



Governmental Audit  
Quality Center

# Using Part 6 of the New Compliance Supplement on Internal Control

December 11, 2019

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Today's speakers



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What we will cover

Why an understanding of internal control responsibilities is important in a single audit

A walk-through the content included in Part 6, *Internal Control*, of the 2019 OMB *Compliance Supplement*:

- Summary of requirements
- Important internal control concepts
- Illustrative internal controls

Common questions and panelist observations

Documentation considerations



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Terminology and abbreviations

AU-C 230 - Audit Documentation	I/C - Internal Control
AU-C 315 - Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement	IT - Information Technology
AU-C 330 - Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained	JoF - Journal of Accountancy
AU-C 935 - Compliance Audits	MW - Material Weakness
CFDA - Catalog of Federal Domestic Assistance	OMB - Office of Management and Budget
COSO - Committee of Sponsoring Organizations of the Treadway Commission	QCR - Quality Control Review
FAQ - Frequently Asked Questions	SD - Significant Deficiency
GAS-SA Guide - AICPA Audit Guide, Government Auditing Standards and Single Audits	TCWG - Those Charged With Governance
Green Book - Standards for Internal Control in the Federal Government	WCGW - What Could Go Wrong

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# Why an Understanding of I/C Responsibilities is Important in a Single Audit

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I/C in a single audit – why important?

Very few types of regulatory requirements require the auditor to test controls for operating effectiveness

- Single audits require this testing

Adding to the complexity, auditors are looking at I/C over compliance in a single audit

- Auditors are often more familiar with I/C over financial reporting

Single audits receive a high level of regulator scrutiny



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I/C in a single audit – why important?

Historically there have been I/C quality problems noted in reviews of single audits by:

- AICPA peer review program
- Federal QCRs
- Ethics investigations

Typically I/C issues have been one of the most prominent problems noted in these reviews




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The 3 most common I/C problem areas noted in reviews of single audits

Insufficient evidence in file that the firm tested controls around each major program's direct and material compliance requirements

Failed to document understanding of controls for each major program's direct and material compliance requirements

No evidence that the firm tested controls over compliance at all




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Other common I/C problem areas noted in single audits

The auditor:

- Combined I/C assessments for all major programs when major programs differed significantly
- Thought a walkthrough of I/C was sufficient
- Did not test controls because assessed control risk at "high"
- Thought testing done on I/C over financial reporting as part of financial statements was sufficient
- Relied heavily on audit programs without understanding the steps they were signing off on
- Documentation significantly lacking




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5 Common Missteps Noted in July 2019 JoA article – All also apply to single audits

Misstep No. 1: Assuming the client has no controls

Misstep No. 2: Not understanding which controls are relevant to the audit

Misstep No. 3: Stopping after determining whether controls exist

Misstep No. 4: Improperly assessing control risk

Misstep No. 5: Failing to link further procedures to control-related risks



[Access the article](#) (written by AICPA auditing standards staff)

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Panel discussion – What steps have you incorporated in your practice to help avoid these types of I/C problems?



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A Walk-Through of Part 6

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Part 6 – A history lesson

Part 6 has been in existence for many years

- Intended for the consideration of auditees and auditors

Prior to the 2016 *Compliance Supplement*, Part 6 provided illustrative controls for all 5 COSO components for each type of compliance requirement (excluding special tests)

- However, Part 6 had become out-of-date and many controls provided were actually processes

In 2016, Part 6 was revised to be more generic and to refer to updated COSO and Green Book

- Many detailed controls that had been provided were deleted




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Part 6 – A history lesson

Many auditors and auditees wished for more detailed example controls in Part 6, similar to what had been provided in the past

A collaborative effort was undertaken by the GAQC Executive Committee and OMB to overhaul Part 6 during 2018-2019

The ultimate result was the issuance of a completely new Part 6 in the 2019 *Compliance Supplement*

- OMB largely adopted what was developed by GAQC
- Key federal agencies also provided input as Part 6 was developed




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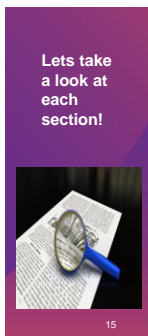
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The 2019 Part 6

The new Part 6 includes:

- A summary of the requirements for I/C under the Uniform Guidance
- A background discussion on important I/C concepts
- Appendices with illustrative entity-wide and specific controls

Access new Part 6 section on the [GAQC 2019 OMB Compliance Supplement Web page](#)




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Part 6 – Summary of requirements - auditees

Under the Uniform Guidance, non-federal entities must:  
Establish and maintain effective I/C over the federal award that provides reasonable assurance that the non-federal entity is managing the federal award in compliance with federal statutes, regulations, and the terms and conditions of the federal award.



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Part 6 refers to other relevant federal guidance



Federal FAQ 303-3 further explains federal I/C expectations for non-federal entities and states that:

- Non-federal entities must have effective I/C
- No requirement that non-federal entities document or evaluate internal controls prescriptively in accordance with COSO or the Green Book (instead a best practice)
- Entities and auditors do not have to reconcile technical differences between them
- Judgment needed to determine the most appropriate and cost effective I/C in a given environment or circumstance

**Caution! The Uniform Guidance does include requirements for non-federal entities to prepare written documentation supporting compliance with certain compliance requirements (e.g., procurement, subrecipient monitoring)**

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Part 6 – Summary of requirements - auditors

Under the Uniform Guidance, auditors must:

- Perform procedures to obtain an understanding of I/C over federal programs sufficient to plan the audit to support a low assessed level of control risk of noncompliance for major programs.
- Plan testing of I/C over the relevant compliance requirements for each major program
- Perform testing of I/C as planned
- Report on I/C over compliance



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What is low assessed level of control risk?

Professional standards do not define or quantify a low assessed level of control risk of noncompliance

Professional judgment is needed in determining the extent of control testing necessary

Keep in mind that this concept is based on the federal agencies' desire to know if conditions indicate that auditees have not implemented adequate I/C for federal programs to ensure compliance



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Part 6 – Summary of requirements – auditors

When I/C over some or all of the compliance requirements for a major program are likely to be ineffective, the planning and performing of testing described on the previous slide are not required

Instead, the auditor must:

- Report a SD or MW
- Assess the related control risk at the maximum; and
- Consider whether additional compliance tests are required because of ineffective I/C



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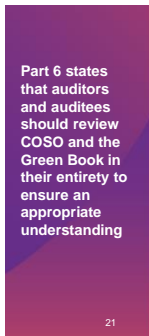
Part 6 – Important I/C concepts

I/C is a process effected by an entity that provides reasonable assurance that entity objectives will be achieved  
System of I/C is expected to provide reasonable assurance of compliance

Management exercises judgment in balancing the cost and benefit of designing, implementing, and operating I/C

I/C provides many benefits to an entity

- Added confidence regarding achievement of objectives
- Feedback on how effectively an entity is operating
- Reduces risks affecting the achievement of compliance objectives



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Part 6 – Important I/C concepts

I/C is not one event or circumstance, but a dynamic and iterative process

- Embedded within this process are controls which consist of policies and procedures

Processes are managed through the fundamental auditee management activities, such as planning, executing, and checking

I/C control embedded within these processes and activities are likely more effective and efficient than stand-alone controls




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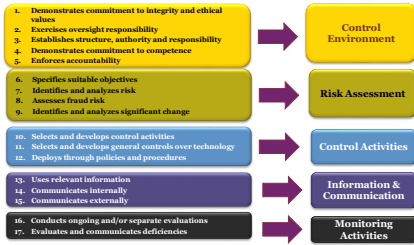
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Part 6 – Important I/C concepts – 5 components and 17 principles of effective I/C



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Part 6 – Important I/C concepts

To determine if an I/C system is effective, auditee management assesses the design, implementation, and operating effectiveness of the five components and 17 principles.

If a principle or component is not effective, or the components are not operating together in an integrated manner, then an I/C system cannot be effective.



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Part 6 – Appendices Introduction

The Appendices are intended to provide illustrative internal controls for each of the five components of I/C

Appendix 1 - **Entity-wide** controls over compliance

Appendix 2 - Control activities **specific** to individual compliance requirements

The appendices are organized this way because many non-federal entities consider and implement I/C in this manner



Seven horizontal lines for notes.

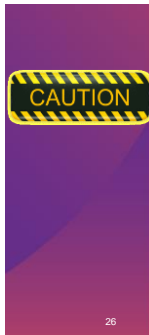
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Part 6 – Appendices – A word of caution!

Illustrative controls provided are not intended to be all-inclusive or a checklist of required I/C!

Non-federal entities:

- Could have adequate I/C even though some or all illustrative controls are not present.
- Could have other appropriate internal controls operating effectively that have not been included among the illustrations.
- Need to exercise judgment in determining the most appropriate and cost-effective I/C



Seven horizontal lines for notes.

26

Part 6 – Appendix 1 – Entity-wide controls

What is an **entity-wide control**?

Entity-wide controls are considered governance controls that apply to most, if not all, types of compliance requirements for one or more Federal programs.

Generally established at the entity-wide level versus at the federal program or type of compliance requirement level



Seven horizontal lines for notes.

27

Part 6 – Appendix 1 – Entity-wide controls

Entity-wide controls often occur in the following I/C components			
Control environment	Risk assessment	Information and communication	Monitoring

When auditees implement I/C in this manner, auditors may obtain an understanding of controls and test controls at the entity-wide level, as well as prepare related documentation at that level

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Examples of controls - control environment

- A code of conduct is documented and communicated
- Conflict of interest statements obtained from key management and TCWG
- Whistleblower submission process exists to receive and evaluate concerns over compliance
- Personnel with federal award compliance responsibilities are properly trained on responsibilities
- Consequences for noncompliance with the code of conduct are enforced
- Audit committee charter exists and addresses federal compliance oversight responsibility

**Entity-wide controls**

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Examples of controls – risk assessment

- Senior management identifies key compliance objectives for types of compliance requirements
- Management analyzes and identifies compliance risk including fraud risk
- Risk mitigation strategies implemented
- Employees receive proper training to address identified risks
- TCWG periodically review a report of risks identified and actions taken during the period
- Regulatory compliance changes are monitored so risk assessments can be properly adjusted

**Entity-wide controls**

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Examples of controls – information and communication

- Management verifies the sources and reliability of information used in making management decisions and execute monitoring controls
- When derived from IT systems, security administration, program maintenance and program execution controls are in place
- Relevant compliance requirement changes are communicated to employees responsible for compliance
- Effective channels of communication exist with Federal granting agencies

Entity-wide controls

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Examples of controls - monitoring

- Management regularly monitors the effective operation of critical control activities including key performance indicators
- If an internal audit function exists, its audit plans align with the federal program risk assessment
- Findings, recommendation and observations by internal and external auditors are distributed and reviewed
- Corrective action plan status is monitored

Entity-wide controls

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Part 6 – Appendix 1 – Entity-wide controls excerpt

Risk Assessment Component

Having established an effective control environment, management assesses the risks facing the entity as it seeks to achieve its objectives. This assessment provides the basis for developing appropriate risk responses. Management assesses the risks the entity faces from both external and internal sources.

Principle 6. Management should define objectives clearly to enable the identification of risks and define risk tolerances.

Illustrative Controls for Principle 6:

- Management establishes an effective risk assessment process that includes the use of a specific risk matrix
- Management identifies key compliance objectives for types of compliance requirements
- Management identifies and evaluates risk tolerances related for controls over compliance

Appendix includes illustrative controls for each of the 4 I/C components, broken down by each related principle

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Panel discussion

If the risk assessment and monitoring components of COSO are not implemented over my client's major federal program, should that automatically result in a SD or MW?



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Part 6 – Appendix 2 – Specific controls

Specific controls often occur in the following I/C component

Control activities

What is a specific control?

- Specific controls are considered operational-level controls that apply to individual types of compliance requirements

When auditees implement I/C in this manner, should obtain the understanding of controls and test specific controls related to control activities, as well as prepare related documentation at that level

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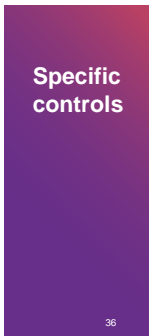
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Examples of controls - control activities

- Documented policies
- Authorization and approval
- Management review
- IT system configuration
- IT system access

Key controls often occur here!



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Part 6 – Appendix 2 – Emphasis on process vs. control

- Process is a series of actions leading to a particular result (e.g., charging costs to a federal award)
- Process is where noncompliance can occur
- Potential noncompliance is often referred to as "what could go wrong"
- A control is designed to prevent or timely detect noncompliance
- When identifying controls, it is important to first consider the processes and the resulting WCGWs
- Controls should be designed, implemented and maintained to be responsive to risk and the WCGWs




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Part 6 – Appendix 2 – Emphasis on process vs. control

Part 6 offers several other important related considerations

- Process owners are often referred to as the doers and the control owner is often referred to as the reviewer.
- A well-designed system of I/C assigns a control to each WCGW. An entity could have one control that addresses one WCGW, a suite of controls that address one WCGW, or one control that addresses multiple WCGWs.
- Controls are often described in terms of a control category, such as authorization, management review, segregation of duties, or system access.




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Part 6 – Appendix 2 – Emphasis on preventative vs. detective controls

A preventive control is designed to avoid an unintended event or result at the time of the transaction

A detective control is designed to discover an unintended event or result after the initial processing has occurred but before the ultimate objective has concluded.

Entities usually employ a mix of both




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Example of preventative vs. detective controls in Appendix 2

**Preventative**

Individuals who initiate procurements are different than those recording the resulting transactions in the general ledger or making disbursements

The information system configuration prevents a participant from being approved as eligible until all criteria required by the program...are input

**Detective**

Property and equipment listings associated with federal funds are reviewed periodically by knowledgeable officials to ensure completeness and accuracy

Supervisors periodically reconcile subrecipient monitoring calendar and planned activities to actual monitoring activities to ensure monitoring taking place as planned

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PART 6 - APPENDIX 2

Illustrative Specific Controls - Control Activities (excerpted from Greenbook).

Note – Regarding revision from June 2019 publication. Content moved to correct cells shown with yellow highlight. Content deleted shown with light blue highlight. Note – the highlighting is not 508 compliant.

Principle 10. Design Control Activities: management should design control activities to achieve objectives and respond to risks.

A. ACTIVITIES ALLOWED OR UNALLOWED B. ALLOWABLE COSTS/COST PRINCIPLES	C. CASH MANAGEMENT	E. ELIGIBILITY	F. EQUIPMENT AND REAL PROPERTY MANAGEMENT
Management identifies and puts into effect actions needed to carry out specific responses to risks identified in the risk assessment process such as misrouting, inappropriate cost transfers, budget overruns, segregation of duties concerns, unauthorized changes to system configurations, fraud, unauthorized payments, etc.	Management identifies and puts into effect actions needed to carry out specific responses to risks identified in the risk assessment process such as time lapses between funds transfer and disbursement, fraud, liquidity pressures, inherent risks with subrecipients, etc.	Management identifies and puts into effect actions needed to carry out specific responses to risks identified in the risk assessment process such as providing benefits to ineligible individuals, calculating amounts to be received for or on behalf of individuals incorrectly, unauthorized changes to system configurations, fraud, unauthorized payments, etc.	Management identifies and puts into effect actions needed to carry out specific responses to risks identified in the risk assessment process for equipment and real property such as inaccurate or incomplete reconciling, inappropriate use, unidentified disposition, segregation of duties concerns, fraud, loss, damage, theft, etc.
Management reviews applicable award agreements or contracts for specific allowable activities requirements, budget parameters, indirect rates, fringe benefit rates, and those activities/costs which require pre-approval by the awarding agency and documents such features into a grant approval form which is	Management reviews applicable award agreements or contracts to determine applicability of drawdown method (advance or reimbursement) to develop its own control	Management reviews applicable award agreements or contracts and identifies specific eligibility requirements including benefits to be paid.	Management reviews applicable award agreements or contracts and identifies specific equipment and real property requirements.

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Don't Forget!

All five components of I/C have to be present and functioning for I/C to be designed effectively

Control activities on their own are not an effective system of I/C

Even within control activities, controls rely on the effective design and operation of other controls

42

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A word about IT controls

Appendix 1 includes illustrative general IT controls in the information and communication I/C component in areas such as:

- Security administration
- Program maintenance
- Program execution

Remember that general IT controls, typically designed and implemented as entity-wide controls (described in Appendix 1), are necessary for the effective operation of application IT controls

Appendix 2 includes specific IT controls in the section relating to Principle 11 (i.e., design activities for the information system)




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Panel discussion

What are your experiences with bringing IT specialists in to assist on your single audit engagements?




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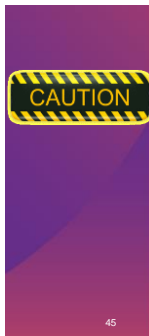
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Part 6 – Appendices – Another word of caution!

The approach taken in the Appendices to present entity-wide and specific controls may not reflect how a particular entity designs and implements I/C

In these situations, auditors should obtain an understanding of controls and test controls at a level that reflects the way management designs and implements I/C, as well as prepare related audit documentation at that level.




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Panel discussion

Just curious....does the entity-wide and specific control approach used in Part 6 reflect the way most of your clients establish I/C?

Asked another way, how often are you having to diverge from the approach provided in Part 6 and revert to addressing some of the Part 6 entity-wide controls at a more specific level (e.g., at the program or location level) and what types of clients are you finding that happens in?



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Other common questions and panelist discussion

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Panel discussion

In recent Web events, the GAOC has been emphasizing a 7-step process for the auditor to tackle I/C. Here are the steps:

- Step 1:** Identify the control objective(s)
- Step 2:** Understand the auditee's "business process of complying"
- Step 3:** Evaluate the risks .."the what could go wrongs"
- Step 4:** Understand controls over "the what could go wrongs"
- Step 5:** Evaluate whether controls are designed effectively and have been placed into operation
- Step 6:** If controls are designed effectively and placed into operation, test key controls for operating effectiveness
- Step 7:** Document entire sequence!

Can you help me understand how Part 6 plays into this 7-step process?



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Panel discussion

My teams struggle with the difference between the steps needed to understand design and implementation vs. testing operating effectiveness of controls. Is a walk-through evidence of testing operating effectiveness?

Any help you can provide in helping clarify this?



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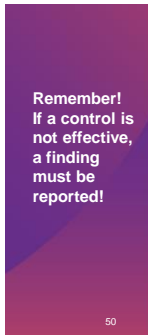
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Understanding design and implementation vs. effectiveness

- Test of design and implementation
  - Walkthrough auditor understanding
  - Conclusion: Control has been properly designed and implemented
- Test of operating effectiveness
  - Test key control attributes
  - Conclusion: Control is effective



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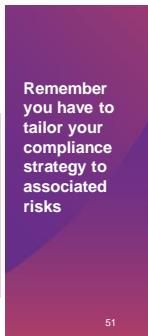
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Understanding design and implementation vs. effectiveness

What are examples of tests of operating effectiveness?

- Procedures can include:
- Inquiries
  - Inspection of documents indicating performance
  - Observation of application of specific controls
  - Re-performance of controls by auditor
  - Generally involves combination of procedures
    - Inquiry alone is not sufficient



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Panel discussion

Question: Can you further explain what key controls are?

Key controls are often specific controls that are found in the control activities I/C component (i.e., the types of controls found in Appendix 2 of Part 6)

Key controls are the most important in preventing or detecting material noncompliance

Key controls are those you test for operating effectiveness = "low control risk"



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Panel discussion

Do I have to test operating effectiveness of the entity-wide controls or can I focus only on testing operating effectiveness of specific controls?



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Panel discussion

In my experience as an auditor and as a peer reviewer, some of this is very challenging for auditors.

For example, identifying and testing controls for allowable costs and eligibility is simple enough but not so easy for other compliance requirements like period of performance.

Thoughts?



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Panel discussion

If the Part 2 matrix of the 2019 *Compliance Supplement* indicates eligibility is not subject to audit, but there are material eligibility determinations being made, should controls relating to that requirement be tested?



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Panel discussion

How has your firm actually incorporated the new Part 6 into your single audit practice? Are you having your teams use it directly, or have you incorporated its guidance into various firm tools and programs?



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## Effect of New Part 6 on Testing Approach and Documentation

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Consider this scenario

You are auditing XYZ Entity with 2 major programs CFDA 17.XXX and CFDA 20.YYY.

The matrix for each CFDA indicates the following types of requirements are subject to audit:

<b>CFDA 17.XXX</b> A/B Allowability C Cash Management D Eligibility H Period of Performance L Reporting M Subrecipient Monitoring	<b>CFDA 20.YYY</b> A/B Allowability C Cash Management F Equipment G Matching H Period of Performance M Subrecipient Monitoring
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### How Part 6 comes into play

Determine whether your client has established entity-wide controls in 4 of the 5 COSO components for 17.XXX and 20.YYY

- If you and/or your client are challenged to identify the types of entity-wide controls that might be in place, refer to Appendix 1 of Part 6 for ideas

For 17.XXX and 20.YYY individually, determine whether your client has established specific controls like those covered in Appendix 2 for each type of compliance requirement subject to audit

Evaluate whether both entity-wide and specific controls are designed effectively and have been placed into operation

Identify key controls

Test key controls for operating effectiveness (and of course, document!)

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### On the documentation front, before Part 6.....

For 17.XXX and 20.YYY you may have organized your internal control testing by:

- Major program;
- Each type of compliance requirement subject to audit; and
- Each of the 5 components of COSO

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On the documentation front, before Part 6....

For 17.XXX, you may have documented controls for each type of compliance requirement that addressed the following (and done the same approach for 20.YYY)

<b>A/B Allowability</b> Control environment, risk assessment, information and communication, and monitoring	<b>C Cash Management</b> Control environment, risk assessment, information and communication, and monitoring	<b>D Eligibility</b> Control environment, risk assessment, information and communication, and monitoring	<b>H Period of Performance</b> Control environment, risk assessment, information and communication, and monitoring	<b>L Reporting</b> Control environment, risk assessment, information and communication, and monitoring	<b>M Subrecipient Monitoring</b> Control environment, risk assessment, information and communication, and monitoring
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Before Part 6....the end result of your documentation approach

You likely had a fair amount of redundancy in the documentation as many of the controls documented for each type of compliance requirements were the same

Approach could lead to possible confusion and error by staff due to the extensive nature of the documentation



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Panel discussion

What do you see changing in terms of how you document I/C now that we have a new Part 6?

- Consider the new Part 6 as you organize your testing:
- Entity level?
  - Specific level?
  - Across major programs?



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Consider the previous scenario but using a different documentation approach due to the new Part 6

Assuming your client has established entity-wide and specific controls in the manner described in Part 6, documentation may be prepared as follows:

For 17.XXX and 20.YYY, you document the entity-wide controls relevant to the following components of COSO and the Green Book:

- Control environment
- Risk assessment
- Information and communication
- Monitoring

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On the documentation front, after the new Part 6.....

So, for 17.XXX you may document the following for each type of compliance requirement (and do the same for 20.YYY requirements)

A/B Allowability Control activities	C Cash Management Control activities	D Eligibility Control activities	H Period of Performance Control activities	L Reporting Control activities	M Subrecipient Monitoring Control activities
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After Part 6.....the end result

More streamlined documentation and less redundancy  
Less chance for error due to streamlining

**CAUTION:** Remember that you need to consider the previous cautions mentioned!

If your client does not establish I/C in the manner described in the new Part 6, you will need to modify your documentation approach to reflect how your client established I/C

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More on I/C Documentation

Chapter 9 of the GAS-SA Guide discusses I/C documentation requirements based on AU-C 230, AU-C 315, AU-C 330, and AU-C 935

Documentation in this area is a focus for peer review and federal QCRs

See the GAS-SA Guide for a complete list of documentation requirements



67

Seven horizontal lines for notes.

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Looking Forward

The GAQC Executive Committee has a project to develop nonauthoritative guidance to illustrate how an auditor might consider documenting I/C in a single audit

- For a larger complex entity
- For a smaller less complex entity

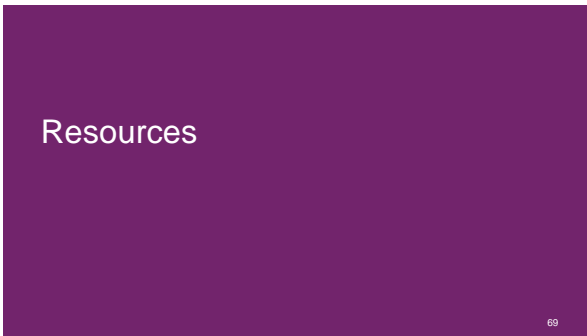
Stay tuned!



68

Seven horizontal lines for notes.

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Resources

69

Seven horizontal lines for notes.

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Previous GAQC archived web events

All events below can be accessed in [single audit section of GAQC archived web events](#):

- Tackling Internal Control Over Compliance in a Single Audit
- Smart Sampling in a Single Audit
- 2019 Compliance Supplement and Single Audit Update
- Single Audit Lightning Round




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Other AICPA Resources

[AICPA Auditing Standards](#)

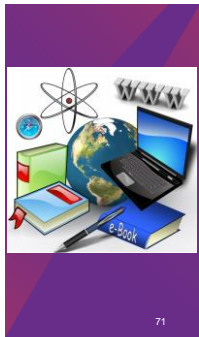
AICPA GAS-SA Guide

- See Chapter 9, *Consideration of Internal Control Over Compliance for Major Programs*
- Order at: <http://www.aicpastore.com/>

[Government Auditing Standards](#)

OMB Compliance Supplement ([see 2019 Supplement on GAQC Web site](#))

- [Access separate Part 6 section](#)




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71

Other AICPA Resources

[AICPA Internal Control Toolkit](#)

Includes:

- [Internal control over financial reporting tool template](#)
- [Process memo template](#)
- [Aid for identifying controls at smaller entities](#)
- [Internal control staff training](#)
- [Internal inspection practice aid](#)
- [Web Event: Take control of your audit by avoiding internal control missteps](#)
- [JoA article](#)




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72



How to access I/C frameworks and other federal guidance

COSO framework

- Available for purchase
- [Access information](#)

Green Book

- Available for free
- [Access Green Book](#)

[Federal FAQs](#) on the Uniform Guidance



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Panel discussion – What do you think are the most important takeaways from today’s presentation?



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How do I get my CPE certificate?

- Access your CPE certificate by clicking the blue “CPE” icon
  - If at the end of this presentation you are eligible for but unable to print your CPE certificate, please log back into this webcast in 24 hours and click the blue “CPE” button. Your certificate will still be available.
  - If you need assistance with locating your certificate, please contact the AICPA Service Center at 888.777.7077 or [service@aicpa.org](mailto:service@aicpa.org).



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Governmental Audit  
Quality Center

# Thank you

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