



**Department of
Development**

Office of Housing and Community Partnerships

Attachment 15

OMB Circular A-133

November 2008

Prepared By:

Ohio Department of Development

Community Development Division

Office of Housing and Community Partnerships

Ted Strickland, Governor of Ohio

Lee Fisher, Lt. Governor of Ohio

Director, Ohio Department of Development

Since the beginning of the strike, OCNCS has been operated by Senior Reactor Operator licensed personnel. As a result, both types of licensed personnel are unavailable for the requalification written examinations and operating tests until the strike is over.

Environmental Impacts of the Proposed Action

The NRC completed its evaluation of the proposed action and concludes that there are no significant environmental impacts associated with the extension of the completion date for the operator requalification program from June 30, 2003, to 90 days following resolution of the strike, but no later than December 31, 2003.

The proposed action will not significantly increase the probability or consequences of accidents, it will make no changes to the types of effluents that may be released off site, and there is no significant increase in occupational or public radiation exposure. Therefore, there are no significant radiological environmental impacts associated with the proposed action.

With regard to potential nonradiological impacts, the proposed action does not have a potential to affect any historic sites. It does not affect nonradiological plant effluents and has no other environmental impact. Therefore, there are no significant nonradiological environmental impacts associated with the proposed action.

Accordingly, the NRC concludes that there are no significant environmental impacts associated with the proposed action.

Environmental Impacts of the Alternatives to the Proposed Action

As an alternative to the proposed action, the NRC staff considered denial of the proposed action (*i.e.*, the "no-action" alternative). Denial of the application would result in no change in current environmental impacts. Thus, the environmental impacts of the proposed action and the alternative action are similar.

Alternative Use of Resources

The action does not involve the use of any different resources than those previously considered in the Final Environmental Statement for OCNCS, dated December 1974.

Agencies and Persons Consulted

On June 9, 2003, the NRC staff consulted with the State official, Mr. Rich Pinney of the New Jersey Department of Environment and Natural Resources, regarding the environmental

impact of the proposed action. The State official had no comments.

Finding of No Significant Impact

On the basis of the environmental assessment, the Commission concludes that the proposed action will not have a significant effect on the quality of the human environment. Accordingly, the Commission has determined not to prepare an environmental impact statement for the proposed action.

For further details with respect to the proposed action, see the licensee's letter dated May 30, 2003. Documents may be examined, and/or copied for a fee, at the NRC's Public Document Room (PDR), located at One White Flint North, Public File Area at O-1 F21, 11555 Rockville Pike (first floor), Rockville, Maryland. Publicly available records are accessible electronically from the Agencywide Documents Access and Management System (ADAMS) Public Electronic Reading Room on the Internet at the NRC Web site, <http://www.nrc.gov/reading-rm/adams.html>. Persons who do not have access to ADAMS or who encounter problems in accessing the documents located in ADAMS, should contact the NRC PDR Reference staff by telephone at 1-800-397-4209 or 301-415-4737, or by e-mail to pdr@nrc.gov.

Dated at Rockville, Maryland, this 24th day of June, 2003.

For the Nuclear Regulatory Commission.

Peter S. Tam,

Senior Project Manager, Section 1, Project Directorate 1, Division of Licensing Project Management, Office of Nuclear Reactor Regulation.

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OFFICE OF MANAGEMENT AND BUDGET

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

AGENCY: Office of Management and Budget.

ACTION: Revision of OMB Circular No. A-133.

SUMMARY: The Office of Management and Budget (OMB) is issuing final revisions to Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." The purpose of these revisions is to (1) increase the threshold for audit from \$300,000 to \$500,000, (2) increase the threshold for cognizant agency for audit from \$25 million to \$50 million, and (3) make related technical changes to facilitate the determination of cognizant agency for audit and provide for Federal agency

reassignment of oversight agency for audit.

DATES: The final revisions are effective for fiscal years ending after December 31, 2003, and early implementation will not be permitted with the exception of the amendment to the definition of oversight agency for audit in Circular A-133, section 1.105. The amendment to the definition of oversight agency for audit is effective July 28, 2003.

FOR FURTHER INFORMATION CONTACT:

Recipients should contact their cognizant agency for audit or oversight agency for audit or Federal awarding agency, as may be appropriate in the circumstances. Subrecipients should contact their pass-through entity. Federal agencies should contact Terrill W. Ramsey, Office of Federal Financial Management, Office of Management and Budget, 202-395-3993.

SUPPLEMENTARY INFORMATION: On August 12, 2002, OMB proposed revisions (67 FR 52545) to OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." The Office of Management and Budget (OMB) is issuing final revisions to Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." The revisions will (1) increase the threshold for audit from \$300,000 to \$500,000, (2) increase the threshold for cognizant agency for audit from \$25 million to \$50 million, and (3) make related technical changes to facilitate the determination of cognizant agency for audit and provide for Federal agency reassignment of oversight agency for audit.

The Single Audit Act Amendments of 1996, 31 U.S.C. 7502(a)(3), provide for the Director of OMB to review the single audit threshold on a biennial basis and increase it as appropriate. The audit threshold established in 1997 required all non-Federal entities (States, local governments, and non-profit organizations) that expend \$300,000 or more in a year in Federal awards to have an audit conducted in accordance with Circular A-133. The revision increases the audit threshold from \$300,000 to \$500,000. This increase relieves almost 6,000 entities from the audit requirements of Circular A-133 while only exempting from audit less than one half of one percent of Federal awards expended (in dollars) by entities currently conducting Circular A-133 audits.

The revision increases the threshold for cognizant agency for audit from \$25 million to \$50 million. This change will reduce the number of non-Federal entities with a cognizant agency for audit assignment from approximately

1,000 to 500. This revision will allow Federal agencies to provide more focused attention where there is the greatest risk in terms of Federal awards expended, but still provide each non-Federal entity with an assigned oversight agency for audit from which to request technical advice. The revision also changes the base years for determining cognizant agency for audit assignments. (Currently, the cognizant agency for audit determination is based on the amount of Federal funding in the year immediately preceding each five-year audit cognizant period. This revision changes the base year to the second year preceding the five-year audit cognizant period to allow sufficient time to make cognizant agency for audit determinations before the start of the audit cognizance period.) Finally, the revision changes the definition of oversight agency for audit to permit Federal agencies to make reassessments.

Response to Comments

OMB received 43 comment letters: Eight from Federal agencies, seven from State governments, four from universities, five from non-profit organizations, 14 from certified public accountants, and five from individuals. Nearly all comments focused on raising the audit threshold: 28 were in favor and 10 opposed. Of the 10 that were opposed to raising the audit threshold, two were from Federal agencies; two were from one State; one from a university; and five from individuals. Opposition centered on concerns over specific programs and the perceived lack of accountability over Federal funds that would fall below the new threshold. On the other hand, several commenters suggested raising the threshold to \$1 million to further alleviate the burden on non-Federal entities expending smaller amounts of Federal funds. OMB believes that, because the revisions only exempt an additional one-half of one percent of Federal dollars expended from audit while providing administrative relief to approximately 6,000 entities, the risk to Federal funds does not outweigh the benefits to grant recipients. OMB, however, appreciates the comments about reduced accountability and concerns expressed by several commenters that raising the audit threshold could provide more opportunities for fraud.

It is important to note that Circular A-133 audit is only one of many monitoring tools available to oversee the administration of and strengthen accountability over Federal grants. Grantee monitoring should occur

throughout the year rather than relying solely on a once-a-year audit. Monitoring activities may take various forms; however, a first monitoring tool should be identifying to the grantee the Federal award information (e.g., Catalog of Federal Domestic Assistance (CFDA) title and number, award name, name of Federal agency) and applicable compliance requirements. Other monitoring tools include reviewing grantee financial and performance reports, performing site visits to review financial and programmatic records and observe operations, and arranging for agreed-upon procedures engagements for certain aspects of grantee activities, such as described in § 230(b)(2) of Circular A-133. Factors such as the size of awards, the complexity of the compliance requirements, and risk of grantee non-compliance as assessed by the grantor may influence the nature and extent of monitoring procedures. Federal laws or regulations may impose monitoring requirements specific to a Federal program. The 2003 OMB Circular A-133 Compliance Supplement clarifies the guidance to auditors related to subrecipient monitoring.

It should also be noted that the Federal Government has the authority to audit and/or investigate any entity suspected of using Federal funds improperly, regardless of the amount of funds involved. Allegations of fraud should be directed to the Federal awarding agency's Office of Inspector General fraud hotline phone numbers which are available on the Internet at <http://www.ignet.gov>.

Nine comments addressed the increase from \$25 million to \$50 million of the threshold for cognizant agency for audit. Seven commenters (two Federal and five non-Federal) supported the increase and two Federal agencies opposed. One concern was that the reduction in the number of cognizant agency for audit assignments would reduce Federal agency monitoring of audit quality. OMB is actively working with Federal agencies to strengthen quality control reviews of audits by selecting a statistical sample of single audits to measure audit quality across Federal programs. This work is expected to improve our ability to measure and improve audit quality.

Four comments concerned the technical changes. One Federal agency (which opposed all of the proposed revisions to Circular A-133) expressed concern about accountability over Federal funds. As noted above, OMB believes that the revisions to Circular A-133 provide an appropriate balance between administrative relief and the risk to Federal funds.

Availability of Revised Circular

OMB has prepared an updated version of Circular A-133, as amended herein. It is available electronically on the OMB Home Page at <http://www.omb.gov> and then select "Grants Management" followed by "Circulars."

Dated: June 23, 2003.

Augustine T. Smythe,
Acting Director.

1. OMB hereby amends Circular A-133 by replacing \$300,000 with \$500,000 in the following sections: § 200(a); § 200(b); § 200(d); § 230(b)(2); and § 400(d)(4).

2. OMB hereby amends Circular A-133 by replacing \$25 million with \$50 million in section § 400(a), first sentence.

3. OMB hereby amends Circular A-133 by replacing section § 400(a), third, fourth, and fifth (parenthetical) sentences with the following: § 400 Responsibilities.

(a) * * * 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 2004, 2009, 2014, and every fifth year thereafter. For example, audit cognizance for periods ending in 2006 through 2010 will be determined based on Federal awards expended in 2004. (However, for 2001 through 2005, the cognizant agency for audit is determined based on the predominant amount of direct Federal awards expended in the recipient's fiscal year ending in 2000).

* * * * *

4. OMB hereby amends Circular A-133, section § 105, by adding at the end of the definition of oversight agency for audit: "A Federal agency with oversight for an auditee may reassign oversight to another Federal agency which provides substantial funding and agrees to be the oversight agency for audit. Within 30 days after any reassignment, both the old and the new oversight agency for audit shall notify the auditee, and, if known, the auditor of the reassignment."

[FR Doc. 03-16355 Filed 6-26-03; 8:45 am]
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OFFICE OF MANAGEMENT AND BUDGET

Use of a Universal Identifier by Grant Applicants

AGENCY: Office of Management and Budget.

ACTION: Notice of final policy issuance.



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

AGENCY: Office of Management and Budget

ACTION: Final Revision of OMB Circular No. A-133, Final Rescission of OMB Circular No. A-128, and Notice of Document Availability of the Provisional Circular A-133 Compliance Supplement.

SUMMARY: This revision of Office of Management and Budget (OMB) Circular No. A-133, re-titled "Audits of States, Local Governments, and Non-Profit Organizations," establishes uniform audit requirements for non-Federal entities that administer Federal awards and implements the Single Audit Act Amendments of 1996, which were signed into law on July 5, 1996 (Public Law 104-156). OMB Circular No. A-128, "Audits of States and Local Governments," issued in 1985, is rescinded, as a result of the consolidation of audit requirements under Circular A-133.

One of the more significant revisions is that the threshold for when an entity is required to have an audit is raised from \$25,000 to \$300,000. This will significantly reduce audit costs for many small entities. Other significant changes are: a report submission due date which is shortened from 13 to nine months and a report submission process that includes a data collection form and streamlined filing requirements (§ ___.320); a new risk-based approach for major program determination (§ ___.520); and, additional guidance for program-specific audits (§ ___.235), audit findings (§ ___.510), and audit findings follow-up (§ ___.315).

This Notice also offers interested parties an opportunity to comment on the provisional "Circular A-133 Compliance Supplement," provided as Appendix B to Circular A-133. However, due to its length, the provisional "Circular A-133 Compliance Supplement" is not included in this Notice. See "ADDRESSES" for information about how to obtain a copy.

DATES: The revised Circular is effective [30 days after publication]. Federal agencies shall adopt the standards set forth in this revised Circular in codified regulations not later than [insert 60 days after publication of this revised Circular in the **Federal Register**].

The standards set forth in § ___.400, which apply directly to Federal agencies, shall apply to audits of fiscal years beginning after June 30, 1996, except as otherwise specified in § ___.400(a). The standards set forth in this Circular which Federal agencies shall apply to non-Federal entities shall apply to audits of fiscal years beginning after June 30, 1996, with the exception that § ___.305(b) applies to audits of fiscal years beginning after June 30, 1998. The requirements of Circular A-128, although the Circular is rescinded, and the 1990 version of Circular A-133 continue to apply for audits of fiscal years beginning on or before June 30, 1996.

All comments on the provisional "Circular A-133 Compliance Supplement" should be in writing, and must be received by November 30, 1997. Late comments will be considered to the extent practicable.

ADDRESSES: A copy of the Circular may be obtained from the OMB fax information line, 202-395-9068, document number 1133; OMB home page on the Internet which is currently located at /OMB, under the captions "OMB Documents," and then "Grants Management;" or by writing or calling the Office of Administration, Publications Office, room 2200, New Executive Office Building, Washington, DC 20503, telephone (202) 395-7332. A single copy of the provisional "Circular A-133 Compliance Supplement" may be obtained from EOP Publications, Office of Administration, 2200 NEOB, Washington, DC 20503 (telephone 202-395-7332). The provisional "Circular A-133 Compliance Supplement" is also available from the OMB home page.

Comments on the provisional "Circular A-133 Compliance Supplement" should be mailed to the 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 the applicable page numbers. When comments of five pages or less are sent in by facsimile (fax), they should be faxed to (202) 395-4915. Electronic mail comments may be submitted via the Internet to RAMSEY_T@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 would send a copy of comments on either a 3.5 or 5.25 inch diskette in either WordPerfect 5.1 or 6.0, 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.

FOR FURTHER INFORMATION CONTACT: Recipients should contact their cognizant or oversight agency for audit, or Federal awarding agency, as may be appropriate in the circumstances. Subrecipients should contact their pass-through entity. Federal agencies should contact Sheila O. Conley, Office of Management and Budget, Office of Federal Financial Management, Financial Standards and Reporting Branch, telephone (202) 395-3993.

SUPPLEMENTARY INFORMATION:

A. Background

The Office of Management and Budget (OMB) received approximately 80 letters providing approximately 600 individual comments in response to its **Federal Register** proposal of November 5, 1996 (61 FR 57232-57249). Letters came from Federal agencies (including Offices of Inspectors General), State governments (including State auditors), certified public accountants (CPAs), internal auditors, non-profit organizations (including colleges and universities), professional organizations, and others. All comments were considered in developing this final revision.

The November 5, 1996, **Federal Register** notice, requested public comment on the proposed revision and retitling of Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," and proposed rescission of Circular A-128, "Audits of States and Local Governments." Section B presents a summary of the major public comments grouped by subject and a response to each comment. Other technical amendments were made to conform to professional auditing standards and to increase clarity and readability.

The November 5, 1996, **Federal Register** notice also requested comment on two proposed information collection requirements contained in the proposed revision to Circular A-133. A summary of the comments received relating to the proposed information collection requirements and response to each comment is published in a companion Notice in this Part in today's *Federal Register*.

Interested parties may wish to refer to this Notice for a detailed discussion of the following information collection matters: estimates of reporting burden; necessity of the data collection form; data collection form duplicates other reported information; data elements in the data collection form; suggested additional data elements for inclusion in the form; who should sign the data collection form for the auditee; level of form's specificity provided in the Circular and supplemental forms; data collection form sent only to the Federal clearinghouse; applicability of Freedom of Information Act and other Federal laws; report copies; report submission and distribution; Federal clearinghouse responsibilities; requirement for the auditor to prepare and sign the data collection form; increased costs for auditors to prepare and sign form; retention of audit workpapers; schedule of expenditures of Federal awards; summary schedule of prior audit findings; summary of the auditor's results; auditor's schedule of findings and questioned costs; report due date; and effective date for the data collection form requirement.

Readers of this Notice should especially note the discussion of the requirement for the auditor to prepare and sign the data collection form due to its impact on the text of the Circular. Other matters addressed in the accompanying Notice also resulted in revisions to the text of the Circular but are not repeated in this Notice.

B. Public Comments and Responses

Overall Reaction to the Proposed Revision to Circular A-133

Comment: Most commenters overwhelmingly supported the proposed revisions and believe that the revisions will greatly increase the efficiency and effectiveness of the single audit process. Several State auditors commented that the proposed revision to Circular A-133 was similar to what they expected, particularly in light of the changes included in the Single Audit Act Amendments of 1996 (1996 Amendments), which were signed into law on July 5, 1996 (Public Law 104-156). Many commenters were pleased with some of the most significant changes, such as: (a) the increased threshold that triggers an audit requirement from \$25,000 to \$300,000; (b) the risk-based approach to determining major programs; (c) the uniformity of audit requirements for States, local governments, and non-profit organizations; and, (d) the removal of the current requirement to report virtually all audit findings and questioned costs. A few commenters requested that the audit threshold remain at \$25,000. Although most commenters supported these significant revisions, many commenters expressed concern about other proposals included in the proposed revision, on which OMB specifically requested public comment, such as the audit coverage for the allowability of charges to cost pools, and whether the auditor should prepare and sign the data collection form.

Response: The most significant provisions included in the proposed revision to Circular A-133 that commenters strongly supported are included in the final revision to Circular A-133. Several proposals, such as the audit threshold of \$300,000, are based in the 1996 Amendments and, therefore, are adopted in the final Circular. Each of the proposals on which OMB requested public comment are addressed in the following sections or accompanying Notice. Some of the comments resulted in changes to the final revision.

Consolidation of Circular A-128 into Circular A-133

Comment: All but one commenter strongly supported the proposal to consolidate Circular A-128 into Circular A-133, and rescind Circular A-128. Reasons cited include less confusion for auditees and auditors, uniformity of audit requirements for non-Federal entities that administer Federal awards, and consistency with concepts included in the 1996 Amendments. One Federal agency that oversees Indian tribal governments expressed concern about rescinding Circular A-128 because many Indian tribal governments have not yet submitted audit reports required by

Circular A-128 for audits of fiscal years beginning on or before June 30, 1996.

Response: Pursuant to the 1996 Amendments, which establish uniform audit requirements for non-Federal entities that administer Federal awards, the final revision to Circular A-133 extends its coverage to include State and local governments. In response to the Federal agency's concern about Indian tribal governments, it should be noted that States, including Indian tribal governments for purposes of the Circular, and local governments are subject to the requirements of Circular A-128, issued April 12, 1985, for audits of fiscal years beginning on or before June 30, 1996. Sanctions are provided in Circular A-128 and are available for use by Federal agencies, as considered necessary, in instances of continued inability or unwillingness to comply with the requirements of Circular A-128. The rescission of Circular A-128 applies to audits of State and local governments for fiscal years beginning after June 30, 1996.

Comment: In light of the proposed rescission of Circular A-128, several commenters requested that the title of Circular A-133 be expanded to also include Indian tribal governments.

Response: No change was made as a result of these comments. For single audit purposes, Indian tribal governments are included under the definition of "State" in Circular A-133 based on the statutory definition of "State" in the Single Audit Act of 1984 and the 1996 Amendments.

Effective Date

Comment: Several Federal agencies questioned which audit requirements are effective prior to codification of the revised Circular in a Federal agency's regulations. Paragraph ten of the proposed revision states that the standards set forth in the revised Circular shall be adopted by Federal agencies in codified regulations not later than six months after publication "in the **Federal Register**, so that they apply to audits of fiscal years beginning after June 30, 1996 ... 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." Several Federal agencies also requested clarification about how the requirements of Circular A-133 should be codified in Federal agency regulations.

Response: The sentence regarding the interim period was removed from the revised Circular. The 1996 Amendments (31 U.S.C. 7505(a)) require that "each Federal agency shall promulgate such amendments to its regulations as may be necessary to conform such regulations to the requirements of this chapter and of such guidance [provided by the Director of OMB to implement the 1996 Amendments]." Federal agencies shall adopt the provisions of the revised Circular not later than 60 days after publication of the revised Circular in the **Federal Register**. OMB is coordinating an effort to facilitate Federal agency compliance with this adoption requirement.

Limited Scope Audits for Subrecipients With Federal Awards Expended of Less Than \$300,000 Annually

Comment: Many commenters requested that further guidance be provided in the Circular to assist in determining what types of procedures would qualify as "limited scope audits to monitor subrecipients."

Response: The 1996 Amendments (31 U.S.C. 7505(b)(1)(A)(ii)) prohibit a non-Federal entity from charging to a Federal award the cost of a Circular A-133 audit when the amount of Federal awards expended is less than \$300,000 per year, except that OMB may allow the cost of limited scope audits to monitor subrecipients. A sentence was added to the final revision of Circular A-133 (§ 230(b)(2)) which defines limited scope audits to include only agreed-upon procedures engagements conducted in accordance with either the American Institute of Certified Public Accountants' (AICPA) generally accepted auditing standards (GAAS) or attestation standards, that are paid for and arranged by a pass-through entity and only address one or more of the following types of compliance requirements: activities allowed or unallowed; allowable costs/cost principles; eligibility; matching, level of effort, earmarking; and, reporting.

For subrecipients that expend less than \$300,000 in Federal awards annually, the cost of any audits or attestation engagements, other than limited scope audits described in the previous paragraph, are not allowable costs and, therefore, cannot be charged to any Federal award. This provision would prohibit the cost of a financial statement audit conducted in accordance with GAAS or generally accepted government auditing standards (GAGAS) issued by the Comptroller General of the United States from being charged (by either a pass-through entity or subrecipient) to Federal awards for a subrecipient that expends less than \$300,000 in Federal awards annually.

Subrecipient Monitoring

Comment: One State agency recommended that pass-through entities no longer be required to monitor subrecipients expending less than \$300,000 in Federal awards. Some pass-through entities expressed concern that they might be expected to perform audit procedures for each of their subrecipients not covered by Circular A-133. Some subrecipients stated concern that the requirement to monitor subrecipients expending under \$300,000 in Federal awards could result in a return to grant-by-grant auditing of such entities.

Response: The 1996 Amendments (31 U.S.C. 7502(f)(2)(B)) require pass-through entities to monitor a subrecipient's use of Federal awards through site visits, limited scope audits, or other means. In light of the increased threshold that triggers an audit requirement under the Circular to \$300,000 or more in Federal awards expended per year, pass-through entities will need to make appropriate changes in their agreements with

subrecipients to reflect that Circular A-133 audits will no longer be required for non-Federal entities with total Federal awards expended of less than \$300,000 annually.

Since pass-through entities are held accountable for Federal awards administered by their subrecipients, they will also 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, such as on-site visits, reviews of documentation supporting requests for reimbursement, and limited scope audits (e.g., agreed-upon procedures performed over eligibility determinations made by subrecipients), can be more targeted and less costly than a full Circular A-133 audit. OMB expects pass-through entities to consider various risk factors in developing subrecipient monitoring procedures, such as the relative size and complexity of the Federal awards administered by subrecipients, prior experience with each subrecipient, and the cost-effectiveness of various monitoring procedures.

For example, if a pass-through entity provides a large percentage of the only Federal award it expends to 10 subrecipients that each expend less than \$300,000 in Federal awards annually, then the pass-through entity should carefully consider the most cost-effective method of monitoring these Federal awards. Perhaps the majority of this Federal award is provided to two subrecipients. The pass-through entity might consider conducting site visits at these two subrecipients and simply reviewing the documentation supporting requests for reimbursement from the other eight subrecipients. Conversely, if a small percentage of a Federal award is provided to subrecipients that each expend less than \$300,000 in Federal awards, the risk to the pass-through entity is most likely low and, therefore, the monitoring procedures could be minimal.

OMB believes that this approach to designing subrecipient monitoring procedures should result in cost-effective monitoring and minimize the return to grant-by-grant auditing. This is a matter of particular importance to OMB and small recipients of Federal awards. Over the next few years, OMB and Federal agencies will review implementation of subrecipient monitoring procedures by pass-through entities to determine whether additional guidance or subsequent revisions to the Circular is warranted in this area.

Audit Coverage for the Allowability of Charges to Cost Pools

Comment: Several Federal auditors and Federal agencies supported the proposed treatment 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 (CAP). Most State auditors, State agencies, CPAs, and college and university commenters strongly opposed the proposal stating that the proposed revision appears to: (1) elevate coverage of indirect costs and CAPs to major program status, which would exceed the requirements of the 1996 Amendments; (2) require coverage regardless of materiality; (3) violate the risk-based approach to determining major programs; and, (4) single out indirect costs for extensive coverage beyond other elements of cost charged to Federal awards. Some commenters noted logistical difficulties that may result from the timing differences between when costs are charged to pools used to support an indirect cost rate or CAP; when the plans are submitted and negotiated; and when indirect costs are actually charged to Federal awards. Several college and university commenters opposed any additional requirements in this area because they believe that Federal cost negotiators perform some sort of audit of costs charged to cost pools under Circular A-21, "Cost Principles for Educational Institutions." Most commenters requested that additional guidance, either in the Circular or the compliance supplement, be provided to assist auditors in this area.

Response: The proposed revision included certain phrases that were intended 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 CAP (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)). The suggested language was included in the proposed revision to address the timing of **when** costs charged to cost pools used to support an indirect cost rate or allocated through a CAP should be audited. This area presents unique timing considerations due to the manner in which indirect cost rates and CAPs are developed. Indirect cost rates are usually based on costs incurred in a base period and applied prospectively. Costs allocated through a CAP are typically based on the actual costs incurred in the current year and also previous years.

OMB did not intend for costs charged to cost pools used to support an indirect cost rate or allocated through a CAP to be audited every year as a major program regardless of materiality. As a result of the comments received, the suggested language relating to the treatment of indirect costs and costs allocated through a CAP was removed from § 500.500, § 500.505, and § 500.510 of the final revision of Circular A-133.

Although specific mention of indirect costs and costs allocated through a CAP was removed from the Circular, this removal does not diminish the auditor's responsibility for such costs. Accordingly, when indirect costs or allocated costs have a direct and material effect on any major program, the auditor is responsible for determining the propriety of costs charged to cost pools that are used to calculate an indirect cost rate or allocated through a CAP in the year in which the charges affect a major program. Because it may not be practical to perform such tests retroactively (e.g., when there is a change in auditors), OMB encourages the auditor to perform tests of costs charged to cost pools during the period when the actual costs were incurred or during the period when the proposal or plan is finalized, rather than waiting until the period when the rate was applied or in which the costs were allocated. Further guidance relating to audit coverage of indirect costs is provided in the provisional "Circular A-133 Compliance Supplement."

To illustrate the unique timing considerations relating to indirect costs and the impact on the audit process, assume that the actual costs charged to cost pools for 1997 form the basis for the indirect cost proposal to be submitted in 1998, and the final negotiated indirect cost rate that will be applied in 1999. Also, assume that indirect costs charged

to a major program in 1999 are material. In this situation, the auditor is strongly encouraged to test actual costs charged to cost pools during 1997 as part of the 1997 audit, since 1997 is the base year, or as part of the 1998 audit, since 1998 is the year when the proposal will be finalized, submitted, and negotiated. If the auditor tests the actual costs charged to the cost pools as part of either the 1997 or 1998 audit (or can appropriately rely on the work performed by other auditors in these years), then the auditor's responsibility in 1999 will relate primarily to determining whether the appropriate rate was applied in 1999. However, if no prior audit work was done relating to the actual costs charged to cost pools used to support the rate used to charge a major program in 1999, then the auditor conducting the 1999 audit would be expected to test such costs, in addition to determining whether the appropriate rate was applied in 1999.

This area is of particular concern to OMB and Federal cost negotiators. Contrary to the views expressed by several commenters, Federal cost negotiators do not typically audit costs charged to cost pools used to support an indirect cost rate or allocated through a CAP. In the next few years, OMB and Federal agencies will monitor the coverage of indirect costs under Circular A-133 audits to determine whether additional guidance or subsequent revisions to the Circular are warranted. OMB may also consider if the coverage of indirect costs should be addressed separately from Circular A-133 audits in the future, possibly as separate engagements using the AICPA's attestation standards.

Audit Cognizance

Comment: One Federal auditor requested that OMB delay the effective date for the new method of determining the cognizant agency for audit for State and local governments because guidance relating to changing from one cognizant agency to another has not yet been provided. Another Federal auditor requested that the Circular name that agency as the cognizant agency for audit for every State based on the large amount of Federal funding provided by that Federal agency to States. Another Federal auditor opposed having one Federal agency responsible for audit cognizance for all States. Several State auditors and State agencies requested that they be permitted to retain their current cognizant agency for audit, and that they have input into future changes, if any, in audit cognizance.

Response: The primary reason for revising the approach to determining audit cognizance is to provide a straightforward method that can be used by the majority of auditees without the involvement of OMB. The previous policy whereby OMB was responsible for assigning audit cognizance did not work well, particularly for non-profit organizations. The proposed revision includes an approach whereby the auditee could readily determine its cognizant or oversight agency for audit based on which Federal agency provided the predominance of funding. However, several commenters noted that the proposal may have unintended consequences on some State and local governments that, under Circular A-128, were previously assigned cognizant agencies for audit by OMB in 1986 and have developed strong working relationships with their cognizant agencies.

In response to the comments received, the Circular was modified to reflect that current cognizant agency assignments shall continue in effect for States (including Indian tribal governments) and local governments that expend more than \$25 million a year in Federal awards until fiscal years beginning after June 30, 2000. Thereafter, the method prescribed in § ____ .400(a) shall be used by State and local governments for determining audit cognizance. This delay should provide sufficient time to smoothly transition from one Federal agency to another, or to request that OMB designate a specific cognizant agency for audit assignment, as circumstances warrant. However, for State and local governments that expend more than \$25 million a year in Federal awards but do not have a currently assigned cognizant agency for audit, § ____ .400(a) shall be used to determine audit cognizance upon the effective date of the Circular.

OMB expects to designate specific audit cognizance assignments for only a limited number of entities. However, if a change in audit cognizance is desired, then auditees are expected to first work through their Federal awarding agencies to obtain a reassignment. If the request cannot be adequately resolved among the Federal agencies, then the Federal agencies may contact OMB to resolve the matter. In response to several commenters, this process will permit auditees to be involved in future changes in audit cognizance.

The proposal indicates that, in instances in which OMB makes a specific cognizant agency for audit assignment, the assignment would be published in the **Federal Register**. OMB reconsidered the necessity of performing this procedure and removed this provision from the final Circular. However, when specific assignments are made by OMB, OMB will inform the parties involved (e.g., the auditee and the Federal agencies involved) of the assignment.

Comment: Several Federal agencies and numerous college and university commenters expressed strong concern that the cognizant agency determination included in Circular A-133 is not consistent with Circular A-21, "Cost Principles for Educational Institutions," and could result in an entity having one cognizant agency for audit purposes and another for indirect cost negotiation.

Response: No change was made as a result of these comments. Under Circular A-21, cost negotiation cognizance for the majority of colleges and universities is currently assigned to either the Department of Health and Human Services (HHS) or the Office of Naval Research (ONR) in the Department of Defense. OMB believes that it is unnecessary to require these two Federal agencies to also assume responsibility for audit cognizance for each of the colleges and universities for which they serve as cost negotiation cognizance. This additional responsibility for audit cognizance may impede HHS' or ONR's ability to fulfill their cost negotiation duties. Cost negotiation cognizance requires a high degree of specialized skills. However, any Federal agency is capable of performing audit cognizance duties. The responsibilities for audit cognizance (§ ____ .400(a)) and indirect cost negotiation are different and, therefore, the same Federal agency need not be cognizant for both. While OMB expects that the Federal agency responsible for audit cognizance and cost negotiation cognizance will be the same in many instances, when they are

different, the Federal agencies involved will be expected to coordinate their efforts to avoid duplication and disruption to the auditee.

Comment: Clarification was requested by many commenters on how to determine the predominant amount of direct funding for purposes of determining the cognizant agency for audit. One Federal auditor questioned whether loans and loan guarantees should be considered in the calculation. Several college and university commenters expressed concern that the term "direct funding" could be misinterpreted to mean the amount of "awards," rather than "expenditures."

Response: No change was made as a result of these comments. The Circular states that the predominant amount of direct funding shall be based upon direct "Federal awards expended" in the recipient's fiscal year. §____.205 of the final revision addresses the basis for determining the amount of Federal awards expended and specifically discusses the treatment of loans and loan guarantees. §____.205 shall also be followed for purposes of determining the cognizant agency for audit.

Required Level of Internal Control Testing

Comment: Four State auditors and one CPA commenter opposed the proposed requirement for the auditor to plan the testing of internal control over major programs to support a low assessed level of control risk. One commenter stated that the Circular assumes that control risk is always either low or high and that it "does not recognize that control risk may be anywhere on a continuum from low to high (with "high" indicating ineffective control). When an auditor gains an understanding of an entity's internal control and determines that the controls are not ineffective, but are also not sufficient to support a low assessed level of control risk, then no amount of planning or testing will support a low assessed level of control risk." Two commenters recommended that OMB allow the assessment of control risk at a moderate level, unless internal control is determined to be ineffective.

Response: No change was made as a result of these comments. Many Federal agencies are concerned that not enough testing of internal control over major programs is performed as part of single audits. The President's Council on Integrity and Efficiency's (PCIE) "Study on Improving the Single Audit Process," issued in September 1993, highlighted the disparity between Federal agencies' expectations relating to the extent of internal control testing and the actual testing of internal control performed by auditors. The study identified the lack of clear requirements as a cause for this deficiency. The study recommended that the Circular "Require the auditor to plan the internal control testing to perform sufficient tests to support an assessed level of control risk of low for each program tested as major." OMB believes that the Circular clearly describes the Federal Government's expectations relating to the coverage of internal control under single audits, in terminology that is consistent with professional auditing standards.

It has been a longstanding Federal policy that the recipient of Federal funds is required to establish a system of internal control to provide reasonable assurance that it is managing Federal funds in compliance with applicable laws and regulations. Also, the 1996 Amendments (31 U.S.C. 7502(e)(3)) require the auditor to test controls unless they are deemed to be ineffective. Therefore, it is reasonable to require the auditor to plan the audit consistent with the level of internal control which the recipient of Federal funds is required to maintain. Also, the Circular permits the auditor to not test internal controls which are inadequate and, instead, disclose a reportable condition (including whether any such condition is a material weakness) and perform additional tests of compliance as necessary in the auditor's judgment.

Compliance Supplement

Comment: Several State auditors and CPA commenters stated that, while significant progress was made to improve the single audit process, it is critically important for OMB to move swiftly to issue a revised compliance supplement, which is needed to conduct single audits. They emphasized the importance of finalizing and publishing this document as quickly as possible to facilitate audits of fiscal years beginning after June 30, 1996 (i.e., the first audits to be conducted using the revised Circular).

Response: OMB agrees that the compliance supplement is vital to successful implementation. In response to these comments, OMB is including a provisional compliance supplement as Appendix B to the final revision to Circular A-133. It is being issued at this time in provisional form so that it can be used as part of the first audits conducted in accordance with the revised Circular A-133. However, the provisional status also provides interested parties with the opportunity to comment on the document and permits OMB to include additional Federal programs in the document in the coming months.

The provisional "Circular A-133 Compliance Supplement" is effective for audits of fiscal years beginning after June 30, 1996, and supersedes the previously issued compliance supplements entitled "Compliance Supplement for Single Audits of State and Local Governments," issued in 1990, and "Compliance Supplement for Audits of Institutions of Higher Learning and Other Non-Profit Institutions," issued in 1991. The definition of the term "compliance supplement" in §____.105 of the final revision was revised to reflect the compliance supplement included as Appendix B to this revised Circular.

Comment: Several State auditors and one CPA requested removal of the requirement for the auditor to determine the current compliance requirements when changes were made to the compliance requirements and the changes are not yet reflected in the compliance supplement.

Response: No change was made as a result of these comments. However, minor modifications were made to § 500(d) to conform the language used in the Circular to the compliance supplement.

The requirement in § 500(d)(3) for auditors to consider whether changes were made in the compliance requirements included in the compliance supplement reflects current practice, which is based on two documents: (1) the PCIE's Position Statement No. 6, titled "Questions and Answers on Circular A-133," and (2) the AICPA's Audit and Accounting Guide, entitled, "Audits of State and Local Governmental Units," dated May 1, 1995.

The PCIE document includes a statement that "If there have been changes [to the compliance requirements included in the compliance supplement], then the auditor should follow the provisions of the compliance supplements as modified by the changes" (page 14). The AICPA's Accounting and Auditing Guide (paragraph 23.37) alerts auditors to the fact that compliance requirements may change over time and that this should be considered in planning tests of compliance. The provisional "Circular A-133 Compliance Supplement" provides guidance to auditors regarding the Federal Government's expectations for auditors to perform reasonable procedures (e.g., inquiry of auditee management, review of applicable contract and grant agreements) to determine currency of the compliance requirements included in the compliance supplement.

Transitional Guidance to Implementing the Risk-Based Approach to Determining Major Programs

Comment: OMB received several inquiries about whether a Type A program may be considered low-risk when it was audited as a major program in accordance with the prior Circular A-133, issued March 8, 1990, or Circular A-128, issued April 12, 1985, and otherwise met the requirements in § 520(c) to be considered as low-risk. Similar inquiries were received regarding whether single audits performed in accordance with the prior Circular A-133 or Circular A-128 would satisfy the requirements of § 530 for an auditee to qualify as a low-risk auditee.

Response: The reference in § 520(c)(1) to the two most recent audit periods includes audit periods in which the audit was performed under either Circular A-128 or the 1990 version of Circular A-133. Therefore, a Type A program which meets the criteria for low-risk under § 520(c)(1), based on the results of an audit performed under Circular A-128 or the 1990 version of Circular A-133, may be considered low-risk. Similarly, the requirement in § 530 that an auditee meet specified criteria for the preceding two years to be considered a low-risk auditee applies to audits performed under Circular A-128 or the 1990 version of Circular A-133.

Also, to provide a transition into the risk-based approach, the provision for deviation from use of risk criteria provided in § 520(i) applies to the first year this revision is applicable and permits auditors to defer implementation of the risk-based approach for one year.

Risk-Based Approach to Determining Major Programs

Comment: Several State auditors and one State agency requested clarification of the requirements for performing risk assessments of Type B programs under § 520(d) and § 520(e)(2). Many commenters questioned if the Circular requires the auditor to perform annual risk assessments of each Type B program (above an amount specified in the Circular) and expressed concern that such a requirement would significantly increase audit costs.

Response: Minor modifications were made to the Circular. Reference to the percentage of coverage rule was removed from § 520(d)(2) of the final revision because, as two commenters noted, program risk is not a consideration in selecting programs to meet the percentage of coverage rule described in § 520(f). Also, editorial changes were made to § 520(d)(2) to emphasize when risk assessments should be performed.

The final revision (§ 520(d)) requires the auditor to identify Type B programs that are high-risk and § 520(e)(2) provides two options for identifying high-risk Type B programs.

Under Option 1, the auditor would be expected to perform risk assessments of all Type B programs that exceed the amount specified in § 520(d)(2), and audit at least one half of these high-risk Type B programs as major, unless this number exceeds the number of low-risk Type A programs identified under § 520(c) (i.e., the "cap"). In this case, the auditor would be required to audit as major the same number of high-risk Type B programs as the cap. For example, a State has ten low-risk Type A programs, and 50 Type B programs above the amount specified in § 520(d)(2). Under Option 1, the auditor would be required to perform risk assessments of the 50 Type B programs. Assume that the auditor determines that there are 25 high-risk Type B programs. One half of the 25 high-risk Type B programs is 12.5, or 13, programs. Under Option 1, the auditor would audit 13 of the high-risk Type B programs as major; however, the cap in this example is ten (i.e., the number of low-risk Type A programs); therefore, the auditor is only required to audit as major 10 high-risk Type B programs.

Under Option 2, the auditor is only required to audit as major one high-risk Type B program for each Type A program identified as low-risk under § 520(c). Under this option, the auditor would not be required to perform risk assessments for any Type B programs when there are no low-risk Type A programs (i.e., the cap is zero). Continuing with the previous example, under Option 2, the auditor would perform risk assessments of Type B programs until ten high-risk Type B programs are identified. The auditor would be required to audit ten high-risk Type B programs as major in this example. Depending on the order in which risk assessments on Type B programs are performed, the auditor might only need to perform risk assessments of ten Type B programs determined to be high-risk, or the auditor may need to perform risk assessments until ten high-risk programs are identified.

The auditor may choose either Option 1 or 2. There is no requirement to justify the reasons for selecting either option. The results under Options 1 and 2 may vary significantly, depending on the number of low-risk Type A programs and high-risk Type B programs. 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.

Comment: OMB received several inquiries about whether large loan and loan guarantee programs (that affect the determination of other Type A programs under §____.520(b)(3)) audited as major programs may be used for purposes of meeting the percentage of coverage rule (§____.520(f)).

Response: The amount of Federal awards expended under such loan and loan guarantee programs that are audited as major may be used for purposes of meeting the percentage of coverage rule. In a related matter, programs audited as major under §____.215(c), in which a Federal agency or pass-through entity requests and pays for a program to be audited as major, may also be used for purposes of meeting the percentage of coverage rule (§____.520(f)).

Comment: Several commenters questioned the difference in the number of days of advance notice a Federal agency shall provide an auditee when a particular program: (1) cannot be considered a low-risk Type A program (at least 120 days prior to the auditee's fiscal year end under §____.520(c)(2)), and (2) must be audited as major (at least 180 days prior to the auditee's fiscal year end under §____.215(c)).

Response: For consistency, a change was made to §____.520(c)(2) of the final revision to require a Federal agency to inform an auditee at least 180 days prior to the auditee's fiscal year end when a Federal program cannot be considered a low-risk Type A program.

Biennial Audits

Comment: All State auditors that commented on the proposal relating to biennial audits strongly opposed the provision included in §____.530(a) of the proposed revision that prohibits non-Federal entities that have biennial audits from qualifying as low-risk auditees. Commenters stated that this prohibition was not included in the 1996 Amendments and that the frequency of the audit has no bearing on the administration of Federal awards. One commenter suggested that, at a minimum, the cognizant or oversight agency for audit be authorized to permit, on a case-by-case basis, non-Federal entities that conduct biennial audits to qualify as low-risk auditees.

Response: A change was made to §____.530(a) to permit non-Federal entities to qualify, on a case-by-case basis, as low-risk auditees with the approval of the cognizant or oversight agency for audit. A change was also made to §____.400(a) of the final revision to add this responsibility to the list of cognizant agency for audit responsibilities.

Comment: One commenter inquired about the effective date of the Circular for biennial periods.

Response: 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 previously applicable Circulars are in effect until this final revision is effective. Therefore, an auditee that conducts biennial audits and has a biennial period beginning on or before June 30, 1996, should apply the provisions of Circular A-128 (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 Circular apply to any biennial periods beginning after June 30, 1996.

Credit Union Loans

Comment: OMB received inquiries about whether loans provided by the National Credit Union Administration (NCUA) should be considered Federal awards subject to the requirements of Circular A-133.

Response: A new paragraph (§____.205(j)) was added to the Circular to address certain loans provided by the NCUA. Specifically, loans made from the National Credit Union Share Insurance Fund and the Central Liquidity Facility are funded by contributions from insured institutions and are not considered Federal awards expended under Circular A-133. However, the NCUA provides loans under other programs, such as the Community Development Revolving Loan Programs for Credit Unions, which are considered Federal awards for purposes of applying Circular A-133.

Auditor Communication Regarding Report Distribution

Comment: Several commenters stated that, if the auditor prepares the data collection form, then the communication required by §____.500(f) of the proposed revision, whereby the auditor is required to notify the auditee of which Federal agencies and pass-through entities are required to receive a copy of the reporting package, will no longer be necessary.

Response: The proposed revision of Circular A-133 included a requirement for the auditor to 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. This requirement was removed. This separate communication is unnecessary because the final Circular (§____.320(h)(3)) requires the auditor to prepare and sign the portion of the

data collection form that identifies which Federal agencies are required to receive a copy of the reporting package.

Basis of Accounting

Comment: One State auditor requested that § ____.310(a) and § ____.500(b) of the Circular be revised to include a statement, similar to a provision (paragraph 2.4(a)) included in GAGAS, that "Financial statement audits also include audits of financial statements prepared in conformity with any of several other bases of accounting discussed in the auditing standards issued by the AICPA." One Federal auditor requested that the Circular require the auditee to use the same basis of accounting in preparing the schedule of expenditures of Federal awards that is used to prepare the auditee's financial statements, and noted that this omission has resulted in significant unreconciled differences on the schedule of expenditures of Federal awards.

Response: No changes were made as a result of these comments. Circular A-133 does not prescribe the basis of accounting that must be used by auditees to prepare their financial statements and schedule of expenditures of Federal awards. However, auditees are required to disclose the basis of accounting and significant accounting policies used in preparing the financial statements and schedule of expenditures of Federal awards. The auditor is required to report (§ ____.500(b)) whether the financial statements are prepared in accordance with generally accepted accounting principles (GAAP), and 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. The auditee must be able to reconcile amounts presented in the financial statements to related amounts included in the schedule of expenditures of Federal awards.

Financial Statements

Comment: Several CPAs commented that § ____.310(a) of the Circular should be modified to recognize that financial statements should reflect the results of operations or changes in net assets. Financial statements prepared in accordance with GAAP for certain types of non-Federal entities reflect changes in net assets rather than results of operations. The commenters suggested that some auditees and auditors may interpret this section as imposing a requirement that is not consistent with GAAP.

Response: The Circular (§ ____.310(a)) was revised to state that financial statements should reflect either the results of operations or changes in net assets.

Comment: Several CPAs commented that the requirement included in § ____.310(a) of the Circular that the financial statements shall be for the same organizational unit that is chosen to meet the requirements of the Circular, considered in conjunction with § ____.500(a), could be problematic for certain auditees and may have unintended consequences. The commenters interpreted the Circular as requiring a direct match between the reporting entity included in the financial statements and the reporting entity covered by the Circular A-133 audit. The commenters questioned whether an auditee, that chooses to meet the Circular's requirements through a series of audits that cover separate departments, agencies, and other organizational units which expended Federal awards, would be required to issue non-GAAP financial statements that omitted the portions of the reporting entity which were separately audited. One commenter requested guidance in a situation where a local government has its school districts separately audited. If the local government's financial statements exclude the school districts (which is what the commenters believe the Circular requires), then the auditor may need to issue a qualified or adverse opinion on the local government's financial statements, which could raise unnecessary red flags and prohibit the auditee from qualifying as a low-risk auditee (§ ____.530). One State manager noted that considerably more public entities are included in that State's financial statement audit than in its state-wide single audit, and that, if the Circular requires such entities to be included in the state-wide single audit, this would result in additional audit costs and complicate the audit process.

Response: § ____.310(a) was revised to clarify OMB's expectations in this area. The revised Circular provides non-Federal entities an option to meet the audit requirements of the Circular through a series of audits that cover the non-Federal entity's departments, agencies, and other organizational units which expended or otherwise administered Federal awards during such fiscal year. If a non-Federal entity elects this option, then separate financial statements and a schedule of expenditures of Federal awards shall be prepared for each such department, agency, or other organizational unit. In these circumstances, a non-Federal entity's organization-wide financial statements may also include departments, agencies, or other organizational units that have separate audits and prepare separate financial statements.

In the example provided by the commenter, it would be acceptable for the local government's financial statements to include the school districts, even though the school districts were not included in the local government's Circular A-133 audit because a separate Circular A-133 audit is conducted of the school districts. However, if separate financial statements were not prepared for the school districts, it would be unacceptable for a separate Circular A-133 audit to be conducted of the school districts (i.e., the local government's organization-wide financial statements could not be used as a substitute for separate financial statements for the school districts).

Schedule of Expenditures of Federal Awards

Comment: One State auditor and one State manager commented that the Circular should not prescribe requirements for the schedule of expenditures of Federal awards beyond the current guidance.

Response: The "current guidance" for presenting the schedule of expenditures of Federal awards information was developed and promulgated by the AICPA, and was not specifically prescribed in Circulars A-128 and A-133 (1990 original issuance). OMB believes that the minimum requirements for the schedule should be specified in the Circular (§____.310(b)). Most respondents to the April 1996 revision of Circular A-133 supported the level of detail reflected in that revision. A few modifications of the requirements were made in this final revision of Circular A-133, in response to specific comments received, as described in the following sections.

Comment: Several CPAs and one State auditor commented that the Circular requires the auditor to be responsible for determining major programs and the threshold used to distinguish between Type A and Type B programs. However, these items are required to be presented in the schedule of expenditures of Federal awards prepared by the auditee and this requirement may blur the distinction between information that is the responsibility of the auditor versus the auditee.

Response: The proposed requirements for the schedule of expenditures of Federal awards to identify major programs and identify the threshold to distinguish between Type A and Type B programs (§____.310(b)(3) and (b)(4) of the proposed revision) were removed. However, the requirement to report this information was added to §____.505 (d) so that this information is now required to be included in the auditor's report(s). While not required, some auditees may find it useful to present this information in the schedule of expenditures of Federal awards.

Comment: Several CPAs recommended that the value of non-cash assistance, insurance in effect, and loans and loans guarantees outstanding be required to be included in the schedule of expenditures of Federal awards. They stated that the option to present this information in a note to the schedule should be eliminated and that the consistency achieved will improve the usefulness of the schedule and facilitate OMB's data collection efforts. One college and university commenter stated that the requirement to provide this information (either in a note or in the schedule) was excessive, and that the same information could be obtained from existing Federal data banks.

Response: A change was made to §____.310(b)(6) as a result of these comments. The Circular permits the option of presenting this information either in the schedule of expenditures of Federal awards or in a note to the schedule; however, an additional sentence was included indicating that it is preferable to present this information in the schedule. It is important to note that, regardless of whether this information is presented in a note or in the schedule, this information must be included in the data collection form. While the requirement to provide such information is not new, the Federal Government does not currently collect and account for this information in a systematic manner or data bank (i.e., some Federal agencies track this information and others do not). A minor addition was made to §____.310(b)(6) to clarify that the amount of insurance in effect during the year should be disclosed.

Report Due Date

Comment: Two Federal auditors commented that the requirement included in the 1996 Amendments to submit the reporting package to the Federal clearinghouse "within the earlier of: 30 days after receipt of the auditor's report(s), or ... " is not clearly specified in the proposed revision.

Response: §____.235(c) and §____.320(a) were modified to incorporate the report due date requirements specified in the 1996 Amendments.

Summary Schedule of Prior Audit Findings

Comment: Several State auditors requested guidance on the auditor's responsibility for deficiencies noted in prior audit findings for which a management decision was not issued and which the auditee believes is no longer valid. Specifically, the commenters asked whether the lack of a timely management decision is evidence that the Federal awarding agency or pass-through entity is not concerned about the finding and whether future audits may exclude coverage of the deficiency that resulted in an audit finding. One State auditor also commented that auditees should not be given the authority to determine when an audit finding is no longer valid or does not warrant further action.

Response: §____.315(b) permits an auditee to determine whether a prior audit finding is no longer valid or does not warrant further action. A valid reason for such a determination is that all of the following have occurred: (1) two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse, (2) the Federal agency or pass-through entity is not currently following up with the auditee on the audit finding, and (3) a management decision was not issued. OMB believes that it is appropriate for the auditee to make this determination. In addition, the auditor is required by §____.500(e) of the Circular to assess the fairness of management's representations in the schedule.

The lack of a management decision for a prior audit finding may provide a basis for the auditee to indicate in the summary schedule of prior audit findings that the finding is no longer valid or does not warrant further action (provided the two other conditions previously listed are met). However, the lack of a management decision does not change the scope of audit work or the auditor's reporting requirements. As an example, if the same deficiency that resulted in a prior audit finding (for which a management decision was not issued) is discovered by the auditor in the current period, the auditor would be required to determine whether the matter met the criteria provided in §____.510 (a) for reporting an audit finding in the auditor's schedule of findings and questioned costs.

For the first year a non-Federal entity is audited under this revised Circular, the prior year report may not have included the equivalent of a summary schedule of prior audit findings. In these cases, the auditee may exercise

judgment and only include, to the extent practical, audit findings from before the prior year. Also, the auditee is not expected to include prior findings that would not have been reported under the criteria provided in § 510(a).

Auditor's Schedule of Findings and Questioned Costs

Comment: Several State auditors and CPA commenters noted that GAGAS does not use the term "findings and questioned costs," and the concept of questioned costs is not discussed in GAGAS. Commenters requested that OMB clarify the requirement included in § 505(d)(2) of the proposed revision.

Response: A change was made to § 505(d)(2) to replace the term "findings and questioned costs" with "findings" so that the final revision requires the auditor's schedule of findings and questioned costs to include a section that reports any findings relating to the financial statements which are required to be reported in accordance with GAGAS.

Comment: One State auditor requested that § 505(a) of the proposed revision be revised to permit unqualified opinions on financial statements prepared in accordance with an other comprehensive basis of accounting.

Response: No change was made as a result of this comment. The 1996 Amendments (31 U.S.C. 7502(e)(1)) require the auditor to "... determine whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles." However, it should be noted that neither the 1996 Amendments nor Circular A-133 prescribe the basis of accounting that must be used by auditees to prepare their financial statements and schedule of expenditures of Federal awards (i.e., non-GAAP statements are acceptable).

Comment: Two CPAs indicated that the reference to § 505(d)(2) and (3) that was included in § 505(d)(3)(ii) of the proposed revision is confusing because it refers to certain schedules that are supposed to be included as part of the schedule of findings and questioned costs.

Response: A change was made to § 505(d)(3)(ii) to reflect that the schedule of findings and questioned costs is comprised of several sections, rather than multiple schedules.

Audit Findings

Comment: Several Federal auditors, State auditors, and CPAs commented on the requirement included in § 510(a)(1) and (2) of the proposed revision that, for reporting purposes, audit findings must be evaluated in relation to a "type of compliance requirement" for a major program or an audit objective identified in the compliance supplement. Some commenters opposed requiring the evaluation of an audit finding in relation to an audit objective because they believe this to be a more constrictive requirement than the currently-used measurement standard, and others requested clarification of the requirement. Two commenters suggested that OMB revise this requirement to allow the auditor to make the determination of reportable conditions and material noncompliance based on the significance of the compliance requirement and the effect on the program as a whole.

Response: No change was made as a result of these comments. The scope of the auditor's work described in § 500(c) and (d) is required at the major program level. However, for audit reporting purposes, the results of the auditor's work must be evaluated against a lower measure. Specifically, the revised Circular requires the auditor to consider an audit finding in relation to a type of compliance requirement for a major program or an audit objective identified in the compliance supplement. The types of compliance requirements and related audit objectives are included in the provisional "Circular A-133 Compliance Supplement." The auditor is expected to determine the types of compliance requirements that could have a direct and material effect on each major program, and to design and conduct tests necessary to render an opinion on compliance with respect to each major program. Clearly, auditor judgment must be used in determining the nature, timing, and extent of audit work to be performed, and in evaluating the audit results. The purpose of the requirement included in § 510(a)(1) and (2) is to advise the auditor of the criteria against which to measure or evaluate the impact of findings for reporting purposes.

It is important to note that, under the existing requirements of Circular A-128, the auditor is required to report all instances of noncompliance and, under the 1990 version of Circular A-133, the auditor is required to report all but nonmaterial instances of noncompliance. The requirements for reporting audit findings included in the revised Circular are less burdensome than the existing requirements with respect to instances of noncompliance.

Comment: Several commenters requested clarification of the requirement in § 510(a)(3) of the proposed revision to report as an audit finding known questioned costs which are greater than \$10,000 for a type of compliance requirement, particularly with respect to determining the impact of multiple instances of noncompliance relating to a type of compliance requirement.

Response: No change was made as a result of these comments. However, the following example is provided to illustrate the requirements of this provision. Suppose an auditor: (1) determines that eligibility (which is one of the types of compliance requirements listed in the compliance supplement) could have a direct and material effect on a major program; (2) designs and conducts tests over eligibility relative to this major program; and, (3) discovers two separate instances of noncompliance, in the amount of \$9000 each, relating to eligibility. The findings involve two different audit objectives relating to eligibility (which are listed in the compliance supplement): one finding relates to an individual participant's eligibility, and the other finding relates to the eligibility of a subrecipient. Since § 510(a)(3) requires the auditor to report known questioned costs which are greater than \$10,000 for a type of compliance

requirement (which is eligibility in this case), the auditor would be expected to report these questioned costs of \$18,000 as an audit finding. The auditor would also be expected to consider the impact of these instances of noncompliance when reporting on compliance on each major program.

Comment: Some Federal agencies strongly object to not requiring known questioned costs of \$10,000 or less to be reported. Conversely, one State auditor commented that the requirement to report known questioned costs greater than \$10,000 could result in auditors' reporting matters that are minimal in relation to the size of a particular Federal program (e.g., a very large State program in which questioned costs of \$11,000 is considered immaterial).

Response: No change was made as a result of these comments. OMB believes that the \$10,000 threshold for reporting questioned costs provides an appropriate balance between reporting all questioned costs (which was previously required for State and local governments) and only reporting substantial questioned costs.

Comment: One Federal auditor requested that OMB require auditors to report an estimate of likely questioned costs when a known or likely questioned cost exceeds \$10,000. The commenter stated that capturing the amount of likely questioned costs should better enable Federal agencies to assess the nature and magnitude of questioned costs on particular Federal awards and assist in prioritizing the resolution of audit findings. The commenter also suggested that OMB encourage auditors to use statistical means to determine likely questioned costs.

Response: No change was made as a result of this comment. § 510(a)(3) requires the auditor to report known questioned costs which are greater than \$10,000, and known questioned costs when likely questioned costs are greater than \$10,000, for a type of compliance requirement. GAAS require the auditor to project the amount of known questioned costs identified in a sample to the items in the major program and to consider the best estimate of total questioned costs (both known and likely) in determining an opinion on compliance. The auditor is required to document this consideration in the audit working papers.

The revised Circular does not require the auditor to report an exact amount or statistical projection of likely questioned costs, but rather to include an audit finding when the auditor's extrapolation of these likely questioned costs is greater than \$10,000. In reporting likely questioned costs, it is important that the auditor follows the requirements of § 510(b) and provides appropriate information for judging the prevalence and consequences of the finding. The use of statistical means of determining likely questioned costs may be beneficial for auditors but it is not required. During the next few years, OMB expects Federal agencies to monitor auditor compliance in this area to assist OMB in determining whether an expansion of these reporting requirements is necessary in subsequent revisions.

Comment: Two CPA commenters requested guidance regarding the treatment of audit findings that cannot be quantified. The commenters cited as an example a situation where an auditor discovers that a pass-through entity consistently failed to provide its subrecipients with Federal award information, including applicable compliance requirements. The commenters stated that § 510(a)(3) could be read to indicate that such nonmonetary findings would not need to be reported.

Response: No change was made as a result of these comments. In the example provided by the commenters, this noncompliance would be required to be reported as an audit finding. The auditor must consider a finding in relation to the type of compliance requirement (subrecipient monitoring, in this case) or an audit objective identified in the compliance supplement. The pertinent audit objective included in the provisional "Circular A-133 Compliance Supplement" relating to this example is for the auditor to "determine whether the pass-through entity identifies Federal award information and compliance requirements to the subrecipient." Because the pass-through entity failed to provide Federal award information to its subrecipients, this noncompliance is material in relation to the audit objective and, therefore, must be reported as an audit finding. In addition, the auditor must consider whether reportable conditions (and possibly material weaknesses in internal control) exist and require reporting with respect to subrecipient monitoring.

Audit Follow-up

Comment: Several commenters requested guidance on whether the auditor is required to follow up on all prior findings, particularly immaterial amounts that were previously required to be reported. Two commenters opposed the requirement for audit follow-up on prior audit findings, even when a finding is unrelated to a major program in the current year.

Response: In the first year audited under the revised Circular, the auditor should use judgment in deciding which previously reported findings require follow-up in the current year. Auditors are not expected to follow up on prior year findings that are immaterial. The auditor should consider the criteria for reporting audit findings, provided in § 510(a), in determining which prior audit findings require follow-up.

No change was made to § 500(e), which requires the auditor to perform follow-up procedures regardless of whether a prior audit finding relates to a major program in the current year. This requirement is consistent with the requirement for management to report on the status of prior findings in the summary schedule of prior audit findings.

Auditor Selection

Comment: Two State auditors requested a change to recognize that some auditors (e.g., State and local

governments) do not have the constitutional or legal authority to arrange for audit services.

Response: A clarification was made to §____.305(a) to indicate that, in procuring (rather than arranging for) audit services, auditees shall follow the provisions described in §____.305(a). If an auditee is not authorized to procure audit services (e.g., State law may require that a State auditor perform all required audits for that State), then the provisions of §____.305(a) do not apply.

Comment: One State agency and one CPA commenter did not support the restriction on auditors that perform Circular A-133 audits and also prepare indirect cost proposal or CAPs. These commenters stated that the AICPA's professional standards adequately address auditor independence.

Response: No change was made as a result of these comments. §____.305(b) precludes the same auditor from preparing the indirect cost proposal or CAP when indirect costs exceeded \$1 million in the prior year. This restriction was developed based on comments relating to April 1996 revision of Circular A-133, in which all Federal agencies that responded cited at least an appearance of a lack of independence when the same auditor both performed the audit and prepared the indirect cost proposal or CAP. The \$1 million threshold was chosen to limit this restriction to a relatively small number of entities, while still protecting the Federal interest.

The implementation date for this provision is delayed two years until audits of fiscal years beginning after June 30, 1998, to minimize any effect this provision could have on existing contracts for audit services. In the future, OMB and Federal agencies will monitor this area to determine whether additional guidance or further revision to the Circular is necessary.

Federal Awarding Agency Responsibilities

Comment: A commenter noted that the Circular does not list as a responsibility of Federal awarding agencies the requirement included in the 1996 Amendments (31 U.S.C. 7502(f)(1)(A)) to inform recipients of the Federal requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements.

Response: A change was made to add this responsibility to the list included in §____.400(c) of the revised Circular.

Request for a Program to be Audited as a Major Program

Comment: Two State auditors opposed the provision included in §____.215(c) in which a Federal agency or pass-through entity may request for a program to be audited as a major program. Reasons cited include: (1) that Federal agencies might use this provision excessively, and (2) that specifying programs to be audited as major is contrary to the risk-based approach to determining major programs.

Response: No changes were made to the Circular as a result of these comments. This process does not significantly change the authority Federal agencies and pass-through entities now have to perform additional audits as long as they pay for them. These audits may be incorporated within the framework of the single audit and thereby eliminate duplicative audit planning and reporting. Since the Federal agency or pass-through entity must still pay the full incremental audit cost, OMB does not expect a significant increase in major programs from this provision.

It should be pointed out that any Type A program selected to be audited under this provision must be low-risk. If it were not low-risk, it would have been audited as a major program under the risk-based approach. Therefore, this provision will not reduce the number of high-risk Type B programs audited as major. Also, programs audited as major under this process count towards meeting the percentage of coverage rule provided in §____.520(f).

Management Decisions

Comment: Several State auditors expressed concern about the provision permitting Federal agencies and pass-through entities, prior to issuing a management decision, to request additional information or documentation from an auditee, including a request that the documentation be audited, as a way of mitigating disallowed costs. Two CPAs requested that the term "audit" be replaced by "auditor assurance" for clarity.

Response: A minor change was made to §____.405(a) to clarify that the request is for auditor assurance relating to the specified documentation. OMB also expects Federal agencies and pass-through entities to use this provision judiciously.

Comment: One State auditor commented that it would be beneficial if auditors could obtain copies of management decisions and suggested that the Federal Government establish a centralized contact from which auditors could request copies.

Response: In the next few years, OMB will consider this and other suggestions to improve the dissemination of management decision information.

Audit Working Papers

Comment: Several auditors requested that the Circular reflect the wording included in the 1996 Amendments (31 U.S.C. 7503(f)) that indicates the purpose for which access to working papers is intended.

Response: A change was made to §____.515(b) to reflect wording similar to the 1996 Amendments relating to this matter.

Additional OMB Guidance

Comment: Several commenters requested additional information about various provisions in the proposed revision and asked whether OMB will publish a "questions and answers" document as implementation issues arise.

Response: Interested parties may wish to refer to the April 30, 1996 (61 FR 19134) and November 5, 1996 (61 FR 57232) **Federal Registers** for discussion of various provisions included in the Circular. Useful information is provided in these Notices that is not necessarily repeated in this Notice. In the future, if there are significant questions concerning the revised Circular A-133, OMB will consider issuing a "questions and answers" document relating to the revised Circular.

Franklin D. Raines
Director

Circular No. A-133 - Revised June 24, 1997 **Audits of States, Local Governments, and** **Non-Profit Organizations**

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, P.L. 98-502, and the Single Audit Act Amendments of 1996, P.L. 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 subsequent 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 the Office of Management and Budget (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, except as otherwise specified in §___.400(a).

The standards set forth in this Circular that Federal agencies shall apply to non-Federal entities shall be adopted by Federal agencies in codified regulations not later than 60 days after publication of this 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. The requirements of Circular A-128, although the Circular is rescinded, and the 1990 version of Circular A-133 remain in effect for audits of fiscal years beginning on or before June 30, 1996.

Franklin D. Raines
Director

Attachment

PART__ --AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS

Subpart A--General

Sec.

- ___100 Purpose.
- ___105 Definitions.

Subpart B--Audits

- ___200 Audit requirements.
- ___205 Basis for determining Federal awards expended.
- ___210 Subrecipient and vendor determinations.
- ___215 Relation to other audit requirements.
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- ___230 Audit costs.
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Subpart C--Auditees

- ___300 Auditee responsibilities.
- ___305 Auditor selection.
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- ___400 Responsibilities.
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Subpart E--Auditors

- ___500 Scope of audit.
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- ___510 Audit findings.
- ___515 Audit working papers.
- ___520 Major program determination.
- ___525 Criteria for Federal program risk.
- ___530 Criteria for a low-risk auditee.

Appendix A to Part __ - Data Collection Form (Form SF-SAC).

Appendix B to Part ___ - Circular A-133 Compliance Supplement.

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 supplement 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 supplement refers to the **Circular A-133 Compliance Supplement**, included as Appendix B to Circular A-133, or such documents as OMB or its designee may issue to replace it. This document is available from the Government Printing Office, Superintendent of Documents, Washington, DC 20402-9325.

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 supplement; 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 violation or 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 refer to the types of compliance requirements listed in the compliance

supplement. Examples include: activities allowed or unallowed; allowable costs/cost principles; cash management; eligibility; matching, level of effort, earmarking; and, reporting.

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

Subpart B--Audits

§____.200 Audit requirements.

(a) **Audit required.** Non-Federal entities that expend \$300,000 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 a 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.

(j) **Certain loans provided by the National Credit Union Administration.** For purposes of this part, loans made from the National Credit Union Share Insurance Fund and the Central Liquidity Facility that are funded by contributions from insured institutions are not considered Federal awards expended.

§ ____ .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. For purposes of this part, limited scope audits only include agreed-upon procedures engagements conducted in accordance with either the AICPA's generally accepted auditing standards or attestation standards, that are paid for and arranged by a pass-through entity and address only one or more of the following types of compliance requirements: activities allowed or unallowed; allowable costs/cost principles; eligibility; matching, level of effort, earmarking; and, reporting.

§ ____.235 Program-specific audits.

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

(b) Program-specific audit guide not available.

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

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

(3) The auditor shall:

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

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

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

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

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

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

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

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

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

(c) Report submission for program-specific audits.

(1) The audit shall be completed and the reporting required by paragraph (c)(2) or (c)(3) of this section submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of

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

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

(3) When a program-specific audit guide is not available, the reporting package for a program-specific audit shall consist of the financial statement(s) of the Federal program, a summary schedule of prior audit findings, and a corrective action plan as described in paragraph (b)(2) of this section, and the auditor's report(s) described in paragraph (b)(4) of this section. The data collection form prepared in accordance with §____.320(b), as applicable to a program-specific audit, and one copy of this reporting package shall be submitted to the Federal clearinghouse designated by OMB to be retained as an archival copy. Also, when the schedule of findings and questioned costs disclosed audit findings or the summary schedule of prior audit findings reported the status of any audit findings, the auditee shall submit one copy of the reporting package to the Federal clearinghouse on behalf of the Federal awarding agency, or directly to the pass-through entity in the case of a subrecipient. Instead of submitting the reporting package to the pass-through entity, when a subrecipient is not required to submit a reporting package to the pass-through entity, the subrecipient shall provide written notification to the pass-through entity, consistent with the requirements of §____.320(e)(2). A subrecipient may submit a copy of the reporting package to the pass-through entity to comply with this notification requirement.

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

Subpart C--Auditees

§____.300 Auditee responsibilities.

The auditee shall:

- (a) Identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received. Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency, and name of the pass-through entity.
- (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.
- (c) Comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs.
- (d) Prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with §____.310.
- (e) Ensure that the audits required by this part are properly performed and submitted when due. When extensions to the report submission due date required by §____.320(a) are granted by the cognizant or oversight agency for audit, promptly notify the Federal clearinghouse designated by OMB and each pass-through entity providing Federal awards of the extension.
- (f) Follow up and take corrective action on audit findings, including preparation of a summary schedule of prior audit findings and a corrective action plan in accordance with §____.315(b) and §____.315(c), respectively.

§____.305 Auditor selection.

(a) **Auditor procurement.** In procuring audit services, auditees shall follow the procurement standards prescribed by the Grants Management Common Rule (hereinafter referred to as the "A-102 Common Rule") published March 11, 1988 and amended April 19, 1995 [insert appropriate CFR citation], Circular A-110, "Uniform Administrative 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 (OMB Circulars are available from the Office of Administration, Publications Office, room 2200, New Executive Office Building, Washington, DC 20503). 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 the A-102 Common Rule, 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 or changes in net assets, 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. However, organization-wide financial statements may also include departments, agencies, and other organizational units that have separate audits in accordance with § ____ .500(a) and prepare separate financial statements.

(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, the auditee may choose to provide information requested by Federal awarding agencies and pass-through entities to make the schedule easier to use. For example, when a Federal program has multiple award years, the auditee may list the amount of Federal awards expended for each award year separately. At a minimum, the schedule shall:

(1) List individual Federal programs by Federal agency. For Federal programs included in a cluster of programs, list individual Federal programs within a cluster of programs. For R&D, total Federal awards expended shall be shown either by individual award or 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.

(2) 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.

(3) 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.

(4) Include notes that describe the significant accounting policies used in preparing the schedule.

(5) To the extent practical, pass-through entities should identify in the schedule the total amount provided to subrecipients from each Federal program.

(6) 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, the amount of insurance in effect during the year, and loans or loan guarantees outstanding at year end. While not required, it is preferable to present this information in the schedule.

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

(b) **Data Collection.**

(1) The auditee shall submit 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, and include data elements similar to those presented in this paragraph. A senior level representative of the auditee (e.g., State controller, director of finance, chief executive officer, or chief financial officer) shall sign a statement to be included as part of the form certifying that: the auditee complied with the requirements of this part, the form was prepared in accordance with this part (and the instructions accompanying the form), and the information included in the form, in its entirety, are accurate and complete.

(2) The data collection form shall include the following data elements:

(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 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 (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).

(vi) A list of the Federal awarding agencies which will receive a copy of the reporting package pursuant to § ____ .320(d)(2) of OMB Circular A-133.

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

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

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

(x) The name of each Federal program and identification of each major program. Individual programs 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.

(xi) The amount of expenditures in the schedule of expenditures of Federal awards associated with each Federal program.

(xii) For each Federal program, a yes or no statement as to whether there are audit findings in each of the following types of compliance requirements and the total amount of any questioned costs:

- (A) Activities allowed or unallowed.
- (B) Allowable costs/cost principles.
- (C) Cash management.
- (D) Davis-Bacon Act.
- (E) Eligibility.
- (F) Equipment and real property management.
- (G) Matching, level of effort, earmarking.
- (H) Period of availability of Federal funds.
- (I) Procurement and suspension and debarment.
- (J) Program income.
- (K) Real property acquisition and relocation assistance.
- (L) Reporting.
- (M) Subrecipient monitoring.
- (N) Special tests and provisions.

(xiii) Auditee Name, Employer Identification Number(s), Name and Title of Certifying Official, Telephone Number, Signature, and Date.

(xiv) Auditor Name, Name and Title of Contact Person, Auditor Address, Auditor Telephone Number, Signature, and Date.

(xv) Whether the auditee has either a cognizant or oversight agency for audit.

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

(3) Using the information included in the reporting package described in paragraph (c) of this section, the auditor shall complete the applicable sections of the form. The auditor shall sign a statement to be included as part of the data collection form that indicates, at a minimum, the source of the information included in the form, the auditor's responsibility for the information, that the form is not a substitute for the reporting package described in paragraph (c) of this section, and that the content of the form is limited to the data elements prescribed by OMB.

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

- (1) Financial statements and schedule of expenditures of Federal awards discussed in § ____.310(a) and § ____.310(b), respectively.

(2) Summary schedule of prior audit findings discussed in § ____.315(b);

(3) Auditor's report(s) discussed in § ____.505; and

(4) Corrective action plan discussed in § ____.315(c).

(d) **Submission to clearinghouse.** All auditees shall submit to the Federal clearinghouse designated by OMB the data collection form described in paragraph (b) of this section and 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.**

(1) In addition to the requirements discussed in paragraph (d) of this section, auditees that are also subrecipients shall submit to each pass-through entity one copy of the 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.

(2) Instead of submitting the reporting package to a pass-through entity, when a subrecipient is not required to submit a reporting package to a pass-through entity pursuant to paragraph (e)(1) of this section, the subrecipient shall provide written notification to the pass-through entity that: an audit of the subrecipient was conducted in accordance with this part (including the period covered by the audit and the name, amount, and CFDA number of the Federal award(s) provided by the pass-through entity); the schedule of findings and questioned costs disclosed no audit findings relating to the Federal award(s) that the pass-through entity provided; and, the summary schedule of prior audit findings did not report on the status of any audit findings relating to the Federal award(s) that the pass-through entity provided. A subrecipient may submit a copy of the reporting package described in paragraph (c) of this section to a pass-through entity to comply with this notification requirement.

(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 data collection form described in paragraph (b) of this section and 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. 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 1997 through

2000 will be determined based on Federal awards expended in 1995. (However, for States and local governments that expend more than \$25 million a year in Federal awards and have previously assigned cognizant agencies for audit, the requirements of this paragraph are not effective until fiscal years beginning after June 30, 2000.) Notwithstanding the manner in which audit cognizance is determined, 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 audit 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.
- (9) For biennial audits permitted under § ____.220, consider auditee requests to qualify as a low-risk auditee under § ____.530(a).

(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 § ____.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) Advise recipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements.
- (3) Ensure that audits are completed and reports are received in a timely manner and in accordance with the requirements of this part.
- (4) Provide technical advice and counsel to auditees and auditors as requested.
- (5) 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.

(6) Assign a person responsible for providing annual updates of the compliance supplement to OMB.

(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 for auditor assurance related to the documentation, 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)(5), 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 after receipt of the audit report 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 other 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.

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

(i) Plan the testing of internal control over major programs 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 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 (including whether any such condition is 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.

(2) The principal compliance requirements applicable to most Federal programs and the compliance requirements of the largest Federal programs are included in the compliance supplement.

(3) For the compliance requirements related to Federal programs contained in the compliance supplement, 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 supplement, the auditor shall determine the current compliance requirements and modify the audit procedures accordingly. For those Federal programs not covered in the compliance supplement, the auditor should use the types of compliance requirements contained in the compliance supplement as guidance for identifying the types of compliance requirements to test, and determine the requirements governing the Federal program by reviewing the provisions of contracts and grant agreements and the laws and regulations referred to in such contracts and grant agreements.

(4) The compliance testing shall include tests of transactions 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 in the current year.

(f) Data Collection Form. As required in § .320**(b)(3)**, the auditor shall complete and sign specified sections of the data collection form.

§ .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 and major programs. 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, 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 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 (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion);
- (vi) A statement as to whether the audit disclosed any audit findings which the auditor is required to report under § ____.510(a);
- (vii) An identification of major programs;
- (viii) The dollar threshold used to distinguish between Type A and Type B programs, as described in § ____.520(b); and
- (ix) A statement as to whether the auditee qualified as a low-risk auditee under § ____.530.

(2) Findings relating to 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 sections of the schedule. However, the reporting in one section of the schedule may be in summary form with a reference to a detailed reporting in the other section of the 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. 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 or an audit objective identified in the compliance supplement. 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. 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 or an audit objective identified in the compliance supplement.
- (3) Known questioned costs which are greater than \$10,000 for a type of compliance requirement for a major

program. 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. 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 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, as part of a quality review, to resolve audit findings, or to carry out oversight responsibilities consistent with the purposes of this part. 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.**

(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.**

(1) 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 180 days prior to the end of the fiscal year to be audited of OMB's approval.

(d) **Step 3.**

(1) 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) The auditor is not expected to perform risk assessments on relatively small Federal programs. Therefore, 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 (e)(2)(i)(A) or (B), 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 supplement.

(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 (or, in the case of biennial audits, preceding two audit periods) shall qualify as a low-risk auditee and be eligible for reduced audit coverage in accordance with § __.520:

(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, unless agreed to in advance by the cognizant or oversight agency for audit.

(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 (or, in the case of biennial audits, preceding two audit periods) 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.

Appendix A to Part __ - Data Collection Form (Form SF-SAC)

[insert SF-SAC after finalized]

Appendix B to Part __ - Circular A-133 Compliance Supplement

Note: The provisional "Circular A-133 Compliance Supplement" is available from the OMB Home Page under the "OMB Documents", in the "Grants Management" section.

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