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## CHAPTER 1. GENERAL AUDIT GUIDANCE

- 1-1. Purpose.** This audit guide is to assist the independent auditor (auditor) in performing audits of profit-motivated entities that are subject to the U.S. Department of Housing and Urban Development's (HUD) uniform financial reporting standards set forth in 24 CFR (Code of Federal Regulations) Part 5, Subpart H; and 24 CFR Part 202.5(g) and related mortgagee letters. HUD requires an audit that consists of two components: a financial statement audit of the entity and a compliance audit of the entity's major HUD programs. The audit must be performed in accordance with generally accepted auditing standards (GAAS), issued by the American Institute of Certified Public Accountants (AICPA), and generally accepted government auditing standards (GAGAS), issued by the Comptroller General of the United States. For Securities and Exchange Commission registrants, the financial statement audit may be performed in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB) and GAGAS. Additionally, the compliance audit is to be conducted in accordance with this audit guide, which requires that the auditor perform procedures that enable the auditor to opine on whether the entity has complied with laws, regulations, and the provisions of contracts or grant agreements applicable to its major HUD programs.

The use of this audit guide is mandatory for audits of all for-profit participants; however, this audit guide is not intended to be a complete manual of audit procedures for the compliance audit. The audit 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 GAGAS. It is meant to supplement those standards with information specific to HUD programs. 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 are met. However, auditors must address all compliance requirements in this audit guide that could have a direct and material effect on a major HUD-assisted program. If the auditor determines that certain procedures for a compliance requirement will not to be performed, the rationale for the exclusion must be explained and documented in the audit documentation in support of the auditor's report. An example would be a situation in which circumstances pertaining to the auditee are such that the auditee is not subject to a particular requirement.

This audit guide is divided into chapters. This chapter, chapter 1, documents the purpose, background, and requirements for performing a HUD-required audit. 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 audit guide. Each of the remaining chapters contains procedures for auditing compliance with specific HUD program requirements.

Chapters 3 through the remainder of the guide contain references to relevant compliance requirements that were in effect at the time each chapter was issued. Auditors should recognize that compliance requirements change periodically and that delays will occur between such changes and revisions to this audit guide. Moreover, auditors should

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recognize that there may be provisions of contracts and grant agreements that are not specified in law, regulation, or other HUD requirements contained in HUD handbooks, notices, and mortgagee letters; therefore, the specifics of such are not included in this audit guide. Accordingly, the auditor should perform reasonable procedures to ensure that compliance requirements are current and to determine whether there are any additional provisions of contracts and grant agreements that should be covered by an audit under this audit guide. Reasonable procedures would be inquiry of auditee management and review of the contracts and grant agreements for major programs. HUD documents are available in the HUD Client Information and Policy System (HUDCLIPS), at the following Internet address:

[http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/administration/hudclips/](http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/)

If the auditor desires technical assistance pertaining to HUD programs, regulations, or operations, the auditor should contact the particular HUD headquarters or field program offices listed in the applicable chapter or contact the office responsible for monitoring or overseeing the activities of the auditee.

- 1-2. Use of This Audit Guide for Audits of States, Local Governments, and Nonprofit Organizations.** Governmental and nonprofit entities also participate in some of the HUD programs covered in chapters 3 through 7 of this audit guide. These entities are subject to the audit requirements in Office of Management and Budget (OMB) Circular A-133, and auditors should normally use OMB's Compliance Supplement to perform the audit and not this audit guide. However, in instances in which a program is not included in the OMB Compliance Supplement but is covered in this audit guide, the auditor should use the compliance requirements and suggested audit procedures in this audit guide for purposes of building an audit program using the guidance in part 7 of the OMB Compliance Supplement.
- 1-3. Audit Scope and Approach.**
- A. Financial Statement Audit.**

The financial statement audit should be planned to be sufficiently comprehensive in scope to permit an expression of an opinion on the financial statements and an in-relation-to opinion on the supplementary information of the HUD-assisted activity as referenced in the relevant chapters in this audit guide.

GAAS 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 the AICPA's Codification of Statements on Auditing Standards (AU-C) Section 315, "Understanding the Entity and Its Environment and Assessing

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the Risks of Material Misstatement.” GAGAS provides an additional requirement for reporting on internal control over financial reporting (see chapter 2 of this audit guide).

## **B. Compliance Audit.**

This audit guide requires an opinion on the auditee’s compliance with specific requirements applicable to each major program included in the audit. The auditor should use the following information to determine whether a program is considered to be a major program for the type of audit being performed using a specific audit guide chapter.

- **Chapters 3 and 4:** A major program is defined as an individual assistance program for which expenditures equaled or exceeded \$500,000 during the applicable year or a project or hospital that had an outstanding HUD-insured or HUD-guaranteed loan balance equal to or exceeding \$500,000 as of the end of the period under audit.
- **Chapter 5:** No major program designation is needed.
- **Chapter 6:** A Government National Mortgage Association (Ginnie Mae) issuer’s Ginnie Mae program is considered major if the issuer had a servicing portfolio or had any remaining principal balance at the end of the audit period.
- **Chapter 7:** A Federal Housing Administration (FHA)-approved lender’s program is considered major regardless of the amount of loans originated or serviced during the period under audit. However, for lenders having combined originations and a servicing portfolio of less than \$2 million, the opinion on compliance need cover only the compliance requirements in chapter 7, section 7-5(A), Quality Control Plan, and 7-5(G), Lender Annual Recertification, Adjusted Net Worth, Liquidity, and Licensing.

The auditor is also to consider the auditee’s internal control over compliance as part of the compliance audit. 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. 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 direct and material requirements of the major 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. 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.

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**1-4. Sample Selection.**

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 a population. The auditor uses 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.

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, the Office of Inspector General (OIG) convened a panel consisting of representatives from OIG, HUD's Real Estate Assessment Center, the AICPA, and several auditing firms with significant HUD experience to discuss the issue and potential solutions. 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 approach has since been endorsed by the AICPA in its Audit Guide for Government Auditing Standards and A-133 Audits.

Whenever a sample is selected to test compliance or to test controls over compliance as part of an audit performed in accordance with this guide, HUD requires that an attribute sampling methodology be used. This requirement is to provide consistency and ensure adequate coverage to support the audit opinions rendered. Appendix A to chapter 1 of this guide, "Attribute Sampling," applies to all audits performed in accordance with this guide. It provides additional information on attribute sampling and minimum sample sizes. The sample sizes stated in appendix A are mandatory and are the minimum sample sizes to be used for all samples selected.

Further information about applying attribute sampling in an audit of Federal programs can be found in the AICPA's Audit Guide for Government Auditing Standards and A-133 Audits. Auditors may substitute an approach from the AICPA's audit guide for the approach described in appendix A, provided that the resulting sample size is equal to or greater than the minimum sample sizes in appendix A.

**1-5. Planning the Audit.**

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

1. That the audit is to be performed in accordance with GAAS; GAGAS; and the current version of HUD's audit guide, HUD Handbook 2000.04.

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2. The estimated date the audit report will be delivered to the auditee. Good coordination between the auditee and auditor is important to ensure timely delivery of the audit report, considering that managers from HUD may hold up advances and other funding approvals, etc., until the audit report is received.

Note that it is the auditee's responsibility to ensure that the audit is completed within the time requirements set forth in its contracts or agreements with HUD and that the conditions stated in the engagement letter are met. However, the auditor should consider the causes for any delays to determine whether they form the basis for an audit finding.

3. That the auditor is required to provide the HUD Secretary or his or 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 hardcopy audit documentation or other documents or electronic copies of electronic audit documentation.
  4. That if the auditor becomes aware of noncompliance with provisions of laws, regulations, contracts, and grant agreements 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. In addition, as required in chapter 2 of this audit guide, the auditor may be required to contact the HUD single audit coordinator to discuss matters relating to fraud or equity skimming. Based on that discussion, the auditor may be requested to prepare a written report on all known or likely fraud that has occurred. Acceptance of the engagement letter grants the auditor permission to contact 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 auditee should be included as follows:
    - a. The auditee is responsible for making the electronic submission to HUD.
    - b. The auditor under a separate agreed-upon procedure engagement is responsible for applying procedures to ensure that the data submitted agree with the auditee's hardcopies of the supporting documentation.
  6. A description of the scope of the planned audit and contents of the report as set forth in chapter 2 of the audit guide.
  7. If applicable, that the auditee grants permission for the successor auditor to discuss and review the predecessor auditor's audit documentation and for the
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auditee to make the appropriate arrangements. Normally the auditor, before issuing an engagement letter, will contact the predecessor auditor to review the predecessor auditor's audit documentation files supporting the prior financial statement audit and any findings included in the predecessor auditor's compliance report. The auditor may also need to discuss with the predecessor auditor matters that are not adequately explained or documented in the audit documentation or a preexisting condition the auditor notes in his or her review that was not in the prior audit report. If the predecessor auditor refuses to allow the successor auditor access to that information or to discuss such matters, the successor auditor should include in the engagement letter that the auditee grants permission for the successor auditor to discuss and review the prior audit documentation and for the auditee to make the appropriate arrangements.

8. A list of the information the auditor wants the auditee to provide for the audit and the requested delivery date of those items.
- B. Testing.** The auditor should use professional judgment to determine the extent of testing necessary to support his or 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. A dual-purpose sample may be used for testing compliance and internal controls over compliance. When a single sample is used to meet more than one audit objective, testing for each audit objective must follow the minimum sample size requirements. All compliance requirements contained in this audit guide that relate to a major program must be addressed.

For audits of entities subject to chapter 3 of the guide, please refer to that chapter for testing considerations in situations in which the project is owned or managed by an entity that owns or manages multiple HUD-assisted projects.

- C. Reporting.** Please refer to chapter 2. The applicable HUD program office establishes the due dates for submission of the audit reporting package to HUD and generally will not grant exceptions except in extraordinary circumstances. Requests to extend the due date for submission of the audit reporting package should not be directed to OIG.
- D. Management Representations.** The auditor is required to obtain written representations from management that include 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 for establishing and maintaining effective control over financial reporting and internal control over compliance.
- E. Audit Documentation.** The auditor must 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. When an auditor becomes aware that HUD or the auditee is contesting an audit finding in the report, the auditor may 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.

- 1-6. Withdrawal From or Termination of an Engagement.** On occasion, an auditor's engagement may be terminated by the auditee after the audit is initiated, or the auditor 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. If fraud or equity skimming that may exist is the reason for the withdrawal or termination, the auditor is to follow the guidance in paragraph 2-5 of chapter 2 of this audit guide. The following are the officials who are to be notified based on the audit guide chapter being used to audit the HUD-funded activity.

<b>Program audited based on audit guide chapter no.</b>	<b>Official to be contacted</b>
3	Deputy Assistant Secretary for Multifamily Housing  Deputy Assistant Secretary for Healthcare Programs (for audits of nursing homes, intermediate care facilities, and board and care homes with mortgages insured under Section 232 of the National Housing Act)
4	Deputy Assistant Secretary for Healthcare Programs
5	Deputy Assistant Secretary for Multifamily Housing  Deputy Assistant Secretary for Healthcare Programs (for audits of nursing homes, intermediate care facilities, and board and care homes with mortgages insured under Section 232 of the National Housing Act)
6	Executive Vice President of Ginnie Mae
7	Director, Office of Lender Approval and Recertification Division
3 through 7	HUD OIG Single Audit Coordinator

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Contact information for the positions listed above can be found on HUD's Internet site. HUD OIG's Single Audit Coordinator can be contacted at the following email address:

[HUDOIGSingleAuditCoordinator@hudoig.gov](mailto:HUDOIGSingleAuditCoordinator@hudoig.gov)

- 1-7. Quality Control Review of Audits.** HUD OIG and HUD's Real Estate Assessment Center have implemented procedures for evaluating audits performed by non-Federal auditors. As part of this evaluation of completed audits, the supporting audit documentation must be made available upon request. To facilitate these requests, the transmittal letter of the audit report should include the name, office, address, and telephone number of the lead person conducting the audit (usually the engagement partner) and the auditor's Federal employer identification number.

Whenever HUD's evaluation of an audit report or audit documentation discloses inadequacies, the auditor may be asked to take corrective action. If HUD determines that the audit report or the audit documentation is substandard or contains major inadequacies, HUD may also consider any or all of the following actions, including but not limited to: (1) filing a complaint against the auditor with the AICPA, the appropriate State board of accountancy, or both; (2) recommending that HUD suspend or debar the auditor from further participation in Federal programs; or (3) referring the case to the U.S. Department of Justice for possible civil or criminal prosecution.

- 1-8. External Peer Review.** As required by GAGAS, audit organizations performing audits pursuant to this guide should obtain an external peer review at least once every 3 years. It is not necessary to submit the peer review report to HUD or HUD OIG unless requested to do so by representatives of those offices or specifically required to do so in other chapters of this audit guide.



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**Appendix A****Attribute Sampling**

This appendix applies to all testing performed for the compliance component of an audit performed using this audit guide.

When planning to test a particular sample of transactions, the auditor should consider the specific audit objective to be achieved and 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. 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 testing begins, the auditor must understand and document what attributes and assertions are being tested. The auditor needs to identify and document the appropriate population and should also perform procedures (for example, reconciliations or inquiry) to ensure that the population from which the sample is 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. 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.

**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 sample size table below is based on the following assumptions:

- **Desired confidence.** Auditors should obtain the appropriate level of assurance by using a confidence level of 90 or 95 percent.
- **Tolerable exception rate.** A 5-10 percent exception rate is acceptable.
- **Expected exception rate.** No exceptions should be expected.

- **Materiality.** Using attribute testing, monetary materiality, or tolerable misstatement is not a necessary input for determining sample size.

### **Sample Size Table.**

Using the above considerations and standard attribute sampling methodology, a low to normal level of assurance can be obtained by applying a 90 percent confidence level when there is an expectation of an error rate between 0 and 5 percent. The minimum recommended sample size using these parameters at a 5 and 10 percent tolerable exception rate is 50 and 25, respectively. Similarly, using a 95 percent confidence level, an expected error rate between 0 and 5 percent, and a 5 or 10 percent tolerable exception rate, the sample size is 65 and 35, respectively. These sample sizes are shown in the table below.

**Compliance sample size table**

<b>Importance or significance of the attribute being tested</b>	<b>Confidence level</b>	<b>Tolerable rate</b>	<b>Minimum sample size for populations over 250</b>
Low to normal	90%	5%	50
Low to normal	90%	10%	25
High	95%	5%	65
High	95%	10%	35

This table is illustrative and 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. Factors indicative of higher risk include but are not limited to

- Whether this is the initial audit of the entity performed by the auditor.
- The entity's size and level of decentralization.
- The existence of a large number of prior, significant deficiencies, material weaknesses, or other audit findings.
- Poor internal controls.
- Extremely high volume of activity relating to a particular compliance requirement.
- High 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 only that specific attribute.

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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 versus high risk. When making the risk determination, it is important to understand the nature of the population.

### **Populations of 250 Items or Fewer.**

When performing compliance testing of populations of 250 items or fewer, auditors generally should examine at least 10 percent of the items in the population. This is a minimum sample size, and qualitative factors may exist that would require a larger sample size.

### **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 or assertion is being 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 represent material compliance findings or significant deficiencies or material weaknesses in internal control. It is not necessary to expand testing when exceptions are found. Refer to 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 report as a compliance violation. The auditor should also 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.

### **Audit Documentation.**

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.

### **Technical Assistance.**

Technical guidance on audit sampling is available in the AICPA's Audit Guide for Government Auditing Standards and A-133 Audits. Auditors may substitute an approach from the AICPA's audit guide for the approach described above, provided that the resulting sample size is equal to or greater than the above minimum sample sizes.