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Proposed statement of position : compliance and internal control auditing for student financial assistance programs using service organizations : proposed amendment to AICPA audit and accounting guide, Audits of colleges and universities; Compliance and internal control auditing for student financial assistance programs using service organizations : proposed amendment to AICPA audit and accounting guide, Audits of colleges and universities; Exposure draft (American Institute of Certified Public Accountants), 1992, Apr. 29

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EXPOSURE DRAFT

PROPOSED STATEMENT OF POSITION

COMPLIANCE AND INTERNAL CONTROL AUDITING FOR STUDENT FINANCIAL ASSISTANCE PROGRAMS USING SERVICE ORGANIZATIONS

**(Proposed Amendment to AICPA Audit and Accounting Guide
Audits of Colleges and Universities)**

APRIL 29, 1992

**Proposed by the Student Financial Assistance Program Audit Task Force,
Auditing Standards Division,
American Institute of Certified Public Accountants**

**Comments should be received by July 13, 1992, and addressed to
Walton T. Conn, Jr., Practice Fellow, Auditing Standards Division, File 4380
AICPA, 1211 Avenue of the Americas, New York, N.Y. 10036-8775**

SUMMARY

The U.S. Department of Education (ED) Audit Guide *Audits of Student Financial Assistance Programs* (ED Audit Guide) requires institutions that participate in its student financial assistance (SFA) programs to engage independent auditors to audit certain aspects of their participation in those programs. Among other reports, auditors who perform such audits are required to issue reports on (1) the participating institutions' compliance with laws and regulations specified in the ED Audit Guide, and (2) the internal control structure used by participating institutions in administering the student financial assistance programs. The ED Audit Guide requires an institution's auditor's reports on compliance and the internal control structure to encompass any functions performed by service organizations, as defined in this proposed statement of position.

This proposed statement of position would amend the Audit and Accounting Guide *Audits of Colleges and Universities* to—

- Provide guidance on an institution's auditor's responsibilities when auditing compliance with the requirements applicable to SFA programs and the internal control structure over compliance at an institution that engages a service organization to perform certain functions related to the administration of its SFA program.
- Provide guidance on a service organization's auditor's responsibilities when auditing compliance with the requirements applicable to SFA programs and the internal control structure over compliance at a service organization that performs certain functions related to the administration of an SFA program.

This exposure draft has been sent to—

- Practice offices of CPA firms.
- Members of the AICPA Council and technical committees.
- State society and chapter presidents, directors, and committee chairpersons.
- Organizations concerned with regulatory and supervisory activities or with other public disclosure of financial activities.
- Persons who have requested copies.

April 29, 1992

Accompanying this letter is an exposure draft of a proposed statement of position (SOP), *Compliance and Internal Control Auditing for Student Financial Assistance Programs Using Service Organizations*, prepared by the Student Financial Assistance Program Audit Task Force. A summary of this proposed SOP also accompanies this letter.

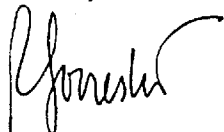
This proposed SOP would amend the Audit and Accounting Guide *Audits of Colleges and Universities* to provide guidance to auditors engaged to audit compliance with laws and regulations applicable to student financial assistance (SFA) programs and the internal control structure at institutions that participate in the U.S. Department of Education's SFA programs and that engage service organizations to perform certain functions relating to the administration of those programs. This proposed SOP would also provide guidance to auditors of service organizations that perform functions related to the administration of SFA programs. This proposed SOP would be effective for periods ending after December 31, 1991.

For fiscal years ended on or before December 31, 1991, the Department of Education will accept reports on compliance with laws and regulations and on the internal control structure that clearly identify those laws and regulations and those categories of the internal control structure (1) that the institution's auditor was able to test at the institution, and (2) that relate to functions performed by a service organization and not tested by the institution's auditor. Auditors should refer to the Audit Risk Alert *Not-for-Profit Organizations Industry Developments—1991* (Product Number 022074) for detailed guidance on reporting in this situation prior to the effective date of the final statement of position.

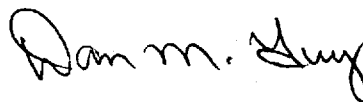
Comments or suggestions on any aspect of this exposure draft will be appreciated. Specifically, we would appreciate comments on the practicality of the divided responsibility approach set forth in this proposed SOP and on the usefulness to institutions' auditors of the service organizations' auditor's reports. To facilitate consideration of responses, comments should refer to specific paragraphs and include supporting reasons for each suggestion or comment.

Written comments on the exposure draft will become part of the public record of the Auditing Standards Division and will be available for public inspection at the offices of the AICPA after July 31, 1992, for one year. Responses should be sent to Walton T. Conn, Jr., Practice Fellow, Auditing Standards Division, File 4380, AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775, in time to be received by July 13, 1992.

Sincerely,



Robert T. Forrester
Chairman
Student Financial Assistance
Program Audit Task Force



Dan M. Guy
Vice President
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COMPLIANCE AND INTERNAL CONTROL AUDITING FOR STUDENT FINANCIAL ASSISTANCE PROGRAMS USING SERVICE ORGANIZATIONS

INTRODUCTION

1. The U.S. Department of Education (ED) requires institutions of higher education that participate in its student financial assistance (SFA) programs¹ to engage independent auditors to audit certain aspects of their participation in those programs in accordance with standards and requirements that exceed generally accepted auditing standards (GAAS).² Such audits are to be performed in accordance with GAAS; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the requirements set forth in *Audits of Student Financial Assistance Programs* (ED Audit Guide), issued by the U.S. Department of Education, Office of the Inspector General. Among other reports, auditors who perform such audits are required to issue reports on—

- Either (a) the basic financial statements of the institution and the SFA program's schedule of expenditures or (b) the SFA program's modified statement of cash receipts and disbursements.³
- The participating institution's compliance with requirements specified in the ED Audit Guide applicable to its SFA programs. Such a report includes an opinion about whether the institution complied, in all material respects, with requirements applicable to the programs.
- The internal control structure over compliance with requirements applicable to SFA programs.⁴ Such a report includes an identification of the internal control structure categories, a description of reportable conditions noted, and a statement about whether the auditor believes any of the reportable conditions described are material weaknesses.

¹ Throughout this SOP, the term *institution* refers to institutions of higher education that participate in the SFA programs of the U.S. Department of Education.

² Public colleges and universities of state or local government entities satisfy the SFA audit requirement if they obtain an audit in accordance with the Single Audit Act of 1984 and Office of Management and Budget (OMB) Circular A-128, *Audits of State and Local Governments*. This SOP and the ED Audit Guide may be helpful to practitioners auditing an SFA program under OMB Circular A-128.

A not-for-profit institution also satisfies the SFA audit requirement with an audit in accordance with OMB Circular A-133, *Audits of Institutions of Higher Education and Other Non-profit Institutions*, which establishes audit requirements for institutions receiving federal awards. The guidance in this SOP may be helpful to practitioners auditing an SFA program under OMB Circular A-133.

³ Auditors should refer to Statement on Auditing Standards (SAS) No. 54, *Illegal Acts By Clients*; SAS No. 55, *Consideration of the Internal Control Structure in a Financial Statement Audit*; and SAS No. 68, *Compliance Auditing Applicable to Governmental Entities and Other Recipients of Governmental Financial Assistance*, for guidance on auditors' responsibilities relating to an entity's internal control structure and compliance with requirements in an audit of financial statements.

⁴ Throughout this SOP, an entity's internal control structure over compliance with requirements governing SFA programs is referred to simply as its *internal control structure*. The internal control structure addressed in this SOP may include parts of, but is not the same as, an internal control structure over financial reporting.

2. Institutions that participate in SFA programs frequently engage a service center (SFA service organization)⁶ to perform certain services relating to the administration of those programs. Such services may include, but are not limited to, determination of student eligibility, funds management, and repayment servicing. The ED Audit Guide requires that auditors' reports on compliance with SFA requirements and on the internal control structure encompass all compliance requirements relating to the administration of SFA programs whether the related services are performed by the institution or by the institution's SFA service organization.⁶

3. When an SFA service organization is involved, the compliance and internal control structure audit requirements can be accomplished through the use of one of the following methods:

- a. The institution's auditor may be able to perform the necessary audit procedures at the institution. This alternative should be used only when the services provided by the SFA service organization for a particular institution are limited to recording that institution's transactions and processing related data and the other functions related to the flow of transactions (such as authorizing transactions and maintaining the related accountability) are performed at the institution.
- b. The institution's auditor may perform the necessary audit procedures at the SFA service organization.
- c. The SFA service organization may engage an auditor to audit compliance with the SFA requirements relating to the services performed by the SFA service organization. When this is the case, the SFA service organization's auditor and the institution's auditor individually take responsibility for performing procedures and reporting thereon for their respective clients. The reports of both the SFA service organization's auditor and the institution's auditor are submitted to the Department of Education.⁷

4. This proposed SOP provides guidance on the method of auditing and reporting described in paragraph 3c. Specifically, it provides guidance on (a) the SFA service organization's auditor's procedures and reports on compliance with SFA requirements and the internal control structure, and (b) the institution's auditor's consideration and use of compliance and internal control reports from an SFA service organization's auditor. This SOP does not provide comprehensive guidance on performing an audit of an SFA program. That guidance is set forth in GAAS, *Government Auditing Standards*, and the ED Audit Guide.

⁵ Throughout this SOP, the term *SFA service organization* refers to an entity that provides either or both of the following services to an institution for that institution's SFA program(s):

- a. Executing transactions and maintaining the related accountability
- b. Recording transactions and processing related data

⁶ Auditors should recognize that SFA service organizations are required to administer functions in compliance with SFA requirements through contractual obligations to their customers. Throughout this SOP, the term *SFA service organization's compliance with SFA requirements* refers to compliance with SFA requirements with which the SFA service organization is contractually obligated to comply.

⁷ This SOP does not preclude the institution's auditor from using the SFA service organization's auditor's work in certain circumstances and making no reference to it in his or her report.

5. The method of auditing and reporting described in paragraph 3c is appropriate only when compliance and internal control reports are available from the SFA service organization's auditor, and when all of the following conditions are met:

- a. The institution's auditor accepts responsibility for determining that SFA compliance requirements have been addressed either by him- or herself or by the SFA service organization's auditor.
- b. The SFA service organization's auditor's report on compliance contains an opinion and all noted instances of noncompliance. The SFA service organization should also communicate instances of noncompliance that relate to the records or transactions of specific institutions to those institutions.
- c. The SFA service organization's auditor's report on the internal control structure contains an identification of the internal control structure categories, a description of reportable conditions noted, and a statement about whether the auditor believes any of the reportable conditions described are material weaknesses.
- d. The compliance and internal control reports from the SFA service organization's auditor are attached to the compliance and internal control reports from the institution's auditor for submission to the Department of Education.

If any of the preceding conditions are not met, the institution's auditor should use one of the methods of auditing and reporting described in paragraph 3a and 3b.

RESPONSIBILITIES OF SERVICE AUDITORS

6. Although an SFA service organization's auditor's engagement differs from an audit of financial statements in accordance with GAAS, it should be performed in accordance with the general standards and the relevant fieldwork and reporting standards, *Government Auditing Standards*, and the ED Audit Guide.

7. An SFA service organization generally performs different services for different institutions. Accordingly, the auditor of an SFA service organization should obtain from its management a statement of the services performed for its various customers to administer the SFA program, as illustrated in appendix G. The SFA service organization's auditor should obtain an understanding of the SFA service organization's contractual obligations to its customers, and should determine which SFA compliance requirements are encompassed by those contractual obligations.

8. For the SFA service organization's auditor's reports on the internal control structure and compliance to be useful to auditors of the SFA service organization's customers, the reports should clearly state which compliance requirements have been addressed in the contracts and in his or her testing. Refer to paragraph 16 for guidance on the contents of management's listing of contractual services provided and the SFA compliance requirements addressed. If the SFA service organization's contracts do not specifically mention compliance with the SFA requirements, the auditor's report on compliance should so state.

Internal Control Structure

9. In order for the internal control and compliance reports on an SFA service organization to be useful, the auditor of an SFA service organization's compliance with SFA requirements should

obtain a sufficient understanding of the internal control structure to plan the compliance audit (including determining the nature, timing, and extent of tests to be performed) and should assess control risk. In addition, the SFA service organization's auditor should determine and report whether the SFA service organization has an internal control structure designed to provide reasonable assurance that it is managing each SFA program service that it provides in compliance with SFA requirements. As part of this determination, the auditor should perform tests of controls to evaluate the effectiveness of the design and operation of the policies and procedures in preventing or detecting material noncompliance. The tests of controls performed should include the types of procedures described in paragraphs 34 and 35 of SAS No. 55.⁸

Compliance

10. The extent of tests of compliance by the SFA service organization's auditor is a matter of professional judgment. The SFA service organization's auditor's procedures and reports may apply to the SFA service organization's compliance operations as a whole if the same internal control structure applies to each customer's records and transactions. If the internal control structure is not the same, the SFA service organization's auditor should test the compliance requirements for each homogeneous population separately. The auditor of an SFA service organization that provides services for multiple customers should perform enough tests to support his or her conclusion in accordance with GAAS.⁹ Sample items should be selected in such a way that the sample can be expected to be representative of the population.

11. The period covered by the SFA service organization's auditor's procedures and reports should be twelve months;¹⁰ however, the period covered by an SFA service organization's auditor's report may not always coincide with the fiscal year of its customers. The Department of Education has indicated that it will accept reports on SFA service organizations as long as the end of the period audited is within six months of the fiscal year end of the institution reporting to the Department of Education.

12. The auditor of an SFA service organization is responsible for reporting whether the SFA service organization complied with SFA requirements. The SFA service organization's auditor should report noncompliance in sufficient detail for the institution to determine the effect of any instances of noncompliance at the SFA service organization on the institution's transactions. Such detail should include (a) the population; (b) the sample size; (c) the deviation rate; (d) the instance of noncompliance; and (e) the reason for noncompliance, if determinable, as illustrated in appendix F. The SFA service organization should communicate those instances of noncompliance that apply to specific institutions to the affected institutions. However, it is not necessary for an SFA service

⁸ Some SFA service organizations may also engage their auditors to issue a report on the internal control structure over financial reporting in accordance with SAS No. 44, *Special-Purpose Reports on Internal Accounting Control at Service Organizations*. Such a report may include parts of, but is not the same as, a report on the internal control structure addressed in this SOP.

⁹ The AICPA Audit and Accounting Guide *Audit Sampling* may be helpful to auditors seeking guidance on the use of sampling.

¹⁰ For institutions that report to the Department of Education biennially, the period covered by the SFA service organization's auditor's procedures and reports should be twenty-four months. This requirement could be fulfilled by one report covering twenty-four months or by two reports that each cover twelve months.

organization's auditor to report noncompliance that was detected by management and corrected during the period under audit.¹¹

13. The auditor of the SFA service organization should obtain sufficient competent evidence that the SFA service organization has communicated instances of noncompliance to the affected institutions. Procedures to obtain such evidence may include inspection, inquiry, observation, and confirmation with the applicable institutions.

Materiality

14. For purposes of planning and performing the tests for each of the compliance requirements applicable to each SFA program, the auditor of an SFA service organization should consider materiality in relation to each of the individual services performed. The auditor of an SFA service organization ordinarily is not able to reach a conclusion on whether the effect of noncompliance, individually or in the aggregate, is material to a customer's SFA program; therefore, the auditor should report all instances of noncompliance. The SFA service organization's auditor should issue a qualified or adverse compliance report when reporting instances of noncompliance that are material in relation to each of the individual services performed.

Management Representations

15. The auditor of an SFA service organization should obtain the following written representations from management:

- a. A statement, to be attached to the report, outlining the terms of the contracts with its institutional customers and the applicable SFA compliance requirements (paragraphs 7, 8, and 16)
- b. A representation letter (paragraph 17)

16. The statement by management to be attached to the auditor's report should ordinarily include a listing of the services contractually required to be performed by the SFA service organization. Since SFA service organizations generally perform different levels of service for different customers, the listing should include *all* SFA compliance requirements performed for *any* customers. Appendix G contains an example of the format that management may use in making the statement to be attached to the auditor's report.

17. The specific written representations obtained by the SFA service organization's auditor in the representation letter should ordinarily include the following:

- a. Management is responsible for complying with SFA requirements with which the SFA service organization has contracted to comply.
- b. Management has disclosed, in the written statement to be attached to the auditor's report, the terms of all contracts with institutions for which the SFA service organization provides services related to SFA programs.

¹¹ Instances of noncompliance include those detected by the auditor and by the SFA service organization.

- c. Management has disclosed to the auditor all known instances of noncompliance with SFA requirements.
- d. Management has complied, in all material respects, with the requirements applicable to SFA programs, except as disclosed to the auditor.
- e. Management has communicated, in writing, any instances of noncompliance that pertain to the transactions or records of specific customers to such customers.
- f. Management has disclosed whether, subsequent to the date as of which compliance is audited, any changes in the internal control structure or other factors that might significantly affect the internal control structure, including any corrective action taken by management with regard to reportable conditions (including material weaknesses), have occurred.

18. Management's refusal to furnish written representation constitutes a limitation on the scope of the audit sufficient to require a qualified opinion or disclaimer of opinion on the SFA service organization's compliance with SFA requirements. Further, the auditor should consider the effects of management's refusal on his or her ability to rely on other management representations.

Reporting

19. ***Internal Control Structure.*** An SFA service organization's auditor's report on an SFA service organization's internal control structure over compliance with SFA requirements should contain the following elements, as appropriate:

- a. A statement that the auditor has audited compliance with requirements applicable to SFA programs and a reference to the auditor's report on compliance
- b. A statement that the audit was conducted in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Audits of Student Financial Assistance Programs*, issued by the U.S. Department of Education, Office of Inspector General
- c. A statement that, in planning and performing the audit of the SFA service organization's compliance with SFA requirements, the auditor considered the entity's internal control structure in order to determine the auditing procedures for the purpose of expressing an opinion on compliance with requirements applicable to SFA programs, and to report on the internal control structure in accordance with the ED Audit Guide
- d. A statement that the establishment and maintenance of the internal control structure are the responsibility of management
- e. An explanation of the broad objectives and inherent limitations of any internal control structure
- f. A description of the SFA service organization's significant internal control structure categories considered as part of the auditor's understanding of the structure
- g. A description of the scope of the auditor's work stating that the auditor obtained an understanding of the design of relevant policies and procedures and whether those policies and procedures have been placed in operation, and assessed control risk
- h. A statement that the auditor performed tests of controls, as required by the ED Audit Guide, to evaluate the effectiveness of the design and operation of internal control struc-

ture policies and procedures that the auditor considered relevant to preventing or detecting material noncompliance with SFA requirements

- i. A statement that the auditor's procedures were less in scope than would be necessary to render an opinion on internal control structure policies and procedures and a disclaimer of opinion on those policies and procedures
- j. The definition of reportable conditions
- k. A description of the reportable conditions noted
- l. The definition of material weakness
- m. A statement that indicates whether the auditor believes any of the reportable conditions described in the report are material weaknesses and, if they are, that identifies the material weaknesses noted
- n. A statement that other matters involving the internal control structure at the SFA service organization and its operation were communicated to management in a separate letter, if applicable
- o. A statement that the report is intended for the information of the audit committee, management, customers, the independent auditors of customers, and the U.S. Department of Education, but that this is not intended to limit the distribution of the report, if it is a matter of public record

20. Appendix A illustrates an SFA service organization's auditor's report on the SFA service organization's internal control structure over compliance with SFA requirements.

21. Compliance. The SFA service organization's auditor's report on compliance should provide detailed information regarding any instances of noncompliance. The level of detail should be sufficient for an institutional customer to assess the effect of noncompliance on its own transactions. Such detail should generally include (a) the population; (b) the sample size; (c) the deviation rate; (d) the instance of noncompliance; and (e) the reason for noncompliance, if determinable. The reason for noncompliance, for example, could be a weakness in the internal control structure or an isolated misfiling of loan documentation.

22. The basic elements of the SFA service organization's auditor's report on compliance with requirements applicable to SFA programs include the following:

- a. A statement that the SFA service organization's compliance with SFA requirements set forth in the attachment was audited
- b. A statement that compliance with the requirements referred to in paragraph 22a, is the responsibility of the SFA service organization's management, and that the auditor's responsibility is to express an opinion on compliance with those requirements based on his or her audit
- c. A statement that the audit was conducted in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Audits of Student Financial Assistance Programs*, issued by the U.S. Department of Education, Office of Inspector General
- d. A statement that generally accepted auditing standards, *Government Auditing Standards*, and the ED Audit Guide require that the auditor plan and perform the audit to obtain

reasonable assurance about whether material noncompliance with the requirements referred to in paragraph 22a occurred

- e. A statement that an audit includes examining, on a test basis, evidence about the SFA service organization's compliance with the requirements referred to in paragraph 22a
- f. A statement that the auditor believes that his or her audit provides a reasonable basis for an opinion
- g. A summary of all instances of noncompliance noted or a reference to a separate schedule of noncompliance, including the items addressed in paragraph 21
- h. A statement that noncompliance was considered in forming an opinion about whether the SFA service organization complied, in all material respects, with requirements referred to in paragraph 22a
- i. A statement that management has represented that instances of noncompliance have been reported to the affected customers
- j. A disclaimer on the effects of any instances of noncompliance on the SFA service organization's customers
- k. An opinion about whether the SFA service organization complied, in all material respects, with the requirements referred to in paragraph 22a
- l. A statement that the report is intended for the information of the audit committee, management, customers, customers' auditors, and the U.S. Department of Education, but that this is not intended to limit the distribution of the report, if it is a matter of public record

23. Appendix B illustrates an unqualified report on an SFA service organization's compliance with requirements applicable to SFA programs. This report is adapted from paragraph 80 of SAS No. 68. For guidance on modified reports, auditors should refer to paragraphs 81 through 85 of SAS No. 68 and adapt the illustrative reports in those paragraphs as appropriate.

RESPONSIBILITIES OF INSTITUTIONAL AUDITORS

Internal Control Structure

24. *Government Auditing Standards* and the ED Audit Guide require the institution's auditor to obtain a sufficient understanding of the internal control structure to plan the compliance audit, including determining the nature, timing, and extent of tests to be performed, and to assess control risk. In addition, the auditor should determine and report whether the institution has an internal control structure designed to provide reasonable assurance that it is managing each SFA program in compliance with SFA requirements. As part of this determination, the institution's auditor is required to perform tests of controls to evaluate the effectiveness of the design and operation of the policies and procedures in preventing or detecting material noncompliance. The tests of controls performed should include the types of procedures described in paragraphs 34 and 35 of SAS No. 55.

25. In assessing whether an SFA service organization's internal control structure policies and procedures, when considered in conjunction with an institution's internal control structure policies and procedures, represent matters considered to constitute reportable conditions, the institution's

auditor should consider the guidance provided in SAS No. 60, *Communication of Internal Control Structure Related Matters Noted in an Audit*.

Compliance

26. The institution's auditor has the responsibility of (a) auditing compliance requirements at the institution, (b) ensuring that the report of the SFA service organization's auditor indicates coverage of all SFA compliance requirements not audited at the institution, and (c) providing information on the effect of noncompliance at the SFA service organization on the institution's SFA program. To satisfy this responsibility, the institution's auditor's procedures should include an evaluation of the relationship between the institution and the SFA service organization, including obtaining an understanding of the contract between the entities.

27. In evaluating the relationship between an institution and the institution's SFA service organization, the institution's auditor should consider: (a) the nature of the services provided by the SFA service organization, (b) which organization authorizes SFA transactions, (c) whether the SFA service organization executes the SFA transactions and maintains the related accountability, and (d) whether the internal control structure of the SFA service organization interacts with that of the institution.

28. If the institution's auditor believes that the SFA service organization's auditor's report is not sufficient to meet the objectives set forth in paragraph 26, he or she may supplement his or her understanding of the SFA service organization's auditor's procedures and conclusions by discussing them with the SFA service organization's auditor. Also, if the institution's auditor believes it is necessary, he or she should request that the SFA service organization's auditor perform agreed-upon procedures at the SFA service organization, or the institution's auditor should perform such procedures.

29. The institution's auditor should obtain from the management of the institution any communications from the SFA service organization relating to instances of noncompliance at the SFA service organization. Additionally, the institution's auditor should confirm with the SFA service organization that there have been no additional communications relating to noncompliance other than those of which the institution's auditor is aware. As discussed in paragraph 12, either the SFA service organization's auditor's report or the communication from the SFA service organization, or both, should contain sufficient detail for the institution and the institution's auditor to determine the effect of the noncompliance on the institution's own transactions. The institution's auditor should attach to his or her report a summary of the instances of noncompliance reported at the SFA service organization and their effect, if any, on the institution. The summary should include (a) a description of the instances of noncompliance, (b) a statement about whether the reported instances of noncompliance related to the transactions of the institution, and (c) the population of the institution's similar transactions administered by the SFA service organization, as illustrated in appendix F.

Materiality

30. In an audit of compliance with the requirements applicable to SFA programs in accordance with the ED Audit Guide, the institution's auditor's consideration of materiality differs from that in an audit of financial statements in accordance with GAAS. In an audit of an entity's financial statements conducted in accordance with GAAS, the auditor considers materiality in relation to the financial statements. In auditing an institution's compliance with requirements applicable to each SFA program, however, the auditor considers materiality in relation to each such SFA

program. When reaching a conclusion about whether the effect of noncompliance, individually or in the aggregate, is material to an SFA program, an auditor ordinarily should consider the nature of the noncompliance and the amount affected by it in relation to the nature and amount of the SFA program under audit. For example, an amount that is material to one SFA program may not be material to an SFA program of a different size or nature. Also, what is material to a particular SFA program might change from one period to another.

Management Representations

31. The auditor of the institution should obtain written representations from management as part of an audit of the institution's compliance with requirements applicable to SFA programs. The specific written representations obtained by the institution's auditor should ordinarily include the following matters:¹²

- a. Management has identified and disclosed to the auditor all assistance provided by the Department of Education through its SFA programs.
- b. Management is responsible for complying with requirements applicable to SFA programs.
- c. Management has disclosed all contracts or other agreements with the institution's SFA service organization.
- d. Management has disclosed to the auditor all known noncompliance with SFA requirements.
- e. Management has complied, in all material respects, with the requirements applicable to SFA programs except as disclosed to the auditor.
- f. Management has disclosed to the auditor all communications from the SFA service organization relating to noncompliance at the SFA service organization.
- g. Management has disclosed whether, subsequent to the date as of which compliance is audited, any changes in the internal control structure or other factors that might significantly affect the internal control structure, including any corrective action taken by management with regard to reportable conditions (including material weaknesses), have occurred.

32. Management's refusal to furnish written representation constitutes a limitation on the scope of the audit sufficient to require a qualified opinion or disclaimer of opinion on the institution's compliance with SFA requirements. Further, the auditor should consider the effects that management's refusal will have on his or her ability to rely on other management representations.

Reporting

33. ***Internal Control Structure.*** A report on the institution's internal control structure over compliance with SFA requirements should contain the following elements, as appropriate:

¹² These representations may be added to a representation letter obtained in connection with an audit of financial statements instead of obtaining a separate letter.

- a. A statement that the auditor has audited the financial statements or Student Financial Assistance Modified Statement of Cash Receipts and Disbursements and a reference to the auditor's related report, including a description of any departure from the standard report
- b. A statement that the auditor has audited compliance with requirements applicable to SFA programs and a reference to the auditor's report on compliance
- c. A statement that the audit was conducted in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Audits of Student Financial Assistance Programs*, issued by the U.S. Department of Education, Office of Inspector General
- d. A statement that, in planning and performing the audit of the SFA program, the auditor considered the institution's internal control structure in order to determine the auditing procedures for the purpose of expressing an opinion on compliance with requirements applicable to SFA programs, and to report on the internal control structure in accordance with the ED Audit Guide
- e. A statement that the establishment and maintenance of the internal control structure are the responsibility of management
- f. An explanation of the broad objectives and inherent limitations of any internal control structure
- g. A description of the institution's significant internal control structure categories considered as part of the auditor's understanding of the structure
- h. A statement that, for internal control structure categories relating to functions performed by an SFA service organization, other auditors obtained an understanding of the design of relevant policies and procedures and determined whether those policies and procedures have been placed in operation, and assessed control risk
- i. A description of the scope of the auditor's work stating that the auditor obtained an understanding of the design of relevant policies and procedures and determined whether those policies and procedures have been placed in operation, and assessed control risk
- j. A statement that the auditor performed tests of controls, as required by the ED Audit Guide, to evaluate the effectiveness of the design and operation of internal control policies and procedures that the auditor considered relevant to preventing or detecting material noncompliance with SFA requirements
- k. A statement that the auditor's procedures were less in scope than would be necessary to render an opinion on internal control structure policies and procedures and a disclaimer of opinion on those policies and procedures
 - l. The definition of reportable conditions
- m. A description of the reportable conditions noted
- n. The definition of material weakness
- o. A statement that indicates whether the auditor believes any of the reportable conditions described in the report are material weaknesses and, if they are, that identifies the material weaknesses noted
- p. A statement that other matters involving the internal control structure and its operation were communicated to management in a separate letter, if applicable

- q. A statement that the report is intended for the information of the audit committee, management, and the U.S. Department of Education, but that this is not intended to limit the distribution of the report, if it is a matter of public record

34. Appendix C illustrates a report on the internal control structure over compliance with SFA requirements. It contains all of the elements listed in paragraph 33 but does not address the internal control structure relevant to the audit of financial statements.¹³

35. Compliance. The basic elements of the institutional auditor's report on compliance with requirements applicable to SFA programs include –

- a. A statement that the auditor has audited the financial statements or Student Financial Assistance Modified Statement of Cash Receipts and Disbursements and a reference to the auditor's related report, including a description of any departure from the standard report.
- b. A statement that the institution's compliance with requirements applicable to SFA programs was audited.
- c. A statement that compliance with the requirements referred to in paragraph 35b is the responsibility of the institution's management, and that the auditor's responsibility is to express an opinion on compliance with those requirements based on his or her audit.
- d. A statement that the audit was conducted in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Audits of Student Financial Assistance Programs*, issued by the U.S. Department of Education, Office of Inspector General.
- e. A statement that generally accepted auditing standards, *Government Auditing Standards*, and the ED Audit Guide require that the auditor plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to in paragraph 35b occurred.
- f. A statement that an audit includes examining, on a test basis, evidence about the institution's compliance with the requirements referred to in paragraph 35b.
- g. A statement that the auditor believes that his or her audit provides a reasonable basis for an opinion.
- h. A summary of all instances of noncompliance noted, or a reference to a separate schedule of noncompliance, that provides (a) the population, (b) the sample size, (c) the deviation rate, (d) each instance of noncompliance, and (e) the reason for noncompliance, if determinable.
- i. A statement that instances of noncompliance were considered in forming an opinion about whether the institution complied, in all material respects, with requirements referred to in paragraph 35b.

¹³ SAS No. 68 provides guidance concerning reporting on the internal control structure in audits performed in accordance with *Government Auditing Standards*. If the auditor issues a report such as that illustrated in appendix C, a separate report on the internal control structure relevant to the financial statement audit, as required by *Government Auditing Standards*, should also be issued.

- j. An opinion about whether the institution complied, in all material respects, with the requirements referred to in paragraph 35b.
- k. A statement that the SFA service organization's compliance with the requirements applicable to services it performs for the institution was audited by another auditor, whose report was furnished to the institution's auditor, and a disclaimer of opinion on compliance with those requirements.
- l. A statement of determination that all of the applicable compliance requirements in the ED Audit Guide are covered by either the institutional auditor's report or the SFA service organization's auditor's report.
- m. A statement that the SFA service organization's auditor's report does not contain any instances of noncompliance pertaining to the services that the SFA service organization provides to the institution. If such instances of noncompliance are reported, the statement should refer to the attached information on the effect of the noncompliance.
- n. A statement that the report is intended for the information of the audit committee, management, and the U.S. Department of Education, but that this is not intended to limit the distribution of the report, if it is a matter of public record.

36. Appendix D illustrates an unqualified report on compliance with requirements applicable to SFA programs when the institution's auditor indicates the division of responsibility by making reference to the audit of the SFA service organization's auditor. This report is adapted from paragraph 80 of SAS No. 68. Appendix E illustrates a qualified opinion. For additional guidance on modified reports, auditors should refer to paragraphs 81 through 85 of SAS No. 68.

EFFECTIVE DATE

37. This SOP is effective for audits of periods ending after December 31, 1991. Earlier application is permissible.

**REPORT ON THE INTERNAL CONTROL STRUCTURE
OVER COMPLIANCE WITH SFA REQUIREMENTS
AT AN SFA SERVICE ORGANIZATION**

Independent Auditor's Report

The Board of Directors
XYZ Service Center:

We have audited XYZ Service Center's compliance with requirements that are applicable to the student financial assistance programs of its customers for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Audits of Student Financial Assistance Programs* (ED Audit Guide), issued by the U.S. Department of Education, Office of Inspector General. Those standards and the ED Audit Guide require that we plan and perform the audit to obtain reasonable assurance about whether XYZ Service Center complied with laws and regulations, noncompliance with which would be material to a student financial assistance program.

In planning and performing our audit for the year ended June 30, 19XX, we considered the service center's internal control structure over compliance in order to determine our auditing procedures for the purpose of expressing our opinion on the service center's compliance with requirements applicable to student financial assistance programs, and to report on the internal control structure in accordance with the ED Audit Guide. This report addresses our consideration of internal control structure policies and procedures relevant to compliance with requirements applicable to student financial assistance programs.

The management of XYZ Service Center is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that student financial assistance programs are managed in compliance with applicable laws and regulations. Because of inherent limitations in any internal control structure, instances of noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures used in complying with student financial assistance requirements in the following categories: [*identify control categories*]. For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and determined whether they have been placed in operation, and we assessed control risk.

We performed tests of controls, as required by the ED Audit Guide, to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that we considered

relevant to preventing or detecting material noncompliance with specific and general requirements applicable to student financial assistance programs. Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the service center's ability to administer student financial assistance programs in accordance with applicable laws and regulations.¹⁴

[Include paragraphs to describe the reportable conditions noted.]

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that noncompliance with laws and regulations that would be material to a student financial assistance program may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.¹⁵

We also noted other matters involving the internal control structure and its operation that we have reported to the management of XYZ Service Center in a separate letter dated August 15, 19XX.

¹⁴ When the auditor notes no reportable conditions during an audit, the seventh through eleventh paragraphs should be replaced with the following two paragraphs:

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that noncompliance with laws and regulations that would be material to a student financial assistance program may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

However, we noted certain matters involving the internal control structure and its operation that we have reported to the management of the Service Center in a separate letter dated [date].

¹⁵ If conditions believed to be material weaknesses are disclosed, the report should describe the weaknesses that have come to the auditor's attention and may state that these weaknesses do not affect the report on the audit of compliance with requirements applicable to student financial assistance programs. The last sentence of this paragraph of the report should be modified as follows:

However, we noted the following matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above. These conditions were considered in determining the nature, timing, and extent of the procedures to be performed in our audit of the Service Center's compliance with requirements applicable to student financial assistance programs for the year ended June 30, 19XX, and this report does not affect our report thereon dated [date].

[A description of the material weaknesses that have come to the auditor's attention would follow.]

This report is intended for the information of the audit committee, management, customers of XYZ Service Center, the independent auditors of its customers, and the U.S. Department of Education. This is not intended to limit the distribution of this report, which is a matter of public record.¹⁶

¹⁶ If the report is not part of the public record, this sentence should not be included in the report.

**OPINION ON AN SFA SERVICE ORGANIZATION'S COMPLIANCE
WITH REQUIREMENTS APPLICABLE TO SFA PROGRAMS**

Independent Auditor's Report

The Board of Directors
XYZ Service Center:

We have audited XYZ Service Center's compliance with the requirements, as categorized in [*the attached schedule—see appendix G*], that are applicable to the student financial assistance programs of its customers for the year ended June 30, 19XX. The management of XYZ Service Center is responsible for the service center's compliance with those requirements. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit of compliance with those requirements in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Audits of Student Financial Assistance Programs* (ED Audit Guide), issued by the U.S. Department of Education, Office of Inspector General. Those standards and the ED Audit Guide require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about XYZ Service Center's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

The results of our audit procedures disclosed immaterial instances of noncompliance with the requirements referred to above, which are described in the accompanying schedule of findings. We considered these instances of noncompliance in forming our opinion on compliance, which is expressed in the following paragraph, and have obtained representation from the management of XYZ Service Center that such noncompliance has been communicated to XYZ Service Center's affected customers. However, we did not apply auditing procedures to the effects of noncompliance on XYZ Service Center's customers. Accordingly, the scope of our work was not sufficient to express, and we do not express, an opinion on any such effects.¹⁷

In our opinion, XYZ Service Center complied, in all material respects, with the requirements categorized in [*the attached schedule—see appendix G*] that are applicable to the student financial assistance programs administered by XYZ Service Center for the year ended June 30, 19XX.

This report is intended for the information of the audit committee, management, customers of XYZ Service Center, the independent auditors of its customers, and the U.S. Department of Education. This is not intended to limit the distribution of this report, which is a matter of public record.¹⁸

¹⁷ If there are no instances of noncompliance, this paragraph should be omitted.

¹⁸ See footnote 16.

**REPORT ON THE INTERNAL CONTROL STRUCTURE
OVER COMPLIANCE WITH SFA REQUIREMENTS
AT AN INSTITUTION**

Independent Auditor's Report

The Board of Trustees
ABC School of Vocational Training:

We have audited the [*financial statements or Student Financial Assistance Modified Statement of Cash Receipts and Disbursements*] of ABC School of Vocational Training as of and for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX. We have also audited ABC School of Vocational Training's compliance with requirements applicable to student financial assistance programs and have issued our report thereon dated August 15, 19XX.

We conducted our audits in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Audits of Student Financial Assistance Programs* (ED Audit Guide), issued by the U.S. Department of Education, Office of Inspector General. Those standards and the ED Audit Guide require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and about whether ABC School of Vocational Training complied with laws and regulations, noncompliance with which would be material to a student financial assistance program.

In planning and performing our audits for the year ended June 30, 19XX, we considered the School's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinions on the School's [*financial statements or Student Financial Assistance Modified Statement of Cash Receipts and Disbursements*] and on its compliance with requirements applicable to student financial assistance programs, and to report on the internal control structure in accordance with the ED Audit Guide. This report addresses our consideration of internal control structure policies and procedures relevant to compliance with requirements applicable to student financial assistance programs. We have addressed policies and procedures relevant to our audit of the financial statements in a separate report dated August 15, 19XX.

The management of ABC School of Vocational Training is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that student financial assistance programs are managed in compliance with applicable laws and regulations. Because of inherent limitations in any internal control structure, errors, irregularities, or instances of noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures used in complying with student financial assistance requirements in the following categories: *[identify control categories]*. For all of the internal control structure categories listed above except *[identify categories relating to functions performed at the SFA service organization]*, we obtained an understanding of the design of relevant policies and procedures and determined whether they have been placed in operation, and we assessed control risk.

The internal control structure policies and procedures relating to *[identify control categories relating to functions performed at the SFA service organization]* are performed at XYZ Service Center. For these control structure categories, other auditors obtained an understanding of the design of relevant policies and procedures, determined whether they have been placed in operation, and assessed control risk. The other auditors' report has been furnished to us; however, the scope of our work did not extend to these internal control structure policies and procedures established and maintained at XYZ Service Center.

We performed tests of controls, as required by the ED Audit Guide, to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that we considered relevant to preventing or detecting material noncompliance with specific and general requirements applicable to student financial assistance programs. Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the School's ability to administer student financial assistance programs in accordance with applicable laws and regulations.¹⁹

[Include paragraphs to describe the reportable conditions noted.]

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that noncompliance with laws and regulations that would be material to a student financial assistance program may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not neces-

¹⁹ When the auditor notes no reportable conditions during an audit, the eighth through twelfth paragraphs should be replaced with the following two paragraphs:

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that noncompliance with laws and regulations that would be material to a student financial assistance program may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

However, we noted certain matters involving the internal control structure and its operation that we have reported to the management of the School in a separate letter dated *[date]*.

sarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.²⁰

We also noted other matters involving the internal control structure and its operation that we have reported to the management of ABC School of Vocational Training in a separate letter dated August 15, 19XX.

This report is intended for the information of the audit committee, management, and the U.S. Department of Education. This is not intended to limit the distribution of this report, which is a matter of public record.²¹

²⁰ If conditions believed to be material weaknesses are disclosed, the report should describe the weaknesses that have come to the auditor's attention and may state that these weaknesses do not affect the report on the audit of compliance with requirements applicable to student financial assistance programs. The last sentence of this paragraph of the report should be modified as follows:

However, we noted the following matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above. These conditions were considered in determining the nature, timing, and extent of the procedures to be performed in our audit of ABC School of Vocational Training's compliance with requirements applicable to student financial assistance programs for the year ended June 30, 19XX, and this report does not affect our report thereon dated [date].

[A description of the material weaknesses that have come to the auditor's attention would follow.]

²¹ See footnote 16.

**OPINION ON AN INSTITUTION'S COMPLIANCE
WITH REQUIREMENTS APPLICABLE TO SFA PROGRAMS**

Independent Auditor's Report

The Board of Trustees
ABC School of Vocational Training:

We have audited the [*financial statements or Student Financial Assistance Modified Statement of Cash Receipts and Disbursements*] of ABC School of Vocational Training as of and for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX.²²

We also have audited ABC School of Vocational Training's compliance with the requirements governing [*list the program requirements, tested by the institution's auditor, as listed in ED Audit Guide*] that are applicable to each of its student financial assistance programs for the year ended June 30, 19XX. The management of ABC School of Vocational Training is responsible for the School's compliance with those requirements. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit of compliance with those requirements in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Audits of Student Financial Assistance Programs* (ED Audit Guide), issued by the U.S. Department of Education, Office of Inspector General. Those standards and the ED Audit Guide require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the School's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

The results of our audit procedures disclosed immaterial instances of noncompliance with the requirements referred to above, which are described in the accompanying schedule of findings. We considered these instances of noncompliance in forming our opinion on compliance, which is expressed in the following paragraph.²³

In our opinion, ABC School of Vocational Training complied, in all material respects, with the requirements governing [*list requirements tested by the institution's auditor*] that are applicable to each of its student financial assistance programs for the year ended June 30, 19XX.

We did not audit ABC School of Vocational Training's compliance with [*identify the requirements governing the functions performed at the SFA service organization that were not tested by the institution's auditor*]. Those requirements govern functions performed by XYZ Service Center. Since we did not apply auditing procedures to satisfy ourselves regarding compliance with those

²² If this paragraph is not applicable, the report should begin with the next paragraph, and "also" should be deleted from the first sentence of the next paragraph.

²³ If there are no instances of noncompliance, this paragraph should be omitted.

requirements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on compliance with those requirements.

XYZ Service Center's compliance with the requirements governing the functions it performs for ABC School of Vocational Training was audited by another auditor, whose report was furnished to us. Based on our review of the other auditor's report, we have determined that all of the compliance requirements included in the ED Audit Guide that are applicable to the programs in which ABC School of Vocational Training participates are addressed in either our report or the report of the other auditors. Further, based on our review of the other auditors' report, we have determined that it does not contain any findings of noncompliance pertaining to the services that XYZ Service Center performs for ABC School of Vocational Training.²⁴

This report is intended for the information of the audit committee, management, and the U.S. Department of Education. This is not intended to limit the distribution of this report, which is a matter of public record.²⁵

²⁴ If the SFA service organization's audit report includes findings of noncompliance with respect to requirements governing functions it performs for the institution, the last sentence of this paragraph should be omitted and the following sentences should be included:

The audit report on XYZ Service Center includes one (or more) finding(s) of noncompliance pertaining to services carried out for ABC School of Vocational Training. The scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the completeness of the reported findings. Information on the effect of the reported finding(s) on ABC School of Vocational Training's SFA programs is included in the accompanying schedule of noncompliance.

If the SFA service organization communicates noncompliance to the institution outside of the audit report, the last sentence of this paragraph should be omitted and the following sentences should be included:

The management of XYZ Service Center has informed ABC School of Vocational Training of one (or more) finding(s) of noncompliance pertaining to services carried out for ABC School of Vocational Training. The scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the completeness of the reported findings. Information on the effect of the finding(s) on ABC School of Vocational Training's SFA programs is included in the accompanying schedule of noncompliance.

²⁵ See footnote 16.

**QUALIFIED OPINION ON AN INSTITUTION'S COMPLIANCE
WITH REQUIREMENTS APPLICABLE TO SFA PROGRAMS**

Independent Auditor's Report

The Board of Trustees
ABC School of Vocational Training:

[The first three paragraphs of the report are the same as those illustrated in appendix D.]

The results of our audit procedures disclosed that ABC School of Vocational Training did not comply with the requirement that the School maintain proof of disbursement of loan proceeds, as described in the accompanying schedule of findings. In our opinion, ABC School of Vocational Training's maintenance of proof of disbursement of loan proceeds is necessary for the School to comply with the requirements applicable to SFA programs.

[The fifth paragraph of the report is the same as the fourth paragraph of the report illustrated in appendix D.]

In our opinion, except for those instances of noncompliance with the requirements applicable to SFA programs referred to in the fourth paragraph of this report and identified in the accompanying schedule of findings, ABC School of Vocational Training complied, in all material respects, with the requirements governing *[list requirements tested by the institution's auditor]* that are applicable to each of its student financial assistance programs for the year ended June 30, 19XX.

[The last three paragraphs of the report are the same as the last three paragraphs of the report illustrated in Appendix D.]

EXAMPLES OF REPORTED INSTANCES OF NONCOMPLIANCE

Finding
at the SFA Service Organization

1. **Missing Files.** XYZ Service Center could not find the files for three of the 100 (3%) randomly selected Perkins loans selected for testing. The outstanding balances totaled \$20,000 on these loans (out of a total of \$1.74 million in the sample). While none of the loans with missing files is currently delinquent or in default, without these files (which contain the original promissory note and other original loan documentation required by 34 CFR 668.xxx), the Department of Education would reject assignment or claim of the related loans if such borrowers default. These missing files appear to be isolated instances, with no common cause discernible. XYZ officials believe the missing files were misfiled. We have no reason to believe that this was not the case because we found no material weaknesses in the service organization's system for obtaining, maintaining, and controlling loan files. We recommend that the service organization continue to search for the missing files and, if they are not found, attempt to obtain replacements for the necessary documents. We further recommend that management remind file department staff of the need to exercise care in maintaining control and in filing loan files.

2. **Student Eligibility Not Documented.** In a random sample of 100 students who received a total of \$980,000 for which the service organization determined eligibility, we found no evidence that XYZ determined whether 15 students (15%), who received a total of \$102,000, had either a high school diploma, a GED, or the ability to benefit from the program as required by 34 CFR 668.xxx. This condition was caused by a systemic weakness in the procedures used by the service center in processing student aid applications. In the course of processing student aid applications, students that are not high school graduates or who do not have a GED are scheduled for an ability-

Finding
at the Institution

1a. *If one or more of the three missing files were from ABC School of Vocational Training, then a finding would be included as follows:* One of the missing loan files described in Finding 1 was for a Perkins loan made by ABC School of Vocational Training. The original face amount of this loan was \$2,000 with a 5% interest rate. The current outstanding principal is \$1,500, and the loan is current. XYZ Service Center has agreed to continue searching for the missing file and, if it is not found, to obtain a replacement for the necessary documents.

1b. *If none of the three missing files pertained to ABC School of Vocational Training, no specific finding would be included in the information on the effect of service center findings at ABC School of Vocational Training.*

2. XYZ Service Center's auditor reported that for 15% of the students tested, there was no documentation to show that non-high school graduates/GED holders had demonstrated the ability to benefit from the programs. XYZ Service Center determines student eligibility, including determining whether non-high school graduates have the ability to benefit, on behalf of ABC School of Vocational Training. During the year ended June 30, 1991, ABC School of Vocational Training awarded \$3,000,000 to 600 students who were determined to be eligible by ABC. This \$3,000,000 is broken down as follows: \$1,500,000 Pell; \$1,500,000 Stafford Loans.

(continued on next page)

**Finding
at the SFA Service Organization**

to-benefit test. However, there is no follow-up to assure that the tests were taken and the results showed that the students had the ability to benefit before student aid was awarded. As a result, for 15% of the students tested (50% of the non-high school graduates in the sample), there was no evidence of the ability to benefit from the training program. In addition, there was no evidence that the students either received a GED or completed a remedial program within prescribed time frames. Without such documentation, there is no evidence that the students were eligible. XYZ officials concurred with the finding. We recommend that the service organization implement control procedures to assure that ability-to-benefit tests are administered and the results are taken into account when making final determinations on student eligibility, prior to disbursing student aid awards.

3. Overpayment of Pell Grants. Because of an error in the computer program used to calculate Pell Grant awards for three of XYZ's clients, each Pell award to students at the three clients during the period included a \$50 overaward. Specifically, the error in the program caused \$50 to be added to each initial disbursement of awards made during this period. As a result, actual initial disbursements to students were always \$50 greater than what should have been disbursed based on the original award amount. This overpayment was not offset by reduced subsequent payments and even resulted in the overpayment of students who were scheduled to receive the maximum award. When this problem was brought to the attention of XYZ officials, they immediately took steps to correct the program to prevent future overawards. The error occurred during a program revision that was implemented on 7/1/90.

Although this problem did not exist in periods prior to the audit period, it continued for three months beyond the audit period. The program in question was used only for three clients, and this error did not affect the other clients for which XYZ calculates Pell awards.

**Finding
at the Institution**

ABC School of Vocational Training has requested that XYZ Service Center review each file to determine whether there was evidence of ability to benefit from the program. *(If known, the auditor should also report the number and amount of awards to students who are non-high school graduates.)*

3a. When the institution is one of three clients affected: ABC School of Vocational Training is one of the three schools that were affected by the computer error reported in the audit of XYZ Service Center that resulted in the overpayment of \$50 to every Pell recipient. During the period in question, Pell disbursements were made to 500 students, resulting in \$250,000 in overpayments. When notified of the problem, ABC School of Vocational Training took immediate steps to recover the overpayment from as many students as possible. As of December 31, 1991, \$50,000 had been recovered from 100 students and deposited in the Pell account. ABC School of Vocational Training plans to continue to recover such amounts from either the students or the institution's general fund, and to deposit money in the Pell account for each of these 100 students.

3b. When the institution is not one of the three clients, no specific reference to the finding is needed as long as it is clear from the general language that the finding does not apply.

**SFA SERVICE ORGANIZATION'S
RESPONSIBILITY FOR
SFA COMPLIANCE REQUIREMENTS**

[To the Independent Auditor:]

XYZ Service Center is required to comply with the requirements that govern student financial assistance programs and that relate to the compliance categories denoted as XYZ Service Center's responsibility in the attached schedule, "Division of Responsibility for Compliance Requirements," based on contracts with its customers. Although XYZ Service Center is responsible for the compliance requirements denoted in the attached schedule for some customers, the contracts with individual customers determine which of the compliance requirements are the responsibility of XYZ Service Center for a particular customer. Accordingly, an individual customer should compare the attached schedule to the contract with XYZ Service Center to determine which compliance requirements are the responsibility of that customer.

XYZ Service Center

Division of Responsibility for Compliance Requirements

<u>Compliance Requirement</u>	<u>Responsibility of Institution</u>	<u>Responsibility of XYZ Service Center</u>	<u>Explanation of Divided Responsibility</u>
I. Cash management			
A. Drawdowns		✓	
B. Authorization vs. expenditures		✓	
C. Reconcile G/L to bank		✓	
D. Bank account notes federal funds		✓	
II. Financial reports			
A. FISAP		✓	
B. EDPMTS		✓	
C. Pell IPS		✓	
D. Stafford SCRs		✓	
III. Institutional eligibility			
A. Participation agreement	✓		
B. Accreditation status	✓		
C. Admissions policy	✓		
D. Eligible programs	✓		
E. Licensure	✓		
F. Administrative capability	✓		
IV. Student eligibility			
A. High school diploma or equivalent or ability to benefit		✓	
B. Regularly enrolled in eligible program	✓	✓	(1)
C. Citizen or permanent resident		✓	
D. Satisfactory progress	✓	✓	(2)
E. Other requirements		✓	
V. Coordination of programs			
A. Financial aid organization		✓	
B. Other information available		✓	
C. Needs analysis		✓	
VI. Administrative capability			
A. Student file maintenance		✓	
B. Record retention		✓	
C. Pell verification		✓	
VII. Disbursements			
A. Financial aid transcripts		✓	
B. Independent/Dependent		✓	
C. Timing and amount of disbursements		✓	

<u>Compliance Requirement</u>	<u>Responsibility of Institution</u>	<u>Responsibility of XYZ Service Center</u>	<u>Explanation of Divided Responsibility</u>
VIII. Refunds or overpayments			
A. Refund calculations		✓	
B. Overpayment calculations		✓	
C. Disbursement and accounting for refunds/overpayments		✓	
IX. Institutional disclosure			
A. Accuracy of institutional data	✓		
B. Disclosure to students	✓		
X. Drug-free workplace	✓		

(continued on next page)

<u>Compliance Requirement</u>	<u>Responsibility of Institution</u>	<u>Responsibility of XYZ Service Center</u>	<u>Explanation of Divided Responsibility</u>
I. Pell grant			
A. Types of expenditures allowed		✓	
B. Program performance			
1. Calculation and disbursement of award		✓	
2. Timing of payment; cutoff dates for receipts of SARs		✓	
C. Financial reports		✓	
II. Campus-based programs (general)			
A. Types of expenditure allowed			
1. Program expenditures		✓	
2. Administrative cost allowance	✓		
B. Program performance			
1. Accuracy of FISAP data		✓	
2. System of need analysis, etc.	✓		
III. Campus-based programs (Perkins and income contingent loan)			
A. Type of expenditures allowed		✓	
B. Cost-sharing: one-ninth matching requirement	✓		
C. Program performance			
1. Student eligibility		✓	
2. Approved promissory note		✓	
3. Due diligence		✓	
4. Repayment records		✓	
D. Special compliance requirements			
1. Minimum cash balance; cash planning		✓	
2. Treatment of interest earned on Perkins loan balance		✓	
IV. Campus-based programs (CWS)			
A. Types of expenditures and employment allowed			
1. Types of employment allowed			
a. Types of expenditures		✓	
b. Types of employment allowed	✓	✓	(3)
B. Matching		✓	
C. Program performance			
1. Selection of students for employment	✓		
2. Approval of time sheets and payment to students	✓		
D. Special compliance requirements			
1. JLD and CSJLD programs		✓	
2. CSL programs		✓	

<u>Compliance Requirement</u>	<u>Responsibility of Institution</u>	<u>Responsibility of XYZ Service Center</u>	<u>Explanation of Divided Responsibility</u>
V. Campus-based programs (SEOG)			
A. Eligible expenditures		✓	
B. Matching	✓		
C. Selection of students for SEOG awards	✓		
VI. Stafford (formerly Guaranteed Student Loan-GSL)/Plus/SLS Loan			
A. Program performance			
1. Determination of eligibility and completion of application for GSL/PLUS/SLS		✓	
2. Default reduction		✓	
3. Entrance and exit counseling	✓		
4. Loan disbursement		✓	
B. GSL and PLUS status reporting			
1. SCRs		✓	
2. Change in enrollment status (GSL)	✓	✓	(4)
3. Change in enrollment status (PLUS/SLS)	✓	✓	(4)
C. Special compliance requirements			
1. Refund policy		✓	
2. Pro-rata refund		✓	
GAO General Compliance Requirements			
A. Political activity	✓		
B. Davis-Bacon Act	✓		
C. Civil rights	✓		
D. Cash management		✓	
E. Relocation assistance and real property acquisition	✓		
F. Federal financial reports		✓	

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- (1) XYZ Service Center's institutional customers determine which programs are eligible.
- (2) XYZ Service Center's institutional customers establish satisfactory progress policies and maintain academic records. XYZ Service Center obtains students' grades from the institutions and applies standards in determining student eligibility.
- (3) XYZ Service Center's institutional customers maintain agreements with employers. XYZ Service Center obtains and maintains employment and pay records.
- (4) XYZ Service Center's institutional customers notify XYZ Service Center of changes in enrollment status, and XYZ Service Center notifies guarantee agencies and lenders of such changes.