



# Department of Defense DIRECTIVE

NUMBER 7600.10

May 20, 1991

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IG, DoD

SUBJECT: Audits of State and Local Governments, Institutions of Higher Education,  
and Other Nonprofit Institutions

References: (a) DoD Directive 7600.10, "Audits of State and Local Governments,"  
February 12, 1988 (hereby canceled)  
(b) Public Law 98-502, "Single Audit Act of 1984," October 19, 1984  
(c) Office of Management and Budget Circular No. A-87, "Cost  
Principles for State and Local Governments," January, 15, 1981  
(d) Office of Management and Budget Circular No. A-122, "Cost  
Principles For Nonprofit Organizations," May 19, 1987  
(e) through (g), see enclosure 1

## 1. REISSUANCE AND PURPOSE

This Directive:

- 1.1. Reissues reference (a) to update policy, responsibilities, and procedures.
- 1.2. Implements reference (b) and enclosures 2 and 3 to establish audit requirements for State and local governments, institutions of higher education, and other nonprofit institutions that receive Federal financial assistance.
- 1.3. Assigns responsibilities within the Department of Defense for monitoring compliance with those requirements.

## 2. APPLICABILITY

This Directive applies to the Office of the Secretary of Defense, the Military Departments, the Chairman of the Joint Chiefs of Staff and the Joint Staff, the Unified

and Specified Commands, the Inspector General of the Department of Defense (IG, DoD), the Defense Agencies, and the DoD Field Activities (hereafter referred to collectively as "the DoD Components") that provide Federal financial assistance to State and local governments, institutions of higher education, and other nonprofit institutions.

### 3. DEFINITIONS

Terms used in this Directive are defined in enclosures 2 and 3 with the following deviation. Funds paid by the National Guard Bureau to States under facilities' operation and maintenance agreements do not constitute "Federal financial assistance" for purposes of Pub. L. 98-502 (1984) (reference (b)) and enclosure 2.

### 4. POLICY

The DoD Components shall rely on and use financial and performance audits performed by non-Federal auditors under enclosure 2 and independent auditors under enclosure 3 in the oversight of Federal financial assistance provided to State and local governments, institutions of higher education, and other nonprofit institutions. Reference (b) provides that a non-Federal audit of the operations of a State or local government performed under enclosure 2 may exclude public colleges and universities, in which case an audit of the public college or university shall be made in accordance with enclosure 3. The DoD Components, however, may request additional audits of such assistance when required by regulation or to ensure effective use of such assistance as deemed necessary. Any additional audit effort shall be planned and carried out in such a way as to avoid duplication and shall be separately funded.

### 5. RESPONSIBILITIES

5.1. The Inspector General of the Department of Defense shall:

5.1.1. Serve as the DoD senior official under enclosures 2 and 3 for policy guidance, direction, and coordination with DoD Components and other Federal Agencies on audit matters related to State and local governments, institutions of higher education and other nonprofit institutions.

5.1.2. For State and local governments, institutions of higher education, and other nonprofit institutions for which the Office of Management and Budget (OMB)

has assigned the DoD cognizance, do the following:

5.1.2.1. Ensure that audits are made and reports are received in a timely manner and in accordance with the requirements of enclosures 2 and 3.

5.1.2.2. Provide technical advice and liaison through the DoD Components to State and local governments, institutions of higher education, other nonprofit institutions, and independent auditors.

5.1.2.3. Make desk reviews of all reports received, and also make quality control reviews of selected audits made by non-Federal audit organizations and provide the results, when appropriate, to other interested organizations.

5.1.2.4. Promptly inform other affected Federal Agencies and appropriate law enforcement officials of any reported illegal acts or irregularities in accordance with requirements of enclosures 2 and 3.

5.1.2.5. Advise the recipient of audits that have been found not to have met the requirements in enclosures 2 and 3. In such instances, the recipient will work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency shall notify the recipient and Federal awarding agencies of the facts and make recommendations for followup action. Major inadequacies or repetitive sub-standard performance of independent auditors shall be referred to appropriate professional bodies for disciplinary action.

5.1.2.6. Coordinate, to the extent practicable, audits requested by other Federal Agencies, in addition to those required by enclosures 2 and 3.

5.1.2.7. Ensure the resolution of audit findings and recommendations that affect DoD programs and those findings affecting programs of more than one Federal Agency. Ensure that a management decision affecting audit resolution shall be made within 6 months after receipt of the audit report.

5.1.3. For local governments, institutions of higher education, and other nonprofit institutions for which the Department of Defense has assumed oversight responsibility, do the following:

5.1.3.1. Provide technical advice and counsel through DoD Components to institutions and independent auditors when requested.

5.1.3.2. Assume all or some of the cognizant agency responsibilities (see

paragraph 5.1.2., above), as deemed necessary.

5.1.4. For other State and local governments, institutions of higher education, and other nonprofit institutions, receive and distribute copies of single audit reports to appropriate DoD Components for appropriate action and followup by designated program officials.

5.1.5. For audit reports that contain conditions affecting DoD programs, institute followup efforts to ensure that corrective actions have been taken by DoD organizations responsible for managing associated programs or funds.

5.2. The Heads of the DoD Components shall:

5.2.1. Designate an official to coordinate with the IG, DoD, on matters dealing with audits of financial assistance provided by the DoD Component to State and local governments, institutions of higher education, and other nonprofit institutions.

5.2.2. Ensure input of accurate award data for Federal financial assistance to the appropriate DoD management information system.

5.2.3. Ensure that the State or local government, institution of higher education, or other nonprofit institution takes appropriate actions to correct audit deficiencies involving financial assistance provided by the DoD Component.

5.2.4. For State and local governments, institutions of higher education, and other nonprofit institutions for which the OMB has assigned DoD cognizance, do the following:

5.2.4.1. Coordinate with the IG, DoD, on requests from other Federal Agencies for audits of State and local governments, institutions of higher education, and other nonprofit institutions, in addition to those required by enclosures 2 and 3.

5.2.4.2. Seek the views of other interested agencies when a coordinated audit approach is to be used and before completing a coordinated program.

5.2.4.3. Help coordinate the audit work and reporting responsibilities among independent public accountants, State auditors, and both resident and non-resident Federal auditors to achieve the most cost-effective audit.

6. PROCEDURES

The costs of audits made by non-Federal auditors under enclosures 2 and 3 are allowable charges to Federal financial assistance programs. The charges may be considered as a direct cost or an allocated indirect cost in accordance with OMB Circular Nos. A-87, A-122, and A-21 (references (c), (d), and (e)); FAR, Part 31 (reference (f)); or the DFARS, Part 231 (reference (g)). Generally, the percentage of costs charged to Federal assistance programs for an audit shall not exceed the percentage of Federal funds expended to the total funds expended by the recipient during the fiscal year. No cost, however, may be charged to Federal programs for audits not made in accordance with enclosures 2 and 3 and other applicable cost principles and regulations.

#### 7. EFFECTIVE DATE AND IMPLEMENTATION

This Directive is effective immediately. Forward one copy of implementing documents to the Inspector General of the Department of Defense within 120 days.



Donald J. Atwood  
Deputy Secretary of Defense

Enclosures - 3

- E1. References, continued
- E2. Office of Management and Budget Circular A-128
- E3. Office of Management and Budget Circular A-133

**E1. ENCLOSURE 1**

**REFERENCES, continued**

- (e) Office of Management and Budget Circular No. A-21, "Cost Principles for Educational Institutions," December 2, 1986
- (f) Federal Acquisition Regulation, Part 31, "Contract Cost Principles and Procedures," current edition
- (g) Defense FAR Supplement (DFARS), Part 231, "Contract Cost Principles and Procedures," current edition

## E2. ENCLOSURE 2

## Office of Management and Budget Circular A-128

19114

Federal Register / Vol. 50, No. 87 / Monday, May 8, 1985 / Notices

## OFFICE OF MANAGEMENT AND BUDGET

## Issuance of Circular A-128 "Audits of State and Local Governments"

**AGENCY:** Office of Management and Budget.

**ACTION:** Final issuance of OMB Circular A-128, "Audits of State and Local Governments."

**SUMMARY:** This OMB Circular provides policy guidance to Federal agencies in the implementation of the Single Audit Act of 1984 (Pub. L. 98-502). It establishes uniform requirements for audits of Federal financial assistance provided to State and local governments and promotes the efficient and effective use of audit services.

**EFFECTIVE DATE:** This Circular was effective April 12, 1985, and shall apply to fiscal years of State and local governments that began after December 31, 1984. Earlier implementation is encouraged. However, until it is implemented, the audit provisions of Attachment P to Circular A-102 shall continue to be observed.

**FOR FURTHER INFORMATION CONTACT:** Palmer A. Marcantonio, Financial Management Division, Office of Management and Budget, Washington, D.C. 20503, (202) 395-3993.

**SUPPLEMENTARY INFORMATION:** On December 26, 1984, a notice was published in the Federal Register (49 FR 50134), asking for comments on a proposed Circular, "Audit requirements for State and local governments." Interested parties were invited to submit comments by February 25, 1985. Almost 150 comments were received from Federal agencies, State and local governments, universities, professional organizations, and others. All comments were considered in developing these final requirements.

There follows a summary of the major comments, grouped by subject and a response to each, including a description of changes made as a result of the comments. Other changes have been made to increase clarity, and readability.

**Supersession**

**Comment:** One commenter said this section should be expanded to provide clarification that this Circular supersedes not only audit requirements of OMB Circular A-102, but also those related to all forms of Federal financial assistance such as Block Grant programs and contracts awarded under Federal acquisition regulations.

**Reply:** Block grant audit regulations will be superseded by individual

department and agency regulations that will be issued shortly. With respect to contracts, the law makes it clear that assistance-type contracts are covered, and we would expect single audits to cover other cost-type contracts awarded to State and local governments as well.

**Comment:** Several commenters said this section should state that the Single Audit Act and this Circular do not relieve recipients of their responsibilities under Attachment P to OMB Circular A-102, "Uniform requirements for grants to State and local governments" for the fiscal years beginning before July 1, 1985.

**Reply:** Section 22 has been revised to say that until this Circular is implemented, the audit provisions of Attachment P to Circular A-102 shall continue to be observed.

**Comment:** One commenter suggested that OMB clearly indicate that GAO will take action to supersede the "Guidelines for Financial and Compliance Audits of Federally Assisted Programs."

**Reply:** The requirement to use the guidelines has been deleted from this Circular. As Circular A-128 is implemented the guidelines will be phased out and auditors will use guidelines developed by appropriate professional bodies.

**Background**

**Comment:** One commenter said the law requires recipients that receive \$100,000 or more each year to have an audit made for that year. However, the commenter said it was not clear if an audit was required in subsequent years if the funds were expended over a number of years.

**Reply:** The audit recipient should have audits made in all subsequent years where significant funds are expended.

**Definitions**

**Comment:** Several commenters said the definition of internal controls continued in the draft Circular could be construed to include only accounting controls. They recommended that the definition include administrative controls too.

**Reply:** We were advised by several groups including the General Accounting Office that the term "administrative controls" may cause some confusion in the accounting profession because the term as used in the auditing literature calls for tests of certain controls not contemplated by the Congress. Instead of using the term administrative controls, Section 8 of the Circular says that controls covering expenditures of Federal funds must be tested. We believe this was the intent of the Act.

**Comment:** A number of commenters asked whether the definition of subrecipient includes commercial or private businesses and organizations.

**Reply:** The Circular covers all Federal assistance funds whether the subrecipient is a private or public organization. All State or local governments that receive Federal financial assistance and provide \$25,000 or more of it to a subrecipient must determine whether subrecipients spent Federal assistance funds in accordance with applicable laws and regulations. For State and local subrecipients and other nonprofit organizations OMB Circulars call for periodic audits. These audits may be used to determine whether the subrecipient spent the funds properly. For commercial or private businesses and organizations receiving Federal assistance funds the State and local governments may use other means such as program reviews to determine if the funds are being spent properly.

**Frequency of Audit**

**Comment:** Several commenters recommended that the one-year requirement for the audit report to be forwarded to the Federal Government be changed to "within six months." Other commenters said the requirement should be deleted altogether because it is not a requirement of the law.

**Reply:** In order for audit reports to be useful they must be timely. The Circular calls for the audit report to be sent no later than one year after the end of the audit period unless a longer period is agreed to with the cognizant agency.

**Compliance Testing**

**Comment:** One commenter suggested that the title of this section be changed to "Internal Control and Compliance Reviews," and a separate paragraph be devoted to testing and evaluation of internal control systems.

**Reply:** The title was changed and a separate section is devoted to reviews of internal control systems.

**Comment:** Several commenters said it was not clear whether the auditor was required to perform a study and evaluation of internal control systems if the auditor did not plan to place reliance on such systems.

**Reply:** The Circular was changed to make it clear that the auditor must make a study and evaluation of internal control systems used in administering Federal assistance programs whether or not the auditor intends to place reliance on these systems.

**Comment:** One commenter said the testing of non-Federal programs seemed to be limited to testing transactions

selected in the review of financial statements. The commenter suggested that either the auditor be required to make separate tests of programs other than the major ones or that the auditor be required to review the management controls over Federal programs that are not defined as major ones.

*Reply:* The law is specific as to how much testing will be made of programs other than major ones. It requires the auditor to determine and report on whether the organization has internal control systems that provide reasonable assurance that it is managing Federal assistance programs in compliance with applicable laws and regulations. Further it provides that transactions for other than major programs that are selected in connection with examinations of financial statements and evaluation of internal controls shall be tested for compliance with Federal laws and regulations that apply to such transactions. The provisions of the Act are reflected in Section 8 of the Circular.

*Comment:* One commenter said the draft Circular required the auditor to determine whether amounts claimed or used for matching were determined in accordance with Circular A-102. "Uniform requirements for grants to State and local governments," and Circular A-87, "Cost principles for State and local governments." The commenter objected because Job Training Partnership Act (JTPA) grantees and subgrantees are not required to comply with these Circulars. The recipients of JTPA funds may have developed their own cost principles and grant requirements which may differ from Circulars A-87 and A-102. Therefore, it would be impractical to test compliance with these Circulars.

*Reply:* Although JTPA grantees may not be subject to OMB Circulars A-102 or A-87 the cost principles and regulations adopted by the grantee should be equivalent to those in the Circulars. If there are significant differences between the grantee's regulations and the Circulars they should be included in the audit report.

*Comment:* Several commenters raised questions about the requirement for governmental units to maintain accounts that identify all Federal funds received and expended and to identify the programs under which they were received. The commenters were concerned that the recipient's official accounting records might have to be modified to meet the requirement.

*Reply:* The requirement for grantees to keep records on each grant is not a new one. Since Circular A-102 was first issued in 1971 Attachment G, "Standards for Grantee Financial

Management Systems," required grantee financial management systems to provide for accurate, current, and complete disclosure of the financial results of each grant program. Therefore, we do not anticipate modification of grantee accounting records will be required as a result of Circular A-128.

#### Subrecipients

*Comment:* One commenter said this section may be interpreted as requiring the recipient to determine whether the subrecipient spent all its Federal funds properly, regardless of the source of the funds.

*Reply:* The section was amended to make it clear recipients were responsible only for the assistance funds provided by them to subrecipients.

*Comment:* One commenter said the roles of the recipient State agency, the Federal agency, and cognizant agency are unclear.

*Reply:* We are working with Federal agencies on procedures for distributing audit reports, resolving audit findings, and carrying out other cognizance responsibilities. We will ask each agency to publish these procedures as soon as possible.

#### Relation to Other Audit Requirements

*Comment:* One commenter made a number of suggestions to make the language more precise. One suggestion was to make it clear that the single audit shall be in lieu of any financial and compliance audit required under Federal assistance programs.

*Reply:* We adopted this suggestion as well as a number of other proposed changes to this section.

#### Cognizant Agencies

*Comment:* Several commenters said the draft Circular appears to require that all recipients, regardless of funding level, have established formal cognizant agency assignments.

*Reply:* The Circular was clarified to say, "Smaller governments not assigned a cognizant agency will be under the general oversight of the Federal agency that provides them the most funds." No formal arrangement is anticipated for these smaller government recipients.

#### Audit Reports

*Comment:* There were a number of comments that said there was confusion between the responsibilities of the cognizant agency and the clearinghouse.

*Reply:* This section was rewritten to accommodate these concerns.

*Comment:* One commenter said that all fraud, abuse, or illegal acts should normally be covered in a separate written report.

*Reply:* The Circular was amended to say a separate report is normally required for fraud, abuse, and illegal acts.

*Comment:* There were a number of comments on how the report distribution process can be improved.

*Reply:* The report distribution process has been streamlined. Now recipients are required to send copies of the audit report to Federal agencies providing funds and one copy of the audit report to a central clearinghouse.

#### Audit Resolution

*Comment:* A number of commenters asked that the six month audit resolution period begin when program officials receive the report, not when the agency receives it.

*Reply:* This section was not changed. Six months from the time an agency receives an audit report seems to be ample time for a Federal agency to receive, process and resolve audit findings.

#### Sanctions

*Comment:* One commenter said the Circular should have a more comprehensive government-wide policy concerning actions that should be taken if a State or locality does not comply with the Act or the Circular.

*Reply:* The Circular now lists a number of actions Federal agencies may consider when a recipient is unable or unwilling to have a proper audit made.

#### Auditor Selection

*Comment:* One commenter said there should be some analysis made by State and local governments to determine the most economical way to obtain audit services.

*Reply:* A new section was added to the Circular reiterating the requirement for State and local governments to follow the procurement standards prescribed by Attachment O of Circular A-102. "Uniform requirements for grants to State and local governments," when arranging for audit services.

Darrell A. Johnson,  
Acting Deputy Associate Director for  
Administration.

#### EXECUTIVE OFFICE OF THE PRESIDENT

Office of Management and Budget  
CIRCULAR NO. A-128

April 12, 1985

To the Heads of Executive Departments and  
Establishments.  
Subject: Audits of State and Local  
Governments.

1. *Purpose.* This Circular is issued pursuant to the Single Audit Act of 1984, Pub. L. 98-502. It establishes audit requirements for State and local governments that receive Federal aid, and defines Federal responsibilities for implementing and monitoring those requirements.

2. *Supersession.* The Circular supersedes Attachment P, "Audit Requirements," of Circular A-102, "Uniform requirements for grants to State and local governments."

3. *Background.* The Single Audit Act builds upon earlier efforts to improve audits of Federal aid programs. The Act requires State or local governments that receive \$100,000 or more a year in Federal funds to have an audit made for that year. Section 7505 of the Act requires the Director of the Office of Management and Budget to prescribe policies, procedures and guidelines to implement the Act. It specifies that the Director shall designate "cognizant" Federal agencies, determine criteria for making appropriate charges to Federal programs for the cost of audits, and provide procedures to assure that small firms or firms owned and controlled by disadvantaged individuals have the opportunity to participate in contracts for single audits.

4. *Policy.* The Single Audit Act requires the following:

a. State or local governments that receive \$100,000 or more a year in Federal financial assistance shall have an audit made in accordance with this Circular.

b. State or local governments that receive between \$25,000 and \$100,000 a year shall have an audit made in accordance with this Circular, or in accordance with Federal laws and regulations governing the programs they participate in.

c. State or local governments that receive less than \$25,000 a year shall be exempt from compliance with the Act and other Federal audit requirements. These State and local governments shall be governed by audit requirements prescribed by State or local law or regulation.

d. Nothing in this paragraph exempts State or local governments from maintaining records of Federal financial assistance or from providing access to such records to Federal agencies, as provided for in Federal law or in Circular A-102, "Uniform requirements for grants to State or local governments."

5. *Definitions.* For the purposes of this Circular the following definitions from the Single Audit Act apply:

a. "Cognizant agency" means the Federal agency assigned by the Office of

Management and Budget to carry out the responsibilities described in paragraph 11 of this Circular.

b. "Federal financial assistance" means assistance provided by a Federal agency in the form of grants, contracts, cooperative agreements, loans, loan guarantees, property, interest subsidies, insurance, or direct appropriations, but does not include direct Federal cash assistance to individuals. It includes awards received directly from Federal agencies, or indirectly through other units of State and local governments.

c. "Federal agency" has the same meaning as the term "agency" in section 551(1) of Title 5, United States Code.

d. "Generally accepted accounting principles" has the meaning specified in the generally accepted government auditing standards.

e. "Generally accepted government auditing standards" means the *Standards For Audit of Government Organizations, Programs, Activities, and Functions*, developed by the Comptroller General, dated February 27, 1981.

f. "Independent auditor" means:

(1) a State or local government auditor who meets the independence standards specified in generally accepted government auditing standards; or

(2) a public accountant who meets such independence standards.

g. "Internal controls" means the plan of organization and methods and procedures adopted by management to ensure that:

(1) resource use is consistent with laws, regulations, and policies;

(2) resources are safeguarded against waste, loss, and misuse; and

(3) reliable data are obtained, maintained, and fairly disclosed in reports.

h. "Indian tribe" means any Indian tribe, band, nation, or other organized group or community, including any Alaskan Native village or regional or village corporations (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.

i. "Local government" means any unit of local government within a State, including a county, a 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.

j. "Major Federal Assistance Program," as defined by Pub. L. 98-502,

is described in the Attachment to this Circular.

k. "Public accountants" means those individuals who meet the qualification standards included in generally accepted government auditing standards for personnel performing government audits.

l. "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, and any multi-State, regional, or interstate entity that has governmental functions and any Indian tribe.

m. "Subrecipient" means any person or government department, agency, or establishment that receives Federal financial assistance to carry out a program through a State or local government, but does not include an individual that is a beneficiary of such a program. A subrecipient may also be a direct recipient of Federal financial assistance.

6. *Scope of audit.* The Single Audit Act provides that:

a. The audit shall be made by an independent auditor in accordance with generally accepted government auditing standards covering financial and compliance audits.

b. The audit shall cover the entire operations of a State or local government or, at the option of that government, it may cover departments, agencies or establishments that received, expended, or otherwise administered Federal financial assistance during the year. However, if a State or local government receives \$25,000 or more in General Revenue Sharing Funds in a fiscal year, it shall have an audit of its entire operations. A series of audits of individual departments, agencies, and establishments for the same fiscal year may be considered a single audit.

c. Public hospitals and public colleges and universities may be excluded from State and local audits and the requirements of this Circular. However, if such entities are excluded, audits of these entities shall be made in accordance with statutory requirements and the provisions of Circular A-110, "Uniform requirements for grants to universities, hospitals, and other nonprofit organizations."

d. The auditor shall determine whether:

(1) the financial statements of the government, department, agency or establishment present fairly its financial

position and the results of its financial operations in accordance with generally accepted accounting principles;

(2) the organization has internal accounting and other control systems to provide reasonable assurance that it is managing Federal financial assistance programs in compliance with applicable laws and regulations; and

(3) the organization has complied with laws and regulations that may have material effect on its financial statements and on each major Federal assistance program.

7. *Frequency of audit.* Audits shall be made annually unless the State or local government has, by January 1, 1987, a constitutional or statutory requirement for less frequent audits. For those governments, the cognizant agency shall permit biennial audits, covering both years, if the government so requests. It shall also honor requests for biennial audits by governments that have an administrative policy calling for audits less frequent than annual, but only for fiscal years beginning before January 1, 1987.

8. *Internal control and compliance reviews.* The Single Audit Act requires that the independent auditor determine and report on whether the organization has internal control systems to provide reasonable assurance that it is managing Federal assistance programs in compliance with applicable laws and regulations.

a. *Internal control review.* In order to provide this assurance the auditor must make a study and evaluation of internal control systems used in administering Federal assistance programs. The study and evaluation must be made whether or not the auditor intends to place reliance on such systems. As part of this review, the auditor shall:

(1) Test whether these internal control systems are functioning in accordance with prescribed procedures.

(2) Examine the recipient's system for monitoring subrecipients and obtaining and acting on subrecipient audit reports.

b. *Compliance review.* The law also requires the auditor to determine whether the organization has complied with laws and regulations that may have a material effect on each major Federal assistance program.

(1) In order to determine which major programs are to be tested for compliance, State and local governments shall identify in their accounts all Federal funds received and expended and the programs under which they were received. This shall include funds received directly from Federal agencies and through other State and local governments.

(2) The review must include the selection and testing of a representative number of charges from each major Federal assistance program. The selection and testing of transactions shall be based on the auditor's professional judgment considering such factors as the amount of expenditures for the program and the individual awards; the newness of the program or changes in its conditions; prior experience with the program, particularly as revealed in audits and other evaluations (e.g., inspections, program reviews); the extent to which the program is carried out through subrecipients; the extent to which the program contracts for goods or services; the level to which the program is already subject to program reviews or other forms of independent oversight; the adequacy of the controls for ensuring compliance; the expectation of adherence or lack of adherence to the applicable laws and regulations; and the potential impact of adverse findings.

(a) In making the test of transactions, the auditor shall determine whether:  
—The amounts reported as expenditures were for allowable services, and  
—The records show that those who received services or benefits were eligible to receive them.

(b) In addition to transaction testing, the auditor shall determine whether:  
—Matching requirements, levels of effort and earmarking limitations were met,

—Federal financial reports and claims for advances and reimbursements contain information that is supported by the books and records from which the basic financial statements have been prepared, and  
—Amounts claimed or used for matching were determined in accordance with OMB Circular A-87, "Cost principles for State and local governments," and Attachment F of Circular A-102, "Uniform requirements for grants to State and local governments."

(c) The principal compliance requirements of the largest Federal aid programs may be ascertained by referring to the *Compliance Supplement for Single Audits of State and Local Governments*, issued by OMB and available from the Government Printing Office. For those programs not covered in the Compliance Supplement, the auditor may ascertain compliance requirements by researching the statutes, regulations, and agreements governing individual programs.

(3) Transactions related to other Federal assistance programs that are selected in connection with examinations of financial statements

and evaluations of internal controls shall be tested for compliance with Federal laws and regulations that apply to such transactions.

9. *Subrecipients.* State or local governments that receive Federal financial assistance and provide \$25,000 or more of it in a fiscal year to a subrecipient shall:

a. Determine whether State or local subrecipients have met the audit requirements of this Circular and whether subrecipients covered by Circular A-110, "Uniform requirements for grants to universities, hospitals, and other nonprofit organizations," have met that requirement;

b. determine whether the subrecipient spent Federal assistance funds provided in accordance with applicable laws and regulations. This may be accomplished by reviewing an audit of the subrecipient made in accordance with this Circular, Circular A-110, or through other means (e.g., program reviews) if the subrecipient has not yet had such an audit;

c. ensure that appropriate corrective action is taken within six months after receipt of the audit report in instances of noncompliance with Federal laws and regulations;

d. consider whether subrecipient audits necessitate adjustment of the recipient's own records; and

e. require each subrecipient to permit independent auditors to have access to the records and financial statements as necessary to comply with this Circular.

10. *Relation to other audit requirements.* The Single Audit Act provides that an audit made in accordance with this Circular shall be in lieu of any financial or financial compliance audit required under individual Federal assistance programs. To the extent that a single audit provides Federal agencies with information and assurances they need to carry out their overall responsibilities, they shall rely upon and use such information. However, a Federal agency shall make any additional audits which are necessary to carry out its responsibilities under Federal law and regulation. Any additional Federal audit effort shall be planned and carried out in such a way as to avoid duplication.

a. The provisions of this Circular do not limit the authority of Federal agencies to make, or contract for audits and evaluations of Federal financial assistance programs, nor do they limit the authority of any Federal agency Inspector General or other Federal audit official.

b. The provisions of this Circular do not authorize any State or local

government or subrecipient thereof to constrain Federal agencies, in any manner, from carrying out additional audits.

c. A Federal agency that makes or contracts for audits in addition to the audits made by recipients pursuant to this Circular shall, consistent with other applicable laws and regulations, arrange for funding the cost of such additional audits. Such additional audits include economy and efficiency audits, program results audits, and program evaluations.

11. *Cognizant agency responsibilities.* The Single Audit Act provides for cognizant Federal agencies to oversee the implementation of this Circular.

a. The Office of Management and Budget will assign cognizant agencies for States and their subdivisions and larger local governments and their subdivisions. Other Federal agencies may participate with an assigned cognizant agency, in order to fulfill the cognizant responsibilities. Smaller governments not assigned a cognizant agency will be under the general oversight of the Federal agency that provides them the most funds whether directly or indirectly.

b. A cognizant agency shall have the following responsibilities:

- (1) Ensure that audits are made and reports are received in a timely manner and in accordance with the requirements of this Circular.
- (2) Provide technical advice and liaison to State and local governments and independent auditors.
- (3) Obtain or make quality control reviews of selected audits made by non-Federal audit organizations, 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 reported illegal acts or irregularities. They should also inform State or local law enforcement and prosecuting authorities, if not advised by the recipient, of any violation of law within their jurisdiction.
- (5) Advise the recipient of audits that have been found not to have met the requirements set forth in this Circular. In such instances, the recipient will be expected to work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency shall notify the recipient and Federal awarding agencies of the facts and make recommendations for followup action. Major inadequacies or repetitive substandard performance of independent auditors shall be referred to appropriate professional bodies for disciplinary action.

(6) Coordinate, to the extent practicable, audits made by or for Federal agencies that are in addition to the audits made pursuant to this Circular; so that the additional audits build upon such audits.

(7) Oversee the resolution of audit findings that affect the programs of more than one agency.

12. *Illegal acts or irregularities.* If the auditor becomes aware of illegal acts or other irregularities, prompt notice shall be given to recipient management officials above the level of involvement. (See also paragraph 13(a)(3) below for the auditor's reporting responsibilities.) The recipient, in turn, shall promptly notify the cognizant agency of the illegal acts or irregularities and of proposed and actual actions, if any. Illegal acts and irregularities include such matters as conflicts of interest, falsification of records or reports, and misappropriations of funds or other assets.

13. *Audit Reports.* Audit reports must be prepared at the completion of the audit. Reports serve many needs of State and local governments as well as meeting the requirements of the Single Audit Act.

a. The audit report shall state that the audit was made in accordance with the provisions of this Circular. The report shall be made up of at least:

(1) The auditor's report on financial statements and on a schedule of Federal assistance; the financial statements; and a schedule of Federal assistance, showing the total expenditures for each Federal assistance program as identified in the *Catalog of Federal Domestic Assistance*. Federal programs or grants that have not been assigned a catalog number shall be identified under the caption "other Federal assistance."

(2) The auditor's report on the study and evaluation of internal control systems must identify the organization's significant internal accounting controls, and those controls designed to provide reasonable assurance that Federal programs are being managed in compliance with laws and regulations. It must also identify the controls that were evaluated, the controls that were not evaluated, and the material weaknesses identified as a result of the evaluation.

(3) The auditor's report on compliance containing:

- A statement of positive assurance with respect to those items tested for compliance, including compliance with law and regulations pertaining to financial reports and claims for advances and reimbursements;
- Negative assurance on those items not tested;

—A summary of all instances of noncompliance; and

—An identification of total amounts questioned, if any, for each Federal assistance award, as a result of noncompliance.

b. The three parts of the audit report may be bound into a single report, or presented at the same time as separate documents.

c. All fraud abuse, or illegal acts or indications of such acts, including all questioned costs found as the result of these acts that auditors become aware of, should normally be covered in a separate written report submitted in accordance with paragraph 13f.

d. In addition to the audit report, the recipient shall provide comments on the findings and recommendations in the report, including a plan for corrective action taken or planned and comments on the status of corrective action taken on prior findings. If corrective action is not necessary, a statement describing the reason it is not should accompany the audit report.

e. The reports shall be made available by the State or local government for public inspection within 30 days after the completion of the audit.

f. In accordance with generally accepted government audit standards, reports shall be submitted by the auditor to the organization audited and to those requiring or arranging for the audit. In addition, the recipient shall submit copies of the reports to each Federal department or agency that provided Federal assistance funds to the recipient. Subrecipients shall submit copies to recipients that provided them Federal assistance funds. The reports shall be sent within 30 days after the completion of the audit, but no later than one year after the end of the audit period unless a longer period is agreed to with the cognizant agency.

g. Recipients of more than \$100,000 in Federal funds shall submit one copy of the audit report within 30 days after issuance to a central clearinghouse to be designated by the Office of Management and Budget. The clearinghouse will keep completed audits on file and follow up with State and local governments that have not submitted required audit reports.

h. Recipients shall keep audit reports on file for three years from their issuance.

14. *Audit Resolution.* As provided in paragraph 11, the cognizant agency shall be responsible for monitoring the resolution of audit findings that affect the programs of more than one Federal agency. Resolution of findings that relate to the programs of a single

Federal agency will be the responsibility of the recipient and that agency. Alternate arrangements may be made on a case-by-case basis by agreement among the agencies concerned.

Resolution shall be made within six months after receipt of the report by the Federal departments and agencies. Corrective action should proceed as rapidly as possible.

**15. Audit workpapers and reports.** Workpapers and reports shall be retained for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by the cognizant agency to extend the retention period. Audit workpapers shall be made available upon request to the cognizant agency or its designee or the General Accounting Office, at the completion of the audit.

**16. Audit Costs.** The cost of audits made in accordance with the provisions of this Circular are allowable charges to Federal assistance programs.

a. The charges may be considered a direct cost or an allocated indirect cost, determined in accordance with the provision of Circular A-87, "Cost principles for State and local governments."

b. Generally, the percentage of costs charged to Federal assistance programs for a single audit shall not exceed the percentage that Federal funds expended represent of total funds expended by the recipient during the fiscal year. The percentage may be exceeded, however, if appropriate documentation demonstrates higher actual cost.

**17. Sanctions.** The Single Audit Act provides that no cost may be charged to Federal assistance programs for audits required by the Act that are not made in accordance with this Circular. In cases of continued inability or unwillingness to have a proper audit, Federal agencies must consider other appropriate sanctions including:

- Withholding a percentage of assistance payments until the audit is completed satisfactorily,
- Withholding or disallowing overhead costs, and
- Suspending the Federal assistance agreement until the audit is made.

**18. Auditor Selection.** In arranging for audit services State and local governments shall follow the procurement standards prescribed by Attachment O of Circular A-102.

"Uniform requirements for grants to State and local governments." The standards provide that while recipients

are encouraged to enter into intergovernmental agreements for audit and other services, analysis should be made to determine whether it would be more economical to purchase the services from private firms. In instances where use of such intergovernmental agreements are required by State statutes (e.g., audit services) these statutes will take precedence.

**19. Small and Minority Audit Firms.** Small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals shall have the maximum practicable opportunity to participate in contracts awarded to fulfill the requirements of this Circular. Recipients of Federal assistance shall take the following steps to further this goal:

a. Assure that small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals are used to the fullest extent practicable.

b. Make information on forthcoming opportunities available and arrange timeframes for the audit so as to encourage and facilitate participation by small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals.

c. Consider in the contract process whether firms competing for larger audits intend to subcontract with small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals.

d. Encourage contracting with small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals which have traditionally audited government programs and, in such cases where this is not possible, assure that these firms are given consideration for audit subcontracting opportunities.

e. Encourage contracting with consortiums of small audit firms as described in paragraph (a) above when a contract is too large for an individual small audit firm or audit firm owned and controlled by socially and economically disadvantaged individuals.

f. Use the services and assistance, as appropriate, of such organizations as the Small Business Administration in the solicitation and utilization of small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals.

**20. Reporting.** Each Federal agency will report to the Director of OMB or

before March 1, 1987, and annually thereafter on the effectiveness of State and local governments in carrying out the provisions of this Circular. The report must identify each State or local government or Indian tribe that, in the opinion of the agency, is failing to comply with the Circular.

**21. Regulations.** Each Federal agency shall include the provisions of this Circular in its regulations implementing the Single Audit Act.

**22. Effective date.** This Circular is effective upon publication and shall apply to fiscal years of State and local governments that begin after December 31, 1984. Earlier implementation is encouraged. However, until it is implemented, the audit provisions of Attachment P to Circular A-102 shall continue to be observed.

**23. Inquiries.** All questions or inquiries should be addressed to Financial Management Division, Office of Management and Budget, telephone number 202/395-3993.

**24. Sunset review date.** This Circular shall have an independent policy review to ascertain its effectiveness three years from the date of issuance.

David A. Stockman,  
Director.

Attachment—Circular A-128

Definition of Major Program as Provided in Pub. L. 98-502

"Major Federal Assistance Program." for State and local governments having Federal assistance expenditures between \$100,000 and \$100,000,000, means any program for which Federal expenditures during the applicable year exceed the larger of \$300,000, or 3 percent of such total expenditures.

Where total expenditures of Federal assistance exceed \$100,000,000, the following criteria apply:

Total expenditures of Federal financial assistance for all programs		Major Federal assistance program means any program that exceeds
More than	But less than	
\$100 million	\$1 billion	\$3 million
\$1 billion	\$2 billion	\$4 million
\$2 billion	\$3 billion	\$7 million
\$3 billion	\$4 billion	\$10 million
\$4 billion	\$5 billion	\$13 million
\$5 billion	\$6 billion	\$16 million
\$6 billion	\$7 billion	\$19 million
Over \$7 billion		\$20 million

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## E3. ENCLOSURE 3

## Office of Management and Budget Circular A-133

Federal Register / Vol. 55, No. 52 / Friday, March 18, 1990 / Notices

10021

## OMB Circular No. A-133

To the Heads of Executive Departments and Establishments

*Subject:* Audits of Institutions of Higher Education and Other Nonprofit Institutions

1. *Purpose.* Circular A-133 establishes audit requirements and defines Federal responsibilities for implementing and monitoring such requirements for institutions of higher education and other nonprofit institutions receiving Federal awards.

2. *Authority.* Circular A-133 is issued under the authority of the Budget and Accounting Act of 1921, as amended; the Budget and Accounting Procedures Act of 1950, as amended; Reorganization Plan No. 2 of 1970; and Executive Order No. 11541.

3. *Supersession.* Circular A-133 supersedes Attachment F, subparagraph 2h, of Circular A-110, "Uniform Administrative Requirements for Grants and Other Agreements with Institutions of Higher Education, Hospitals, and other Nonprofit Organizations."

4. *Applicability.* The provisions of Circular A-133 apply to:

a. Federal departments and agencies responsible for administering programs that involve grants, cost-type contracts and other agreements with institutions of higher education and other nonprofit recipients.

b. Nonprofit institutions, whether they are recipients, receiving awards directly from Federal agencies, or are sub-recipients, receiving awards indirectly through other recipients.

These principles, to the extent permitted by law, constitute guidance to be applied by agencies consistent with

and within the discretion, conferred by the statutes governing agency action.

5. *Requirements and Responsibilities.*

The specific requirements and responsibilities of Federal departments and agencies and institutions of higher education and other nonprofit institutions are set forth in the attachment.

6. *Effective Date.* The provisions of Circular A-133 are effective upon publication and shall apply to audits of nonprofit institutions for fiscal years that begin on or after January 1, 1990. Earlier implementation is encouraged. However, until this Circular is implemented, the audit provisions of Attachment F to Circular A-110 shall continue to be observed.

7. *Policy Review (Sunset) Date.* Circular A-133 will have a policy review three years from the date of issuance.

8. *Inquiries.* Further information concerning Circular A-133 may be obtained by contacting the Financial Management Division, Office of Management and Budget, Washington, D.C. 20503, telephone (202) 395-3993. Richard G. Darman,  
*Director.*

## Attachment

1. *Definitions.* For the purposes of this Circular, the following definitions apply:

a. *Award* means financial assistance, and Federal cost-type contracts used to buy services or goods for the use of the Federal Government. It includes awards received directly from the Federal agencies or indirectly through recipients. It does not include procurement contracts to vendors under grants or contracts, used to buy goods or services. Audits of such vendors shall be covered by the terms and conditions of the contract.

b. *Cognizant agency* means the Federal agency assigned by the Office of Management and Budget to carry out the responsibilities described in paragraph 3 of this Attachment.

c. *Coordinated audit approach* means an audit wherein the independent auditor, and other Federal and non-Federal auditors consider each other's work, in determining the nature, timing, and extent of his or her own auditing procedures. A coordinated audit must be conducted in accordance with *Government Auditing Standards* and meet the objectives and reporting requirements set forth in paragraph 12(b) and 15, respectively, of this Attachment. The objective of the coordinated audit approach is to minimize duplication of audit effort, but not to limit the scope of the audit work so as to preclude the independent auditor from meeting the objectives set

forth in paragraph 12(b) or issuing the reports required in paragraph 15 in a timely manner.

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

e. *Federal Financial Assistance.*

(1) *Federal financial assistance* means assistance provided by a Federal agency to a recipient or sub-recipient to carry out a program. Such assistance may be in the form of:

- Grants;
- Contracts;
- Cooperative agreements;
- Loans;
- Loan guarantees;
- Property;
- Interest subsidies;
- Insurance;
- Direct appropriations;
- Other non-cash assistance.

(2) Such assistance does not include direct Federal cash assistance to individuals.

(3) Such assistance includes awards received directly from Federal agencies, or indirectly when sub-recipients receive funds identified as Federal funds by recipients.

(4) The granting agency is responsible for identifying the source of funds awarded to recipients; the recipient is responsible for identifying the source of funds awarded to sub-recipients.

f. *Generally accepted accounting principles* has the meaning specified in the *Government Auditing Standards*.

g. *Independent auditor* means:

- (1) A Federal, State, or local government auditor who meets the standards specified in the *Government Auditing Standards*; or
- (2) A public accountant who meets such standards.

h. *Internal control structure* means the policies and procedures established to provide reasonable assurance that:

- (1) Resource use is consistent with laws, regulations, and award terms;
- (2) Resources are safeguarded against waste, loss, and misuse; and
- (3) Reliable data are obtained, maintained, and fairly disclosed in reports.

i. *Major program* means an individual award or a number of awards in a category of Federal assistance or support for which total expenditures are the larger of three percent of total Federal funds expended or \$100,000, on which the auditor will be required to express an opinion as to whether the major program is being administered in compliance with laws and regulations.

Each of the following categories of Federal awards shall constitute a major

program where total expenditures are the larger of three percent of total Federal funds expended or \$100,000:

—Research and Development.

—Student Financial Aid.

—Individual awards not in the student aid or research and development category.

**j. Management decision** means the evaluation by the management of an establishment of the findings and recommendations included in an audit report and the issuance of a final decision by management concerning its response to such findings and recommendations, including actions concluded to be necessary.

**k. Nonprofit institution** means any corporation, trust, association, cooperative or other organization which (1) is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest; (2) is not organized primarily for profit; and (3) uses its net proceeds to maintain, improve, and/or expand its operations. The term "nonprofit institutions" includes institutions of higher education, except those institutions that are audited as part of single audits in accordance with Circular A-128 "Audits of State and Local Governments." The term does not include hospitals which are not affiliated with an institution of higher education, or State and local governments and Indian tribes covered by Circular A-128 "Audits of State and Local Governments."

**l. Oversight agency** means the Federal agency that provides the predominant amount of direct funding to a recipient not assigned a cognizant agency, unless no direct funding is received. Where there is no direct funding, the Federal agency with the predominant indirect funding will assume the general oversight responsibilities. The duties of the oversight agency are described in paragraph 4 of this Attachment.

**m. Recipient** means an organization receiving financial assistance to carry out a program directly from Federal agencies.

**n. Research and development** includes all research activities, both basic and applied, and all development activities that are supported at universities, colleges, and other nonprofit institutions. "Research" is defined as a systematic study directed toward fuller scientific knowledge or understanding of the subject studied. "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.

**o. Student Financial Aid** includes those programs of general student assistance in which institutions participate, such as those authorized by Title IV of the Higher Education Act of 1965 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 awards to students on a competitive basis, or for specified studies or research.

**p. Sub-recipient** means any person or government department, agency, establishment, or nonprofit organization that receives financial assistance to carry out a program through a primary recipient or other sub-recipient, but does not include an individual that is a beneficiary of such a program. A sub-recipient may also be a direct recipient of Federal awards under other agreements.

**q. Vendor** means an organization providing a recipient or sub-recipient with generally required goods or services that are related to the administrative support of the Federal assistance program.

#### 2. Audit of Nonprofit Institutions.

**a. Requirements Based on Awards Received.** (1) Nonprofit institutions that receive \$100,000 or more a year in Federal awards shall have an audit made in accordance with the provisions of this Circular. However, nonprofit institutions receiving \$100,000 or more but receiving awards under only one program have the option of having an audit of their institution prepared in accordance with the provisions of the Circular or having an audit made of the one program. For prior or subsequent years, when an institution has only loan guarantees or outstanding loans that were made previously, the institution may be required to conduct audits for those programs, in accordance with regulations of the Federal agencies providing those guarantees or loans.

(2) Nonprofit institutions that receive at least \$25,000 but less than \$100,000 a year in Federal awards shall have an audit made in accordance with this Circular or have an audit made of each Federal award, in accordance with Federal laws and regulations governing the programs in which they participate.

(3) Nonprofit institutions receiving less than \$25,000 a year in Federal awards are exempt from Federal audit requirements, but records must be available for review by appropriate officials of the Federal grantor agency or subcontracting entity.

#### b. Oversight by Federal Agencies. (1)

To each of the larger nonprofit institutions the Office of Management and Budget (OMB) will assign a Federal agency as the cognizant agency for monitoring audits and ensuring the resolution of audit findings that affect the programs of more than one agency.

(2) Smaller institution not assigned a cognizant agency will be under the general oversight of the Federal agency that provides them with the most funds.

(3) Assignments to Federal cognizant agencies for carrying out responsibilities in this section are set forth in a separate supplement to this Circular.

(4) Federal Government-owned, contractor-operated facilities at institutions or laboratories operated primarily for the Government are not included in the cognizance assignments. These will remain the responsibility of the contracting agencies. The listed assignments cover all of the functions in this Circular unless otherwise indicated. The Office of Management and Budget will coordinate changes in agency assignments.

#### 3. Cognizant Agency Responsibilities.

A cognizant agency shall:

**a.** Ensure that audits are made and reports are received in a timely manner and in accordance with the requirements of this Circular.

**b.** Provide technical advice and liaison to institutions and independent auditors.

**c.** Obtain or make quality control reviews of selected audits made by non-Federal audit organizations, and provide the results, when appropriate, to other interested organizations.

**d.** Promptly inform other affected Federal agencies and appropriate Federal law enforcement officials of any reported illegal acts or irregularities. A cognizant agency should also inform State or local law enforcement and prosecuting authorities, if not advised by the recipient, of any violation of law within their jurisdiction.

**e.** Advise the recipient of audits that have been found not to have met the requirements set forth in this Circular. In such instances, the recipient will work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency shall notify the recipient and Federal awarding agencies of the facts and make recommendations for follow-up action. Major inadequacies or repetitive substandard performance of independent auditors shall be referred to appropriate professional bodies for disciplinary action.

**f.** Coordinate, to the extent practicable, audits or reviews made for Federal agencies that are in addition to

the audits made pursuant to this Circular, so that the additional audits or reviews build upon audits performed in accordance with the Circular.

g. Ensure the resolution of audit findings that affect the programs or more than one agency.

h. Seek the views of other interested agencies before completing a coordinated program.

i. Help coordinate the audit work and reporting responsibilities among independent public accountants, State auditors, and both resident and non-resident Federal auditors to achieve the most cost-effective audit.

4. *Oversight Agency Responsibilities.* An oversight agency shall provide technical advice and counsel to institutions and independent auditors when requested by the recipient. The oversight agency may assume all or some of the responsibilities normally performed by a cognizant agency.

5. *Recipient Responsibilities.* A recipient that receives a Federal award and provides \$25,000 or more of it during its fiscal year to a sub-recipient shall:

a. Ensure that the nonprofit institution sub-recipients that receive \$25,000 or more have met the audit requirements of this Circular, and that sub-recipients subject to OMB Circular A-128 have met the audit requirements of that Circular;

b. Ensure that appropriate corrective action is taken within six months after receipt of the sub-recipient audit report in instances of noncompliance with Federal laws and regulations;

c. Consider whether sub-recipient audits necessitate adjustment of the recipient's own records; and

d. Require each sub-recipient to permit independent auditors to have access to the records and financial statements as necessary for the recipient to comply with this Circular.

6. *Relation to Other Audit Requirements.* a. An audit made in accordance with this Circular shall be in lieu of any financial audit required under individual Federal awards. To the extent that an audit made in accordance with this Circular provides Federal agencies with the information and assurances they need to carry out their overall responsibilities, that shall rely upon and use such information.

However, a Federal agency shall make any additional audits or reviews necessary to carry out responsibilities under Federal law and regulation. Any additional Federal audits or reviews shall be planned and carried out in such a way as to build upon work performed by the independent auditor.

b. Audit planning by Federal audit agencies should consider the extent to which reliance can be placed upon work

performed by other auditors. Such auditors include State, local, Federal, and other independent auditors, and a recipient's internal auditors. Reliance placed upon the work of other auditors should be documented and in accordance with *Government Auditing Standards*.

c. The provisions of this Circular do not limit the authority of Federal agencies to make or contract for audits and evaluations of Federal awards, nor do they limit the authority of any Federal agency Inspector General or other Federal official.

d. The provisions of this Circular do not authorize any institution or sub-recipient thereof to constrain Federal agencies, in any manner, from carrying out additional audits, evaluations or reviews.

e. A Federal agency that makes or contracts for audits, in addition to the audits made by recipients pursuant to this Circular, shall, consistent with other applicable laws and regulations, arrange for funding the cost of such additional audits. Such additional audits or reviews include financial, performance audits and program evaluations.

7. *Frequency of Audit.* Audits shall usually be performed annually but not less frequently than every two years.

8. *Sanctions.* No audit costs may be charged to Federal awards when audits required by this Circular have not been made or have been made but not in accordance with this Circular. In cases of continued inability or unwillingness to have a proper audit in accordance with the Circular, Federal agencies must consider appropriate sanctions including:

- withholding a percentage of awards until the audit is completed satisfactorily;
- withholding or disallowing overhead costs; or
- suspending Federal awards until the audit is made.

9. *Audit Costs.* The cost of audits made in accordance with the provisions of this Circular are allowable charges to Federal awards. The charges may be considered a direct cost or an allocated indirect cost, determined in accordance with the provisions of Circular A-21, "Cost Principles for Universities" or Circular A-122, "Cost Principles for Nonprofit Organizations," FAR subpart 31, or other applicable cost principles or regulations.

10. *Auditor Selection.* In arranging for audit services institutions shall follow the procurement standards prescribed by Circular A-110, "Uniform Requirements for Grants and Agreements with Institutions of Higher

Education, Hospitals and other Nonprofit Organizations."

11. *Small and Minority Audit Firms.*

a. Small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals shall have the maximum practicable opportunity to participate in contracts awarded to fulfill the requirements of this Circular.

b. Recipients of Federal awards shall take the following steps to further this goal:

(1) Ensure that small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals are used to the fullest extent practicable;

(2) Make information on forthcoming opportunities available and arrange timeframes for the audit to encourage and facilitate participation by small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals;

(3) Consider in the contract process whether firms competing for larger audits intend to subcontract with small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals;

(4) Encourage contracting with small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals which have traditionally audited government programs, and in cases where this is not possible, assure that these firms are given consideration for audit subcontracting opportunities;

(5) Encourage contracting with consortiums of small audit firms as described in section (1), above, when a contract is too large for an individual small audit firm or audit firm owned and controlled by socially and economically disadvantaged individuals; and

(6) Use the services and assistance, as appropriate, of such organizations as the Small Business Administration in the solicitation and utilization of small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals.

12. *Scope of Audit and Audit Objectives.*

a. The audit shall be made by an independent auditor in accordance with *Government Auditing Standards* developed by the Comptroller General of the United States covering financial audits. An audit under this Circular should be an organization-wide audit of the institution. However, there may be instances where Federal auditors are performing audits or are planning to perform audits at nonprofit institutions. In these cases, to minimize duplication

of audit work, a coordinated audit approach may be agreed upon between the independent auditor, the recipient and the cognizant agency or the oversight agency. Those auditors who assume responsibility for any or all of the reports called for by paragraph 15 should follow guidance set forth in *Government Auditing Standards* in using work performed by others.

b. The auditor shall determine whether: (1) The financial statements of the institution present fairly its financial position and the results of its operations in accordance with generally accepted accounting principles; (2) The institution has an internal control structure to provide reasonable assurance that the institution is managing Federal awards in compliance with applicable laws and regulations, and controls that ensure compliance with the laws and regulations that could have a material impact on the financial statements; and (3) The institution has complied with laws and regulations that may have a direct and material effect on its financial statement amounts and on each major Federal program.

### 13. Internal Controls Over Federal Awards; Compliance Reviews.

a. *General.* The independent auditor shall determine and report on whether the recipient has an internal control structure to provide reasonable assurance that it is managing Federal awards in compliance with applicable laws, regulations, and contract terms, and that it safeguards Federal funds. In performing these reviews, independent auditors should rely upon work performed by a recipient's internal auditors to the maximum extent possible. The extent of such reliance should be based upon the *Government Auditing Standards*.

b. *Internal Control Review.* (1) In order to provide this assurance on internal controls, the auditor must obtain an understanding of the internal control structure and assess levels of internal control risk. After obtaining an understanding of the controls, the assessment must be made whether or not the auditor intends to place reliance on the internal control structure.

(2) As part of this review, the auditor shall: (a) Perform tests of controls to evaluate the effectiveness of the design and operation of the policies and procedures in preventing or detecting material noncompliance. Tests of controls will not be required for those areas where the internal control structure policies and procedures are likely to be ineffective in preventing or detecting noncompliance, in which case a reportable condition or a material weakness should be reported in

accordance with paragraph 15 c(2) of this Circular.

(b) Review the recipient's system for monitoring sub-recipients and obtaining and acting on sub-recipient audit reports.

(c) Determine whether controls are in effect to ensure direct and indirect costs were computed and billed in accordance with the guidance provided in the general requirements section of the compliance supplement to this Circular.

### c. Compliance Review.

(1) The auditor shall determine whether the recipient has complied with laws and regulations that may have a direct and material effect on any of its major Federal programs. In addition, transactions selected for non-major programs shall be tested for compliance with Federal laws and regulations that apply to such transactions.

(2) In order to determine which major programs are to be tested for compliance, recipients shall identify, in their accounts, all Federal funds received and expended and the programs under which they were received. This shall include funds received directly from Federal agencies, through other State and local governments or other recipients. To assist recipients in identifying Federal awards, Federal agencies and primary recipients shall provide the *Catalog of Federal Domestic Assistance* (CFDA) numbers to the recipients when making the awards.

(3) The review must include the selection of an adequate number of transactions from each major Federal financial assistance program so that the auditor obtains sufficient evidence to support the opinion on compliance required by paragraph 15c(3) of this Attachment. The selection and testing of transactions shall be based on the auditors' professional judgment considering such factors as the amount of expenditures for the program; the newness of the program or changes in its conditions; prior experience with the program particularly as revealed in audits and other evaluations (e.g., inspections, program reviews, or system reviews required by Federal Acquisition Regulations); the extent to which the program is carried out through sub-recipients; the extent to which the program contracts for goods or services; the level to which the program is already subject to program reviews or other forms of independent oversight; the adequacy of the controls for ensuring compliance; the expectation of adherence or lack of adherence to the applicable laws and regulations; and the potential impact of adverse findings.

(4) In making the test of transactions, the auditor shall determine whether:

—the amounts reported as expenditures were for allowable services, and  
—the records show that those who received services or benefits were eligible to receive them.

(5) In addition to transaction testing, the auditor shall determine whether:

—Matching requirements, levels of effort and earmarking limitations were met,  
—Federal financial reports and claims for advances and reimbursement contain information that is supported by books and records from which the basic financial statements have been prepared, and  
—Amounts claimed or used for matching were determined in accordance with (1) OMB Circular A-21, "Cost Principles for Educational Institutions"; (2) matching or cost sharing requirements in Circular A-110, "Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Nonprofit Organizations"; (3) Circular A-122, "Cost Principles for Nonprofit Organizations"; (4) FAR subpart 31 cost principles; and (5) other applicable cost principles or regulations.

(6) The principal compliance requirements of the largest Federal programs may be ascertained by referring to the "Compliance Supplement for Single Audits of Educational Institutions and Other Nonprofit Organizations," and the "Compliance Supplement for Single Audits of State and Local Governments," issued by OMB and available from the Government Printing Office. For those programs not covered in the Compliance Supplements, the auditor should ascertain compliance requirements by reviewing the statutes, regulations, and agreements governing individual programs.

(7) Transactions related to other awards that are selected in connection with examinations of financial statements and evaluations of internal controls shall be tested for compliance with Federal laws and regulations that apply to such transactions.

14. *Illegal Acts.* If, during or in connection with the audit of a nonprofit institution, the auditor becomes aware of illegal acts, such acts shall be reported in accordance with the provisions of the *Government Auditing Standards*.

### 15. Audit Reports.

a. Audit reports must be prepared at the completion of the audit.

b. The audit report shall state that the audit was made in accordance with the provisions of this Circular.

c. The report shall be made up of at least the following three parts:

(1) The financial statements and a schedule of Federal awards and the auditor's report on the statements and the schedule. The schedule of Federal awards should identify major programs and show the total expenditures for each program. Individual major programs other than Research and Development and Student Aid should be listed by catalog number as identified in the *Catalog of Federal Domestic Assistance*. Expenditures for Federal programs other than major programs shall be shown under the caption "other Federal assistance." Also, the value of non-cash assistance such as loan guarantees, food commodities or donated surplus properties or the outstanding balance of loans should be disclosed in the schedule.

(2) A written report of the independent auditor's understanding of the internal control structure and the assessment of control risk. The auditor's report should include as a minimum: (1) The scope of the work in obtaining understanding of the internal control structure and in assessing the control risk, (2) the nonprofit institution's significant internal controls or control structure including the controls established to ensure compliance with laws and regulations that have a material impact on the financial statements and those that provide reasonable assurance that Federal awards are being managed in compliance with applicable laws and regulations, and (3) the reportable conditions, including the identification of material weaknesses, identified as a result of the auditor's work in understanding and assessing the control risk. If the auditor limits his/her consideration of the internal control structure for any reason, the circumstances should be disclosed in the report.

(3) The auditor's report on compliance containing:

—An opinion as to whether each major Federal program was being administered in compliance with laws and regulations applicable to the matters described in paragraph 13(c)(3) of this Attachment, including compliance with laws and regulations pertaining to financial reports and claims for advances and reimbursements;

—A statement of positive assurance on those items that were tested for compliance and negative assurance on those items not tested;

—Material findings of noncompliance presented in their proper perspective:

- The size of the universe in number of items and dollars,
- The number and dollar amount of transactions tested by the auditors,
- The number of corresponding dollar amount of instances of noncompliance;

—Where findings are specific to a particular Federal award, an identification of total amounts questioned, if any, for each Federal award, as a result of noncompliance and the auditor's recommendations for necessary corrective actions.

d. The three parts of the audit report may be bound into a single document, or presented at the same time as separate documents.

e. Nonmaterial findings need not be disclosed with the compliance report but should be reported in writing to the recipient in a separate communication. The recipient, in turn, should forward the findings to the Federal grantor agencies or subgrantor sources.

f. All fraud or illegal acts or indications of such acts, including all questioned costs found as the result of these acts that auditors become aware of, may be covered in a separate written report submitted in accordance with the *Government Auditing Standards*.

g. The auditor's report should disclose the status of known but uncorrected significant material findings and recommendations from prior audits that affect the current audit objectives as specified in the *Government Auditing Standards*.

h. In addition to the audit report, the recipient shall provide a report of its comments on the findings and recommendations in the report, including a plan for corrective action taken or planned and comments on the status of corrective action taken on prior findings. If corrective action is not necessary, a statement describing the reason it is not should accompany the audit report.

i. Copies of the audit report shall be submitted in accordance with the reporting standards for financial audits contained in the *Government Auditing Standards*. Sub-recipient auditors shall submit copies to recipients that provided Federal awards. The report shall be due within 30 days after the completion of the audit, but the audit should be completed and the report submitted not later than 13 months after the end of the recipient's fiscal year unless a longer period is agreed to with the cognizant or oversight agency.

j. Recipients of more than \$100,000 in Federal awards shall submit one copy of

the audit report within 30 days after issuance to a central clearinghouse to be designated by the Office of Management and Budget. The clearinghouse will keep completed audit reports on file.

k. Recipients shall keep audit reports, including subrecipient reports, on file for three years from their issuance.

#### 16. Audit Resolution.

a. As provided in paragraph 3, the cognizant agency shall be responsible for ensuring the resolution of audit findings that affect the programs of more than one Federal agency. Resolution of findings that relate to the programs of a single Federal agency will be the responsibility of the recipient and the agency. Alternate arrangements may be made on case-by-case basis by agreement among the agencies concerned.

b. A management decision shall be made within six months after receipt of the report by the Federal agencies responsible for audit resolution. Corrective action should proceed as rapidly as possible.

17. *Audit Workpapers and Reports.* Workpapers and reports shall be retained for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by the cognizant agency to extend the retention period. Audit workpapers shall be made available upon request to the cognizant agency or its designee or the General Accounting Office, at the completion of the audit.

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