

Federal Register

Tuesday
November 5, 1996

Part V

**Office of
Management and
Budget**

**Audits of States, Local Governments, and
Non-Profit Organizations; Notice**

OFFICE OF MANAGEMENT AND BUDGET

Audits of States, Local Governments, and Non-Profit Organizations

AGENCY: Office of Management and Budget.

ACTION: Proposed revision of OMB Circular No. A-133 and proposed rescission of OMB Circular No. A-128.

SUMMARY: This Notice offers interested parties an opportunity to comment on further proposed revisions to Office of Management and Budget (OMB) Circular No. A-133, "Audits of Institutions of Higher Education and Other Non-Profit Institutions," and the proposed consolidation of OMB Circular No. A-128, "Audits of State and Local Governments," into Circular No. A-133 (with Circular A-128 being rescinded). This Notice also requests comment on two proposed information collections contained in the proposed revision to Circular A-133. These actions are being proposed to implement the Single Audit Act Amendments of 1996 (1996 Amendments), which were signed into law on July 5, 1996 (Public Law 104-156).

In the proposed revisions to Circular A-133, as published in the Federal Register on March 17, 1995 (60 FR 14594), OMB stated an intent to seek modifications to the Single Audit Act of 1984 (1984 Act) and, upon passage, extend the provisions of Circular A-133 to include audits of States and local governments and then rescind Circular A-128. (Indian tribal governments are included under the definition of States and are covered under the 1984 Act, Circular A-128, the 1996 Amendments, and this proposed revision.) The April 1996 revision of Circular A-133 was coordinated with the 1996 Amendments such that only minimum changes are now necessary to include States and local governments under Circular A-133. When States and local governments are covered under Circular A-133, OMB will rescind Circular A-128.

Interested parties may wish to refer to the March 17, 1995, and April 30, 1996, Federal Register (61 FR 19134) for a more detailed discussion of the changes made during the recent revisions to Circular A-133.

DATES: All comments on this proposal should be in writing, and must be received by January 6, 1997. Late comments will be considered to the extent practicable.

ADDRESSES: Comments should be mailed to Office of Management and Budget, Office of Federal Financial Management, Financial Standards and

Reporting Branch, Room 6025, New Executive Office Building, Washington, DC 20503. Where possible, comments should reference applicable paragraph or section numbers in the proposed revision. When comments are sent in by facsimile (fax), they should be faxed to (202) 395-4915. Electronic mail comments may be submitted via Internet to CONLEY_S@A1.EOP.GOV. Please include the full body of electronic mail comments in the text of the message and not as an attachment. Please include the name, title, organization, postal address, and E-mail address in the text of the message.

To facilitate conversion of the comments into a computer format for analysis, it would be helpful if respondents send a copy of comments on either a 3.5 or 5.25 inch diskette in either WordPerfect 5.1, WordPerfect for Windows, or ASCII format. When a diskette cannot be provided, it would be helpful if the comments were printed in pica or an equivalent 10 characters per inch type on white paper so the document can be easily scanned into a computer format.

A copy of the current Circulars A-128 and A-133 may be obtained from the OMB fax information line, 202-395-9068, document numbers 1128 and 1133, respectively, or by writing or calling the Office of Administration, Publications Office, Room 2200, New Executive Office Building, Washington, DC 20503, telephone (202) 395-7332. Also, Circular A-133 and this proposed revision are available on the OMB home page on the internet which is currently located at <http://www.whitehouse.gov/WH/EOP/OMB/html/ombhome.html>.

FOR FURTHER INFORMATION CONTACT: Sheila O. Conley, Office of Federal Financial Management (OFFM), Financial Standards and Reporting Branch, OMB telephone (202) 395-3993 and fax (202) 395-4915. A redlined/strikeout version showing the detailed changes between the recently revised OMB Circular A-133 and the further proposed revision is available by written request to OFFM.

SUPPLEMENTARY INFORMATION: Pursuant to the Single Audit Act Amendments of 1996 (Pub. L. 104-156), the proposed revision requires non-Federal entities (States, local governments, and non-profit organizations) expending \$300,000 or more in a year in Federal awards to have an audit, sets forth requirements for both the performance and reporting of this audit, and provides for follow-up on audit findings. Each non-Federal entity is responsible for having its audit conducted and ensuring that subrecipients expending \$300,000

or more in a year meet the audit requirements of Office of Management and Budget (OMB) Circular A-133 which will be renamed "Audits of States, Local Governments, and Non-Profit Organizations."

Significant Changes from Circular A-128 to Circular A-133

The Single Audit Act Amendments of 1996, signed by the President on July 5, 1996, called for uniform requirements for audits of all types of organizations. As a consequence, OMB proposes to collocate requirements for States, local governments, and non-profit organizations in Circular A-133, which currently addresses only non-profit organizations. At the same time, OMB would rescind Circular A-128, "Audits of State and Local Governments," which currently specifies audit requirements for States and local governments.

The April 1996 revision of Circular A-133 includes the following major changes which are not reflected in Circular A-128 issued April 12, 1985:

- (1) increased the threshold that triggers an audit requirement under the Circular from \$25,000 to \$300,000 (§ __.200(a));
- (2) prescribed a risk-based approach to determine major programs (§ __.520);
- (3) required a minimum major program coverage of 50 percent (25 percent for low-risk auditees) of Federal awards expended (§ __.520(f));
- (4) clarified the required level of internal control testing (§ __.500(c));
- (5) provided minimum reporting requirements for the schedule of expenditures of Federal awards (§ __.310(b));
- (6) required auditees to prepare a summary schedule of prior audit findings (§ __.315) and a data collection form (§ __.320(b));
- (7) required auditors to report audit findings and questioned costs in a single schedule, including a summary of the auditor's results (§ __.505(a)(4));
- (8) prescribed criteria for reporting audit findings and questioned costs (§ __.510);
- (9) modified the method of determining the cognizant agency for audit (§ __.400(a));
- (10) after a two-year transition period, precluded the same auditor from preparing the indirect cost proposal or cost allocation plan when indirect costs exceeded \$1 million in the prior year (§ __.305(b));
- (11) after a two-year transition period, shortened the due date for submitting reports from 13 months to nine months (§ __.320(a));
- (12) streamlined the report submission process and expanded the

role of the Federal clearinghouse (§ .320);

(13) changed the basis for determining the amount of Federal awards administered by the non-Federal entity from receipts to expenditures (§ .200);

(14) provided guidance for conducting program-specific audits (§ .235); and,

(15) reorganized the Circular into a "common rule" format to facilitate codification by Federal agencies and improve the presentation of information included in the Circular.

Significant Proposed Revisions to Circular A-133

The most significant difference between this proposed revision and the recently revised Circular A-133 is the inclusion of States and local governments. This proposed revision also includes changes relating to the effective date (31 U.S.C. 7507), the provisions permitting biennial audits in limited circumstances (31 U.S.C. 7502(b)(2) and (3)), and the allowability of audit costs (31 U.S.C. 7505(b)(1)(A)(ii)) to conform the April 1996 revision of Circular A-133 to the 1996 Amendments. Aside from these changes, the 1996 Amendments do not require other substantive changes to Circular A-133.

The following discussion is provided to describe the changes needed to conform this proposed revision with the 1996 Amendments, solicit input from interested parties, and summarize some of the other changes included in this proposed revision. The readers' attention is directed to section D. Proposed Requirement for the Auditor to Prepare and Sign the Data Collection Form Required by Circular A-133, because it is particularly important to OMB that commenters provide views on the matters discussed in this section.

A. Effective Dates

The 1996 Amendments apply to any non-Federal entity with respect to any of its fiscal years which begin after June 30, 1996 (31 U.S.C. 7507). Changes are proposed in paragraph 10 of the Circular, "Effective Dates," to reflect the effective dates mandated in the 1996 Amendments.

Inquirers asked which circular applies for biennial audits when the biennial period includes time before and after the effective date of the proposed revision. The 1996 Amendments do not specifically address the effective dates for biennial audits. OMB interprets the 1996 Amendments to be effective for any biennial periods which begin after June 30, 1996. As with annual audits, the prior circulars are in effect until this proposed revision is effective.

Therefore, a non-Federal entity which elects a biennial audit and has a biennial period beginning on or before June 30, 1996, should apply the provisions of Circular A-128 issued April 12, 1985 (for a State or local government) or Circular A-133 issued March 8, 1990 (for a non-profit organization), as applicable. The requirements of this proposed revision apply to any biennial periods beginning after June 30, 1996.

Circular A-133 shortened the report due date from 13 months to nine months after the end of the audit period (§ .320(a)). However, the 1996 Amendments (31 U.S.C. 7502(h)) provide for a transition period of at least two years during which the report due date would remain at 13 months. The proposed revision at § .320(a) incorporates this transition period such that the due date of nine months after the end of the audit period is not effective until audits of fiscal years beginning after June 30, 1998. Cognizant or oversight agencies may still provide extensions.

Paragraphs 6 and 10 of the April 1996 revision of Circular A-133 instructed Federal agencies to adopt the standards set forth in the Circular in codified regulations not later than November 30, 1996. As a result of the 1996 Amendments, the April 1996 revision of Circular A-133, which applies only to non-profit organizations, will not become operable unless this proposed revision is not finalized by June 30, 1997 (i.e., OMB expects that Circular A-133 issued March 8, 1990, will apply to non-profit organizations and Circular A-128 issued April 12, 1985, will apply to States and local governments prior to the effective dates of the 1996 Amendments, and this proposed revision will apply to these types of organizations when the 1996 Amendments become effective).

Therefore, Federal agencies may forgo the requirement under the April 1996 revision of Circular A-133 to adopt the standards set forth in the Circular in codified regulations not later than November 30, 1996. However, the 1996 Amendments (31 U.S.C. 7505(a)) require each Federal agency to promulgate such revisions to its regulations as may be necessary to conform such regulations to the requirements of the 1996 Amendments and OMB implementing guidance. Accordingly, the proposed revision includes a provision in paragraphs 6 and 10 of the Circular whereby Federal agencies shall adopt the standards set forth in the Circular in codified regulations not later than six months after publication of the final revision in the Federal Register.

B. Biennial Audits in Limited Circumstances

Changes are proposed at § .220 to permit biennial audits in limited circumstances in accordance with the 1996 Amendments. The provisions in the 1996 Amendments which allow non-Federal entities to elect a biennial audit are very specific (31 U.S.C. 7502(b)(2) and (3)). For a State or local government to qualify for a biennial audit election, there must be a *requirement* (as opposed to authorization) in a State's constitution or State or local law which was in effect on January 1, 1987. Also, this *requirement* must still be in effect. Only non-profit organizations that had biennial audits for all biennial periods ending between July 1, 1992, and January 1, 1995, may elect a biennial audit. OMB expects that very few States, local governments, or non-profit organizations meet this criteria. Nonetheless, all auditees are encouraged to have annual audits which provide increased accountability.

The April 1996 revision of Circular A-133 includes a provision whereby a Federal agency or pass-through agency may allow a non-profit organization that elects a program-specific audit under § .200(c) to perform the audit every two years. This provision was removed from the proposed revision to conform with the biennial audit requirements specified in the 1996 Amendments.

Changes are also proposed at § .520 and § .530(a) to the major program determination process and the criteria for low-risk auditee for situations which are unique to single audits which are performed on a biennial basis.

C. Audit Costs Prohibited for Subrecipients With Federal Awards Expended of Less Than \$300,000 Annually

The 1996 Amendments discourage pass-through entities from requiring single audits of subrecipients with total Federal awards expended of less than \$300,000 annually. This is done by prohibiting charges to Federal awards for audit costs under these circumstances (31 U.S.C. 7505(b)(1)(A)(ii)). However, pass-through entities are not prohibited from charging subrecipient monitoring costs, provided those procedures are of lesser scope than a single audit.

For example, if a pass-through entity requires a subrecipient which expends less than \$300,000 annually in total Federal awards to have a single audit conducted in accordance with the 1996 Amendments, this audit must be paid for with other than Federal funds.

However, the 1996 Amendments do not prohibit charging Federal awards for limited scope audits and other subrecipient monitoring procedures.

Pass-through entities would need to make appropriate changes in their agreements with subrecipients to reflect that audits will no longer be required for non-Federal entities with total Federal awards expended of less than \$300,000 annually. Pass-through entities will need to review their overall subrecipient monitoring process, and decide what, if any, additional monitoring procedures may be necessary to ensure subrecipient compliance. Monitoring procedures, which include limited scope audits, can be more targeted and less costly than a full Circular A-133 audit. Subrecipient monitoring procedures include: on-site visits, reviews of documentation supporting requests for reimbursement, limited scope audits of specific compliance areas (e.g., eligibility determinations made by subrecipients), and financial statement audits in accordance with generally accepted government auditing standards. A pass-through entity should consider the cost-effectiveness of monitoring procedures compared to the relative size and complexity of the Federal awards administered by subrecipients in determining the appropriateness of monitoring procedures.

D. Proposed Requirement for the Auditor To Prepare and Sign the Data Collection Form Required by Circular A-133

To streamline the distribution of audit reports and improve the governmentwide collection and analysis of single audit results, Circular A-133 provides for a machine-readable form (§ .320(b)) to be prepared at the completion of each audit and submitted to the Federal clearinghouse designated by OMB and pass-through entities. The data collection form will provide key information about the non-Federal entity, the Federal awards it administers, and the audit results. It will serve as the basis for developing a governmentwide database on covered Federal awards administered by non-Federal entities. The April 1996 revision of Circular A-133 provides for a data collection form to be submitted to the Federal clearinghouse and each pass-through entity in lieu of sending the full single audit reporting package when there are no audit findings.

The April 1996 revision of Circular A-133 requires the auditee's management to prepare the data collection form. Many auditees are concerned about the additional burden this reporting requirement would place

on them. A more efficient and effective method could be to have the auditor prepare the form and sign it as preparer. OMB believes this would not significantly increase audit costs, since most of the information requested on the form will be obtained directly from the schedule of expenditures of Federal awards and the auditor's reports. Since the auditor is most knowledgeable about the audit results, OMB expects that it will be efficient for the auditor to simply prepare the form at the completion of the audit. Also, OMB believes that the incremental legal exposure faced by the auditor as a result of signing the form can be minimized by restricting its use to the Federal clearinghouse and pass-through entities for the sole purpose of data collection and so stating on the form. Under this method, the auditee would continue to be required to provide assurance to the Federal Government and pass-through entities that the auditee engaged an auditor to conduct an audit in accordance with the Circular, that the audit was completed, and that the information included on the form is accurate.

OMB believes that the auditor's association with the data collection form will add value to its usefulness, reduce the need for Federal awarding agencies and pass-through entities to perform unnecessary verification procedures, improve the accuracy of the governmentwide database, streamline the single audit report submission process, and reduce burden on auditees.

Therefore, OMB is considering adding a provision that requires the auditor to prepare the data collection form and sign it. If this change is made, OMB will work with the auditing profession and other interested parties to develop any necessary revisions to the form. Respondents are encouraged to comment on this change, including: Whether the auditor should prepare and sign the data collection form; what would be the estimated cost of the auditor's performing this service; whether it would be beneficial to auditees, Federal agencies, and pass-through entities; and, whether there are concerns over litigation exposure.

The name of the certification form required under § .320(b) of the April 1996 revision of Circular A-133 is changed to "Data Collection Form" in the proposed revision to more appropriately characterize the nature of the information request. This name change also affects § .235(c)(2), § .235(c)(3), § .320(c), § .320(e)(i), and § .320(h).

E. Audit Coverage Over the Allowability of Charges to Cost Pools

Changes are proposed at § .500(c), § .500(d), § .505(b), § .505(c), and § .510(a) to clarify the auditor's responsibility for testing and reporting on the allowability of costs charged to cost pools: (1) used to support an indirect cost rate, or (2) allocated through a State/local-wide central service cost allocation plan (as fully described in Appendix C of Circular A-87, "Cost Principles for State, Local and Indian Tribal Governments," issued May 4, 1995 (60 FR 26484), and hereinafter referred to as a "cost allocation plan"). The proposed language is added to address the timing of costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan. Indirect cost rates are based on costs incurred in a base period and applied prospectively. Costs allocated through a cost allocation plan are based on the actual costs incurred in two previous years.

Because it would not be practical to perform such tests retroactively, the auditor is expected to perform tests of costs charged to cost pools during the period that the actual costs were incurred, rather than during the period in which the rate was applied or in which the costs were allocated. For example, if the actual costs charged to cost pools for 1997 form the basis for the indirect cost proposal and the final negotiated indirect cost rate that will be applied in 1998 and 1999, then the auditor should test actual costs charged to cost pools during 1997 as part of the 1997 audit, since 1997 is the base year. The auditor would not be expected to test such costs as part of the 1998 and 1999 audits.

F. Pilot Project Authority

The 1996 Amendments (31 U.S.C. 7502(j)) authorize OMB, in consultation with the Chair and Ranking Minority Member of the Committee on Governmental Affairs of the Senate and the Chair and Ranking Minority Member of the Committee on Government Reform and Oversight of the House of Representatives, to approve pilot projects to test alternative methods of achieving the purposes of the 1996 Amendments. Such pilot projects, which would be voluntary undertakings by non-Federal entities, would provide a means of assessing new ways of testing and reporting on Federal awards.

Suggestions from auditees for pilot projects should be submitted first to Federal funding agencies. If a Federal agency concludes that a suggested pilot project has merit, the Federal agency

may present the suggestion to OMB for consideration. OMB will consult with the appropriate members of the House and Senate prior to authorizing any pilot projects under the 1996 Amendments.

G. Other Changes To Comply With the 1996 Amendments

The revision proposes the following other changes to comply with the 1996 Amendments and include States and local governments under Circular A-133.

(1) Retitles the Circular to include States and local governments. States and local governments were also added to paragraph 1 of the Circular.

(2) Deletes the references to Circular A-128 from paragraph 4 of the Circular and sections § .105 and § .400(d)(4) of the attachment.

(3) Changes definitions in § .105 of "Federal award" "Federal financial assistance" "Federal program" "internal control" "internal control pertaining to the compliance requirements over Federal programs" "pass-through entity" and "subrecipient" to conform with the definitions included in the 1996 Amendments.

(4) Adds definitions in § .105 for the terms "Indian tribe," "local government," and "State," which are defined terms in the 1996 Amendments.

(5) Adds definitions in § .105 for the term "non-Federal entity" and replaces the term "non-profit organization" with "non-Federal entity" in paragraphs 4, 6, and 10 of the Circular and sections § .100, § .105, § .200(d), § .205(a), and § .205(h) of the attachment.

(6) Replaces the term "non-profit organization" with "subrecipient" in § .205(i).

(7) Adds "full" as a modifier of cost in § 7.215(b).

(8) Changes title of schedule in § .235(b)(2) to "schedule of expenditures of Federal awards."

(9) Changes title of "central clearinghouse" to "Federal clearinghouse" in § .235(c)(2), § .235(c)(3), § .300(e), § .315(b)(4)(i), § .320(b), § .320(d), § .320(g), § .320(h), § .320(i), and § .320(j).

(10) Adds reference to Grants Management Common Rule in § .305(a).

(11) Drops "non-profit" as a modifier to pass-through entity and subrecipients in § .400(d) and § .400(d)(4), respectively.

(12) Adds a provision to cover a series of audits in § .500(a).

(13) Changes the schedule of findings and questioned costs (§ .505(d)) to

include information from the audit of the financial statements performed in accordance with generally accepted government auditing standards. Consistency changes were made to § .235(b)(4)(iv) for program-specific audits.

(14) Drops from § .520(b)(3) the reference to insurance programs because insurance programs are not specifically cited in the 1996 Amendments.

H. Other Changes

The revision proposes the following detailed changes.

(1) Adds to § .235(c)(3) a requirement that one copy of the data collection form prepared in accordance with § .320(b) be submitted to each pass-through entity.

(2) Adds to § .320(b) a requirement that the auditee identify the cognizant or oversight agency for audit on the data collection form.

(3) Changes the requirement in § .400(a)(4) for the cognizant agency for audit to report to other Federal agencies any direct reporting of irregularities and illegal acts.

(4) Simplifies the summary of the auditor's results in § .505 by removing the requirement for a statement concerning the auditee's ability to continue as a going concern and consolidating the reporting of audit findings which were not reportable conditions or material non-compliance.

(5) Adds to the definition of audit findings reported (§ .510(a)(4)) known questioned costs greater than \$10,000 for Federal programs which are not audited as major programs. Consistent with this, adds in § .520(c) a reference to this requirement.

(6) Removes from § .510(a)(6) the definition of fraud because this term is the same as in professional auditing standards.

(7) Adds in § .520(d) and § .520(e) an option to allow an auditor to minimize the risk assessment required for Type B programs under certain circumstances.

(8) Adds in § .520(e) a statement to encourage auditors to use an approach in identifying high-risk Type B program which provides an opportunity for different high-risk Type B programs to be audited as major over a period of time.

I. Changes for Clarity

The revision proposes the following changes for clarity.

(1) Changes the title of the Circular to use the term "non-profit organizations" in lieu of the phrase "institutions of higher education and other non-profit institutions" since non-profit

organization is the defined term (§ .105) which includes non-profit institutions of higher education.

(2) Changes the definitions in § .105 of cluster of programs and Federal programs to clarify that research and development (R&D) and student financial aid (SFA) are types of clusters of programs. Based upon this change, the phrase "category of programs" was replaced with "cluster of programs" in § .105, § .310(b)(6), § .320(b).

Moves discussion of State governments combining funding from definition of Federal programs to definition of cluster of programs in § .105. Adds to § .105 emphasis that when a State designates a cluster of programs, the State must identify the Federal awards and advise subrecipients of the applicable compliance requirements.

(3) Replaces the reference to "Federal expenditures" with "Federal awards expended" in § .200(d), § .310(b)(2), § .310(b)(6), § .310(b)(7), § .520(b)(1), § .520(d)(2), § .520(f), § .525(d)(4), § .530(d)(3).

(4) For consistency with the format of the effective date of the Circular, changes the date format from fiscal years "ending" to fiscal years "beginning" in § .305(b).

(5) Clarifies in § .315(b) that follow-up on prior audit findings is concerned with those relative to Federal awards as opposed to those relative to the financial statements of the entity.

(6) Clarifies in § .500(a) that the entity's financial statements and schedule of expenditures of Federal awards must be for the same fiscal year.

(7) Replaces in § .500(c) the term "achieve" with "support."

(8) Clarifies in § .510(a)(2) that this reporting only relates to major programs and removes discussion relating to auditor conclusions which is included in generally accepted government auditing standards.

(9) Clarifies in § .510(a)(5) and § .510(a)(6) that the reference to the schedule of findings and questioned costs is to the part of the schedule that deals with Federal awards.

(10) Changes the term "50 percent rule" to "percentage of coverage rule" in § .520(d)(2), § .520(e)(3), § .520(f), § .520(i).

(11) Clarifies in § .530(d) that this provision applies for either of the preceding two years in which the program was classified as a Type A program.

Information Collection Activity Under OMB Review

In accordance with the Paperwork Reduction Act (44 U.S.C. Chapter 35 *et seq.*), this notice requests comment on

the following two proposed information collections contained in this proposed revision. The information collection request involves two types of entities: (1) Reports from auditors to auditees concerning audit results, audit findings, and questioned costs; and, (2) reports from auditees to the Federal Government providing information about the auditees, the awards they administer, and the audit results. The proposed revision specifies what auditors are required to report to auditees, under § .235(b)(4), for program-specific audits, and § .505, "Audit Reporting," for single audits. The proposed revision also specifies what auditees are required to report to the Federal clearinghouse designated by OMB and pass-through entities, if applicable, under § .235(c), for program-specific audits, and § .320, "Report Submission," for single audits.

The information collection requests included in this proposal would result in a decrease in overall reporting burden. Although the reporting burden per audit will increase under this proposal from 26 to 34 hours (described in the following paragraphs), fewer entities will be subject to the reporting requirements as a result of the proposal to increase the threshold that triggers an audit requirement under the Circular from \$25,000 to \$300,000. Based on available information, OMB estimates that approximately 25,000 non-Federal entities would be subject to the information collection requirement included in this proposal; whereas, approximately 35,000 non-Federal entities are subject to the current requirements under Circulars A-128 and A-133. The overall reporting burden currently approximates 910,000 hours (35,000 non-Federal entities at 26 hours per audit). Under the proposal, the overall reporting burden would be approximately 850,000 hours (25,000 non-Federal entities at 34 hours per audit), or 60,000 hours less than the current reporting burden. In addition, as more fully discussed below, there is an opportunity to reduce further the overall reporting burden under the proposal from 850,000 to 800,000 hours by having auditors, rather than auditees, prepare the data collection form discussed below.

Congress intended to improve the contents of single audit reports to make them more useful by enacting the 1996 Amendments. OMB believes that the increase in reporting burden per audit is warranted because several changes included in the proposed revision would improve the usefulness and effectiveness of single audit reporting

with respect to information provided by both auditors and auditees.

OMB estimates that reporting by *auditors* currently takes approximately 10 hours on the average per audit under Circulars A-128 and A-133, and will take 14 hours under the proposal. The estimated increase of 4 hours of reporting burden per audit on *auditors* is due primarily to a provision in the 1996 Amendments (31 U.S.C. 7502(g)(2)) which requires the auditor, for the first time, to prepare a summary of audit results. In its report on the 1996 Amendments, the Committee on Government Reform and Oversight stated that "the complexity of the reports makes it difficult for the average reader to understand what has been audited and reported ... A summary of the audit results would highlight important information and thus enable users to quickly discern the overall results of an audit" (H.R. Report 104-607, page 18).

OMB estimates that reporting by *auditees* currently takes approximately 16 hours on the average per audit under Circulars A-128 and A-133, and will take 20 hours under the proposal. The estimated increase of 4 hours of reporting burden per audit on *auditees* is due primarily to a proposed requirement whereby management would prepare two new documents to improve the usefulness of single audit reports.

The first of these reports is a summary schedule of prior audit findings which will provide the current status of previously reported audit findings until such findings are corrected. This information, which is important to Federal funding agencies and pass-through entities, is currently required under Circulars A-128 and A-133 but it is not consistently provided in single audit reports. As a result, Federal funding agencies and pass-through entities frequently request this type of information long after a finding is reported, which results in additional burden on Federal agencies, auditees, and auditors. The proposed requirements provide additional guidance to auditees on where and how to present information regarding prior audit findings. While additional time may be required up-front for certain auditees to prepare the summary schedule of prior audit findings, the reporting burden for such entities should be offset by the elimination of the inefficiencies caused by the current practice of having to retrieve and provide information after-the-fact on old audit findings.

The second report management would be required to prepare is the "Data

Collection Form" prescribed in § .320(b) of the proposed revision and discussed previously in Section D (Proposed Requirement for the Auditor to Prepare and Sign the Data Collection Form Required by Circular A-133). The data collection form will facilitate streamlining the report distribution process and improve the governmentwide collection and analysis of single audit results.

OMB believes that the overall reporting burden under the proposed revision could be further reduced by having the auditor prepare the data collection form. Specifically, OMB estimates that if *auditors*, rather than *auditees*, prepare the data collection form then the estimate of reporting burden on auditors would *increase* by two hours (that is, from 14 hours to 16 hours), and the estimate of reporting burden on auditees would *decrease* by four hours (that is, from 20 hours to 16 hours) per audit under the proposal. This would result in a *net* decrease of 2 hours per audit, or 50,000 hours in overall reporting burden (25,000 non-Federal entities at 2 hours savings per audit). As a result of having auditors, rather than auditees, prepare the data collection form, overall reporting burden could be reduced from 850,000 to 800,000 hours.

Comments are invited on: (a) Whether the proposed information collection is necessary for the proper performance of the functions of the agencies, including whether the information has practical utility; (b) the accuracy of the estimate of the burden of the collection of the information; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden related to the collection of information on respondents, including use of automated collection techniques or other forms of information technology. G. Edward DeSeve, Controller.

1. OMB proposes to rescind Circular A-128 upon issuance of a revised Circular A-133 that covers States and local governments.

2. OMB proposes to revise Circular A-133 to read as follows:

To the Heads of Executive Departments and Establishments

Subject: Audits of States, Local Governments, and Non-Profit Organizations

1. *Purpose.* This Circular is issued pursuant to the Single Audit Act of 1984, Public Law 98-502, and the Single Audit Act Amendments of 1996, Public Law 104-156. It sets forth standards for obtaining consistency and uniformity among Federal agencies for the audit of States, local

governments, and non-profit organizations expending Federal awards.

2. *Authority.* Circular A-133 is issued under the authority of sections 503, 1111, and 7501 *et seq.* of title 31, United States Code, and Executive Orders 8248 and 11541.

3. *Rescission and Supersession.* This Circular rescinds Circular A-128, "Audits of State and Local Governments," issued April 12, 1985, and supersedes the prior Circular A-133, "Audits of Institutions of Higher Education and Other Non-Profit Institutions," issued April 22, 1996. For effective dates, see paragraph 10.

4. *Policy.* Except as provided herein, the standards set forth in this Circular shall be applied by all Federal agencies. If any statute specifically prescribes policies or specific requirements that differ from the standards provided herein, the provisions of the statute shall govern.

Federal agencies shall apply the provisions of the sections of this Circular to non-Federal entities, whether they are recipients expending Federal awards received directly from Federal awarding agencies, or are subrecipients expending Federal awards received from a pass-through entity (a recipient or another subrecipient).

This Circular does not apply to non-U.S. based entities expending Federal awards received either directly as a recipient or indirectly as a subrecipient.

5. *Definitions.* The definitions of key terms used in this Circular are contained in § .105 in the Attachment to this Circular.

6. *Required Action.* The specific requirements and responsibilities of Federal agencies and non-Federal entities are set forth in the Attachment to this Circular. Federal agencies making awards to non-Federal entities, either directly or indirectly, shall adopt the language in the Circular in codified regulations as provided in Section 10 (below), unless different provisions are required by Federal statute or are approved by OMB.

7. *OMB Responsibilities.* OMB will review Federal agency regulations and implementation of this Circular, and will provide interpretations of policy requirements and assistance to ensure uniform, effective and efficient implementation.

8. *Information Contact.* Further information concerning Circular A-133 may be obtained by contacting the Financial Standards and Reporting Branch, Office of Federal Financial Management, Office of Management and Budget, Washington, DC 20503, telephone (202) 395-3993.

9. *Review Date.* This Circular will have a policy review three years from the date of issuance.

10. *Effective Dates.* The standards set forth in § .400 of the Attachment to this Circular, which apply directly to Federal agencies, shall be effective July 1, 1996, and shall apply to audits of fiscal years beginning after June 30, 1996.

The standards set forth in this Circular that Federal agencies are to apply to non-Federal entities shall be adopted by Federal agencies in codified regulations not later than six months after publication of the final revision in the Federal Register, so that they will

apply to audits of fiscal years beginning after June 30, 1996, with the exception that § .305(b) of the Attachment applies to audits of fiscal years beginning after June 30, 1998. In the interim period, until the standards in this Circular are adopted and become applicable, the audit provisions of Circular A-128 issued April 12, 1985, and Circular A-133, issued April 22, 1996, shall continue in effect.

Franklin D. Raines,
Director.

Attachment

PART —AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS

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Subpart A—General

§ .100 Purpose.

This part sets forth standards for obtaining consistency and uniformity among Federal agencies for the audit of non-Federal entities expending Federal awards.

§ .105 Definitions.

Auditee means any non-Federal entity that expends Federal awards which must be audited under this part.

Auditor means an auditor that is a public accountant or a Federal, State or local government audit organization, which meets the general standards

specified in generally accepted government auditing standards (GAGAS). The term *auditor* does not include internal auditors of non-profit organizations.

Audit finding means deficiencies which the auditor is required by § .510(a) to report in the schedule of findings and questioned costs.

CFDA number means the number assigned to a Federal program in the *Catalog of Federal Domestic Assistance* (CFDA).

Cluster of programs means a grouping of closely related programs that share common compliance requirements. The types of clusters of programs are research and development (R&D), student financial aid (SFA), and other clusters. "Other clusters" are as defined by the Office of Management and Budget (OMB) in the compliance supplements or as designated by a State for Federal awards the State provides to its subrecipients that meet the definition of a cluster of programs. When designating an "other cluster," a State shall identify the Federal awards included in the cluster and advise the subrecipients of compliance requirements applicable to the cluster, consistent with § .400(d)(1) and § .400(d)(2), respectively. A cluster of programs shall be considered as one program for determining major programs, as described in § .520, and, with the exception of R&D as described in § .200(c), whether a program-specific audit may be elected.

Cognizant agency for audit means the Federal agency designated to carry out the responsibilities described in § .400(a).

Compliance supplements refers to the *Compliance Supplement for Audits of Institutions of Higher Learning and Other Non-Profit Institutions* and the *Compliance Supplement for Single Audits of State and Local Governments* or such documents as OMB or its designee may issue to replace them. These documents are available from the Government Printing Office, Superintendent of Documents, P.O. Box 371954, Pittsburgh, PA 15250-7954, telephone (202) 512-1800.

Corrective action means action taken by the auditee that:

- (1) Corrects identified deficiencies;
- (2) Produces recommended improvements; or
- (3) Demonstrates that audit findings are either invalid or do not warrant auditee action.

Federal agency has the same meaning as the term *agency* in Section 551(1) of title 5, United States Code.

Federal award means Federal financial assistance and Federal cost-

reimbursement contracts that non-Federal entities receive directly from Federal awarding agencies or indirectly from pass-through entities. It does not include procurement contracts, under grants or contracts, used to buy goods or services from vendors. Any audits of such vendors shall be covered by the terms and conditions of the contract. Contracts to operate Federal Government owned, contractor operated facilities (GOCOs) are excluded from the requirements of this part.

Federal awarding agency means the Federal agency that provides an award directly to the recipient.

Federal financial assistance means assistance that non-Federal entities receive or administer in the form of grants, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance, but does not include amounts received as reimbursement for services rendered to individuals as described in § .205(h) and § .205(i).

Federal program means:

(1) All Federal awards to a non-Federal entity assigned a single number in the CFDA.

(2) When no CFDA number is assigned, all Federal awards from the same agency made for the same purpose should be combined and considered one program.

(3) Notwithstanding paragraphs (1) and (2) of this definition, a cluster of programs. The types of clusters of programs are:

- (i) Research and development (R&D);
- (ii) Student financial aid (SFA); and
- (iii) "Other clusters," as described in the definition of cluster of programs in this section.

GAGAS means generally accepted government auditing standards issued by the Comptroller General of the United States, which are applicable to financial audits.

Generally accepted accounting principles has the meaning specified in generally accepted auditing standards issued by the American Institute of Certified Public Accountants (AICPA).

Indian tribe means any Indian tribe, band, nation, or other organized group or community, including any Alaskan Native village or regional or village corporation (as defined in, or established under, the Alaskan Native Claims Settlement Act) that is recognized by the United States as eligible for the special programs and services provided by the United States to Indians because of their status as Indians.

Internal control means a process, effected by an entity's management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- (1) Effectiveness and efficiency of operations;
- (2) Reliability of financial reporting; and
- (3) Compliance with applicable laws and regulations.

Internal control pertaining to the compliance requirements for Federal programs (Internal control over Federal programs) means a process—effected by an entity's management and other personnel—designed to provide reasonable assurance regarding the achievement of the following objectives for Federal programs:

- (1) Transactions are properly recorded and accounted for to:
 - (i) Permit the preparation of reliable financial statements and Federal reports;
 - (ii) Maintain accountability over assets; and
 - (iii) Demonstrate compliance with laws, regulations, and other compliance requirements;
- (2) Transactions are executed in compliance with:
 - (i) Laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on a Federal program; and
 - (ii) Any other laws and regulations that are identified in the compliance supplements; and
- (3) Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

Loan means a Federal loan or loan guarantee received or administered by a non-Federal entity.

Local government means any unit of local government within a State, including a county, borough, municipality, city, town, township, parish, local public authority, special district, school district, intrastate district, council of governments, and any other instrumentality of local government.

Major program means a Federal program determined by the auditor to be a major program in accordance with § .520 or a program identified as a major program by a Federal agency or pass-through entity in accordance with § .215(c).

Management decision means the evaluation by the Federal awarding agency or pass-through entity of the audit findings and corrective action plan and the issuance of a written decision as to what corrective action is necessary.

Non-Federal entity means a State, local government, or non-profit organization.

Non-profit organization means:

- (1) any corporation, trust, association, cooperative, or other organization that:
 - (i) Is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest;
 - (ii) Is not organized primarily for profit; and
 - (iii) Uses its net proceeds to maintain, improve, or expand its operations; and
- (2) The term *non-profit organization* includes non-profit institutions of higher education and hospitals.

OMB means the Executive Office of the President, Office of Management and Budget.

Oversight agency for audit means the Federal awarding agency that provides the predominant amount of direct funding to a recipient not assigned a cognizant agency for audit. When there is no direct funding, the Federal agency with the predominant indirect funding shall assume the oversight responsibilities. The duties of the oversight agency for audit are described in § .400(b).

Pass-through entity means a non-Federal entity that provides a Federal award to a subrecipient to carry out a Federal program.

Program-specific audit means an audit of one Federal program as provided for in § .200(c) and § .235.

Questioned cost means a cost that is questioned by the auditor because of an audit finding:

- (1) Which resulted from a possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of Federal funds, including funds used to match Federal funds;
- (2) Where the costs, at the time of the audit, are not supported by adequate documentation; or
- (3) Where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

Recipient means a non-Federal entity that expends Federal awards received directly from a Federal awarding agency to carry out a Federal program.

Research and development (R&D) means all research activities, both basic and applied, and all development activities that are performed by a non-Federal entity. *Research* is defined as a systematic study directed toward fuller scientific knowledge or understanding of the subject studied. The term research also includes activities involving the training of individuals in research

techniques where such activities utilize the same facilities as other research and development activities and where such activities are not included in the instruction function. *Development* is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes.

Single audit means an audit which includes both the entity's financial statements and the Federal awards as described in § .500.

State means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Trust Territory of the Pacific Islands, any instrumentality thereof, any multi-State, regional, or interstate entity which has governmental functions, and any Indian tribe as defined in this section.

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

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

Types of compliance requirements refers to the types of compliance requirements listed in the compliance supplements. Examples include cash management, Federal financial reporting, allowable costs/cost principles, types of services allowed or unallowed, eligibility, and matching.

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

Subpart B—Audits

§ .200 Audit Requirements.

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

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

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

(d) *Exemption when Federal awards expended are less than \$300,000.* Non-Federal entities that expend less than \$300,000 a year in Federal awards are exempt from Federal audit requirements for that year, except as noted in § .215(a), but records must be available for review or audit by appropriate officials of the Federal agency, pass-through entity, and General Accounting Office (GAO).

(e) *Federally Funded Research and Development Centers (FFRDC).* Management of an auditee that owns or operates an FFRDC may elect to treat the FFRDC as a separate entity for purposes of this part.

§ .205 Basis for determining Federal awards expended.

(a) *Determining Federal awards expended.* The determination of when an award is expended should be based on when the activity related to the award occurs. Generally, the activity pertains to events that require the non-Federal entity to comply with laws, regulations, and the provisions of contracts or grant agreements, such as: expenditure/expense transactions associated with grants, cost-

reimbursement contracts, cooperative agreements, and direct appropriations; the disbursement of funds passed through to subrecipients; the use of loan proceeds under loan and loan guarantee programs; the receipt of property; the receipt of surplus property; the receipt or use of program income; the distribution or consumption of food commodities; the disbursement of amounts entitling the non-Federal entity to an interest subsidy; and, the period when insurance is in force.

(b) *Loan and loan guarantees (loans).* Since the Federal Government is at risk for loans until the debt is repaid, the following guidelines shall be used to calculate the value of Federal awards expended under loan programs, except as noted in paragraphs (c) and (d) of this section:

(1) Value of new loans made or received during the fiscal year; plus
(2) Balance of loans from previous years for which the Federal Government imposes continuing compliance requirements; plus

(3) Any interest subsidy, cash, or administrative cost allowance received.

(c) *Loan and loan guarantees (loans) at institutions of higher education.* When loans are made to students of an institution of higher education but the institution does not make the loans, then only the value of loans made during the year shall be considered Federal awards expended in that year. The balance of loans for previous years is not included as Federal awards expended because the lender accounts for the prior balances.

(d) *Prior loan and loan guarantees (loans).* Loans, the proceeds of which were received and expended in prior years, are not considered Federal awards expended under this part when the laws, regulations, and the provisions of contracts or grant agreements pertaining to such loans impose no continuing compliance requirements other than to repay the loans.

(e) *Endowment funds.* The cumulative balance of Federal awards for endowment funds which are federally restricted are considered awards expended in each year in which the funds are still restricted.

(f) *Free rent.* Free rent received by itself is not considered a Federal award expended under this part. However, free rent received as part of an award to carry out a Federal program shall be included in determining Federal awards expended and subject to audit under this part.

(g) *Valuing non-cash assistance.* Federal non-cash assistance, such as free rent, food stamps, food commodities, donated property, or

donated surplus property, shall be valued at fair market value at the time of receipt or the assessed value provided by the Federal agency.

(h) *Medicare*. Medicare payments to a non-Federal entity for providing patient care services to Medicare eligible individuals are not considered Federal awards expended under this part.

(i) *Medicaid*. Medicaid payments to a subrecipient for providing patient care services to Medicaid eligible individuals are not considered Federal awards expended under this part unless a State requires the funds to be treated as Federal awards expended because reimbursement is on a cost-reimbursement basis.

§ .210 Subrecipient and vendor determinations.

(a) *General*. An auditee may be a recipient, a subrecipient, and a vendor. Federal awards expended as a recipient or a subrecipient would be subject to audit under this part. The payments received for goods or services provided as a vendor would not be considered Federal awards. The guidance in paragraphs (b) and (c) of this section should be considered in determining whether payments constitute a Federal award or a payment for goods and services.

(b) *Federal award*. Characteristics indicative of a Federal award received by a subrecipient are when the organization:

- (1) Determines who is eligible to receive what Federal financial assistance;
- (2) Has its performance measured against whether the objectives of the Federal program are met;
- (3) Has responsibility for programmatic decision making;
- (4) Has responsibility for adherence to applicable Federal program compliance requirements; and
- (5) Uses the Federal funds to carry out a program of the organization as compared to providing goods or services for a program of the pass-through entity.

(c) *Payment for goods and services*. Characteristics indicative of a payment for goods and services received by a vendor are when the organization:

- (1) Provides the goods and services within normal business operations;
- (2) Provides similar goods or services to many different purchasers;
- (3) Operates in a competitive environment;
- (4) Provides goods or services that are ancillary to the operation of the Federal program; and
- (5) Is not subject to compliance requirements of the Federal program.

(d) *Use of judgment in making determination*. There may be unusual

circumstances or exceptions to the listed characteristics. In making the determination of whether a subrecipient or vendor relationship exists, the substance of the relationship is more important than the form of the agreement. It is not expected that all of the characteristics will be present and judgment should be used in determining whether an entity is a subrecipient or vendor.

(e) *For-profit subrecipient*. Since this part does not apply to for-profit subrecipients, the pass-through entity is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients. The contract with the for-profit subrecipient should describe applicable compliance requirements and the for-profit subrecipient's compliance responsibility. Methods to ensure compliance for Federal awards made to for-profit subrecipients may include pre-award audits, monitoring during the contract, and post-award audits.

(f) *Compliance responsibility for vendors*. In most cases, the auditee's compliance responsibility for vendors is only to ensure that the procurement, receipt, and payment for goods and services comply with laws, regulations, and the provisions of contracts or grant agreements. Program compliance requirements normally do not pass through to vendors. However, the auditee is responsible for ensuring compliance for vendor transactions which are structured such that the vendor is responsible for program compliance or the vendor's records must be reviewed to determine program compliance. Also, when these vendor transactions relate to a major program, the scope of the audit shall include determining whether these transactions are in compliance with laws, regulations, and the provisions of contracts or grant agreements.

§ .215 Relation to other audit requirements.

(a) *Audit under this part in lieu of other audits*. An audit made in accordance with this part shall be in lieu of any financial audit required under individual Federal awards. To the extent this audit meets a Federal agency's needs, it shall rely upon and use such audits. The provisions of this part neither limit the authority of Federal agencies, including their Inspectors General, or GAO to conduct or arrange for additional audits (e.g., financial audits, performance audits, evaluations, inspections, or reviews) nor authorize any auditee to constrain Federal agencies from carrying out additional audits. Any additional audits

shall be planned and performed in such a way as to build upon work performed by other auditors.

(b) *Federal agency to pay for additional audits*. A Federal agency that conducts or contracts for additional audits shall, consistent with other applicable laws and regulations, arrange for funding the full cost of such additional audits.

(c) *Request for a program to be audited as a major program*. A Federal agency may request an auditee to have a particular Federal program audited as a major program in lieu of the Federal agency conducting or arranging for the additional audits. To allow for planning, such requests should be made at least 180 days prior to the end of the fiscal year to be audited. The auditee, after consultation with its auditor, should promptly respond to such request by informing the Federal agency whether the program would otherwise be audited as a major program using the risk-based audit approach described in § .520 and, if not, the estimated incremental cost. The Federal agency shall then promptly confirm to the auditee whether it wants the program audited as a major program. If the program is to be audited as a major program based upon this Federal agency request, and the Federal agency agrees to pay the full incremental costs, then the auditee shall have the program audited as a major program. A pass-through entity may use the provisions of this paragraph for a subrecipient.

§ .220 Frequency of audits.

Except for the provisions for biennial audits provided in paragraphs (a) and (b) of this section, audits required by this part shall be performed annually. Any biennial audit shall cover both years within the biennial period.

(a) A State or local government that is required by constitution or statute, in effect on January 1, 1987, to undergo its audits less frequently than annually, is permitted to undergo its audits pursuant to this part biennially. This requirement must still be in effect for the biennial period under audit.

(b) Any non-profit organization that had biennial audits for all biennial periods ending between July 1, 1992, and January 1, 1995, is permitted to undergo its audits pursuant to this part biennially.

§ .225 Sanctions.

No audit costs may be charged to Federal awards when audits required by this part have not been made or have been made but not in accordance with this part. In cases of continued inability or unwillingness to have an audit

conducted in accordance with this part, Federal agencies and pass-through entities shall take appropriate action using sanctions such as:

(a) Withholding a percentage of Federal awards until the audit is completed satisfactorily;

(b) Withholding or disallowing overhead costs;

(c) Suspending Federal awards until the audit is conducted; or

(d) Terminating the Federal award.

§ .230 Audit costs.

(a) *Allowable costs.* Unless prohibited by law, the cost of audits made in accordance with the provisions of this part are allowable charges to Federal awards. The charges may be considered a direct cost or an allocated indirect cost, as determined in accordance with the provisions of applicable OMB cost principles circulars, the Federal Acquisition Regulation (FAR) (48 CFR parts 30 and 31), or other applicable cost principles or regulations.

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

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

(2) The cost of auditing a non-Federal entity which has Federal awards expended of less than \$300,000 per year and is thereby exempted under § .200(d) from having an audit conducted under this part. However, this does not prohibit a pass-through entity from charging Federal awards for the cost of limited scope audits to monitor its subrecipients in accordance with § .400(d)(3), provided the subrecipient does not have a single audit.

§ .235 Program-specific audits.

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

(b) *Program-specific audit guide not available.* (1) When a program-specific audit guide is not available, the auditee and auditor shall have basically the same responsibilities for the Federal

program as they would have for an audit of a major program in a single audit.

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

(3) The auditor shall:

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

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

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

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

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

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

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

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

and material effect on the Federal program; and

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

(c) *Report submission for program-specific audits.* The audit shall be completed and the reporting required by paragraph (c)(2) or (c)(3) of this section submitted within nine months after the end of the audit period, unless a longer period is agreed to in advance by the Federal agency that provided the funding or a different period is specified in a program-specific audit guide.

(However, for fiscal years beginning on or before June 30, 1998, auditees shall have 13 months after the end of the audit period to complete the audit and submit the reporting package unless a different period is specified in a program-specific audit guide.) This required reporting shall be submitted within 30 days after the issuance of the auditor's report(s) to the auditee. Unless restricted by law or regulation, the auditee shall make report copies available for public inspection.

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

(3) When a program-specific audit guide is not available, the reporting package for a program-specific audit shall consist of the data collection form prepared in accordance with § .320(b), as applicable to a program-specific audit, the financial statement(s) of the Federal program, a summary schedule of prior audit findings, and a corrective action plan as described in paragraph (b)(2) of this section, and the auditor's report(s) described in paragraph (b)(4) of this section. One copy of this reporting package shall be submitted to the Federal clearinghouse designated by OMB to be retained as an archival copy and one copy of the data collection form prepared in accordance with § .320(b) shall be submitted to each pass-through entity. Also, when the schedule of findings and questioned

costs disclosed audit findings or the summary schedule of prior audit findings reported the status of any audit findings, the auditee shall submit one copy of the reporting package to the Federal clearinghouse on behalf of the Federal awarding agency, or directly to the pass-through entity in the case of a subrecipient.

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

Subpart C—Auditees

§ .300 Auditee responsibilities.

The auditee shall:

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

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

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

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

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

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

§ .305 Auditor selection.

(a) *Auditor procurement.* In arranging for audit services, auditees shall follow the procurement standards prescribed by the Grants Management Common Rule (GMCR) published March 11, 1988 and amended April 19, 1995 [Each agency should insert appropriate CFR citation.] Circular A-110, "Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations," or the FAR (48 CFR part 42), as applicable. (Circular available from Office of Administration, Publications Office, Room 2200, New Executive Office Building, Washington, DC 20503; telephone (202) 395-7332.) Whenever possible, auditees shall make positive efforts to utilize small businesses, minority-owned firms, and women's business enterprises, in procuring audit services as stated in GMCR, OMB Circular A-110, or the FAR (48 CFR part 42), as applicable. In requesting proposals for audit services, the objectives and scope of the audit should be made clear. Factors to be considered in evaluating each proposal for audit services include the responsiveness to the request for proposal, relevant experience, availability of staff with professional qualifications and technical abilities, the results of external quality control reviews, and price.

(b) *Restriction on auditor preparing indirect cost proposals.* An auditor who prepares the indirect cost proposal or cost allocation plan may not also be selected to perform the audit required by this part when the indirect costs recovered by the auditee during the prior year exceeded \$1 million. This restriction applies to the base year used in the preparation of the indirect cost proposal or cost allocation plan and any subsequent years in which the resulting indirect cost agreement or cost allocation plan is used to recover costs. To minimize any disruption in existing contracts for audit services, this paragraph applies to audits of fiscal years beginning after June 30, 1998.

(c) *Use of Federal auditors.* Federal auditors may perform all or part of the work required under this part if they comply fully with the requirements of this part.

§ .310 Financial statements.

(a) *Financial statements.* The auditee shall prepare financial statements that reflect its financial position, results of operations, and, where appropriate, cash flows for the fiscal year audited. The financial statements shall be for the same organizational unit and fiscal year

that is chosen to meet the requirements of this part.

(b) *Schedule of expenditures of Federal awards.* The auditee shall also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements. While not required, it is appropriate for the auditee to provide information requested to make the schedule easier to use by Federal awarding agencies and pass-through entities. For example, when a Federal program has multiple award years, the auditee may list the amount of each award year separately. At a minimum, the schedule shall:

(1) List individual Federal programs by Federal agency and major subdivision within a Federal agency. For Federal awards received as a subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity shall be included.

(2) Provide total Federal awards expended for each individual Federal program and the CFDA number or other identifying number when the CFDA information is not available.

(3) Identify major programs.

(4) Include notes that describe the significant accounting policies used in preparing the schedule and identify in the notes the dollar threshold used to distinguish between Type A and Type B programs, as described in § .520(b).

(5) To the extent practical, pass-through entities should identify in the schedule the total amount provided to subrecipients from each Type A program and from each Type B program which is audited as a major program.

(6) List individual Federal awards within a cluster of programs. However, when it is not practical to list each individual Federal award for R&D, total Federal awards expended shall be shown by Federal agency and major subdivision within the Federal agency. For example, the National Institutes of Health is a major subdivision in the Department of Health and Human Services.

(7) Include, in either the schedule or a note to the schedule, the value of the Federal awards expended in the form of non-cash assistance, insurance in effect during the year, and loans or loan guarantees outstanding at year end.

§ .315 Audit findings follow-up.

(a) *General.* The auditee is responsible for follow-up and corrective action on all audit findings. As part of this responsibility, the auditee shall prepare a summary schedule of prior audit findings. The auditee shall also prepare a corrective action plan for current year audit findings. The summary schedule

of prior audit findings and the corrective action plan shall include the reference numbers the auditor assigns to audit findings under § 510(c). Since the summary schedule may include audit findings from multiple years, it shall include the fiscal year in which the finding initially occurred.

(b) *Summary schedule of prior audit findings.* The summary schedule of prior audit findings shall report the status of all audit findings included in the prior audit's schedule of findings and questioned costs relative to Federal awards. The summary schedule shall also include audit findings reported in the prior audit's summary schedule of prior audit findings except audit findings listed as corrected in accordance with paragraph (b)(1) of this section, or no longer valid or not warranting further action in accordance with paragraph (b)(4) of this section.

(1) When audit findings were fully corrected, the summary schedule need only list the audit findings and state that corrective action was taken.

(2) When audit findings were not corrected or were only partially corrected, the summary schedule shall describe the planned corrective action as well as any partial corrective action taken.

(3) When corrective action taken is significantly different from corrective action previously reported in a corrective action plan or in the Federal agency's or pass-through entity's management decision, the summary schedule shall provide an explanation.

(4) When the auditee believes the audit findings are no longer valid or do not warrant further action, the reasons for this position shall be described in the summary schedule. A valid reason for considering an audit finding as not warranting further action is that all of the following have occurred:

(i) Two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse;

(ii) The Federal agency or pass-through entity is not currently following up with the auditee on the audit finding; and

(iii) A management decision was not issued.

(c) *Corrective action plan.* At the completion of the audit, the auditee shall prepare a corrective action plan to address each audit finding included in the current year auditor's reports. The corrective action plan shall provide the name(s) of the contact person(s) responsible for corrective action, the corrective action planned, and the anticipated completion date. If the auditee does not agree with the audit

findings or believes corrective action is not required, then the corrective action plan shall include an explanation and specific reasons.

§ 320 Report submission.

(a) *General.* The audit shall be completed and the reporting package described in paragraph (c) of this section submitted within nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit. (However, for fiscal years beginning on or before June 30, 1998, auditees shall have 13 months after the end of the audit period to complete the audit and submit the reporting package.) The reporting package shall be submitted within 30 days after issuance of the auditor's report(s) to the auditee. Unless restricted by law or regulation, the auditee shall make copies available for public inspection.

(b) *Data Collection.* The auditee shall complete a data collection form which states whether the audit was completed in accordance with this part and provides information about the auditee, its Federal programs, and the results of the audit. The form shall be approved by OMB, available from the Federal clearinghouse designated by OMB, include data elements similar to those presented in this paragraph, and use a machine-readable format. The auditee's chief executive officer or chief financial officer shall sign a statement that the information on the form is accurate and complete as follows:

Certificate of Audit

This is to certify that, to the best of my knowledge and belief, the [specify name of the auditee] has: (1) Engaged an auditor to perform an audit in accordance with the provisions of OMB Circular A-133 for the [specify number] months ended [specify date]; (2) the auditor has completed such audit and presented a signed audit report which states that the audit was conducted in accordance with the provisions of the Circular; and, (3) the information on the attached form is accurate and complete and reflects the results of this audit, as presented in the auditor's report. I declare that the foregoing is true and correct.

Attachment to Certificate

Data Collection Form

1. The type of report the auditor issued on the financial statements of the auditee (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).

2. A yes or no statement as to whether the auditor's report on the financial statements indicated that the auditor has substantial doubt about the auditee's ability to continue as a going concern.

3. The type of report the auditor issued on compliance for major programs (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).

4. A list of the Federal awarding agencies and pass-through entities which will receive a copy of the reporting package pursuant to § 320(d)(2) and § 320(e)(2), respectively, of OMB Circular A-133. An explanation should be provided if this list is different from the communication the auditor provides to the auditee under § 500(f) of OMB Circular A-133.

5. A yes or no statement as to whether the auditee qualified as a low-risk auditee under § 530 of OMB Circular A-133.

6. The dollar threshold used to distinguish between Type A and Type B programs as defined in § 520(b) of OMB Circular A-133.

7. The Catalog of Federal Domestic Assistance (CFDA) number for each Federal program, as applicable.

8. The name of each Federal program and identification of each major program. Individual awards within a cluster of programs should be listed in the same level of detail as they are listed in the schedule of expenditures of Federal awards.

9. The amount of expenditures in the schedule of expenditures of Federal awards associated with each Federal program.

10. A yes or no statement as to whether there are audit findings and the amount of any questioned costs related to the following for each Federal program:

a. Types of services allowed or unallowed b. Eligibility c. Matching, level of effort, or earmarking d. Federal financial reporting e. Program income f. Procurement g. Subrecipient monitoring h. Allowable costs/cost principles i. Other

11. Auditee Name: _____

Employer Identification Number: _____

Name and Title of Responsible Official: _____

Telephone Number: _____

Signature: _____

Date: _____

12. Auditor Name: _____

Name and Title of Contact Person: _____

Auditor Address: _____

Auditor Telephone Number: _____

13. Whether the auditee has a cognizant or oversight agency for audit.

14. The name of the cognizant or oversight agency for audit determined in accordance with § _____ .400(a) and § _____ .400(b), respectively.

(c) *Reporting Package.* The reporting package shall include the:

- (1) Data collection form discussed in paragraph (b) of this section;
- (2) Financial statements and schedule of expenditures of Federal awards discussed in § _____ .310(a) and § _____ .310(b), respectively;
- (3) Summary schedule of prior audit findings discussed in § _____ .315(b);
- (4) Auditor's report(s) discussed in § _____ .505; and
- (5) Corrective action plan discussed in § _____ .315(c).

(d) *Submission to clearinghouse.* All auditees shall submit to the Federal clearinghouse designated by OMB one copy of the reporting package described in paragraph (c) of this section for:

- (1) The Federal clearinghouse to retain as an archival copy; and
- (2) Each Federal awarding agency when the schedule of findings and questioned costs disclosed audit findings relating to Federal awards that the Federal awarding agency provided directly or the summary schedule of prior audit findings reported the status of any audit findings relating to Federal awards that the Federal awarding agency provided directly.

(e) *Additional submission by subrecipients.* In addition to the requirements discussed in paragraph (d) of this section, subrecipients shall submit to each pass-through entity one copy of the:

- (1) Data collection form discussed in paragraph (b) of this section; and
- (2) Reporting package described in paragraph (c) of this section for each pass-through entity when the schedule of findings and questioned costs disclosed audit findings relating to Federal awards that the pass-through entity provided or the summary schedule of prior audit findings reported the status of any audit findings relating to Federal awards that the pass-through entity provided.

(f) *Requests for report copies.* In response to requests by a Federal agency or pass-through entity, auditees shall submit the appropriate copies of the reporting package described in paragraph (c) of this section and, if requested, a copy of any management letters issued by the auditor.

(g) *Report retention requirements.* Auditees shall keep one copy of the reporting package described in

paragraph (c) of this section on file for three years from the date of submission to the Federal clearinghouse designated by OMB. Pass-through entities shall keep subrecipients' submissions on file for three years from date of receipt.

(h) *Clearinghouse responsibilities.* The Federal clearinghouse designated by OMB shall distribute the reporting packages received in accordance with paragraph (d)(2) of this section and § _____ .235(c)(3) to applicable Federal awarding agencies, maintain a data base of completed audits, provide appropriate information to Federal agencies, and follow up with known auditees which have not submitted the required data collection forms and reporting packages.

(i) *Clearinghouse address.* The address of the Federal clearinghouse currently designated by OMB is Federal Audit Clearinghouse, Bureau of the Census, 1201 E. 10th Street, Jeffersonville, IN 47132.

(j) *Electronic filing.* Nothing in this part shall preclude electronic submissions to the Federal clearinghouse in such manner as may be approved by OMB. With OMB approval, the Federal clearinghouse may pilot test methods of electronic submissions.

Subpart D—Federal Agencies and Pass-Through Entities

§ _____ .400 Responsibilities.

(a) *Cognizant agency for audit responsibilities.* Recipients expending more than \$25 million a year in Federal awards shall have a cognizant agency for audit. The designated cognizant agency for audit shall be the Federal awarding agency that provides the predominant amount of direct funding to a recipient unless OMB makes a specific cognizant agency for audit assignment and provides notice in the Federal Register. To provide for continuity of cognizance, the determination of the predominant amount of direct funding shall be based upon direct Federal awards expended in the recipient's fiscal years ending in 1995, 2000, 2005, and every fifth year thereafter. For example, audit cognizance for periods ending in 1996 through 2000 will be determined based on Federal awards expended in 1995. A Federal awarding agency with cognizance for an auditee may reassign cognizance to another Federal awarding agency which provides substantial direct funding and agrees to be the cognizant agency for audit. Within 30 days after any reassignment, both the old and the new cognizant agency for audit shall notify the auditee, and, if

known, the auditor of the reassignment. The cognizant agency for audit shall:

(1) Provide technical advice and liaison to auditees and auditors.

(2) Consider auditee requests for extensions to the report submission due date required by § _____ .320(a). The cognizant agency for audit may grant extensions for good cause.

(3) Obtain or conduct quality control reviews of selected audits made by non-Federal auditors, and provide the results, when appropriate, to other interested organizations.

(4) Promptly inform other affected Federal agencies and appropriate Federal law enforcement officials of any direct reporting by the auditee or its auditor of irregularities or illegal acts, as required by GAGAS or laws and regulations.

(5) Advise the auditor and, where appropriate, the auditee of any deficiencies found in the audits when the deficiencies require corrective action by the auditor. When advised of deficiencies, the auditee shall work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency for audit shall notify the auditor, the auditee, and applicable Federal awarding agencies and pass-through entities of the facts and make recommendations for follow-up action. Major inadequacies or repetitive substandard performance by auditors shall be referred to appropriate State licensing agencies and professional bodies for disciplinary action.

(6) Coordinate, to the extent practical, audits or reviews made by or for Federal agencies that are in addition to the audits made pursuant to this part, so that the additional audits or reviews build upon audits performed in accordance with this part.

(7) Coordinate a management decision for audit findings that affect the Federal programs of more than one agency.

(8) Coordinate the audit work and reporting responsibilities among auditors to achieve the most cost-effective audit.

(b) *Oversight agency for audit responsibilities.* An auditee which does not have a designated cognizant agency for audit will be under the general oversight of the Federal agency determined in accordance with the definition of oversight agency for audit in § _____ .105. The oversight agency for audit:

(1) Shall provide technical advice to auditees and auditors as requested.

(2) May assume all or some of the responsibilities normally performed by a cognizant agency for audit.

(c) *Federal awarding agency responsibilities.* The Federal awarding

agency shall perform the following for the Federal awards it makes:

(1) Identify Federal awards made by informing each recipient of the CFDA title and number, award name and number, award year, and if the award is for R&D. When some of this information is not available, the Federal agency shall provide information necessary to clearly describe the Federal award.

(2) Ensure that audits are completed and reports are received in a timely manner and in accordance with the requirements of this part.

(3) Provide technical advice and counsel to auditees and auditors as requested.

(4) Issue a management decision on audit findings within six months after receipt of the audit report and ensure that the recipient takes appropriate and timely corrective action.

(5) Assign a person responsible to inform OMB annually of any updates needed to the compliance supplements.

(d) *Pass-through entity responsibilities.* A pass-through entity shall perform the following for the Federal awards it makes:

(1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.

(2) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.

(3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

(4) Ensure that subrecipients expending \$300,000 or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.

(5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.

(6) Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.

(7) Require each subrecipient to permit the pass-through entity and auditors to have access to the records

and financial statements as necessary for the pass-through entity to comply with this part.

§ .405 Management decision.

(a) *General.* The management decision shall clearly state whether or not the audit finding is sustained, the reasons for the decision, and the expected auditee action to repay disallowed costs, make financial adjustments, or take other action. If the auditee has not completed corrective action, a timetable for follow-up should be given. Prior to issuing the management decision, the Federal agency or pass-through entity may request additional information or documentation from the auditee, including a request that the documentation be audited, as a way of mitigating disallowed costs. The management decision should describe any appeal process available to the auditee.

(b) *Federal agency.* As provided in § .400(a)(7), the cognizant agency for audit shall be responsible for coordinating a management decision for audit findings that affect the programs of more than one Federal agency. As provided in § .400(c)(4), a Federal awarding agency is responsible for issuing a management decision for findings that relate to Federal awards it makes to recipients. Alternate arrangements may be made on a case-by-case basis by agreement among the Federal agencies concerned.

(c) *Pass-through entity.* As provided in § .400(d)(5), the pass-through entity shall be responsible for making the management decision for audit findings that relate to Federal awards it makes to subrecipients.

(d) *Time requirements.* The entity responsible for making the management decision shall do so within six months of receipt of the audit report. Corrective action should be initiated within six months and proceed as rapidly as possible.

(e) *Reference numbers.* Management decisions shall include the reference numbers the auditor assigned to each audit finding in accordance with § .510(c).

Subpart E—Auditors

§ .500 Scope of audit.

(a) *General.* The audit shall be conducted in accordance with GAGAS. The audit shall cover the entire operations of the auditee; or, at the option of the auditee, such audit shall include a series of audits that cover departments, agencies, and other organizational units which expended or otherwise administered Federal awards

during such fiscal year, provided that each such audit shall encompass the financial statements and schedule of expenditures of Federal awards for each such department, agency, and organizational unit, which shall be considered to be a non-Federal entity. The financial statements and schedule of expenditures of Federal awards shall be for the same fiscal year.

(b) *Financial statements.* The auditor shall determine whether the financial statements of the auditee are presented fairly in all material respects in conformity with generally accepted accounting principles. The auditor shall also determine whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the auditee's financial statements taken as a whole.

(c) *Internal control.* (1) In addition to the requirements of GAGAS, the auditor shall perform procedures to obtain an understanding of internal control over Federal programs sufficient to plan the audit to support a low assessed level of control risk for major programs and the allowability of costs charged to cost pools used to support an indirect cost rate or allocated through a State/local-wide central service cost allocation plan (as fully described in Appendix C of Circular A-87, "Cost Principles for State, Local and Indian Tribal Governments," issued May 4, 1995, and hereinafter referred to as a "cost allocation plan"). (Circular available from Office of Administration, Publications Office, Room 2200, New Executive Office Building, Washington, DC 20503; telephone (202) 395-7332.)

(2) Except as provided in paragraph (c)(3) of this section, the auditor shall:

(i) Plan the testing of internal control over major programs and the allowability of costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program; and

(ii) Perform testing of internal control as planned in paragraph (c)(2)(i) of this section.

(3) When internal control over some or all of the compliance requirements for a major program and the allowability of costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan are likely to be ineffective in preventing or detecting noncompliance, the planning and performing of testing described in paragraph (c)(2) of this section are not required for those compliance requirements. However, the auditor

shall report a reportable condition or a material weakness in accordance with § .510, assess the related control risk at the maximum, and consider whether additional compliance tests are required because of ineffective internal control.

(d) *Compliance.* (1) In addition to the requirements of GAGAS, the auditor shall determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs and the allowability of costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan.

(2) The principal compliance requirements common to most Federal programs and the programmatic compliance requirements of the largest Federal programs are included in the compliance supplements.

(3) For the compliance requirements (common and programmatic) related to Federal programs contained in the compliance supplements, an audit of these compliance requirements will meet the requirements of this part. Where there have been changes to the compliance requirements and the changes are not reflected in the compliance supplements, the auditor shall determine the current compliance requirements and modify the audit procedures accordingly. For those Federal programs not covered in the compliance supplements, the auditor should use the types of compliance requirements (e.g., cash management, Federal financial reporting, allowable costs/cost principles, types of services allowed or unallowed, eligibility, and matching) contained in the compliance supplements as guidance for identifying the types of compliance requirements to test, and determine the requirements governing the Federal program by reviewing the provisions of contracts and grant agreements and the laws and regulations referred to in such contracts and grant agreements. The auditor should consult with the applicable Federal agency to determine the availability of agency-prepared supplements or audit guides.

(4) The compliance testing shall include tests of transactions, including costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan, and such other auditing procedures necessary to provide the auditor sufficient evidence to support an opinion on compliance.

(e) *Audit follow-up.* The auditor shall follow up on prior audit findings, perform procedures to assess the reasonableness of the summary

schedule of prior audit findings prepared by the auditee in accordance with § .315(b), and report, as a current year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding. The auditor shall perform audit follow-up procedures regardless of whether a prior audit finding relates to a major program or the allowability of costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan in the current year.

(f) *Communication.* The auditor shall communicate, preferably in writing, to the auditee which Federal awarding agencies and pass-through entities are required to receive a copy of the reporting package pursuant to § .320(d)(2) and § .320(e)(2), respectively. The auditor shall retain a record of this communication in the auditor's working papers.

§ .505 Audit reporting.

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

(a) An opinion (or disclaimer of opinion) as to whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles and an opinion (or disclaimer of opinion) as to whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the financial statements taken as a whole.

(b) A report on internal control related to the financial statements, major programs, and the allowability of costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan. This report shall describe the scope of testing of internal control and the results of the tests, and, where applicable, refer to the separate schedule of findings and questioned costs described in paragraph (d) of this section.

(c) A report on compliance with laws, regulations, and the provisions of contracts or grant agreements, noncompliance with which could have a material effect on the financial statements. This report shall also include an opinion (or disclaimer of opinion) as to whether the auditee complied with laws, regulations, and the provisions of contracts or grant

agreements which could have a direct and material effect on each major program and on the allowability of costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan, and, where applicable, refer to the separate schedule of findings and questioned costs described in paragraph (d) of this section.

(d) A schedule of findings and questioned costs which shall include the following three components:

(1) A summary of the auditor's results which shall include:

(i) The type of report the auditor issued on the financial statements of the auditee (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion);

(ii) Where applicable, a statement that reportable conditions in internal control were disclosed by the audit of the financial statements and whether any such conditions were material weaknesses;

(iii) A statement as to whether the audit disclosed any noncompliance which is material to the financial statements of the auditee;

(iv) Where applicable, a statement that reportable conditions in internal control over major programs and the allowability of costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan were disclosed by the audit and whether any such conditions were material weaknesses;

(v) The type of report the auditor issued on compliance for major programs and with the provisions of applicable OMB cost principles circulars, the FAR (48 CFR parts 30 and 31), or other applicable cost principles or regulations pertaining to the allowability of costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion); and

(vi) A statement as to whether the audit disclosed any audit findings which the auditor is required to report under § .510(a).

(2) Findings and questioned costs for the financial statements which are required to be reported in accordance with GAGAS.

(3) Findings and questioned costs for Federal awards which shall include audit findings as defined in § .510(a).

(i) Audit findings (e.g., internal control findings, compliance findings, questioned costs, or fraud) which relate to the same issue should be presented as a single audit finding. Where

practical, audit findings should be organized by Federal agency or pass-through entity.

(ii) Audit findings which relate to both the financial statements and Federal awards, as reported under paragraphs (d)(2) and (d)(3) of this section, respectively, should be reported in both schedules. However, the reporting in one schedule may be in summary form with a reference to a detailed reporting in the other schedule.

§ .510 Audit findings.

(a) *Audit findings reported.* The auditor shall report the following as audit findings in a schedule of findings and questioned costs:

(1) Reportable conditions in internal control over major programs and over the allowability of costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan. The auditor's determination of whether a deficiency in internal control is a reportable condition for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program, total costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan, or an audit objective identified in the compliance supplements. The auditor shall identify reportable conditions which are individually or cumulatively material weaknesses.

(2) Material noncompliance with the provisions of laws, regulations, contracts, or grant agreements related to a major program and the provisions of applicable OMB cost principles circulars, the FAR, or other applicable cost principles or regulations pertaining to the allowability of costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan. The auditor's determination of whether a noncompliance with the provisions of laws, regulations, contracts, or grant agreements is material for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program, total costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan, or an audit objective identified in the compliance supplements.

(3) Known questioned costs which are greater than \$10,000 for a type of compliance requirement for a major program and costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan. Known questioned costs are those specifically identified by the auditor. In

evaluating the effect of questioned costs on the opinion on compliance, the auditor considers the best estimate of total costs questioned (likely questioned costs), not just the questioned costs specifically identified (known questioned costs). The auditor shall also report known questioned costs when likely questioned costs are greater than \$10,000 for a type of compliance requirement for a major program and costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan. In reporting questioned costs, the auditor shall include information to provide proper perspective for judging the prevalence and consequences of the questioned costs.

(4) Known questioned costs which are greater than \$10,000 for a Federal program which is not audited as a major program. Except for audit follow-up, the auditor is not required under this part to perform audit procedures for such a Federal program; therefore, the auditor will normally not find questioned costs for a program which is not audited as a major program. However, if the auditor does become aware of questioned costs for a Federal program which is not audited as a major program (e.g., as part of audit follow-up or other audit procedures) and the known questioned costs are greater than \$10,000, then the auditor shall report this as an audit finding.

(5) The circumstances concerning why the auditor's report on compliance for major programs and the allowability of costs charged to cost pools used to support an indirect cost rate or allocated through a cost allocation plan is other than an unqualified opinion, unless such circumstances are otherwise reported as audit findings in the schedule of findings and questioned costs for Federal awards.

(6) Known fraud affecting a Federal award, unless such fraud is otherwise reported as an audit finding in the schedule of findings and questioned costs for Federal awards. This paragraph does not require the auditor to make an additional reporting when the auditor confirms that the fraud was reported outside of the auditor's reports under the direct reporting requirements of GAGAS.

(7) Instances where the results of audit follow-up procedures disclosed that the summary schedule of prior audit findings prepared by the auditee in accordance with § .315(b) materially misrepresents the status of any prior audit finding.

(b) *Audit finding detail.* Audit findings shall be presented in sufficient detail for the auditee to prepare a

corrective action plan and take corrective action and for Federal agencies and pass-through entities to arrive at a management decision. The following specific information shall be included, as applicable, in audit findings:

(1) Federal program and specific Federal award identification including the CFDA title and number, Federal award number and year, name of Federal agency, and name of the applicable pass-through entity. When information, such as the CFDA title and number or Federal award number, is not available, the auditor shall provide the best information available to describe the Federal award.

(2) The criteria or specific requirement upon which the audit finding is based, including statutory, regulatory, or other citation.

(3) The condition found, including facts that support the deficiency identified in the audit finding.

(4) Identification of questioned costs and how they were computed.

(5) Information to provide proper perspective for judging the prevalence and consequences of the audit findings, such as whether the audit findings represent an isolated instance or a systemic problem. Where appropriate, instances identified shall be related to the universe and the number of cases examined and be quantified in terms of dollar value.

(6) The possible asserted effect to provide sufficient information to the auditee and Federal agency, or pass-through entity in the case of a subrecipient, to permit them to determine the cause and effect to facilitate prompt and proper corrective action.

(7) Recommendations to prevent future occurrences of the deficiency identified in the audit finding.

(8) Views of responsible officials of the auditee when there is disagreement with the audit findings, to the extent practical.

(c) *Reference numbers.* Each audit finding in the schedule of findings and questioned costs shall include a reference number to allow for easy referencing of the audit findings during follow-up.

§ .515 Audit working papers.

(a) *Retention of working papers.* The auditor shall retain working papers and reports for a minimum of three years after the date of issuance of the auditor's report(s) to the auditee, unless the auditor is notified in writing by the cognizant agency for audit, oversight agency for audit, or pass-through entity to extend the retention period. When

the auditor is aware that the Federal awarding agency, pass-through entity, or auditee is contesting an audit finding, the auditor shall contact the parties contesting the audit finding for guidance prior to destruction of the working papers and reports.

(b) *Access to working papers.* Audit working papers shall be made available upon request to the cognizant or oversight agency for audit or its designee, a Federal agency providing direct or indirect funding, or GAO at the completion of the audit. Access to working papers includes the right of Federal agencies to obtain copies of working papers, as is reasonable and necessary.

§ .520 Major program determination.

(a) *General.* The auditor shall use a risk-based approach to determine which Federal programs are major programs. This risk-based approach shall include consideration of: Current and prior audit experience, oversight by Federal agencies and pass-through entities, and the inherent risk of the Federal program. The process in paragraphs (b) through (i) of this section shall be followed.

(b) *Step 1.* The auditor shall identify the larger Federal programs, which shall be labeled Type A programs. Type A programs are defined as Federal programs with Federal awards expended during the audit period exceeding the larger of:

(i) \$300,000 or three percent (.03) of total Federal awards expended in the case of an auditee for which total Federal awards expended equal or exceed \$300,000 but are less than or equal to \$100 million.

(ii) \$3 million or three-tenths of one percent (.003) of total Federal awards expended in the case of an auditee for which total Federal awards expended exceed \$100 million but are less than or equal to \$10 billion.

(iii) \$30 million or 15 hundredths of one percent (.0015) of total Federal awards expended in the case of an auditee for which total Federal awards expended exceed \$10 billion.

(2) Federal programs not labeled Type A under paragraph (b)(1) of this section shall be labeled Type B programs.

(3) The inclusion of large loan and loan guarantees (loans) should not result in the exclusion of other programs as Type A programs. When a Federal program providing loans significantly affects the number or size of Type A programs, the auditor shall consider this Federal program as a Type A program and exclude its values in determining other Type A programs.

(4) For biennial audits permitted under § .220, the determination of

Type A and Type B programs shall be based upon the Federal awards expended during the two-year period.

(c) *Step 2.* The auditor shall identify Type A programs which are low-risk. For a Type A program to be considered low-risk, it shall have been audited as a major program in at least one of the two most recent audit periods (in the most recent audit period in the case of a biennial audit), and, in the most recent audit period, it shall have had no audit findings under § .510(a).

However, the auditor may use judgment and consider that audit findings from questioned costs under § .510(a)(3) and § .510(a)(4), fraud under § .510(a)(6), and audit follow-up for the summary schedule of prior audit findings under § .510(a)(7) do not preclude the Type A program from being low-risk. The auditor shall consider: the criteria in § .525(c), § .525(d)(1), § .525(d)(2), and § .525(d)(3); the results of audit follow-up; whether any changes in personnel or systems affecting a Type A program have significantly increased risk; and apply professional judgment in determining whether a Type A program is low-risk.

(2) Notwithstanding paragraph (c)(1) of this section, OMB may approve a Federal awarding agency's request that a Type A program at certain recipients may not be considered low-risk. For example, it may be necessary for a large Type A program to be audited as major each year at particular recipients to allow the Federal agency to comply with the Government Management Reform Act of 1994 (31 U.S.C. 3515). The Federal agency shall notify the recipient and, if known, the auditor at least 120 days prior to the end of the fiscal year to be audited of OMB's approval.

(d) *Step 3.* The auditor shall identify Type B programs which are high-risk using professional judgment and the criteria in § .525. However, should the auditor select Option 2 under Step 4 (paragraph (e)(2)(i)(B) of this section), the auditor is not required to identify more high-risk Type B programs than the number of low-risk Type A programs. Except for known reportable conditions in internal control or compliance problems as discussed in § .525(b)(1), § .525(b)(2), and § .525(c)(1), a single criteria in § .525 would seldom cause a Type B program to be considered high-risk.

(2) An audit under this part is not expected to test relatively small Federal programs. Therefore, except to meet the percentage of coverage rule discussed in

paragraph (f) of this section, the auditor is only required to perform risk assessments on Type B programs that exceed the larger of:

(i) \$100,000 or three-tenths of one percent (.003) of total Federal awards expended when the auditee has less than or equal to \$100 million in total Federal awards expended.

(ii) \$300,000 or three-hundredths of one percent (.0003) of total Federal awards expended when the auditee has more than \$100 million in total Federal awards expended.

(e) *Step 4.* At a minimum, the auditor shall audit all of the following as major programs:

(1) All Type A programs, except the auditor may exclude any Type A programs identified as low-risk under Step 2 (paragraph (c)(1) of this section).

(2) (i) High-risk Type B programs as identified under either of the following two options:

(A) *Option 1.* At least one half of the Type B programs identified as high-risk under Step 3 (paragraph (d) of this section), except this paragraph (e)(2)(i)(A) does not require the auditor to audit more high-risk Type B programs than the number of low-risk Type A programs identified as low-risk under Step 2.

(B) *Option 2.* One high-risk Type B program for each Type A program identified as low-risk under Step 2.

(ii) When identifying which high-risk Type B programs to audit as major under either Option 1 or 2 in paragraph (a)(2)(i)(A) or (B) of this section, the auditor is encouraged to use an approach which provides an opportunity for different high-risk Type B programs to be audited as major over a period of time.

(3) Such additional programs as may be necessary to comply with the percentage of coverage rule discussed in paragraph (f) of this section. This paragraph (e)(3) may require the auditor to audit more programs as major than the number of Type A programs.

(f) *Percentage of coverage rule.* The auditor shall audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 50 percent of total Federal awards expended. If the auditee meets the criteria in § .530 for a low-risk auditee, the auditor need only audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 25 percent of total Federal awards expended.

(g) *Documentation of risk.* The auditor shall document in the working papers the risk analysis process used in determining major programs.

(h) *Auditor's judgment.* When the major program determination was performed and documented in accordance with this part, the auditor's judgment in applying the risk-based approach to determine major programs shall be presumed correct. Challenges by Federal agencies and pass-through entities shall only be for clearly improper use of the guidance in this part. However, Federal agencies and pass-through entities may provide auditors guidance about the risk of a particular Federal program and the auditor shall consider this guidance in determining major programs in audits not yet completed.

(i) *Deviation from use of risk criteria.* For first-year audits, the auditor may elect to determine major programs as all Type A programs plus any Type B programs as necessary to meet the percentage of coverage rule discussed in paragraph (f) of this section. Under this option, the auditor would not be required to perform the procedures discussed in paragraphs (c), (d), and (e) of this section.

(1) A first-year audit is the first year the entity is audited under this part or the first year of a change of auditors.

(2) To ensure that a frequent change of auditors would not preclude audit of high-risk Type B programs, this election for first-year audits may not be used by an auditee more than once in every three years.

§ .525 Criteria for Federal program risk.

(a) *General.* The auditor's determination should be based on an overall evaluation of the risk of noncompliance occurring which could be material to the Federal program. The auditor shall use auditor judgment and consider criteria, such as described in paragraphs (b), (c), and (d) of this section, to identify risk in Federal programs. Also, as part of the risk analysis, the auditor may wish to discuss a particular Federal program with auditee management and the Federal agency or pass-through entity.

(b) *Current and prior audit experience.* (1) Weaknesses in internal control over Federal programs would indicate higher risk. Consideration should be given to the control environment over Federal programs and such factors as the expectation of management's adherence to applicable laws and regulations and the provisions of contracts and grant agreements and the competence and experience of personnel who administer the Federal programs.

(i) A Federal program administered under multiple internal control structures may have higher risk. When assessing risk in a large single audit, the auditor shall consider whether weaknesses are isolated in a single operating unit (e.g., one college campus) or pervasive throughout the entity.

(ii) When significant parts of a Federal program are passed through to subrecipients, a weak system for monitoring subrecipients would indicate higher risk.

(iii) The extent to which computer processing is used to administer Federal programs, as well as the complexity of that processing, should be considered by the auditor in assessing risk. New and recently modified computer systems may also indicate risk.

(2) Prior audit findings would indicate higher risk, particularly when the situations identified in the audit findings could have a significant impact on a Federal program or have not been corrected.

(3) Federal programs not recently audited as major programs may be of higher risk than Federal programs recently audited as major programs without audit findings.

(c) *Oversight exercised by Federal agencies and pass-through entities.* (1) Oversight exercised by Federal agencies or pass-through entities could indicate risk. For example, recent monitoring or other reviews performed by an oversight entity which disclosed no significant problems would indicate lower risk. However, monitoring which disclosed significant problems would indicate higher risk.

(2) Federal agencies, with the concurrence of OMB, may identify Federal programs which are higher risk. OMB plans to provide this identification in the compliance supplements.

(d) *Inherent risk of the Federal program.* (1) The nature of a Federal program may indicate risk. Consideration should be given to the complexity of the program and the extent to which the Federal program contracts for goods and services. For example, Federal programs that disburse funds through third party contracts or have eligibility criteria may be of higher risk. Federal programs primarily involving staff payroll costs may have a high-risk for time and effort reporting, but otherwise be at low-risk.

(2) The phase of a Federal program in its life cycle at the Federal agency may indicate risk. For example, a new Federal program with new or interim regulations may have higher risk than

an established program with time-tested regulations. Also, significant changes in Federal programs, laws, regulations, or the provisions of contracts or grant agreements may increase risk.

(3) The phase of a Federal program in its life cycle at the auditee may indicate risk. For example, during the first and last years that an auditee participates in a Federal program, the risk may be higher due to start-up or closeout of program activities and staff.

(4) Type B programs with larger Federal awards expended would be of higher risk than programs with substantially smaller Federal awards expended.

§ .530 Criteria for a low-risk auditee.

An auditee which meets all of the following conditions for each of the preceding two years shall qualify as a low-risk auditee and be eligible for reduced audit coverage in accordance with § .520(f):

(a) Single audits were performed on an annual basis in accordance with the provisions of this part. A non-Federal entity that has biennial audits does not qualify as a low-risk auditee.

(b) The auditor's opinions on the financial statements and the schedule of expenditures of Federal awards were unqualified. However, the cognizant or oversight agency for audit may judge that an opinion qualification does not affect the management of Federal awards and provide a waiver.

(c) There were no deficiencies in internal control which were identified as material weaknesses under the requirements of GAGAS. However, the cognizant or oversight agency for audit may judge that any identified material weaknesses do not affect the management of Federal awards and provide a waiver.

(d) None of the Federal programs had audit findings from any of the following in either of the preceding two years in which they were classified as Type A programs:

(1) Internal control deficiencies which were identified as material weaknesses;

(2) Noncompliance with the provisions of laws, regulations, contracts, or grant agreements which have a material effect on the Type A program; or

(3) Known or likely questioned costs that exceed five percent of the total Federal awards expended for a Type A program during the year.