements: activities allowed or unallowed; allowable costs/cost principles; eligibility; matching, level of effort, earmarking; and, reporting.

**§\_\_.235 Program-specific audits.**

(a) Program-specific audit guide available. In many cases, a program-specific audit guide will be available to provide specific guidance to the auditor with respect to internal control, compliance requirements, suggested audit procedures, and audit reporting requirements. The auditor should contact the Office of Inspector General of the Federal agency to determine whether such a guide is available. When a current program-specific audit guide is available, the auditor shall follow GAGAS and the guide when performing a program-specific audit.

(b) Program-specific audit guide not available. (1) When a program-specific audit guide is not available, the auditee and auditor shall have basically the same responsibilities for the Federal program as they would have for an audit of a major program in a single audit.

(2) The auditee shall prepare the financial statement(s) for the Federal program that includes, at a minimum, a schedule of expenditures of Federal awards for the program and notes that describe the significant accounting policies used in preparing the schedule, a summary schedule of prior audit findings consistent with the requirements of **§\_\_.315(b)**, and a corrective action plan consistent with the requirements of **§\_\_.315(c)**.

(3) The auditor shall:

(i) Perform an audit of the financial statement(s) for the Federal program in accordance with GAGAS;

(ii) Obtain an understanding of internal control and perform tests of internal control over the Federal program consistent with the requirements of **§\_\_.500(c)** for a major program;

(iii) Perform procedures to determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on the Federal program consistent with the requirements of **§\_\_.500(d)** for a major program; and

(iv) Follow up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee, and report, as a current year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding in accordance with the requirements of § \_\_.500(e).

(4) The auditor's report(s) may be in the form of either combined or separate reports and may be organized differently from the manner presented in this section. The auditor's report(s) shall state that the audit was conducted in accordance with this part and include the following:

(i) An opinion (or disclaimer of opinion) as to whether the financial statement(s) of the Federal program is presented fairly in all material respects in conformity with the stated accounting policies;

(ii) A report on internal control related to the Federal program, which shall describe the scope of testing of internal control and the results of the tests;

(iii) A report on compliance which includes an opinion (or disclaimer of opinion) as to whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements which could have a direct and material effect on the Federal program; and

(iv) A schedule of findings and questioned costs for the Federal program that includes a summary of the auditor's results relative to the Federal program in a format consistent with § \_\_.505(d)(1) and findings and questioned costs consistent with the requirements of § \_\_.505(d)(3).

(c) Report submission for program-specific audits.

(1) The audit shall be completed and the reporting required by paragraph (c)(2) or (c)(3) of this section submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the Federal agency that provided the funding or a different period is specified in a program-specific audit guide. (However, for fiscal years beginning on or before June 30, 1998, the audit shall be completed and the required reporting shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or 13 months after the end of the audit period, unless a different period is specified in a program-specific audit guide.) Unless restricted by law or regulation, the auditee shall make report copies available for public inspection.

(2) When a program-specific audit guide is available, the auditee shall submit to the Federal clearinghouse designated by OMB the data collection form prepared in accordance with § \_\_.320(b), as applicable to a program-specific audit, and the reporting required by the program-specific audit guide to be retained as an archival copy. Also, the auditee shall submit to the Federal awarding agency or pass-through entity the reporting required by the program-specific audit guide.

(3) When a program-specific audit guide is not available, the reporting package for a program-specific audit shall consist of the financial statement(s) of the Federal program, a summary schedule of prior audit findings, and a corrective action plan as described in paragraph (b)(2) of this section, and the auditor's report(s) described in paragraph (b)(4) of this section. The data collection form prepared in accordance with

§ \_\_.320(b), as applicable to a program-specific audit, and one copy of this reporting package shall be submitted to the Federal clearinghouse designated by OMB to be retained as an archival copy. Also, when the schedule of findings and questioned costs disclosed audit findings or the summary schedule of prior audit findings reported the status of any audit findings, the auditee shall submit one copy of the reporting package to the Federal clearinghouse on behalf of the Federal awarding agency, or directly to the pass-through entity in the case of a subrecipient. Instead of submitting the reporting package to the pass-through entity, when a subrecipient is not required to submit a reporting package to the pass-through entity, the subrecipient shall provide written notification to the pass-through entity, consistent with the requirements of § \_\_.320(e)(2). A subrecipient may submit a copy of the reporting package to the pass-through entity to comply with this notification requirement.

(d) Other sections of this part may apply. Program-specific audits are subject to § \_\_.100 through § \_\_.215(b), § \_\_.220 through § \_\_.230, § \_\_.300 through § \_\_.305, § \_\_.315, § \_\_.320(f) through § \_\_.320(j), § \_\_.400 through § \_\_.405, § \_\_.510 through § \_\_.515, and other referenced provisions of this part unless contrary to the provisions of this section, a program-specific audit guide, or program laws and regulations.

#### **Subpart C--Auditees**

#### **§ \_\_.300 Auditee responsibilities.**

The auditee shall:

(a) Identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received. Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency, and name of the pass-through entity.

(b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

(c) Comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs.

(d) Prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with § \_\_.310.

(e) Ensure that the audits required by this part are properly performed and submitted when due. When extensions to the report submission due date required by § \_\_.320(a) are granted by the cognizant or oversight agency for audit, promptly notify the Federal clearinghouse designated by OMB and each pass-through entity providing Federal awards of the extension.

(f) Follow up and take corrective action on audit findings, including preparation of a summary schedule of prior audit findings and a corrective action plan in accordance with § \_\_.315(b) and § \_\_.315(c), respectively.

#### **§ \_\_.305 Auditor selection.**

## **PART 7 - GUIDANCE FOR AUDITING PROGRAMS NOT INCLUDED IN THIS COMPLIANCE SUPPLEMENT**

**Purpose** - OMB Circular A-133 (§\_\_\_.500(d)(3)) states that for those Federal programs not covered in the compliance supplement, the auditor should use the types of compliance requirements (see 14 types of compliance requirements described in Part 3) contained in the compliance supplement (this Supplement) as guidance for identifying the types of compliance requirements to test, and determine the requirements governing the Federal program by reviewing the provisions of contract and grant agreements and the laws and regulations referred in such contract and grant agreements.

The purpose of this Part is to provide the auditor with guidance on how to identify the applicable compliance requirements for programs not included in this Supplement for single audits and for program-specific audits when a program-specific audit guide is not available. This Supplement includes only the largest and/or riskiest Federal programs. However, there are more than 600 assistance programs currently funded by the Federal Government. Therefore, it is likely that the auditor will encounter programs that the auditor is required to test as major programs that are not included in this Supplement. For this reason, the following guidance is provided for the auditor to identify those compliance requirements that should be tested.

**Organization of this Supplement** - First, a review of how this Supplement is organized will be helpful, since the auditor must consider several parts of the Supplement in identifying compliance requirements to be tested. This Supplement is comprised of the following parts:

- Part 1 - Background, Purpose, and Applicability
- Part 2 - Matrix of Compliance Requirements
- Part 3 - Compliance Requirements
- Part 4 - Agency Program Requirements
- Part 5 - Clusters of Programs
- Part 6 - Internal Control
- Part 7 - Guidance for Auditing Programs Not Included in This Compliance Supplement

In determining the compliance requirements to test for programs not included in this Supplement, the auditor shall to refer to Parts 3 and 5. Part 3 identifies and describes the 14 types of compliance requirements where noncompliance may have a direct and material effect on a Federal program and provides audit objectives and suggested audit procedures. The 14 types of compliance requirements are:

- A. Activities Allowed or Unallowed
- B. Allowable Costs/Cost Principles
- C. Cash Management
- D. Davis-Bacon Act
- E. Eligibility
- F. Equipment and Real Property Management
- G. Matching, Level of Effort, Earmarking
- H. Period of Availability of Federal Funds
- I. Procurement and Suspension and Debarment

- J. Program Income
- K. Real Property Acquisition and Relocation Assistance
- L. Reporting
- M. Subrecipient Monitoring
- N. Special Tests and Provisions

Part 5 enumerates those programs that are considered to be clusters of programs as defined by OMB Circular A-133 (§\_\_.105). A cluster of programs means Federal programs with different *Catalog of Federal Domestic Assistance* (CFDA) numbers that are defined as a cluster of programs because they are closely related programs and share compliance requirements. Part 5 identifies research and development (R&D) and Student Financial Assistance (SFA) as clusters, as well as certain other clusters. Also, Part 5 identifies other clusters of programs that are not included in this Supplement.

For programs not included in this Supplement, the auditor must determine the applicable compliance requirements. While a Federal program may have many compliance requirements, normally there are only a few key compliance requirements that could have a direct and material effect on the program. Since the single audit process is not intended to cover every compliance requirement, this Supplement and the auditor's focus should be on the 14 types of compliance requirements enumerated in Part 3. The following are suggested procedures to assist the auditor in making this determination.

Although the focus of this Supplement is on compliance requirements that could have a direct and material effect on a major program, auditors also have responsibility under *Generally Accepted Government Auditing Standards* (GAGAS) for other requirements when specific information comes to the auditors' attention that provides evidence concerning the existence of possible noncompliance that could have a material indirect effect on a major program.

### **Steps for Identifying Compliance Requirements**

Determining what compliance requirements to test involves several steps. The auditor should address the following questions:

1. What are the program objectives, program procedures, and compliance requirements for a specific program?
2. Which of the compliance requirements could have a direct and material effect on the program?
3. Which of the compliance requirements are susceptible to testing by the auditor?
4. Into which of the 14 types of compliance requirements does each compliance requirement fall?
5. For Special Tests and Provisions, what are the applicable audit objectives and audit procedures?

1. *What are the program objectives, program procedures, and compliance requirements for a specific program?*

The first step is to gain an understanding of how the program works (e.g., the program objectives and procedures) and determine what laws, regulations, and provisions of contract or grant agreements (compliance requirements) apply to the program. The auditor should consider the following steps:

- a. Discuss the program with the non-Federal entity and, if necessary, the Federal agency or, in the case of a subrecipient, the pass-through entity.
- b. Review the contract and grant agreements and referenced laws and regulations applicable to the program, including any amendments or closeout agreements. The documents or agreements may identify the name and telephone number of a Federal contact person or, if a subaward, the contact person for the pass-through entity whom the auditor may wish to contact for additional information.

**Note:** The auditor should be aware that a particular non-Federal entity or Federal award may be subject to provisions that are unique to that entity or award. For example, previous noncompliance by a non-Federal entity may result in additional requirements to which the non-Federal entity must adhere, in order to continue its participation in the Federal program. Such provisions would generally not be based on laws and regulations applicable to all awards under the Federal program. Reasonable procedures to identify such compliance requirements would be inquiry of non-Federal entity management and review of the contract and grant agreements pertaining to the program. Any such requirements identified which could have a direct and material effect on a major program should be included in the audit.

- c. Review the CFDA. The CFDA provides summary information about each program and includes the name and telephone number of a Federal contact person. A searchable copy of the CFDA is available through the Internet at <http://www.cfda.gov>.
- d. If there is a program-specific audit guide or other audit guidance issued by the Federal agency's Office of the Inspector General (OIG), the auditor may wish to consider this guidance in identifying the program objectives, program procedures, and compliance requirements. The availability of program audit guides can be determined by contacting the appropriate Regional OIG.
- e. Consider other audit guidance, including previously issued guidance, pertaining to the program that has continuing relevance.

2. *Which of the compliance requirements could have a direct and material effect on the program?*

*Generally Accepted Government Auditing Standards* require that the auditor plan the audit to provide reasonable assurance that the financial statements are free of material misstatement resulting from violations of laws and regulations that have a direct and material effect on the determination of financial statement amounts. OMB Circular A-133 requires the auditor to perform procedures to determine whether the non-Federal entity has complied with laws, regulations, and the provisions of contract or grant agreements that could have a direct and material effect on each major program. Therefore, the auditor must determine which compliance requirements could have a direct and material effect on each major program.

In assessing materiality, the auditor should consider that materiality is based on qualitative as well as quantitative aspects. Also, the auditor should consider whether to set materiality at lower levels in audits of Federal programs than private sector audits of financial statements due to the visibility and sensitivity of such programs. Examples of characteristics indicative of compliance requirements that could have a direct and material effect on a major program include:

- Noncompliance could likely result in questioned costs.
- The requirement affects a large part of the Federal program (e.g., a material amount of program dollars).
- Noncompliance could cause the Federal agency, or pass-through entity, in the case of a subrecipient, to take action, such as seeking reimbursement of all or a part of the award and suspending the recipient's or subrecipient's participation in the program.

3. *Which of the compliance requirements are susceptible to testing by the auditor?*

The auditor is only expected to test compliance for those requirements that are susceptible to testing by the auditor (i.e., the requirements can be evaluated against objective criteria, and the auditor can reasonably be expected to have sufficient basis for recognizing noncompliance). Further, the auditor would not be expected to test for compliance with requirements that the Federal agency should have the ability to verify in the normal course of administering the program (e.g., if the requirement is that the non-Federal entity must file a report by a certain date, the Federal agency should know whether it received the report on time). Characteristics of compliance requirements that auditors are typically expected to test include those:

- That are practical to test.
- With objective criteria available for the auditor to assess compliance.
- Where an audit objective can be written that supports an opinion on compliance.
- When testing adds value, for example:

- It is likely that the auditor could document the noncompliance in a manner that (1) permits the Federal or pass-through entity to take action, or (2) gives the Federal or pass-through entity an early warning to initiate a monitoring visit or other contact with the non-Federal entity.
- The Federal or pass-through entity does not otherwise have information that verifies compliance.

4. *Into which of the 14 types of compliance requirements does each compliance requirement fall?*

**Note:** In performing this step, the auditor may find it helpful to prepare a matrix similar to the matrix included in Part 2 for programs included in this Supplement.

The auditor shall use the 14 types of compliance requirements listed for identifying which requirements applicable to the program are subject to testing. Not all compliance requirements apply to all programs. Conversely, certain types almost always apply.

- A. **Activities Allowed or Unallowed** almost always applies to Federal programs. The auditor should look at the program requirements and Federal award documents for what constitutes allowable or unallowable activities.
- B. **Allowable Costs/Cost Principles** almost always applies since most Federal programs have charges for goods or services. However, if a program only involves benefits to eligible recipients, with no administrative costs, purchases of goods or services (including salaries and overhead), or allocated costs, then allowable costs may not apply.
- C. **Cash Management** almost always applies to Federal programs. An exception would be a Federal award that operates on a cost reimbursement basis only with no cash being advanced.
- D. **Davis-Bacon Act** only applies as required by the Act itself, the Department of Labor's (DOL) governmentwide implementation of the Davis-Bacon Act, or by Federal program legislation, for construction contracts in excess of \$2000 financed by Federal funds. The auditor should review award documents to determine whether the Davis-Bacon Act applies.
- E. **Eligibility** applies to most Federal programs which provide benefits to individuals, groups of individuals, or make subawards. For programs with eligibility requirements, the auditor should review the program laws, regulations, and provisions of contract or grant agreements to determine the specific eligibility requirements. Eligibility involves not only individuals but also possibly groups of individuals, geographical areas, or subrecipients. Additionally, the auditor should consider whether continuing, as well as initial, eligibility requirements apply. Furthermore, eligibility involves both who is eligible and the amount of benefits provided to the eligible.

- F. **Equipment and Real Property Management** requirements applies to Federal programs which purchase equipment or real property.
- G. **Matching, Level of Effort, Earmarking** is not universal, and, if applicable, would be specific to the Federal program and often the non-Federal entity. Therefore, the auditor will have to review the laws, regulations, contract or grant agreements applicable to the program to determine specific requirements for matching, level of effort, and/or earmarking.
- H. **Period of Availability of Federal Funds** almost always applies to Federal programs. The contract or grant agreement applicable to the program often indicates the period during which the funds are available for obligation under the program. The auditor should also look for program requirements regarding carry-over of unused funds to future funding periods, and whether pre-award costs are allowable, to what extent, and under what circumstances.
- I. **Procurement and Suspension and Debarment** applies, in the case of procurement, any time the entity procures goods or services. Suspension and debarment applies to certain procurements and to all subawards.
- J. **Program Income** applies to any program that generates program income (primarily related to the disposition of the income). Program regulations or the contract or grant agreements applicable to the program may specify additional criteria.
- K. **Real Property Acquisition and Relocation Assistance** only applies as required by the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (URA) for payments to persons displaced from their homes, businesses, or farms by federally-assisted programs. While this requirement only applies to a few programs, when it does apply, it is generally a significant aspect of the program. For example, the U.S. Department of Transportation (DOT) funds many programs to construct highways in which real property acquisition and relocation assistance is a significant part of the program activities. The U.S. Department of Housing and Urban Development has the most transactions subject to the URA and DOT has the most Federal dollars affected.
- L. **Reporting** almost always applies to Federal programs. The standard financial reports are described in Part 3; however, the Federal agency or the pass-through entity may have developed its own forms for financial reporting. These forms may be in addition to or in lieu of the standard Federal financial reports and may include electronic submissions. The auditor should determine whether the standard reports are used, and if not, whether other forms are used to report the same or similar information. Information collections (which, as defined in 5 CFR section 1320.3(c), involves 10 or more respondents) by Federal agencies must be approved by OMB in accordance with the Paperwork Reduction Act of 1995 (44 USC 3501-3520) and assigned an OMB control number. A Federal agency may

not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a valid control number

For performance reporting and special reporting, if there is a program in this Supplement funded by the same Federal agency that requires the same performance or special reporting required by the program for which the auditor is seeking to identify compliance requirements, and this Supplement requires testing of those data, then the auditor should use such guidance in identifying compliance requirements to test. Otherwise, the auditor is only required to test financial reporting.

- M. **Subrecipient Monitoring** applies when Federal awards are passed through to a subrecipient. If the entity is not a pass-through entity, this requirement does not apply.
- N. **Special Tests and Provisions** includes those compliance requirements that do not fit the description of the types of compliance requirements discussed above. These will generally be the most difficult type of compliance requirement to identify because, by definition, they are unique to each program. In addition to reviewing the program's contract and grant agreements and referenced laws and regulations, the auditor should also make inquiries of the non-Federal entity to help identify and understand Special Tests and Provisions.

For each of the types of compliance requirements listed above, except for Special Tests and Provisions, the auditor shall consider the compliance requirements and related audit objectives in Part 3. In making a determination not to test a compliance requirement, the auditor must conclude that the requirement either does not apply to the particular non-Federal entity or that noncompliance with the requirement could not have a material effect on a major program (e.g., the auditor would not be expected to test Procurement if the non-Federal entity charges only small amounts of purchases to a major program). The suggested audit procedures in Part 3 are provided to assist auditors in planning and performing tests of non-Federal entity compliance with the requirements of Federal programs. Auditor judgment will be necessary to determine whether the suggested audit procedures are sufficient to achieve the stated audit objective and whether additional or alternative audit procedures are needed.

*Internal Control* - Consistent with the requirements of OMB Circular A-133, Part 3 includes audit objectives and suggested audit procedures to test internal control. However, the auditor must determine the specific procedures to test internal control on a case by case basis considering factors such as the non-Federal entity's internal control, the compliance requirements, the audit objectives for compliance, the auditor's assessment of control risk, and the audit requirement to test internal control as prescribed in OMB Circular A-133.

5. *For Special Tests and Provisions, what are the applicable audit objectives and audit procedures?*

For each of the types of compliance requirements discussed above, Part 3 includes audit objectives and suggested audit procedures, except for Special Tests and Provisions. As noted above, Special Tests and Provisions are sufficiently unique to every program that including audit objectives and suggested audit procedures is not practicable. Therefore, the auditor will have to develop audit objectives and audit procedures for each identified Special Test and Provision using the guidance described in Part 3 under Special Tests and Provisions.