

1998

# Audits of states, local governments, and not-for-profit organizations receiving federal awards; Statement of position 98-3;

American Institute of Certified Public Accountants. Single Audit Working Group

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**AICPA**

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

*March 17, 1998*

## **Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards**

*Includes Guidance on the Single Audit Act Amendments  
of 1996 and Office of Management and Budget  
Circular A-133, *Audits of States, Local Governments,  
and Non-Profit Organizations* (June 1997 Revision)*

*Supersedes AICPA Statement of Position 92-9,  
*Audits of Not-for-Profit Organizations Receiving Federal Awards*,  
and Part VII, "Audits of Federal Financial Assistance," of the  
AICPA Audit and Accounting Guide *Audits of State and  
Local Governmental Units**

*Issued Under the Authority of the  
Auditing Standards Board*

## **NOTE**

This Statement of Position presents the recommendations of the AICPA Single Audit Working Group regarding the performance of audits in accordance with the Single Audit Act Amendments of 1996 and Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (June 1997 revision). This edition incorporates guidance contained in *Government Auditing Standards* (1994 revision) and Statement on Auditing Standards No. 74, *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance*. Members of the AICPA Auditing Standards Board have found the recommendations in this Statement of Position to be consistent with existing standards covered by rule 202 of the AICPA Code of Professional Conduct. AICPA members should be prepared to justify departures from the recommendations in this Statement of Position.



## **Stop using the separate pamphlet for SOP 98-3**

*Submitted by lvolkert on 10/20/1999 01:41 PM*

Statement of Position 98-3, Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards, issued 3/17/98, is now out of date.

In mid-1999, we made a decision to no longer sell SOP 98-3 as a separate document. Instead, it will be updated each year for conforming changes and included as an appendix to both the NFP Guide and the S&L Govt. Guide. This policy began with the May 1999 conforming changes to the guides. The latest version of SOP 98-3 is included in the May 1999 version of the NFP and govt. guides. It did change a bit because we had to update it (including the illustrative reports) for SAS No. 87. It will continue to be updated on an annual basis. If you search the SOP electronically, make sure you are searching the most recent version.

Per Mary Foelster's e-mail dated 10/20/99

Mary Foelster

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## SUMMARY

This Statement of Position (SOP) provides guidance on the auditor's responsibilities when conducting a single audit or program-specific audit in accordance with the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (June 1997 revision). This SOP supersedes SOP 92-9, *Audits of Not-for-Profit Organizations Receiving Federal Awards*, and part VII, "Audits of Federal Financial Assistance," of the AICPA Audit and Accounting Guide *Audits of State and Local Governmental Units*.

In addition to providing an overview of the auditor's responsibilities in an audit of federal awards, this SOP—

- Describes the applicability of the Single Audit Act Amendments of 1996 and Circular A-133.
- Describes the auditor's responsibility for testing and reporting on the schedule of expenditures of federal awards.
- Describes the auditor's responsibility for considering internal control and for performing tests of compliance with applicable laws, regulations, and program compliance requirements under generally accepted auditing standards, *Government Auditing Standards*, and Circular A-133.
- Describes the auditor's responsibility for reporting and provides examples of the reports required by *Government Auditing Standards* and Circular A-133.
- Describes the auditor's responsibility for testing and reporting in a program-specific audit.

Further, this SOP incorporates guidance from the following documents:

- The Single Audit Act Amendments of 1996 and Circular A-133
- AICPA Statement on Auditing Standards No. 74, *Compliance Auditing Considerations in Audits of Govern-*

*mental Entities and Recipients of Governmental  
Financial Assistance*

- *Government Auditing Standards* (1994 revision)
- *The OMB Circular A-133 Compliance Supplement*  
(June 1997 revision)



# CHAPTER 1

## Introduction and Overview

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### Introduction

#### Purpose and Applicability

- 1.1 The purpose of this Statement of Position (SOP) is to provide auditors of states, local governments, and not-for-profit organizations (NPOs) that receive federal awards with a basic understanding of the procedures they should perform and of the reports they should issue for single audits and program-specific audits under—
- a. The Single Audit Act Amendments of 1996 (hereinafter referred to as the Single Audit Act or the Act).<sup>1</sup>
  - b. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*,<sup>2</sup> and the related *OMB Circular A-133 Compliance Supplement*.
  - c. The standards applicable to financial audits contained in the 1994 revision of *Government Auditing Standards* (also referred to as the Yellow Book), issued by the Comptroller General of the United States of the U.S. General Accounting Office (GAO).<sup>3</sup> These standards incorporate the fieldwork and reporting standards of generally accepted auditing standards (GAAS)<sup>4</sup> issued

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1. The Single Audit Act Amendments of 1996 (Public Law 104-156) was enacted into law in July 1996 and replaced the Single Audit Act of 1984. A reprint of the Single Audit Act Amendments of 1996 is included in appendix A of this SOP.

2. Circular A-133 (as revised on June 30, 1997), is reprinted in appendix B of this SOP.

3. The standards applicable to financial audits include the general, fieldwork, and reporting standards described in chapters 3, 4, and 5 of *Government Auditing Standards*.

4. GAAS requirements are discussed in this SOP to the extent necessary to explain the related requirements of *Government Auditing Standards*. Auditors should refer to relevant AICPA Statements on Auditing Standards and also related Audit and Accounting Guides such as *Not-for-Profit Organizations*, *Health Care Organizations*, and *Audits of State and Local Governmental Units* for additional information on GAAS requirements.

by the American Institute of Certified Public Accountants (AICPA).

- 1.2 This SOP provides guidance about financial and compliance auditing standards and requirements related to single audits (chapters 1 through 10) and program-specific audits (chapter 11) for entities (also referred to as auditees) subject to the Single Audit Act and Circular A-133. Applicable standards and requirements are promulgated by the OMB, GAO, and AICPA. This SOP also provides guidance on applicable auditing standards and requirements established by those organizations to assist auditors in planning, performing, and reporting on single audits and program-specific audits in accordance with those standards and requirements, and includes illustrative audit reports. Since Circular A-133 is the federal policy guidance to which auditors are held in performing single audits, this SOP will primarily focus on its requirements.
- 1.3 This SOP is organized by chapters in which the important considerations in performing single audits and program-specific audits are discussed (see table of contents).
- 1.4 This SOP is not a complete manual of procedures, nor should it supplant the auditor's judgment about the audit work required in particular situations. Because of the variety of federal, state, and local financial assistance programs and the complexity of the regulations that govern them, the procedures included in this SOP cannot cover all the circumstances or conditions that would be encountered in the audits of every entity. The auditor should use professional judgment to tailor his or her procedures to meet the conditions of the particular engagement, so that the audit objectives may be achieved.
- 1.5 Auditors should be aware that certain states have imposed additional audit requirements related to state or local financial assistance. The guidance in this SOP does not extend to individual state requirements (except for the guidance in paragraphs 3.47, 3.48, and 6.71). Furthermore, pass-through entities may impose additional audit requirements on their subrecipients related to the financial assistance passed through. The guidance in this SOP also does not extend to those requirements.

## Definitions

- 1.6 The terms used in this SOP are intended to be consistent with the definitions in the Single Audit Act and Circular A-133. Similarly, the term *not-for-profit organization* as used in this SOP is consistent with the definition of the term *non-profit organization* in Circular A-133 (see appendix B) and includes not-for-profit institutions of higher education, hospitals, and other health care providers.

## Effective Dates

- 1.7 The requirements of the Single Audit Act and Circular A-133 are effective for audits of fiscal years beginning after June 30, 1996. This SOP also includes auditing guidance through AICPA Statement on Auditing Standards (SAS) No. 85, *Management Representations* (AICPA, *Professional Standards*, vol. 1, AU sec. 333). The effective dates of this auditing guidance should be applied as provided for in the related literature. This SOP does not change the effective dates of the auditing standards, the Act, and Circular A-133. The remaining provisions of this SOP are applicable to audits of fiscal years beginning after June 30, 1996, in which the related fieldwork commences on or after March 1, 1998. Earlier application is encouraged.

## Objectives of a Single Audit

- 1.8 A single audit has two main objectives: (a) an audit of the entity's financial statements and the reporting on the schedule of expenditures of federal awards in relation to those financial statements and (b) a compliance audit of federal awards expended during the fiscal year. Each of these results in the preparation and issuance of certain audit reports (see paragraph 2.7 for a more detailed description of the audit objectives).

## ***Audit of Entity's Financial Statements and Reporting on the Schedule of Expenditures of Federal Awards***

- 1.9 The financial statement audit required by Circular A-133 is performed in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* and GAAS, and it results in the auditor reporting on

the entity's financial statements and on the scope of the auditor's testing of compliance and internal control over financial reporting and presents the results of those tests. The primary sources of guidance and standards regarding financial statement audits are the AICPA Statements on Auditing Standards (SASs), particularly SAS No. 74, *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance* (AICPA, *Professional Standards*, vol. 1, AU sec. 801); *Government Auditing Standards*; and the following AICPA Audit and Accounting Guides, as applicable: *Not-for-Profit Organizations*, *Audits of State and Local Governmental Units*, *Health Care Organizations*, and *Audits of Colleges and Universities*.<sup>5</sup> Refer to chapter 4 for a more detailed discussion of financial statement audit considerations under Circular A-133. Guidance on reporting on the schedule of expenditures of federal awards is provided in SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1, AU sec. 551). Refer to chapter 5 for a more detailed discussion of the schedule of expenditures of federal awards.

## **Compliance Audit of Federal Awards**

1.10 Under Circular A-133, the auditor has additional testing and reporting responsibilities for compliance, as well as internal control over compliance, beyond a financial statement audit performed in accordance with *Government Auditing Standards* and GAAS. The compliance audit of federal awards expended during the fiscal year provides a basis for issuing an additional report on compliance related to major programs and on internal control over compliance.<sup>6</sup> The various types of federal awards and payment methods are described in paragraphs 1.17 through 1.23. Compliance auditing considerations applicable to major programs and internal control over compliance are discussed in chapters 6 and 8. Reporting is discussed in chapter 10.

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5. Auditors should note that although *Audits of Colleges and Universities* has been superseded by *Not-for-Profit Organizations*, it continues to be applicable in a governmental environment (that is, public institutions).

6. A major program is defined in Circular A-133. See the discussion of the determination of major programs in chapter 7.

## **Adherence to Professional Standards and Requirements**

- 1.11 The auditor should be aware that AICPA Ethics Interpretation 501-3, *Failure to Follow Standards and/or Procedures or Other Requirements in Governmental Audits*, states that when an auditor undertakes an audit of government grants or recipients of government monies and agrees to follow specified government audit standards, guides, procedures, statutes, rules, and regulations, he or she is obligated to follow these standards or guidelines in addition to GAAS. Failure to do so is an act discreditable to the profession and a violation of rule 501 of the AICPA Code of Professional Conduct, unless it is disclosed in the auditor's report that these rules were not followed and the reasons for doing so are given.

## **Relationship of the Single Audit Act, Circular A-133, Government Auditing Standards, and GAAS**

- 1.12 The Single Audit Act Amendments of 1996 were enacted to streamline and improve the effectiveness of audits of federal awards and to reduce the audit burden on states, local governments, and NPOs. Those goals were achieved, in part, by increasing the dollar threshold for requiring a single audit to \$300,000 in federal awards expended from \$25,000 in federal awards received and introducing a risk-based approach for determining which federal programs are to be considered major programs (see paragraph 2.2 for a further discussion of the audit threshold). The Single Audit Act requires single audits and program-specific audits of federal awards to be performed in accordance with *Government Auditing Standards*,<sup>7</sup> and gives the Director of OMB the authority to develop government-wide guidelines and policy on performing audits to comply with the Act. The OMB established audit guidelines and policy in

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7. *Government Auditing Standards* includes standards for financial audits as well as for performance audits. The references to *Government Auditing Standards* in this SOP encompass only the standards applicable to financial audits and not the performance audit standards (see note 3). However, *Government Auditing Standards* states that auditors should follow, as appropriate, the report contents standards for objectives, scope, and methodology; audit results; the view of responsible officials; and its report presentation standards. A discussion of these standards is contained in the performance auditing standards in chapter 7 of *Government Auditing Standards* (see paragraph 10.21).

Circular A-133, which was revised and issued June 30, 1997,<sup>8</sup> and establishes a uniform system of auditing states, local governments, and NPOs that expend federal awards. (Chapter 2 provides an overview of Single Audit Act and Circular A-133 requirements.) Circular A-133 has been adopted in regulation by individual federal departments and agencies.

- 1.13 In performing audits in accordance with the standards applicable to financial audits contained in *Government Auditing Standards*, the auditor assumes certain responsibilities beyond those of audits performed in accordance with GAAS.<sup>9</sup> *Government Auditing Standards* includes general standards, incorporates the fieldwork and reporting standards under GAAS, and includes additional fieldwork and reporting standards. *Government Auditing Standards* includes additional standards in such areas as quality control reviews, continuing professional education, working papers, and audit follow-up (see paragraphs 3.8 through 3.21 for a detailed discussion of the additional standards). The reporting responsibilities in *Government Auditing Standards* require additional reporting on compliance and on internal control over financial reporting (see paragraphs 3.19 through 3.21 and 10.15 through 10.16 for a detailed discussion of the reporting requirements).

## **Compliance Testing**

- 1.14 Table 1.1 presents the relationship among the compliance testing requirements of GAAS, *Government Auditing Standards*, the Single Audit Act, and Circular A-133. Compliance testing requirements are discussed in detail in chapter 6. SAS

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8. The June 30, 1997, revision to Circular A-133 superseded OMB Circular A-128, *Audits of State and Local Governments*, and all previous versions of Circular A-133.

9. Paragraphs 21 through 23 of SAS No. 74 describe the auditor's responsibility when he or she has been engaged to perform an audit in accordance with GAAS and becomes aware that the entity is subject to an audit requirement that may not be encompassed in the terms of the engagement. In such a situation, SAS No. 74 requires that the auditor communicate to management and the audit committee, or to others with equivalent authority or responsibility, that an audit in accordance with GAAS alone may not satisfy the relevant legal, regulatory, or contractual requirements. That communication may be oral or written. However, if the communication is oral, the auditor should document the communication in the working papers. The auditor should consider how the client's actions in response to such a communication relate to other aspects of the audit, including the potential effect on the financial statements and on the auditor's report on those financial statements. Specifically, the auditor should consider management's actions in relation to the guidance in SAS No. 54, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol.1, AU sec. 317), and SAS No. 82, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol.1, AU sec. 316).

No. 74 provides general guidance on the auditor's responsibility for compliance auditing under GAAS, *Government Auditing Standards*, and federal audit requirements. In SAS No. 54, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1, AU sec. 317), the auditor's responsibility in a GAAS audit for considering laws and regulations and how they affect the financial statement audit is described. SAS No. 82, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316), and SAS No. 47, *Audit Risk and Materiality in Conducting an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 312), as amended by SAS No. 82, describe the auditor's responsibility in a GAAS audit for the consideration of fraud and errors.

### **Internal Control Consideration**

1.15 Table 1.2 presents the relationship among the requirements to consider internal control under GAAS, *Government Auditing Standards*, the Single Audit Act, and Circular A-133. Internal control requirements are discussed in detail in chapters 4 and 8.

**TABLE 1.1 Compliance Testing**

	Fieldwork Responsibilities	Reporting Responsibilities
Generally accepted auditing standards	Design the audit to provide reasonable assurance that the financial statements are free of material misstatements resulting from violations of laws and regulations that have a direct and material effect on the determination of financial statement amounts in accordance with SAS No. 54, <i>Illegal Acts by Clients</i> , as described in SAS No. 74, <i>Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance</i> , and to provide reasonable assurance about whether the financial statements are free of material misstatements (whether caused by error or	Requires the auditor to adequately inform the audit committee or others with equivalent authority and responsibility about any illegal acts that the auditor becomes aware of during the audit unless they are clearly inconsequential. Whenever the auditor has determined that there is evidence that fraud may exist, that matter should be brought to the attention of an appropriate level of management. Fraud involving senior management and fraud that causes a material misstatement of the financial statements should be reported directly to the audit committee. When the auditor identifies fraud risk

*continued*

**TABLE 1.1 Compliance Testing (continued)**

	Fieldwork Responsibilities	Reporting Responsibilities
	fraud), as described in SAS No. 82, <i>Consideration of Fraud in a Financial Statement Audit</i> , and SAS No. 47, <i>Audit Risk and Materiality in Conducting an Audit</i> .	factors that have continuing control implications, the auditor should communicate those factors that are considered reportable conditions to senior management and the audit committee. See SAS No. 82, paragraphs 38 through 40, for an additional discussion of the reporting requirements of SAS No. 82.
<i>Government Auditing Standards</i>	Same responsibilities as required by GAAS, but <i>Government Auditing Standards</i> specifically states that auditors should design the audit to provide reasonable assurance of detecting material misstatements resulting from noncompliance with provisions of contracts or grant agreements that have a direct and material effect on the determination of financial statement amounts.	Requires a written report describing the scope of the auditor's testing of compliance with laws and regulations and presenting the results of those tests (additional details on the reporting responsibilities are included in paragraphs 10.15, 10.16, and 10.21 through 10.25).
Single Audit Act and Circular A-133	Determine whether the entity complied with laws, regulations, and the provisions of contracts or grant agreements pertaining to federal awards that have a direct and material effect on each major program.	Requires the auditor to express an opinion on whether the entity complied with laws, regulations, and with the provisions of contracts or grant agreements which could have a direct and material effect on each major program and, where applicable, refer to a separate schedule of findings and questioned costs.

**TABLE 1.2 Internal Control Responsibilities**

	Fieldwork Responsibilities	Reporting Responsibilities
Generally accepted auditing standards	Obtain an understanding of internal control over financial reporting sufficient to plan the audit by performing procedures to understand both the design of controls relevant to an audit of financial statements and whether they have	Requires the auditor to communicate, either orally or in writing, any reportable conditions as described in SAS No. 60, <i>Communication of Internal Control Related Matters Noted in an Audit</i> .



**Fieldwork  
Responsibilities**

**Reporting  
Responsibilities**

been placed in operation, and assess control risk, in accordance with SAS No. 55, *Consideration of Internal Control in a Financial Statement Audit*, as amended by SAS No. 78, *Consideration of Internal Control in a Financial Statement Audit: An Amendment to SAS No. 55*.

**Government  
Auditing  
Standards**

Same responsibilities as GAAS. *Government Auditing Standards* provides additional guidance on the control environment, safeguarding controls, controls over compliance with laws and regulations, and control risk assessments.

Requires a written report describing the scope of the auditor's testing of internal control and presenting the results of those tests. Also requires separate identification and written communication of all reportable conditions, including those reportable conditions that are individually or cumulatively material weaknesses.

**Single Audit  
Act and  
Circular  
A-133**

With regard to internal control over compliance, the auditor is required to do the following (in addition to the requirements of *Government Auditing Standards*): (1) perform procedures to obtain an understanding of internal control over federal programs that is sufficient to plan the audit to support a low assessed level of control risk for major programs, (2) 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 (3) perform tests of internal control (unless the internal control is likely to be ineffective in preventing or detecting noncompliance).

Requires a written report on internal control over major programs describing the scope of testing internal control and the results of the tests, and, where applicable, referring to a separate schedule of findings and questioned costs.

\* Circular A-133 requires the auditor to plan the audit to support a low assessed level of control risk for major programs; however, it does not actually require the achievement of a low assessed level of control risk. See paragraphs 8.16 through 8.22.

## Reporting

1.16 A matrix depicting the recommended auditor's reports in a single audit required by GAAS, *Government Auditing Standards*, and Circular A-133 appears in table 1.3. Reporting is discussed in detail in chapter 10.

**TABLE 1.3 Recommended Reporting in Single Audits**

Report	Required by—		
	GAAS	Government Auditing Standards	Circular A-133
Opinion (or disclaimer of opinion) on financial statements and supplementary schedule of expenditures of federal awards	X	X	X
Report on compliance and on internal control over financial reporting based on an audit of financial statements		X	X
Report on compliance and internal control over compliance applicable to each major program (this report must include an opinion [or disclaimer of opinion] on compliance)			X
Schedule of findings and questioned costs			X

## Types of Federal Awards and Payment Methods

### Definition of Federal Awards

1.17 Circular A-133 defines federal awards as *federal financial assistance* and *federal cost-reimbursement contracts* that auditees 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. See paragraph 2.15 for a discussion of subrecipient and vendor determinations.

### Federal Financial Assistance—Classification and Types

1.18 Federal sponsors have classified federal financial assistance into program categories in the *Catalog of Federal Domestic Assistance* (CFDA), published by the Government Printing Office. Circular A-133 defines federal programs as all fed-

eral awards under the same CFDA number. Certain clusters of federal programs should be treated as one program for determining major programs. Research and development, student financial aid, and certain other programs are defined as a cluster in the *OMB Circular A-133 Compliance Supplement* because they are closely related and share common compliance requirements (see paragraphs 1.26 through 1.28 and chapters 2 and 6 for additional discussion of the *Compliance Supplement*).

- 1.19 Sometimes state governments combine funding from different federal awards in providing assistance to their subrecipients when the awards are closely related programs and share common compliance requirements. In this case, Circular A-133 states that the state may require the subrecipient to treat the combined federal awards as a cluster of programs. See paragraph 2.18 for further information.
- 1.20 There are over 1,000 individual grant programs and several distinct types of federal award payment methods. Many of these programs are described in the CFDA; however, certain programs may not be included. For example, contracts may not be listed in the CFDA. Circular A-133 states that when a CFDA number is not assigned, all federal awards from the same agency that are made for the same purpose should be combined and considered one program.
- 1.21 Programs in the CFDA are classified into fifteen types of assistance. Benefits and services are provided through seven financial and eight nonfinancial types of assistance. The following list describes the eight principal types of assistance that are available.
  - *Formula grants.* For activities of a continuing nature not confined to a specific project, allocations of money to nonfederal entities are made in accordance with a distribution formula prescribed by law or administrative regulation. One example is the Department of Agriculture's award to land-grant universities for cooperative extension services. Another example is the Department of Justice's award to state and local governments for drug control and systems improvement.

- *Project grants.* These involve the funding (for fixed or known periods) of specific projects, or the delivery of specific services or products, without liability for damages resulting from a failure to perform. Project grants include fellowships, scholarships, research grants, training grants, traineeships, experimental and demonstration grants, evaluation grants, planning grants, technical assistance grants, construction grants, and unsolicited contractual agreements.
- *Direct payments for specific use.* Financial assistance is provided by the federal government directly to individuals, private firms, and other private institutions to encourage or subsidize a particular activity by conditioning the receipt of the assistance upon the recipient's performance. These do not include solicited contracts for the procurement of goods and services for the federal government.
- *Direct payments with unrestricted use.* Financial assistance is provided by the federal government directly to beneficiaries who satisfy federal eligibility requirements with no restrictions imposed on how the money is spent. Included are payments under retirement, pension, and compensation programs.
- *Direct loans.* Financial assistance is provided through the lending of federal monies for a specific period of time, with a reasonable expectation of repayment. Such loans may or may not require the payment of interest.
- *Guaranteed insured loans.* For these programs, the federal government makes an arrangement to indemnify a lender against part of any defaults by those responsible for the repayment of loans.
- *Insurance.* Financial assistance is provided to assure reimbursement for losses sustained under specified conditions. Coverage may be provided directly by the federal government or through a private carrier, and may or may not involve the payment of premiums.
- *Sale, exchange, or donation of property and goods.* These programs provide for the sale, exchange, or donation of federal real property, personal property,

commodities, and other goods, including land, buildings, equipment, food, and drugs. This does not include the loan of, use of, or access to federal facilities or property.

### **Federal Cost-Reimbursement Contracts**

- 1.22 The definition of federal awards also includes federal cost-reimbursement contracts. These are contracts with nonfederal entities to provide goods or services to the federal government. These contracts are generally governed by the Federal Acquisition Regulations (found in part 41 of the *Code of Federal Regulations*) and the terms of the contracts.
- 1.23 Awards may be provided to entities through reimbursement arrangements in which recipients bill grantors for costs as incurred. Some programs provide for advance payments. Other programs permit entities to draw cash as grant expenditures are incurred.

### **Determining the Scope of a Single Audit**

- 1.24 The scope of the auditor's work in an audit in accordance with Circular A-133 is determined by (a) the level of assessed risk associated with the federal programs and whether they are identified as a major program and (b) the compliance requirements applicable to those programs.

### **Risk-Based Approach**

- 1.25 The audit scope depends on whether the federal awards expended are identified as relating to major programs. Circular A-133 places the responsibility for identifying major programs on the auditor, and it provides criteria for the auditor to use in applying a risk-based approach. The auditor's determination of the programs to be audited is based on an overall evaluation of the risk of noncompliance occurring which could be material to the individual federal programs. In evaluating risk, the auditor considers, among other things, the current and prior audit experience with the auditee, oversight by the federal agencies and pass-through entities, and the inherent risk of the federal programs. Chapter 7 includes a detailed discussion of applying the risk-based approach to determining major programs.

## **Compliance Requirements**

- 1.26 Circular A-133 requires the auditor to 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. The term *compliance requirements* refers to the laws, regulations, and provisions of contracts and grant agreements that an auditor should consider in making this determination (see chapter 6 for a more detailed discussion).
- 1.27 The principal compliance requirements and suggested audit procedures for the largest federal programs are included in the *Compliance Supplement*.<sup>10</sup>
- 1.28 With regard to federal programs included in the *Compliance Supplement*, the auditor should follow the guidance contained in the *Compliance Supplement* for testing compliance requirements. The auditor should be aware that compliance requirements may change over time. Thus, the auditor should also inquire of the auditee and review the provisions of grant agreements to determine whether compliance requirements reflected in the *Compliance Supplement* have changed. If there have been changes, the auditor should follow the provisions of the *Compliance Supplement* as modified by the changes (see chapters 2 and 6 for a more detailed discussion of the *Compliance Supplement*). For programs not listed in the *Compliance Supplement*, the auditor should follow *Compliance Supplement* part 7 “Guidance for Auditing Programs Not Included in This Compliance Supplement,” which instructs the auditor to use the types of compliance requirements (for example, cash management, reporting, allowable costs/cost principles, activities allowed or unallowed, eligibility, and matching, level of effort, and earmarking) contained in the *Compliance Supplement* as guidance for identifying the types of compliance requirements to test, and to determine the requirements governing the federal program by review-

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10. A copy of the *Compliance Supplement* may be obtained from EOP Publications, Office of Administration, 2200 NEOB, Washington, D.C. 20503; (202) 395-7332. It is also available from the OMB’s home page at <http://www.whitehouse.gov/WH/EOP/omb>, under the captions “OMB Documents,” and then “Grants Management,” and the Office of Inspector General home page at <http://www.ignet.gov>.

ing the provisions of contracts and grant agreements and the laws and regulations referred to in such contracts and grant agreements.

- 1.29 In addition, some agencies have developed audit guides or supplements related to their programs. Auditors should consult with the applicable federal agency to determine the availability of agency-prepared supplements or audit guides. This guidance, where applicable, may be obtained from the Office of Inspector General of the appropriate federal agency.

## **The Auditor's Responsibilities in Single Audits—An Overview**

### **Compliance With Laws and Regulations**

- 1.30 In addition to the requirements of GAAS and *Government Auditing Standards*, Circular A-133 requires the auditor to provide an opinion on whether the auditee 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. The auditor's responsibility for compliance auditing is discussed further in chapter 6. The required reporting and the schedule of findings and questioned costs are discussed in chapter 10.

### **Internal Control Over Compliance**

#### **Planning**

- 1.31 In a single audit, the auditor must obtain an understanding of the design and operation of internal control over compliance with requirements that could have a direct and material effect on a major program. The auditor's work in this area is in addition to the consideration of internal control over financial reporting that is part of a financial statement audit. Specifically, the auditor must obtain an understanding of internal control over compliance that is sufficient to plan the audit to support a low assessed level of control risk for major programs.

#### **Testing**

- 1.32 Circular A-133 also requires auditors to test internal control over compliance by implementing the planned tests.

Evidence gained from the tests of controls relevant to compliance requirements may be used by the auditor to determine the nature, timing, and extent of the testing required to express an opinion on compliance with requirements applicable to major programs. The requirements and auditor responsibilities associated with internal control over compliance in a single audit are discussed in chapter 8.



## CHAPTER 2

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# Overview of the Single Audit Act, Circular A-133, and the OMB Circular A-133 Compliance Supplement

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- 2.1 This chapter provides an overview of the significant requirements and guidance in the Single Audit Act, Circular A-133, and the *OMB Circular A-133 Compliance Supplement*. Because Circular A-133 incorporates the requirements of the Single Audit Act and provides additional guidance, the requirements of the Act and Circular A-133 are discussed together as one in this SOP. Accordingly, references to Circular A-133 also include the requirements of the Single Audit Act. Auditors should refer to the Single Audit Act, Circular A-133, and the *Compliance Supplement* for a complete understanding of the requirements. The Single Audit Act and Circular A-133 are reprinted in appendixes A and B, respectively. See note 10 of chapter 1 for instructions on how to obtain a copy of the *Compliance Supplement*.

## Single Audit Act and Circular A-133 Requirements

### General Audit Requirements

#### *Audit Threshold*

- 2.2 Entities that expend \$300,000 or more in a fiscal year in federal awards are subject to the Single Audit Act and Circular A-133 and, therefore, must have a single or program-specific audit. Entities expending awards under only one program (excluding research and development [R&D]) may elect to have a program-specific audit if the program's laws, regulations, or grant agreements do not require a financial statement audit. A program-specific audit may not be elected for R&D unless (a) all expenditures are for awards

received from the same federal agency or from the same federal agency and the same pass-through entity and (b) advance approval is obtained (see chapter 11 for additional guidance on program-specific audits). Entities that expend less than \$300,000 in a fiscal year in federal awards are exempt from audit requirements in the Single Audit Act and Circular A-133. However, those entities are not exempt from other federal requirements (including those to maintain records) concerning federal awards provided to the entity. Such records must be available for review or audit by appropriate officials of a federal agency, pass-through entity, and the GAO. The Single Audit Act provides that, every two years, the OMB may review the amount for requiring audits and may raise the dollar threshold amount above \$300,000.

### **Applicable Standards and Covered Entity**

- 2.3 Circular A-133 audits must be conducted by an independent auditor<sup>1</sup> in accordance with *Government Auditing Standards*, and they must cover the entire operations of the auditee or, at the option of the auditee, the audit may include a series of audits that cover departments, agencies, and other organizational units that expended or otherwise administered federal awards during the fiscal year, provided that each audit encompasses the financial statements and the schedule of expenditures of federal awards for each such department, agency, and organizational unit (see paragraph 3.25 for a more detailed discussion of this requirement).

### **Relation to Other Audit Requirements**

- 2.4 A Circular A-133 audit is deemed to be in lieu of any financial audit of federal awards that an entity is required to undergo under any other federal law or regulation. However, notwithstanding a Circular A-133 audit, a federal agency (including its Inspectors General or GAO) may conduct or arrange for additional audits (for example, financial audits, performance audits, evaluations, inspections, or reviews) that are necessary to carry out their

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1. The Single Audit Act defines “independent auditor” as (a) an external state or local government auditor who meets the independence standards included in *Government Auditing Standards* or (b) a public accountant who meets such independence standards.

responsibilities under federal law or regulation. Any additional audits should be planned and performed in such a way as to build upon work performed by auditors. A federal agency that conducts or contracts for additional audits must arrange for funding the full cost of such additional audits. See paragraph 2.19 for a discussion of the federal agency option to request certain programs to be audited as major programs.

### ***Frequency of Audits***

- 2.5 Circular A-133 audits must be performed annually unless an auditee meets one of the following criteria that would allow it to have biennial audits (biennial audits should cover both years within the biennial period):
- State or local governments that are required by constitution or statute (in effect on January 1, 1987) to undergo audits less frequently than annually are permitted to have Circular A-133 audits performed biennially. This requirement must still be in effect for the biennial period under audit.
  - NPOs that had biennial audits for all biennial periods ending between July 1, 1992, and January 1, 1995, are permitted to have Circular A-133 audits performed biennially.

### ***Non-U.S.-Based Entities***

- 2.6 Circular A-133 does not apply to non-U.S.-based entities expending federal awards received either directly as a recipient or indirectly as a subrecipient. For example, if a federal agency provides financial assistance to an orphanage operated by a foreign government, Circular A-133 would not apply. However, the circular does apply to expenditures made by U.S.-based entities outside of the United States and by foreign branches of U.S.-based entities. For example, if a university based in the United States receives a federal award for travel and a three-month residence in a foreign country to conduct research, Circular A-133 would apply to the travel and the related research costs incurred in the foreign country. Another example would be a hospital that receives a federal award to perform medical research in a

foreign country. If the research is conducted in the hospital's research laboratory based in the foreign country, the federal award would be subject to an audit under Circular A-133.

## **Audit Objectives and Reporting Matters**

### ***Audit Objectives***

2.7 In a single audit, the auditor's objectives are to—

- Determine whether the financial statements of the auditee are presented fairly in all material respects in conformity with generally accepted accounting principles. (Note that Circular A-133 does not prescribe the basis of accounting that must be used by auditees to prepare their financial statements. See paragraphs 4.2 and 4.3 for a further discussion.)
- 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.
- Obtain an understanding of the internal control over compliance for each major program, assess the control risk, and perform tests of those controls unless the controls are deemed to be ineffective (the auditor must perform procedures to obtain an understanding of internal control over federal programs that is sufficient to plan the audit to support a low assessed level of control risk for each major program).
- Determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements pertaining to federal awards that may have a direct and material effect on each of its major programs.

### ***Audit Reports***

2.8 Section 505 of Circular A-133 includes specific auditor reporting requirements. Those requirements are summarized in paragraph 10.3. See paragraphs 10.8 through 10.10 for a description of the reports illustrated in this SOP to meet the reporting requirements of Circular A-133.

## ***Timing of the Submission of the Report***

- 2.9 The audit should be completed and the data collection form and the reporting package (described in paragraphs 2.24, 2.25, and 10.6 through 10.7), including the auditor's reports, should be submitted by the auditee (to the federal clearinghouse designated by the OMB) within the earlier of thirty days after receipt of the auditor's reports 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 (see paragraphs 10.74 through 10.79 for a further discussion).<sup>2</sup>

## ***Audit Follow-Up***

- 2.10 Circular A-133 requires the auditor to 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. (See paragraphs 3.24 and 6.61 through 6.67 for a further discussion of the auditor's responsibility for audit follow-up).

## **Auditor Selection and Audit Costs**

### ***Procurement of Audit Services and Restriction on Auditors Who Prepare Indirect Cost Proposals***

- 2.11 Circular A-133 also establishes guidance on the procurement of audit services, as well as guidance on the restrictions on the selection of auditors who also prepare the indirect cost proposal or cost allocation plan. Auditors who prepare the indirect cost proposal or cost allocation plan may not also be selected to perform the Circular A-133 audit if the indirect costs recovered by the auditee during the prior year exceeded \$1 million.<sup>3</sup> See paragraph 3.52 for additional information on this restriction.

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2. Auditors should note that there is a delayed implementation for this requirement. Therefore, for fiscal years beginning on or before June 30, 1998, the audit must be completed and the data collection form and the reporting package should be submitted (to the federal clearinghouse designated by the OMB) within the earlier of thirty days after receipt of the auditor's report or thirteen months after the end of the audit period.

3. The implementation date for this provision is for audits of fiscal years beginning after June 30, 1998.

## **Audit Costs**

2.12 Circular A-133 provides guidance on whether the charging of audit costs to federal awards may be allowed. Unless prohibited by law, the costs of Circular A-133 audits 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, or other applicable cost principles or regulations. The costs of single audits that are not conducted in accordance with Circular A-133 are unallowable. Furthermore, audit costs associated with Circular A-133 audits of entities that expend less than \$300,000 per year in federal awards are unallowable. However, this provision does not prohibit pass-through entities from charging federal awards for the costs of limited-scope audits to monitor its subrecipients. See paragraph 9.32 for further information on the allowability of audit costs associated with limited-scope audits. With regard to the amount of audit cost that can be charged to a federal award, the Single Audit Act states that in the absence of documentation demonstrating a higher actual cost, the percentage of the cost of single audits charged to federal awards by an entity may not exceed the ratio of total federal awards expended to the entity's total expenditures for the fiscal year.

## **Basis for Determining When Federal Awards Are Expended**

2.13 The determination of when an award is expended is based on when the activity related to the award occurs. In general, the activity pertains to events that require the auditee to comply with laws, regulations, and the provisions of contracts or grant agreements. Such events include the following:

- 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 auditee to an interest subsidy
- The period when insurance is in force

2.14 Circular A-133 provides specific guidance on the basis of determining federal awards expended for the following noncash items (see paragraphs 5.13 through 5.15 for additional discussion):

- Loans and loan guarantees, including those at institutions of higher education
- Prior loans and loan guarantees
- Endowment funds
- Free rent
- Noncash assistance, such as free rent, food stamps, food commodities, donated property, or donated surplus property
- Medicare payments to a nonfederal entity for providing patient care services
- Medicaid payments to a subrecipient for providing patient care services

### **Subrecipient and Vendor Determinations**

2.15 An auditee may be a recipient, a subrecipient, and a vendor. Federal awards expended as a recipient or a subrecipient are subject to audit under Circular A-133. The payments received for goods or services provided as a vendor would not be considered federal awards. Circular A-133 provides specific guidance on determining whether payments constitute a federal award or a payment for goods and services. This guidance is discussed further in chapter 9.

## **Major Program Determination**

### ***Risk-Based Approach***

2.16 Circular A-133 requires the auditor to use a risk-based approach to determine which federal programs are major programs. The risk-based approach includes consideration of current and prior audit experience, oversight by federal agencies and pass-through entities, and the inherent risk of the federal programs. This risk-based approach and the determination of major programs are discussed in chapter 7.

### ***Low-Risk Auditee***

2.17 Circular A-133 contains certain criteria for considering an auditee to be a low-risk auditee. A low risk-auditee is eligible for reduced audit coverage. It should be noted that *low-risk auditee* is a term defined in Circular A-133 for the purpose of applying the percentage-of-coverage rule (see paragraphs 7.24 and 7.25) in the risk-based approach. It does not imply or require the auditor to assess audit risk or any of its components as low for an entity that meets the Circular A-133 definition of a low-risk auditee.

### ***Cluster of Programs***

2.18 OMB Circular A-133 defines a cluster of programs as a grouping of closely related federal programs that share common compliance requirements. The types of clusters of programs are R&D, student financial aid (SFA), and other clusters. "Other clusters" are defined by the OMB in the *Compliance Supplement* or are designated as such by a state for the federal awards the state provides to its subrecipients that meet the definition of a cluster of programs. When a state designates federal awards as an "other cluster," it must also identify the federal awards included in the cluster and advise the subrecipients of the compliance requirements applicable to the cluster. A cluster of programs should be considered as one program for determining major programs and (with the exception of R&D), whether a program-specific audit may be elected.

### ***Federal Agency Selection of Additional Major Programs***

2.19 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 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. After consultation with its auditor, the auditee should promptly respond to such a request by informing the federal agency whether the program would otherwise be audited as a major program using the risk-based approach (described in chapter 7) and, if not, the estimated incremental cost. The federal agency must 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 the federal agency request, and the federal agency agrees to pay the full incremental costs, then the auditee must have the program audited as a major program. This approach may also be used by pass-through entities for a subrecipient.

## **Auditee Responsibilities**

### ***Preparation of Appropriate Financial Statements***

2.20 Circular A-133 requires auditees to prepare financial statements that reflect their financial position, the results of operations or changes in net assets, and, where appropriate, cash flows for the fiscal year audited. The financial statements must be for the same organizational unit and fiscal year that is chosen to meet the requirements of Circular A-133. However, organization-wide financial statements may also include departments, agencies, and other organizational units that have separate audits in accordance with Circular A-133 and prepare separate financial statements (see paragraph 3.25 for a further discussion). Circular A-133 also requires auditees to prepare a schedule of expenditures of federal awards for the period covered by the financial statements. (The schedule of expenditures of federal awards is discussed in chapter 5.)

### ***Summary Schedule of Prior Audit Findings***

2.21 The auditee is also required to prepare a summary schedule of prior audit findings. The schedule should report the status of all audit findings included in the prior audit's schedule of findings and questioned costs relative to federal awards. It should also include audit findings reported in the

prior audit's summary schedule of prior audit findings, except audit findings that have been corrected or are no longer valid. See paragraphs 10.68 through 10.70 for a further discussion of this schedule.

### **Other Responsibilities**

2.22 In addition to the responsibilities described in paragraphs 2.20 and 2.21, Circular A-133 establishes certain other responsibilities for auditees, including the following:

- Identifying in its accounts all federal awards received and expended and the federal programs under which they were received, including, as applicable, the CFDA title and number, the award number and year, the name of the federal agency, and the name of the pass-through entity
- Establishing and maintaining effective internal control over compliance for 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
- Complying with laws, regulations, and the provisions of contract or grants agreements related to each of its federal programs
- Ensuring that the audits required by Circular A-133 are properly performed and submitted when due
- Following up and taking corrective action on audit findings (including the preparation of a summary schedule of prior audit findings (see paragraph 2.21) and a corrective action plan (see paragraph 2.26); corrective action should be initiated within six months after the receipt of the audit report and proceed as rapidly as possible

### **Responsibility for Compliance at the Financial Statement Level and for Internal Control Over Financial Reporting**

2.23 Although not specifically stated in Circular A-133, the auditee is also responsible for complying with the requirements of laws, regulations, and the provisions of contracts

or grant agreements that could have a material effect on the financial statements and for establishing and maintaining effective internal control over financial reporting. These responsibilities support the requirements of *Government Auditing Standards*.

### **Reporting Package**

2.24 The auditee is also required to submit a reporting package that includes financial statements and a schedule of expenditures of federal awards (see paragraph 2.20 and chapters 4 and 5), the summary schedule of prior audit findings (see paragraph 2.21), the auditor's reports (see paragraph 2.8), and a corrective action plan (see paragraph 2.26). Although not part of the reporting package, the submission of the report must also include the data collection form described in paragraph 2.25. The report submission requirements of Circular A-133 are described in paragraphs 2.9 and 10.74 through 10.79. Auditees must keep one copy of the data collection form and the reporting package on file for three years from the date of submission to the federal clearinghouse. Furthermore, unless restricted by law or regulation, the auditee is required to make copies of the data collection form and the reporting package available for public inspection.

### **Data Collection Form**

2.25 The auditee is required to complete and sign certain sections of a data collection form which states whether the audit was completed in accordance with Circular A-133 and provides information about the auditee, its federal programs, and the results of the audit. The auditor is also required to complete and sign certain sections of this form. See paragraphs 10.71 through 10.73 for a further discussion of the data collection form.

### **Corrective Action Plan**

2.26 At the completion of the audit, the auditee should prepare a corrective action plan to address each audit finding included in the current year's auditor's reports. See paragraphs 10.68 through 10.70 for a further discussion of the corrective action plan.

## **Federal Awarding Agency Responsibilities**

2.27 For federal agencies that provide federal awards to recipients, Circular A-133 establishes certain responsibilities including the following:

- Identifying the federal awards made by informing each recipient of the CFDA title and number, the award name and number, the award year, and if the award is for R&D. When some of this information is not available, the federal agency must provide information necessary to clearly describe the federal award
- Advising recipients of the requirements imposed on them by federal laws, regulations, and the provisions of contracts or grant agreements
- Ensuring that audits are completed and reports are received in a timely manner and in accordance with the requirements of Circular A-133
- Providing technical advice and counsel to auditees and auditors as requested
- Issuing a management decision on audit findings within six months after receipt of the audit report and ensuring that the recipient takes appropriate and timely corrective action
- Assigning a person to provide annual updates of the *Compliance Supplement* to the OMB

## **Pass-Through Entity Responsibilities**

2.28 Pass-through entities have many responsibilities that are similar to those of federal awarding agencies. See chapter 9 for a detailed description of the responsibilities of pass-through entities.

## **Cognizant Agency for Audit**

### **Definition**

2.29 Circular A-133 defines the cognizant agency for audit as a federal agency designated to carry out the federal responsibilities with regard to a single audit. For recipients expend-

ing more than \$25 million a year in federal awards, the cognizant agency for audit will be the federal awarding agency that provides the predominant amount of direct funding to the recipient unless the OMB makes a specific cognizant agency for audit assignment. The determination of the predominant amount of direct funding is based on the direct federal awards expended by a recipient during its fiscal year ending in 1995, 2000, 2005, and every fifth year thereafter. For example, the audit cognizance for periods ending in 1997 through 2000 will be determined based on the federal awards expended in 1995.<sup>4</sup> Audit cognizance can be reassigned if both the old and the new federal agencies notify the auditee (and, if known, the auditor), of the change within thirty days of the reassignment. A recipient may have one federal agency responsible for audit cognizance and another federal agency responsible for the negotiation of indirect costs.

## **Responsibilities**

2.30 Circular A-133 states that a cognizant agency for audit is responsible for—

- Providing technical audit advice and liaison to auditees and auditors.
- Considering auditee requests for extensions to the report submission due date. The cognizant agency for audit may grant extensions for good cause.
- Obtaining or conducting quality control reviews of selected audits made by nonfederal auditors and providing the results, when appropriate, to other interested organizations.
- Promptly informing 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 *Government Auditing Standards* or laws and regulations.

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4. It should be noted that 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 in this paragraph are not effective until fiscal years beginning after June 30, 2000.

- Advising 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 should work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency for audit must notify the auditor, the auditee, and the applicable federal awarding agencies and pass-through entities of the facts and make recommendations for follow-up action. Major inadequacies or repeated substandard performance by auditors will be referred to appropriate state licensing agencies and professional bodies for disciplinary action.
- Coordinating, to the extent practicable, the audits or reviews made by or for federal agencies that are in addition to audits under Circular A-133, so that the additional audits or reviews build upon the Circular A-133 audits performed.
- Coordinating a management decision for audit findings that affect the federal programs of more than one federal agency.
- Coordinating the audit work and reporting responsibilities among auditors, to achieve the most cost-effective audit.

For biennial audits, the cognizant agency for audit is also responsible for considering auditee requests to qualify as a low-risk auditee.

## **Oversight Agency for Audit**

### ***Definition***

2.31 An auditee that does not have a designated cognizant agency for audit that (that is, one that expends \$25 million or less in federal awards) will have an oversight agency for audit. Circular A-133 defines the oversight agency for audit as a federal awarding agency that provides the predominant amount of direct funding to a recipient not assigned a cognizant agency for audit (see paragraphs 2.29 and 2.30). When there is no direct funding, the federal agency with the predominant indirect funding is required to assume the oversight responsibilities.

## **Responsibilities**

- 2.32 Circular A-133 describes the duties of oversight agencies for audit. The responsibilities of an oversight agency for audit are not as broad as those of a cognizant agency for audit. However, an oversight agency's primary responsibility is to provide technical advice to auditees and auditors when it is requested. An oversight agency may assume all or some of the responsibilities normally performed by a cognizant agency for audit.

## **Program-Specific Audits**

- 2.33 Circular A-133 provides general guidance on performing program-specific audits. In many cases, a program-specific audit guide will be available from the federal agency's Office of Inspector General. The audit guide will provide specific guidance to the auditor with respect to internal control, compliance requirements, suggested audit procedures, and audit reporting requirements. When a program-specific audit guide is not available, the auditee and auditor have basically the same responsibilities for the federal program as they would have for an audit of a major program in a single audit. Program-specific audits are discussed further in chapter 11.

## **OMB Circular A-133 Compliance Supplement**

- 2.34 The *Compliance Supplement* is based on the requirements of the Single Audit Act and Circular A-133, which provide for the issuance of a compliance supplement to assist auditors in performing the required audits. The *Compliance Supplement* serves to identify existing compliance requirements that the federal government expects to be considered as part of an audit in accordance with the Single Audit Act and Circular A-133. For the programs included in the *Compliance Supplement*, it provides a source of information for auditors to understand the federal program's objectives, procedures, and compliance requirements relevant to the audit, as well as the audit objectives and suggested audit procedures for determining compliance with these requirements. It also provides guidance to assist auditors in determining compliance requirements relevant to the audit,

audit objectives, and suggested audit procedures for programs not included in the *Compliance Supplement*. For single audits, the *Compliance Supplement* replaces agency audit guides and other audit requirement documents for individual federal programs.

- 2.35 The *Compliance Supplement* is effective for audits of fiscal years beginning after June 30, 1996, and supersedes the compliance supplements, *Audits of States and Local Governments* (issued in 1990), and *Audits of Institutions of Higher Education and Other Non-Profit Organizations* (issued in 1991). The *Compliance Supplement* is discussed in greater detail in paragraphs 1.27, 1.28, and 6.21 through 6.30.



## CHAPTER 3

# Planning and Other Special Audit Considerations of Circular A-133

- 3.1 In planning an audit to meet the requirements of Circular A-133, the auditor needs to consider several matters in addition to those ordinarily associated with an audit of financial statements in accordance with GAAS and *Government Auditing Standards*.<sup>1</sup> In this chapter the overall planning considerations in a single audit conducted in accordance with Circular A-133 are discussed. Many of these planning considerations are also applicable in a program-specific audit. Program-specific audits are discussed in detail in chapter 11.
- 3.2 The following matters are relevant to the planning of a single audit:
- Satisfying Circular A-133 requirements and other relevant legal, regulatory, or contractual requirements (see paragraphs 3.3 through 3.5)
  - Establishing an understanding with the auditee (see paragraphs 3.6 through 3.7)
  - Satisfying the additional requirements of *Government Auditing Standards* (see paragraphs 3.8 through 3.21)
  - Satisfying the additional requirements of the Single Audit Act and Circular A-133 regarding working papers and audit follow-up (see paragraphs 3.22 through 3.24)
  - Defining the entity to be audited (see paragraph 3.25)
  - Determining the audit period (see paragraphs 3.26 and 3.27)

1. In AICPA *Professional Standards*, AU section 311, "Planning and Supervision," the auditor's responsibilities for planning and supervision in an audit of financial statements in accordance with GAAS are described. Paragraphs 4.6 and 4.7 of *Government Auditing Standards* describe its planning requirements.

- Initial-year audit considerations (see paragraphs 3.28 and 3.29)
- The timing of the completion of the audit and reporting submission deadlines (see paragraph 3.30)
- Determining the major programs to be audited (see paragraph 3.31)
- The preliminary assessment of audit risk (see paragraph 3.32)
- Audit materiality considerations (see paragraphs 3.33 through 3.38)
- Determining compliance requirements (see paragraph 3.39)
- Developing an efficient audit approach (see paragraph 3.40)
- Joint audits and reliance on others (see paragraphs 3.41 through 3.44)
- Existence of internal audit function (see paragraph 3.45)
- Communications with the cognizant agency for audit and others (see paragraph 3.46)
- Understanding the applicable state and local compliance and reporting requirements (see paragraphs 3.47 through 3.49)
- Desk reviews and on-site reviews (see paragraphs 3.50 and 3.51)
- The restriction on the auditor's preparation of indirect cost proposals (see paragraph 3.52)
- The exit conference (see paragraphs 3.53 and 3.54)

### **Satisfying Circular A-133 Requirements and Other Relevant Legal, Regulatory, or Contractual Requirements**

3.3 Because of the variety of audit requirements to which entities receiving federal awards are subject, paragraph 21 of SAS

No. 74, *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance* (AICPA, *Professional Standards*, vol. 1, AU sec. 801.21), states that auditors should exercise due professional care in ensuring that they and management understand the type of engagement to be performed. The auditor should consider including a statement about the type of engagement and whether it is intended to meet specific audit requirements in a proposal, in a contract, or in the communication issued to establish an understanding with the auditee (see paragraphs 3.6 through 3.7 for a further discussion of the establishment of an understanding with the auditee).

- 3.4 Management is also responsible for obtaining audits that satisfy relevant legal, regulatory, or contractual requirements. Paragraph 22 of SAS No. 74 (AICPA, *Professional Standards*, vol. 1, AU sec. 801.22) states that GAAS do not require the auditor to perform procedures beyond those he or she considers necessary to obtain sufficient competent evidential matter to form a basis for the opinion on the financial statements. However, if during a GAAS audit of the financial statements, the auditor becomes aware that the entity is subject to an audit requirement that may not be encompassed in the terms of the engagement, the auditor should communicate to management and the audit committee, or to others with equivalent authority and responsibility, that an audit in accordance with GAAS may not satisfy the relevant legal, regulatory, or contractual requirements.<sup>2</sup> For example, the auditor will be required to make this communication if he or she is engaged to perform an audit of an entity's financial statements in accordance with GAAS and the auditor becomes aware that by law, regulation, or contractual agreement, the entity is also required to have an audit performed in accordance with one or more of the following:

- *Government Auditing Standards*
- The Single Audit Act and Circular A-133

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2. For entities that do not have audit committees, "others with equivalent authority and responsibility" may include the board of directors, the board of trustees, the owner in owner-managed entities, the city council, or the legislative standing committee.

- Other compliance audit requirements, such as state or local laws or program-specific audits under federal audit guides

3.5 Paragraph 23 of SAS No. 74 (AICPA, *Professional Standards*, vol. 1, AU sec. 801.23) states that the required communication may be oral or written. If the communication is oral, the auditor should document the communication in the working papers. The auditor should consider how the client's actions in response to such a communication relate to other aspects of the audit, including their potential effect on the financial statements and on the auditor's report on those financial statements. Specifically, the auditor should consider management's actions (such as not arranging for an audit that meets the applicable requirements) in relation to the guidance in SAS No. 54, *Illegal Acts By Clients*, and SAS No. 82, *Consideration of Fraud in a Financial Statement Audit*.

## **Establishing an Understanding With the Auditee**

3.6 SAS No. 83, *Establishing an Understanding With the Client* (AICPA, *Professional Standards*, vol. 1, AU sec. 310), states that the auditor should establish an understanding with the auditee regarding the services to be performed. Such understanding reduces the risk that either the auditor or the auditee may misinterpret the needs or expectations of the other party. The understanding should include the objectives of the engagement, management's responsibilities, the auditor's responsibilities, and the limitations of the engagement. The auditor should document this understanding in the working papers, preferably through a written communication with the auditee. If the auditor believes an understanding with the client has not been established, he or she should decline to accept the engagement.

3.7 SAS No. 83 includes a listing of the matters that should generally be included when the auditor establishes an understanding with the auditee regarding an audit of the financial statements. In addition to those matters, the auditor

should also consider including the following information in the communication when he or she is engaged to perform a single audit:

- A description of the financial statements and supplemental schedule(s) to be audited
- The reporting period
- The auditing standards and requirements that will be followed (for example, GAAS, *Government Auditing Standards*, and Circular A-133)
- The objective of an audit in accordance with Circular A-133
- A description of the reports the auditor is expected to prepare and issue, including any limitation on their use or distribution
- A description of management's responsibility for (a) the financial statements and the schedule of expenditures of federal awards; (b) internal control over financial reporting and internal control over compliance; (c) compliance with laws, regulations, and the provisions of contracts and grant agreements; (d) following up and taking corrective action on audit findings, including the preparation of a summary schedule of prior audit findings and a corrective action plan; and (e) submitting the reporting package
- A statement that management has made the auditor aware of significant vendor relationships where the vendor is responsible for program compliance (so that the auditor can determine if additional procedures on vendor records will be necessary—see paragraphs 9.16 and 9.17)
- A description of the auditor's responsibility in an audit of financial statements and in a compliance audit of major programs under Circular A-133, including the determination of major programs, the consideration of internal control, and reporting responsibilities
- Other communications that may arise from the audit

- A description of the working paper retention requirements
- A statement that the working papers will be made available upon request to appropriate federal agencies and the GAO
- The communication with audit committees or other responsible individuals required by *Government Auditing Standards* (see paragraphs 3.19 and 3.20 for a further discussion of this requirement)

SAS No. 83 also states that the establishment of an understanding may be communicated in the form of an engagement letter.

## **Satisfying the Additional Requirements of Government Auditing Standards**

3.8 Circular A-133 requires that audits of the financial statements and of the federal awards of the auditee be performed in accordance with *Government Auditing Standards* (see chapter 4 for a further discussion). In an audit in accordance with *Government Auditing Standards*, the auditor has considerations beyond those in a GAAS audit. *Government Auditing Standards* incorporates the fieldwork and reporting standards of GAAS and has general standards (described in chapter 2 of *Government Auditing Standards*) that are similar to those of the AICPA (that is, auditor qualifications, independence, and due professional care). However, *Government Auditing Standards* also contains additional general, fieldwork, and reporting requirements, which are summarized in Table 3.1 and discussed in detail in the three subsequent sections of this chapter.

**TABLE 3.1 Additional Financial Statement Audit Requirements of Government Auditing Standards**

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### *General Requirements*

- Continuing professional education (CPE) in subjects directly related to the government environment and to government auditing or to the specific or unique environment that the audited entity operates in

- Appropriate internal quality control system and external quality control review every three years

**Fieldwork Requirements**

- Audit follow-up requirements on known material findings and recommendations from previous audits
- Plan audit to provide reasonable assurance of detecting misstatements resulting from noncompliance with provisions of contracts and grant agreements that have a direct and material effect on the determination of financial statement amounts
- Additional working paper requirements

**Reporting Requirements**

- Communication with audit committees or other responsible individuals
- Referring to *Government Auditing Standards* in the auditor's report
- Reporting on compliance with laws and regulations and on internal controls
- Consideration of privileged and confidential information
- Report distribution

3.9 *Government Auditing Standards* also provides additional guidance on audit materiality, on fraud<sup>3</sup> and illegal acts, and on internal controls. Table 3.2 summarizes where this additional guidance is provided in *Government Auditing Standards* and also where it is discussed in this SOP.

**TABLE 3.2 Additional Guidance in Government Auditing Standards**

Area of Additional Guidance	<i>Government Auditing Standards</i> Reference	SOP Reference
Materiality	Paragraphs 4.8 and 4.9	Paragraph 3.34
Fraud and illegal acts	Paragraphs 4.14 through 4.17	Paragraphs 10.21 through 10.25
Internal controls	Paragraphs 4.21 through 4.33	Paragraphs 4.17 and 4.18

3. The term *fraud* as used in SAS No. 82, *Consideration of Fraud in a Financial Statement Audit*, is synonymous with the term *irregularities* as used in *Government Auditing Standards*. Therefore, in discussing the requirements of *Government Auditing Standards*, this SOP will use the term *fraud* instead of the term *irregularities*.

## **General Requirements**

### ***Continuing Professional Education***

- 3.10 *Government Auditing Standards* requires auditors to participate in a program of continuing professional education (CPE) and training. Every two years, all auditors (whether certified or not) performing audits in accordance with *Government Auditing Standards* should complete at least eighty credit hours of training that contribute directly to their professional proficiency. At least twenty of those hours should be completed in each year of the two-year period. For auditors responsible for planning, directing, or reporting on the audit and for auditors conducting substantial portions of the audit, at least twenty-four hours should be in subjects directly related to the government environment and to government auditing. If the auditee operates in a specific or unique environment, auditors should receive training that is related to that environment. For example, if the auditor performs an audit of a not-for-profit organization, the twenty-four hours should be in topics related to the not-for-profit accounting and auditing environment. These could include compliance and government-related courses or those broadly related to the type of not-for-profit organization being audited.
- 3.11 *Interpretation of Continuing Education and Training Requirements*, a detailed interpretation of the foregoing CPE standards, is available from the GPO (stock number 020-000-00250-6). Among other things, this interpretation discusses who is subject to the CPE requirements and what programs, activities, and subjects qualify as acceptable CPE. During engagement planning, auditors and audit organizations should ensure that members of the audit team have met or will meet the appropriate CPE requirements within two years of the start of the first audit in accordance with *Government Auditing Standards*, and every two years thereafter.

### **Quality Control**

- 3.12 *Government Auditing Standards* also states that the audit organization should have in place an appropriate internal quality control system and undergo an external quality control review (for example, a peer review). An external



quality control review should be conducted at least once every three years by an organization not affiliated with the organization being reviewed.

- 3.13 *Government Auditing Standards* further requires audit organizations seeking to enter into a contract to perform an audit in accordance with *Government Auditing Standards* to provide their most recent external quality control review report to the party contracting for the audit. Auditors are not required to provide separate letters of comment. Auditors should consider documenting in the working papers the provision of the quality control review report to the party contracting for the audit.

## **Fieldwork Requirements**

### ***Audit Follow-Up***

- 3.14 *Government Auditing Standards* states that the auditee is responsible for resolving audit findings and recommendations. It further requires auditors to follow up on known material findings and recommendations from previous audits that could affect the financial statement audit. The purpose of this follow-up is to determine whether the auditee has taken timely and appropriate corrective actions. *Government Auditing Standards* also requires auditors to report the status of uncorrected material findings and recommendations that are from prior audits and that affect the financial statement audit. (See paragraphs 3.24, 6.61 through 6.67, and 10.62 for a further discussion of the auditor's responsibility for audit follow-up under both *Government Auditing Standards* and Circular A-133 and how these responsibilities correlate.)

### ***Responsibilities With Regard to the Provisions of Contracts and Grant Agreements***

- 3.15 Paragraph 4.13 of *Government Auditing Standards* refers to additional responsibilities with regard to detecting material misstatements resulting from noncompliance with the provisions of contract and grant agreements that have a direct and material effect on the determination of financial statement amounts. However, it has generally been interpreted under GAAS that the phrase *laws and regulations*

in SAS No. 54 implicitly includes the provisions of contracts and grant agreements. Thus, the auditor's responsibility with regard to detecting material misstatements resulting from noncompliance with the provisions of contracts and grant agreements under *Government Auditing Standards* equates to the auditor's responsibility under GAAS.

### **Working Papers**

- 3.16 SAS No. 41, *Working Papers* (AICPA, *Professional Standards*, vol. 1, AU sec. 339), provides guidance on the auditor's preparation and maintenance of working papers. *Government Auditing Standards* includes an additional standard that requires working papers to contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditor's significant conclusions and judgments. This additional standard requires working papers to include sufficient documentation of the transactions and records examined that would enable an experienced auditor to examine the same transactions and records. *Government Auditing Standards* also states that auditors should provide for working paper access to other auditors, to facilitate reviews of audit quality and reliance by other auditors on the auditor's work, and should provide for such access in contractual arrangements for *Government Auditing Standards* audits (see paragraphs 3.22 and 3.23 for a discussion of the working paper access and retention requirements under Circular A-133).
- 3.17 Audits done in accordance with *Government Auditing Standards* are subject to review by other auditors and by oversight officials more frequently than are audits done in accordance with GAAS. Thus, whereas GAAS cites two main purposes of working papers (providing the principal support for the audit report and aiding auditors in the conduct and supervision of the audit), working papers serve an additional purpose in audits performed in accordance with *Government Auditing Standards*. Working papers allow for the review of audit quality by providing the reviewer written documentation of the evidence supporting the auditor's significant conclusions and judgments.

3.18 *Government Auditing Standards* specifically states that working papers should contain—

- The objectives, scope, and methodology, including any sampling criteria used.
- Documentation of the work performed to support significant conclusions and judgments, including descriptions of the transactions and records examined that would enable an experienced auditor to examine the same transactions and records.<sup>4</sup>
- Evidence of supervisory reviews of the work performed.

## **Reporting Requirements**

### ***Communication With Audit Committees or Other Responsible Individuals***

3.19 *Government Auditing Standards* includes an additional reporting standard that requires the auditor to communicate certain information related to the conduct and reporting of the audit to the audit committee or to the individuals with whom they have contracted for the audit. This standard applies in all situations in which there is an audit committee or the audit is performed under contract. In other situations, the auditor may still find it useful to communicate with management or other officials of the auditee, although it is not required. The auditor should communicate the following information to the audit committee or representatives of the contractor:

- a. The auditor's responsibilities in a financial statement audit, including his or her responsibilities for testing and reporting on internal control and compliance with laws and regulations
- b. The nature of any additional testing of internal controls and compliance required by laws and regulations
- c. The responsibilities and the nature of any additional testing described in items *a* and *b* should be contrasted

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4. Auditors may meet this requirement by listing voucher numbers, check numbers, or other means of identifying specific documents they examined. Auditors are not required to include in the working papers copies of documents they examined nor are they required to list detailed information from those documents.

with other financial related audits of internal control and compliance (to help responsible parties understand the limitations of the auditor's responsibilities for testing and reporting on internal control and compliance)

- 3.20 Professional judgment should be used in determining the form and content of the communication, which may be oral or written. If the communication is oral, the auditor should document the communication in the working papers. If written, the required communication may be issued as a separate communication or as part of the auditor's communication issued to establish an understanding with the auditee (see paragraphs 3.6 through 3.7).

### **Other Additional Reporting Requirements**

- 3.21 The other additional reporting requirements of *Government Auditing Standards*—referring to *Government Auditing Standards* in the auditor's report, reporting on compliance with laws and regulations and on internal control, consideration of privileged and confidential information, and report distribution—are addressed in paragraphs 10.15 and 10.16.

## **Satisfying the Additional Requirements of the Single Audit Act and Circular A-133 Regarding Working Papers and Audit Follow-Up**

### **Working Papers**

- 3.22 The Single Audit Act states that upon request by a federal agency or the Comptroller General, any independent auditor conducting a single audit should make the auditor's working papers available to the federal agency or the Comptroller General (a) as part of a quality review, (b) to resolve audit findings, or (c) to carry out oversight responsibilities. It also states that access to the auditor's working papers shall include the right to obtain copies. The Single Audit Act intends that federal agencies be judicious in the exercise of this authority and that the release of the working papers should not compromise the confidentiality of proprietary information.

The Single Audit Act also intends that any trade secrets and confidential commercial or financial information obtained from the working papers be treated as confidential under the Freedom of Information Act. Auditors should refer to the guidance in the AICPA Auditing Interpretation titled *Providing Access to or Photocopies of Working Papers to a Regulator* (AICPA, *Professional Standards*, vol. 1, AU sec. 9339), when a regulator requests access to the auditor's working papers pursuant to law, regulation, or audit contract.

- 3.23 Circular A-133 requires that auditors retain working papers and reports for a minimum of three years after the date of issuance of the auditor's report 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 is required to contact the parties contesting the audit finding for guidance prior to the destruction of the working papers and reports.

## **Audit Follow-Up**

- 3.24 In addition to the requirements of *Government Auditing Standards*, Circular A-133 requires the auditor to 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. (See paragraphs 6.61 through 6.67 and 10.62 for a further discussion of the responsibility for audit follow-up under both Circular A-133 and *Government Auditing Standards* and how these responsibilities correlate.)

## **Defining the Entity to Be Audited**

- 3.25 One of the initial tasks during the planning process of a single audit is determining whether management has properly defined the entity to be audited. Circular A-133 requires that single audits must cover the entire operations of the auditee.

However, Circular A-133 provides auditees the option to meet the audit requirements of the circular through a series of audits that cover an auditee's departments, agencies, and other organizational units which expended or otherwise administered federal awards during a fiscal year. If an auditee elects this option, then separate financial statements and a schedule of expenditures of federal awards must be prepared for each such department, agency, or other organizational unit. In these circumstances, an auditee's organization-wide financial statements may also include departments, agencies, or other organizational units that have separate audits and prepare separate financial statements. For example, if a local government has its school districts audited separately, 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 was 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 (that is, the local government's organization-wide financial statements could not be used as a substitute for separate financial statements for the school districts). See paragraph 10.34 for a discussion of the situation where the implementation regulations of certain federal agencies define the entity to be audited differently than GAAP.

## **Determining the Audit Period**

### **Fiscal Year and Program Period May Differ**

- 3.26 An audit performed in accordance with Circular A-133 should cover the auditee's financial transactions (including transactions related to federal awards) for its fiscal year (or a two-year period, if allowed by Circular A-133), which is not necessarily the same as the period of the program being funded (see paragraph 2.5 for further information on biennial audits). Thus, the audit might include only a part of the transactions of a federal award, because some transactions may not occur within the period covered by the audit.

## **Stub Periods**

3.27 Stub periods may occur when an auditee converts from a program-specific audit to a single audit or changes audit periods. One example would be a community college with a September 30 year end that previously had a program-specific audit and is now converting to a single audit. The prior program-specific audits were performed based on a June 30 award year. The first single audit will be for the year ending September 30. This would leave the community college with an unaudited stub period of June 30 to September 30. Arrangements should be made to meet the audit requirements for federal expenditures during the stub period. This is usually done either as a separate audit of the stub period or by including expenditures of the stub period with the following period's Circular A-133 audit. The cognizant or oversight agency for audit or the pass-through entity should be contacted for advice on how stub periods should be addressed.

## **Initial-Year Audit Considerations**

### **Preceding Period Audited by Another Auditor**

3.28 Whenever an auditor is considering accepting an engagement in which the federal awards of the preceding period were audited by another auditor, he or she should refer to the guidance in SAS No. 84, *Communications Between Predecessor and Successor Auditors* (AICPA, *Professional Standards*, vol. 1, AU sec. 315). It provides guidance on communications between predecessor and successor auditors when a change in auditors is in process or has taken place, and it includes illustrative letters. SAS No. 84 also provides communications guidance when possible misstatements are discovered in financial statements reported on by a predecessor auditor.

### **Factors to Consider Under the Risk-Based Approach**

3.29 When the engagement includes the selection of major programs using the risk-based approach, an auditor accepting, or contemplating accepting, an engagement should consider gathering information about the following:

- Federal awards expended by federal program
- Prior-period findings and questioned costs (including the corrective action plan and management decision related to the findings and summary schedule of prior audit findings)
- Whether the predecessor auditor used the exception that allows deviation from the risk-based approach during the last three years (see paragraph 7.20)
- Correspondence from program officials indicating potential problems
- New programs
- Changes to programs
- Amount of funding passed through to subrecipients by individual federal program
- Extent to which computer processing is used to administer federal programs
- Federal programs audited as major programs for the last two years

## **Timing of the Completion of the Audit and Reporting Submission Deadlines**

3.30 When planning the timing of the audit, auditors should be aware that Circular A-133 requires that the audit be completed and the data collection form and reporting package (described in paragraphs 2.24 through 2.25, 10.6, 10.7, and 10.71 through 10.73) be submitted to the federal clearinghouse within a certain time period. The timing requirements are discussed in detail in paragraphs 10.74 through 10.79.

## **Determining the Major Programs to Be Audited**

3.31 As discussed in paragraphs 2.16 through 2.19, Circular A-133 requires the auditor to use a risk-based approach to determine which federal programs are major programs. This determination will affect the scope of the audit and



the compliance requirements to be tested. The determination of major programs is discussed further in chapter 7.

## **Preliminary Assessment of Audit Risk**

3.32 As required by SAS No. 54, the auditor considers laws and regulations that are generally recognized by auditors to have a direct and material effect on the determination of financial statement amounts. While not explicitly stated in SAS No. 54, it has generally been interpreted that the phrase “laws and regulations” implicitly includes provisions of contracts and grant agreements. (Auditors should note that *Government Auditing Standards* explicitly states that the auditor should design the audit to provide reasonable assurance of detecting material misstatements resulting from noncompliance with the provisions of contracts or grant agreements that have a direct and material effect on the determination of financial statements amounts.) Circular A-133 further requires the auditor to 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. In developing an audit plan, the auditor should assess the risk that noncompliance may cause the financial statements to contain a material misstatement or may have a material effect on each major program. Furthermore, the auditor should consider risk factors related to the risk of noncompliance with those laws, regulations, and provisions of contracts and grant agreements and to the related control activities designed to prevent or to detect such noncompliance. As required by SAS No. 82, the auditor should also specifically assess the risk of material misstatement of the financial statements because of error or fraud and should consider that assessment in designing the audit procedures to be performed (see paragraphs 4.32 through 4.37). Audit risk is discussed in greater detail in paragraphs 6.7 through 6.12.

## **Audit Materiality Considerations**

3.33 SAS No. 47, *Audit Risk and Materiality in Conducting an Audit*, provides guidance on the auditor’s consideration of

materiality when he or she plans and performs an audit of financial statements in accordance with GAAS. Materiality, as it relates to the financial statement audit, is further discussed in the following related AICPA Audit and Accounting Guides:

- *Not-for-Profit Organizations*
- *Audits of State and Local Governmental Units*
- *Health Care Organizations*
- *Audits of Colleges and Universities*<sup>5</sup>

## **Materiality Guidance in Government Auditing Standards**

3.34 As noted in paragraph 3.9, *Government Auditing Standards* contains guidance on certain areas, including materiality considerations. Paragraphs 4.8 and 4.9 of *Government Auditing Standards* state that “auditors’ consideration of materiality is a matter of professional judgment and is influenced by their perception of the needs of a reasonable person who will rely on the financial statements. Materiality judgments are made in light of surrounding circumstances and necessarily involve both quantitative and qualitative considerations. In an audit of the financial statements of a government entity or an entity that receives government assistance, auditors may set lower materiality levels than in audits in the private sector because of the public accountability of the auditee, the various legal and regulatory requirements, and the visibility and sensitivity of government programs, activities, and functions.”

## **Materiality Differences Between the Financial Statement Audit and the Single Audit**

3.35 In auditing compliance with requirements governing major programs in accordance with Circular A-133, the auditor’s consideration of materiality differs from that in an audit of financial statements in accordance with GAAS and *Government Auditing Standards*. In an audit of financial statements, materiality is considered in relation to

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5. Auditors should note that although *Audits of Colleges and Universities* has been superseded by *Not-for-Profit Organizations*, it continues to be applicable in a governmental environment (that is, public institutions).

the financial statements being audited. In designing audit tests and developing an opinion on an auditee's compliance with requirements having a direct and material effect on each major program, however, the auditor considers materiality in relation to each major program (see paragraphs 6.13 through 6.16 for a further discussion of materiality considerations).

## **Materiality for Purposes of Reporting Audit Findings**

- 3.36 Circular A-133 requires the auditor to consider a lower level of materiality for purposes of reporting audit findings in the schedule of findings and questioned costs. The auditor should be cautious that this "audit finding" materiality not be confused with (a) the materiality used for planning and performing the single audit, (b) giving an opinion on the financial statements, and (c) giving an opinion on the auditee's compliance with requirements having a direct and material effect on each major program (see paragraph 3.35 above).
- 3.37 Among other findings that must be reported, Circular A-133 requires the auditor to report material noncompliance with the provisions of laws, regulations, contracts, or grant agreements related to a major program in the schedule of findings and questioned costs (other findings that are required to be reported are described in paragraph 10.63). 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 example, activities allowed or unallowed, cash management, eligibility, or reporting) for a major program or an audit objective identified in the *Compliance Supplement*.
- 3.38 For example, when the auditor discovers one or more instances of noncompliance involving the reporting type of compliance requirement for a particular major program, several materiality determinations must be made using professional judgment. First, the auditor must decide whether the noncompliance is material to the reporting type of compliance requirement for the particular major program. If the auditor determines the noncompliance is material to the reporting type of compliance requirement, the noncom-

pliance would be reported as a finding in the schedule of findings and questioned costs. Second, the auditor must decide whether the discovered noncompliance is material, either individually or when aggregated with other noncompliance findings, in relation to the particular major program taken as a whole. If the auditor determines the noncompliance is material to the major program taken as a whole, the auditor would express a qualified or adverse opinion on compliance with respect to the particular major program.

## **Determining Compliance Requirements**

3.39 In planning the consideration of the internal control and compliance aspects of the audit, the auditor should obtain from management the principal compliance requirements at the start of the audit (see paragraph 4.27 for a listing of possible audit procedures to assess management's identification of compliance requirements). The auditee and auditor may also ascertain the principal compliance requirements for the largest federal programs by referring to the *Compliance Supplement*. For programs not included in the *Compliance Supplement*, auditors should refer to part 7 of that document, which provides guidance for auditing programs not included in the *Compliance Supplement*. Among other things, part 7 instructs auditors to review the federal award document and referenced laws and regulations applicable to the program, the CFDA, and previously issued compliance supplements (see paragraph 6.30 for further information).

## **Developing an Efficient Audit Approach**

3.40 Auditors should consider planning and performing a single audit to achieve maximum audit efficiency. Examples of ways to achieve audit efficiency follow.

- The financial statement audit and the single audit could be planned at the same time.
- If the auditee's system administers more than one major program using common internal control, the transactions of those programs could be combined into one population for selecting sample sizes. When

testing transactions selected from the major programs, the auditor could use the sample to test internal control over financial reporting, internal control over compliance, and compliance requirements.

- Since Circular A-133 requires the planning and performance of internal control work to assess control risk as low (unless weakness are found), the auditor could take advantage of the low assessed level of control risk when he or she performs the substantive testing of compliance.
- Helpful quality control materials (such as planning checklists and reporting checklists) could be used.

## **Joint Audits and Reliance on Others**

- 3.41 Circular A-133 encourages auditees, whenever possible, to make positive efforts to utilize small business, minority-owned firms, and women's business enterprises. In keeping with the spirit of this provision, certain auditees may engage such independent accounting firms on a joint-venture or subcontract basis. In these instances it may be necessary to refer to the work of other auditors. Prior to entering into an agreement to perform a joint audit or to subcontract with another firm, the auditor should consider SAS No. 1, section 543, "Part of Audit Performed by Other Independent Auditors," and Ethics Interpretation 101-10, *The Effect on Independence of Relationships With Entities Included in the Governmental Financial Statements*.
- 3.42 In some circumstances, each of the auditors participating in the single audit will jointly sign the audit reports. This is appropriate only when each auditor or firm has complied with GAAS and *Government Auditing Standards* and is in a position that would justify being the only signatory of the report.
- 3.43 If part of the single audit is performed by governmental auditors, the auditors should be satisfied that the government auditors meet the independence standards in chapter 3 of *Government Auditing Standards* as well as the CPE and quality control standards. These standards require that government auditors be free from organizational, personal,

and external impairments to independence and that they maintain an independent attitude and appearance.

- 3.44 Another common occurrence, particularly in a governmental environment, is the separation of a single audit between the principal auditor of the reporting entity and a secondary auditor of a component unit included in the financial statements of the reporting entity (see paragraph 3.25). The principal auditor's report on the financial statements of the reporting entity most often refers to the report of the secondary auditor as it relates to the financial statements of the component unit. The principal auditor may also need to refer to the programs audited by other auditors in his or her reports on the schedule of expenditures of federal awards, compliance, and internal control related to federal awards, as they relate to federal awards administered by the component unit. In such cases, the auditor should follow the guidance in SAS No. 1, section 543.

## **Existence of Internal Audit Function**

- 3.45 Another factor the auditor should consider when planning the single audit is whether the auditee has an internal audit function and the extent to which internal auditors are involved in monitoring compliance with specified requirements. The auditor should consider the guidance in SAS No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 322), when addressing the competence and objectivity of internal auditors; the nature, timing, and extent of work to be performed; and other related matters (for example, in obtaining an understanding of the entity's internal control over financial reporting and compliance, assessing audit risk, and performing substantive procedures).

## **Communications With the Cognizant Agency for Audit and Others**

- 3.46 When professional judgment indicates it is appropriate, the auditor may communicate with the cognizant agency for audit, the oversight agency for audit, federal awarding agen-

cies, pass-through entities, state auditors, or state awarding agencies, to aid in planning the audit. The auditor might want to consider documenting such communications, as well as any decisions rendered as a result. If a planning meeting is held, matters such as the following may be discussed:

- The audit plan
- The scope of the compliance testing of federal programs
- The intended use of the *Compliance Supplement*
- The identification of federal awards, including those that are considered to be major programs
- The form and content of the supplemental schedule of expenditures of federal awards
- The testing of the monitoring of subrecipients
- The scope of the review and testing of internal control
- The testing of compliance requirements
- The status of prior-year findings and questioned costs
- Federal agency or pass-through entity management decisions on prior-year findings
- Compliance requirements and any changes to those requirements

## **Understanding the Applicable State and Local Compliance and Reporting Requirements**

### **Impact on Circular A-133 Audit**

3.47 Auditors may be engaged to test and report on compliance with state and local laws and regulations in addition to testing and reporting on the compliance requirements imposed by *Government Auditing Standards* and Circular A-133. For example, there may be state-imposed state award requirements that provide state funds to political subdivisions or NPOs (in this example, the state is not a pass-through entity). Even though such nonfederal awards are not considered part of the total federal awards expended by the auditee and are

not subject to audit in accordance with Circular A-133, auditors would still need to consider such laws and regulations under GAAS and *Government Auditing Standards*. Therefore, in connection with the financial statement audit, auditors should obtain an understanding of applicable state and local compliance and reporting requirements that have a direct and material effect on the financial statements being audited.

## **Compliance Audits of State or Local Grants**

3.48 When engaged to audit one or more grants subject to state or local compliance requirements, the auditor should consider performing the following procedures:

- Determine whether the state or local government has a compliance supplement or other audit guide for the program.
- Inquire of management about the additional compliance auditing requirements applicable to the entity.
- Inquire of the audit divisions of the sponsoring agencies about the audit requirements applicable to the entity.
- Obtain any applicable audit guidance from the grantor agency (including any audit guides, amendments, administrative rulings, and the like) pertaining to the grant.
- Read the grant agreements and any amendments, including referenced laws and regulations.
- Review information about governmental audit requirements that is available from state societies of CPAs or associations of governments.
- When appropriate, discuss with the grantor agency the scope of the testing that is expected to be performed.

## **Compliance Audits Not Involving Governmental Assistance**

3.49 Guidance for engagements related to management's written assertion about an entity's compliance with specified state



or local laws, regulations, rules, or contracts not involving governmental financial assistance is provided in Statement on Standards for Attestation Engagements (SSAE) No. 3, *Compliance Attestation* (AICPA, *Professional Standards*, vol. 1, AT sec. 500).

## **Desk Reviews and On-Site Reviews**

- 3.50 In addition to the quality control requirements set forth in *Government Auditing Standards* (see paragraphs 3.12 and 3.13), cognizant agencies for audit have implemented procedures for evaluating the quality of audits. These procedures include both desk reviews and on-site reviews (note that the oversight agencies for audit may also perform these reviews). As a part of the cognizant agencies' evaluation of the completed reports of such engagements, and, as required by Circular A-133, the supporting audit working papers must be made available upon request of the representative of the federal agency. Audit working papers are typically reviewed at a location agreed upon by the cognizant agency for audit and the independent auditor. (See the additional discussion in paragraphs 3.16 and 3.22 regarding working paper access issues.)
- 3.51 Whenever a review of the audit report or the working papers discloses an inadequacy, the audit firm is contacted for corrective action. Where major inadequacies are identified and the representative of the cognizant agency for audit determines that the audit report and the working papers are substandard, cognizant agencies may take further steps. In those instances in which the audit was determined to be substandard by the federal agency, the matter may be submitted to state boards of public accountancy.

## **Restriction on the Auditor's Preparation of Indirect Cost Proposals**

- 3.52 Circular A-133 precludes the auditor who prepares the indirect cost proposal or cost allocation plan from performing the single audit when indirect costs recovered during the prior year by the auditee exceed \$1 million. This restriction

applies to the base year used in the preparation of the indirect proposal or cost allocation plan and to any subsequent years in which the resulting indirect cost agreement or cost allocation plan is used to recover costs. The implementation date for this provision is for audits of fiscal years beginning after June 30, 1998. For example, an auditor who prepares an indirect cost proposal or cost allocation plan that is used as the basis for charging indirect costs in the fiscal year ending June 30, 1999, is not permitted to perform the 1999 single audit (assuming that the indirect costs recovered during the prior year exceeded \$1 million).

## **Exit Conference**

- 3.53 Upon completion of fieldwork, the auditor should consider holding a closing or exit conference with senior officials of the auditee. The exit conference gives the auditor an opportunity to obtain management's comments on the accuracy and completeness of his or her facts and conclusions, including whether or not management concurs with the audit findings. This conference also serves to provide the auditee with advance information so that it may initiate corrective action without waiting for a final audit report. In the case of decentralized operations, as at a university, auditors should consider having preliminary meetings with deans, department heads, and other operating personnel who have direct responsibility for financial management systems and the administration of sponsored projects.
- 3.54 The auditor should consider documenting the names of the auditors who conducted the exit conference, the names and positions of the representatives with whom exit conferences were held and any comments that they had, and other details of the discussions.

## **CHAPTER 4**

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# **Financial Statement Audit Considerations Under Circular A-133**

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### **Introduction**

- 4.1 Circular A-133 requires auditees to prepare financial statements that reflect their financial position, their results of operations or changes in net assets, and, where appropriate, their cash flows for the fiscal year. The financial statements must be for the same organizational unit and fiscal year that is chosen to meet the requirements of Circular A-133. However, organization-wide financial statements may also include departments, agencies, and other organizational units that have separate audits and prepare separate financial statements (see paragraph 4.5 below). Circular A-133 also requires auditees to prepare a schedule of expenditures of federal awards for the period covered by the financial statements. (The schedule of expenditures of federal awards is discussed in chapter 5.)
- 4.2 Circular A-133 does not prescribe the basis of accounting that must be used by auditees to prepare their financial statements. However, auditees are required to disclose the basis of accounting and significant accounting policies used in preparing the financial statements. Auditees must be able to reconcile amounts presented in the financial statements to related amounts in the schedule of expenditures of federal awards.
- 4.3 Circular A-133 does, however, require the auditor to report whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP). This results in the expression of an opinion or a disclaimer of opinion. (Guidance on reporting on the financial statements of the auditee appears in chapter 10). If the auditee prepares its financial statements in conformity with a comprehensive basis of ac-

counting other than GAAP,<sup>1</sup> the auditor is still required to express or disclaim an opinion and should follow the reporting guidance in SAS No. 62, *Special Reports*.

- 4.4 The financial statements are also required to be audited in accordance with *Government Auditing Standards* (see paragraphs 3.8 through 3.21, 4.17 through 4.19, and 4.41). Circular A-133 does not impose on the financial statement audit any additional audit requirements beyond *Government Auditing Standards*.
- 4.5 The audit must cover the entire operations of the auditee, or at the option of the auditee, the audit may include a series of audits that cover departments, agencies, and other organizational units that expended or otherwise administered federal awards during the fiscal year, provided that each audit encompasses the financial statements and schedule of expenditures of federal awards for each such department, agency, and other organizational unit (see paragraph 3.25 for a further discussion).
- 4.6 In performing the financial statement audit, the auditor should refer to the accounting and auditing guidance applicable to specific industries as found in the following AICPA Audit and Accounting Guides: *Not-for-Profit Organizations*, *Audits of State and Local Governmental Units*, *Health Care Organizations*, and *Audits of Colleges and Universities*.<sup>2</sup>
- 4.7 In this chapter, the requirements of GAAS related to the auditor's consideration of compliance and internal control over financial reporting in a financial statement audit are summarized and the additional requirements of *Government Auditing Standards* in those areas are discussed.

## **Consideration of Internal Control Over Financial Reporting**

- 4.8 In the following paragraphs the requirements of GAAS and *Government Auditing Standards* applicable to the auditor's

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1. A comprehensive basis of accounting other than GAAP is defined in paragraph 4 of SAS No. 62, *Special Reports* (AICPA, *Professional Standards*, vol. 1, AU sec. 623.04).

2. Auditors should note that although *Audits of Colleges and Universities* has been superseded by *Not-for-Profit Organizations*, it continues to be applicable in a governmental environment (that is, public institutions).

consideration of internal control over financial reporting in a financial statement audit are described.

## **Summary of GAAS Requirements**

- 4.9 SAS No. 55, *Consideration of Internal Control in a Financial Statement Audit*, as amended by SAS No. 78, *Consideration of Internal Control in a Financial Statement Audit: An Amendment to SAS No. 55* (AICPA, *Professional Standards*, vol. 1, AU sec. 319), provides guidance on the independent auditor's consideration of an auditee's internal control in an audit of financial statements in accordance with GAAS, defines internal control, describes the objectives and components of internal control, and explains how an auditor should consider internal control in planning and performing an audit.
- 4.10 When obtaining an understanding of internal control over financial reporting and assessing control risk for the assertions embodied in the financial statements, the auditor should refer to SAS No. 55, as amended by SAS No. 78, and to guidance applicable to specific industries as found in the AICPA Audit and Accounting Guides listed in paragraph 4.6.

### **Definition of Internal Control**

- 4.11 The definition of internal control in both SAS No. 55, as amended by SAS No. 78, and Circular A-133 is consistent with the definition and description of internal control contained in *Internal Control—Integrated Framework*, published by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. The definition is as follows:

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

- Effectiveness and efficiency of operations;
- Reliability of financial reporting; and
- Compliance with applicable laws and regulations.

## **Control Objectives**

4.12 The three categories of control objectives described previously are what an auditee strives to achieve. These distinct but somewhat overlapping categories have differing purposes and allow a directed focus to meet the needs of the auditee and others regarding each separate purpose. In general, controls that are relevant to an audit of financial statements pertain to the auditee's objective of the reliability of financial reporting and involve the preparation of financial statements for external purposes that are fairly presented in conformity with GAAP or a comprehensive basis of accounting other than GAAP (see note 1 of this chapter). However, controls pertaining to the operations and compliance objectives may also be relevant to a financial statement audit to the extent that they pertain to data the auditor evaluates or uses in applying auditing procedures to the financial statements. Controls relevant to an audit of the financial statements are referred to collectively in this SOP as "internal control over financial reporting" and are encompassed in the reporting on internal control required by *Government Auditing Standards* (see paragraphs 10.38 through 10.40). Controls relevant to an audit of compliance with requirements applicable to major federal programs are referred to collectively in this SOP as "internal control over compliance" and are encompassed in the report on internal control required by Circular A-133 (see paragraphs 10.46 through 10.49). In a particular single audit engagement, some controls may be relevant to both the audit of the financial statements and the audit of compliance. When this occurs, those controls would be encompassed in both internal control reports. Section 505 of Circular A-133 provides guidance on reporting findings involving reportable conditions in internal control in such a circumstance (see paragraph 10.56).

## **Components of Internal Control**

4.13 The five components of internal control are the control environment, risk assessment, control activities, information and communication, and monitoring. SAS No. 55, as amended by SAS No. 78, requires the auditor to obtain an

understanding of each of those components that is sufficient to plan the audit by performing procedures to understand (a) the design of controls relevant to an audit of financial statements, and (b) whether they have been placed in operation. In all audits of financial statements, including those audited as part of a single audit, this understanding incorporates knowledge about the design of controls relevant to compliance with laws and regulations that have a direct and material effect on the determination of financial statement amounts, as well as knowledge about whether they have been placed in operation. After obtaining this understanding, the auditor assesses control risk for the assertions embodied in the account balance, transaction class, and disclosure components of the financial statements.

### ***Relationship Between Objectives and Components***

- 4.14 There is a direct relationship between the three categories of control objectives (what an auditee strives to achieve) and the control components (what is needed to achieve the objectives). Although an auditee's internal control addresses objectives in each of the categories referred to in the definition of internal control in paragraph 4.11, not all of these objectives and related controls are relevant to an audit of the auditee's financial statements.

### ***Documentation Requirements***

- 4.15 SAS No. 55, as amended by SAS No. 78, requires the auditor to document the understanding of the auditee's internal control components that was obtained to plan the audit. In addition, the auditor should document the basis for his or her conclusions about the assessed level of control risk. The form and extent of this documentation is influenced by the size and complexity of the auditee, as well as by the nature of the auditee's internal control (see paragraphs 3.16 through 3.18 for a discussion of the working paper requirements of *Government Auditing Standards*). Auditors should refer to SAS No. 55, as amended by SAS No. 78, for more detail on the documentation requirements related to internal control over financial reporting.

## **Communication Requirements**

4.16 The auditor should consult the guidance in SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325), for guidance on identifying and reporting conditions that relate to an entity's internal control over financial reporting observed during an audit of financial statements (see also paragraphs 4.19 and 10.26 through 10.30). The auditor should also consult the guidance in SAS No. 61, *Communication With Audit Committees* (AICPA, *Professional Standards*, vol. 1, AU sec. 380), for required communications to persons who have responsibility for the oversight of the financial reporting process (see also paragraph 10.14).

## **Responsibilities Under Government Auditing Standards**

### **Fieldwork**

4.17 *Government Auditing Standards* does not prescribe any additional fieldwork standards with respect to the auditor's consideration of internal control over financial reporting beyond those required in an audit conducted in accordance with GAAS. However, paragraphs 4.22 through 4.33 of *Government Auditing Standards* provide guidance on four aspects of internal control over financial reporting that are important to the judgments auditors make about audit risk and about the evidence needed to support their opinion on the financial statements. These aspects are summarized as follows:

- *Control environment.* Auditors' judgments about the control environment may influence (either positively or negatively) judgments about specific control procedures.
- *Safeguarding controls.* These are the controls that prevent or timely detect unauthorized transactions and unauthorized access to assets resulting in possible losses that are material to the financial statements. Therefore, the understanding of safeguarding controls assists auditors in planning the audit to detect material misappropriations as well as to assess



other risks that the financial statements could be materially misstated.

- *Controls over compliance with laws and regulations.* These are important to auditors in identifying the types of potential misstatements that could occur and the factors that could affect the risk of material misstatement. Such information can help provide reasonable assurance that the financial statements are free of material misstatements resulting from violations of laws and regulations that have a direct and material effect on the determination of financial statement amounts.
- *Control risk assessments.* These are important in determining the nature, timing, and extent of the audit tests to be performed. *Government Auditing Standards* reminds auditors that when control risk is assessed below the maximum for a given financial statement assertion, the need for evidence from substantive tests of that assertion is reduced. Auditors are not required to assess control risk below the maximum and to rely on controls. However, auditors may find it efficient to do so for larger entities or those with complex operations. The auditors' ability to rely on controls is directly related to the evidence obtained to show that the controls work. Auditors may find it necessary to reconsider assessments of control risk when substantive tests detect misstatements.

4.18 The auditor should consider this guidance as it relates to the consideration of the auditee's internal control over financial reporting in the audit of the financial statements.

## **Reporting**

4.19 Reporting on the internal control over financial reporting under *Government Auditing Standards* differs from such reporting under SAS No. 60. *Government Auditing Standards* requires written reporting on internal control over financial reporting in all audits. SAS No. 60 requires communication (either written or oral) only when the auditor has noted reportable conditions. *Government Auditing*

*Standards* requires a description of any reportable conditions noted, including the identification of those that are individually or cumulatively material weaknesses. SAS No. 60 permits, but does not require, the auditor to identify and communicate separately, as material weaknesses, those reportable conditions that, in the auditor's judgment, are considered to be material weaknesses. Finally, *Government Auditing Standards* requires communication of the following matters, which are not addressed by SAS No. 60: (a) a description of the scope of the auditor's testing of internal control and the results of those tests and (b) deficiencies in internal control that are not considered reportable conditions (see the discussion in paragraph 10.29). See paragraphs 3.19 through 3.20 and 10.26 through 10.30 for a more detailed discussion of the reporting requirements related to internal control over financial reporting.

## **Compliance Considerations**

- 4.20 The auditor should be aware of the unique characteristics of the compliance auditing environment. States, local governments, and not-for-profit organizations differ from commercial enterprises in that they may be subject to diverse compliance requirements. Management is responsible for ensuring compliance with relevant laws and regulations. That responsibility encompasses the identification of applicable laws and regulations and the establishment of internal control designed to provide reasonable assurance that the auditee complies with those laws and regulations.
- 4.21 In the following paragraphs, the requirements of GAAS that are applicable to the auditor's consideration of compliance in a financial statement audit are summarized and the additional requirements of *Government Auditing Standards* are discussed.

## **Summary of GAAS Requirements**

### **General Guidance**

- 4.22 SAS No. 74, *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental*

*Financial Assistance*, provides general guidance when the auditor is engaged to audit an entity that receives federal awards, including audits performed under GAAS, *Government Auditing Standards*, and Circular A-133. SAS No. 74 describes the auditor's responsibility in a GAAS audit for considering laws and regulations and how they affect the financial statement audit and also discusses the auditor's responsibility for compliance auditing related to federal awards in an audit performed under Circular A-133. The auditor's responsibility for compliance auditing related to federal awards is discussed in chapter 6 of this SOP.

- 4.23 The auditor is required to design the audit to provide reasonable assurance that the financial statements are free of material misstatements resulting from violations of laws and regulations, error, or fraud. SAS No. 54, *Illegal Acts by Clients*, describes the auditor's responsibility in a GAAS audit for considering laws and regulations and how they affect the financial statement audit. SAS No. 82, *Consideration of Fraud in a Financial Statement Audit*, and SAS No. 47, *Audit Risk and Materiality in Conducting an Audit*, as amended by SAS No. 82, describe the auditor's responsibility in a GAAS audit for the consideration of fraud and errors. The requirements of SAS Nos. 54, 82, and 47 are described in paragraphs 4.24 through 4.38.

### **SAS No. 54 Requirements**

- 4.24 SAS No. 54 requires the auditor to design the audit to provide reasonable assurance that the financial statements are free of material misstatements resulting from violations of laws and regulations that have a direct and material effect on the determination of financial statement amounts. This involves identifying laws and regulations that may have a direct and material effect on the determination of financial statement amounts, and then assessing the risk that non-compliance with these laws and regulations may cause the financial statements to contain a material misstatement. The auditor considers such laws or regulations from the perspective of their known relation to audit objectives derived from financial statement assertions rather than from the perspective of legality per se.

- 4.25 Although it has not been explicitly stated in SAS No. 54, the phrase “laws and regulations” has generally been interpreted to implicitly include the provisions of contract and grant agreements (see paragraph 3.15). Laws, regulations, and provisions of contracts and grant agreements are referred to in this SOP as “compliance requirements.” Violations of laws, regulations, and provisions of contracts and grant agreements are referred to in this SOP as “instances of noncompliance.”
- 4.26 In considering whether the financial statements may be materially misstated because of instances of noncompliance, the auditor should—
- Assess whether management has identified compliance requirements that have a direct and material effect on the determination of amounts in the financial statements.
  - Obtain an understanding of the possible effects of these compliance requirements on the determination of financial statement amounts.
  - Assess the risk that a material misstatement of the financial statements has occurred because of instances of noncompliance.
  - Design and conduct the audit to provide reasonable assurance of detecting such material noncompliance.
- 4.27 The auditor may consider performing the following procedures in assessing management’s identification of these compliance requirements and in obtaining an understanding of their possible effects on the determination of financial statement amounts:
- a. Consider knowledge about these compliance requirements that has been obtained from prior years’ audits.
  - b. Discuss these compliance requirements with the auditee’s chief financial officer, legal counsel, or grant administrators.
  - c. Obtain written representation from management regarding the completeness of management’s identification of compliance requirements (see paragraph 4.40).

- d. Review the relevant portions of any directly related agreements, such as those related to grants and loans.
- e. Identify sources of revenue, review any related agreements (for example, loan agreements or grant agreements) and inquire about the applicability of any overall governmental regulations to the accounting for the revenue.
- f. Obtain publications pertaining to compliance requirements. These publications often address federal tax and other reporting requirements, such as the Department of the Treasury and the Internal Revenue Service requirements pertaining to information returns and regulations concerning the calculation of arbitrage rebates and refunds.
- g. Obtain copies of, and review pertinent sections of, the state constitution, laws, and regulations concerning the auditee. The sections of these documents pertaining to financial reporting, debt, taxation, budget, and appropriation and procurement matters may be especially relevant.
- h. Review the minutes of meetings of the governing body of the auditee for the enactment of laws and regulations or information about contracts and grant agreements that have a direct and material effect on the determination of financial statement amounts.
- i. Inquire of the office of the federal, state, or local auditor or other appropriate audit oversight organization about the compliance requirements applicable to entities within their jurisdiction, including statutes and uniform reporting requirements.
- j. Review information about applicable federal and state program compliance requirements, such as the information included in the *Compliance Supplement*, the CFDA, and state and local policies and procedures.
- k. Review the guidance contained in the applicable AICPA Audit and Accounting Guides referred to in paragraph 4.6 and review the materials available from

other professional organizations, such as state societies of CPAs or industry associations.

1. Inquire of the audit, finance, or program administrators from which grants are received about the restrictions, limitations, terms, and conditions under which such grants were provided. These administrators can usually be helpful in identifying compliance requirements, which they may identify separately or publish in an audit guide.

4.28 In obtaining an understanding of the possible effects on financial statements of compliance requirements that are generally recognized by auditors to have a direct and material effect on the determination of financial statement amounts, the auditor may consider—

- The materiality of the effect on financial statement amounts.
- The level of management or employee involvement in the compliance-assurance process.
- The opportunity for concealment of instances of noncompliance.

4.29 As part of assessing the risk of material misstatement, the auditor should assess the risk that instances of noncompliance may cause such a material misstatement. Based on that assessment, the auditor should design the audit to provide reasonable assurance of detecting instances of noncompliance that are material to the financial statements. Therefore, the auditor should design the audit to provide reasonable assurance that the financial statements are free of material misstatements resulting from instances of noncompliance that have a direct and material effect on the determination of financial statement amounts (see paragraph 6.53 for a discussion of the impact on the financial statements of actual and projected errors noted in a single audit, and see paragraph 10.42 for a discussion of situations that could occur when the auditor reports on the results of compliance testing) .

4.30 Auditees may be affected by many other laws and regulations, including those related to occupational safety and health,

environmental protection, equal employment, food and drug, and price fixing. These laws and regulations generally concern an auditee's operations more than financial reporting and accounting. Their effect on an auditee's financial statements is indirect and normally takes the form of the disclosure of a contingent liability that follows from the allegation or determination of illegality. The auditor would not ordinarily have sufficient basis to recognize possible violations of these laws and regulations. Even when violations of such laws and regulations can have consequences that are material to the financial statements, the auditor may not become aware of the existence of the illegal act unless he or she is informed by the auditee, or unless there is evidence of an investigation or enforcement proceeding in the records, documents, or other information normally inspected in an audit of financial statements.<sup>3</sup>

- 4.31 If specific information comes to the auditor's attention that provides evidence concerning the existence of possible instances of noncompliance that could have a material indirect effect on the financial statements, the auditor should apply audit procedures specifically directed to ascertaining whether an instance of noncompliance occurred. However, because of the characteristics of such noncompliance, an audit made in accordance with GAAS provides no assurance that indirect-effect instances of noncompliance will be detected or that any contingent liabilities that may result will be disclosed.

### **SAS No. 82 Requirements**

- 4.32 SAS No. 1, section 110, "Responsibilities and Functions of the Independent Auditor" (AICPA, *Professional Standards*, vol. 1, AU sec. 110), states that the auditor also has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error

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3. In addition, for compliance with laws and regulations that have an indirect effect on the determination of financial statement amounts, SAS No. 54 notes that, where applicable, the auditor should also inquire of management concerning (a) the client's policies relative to the prevention of illegal acts and (b) the use of directives issued by the client, as well as periodic representations obtained by the client, from management at appropriate levels of authority, concerning compliance with laws and regulations.

or fraud. SAS No. 82 provides guidance to auditors in fulfilling that responsibility, as it relates to fraud, in an audit of financial statements conducted in accordance with GAAS.

- 4.33 Although fraud is a broad legal concept, the auditor's interest specifically relates to fraudulent acts that cause a material misstatement of financial statements. The primary factor that distinguishes fraud from error is whether the underlying action that results in the misstatement of financial statements is intentional or unintentional. Two types of misstatements are relevant to the auditor's consideration of fraud in a financial statement audit: misstatements arising from fraudulent financial reporting and misstatements arising from the misappropriation of assets. These two types of misstatements, as well as the characteristics of fraud, are discussed further in paragraphs 3 through 10 of SAS No. 82 (AICPA, *Professional Standards*, vol. 1, AU secs. 316.03 through 316.10).
- 4.34 The risk of material misstatement of the financial statements due to fraud is part of audit risk. Therefore, the auditor should specifically assess the risk of material misstatement of the financial statements due to fraud and should consider that assessment in designing the audit procedures to be performed. In making this assessment, the auditor should consider fraud risk factors that relate to both misstatements arising from fraudulent financial reporting and misstatements arising from the misappropriation of assets in each of the following categories:

### ***Misstatements Arising From Fraudulent Financial Reporting***

- Management's characteristics and influence over the control environment
- Industry conditions
- Operating characteristics and financial stability

### ***Misstatements Arising From the Misappropriation of Assets***

- Susceptibility of assets to misappropriation
- Controls



The auditor should exercise professional judgment when considering (a) risk factors individually or in combination and (b) whether there are specific controls that mitigate the risk. Risk factors are discussed in greater detail in paragraphs 16 through 25 of SAS No. 82 (AICPA, *Professional Standards*, vol. 1, AU secs. 316.16 through 316.25).

- 4.35 As noted previously, an auditor's interest specifically relates to fraudulent acts that cause a material misstatement in the financial statements. When the auditor is identifying risk factors and other conditions in an audit of financial statements performed in conjunction with a single audit, the auditor's responsibilities under SAS No. 82 are expanded to include (in addition to the risk factors normally associated with financial statements) the consideration of risk factors associated with the receipt of federal awards that could present a material misstatement of the financial statements. Auditors may wish to refer to the AICPA practice aid titled *Considering Fraud in a Financial Statement Audit: Practical Guidance for Applying SAS No. 82*, which includes specific nonauthoritative guidance on applying the concepts of SAS No. 82 to several industries, including government, health care, and not-for-profit organizations. Among other things, it identifies example risk factors for those industries, including risk factors that relate to recipients of federal awards.
- 4.36 In planning the audit, the auditor should document in the working papers evidence of the performance of the assessment of the risk of material misstatement due to fraud. Where risk factors are identified as being present, the documentation should include (a) those risk factors identified and (b) the auditor's response to those risk factors, individually or in combination. In addition, if, during the performance of the audit, fraud risk factors or other conditions are identified that cause the auditor to believe that an additional response is required, these risk factors or other conditions, as well as any further response that the auditor concluded was appropriate, should also be documented.
- 4.37 SAS No. 82 also contains requirements on the auditor's response to the results of the assessment of risk, the evaluation of audit test results, and communications about fraud

to management, the audit committee, and others. Auditors should refer to SAS No. 82 for a description of the specific requirements in those areas (see also paragraphs 10.18 through 10.20).

### **SAS No. 47 Requirements**

4.38 SAS No. 47, as amended by SAS No. 82, provides guidance to auditors in fulfilling the responsibility described in paragraph 4.32, as it relates to errors, in an audit of financial statements conducted in accordance with GAAS. Errors are described as unintentional misstatements, or as omissions of amounts or disclosures, in financial statements. Errors may involve (a) mistakes in gathering or processing data from which financial statements are prepared, (b) unreasonable accounting estimates arising from oversight or the misinterpretation of facts, and (c) mistakes in the application of accounting principles relating to amounts, classification, the manner of presentation, or disclosure. When the auditor is considering his or her responsibility to obtain reasonable assurance that the financial statements are free of material misstatement, there is no important distinction between error and fraud. There is a distinction, however, in the auditor's response to detected misstatements. An isolated, immaterial error in processing accounting data or in applying accounting principles is generally not significant to the audit. In contrast, when fraud is detected, the auditor should consider its implications for the integrity of management or employees and its possible effect on other aspects of the audit. Auditors should refer to SAS No. 47 for more detailed guidance.

### **Working Paper Documentation**

4.39 The auditor should document the procedures performed to evaluate compliance with laws and regulations that have a direct and material effect on the determination of financial statement amounts in accordance with SAS No. 41, *Working Papers*. (See paragraphs 3.16 through 3.18 of this SOP for a discussion of the *Government Auditing Standards* requirements related to working papers.) The fraud risk fac-

tors identified and the auditor's response to those risk factors should be documented in accordance with SAS No. 82 (see paragraph 4.36). The auditor's understanding of internal control over financial reporting as it pertains to compliance with such laws and regulations, as well as the related assessment of control risk, should be documented in accordance with SAS No. 55, as amended by SAS No. 78 (see paragraph 4.15).

### **Written Representations From Management**

4.40 SAS No. 85, *Management Representations*, requires the auditor to obtain written representations from management as part of an audit conducted in accordance with GAAS. It also includes an illustrative management representation letter and an appendix containing additional representations that may be appropriate to be included in a management representation letter in certain circumstances. With respect to compliance requirements affecting the financial statement audit, auditors should consider obtaining additional representations from management acknowledging that management (see paragraphs 6.68 and 6.69 for a discussion of additional management representations in a single audit)—

- a. Is responsible for compliance with the laws, regulations, and provisions of contracts and grant agreements applicable to the auditee.
- b. Is responsible for establishing and maintaining effective internal control over financial reporting.
- c. Has identified and disclosed to the auditor all laws, regulations, and provisions of contracts and grant agreements that have a direct and material effect on the determination of financial statement amounts.
- d. Has identified and disclosed to the auditor violations (or possible violations) of laws, regulations, and provisions of contracts and grant agreements whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.

## **Additional Responsibilities Under Government Auditing Standards**

4.41 *Government Auditing Standards* prescribes as part of the financial statement audit additional fieldwork and reporting requirements beyond those in GAAS that are related to compliance. The additional fieldwork responsibilities are related to audit follow-up on known material findings and recommendations from previous audits, as well as to working paper access and documentation. (See paragraphs 3.14 through 3.18 of this SOP for a further discussion of these requirements.) With regard to reporting, *Government Auditing Standards* requires, among other things, that the auditor report on the scope of his or her testing of compliance and present the results of those tests. See paragraphs 10.15 and 10.16 for a more detailed discussion of the *Government Auditing Standards* reporting requirements related to compliance.

### **Reasonable Assurance**

4.42 SAS No. 1, section 230, “Due Professional Care in the Performance of Work” (AICPA, *Professional Standards*, vol. 1, AU sec. 230), states that since the auditor’s opinion on the financial statements is based on the concept of obtaining reasonable assurance, the auditor is not an insurer and his or her audit report does not constitute a guarantee. Therefore, the subsequent discovery that a material misstatement, whether from error or fraud, exists in the financial statements does not, in and of itself, evidence (a) failure to obtain reasonable assurance, (b) inadequate planning, performance, or judgment, (c) the absence of due professional care, or (d) a failure to comply with GAAS.

## **CHAPTER 5**

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# **Schedule of Expenditures of Federal Awards**

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### **Overview of Schedule Requirements**

- 5.1 Circular A-133 requires the auditor to 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. This schedule, prepared by the auditee, reports the total expenditures for each federal program (see paragraph 1.18 for the Circular A-133 definition of federal programs). In this chapter the identification of federal awards, the general presentation requirements governing the schedule, pass-through awards, noncash awards, and endowment funds are described. The auditor's reporting on the schedule is discussed in paragraphs 10.36 through 10.37.

### **Identification of Federal Awards**

#### **Federal Agency and Pass-Through Entity Requirements**

- 5.2 Circular A-133 requires federal agencies and pass-through entities to identify the federal awards made by informing each recipient or subrecipient of the CFDA title and number, the award's name and number, the award year, and whether the award is for R&D. When some of this information is not available, the federal agency or pass-through entity is required to provide the information necessary to describe the federal award clearly.

#### **Auditee Requirements**

- 5.3 Circular A-133 also requires the auditee to identify in its accounts all federal awards received and expended, as well

as the federal programs under which they were received. Federal program and award identification includes, as applicable, the CFDA title and number, the award number and year, the name of the federal granting agency, and the name of the pass-through entity.

## **Auditor Assessment of Auditee Identification of Federal Programs**

- 5.4 In assessing the appropriateness and completeness of the auditee's identification of federal programs in the schedule, the auditor should consider, among other matters, evidence obtained from audit procedures performed to evaluate the completeness and classification of recorded revenues and expenditures. This may include sending confirmations to granting federal agencies or pass-through entities in an audit of a subrecipient. When the auditee is unable to identify federally funded expenditures separately, the auditor should consider whether a reportable condition exists. If it does, a finding should be reported in the schedule of findings and questioned costs (see chapter 10 for a further discussion of reporting findings and the schedule of findings and questioned costs).

## **General Presentation Requirements**

### **Basis of Accounting**

- 5.5 Circular A-133 does not prescribe the basis of accounting that must be used by the auditee to prepare the schedule of expenditures of federal awards. Some auditees may choose to prepare the schedule on a basis of accounting that is different from that in the financial statements. In any case, the auditee is required to disclose the basis of accounting and the significant accounting policies used in preparing the schedule. The auditee must also be able to reconcile amounts presented in the financial statements to related amounts in the schedule of expenditures of federal awards.

### **Required Schedule Contents**

- 5.6 Circular A-133 requires the auditee to prepare a schedule of expenditures of federal awards for the period covered by

the auditee's financial statements. At a minimum, the schedule should—

- List individual federal programs by federal agency. For federal programs included in a cluster of programs (see paragraphs 1.18, 1.19, and 2.18), list individual federal programs within a cluster of programs. For R&D, the total federal awards expended must 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 (the federal agency).
- Include, for federal awards received as a subrecipient, the name of the pass-through entity and the identifying number assigned by the pass-through entity.
- Provide the total federal awards expended for each individual federal program and the CFDA number or other identifying number when the CFDA information is not available.
- Include notes that describe the significant accounting policies used in preparing the schedule.
- Identify, to the extent practical, the total amount provided to subrecipients by pass-through entities from each federal program (see chapter 9 for a further discussion of the audit considerations of federal pass-through awards).
- Include, in either the schedule or a note to the schedule, the value of federal awards expended in the form of noncash assistance, the amount of insurance in effect during the year, and loans or loan guarantees outstanding at year end (see paragraph 5.13).

Example schedules of expenditures of federal awards appear in appendix C.

## **Providing Additional Information**

- 5.7 Although not required, the auditee may choose to provide other information (in addition to the foregoing requirements) that is 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 choose to list the amount of federal awards expended for each award year separately, if so requested by a federal agency.

## **Schedule Not in Agreement With Other Federal Award Reporting**

- 5.8 Auditors should note that the information included in the schedule may not fully agree with other federal award reports that the auditee submits directly to federal granting agencies because, among other reasons, the award reports (a) may be prepared for a different fiscal period and (b) may include cumulative (from prior years) data rather than data for the current year only.

## **Inclusion of Nonfederal Awards**

- 5.9 Circular A-133 does not require nonfederal awards (for example, state awards) to be presented in the schedule. However, to meet state or other requirements, auditees may decide to include such awards in the schedule. If such nonfederal data are presented, they should be segregated and clearly designated as nonfederal. The title of the schedule should also be modified to indicate that nonfederal awards are included.

## **CFDA Number Not Available**

- 5.10 The auditee may be unable to obtain the CFDA number, which is sometimes the case for new federal programs and R&D programs. In addition, cost-type contracts will normally not have a CFDA number. When the CFDA number is not available, the auditee should indicate that fact and should include in the schedule the program's name and, if available, other identifying number.

## **Pass-Through Awards**

### **Treatment of Pass-Through Awards**

- 5.11 Circular A-133 defines a subrecipient as an entity that expends federal awards that are received from a pass-through



entity to carry out a federal program. State or local government redistributions of federal awards to subrecipients, known as “pass-through awards,” should be treated by the subrecipient as though they were received directly from the federal government. Accordingly, pass-through awards should be included in the scope of the single audit on the same basis as that of federal awards that are received directly. The audit considerations of federal pass-through awards are discussed further in chapter 9. As noted in paragraph 5.6, in addition to the other general presentation requirements, Circular A-133 requires the schedule to include the name of the pass-through entity and the identifying number assigned by the pass-through entity for federal awards received as a subrecipient.

## **Commingled Assistance**

5.12 The individual sources (that is, federal, state, and local) of federal awards may not be separately identifiable because of commingled assistance from different levels of government. If the commingled portion cannot be separated to specifically identify the individual funding sources, the total amount should be included in the schedule, with a footnote describing the commingled nature of the funds.

## **Noncash Awards**

### **Treatment of Noncash Awards**

5.13 Most federal awards are in the form of cash awards. However, there are a number of federal programs that do not involve cash transactions. These programs may include food stamps, commodities, loan guarantees, loans, surplus property, interest rate subsidies, or insurance. Circular A-133 requires the value of federal awards expended in the form of noncash assistance (such as loan guarantees, loans, insurance programs, surplus property, food stamps issued, or commodities distributed) to be reported either on the face of the schedule or disclosed in the notes to the schedule. The OMB states in Circular A-133 that although it is not required, it is preferable to present this information in the schedule rather than

in the notes to the schedule. See paragraphs 2.13 and 2.14 for a discussion on determining when awards, including non-cash awards, are considered to be expended.

## **Determining the Value of the Noncash Awards Expended**

5.14 Table 5.1 shows the bases generally used to determine the value of noncash awards expended (see section 205 of Circular A-133 for additional details).

## **Loan and Loan Guarantee Continuing Compliance Requirements**

5.15 As noted previously, in determining the value of total non-cash awards expended for loans and loan guarantees, the balances of loans from previous years must be included if the federal government imposes continuing compliance requirements. Circular A-133 does not specifically define the term *continuing compliance requirements*. Therefore, it is a matter of judgment as to whether continuing compliance requirements are significant enough to require inclusion of prior-year loan or loan guarantee balances. For example, if in a prior year an auditee expended the proceeds of a federal loan to construct a building, and the current-year activity consists only of loan repayments and a requirement by the federal lender for the auditee to submit a report that only details loan payment information, it may not be necessary to include the prior year's loan balance in determining the total amount of loans expended. However, if the federal lender requires the auditee to ensure on an ongoing basis that a certain percentage of the building is rented to low-income residents, it would likely be necessary to include the prior year's loan balance in determining the total amount of loans expended. The auditor should consider contacting the federal agency Office of Inspector General for assistance in determining whether continuing compliance requirements are significant enough to require inclusion of the balances of prior loans or loan guarantees.

**TABLE 5.1 Determining the Value of Noncash Awards Expended**

<b>Types of Noncash Awards</b>	<b>Basis Used to Determine the Value of Noncash Awards Expended</b>
Loans and loan guarantees*	Value of new loans made or received during the fiscal year plus the balance of loans from previous years for which the federal government imposes continuing compliance requirements (see paragraph 5.15), plus any interest subsidy, cash, or administrative cost allowance received.
Loans and loan guarantees (loans) at institutions of higher education*	When loans are made to students but the institution of higher education does not make the loans, only the value of loans made during the year are considered federal awards expended. The balance of loans for previous years is not included because the lender accounts for the prior balances.
Insurance	Fair market value of insurance contract at the time of receipt, or the assessed value provided by the federal agency.
Food stamps	Fair market value of food stamps at the time of receipt, or the assessed value provided by the federal agency.
Commodities	Fair market value of commodities at the time of receipt, or the assessed value provided by the federal agency.
Donated property or donated surplus property	Fair market value of donated property or donated surplus property at the time of receipt, or the assessed value provided by the federal agency.
Free rent	Fair market value of free rent at the time of receipt, or the assessed value provided by the federal agency. Free rent is not considered an award expended unless it is received as part of an award to carry out a federal program.

\* The proceeds of loans that were received and expended in prior years are not considered federal awards expended 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.

## **Endowment Funds**

- 5.16 Circular A-133 states that 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.

## CHAPTER 6

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# Compliance Auditing Applicable to Major Programs

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- 6.1 In this chapter the auditor's consideration of compliance requirements applicable to major programs in a single audit under Circular A-133 is discussed (as noted in paragraph 11.5, much of the guidance in this chapter would also be applicable to a program-specific audit when a program-specific audit guide is not available). The consideration of internal control over compliance for major programs is discussed in chapter 8. The related reporting requirements are discussed in chapter 10. The auditor's consideration of the auditee's compliance with laws, regulations, and the provisions of contracts or grant agreements in a financial statement audit is discussed in chapter 4.

### Single Audit Compliance Objectives

- 6.2 In addition to a financial statement audit in accordance with GAAS and *Government Auditing Standards*, Circular A-133 requires the auditor to 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 (these are hereinafter referred to as "compliance requirements"). A single audit results in the auditor expressing an opinion on the auditee's compliance with these compliance requirements for each of its major programs. To express such an opinion, the auditor accumulates sufficient evidence by planning and performing tests of transactions and such other auditing procedures as are necessary in support of the entity's compliance with applicable compliance requirements, thereby limiting audit risk to an appropriately low level.

## **Responsibilities of Auditee**

- 6.3 The auditee is responsible (a) for complying with the compliance requirements related to each of its federal programs and (b) for establishing and maintaining effective internal control over compliance for 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. The auditor should obtain management's written representations regarding its compliance and internal control responsibilities as discussed in paragraphs 6.68 through 6.69.
- 6.4 The form and extent of the documentation of management's compliance will vary depending on the nature of the compliance requirements and the size and complexity of the entity. The auditee may have documentation in the form of accounting or statistical data, case files, entity policy manuals, accounting manuals, narrative memoranda, procedural write-ups, flowcharts, completed questionnaires, or internal auditors' reports.

## **Use of Professional Judgment**

- 6.5 The planning, conduct, and evaluation of the results of compliance testing in a single audit require the auditor to exercise professional judgment. The following factors may be considered by the auditor in applying his or her professional judgment:
- The assessment of inherent risk, control risk, and fraud risk
  - The assessment of materiality
  - The evidence obtained from other auditing procedures
  - The amount of expenditures for the program
  - The diversity or homogeneity of expenditures for the program

- The length of time that the program has operated, or changes in its conditions
- The current and prior auditing experience with the program, particularly findings in previous audits and other evaluations (that is, inspections, program reviews, or system reviews required by the federal acquisition regulations)
- The extent to which the program is carried out through subrecipients, as well as the related monitoring activities
- 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 expectation of noncompliance or compliance with the applicable compliance requirements
- The extent to which computer processing is used to administer the program, as well as the complexity of the processing
- Whether the program has been identified as being high-risk by the OMB in the *Compliance Supplement*

## **Audit Risk Considerations**

- 6.6 To express an opinion on compliance, the auditor accumulates sufficient evidence in support of compliance, thereby limiting audit risk to an appropriately low level. The auditor's consideration of audit risk and materiality when he or she plans and performs a single audit is similar to the consideration in a financial statement audit in accordance with SAS No. 47, *Audit Risk and Materiality in Conducting an Audit*, as amended by SAS No. 82, *Consideration of Fraud in a Financial Statement Audit*. Audit risk and materiality, among other matters, need to be considered together in determining the nature, timing, and extent of auditing procedures and in evaluating the results of those procedures.

## Components of Audit Risk

6.7 Audit risk is the risk that the auditor may unknowingly fail to appropriately modify his or her opinion on compliance. It is composed of inherent risk, control risk, fraud risk, and detection risk. For the purposes of a single audit, these components are defined as follows:

- *Inherent risk*—the risk that material noncompliance with a major program’s compliance requirements could occur, assuming there is no related internal control
- *Control risk*—the risk that material noncompliance that could occur in a major program will not be prevented or detected on a timely basis by the entity’s internal control
- *Fraud risk*—the risk that intentional material noncompliance with a major program’s compliance requirements could occur
- *Detection risk*—the risk that the auditor’s procedures will lead him or her to conclude that noncompliance that could be material to a major program does not exist when, in fact, such noncompliance does exist

In paragraphs 6.8 through 6.12, each of these components of audit risk is discussed and an explanation of how the components of audit risk interrelate in providing a basis for the auditor’s opinion on compliance is given.

### Inherent Risk

6.8 In assessing inherent risk, the auditor should consider factors that are relevant to compliance engagements. Such factors include the following (the factors listed in paragraph 6.5 should also be considered):

- The complexity of the compliance requirements
- The length of time the entity has been subject to the compliance requirements
- Prior experience with the entity’s compliance



- The potential impact of noncompliance, both qualitatively and quantitatively

6.9 The auditor's assessment of inherent risk over major programs may be performed in part when the auditor is determining major programs using the risk-based approach (see paragraph 7.36). The nature of some programs may indicate higher inherent risk. Programs with higher inherent risk may be of a higher risk for the purpose of determining major programs. Circular A-133 provides the following examples for program characteristics with potentially higher inherent risks:

- Complex programs and the extent to which a program contracts for goods and services have the potential for higher risk. 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 may otherwise be at low risk.
- The phase of a federal program's life cycle at the federal agency may indicate risk. For example, a new program with new or interim regulations may have a higher risk than an established program with time-tested regulations. In addition, significant changes in federal programs, laws, or regulations or in the provisions of contracts or grant agreements may increase risk.
- The phase of a program's life cycle at the auditee may indicate risk. For example, during the first and last years in which an auditee participates in a program, the risk may be higher because of the start-up or closeout of the program's activities and staff.
- Type B programs with larger federal awards expended would be of higher risk than would programs with substantially smaller federal awards expended.

## **Control Risk**

6.10 Circular A-133 requires the auditor to plan the testing of internal control over compliance for major programs, to support a low assessed level of control risk for the asser-

tions relevant to the compliance requirements for each major program. The circular does not, however, actually require the achievement of a low assessed level of control risk. The assessment of control risk contributes to the auditor's evaluation of the risk that material noncompliance exists in a major program. The process of assessing control risk (together with assessing inherent risk and fraud risk) provides evidential matter about the risk that such non-compliance may exist. The auditor uses this evidential matter as part of the reasonable basis for his or her opinion on compliance. The auditor's consideration of internal control over compliance for major programs, including the assessment of control risk, is discussed in chapter 8.

## **Fraud Risk**

6.11 SAS No. 82 provides guidance to the auditor on his or her responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement due to fraud (see paragraphs 4.32 through 4.37). Because SAS No. 82 only applies to an audit of financial statements, its requirements do not apply to an audit of an auditee's compliance with specified requirements applicable to its major programs. However, as part of assessing audit risk in a single or program-specific audit, the auditor should specifically assess the risk of material non-compliance with a major program's compliance requirements occurring due to fraud. The auditor should consider that assessment in designing the audit procedures to be performed. Auditors may wish to refer to the AICPA practice aid titled, *Considering Fraud in a Financial Statement Audit: Practical Guidance for Applying SAS No. 82*, which identifies example risk factors that relate to recipients of federal awards. When the auditor has assessed fraud risk and has deemed that a further response is necessary, the guidance in paragraphs 26 through 32 of SAS No. 82 (AICPA, *Professional Standards*, vol. 1, AU sec. 316.26-.32) may be helpful.

## **Detection Risk**

6.12 In determining an acceptable level of detection risk, the auditor considers his or her assessments of inherent risk, control

risk, and fraud risk, and the extent to which he or she seeks to restrict the audit risk related to the major program. As assessed inherent risk, control risk, or fraud risk decreases, the acceptable level of detection risk increases. Accordingly, the auditor may alter the nature, timing, and extent of the compliance tests performed based on the assessments of inherent risk, control risk, and fraud risk. Circular A-133 states that compliance testing must include tests of transactions and such other auditing procedures necessary to provide the auditor with sufficient evidence to support an opinion on compliance. Such compliance testing serves to limit detection risk.

## **Materiality Considerations**

- 6.13 In a compliance audit, the auditor's consideration of materiality differs from that in an audit of financial statements (see paragraphs 3.33 through 3.38). Materiality is affected by (a) the nature of the compliance requirements, which may or may not be quantifiable in monetary terms, (b) the nature and frequency of noncompliance identified with an appropriate consideration of sampling risk, and (c) qualitative considerations, such as the needs and expectations of federal agencies and pass-through entities. Qualitative factors that indicate that an identified instance of noncompliance may be immaterial include (a) a low risk of public or political sensitivity, (b) a single exception that has a low risk of being pervasive, or (c) an indication, based on the auditor's judgment and experience, that the affected federal agency or pass-through entity would normally not need to resolve the finding or take follow-up action.

## **Materiality Judgments About Compliance Applied to Each Major Program Taken as a Whole**

- 6.14 In designing audit tests and developing an opinion on the auditee's compliance with compliance requirements, the auditor should apply the concept of materiality to each major program taken as a whole, rather than to all major programs combined.
- 6.15 For purposes of evaluating the results of compliance testing, a material instance of noncompliance is defined as a failure

to follow requirements, or a violation of prohibitions, established by law, regulation, contract, or grant that results in an aggregation of noncompliance (that is, the auditor's best estimate of the overall noncompliance) that is material to the affected federal program. It should be noted that several instances of noncompliance that may not be individually material should be assessed to determine if, in the aggregate, they could have a material effect. Because the auditor expresses an opinion on each major program and not on all the major programs combined, reaching a conclusion about whether the instances of noncompliance (either individually or in the aggregate) are material to a major program requires consideration of the type and nature of the noncompliance, as well as the actual and projected effect on each major program in which the noncompliance was noted. Instances of noncompliance that are material to one major program may not be material to a major program of a different size or nature. In addition, the level of materiality relative to a particular major program can change from one audit to the next.

## **Effect of Material Noncompliance on the Financial Statements**

6.16 If the tests of compliance reveal material noncompliance at the major program level, the auditor should consider its effect on the financial statements. The auditor should also consider the cumulative effect of all instances of noncompliance on the financial statements. (See also paragraphs 6.53 and 10.42).

## **Performing a Compliance Audit**

6.17 The auditor should exercise (a) due care in planning and performing the audit and in evaluating the results of his or her audit procedures, and (b) the proper degree of professional skepticism to achieve reasonable assurance that material noncompliance will be detected.

6.18 In performing compliance tests, the auditor should—

- a. Identify the auditee's major programs to be tested and reported on for compliance (paragraph 6.19 and chapter 7).

- b. Identify the applicable compliance requirements (paragraphs 6.20 through 6.30).
- c. Plan the engagement (paragraphs 6.31 through 6.34 and chapter 3).
- d. Consider relevant portions of the entity's internal control over compliance for major programs (paragraph 6.35 and chapter 8).
- e. Obtain sufficient evidence, which involves testing compliance with applicable compliance requirements (paragraphs 6.36 through 6.47).
- f. Consider subsequent events (paragraphs 6.48 through 6.50).
- g. Form an opinion about whether the auditee complied with the applicable compliance requirements (paragraphs 6.51 through 6.60).
- h. Perform follow-up procedures on previously identified findings (paragraph 6.61 through 6.67).

## **Identifying Major Programs to Be Tested**

6.19 Circular A-133 requires the auditor to determine the major programs to be tested in a single audit using a risk-based approach. The application of the risk-based approach to determine major programs is discussed in chapter 7.

## **Identifying Applicable Compliance Requirements**

6.20 The auditor must determine the applicable compliance requirements to be tested and reported on in a single audit (that is, those laws, regulations, and provisions of contracts or grant agreements that may have a direct and material effect on each major federal program). The auditor should use professional judgment in making this determination.

## **Compliance Supplement**

6.21 The *Compliance Supplement* is based on the requirements of the Single Audit Act and Circular A-133, which provide for the issuance of a compliance supplement to assist auditors in performing the required audits (see paragraphs 1.27

through 1.29, 2.34, and 2.35 for additional discussion of the *Compliance Supplement* and for instructions on how to obtain a copy). The *Compliance Supplement* identifies the fourteen types of compliance requirements applicable to most federal programs. It also includes the compliance requirements specific to certain of the largest federal programs. Part 7 of the *Compliance Supplement* provides guidance to assist the auditor in identifying the compliance requirements for federal programs not included in the *Compliance Supplement* (see also paragraph 6.30).

### **Fourteen Types of Compliance Requirements**

6.22 Part 3 of the *Compliance Supplement* lists and describes the fourteen types of compliance requirements and the related audit objectives that the auditor should consider in every audit conducted under Circular A-133, with the exception of program-specific audits performed in accordance with a federal agency's program specific audit guide (see paragraph 11.4). Suggested audit procedures are also provided to assist the auditor in planning and performing tests of the auditee's compliance with the requirements of federal programs. The auditor's judgment will be necessary to determine whether the suggested audit procedures are sufficient to achieve the stated audit objectives and whether additional or alternative audit procedures are needed (see paragraph 6.44). The fourteen types of compliance requirements are as follows:

- 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

The auditor should consider the applicability of these compliance requirements to the auditee's major programs. Part 2 of the *Compliance Supplement* provides a matrix that is useful to the auditor for this purpose by identifying whether particular compliance requirements apply to the federal programs included in the *Compliance Supplement*. In making a determination not to test a compliance requirement identified as applicable to a particular program, the auditor must conclude either that the requirement does not apply to the particular auditee or that noncompliance with the requirements could not have a material effect on a major program.

### ***Keeping Abreast of Changes in Compliance Requirements***

- 6.23 Circular A-133 states that an audit of the compliance requirements related to federal programs contained in the *Compliance Supplement* will meet the requirements of the circular. However, it also states that when there have been changes to the compliance requirements and the changes are not reflected in the *Compliance Supplement*, the auditor must determine the current compliance requirements and modify the audit procedures accordingly.
- 6.24 Although Circular A-133 provides that federal agencies are responsible to inform the OMB annually of any updates needed to the *Compliance Supplement*, the auditor should recognize that laws and regulations change periodically and that delays will occur between such changes and revisions to the *Compliance Supplement*. Accordingly, the auditor should perform reasonable procedures to ensure that compliance requirements are current. Besides describing the compliance requirements, the *Compliance Supplement* includes references to the Code of Federal Regulations and other sources of information about the requirements. The auditor may refer to those other sources of information to identify significant changes to the requirements or perform other procedures, including the following:
- Discussions with appropriate individuals within the auditee organization (that is, the chief financial officer, internal auditors, legal counsel, the compliance officer, or grant or contract administrators)

- A review of contracts or grant agreements, new guidance material issued by the granting agency or pass-through entity (for example, handbooks and operating procedures), and correspondence from the granting agency or pass-through entity
- An inquiry of granting agency personnel (appendix III of the *Compliance Supplement* includes a listing of federal agency contacts, including addresses, phone numbers, and E-mail or Web page addresses that could be useful if the auditor decides to make such an inquiry)

### **Considering Additional Provisions of Contracts or Grant Agreements**

- 6.25 The *Compliance Supplement* states that in addition to the compliance requirements identified in the supplement, auditors need to consider whether there are any provisions of contracts or grant agreements that are unique to a particular entity (for example, the grant agreement may specify the matching percentage, or an entity may have agreed to additional requirements that are not required by law or regulation, perhaps as part of a resolution of prior audit findings).
- 6.26 Therefore, in using the *Compliance Supplement* to identify applicable compliance requirements, the auditor needs to consider—
- a. The applicability to the federal program of the fourteen types of compliance requirements identified in part 3 of the *Compliance Supplement*.
  - b. Additional compliance requirements specific to the federal program as identified in part 4 of the *Compliance Supplement*.
  - c. Any provisions of contracts or grants that are unique to the particular entity.

### **Compliance Requirements Specific to Certain Federal Programs**

- 6.27 Part 4 of the *Compliance Supplement* discusses program objectives, program procedures, and compliance require-



ments that are specific to each federal program included. With the exception of special tests and provisions, the auditor should refer to part 3 of the *Compliance Supplement* for the audit objectives and suggested audit procedures that pertain to the compliance requirements associated with each program. Since special tests and provisions are unique to each program, the audit objectives and suggested audit procedures for each program are included in part 4.

### **Compliance Requirements Specific to a Cluster of Programs**

6.28 As noted in paragraph 2.18, a cluster of programs is a grouping of closely related programs that have similar compliance requirements (for example, SFA, R&D, and other clusters). Part 5 of the *Compliance Supplement* identifies those programs that are considered to be clusters of programs. It also provides compliance requirements, audit objectives, and suggested audit procedures for the clusters.

### **Relationship of the Compliance Supplement to Federal Program Audit Guides**

6.29 The *Compliance Supplement* states that for single audits, the supplement replaces federal agency audit guides and other audit requirement documents for individual federal programs.<sup>1</sup> Accordingly, for a federal program included in the *Compliance Supplement* and having a separate federal program audit guide or other federal program audit requirement documents, the auditor needs to consider only those compliance requirements in the *Compliance Sup-*

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1. Auditors should note that two federal agencies, the Department of Housing and Urban Development and the Department of Education have issued interim supplements to address the requirements of certain agency programs. Those supplements provide guidance similar to that provided in part 4 of the *Compliance Supplement*. A description of the supplements and the authoritative status of each are discussed in part 1 of the *Compliance Supplement*. Auditors should refer to the *Compliance Supplement* to determine whether to use the interim supplements or the *Compliance Supplement* for the federal programs included in the supplements. As of the date of this SOP, the OMB has indicated that the federal programs included in the Department of Education interim supplement will be included in the next revision of the *Compliance Supplement*.

plement when performing a single audit (versus a program-specific audit).

### **Federal Programs Not Included in the Compliance Supplement**

6.30 The *Compliance Supplement* does not include all federal programs from which an auditee may receive federal awards. Circular A-133 states that for those federal programs not covered in the *Compliance Supplement*, the auditor should use the fourteen types of compliance requirements (see paragraph 6.22) contained in the supplement as guidance for identifying the types of compliance requirements to test, and should determine the requirements governing the federal program by reviewing the provisions of contracts and grant agreements and the laws and regulations referred to in such contracts and grant agreements. The auditor should follow the guidance in part 7 of the *Compliance Supplement* for identifying the applicable compliance requirements to test and report on in a single audit. That guidance outlines the following steps to determine which compliance requirements to test:

- a. Identify the applicable compliance requirements for the federal program.
- b. Determine which of the compliance requirements identified in step *a* could have a direct and material effect on the major program.
- c. Determine which of the compliance requirements identified in step *b* are susceptible to testing by the auditor.
- d. Determine which of the fourteen types of compliance requirements would the compliance requirements identified in step *c* fall into.
- e. For special tests and provisions, determine the applicable audit objectives and audit procedures.

Part 7 of the *Compliance Supplement* provides more detailed guidance on the steps to perform to identify applicable compliance requirements.

## **Planning the Engagement**

### **General Considerations**

- 6.31 Planning a compliance audit involves developing an overall strategy for the expected conduct and scope of the engagement. To develop such a strategy, auditors need to have sufficient knowledge to enable them to understand adequately the events, transactions, and practices that, in their judgment, have a significant effect on compliance. Proper planning and supervision contribute to the effectiveness of audit procedures. Proper planning directly influences the selection of appropriate procedures and the timeliness of their application, and proper supervision helps ensure that planned procedures are appropriately applied.
- 6.32 Factors to be considered by the auditor in planning a compliance audit include (a) the anticipated level of audit risk related to the compliance requirements on which the auditor will report (see paragraphs 6.6 through 6.12), (b) preliminary judgments about materiality levels for audit purposes (see paragraphs 6.13 through 6.16), and (c) conditions that may require extension or modification of audit procedures.
- 6.33 The nature, timing, and extent of planning will vary with the nature and complexity of the compliance requirements and the auditor's prior experience with the auditee. As part of the planning process, the auditor should consider the nature, timing, and extent of the work to be performed to accomplish the objectives of the compliance audit. Nevertheless, as the compliance audit progresses, changed conditions may make it necessary to modify planned procedures. For discussion of additional planning considerations, see chapter 3.

### **Multiple Components**

- 6.34 In a compliance audit in which the auditee has operations in several components (for example, locations or branches), the auditor may determine that it is not necessary to test compliance with requirements at every component. In making such a determination and in selecting the components to be tested, the auditor should consider such factors as the following: (a) the degree to which the specified compliance requirements

apply at the component level, (b) judgments about materiality, (c) the degree of centralization of the records, (d) the effectiveness of controls, particularly those that affect management's direct control over the exercise of authority delegated to others, as well as its ability to supervise activities at various locations effectively, (e) the nature and extent of operations conducted at the various components, and (f) the similarity of operations and controls over compliance for different components. See paragraph 8.13 for a discussion of internal control considerations for multiple components.

## **Consideration of Internal Control Over Compliance for Major Programs**

6.35 The auditor should obtain an understanding of relevant portions of internal control over compliance sufficient to plan the audit and to assess control risk for compliance with specified requirements. In planning the audit, the auditor should use this knowledge to identify types of potential noncompliance, to consider factors that affect the risk of material noncompliance, and to design appropriate tests of compliance. Circular A-133 specifically requires the auditor to perform procedures to obtain an understanding of internal control over compliance for federal programs sufficient to plan the audit to support a low assessed level of control risk for major programs. Circular A-133 also requires the auditor to perform testing of controls as planned. In some instances, the auditor may be able to perform compliance testing for major programs concurrently with tests of controls (see paragraph 3.40). Any reportable conditions in internal control over compliance for major programs that are noted are required to be reported as an audit finding (see paragraph 10.63). Control risk is discussed further in paragraph 6.10, and the auditor's consideration of internal control over compliance for major programs (including the final control risk assessment and the performance of tests of controls) is discussed in more detail in chapter 8.

## **Performing Compliance Testing**

6.36 Circular A-133 requires that compliance testing include tests of transactions and such other auditing procedures as

are necessary to provide the auditor with sufficient evidence to support an opinion on compliance for each major program. Such compliance testing may be performed (a) concurrently with tests of controls, (b) as substantive testing, or (c) as a combination of the two. In performing compliance testing, the auditor attempts to obtain reasonable assurance that the auditee complied, in all material respects, with the compliance requirements. This includes designing the compliance audit to detect both intentional and unintentional noncompliance. Absolute assurance is not attainable because of factors such as the need for judgment, the use of sampling, and the inherent limitations of internal control over compliance and because much of the evidence available to the auditor is persuasive rather than conclusive in nature. Furthermore, procedures that are effective for detecting unintentional noncompliance may be ineffective for detecting noncompliance that is intentional and is concealed through a collusion between the client's personnel and third parties or among the management or employees of the client. Therefore, the subsequent discovery that material noncompliance exists does not, in and of itself, evidence inadequate planning, performance, or judgment on the part of the auditor.

- 6.37 In determining the nature, timing, and extent of tests to perform, the auditor's professional judgment regarding the appropriate level of detection risk should be used. In applying his or her judgment, the auditor should be aware that small sample sizes for tests of details with a low dollar value and from a large population generally do not, by themselves, provide sufficient evidence. In determining the nature, timing, and extent of the testing of an auditee's compliance with compliance requirements, the auditor should consider audit risk and materiality related to each major program. The auditor plans compliance tests to reduce detection risk to an acceptable level. The evidence provided by these tests, along with evidence regarding inherent risk and control risk, provides the basis for expressing an opinion on whether the auditee complied, in all material respects, with the compliance requirements for each major program.
- 6.38 In determining the nature of his or her tests of compliance with requirements governing major programs, the auditor

should consider the nature of those requirements. For example, to test compliance with requirements applicable to the allowability of expenditures using program funds, audit procedures should be designed to provide the auditor with sufficient evidential matter to evaluate how management expended the funds.

### ***Sufficient Evidence***

6.39 The auditor should apply procedures to provide reasonable assurance of detecting material noncompliance. The selection and application of procedures that will accumulate evidence that is sufficient in the circumstances to provide a reasonable basis for expressing an opinion on compliance require the careful exercise of professional judgment. A broad array of available procedures may be applied in a compliance audit. In establishing a proper combination of procedures to restrict audit risk appropriately, the auditor should consider the following presumptions, bearing in mind that they are not mutually exclusive and may be subject to important exceptions:

- a. Evidence obtained from independent sources outside an entity provides greater assurance of an entity's compliance than evidence secured solely from within the entity.
- b. Information obtained from the auditor's direct personal knowledge (such as through physical examination, observation, computation, operating tests, or inspection) is more persuasive than information obtained indirectly.
- c. The more effective the internal control, the greater the assurance it provides about the entity's compliance.

6.40 Thus, in the hierarchy of available audit procedures, those that involve search and verification (for example, inspection, confirmation, or observation)—particularly when independent sources outside the entity are used—are generally more effective in reducing audit risk than are those involving internal inquiries and comparisons of internal information (for example, analytical procedures and discussions with the individuals responsible for compliance).

- 6.41 In a compliance audit, the auditor's objective is to accumulate sufficient evidence to limit audit risk to a level that is, in the auditor's professional judgment, appropriately low for the high level of assurance being provided. An auditor should select from all available procedures (that is, procedures that assess inherent, control, and fraud risk and restrict detection risk)—any combination that can limit audit risk to such an appropriately low level.
- 6.42 For regulatory requirements, the auditor's procedures may include reviewing reports of significant examinations and related communications between regulatory agencies and the entity and, when appropriate, making inquiries of the regulatory agencies, including inquiries about examinations in progress.

### ***Audit Objectives***

- 6.43 As noted in paragraph 6.22, the *Compliance Supplement* contains the audit objectives for each type of compliance requirement that the auditor should consider in planning and performing tests of compliance requirements. The audit objectives are useful in understanding the specific objectives to be satisfied when the auditor performs audit tests and determines whether the noncompliance that is identified is material.

### ***Suggested Audit Procedures***

- 6.44 The *Compliance Supplement* contains suggested audit procedures for testing federal programs for compliance. These suggested audit procedures represent procedures that may be used by the auditor in developing an audit program. The suggested audit procedures may also be useful in testing the same types of compliance requirements for programs that are not included in the *Compliance Supplement*. These suggested audit procedures represent a tool available to the auditor; however, the auditor is neither required to follow these audit procedures nor restricted to using only these procedures. The auditor should use professional judgment in determining the appropriate audit procedures to be performed to allow him or her to obtain sufficient evidence to form an opinion on the auditee's

compliance with the compliance requirements that could have a direct and material effect on each major program.

### **Audit Sampling**

- 6.45 The auditor generally uses audit sampling to obtain evidential matter. There are two approaches to audit sampling: nonstatistical and statistical. Circular A-133 does not require any particular sampling approach in a single audit. The factors to be considered in planning, designing, and evaluating audit samples (including planning a particular sample for a test of controls) are discussed in SAS No. 39, *Audit Sampling* (AICPA, *Professional Standards*, vol. 1, AU sec. 350). When planning to test a particular sample of transactions, the auditor should consider the specific audit objective to be achieved and should determine that the audit procedure, or combination of procedures, to be applied will achieve that objective. The size of a sample necessary to provide sufficient evidential matter depends on both the objectives and the efficiency of the sample. Auditors should note that SAS No. 74, *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance*, and Circular A-133 require the auditor to determine both the known questioned costs and likely questioned costs associated with audit findings. The determination of likely questioned costs may require the projection of sample results to determine whether a finding is required to be reported in the schedule of findings and questioned costs. Circular A-133 does not require the auditor to report an exact amount or a statistical projection of likely questioned costs, but rather to include an audit finding when the auditor's estimate of likely questioned costs is greater than \$10,000. See paragraph 6.59 for a further discussion of likely questioned costs.
- 6.46 The AICPA Audit and Accounting Guide *Audit Sampling* provides guidance to help auditors apply audit sampling in accordance with SAS No. 39. In the Audit Guide, sampling in compliance tests of internal controls and in substantive tests of details, as well as dual-purpose testing is discussed.

### **Using Separate Samples for Each Major Program**

- 6.47 Although the auditor must obtain sufficient evidence to support an opinion on compliance for each major federal pro-



gram, separate samples for each major program are not required. Experience has shown, however, that it is preferable to select separate samples from each major program because the separate sample provides clear evidence of the tests performed, the results of those tests, and the conclusions reached. If the auditor chooses to select audit samples from the entire universe of major program transactions, the working papers should be presented in such a fashion that they clearly indicate that the results of such samples, together with other audit evidence, are sufficient to support the opinion on each major program's compliance. As noted in paragraph 6.37, the auditor should be aware that a sample of a few items with a low dollar value and from a large population, generally does not, by itself, provide sufficient evidence.

## **Consideration of Subsequent Events**

- 6.48 The auditor's consideration of subsequent events in a compliance audit is similar to the auditor's consideration of subsequent events in a financial statement audit, as outlined in SAS No. 1, section 560, "Subsequent Events" (AICPA, *Professional Standards*, vol. 1, AU sec. 560). The auditor should consider information about events relating to the applicable compliance requirements that comes to his or her attention after the end of the audit period and prior to the issuance of his or her report.
- 6.49 Two types of subsequent events require consideration by management and evaluation by the auditor. The first type consists of events that provide additional information about the entity's compliance during the audit period. For the period from the end of the audit period to the date of the auditor's report, the auditor should perform procedures to identify such events. These procedures should include, but may not be limited to, inquiries about and consideration of the following information:
- Relevant internal auditors' reports issued during the subsequent period
  - Other auditors' reports identifying noncompliance that were issued during the subsequent period
  - Regulatory agencies' reports on the entity's noncompliance that were issued during the subsequent period

- Information about the entity's noncompliance, obtained through other professional engagements for that entity
- 6.50 The second type of subsequent events consists of noncompliance that occurs subsequent to the audit period but before the date of the auditor's report. The auditor has no responsibility to detect such noncompliance. However, should such noncompliance come to the auditor's attention, it may be of such a nature and significance that the auditor should consider whether the matter is adequately disclosed in the notes to the schedule of expenditures of federal awards.

## **Evaluation and Reporting of Noncompliance**

### ***Instances of Noncompliance (Findings)***

- 6.51 The auditor's tests of compliance with compliance requirements may disclose instances of noncompliance. Circular A-133 refers to these instances of noncompliance as "findings." Such findings may be of a monetary nature and involve questioned costs or may be nonmonetary and not result in questioned costs. Both *Government Auditing Standards* and Circular A-133 specify how certain findings should be reported. The auditor's opinion on compliance and his or her responsibilities for reporting findings are discussed in greater detail in chapter 10.

### ***Compliance Opinion***

- 6.52 Circular A-133 requires the auditor to report on compliance, which includes an opinion or disclaimer of opinion (on each major program) on whether the auditee complied with the applicable compliance requirements, and to prepare a schedule of findings and questioned costs (see paragraphs 10.41 through 10.46 and 10.55 through 10.67 for a further discussion). In evaluating whether the auditee complied with the compliance requirements in all material respects, the auditor should consider (a) the nature and frequency of the noncompliance identified, and (b) whether such noncompliance is material relative to the nature of the compliance requirements. Assessing materiality at the appropriate level is critical to the proper evaluation of findings. Materi-

ality as it relates to giving an opinion on the auditee's compliance is discussed in paragraphs 6.13 through 6.16. The auditor's evaluation of the effect of questioned costs on the compliance opinion is discussed in paragraph 6.55.

### **Financial Statement Impact**

6.53 The auditor also has the responsibility of assessing the impact of the actual and projected error noted in the single audit against the materiality level established for the basic financial statements (see paragraph 6.16). The auditor should consider the effect of (a) any contingent liability that may arise from the noncompliance in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*, and (b) for nongovernmental entities, any uncertainty regarding the resolution of instances of non-compliance in accordance with SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*.

### **Questioned Costs**

6.54 Questioned costs are defined by Circular A-133 to include costs that are questioned by the auditor because of an audit finding (a) that 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, (b) for which the costs, at the time of the audit, are not supported by adequate documentation, or (c) for which the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

### **Evaluating the Effect of Questioned Costs on the Compliance Opinion**

6.55 In evaluating the effect of questioned costs on the opinion on compliance, the auditor considers the best estimate of the total costs questioned for each major program (likely questioned costs), not just the questioned costs specifically identified (known questioned costs). There may be instances in which the known questioned costs are not consid-

ered material but the likely questioned costs are considered material. In this situation, the auditor should consider the noncompliance to be material or may expand the scope of the audit and apply additional audit procedures to further establish the likely questioned costs. For example, if an auditor's sample results in known questioned costs related to three sample items out of thirty selected, the three errors may not be considered material. However, the auditor's projection of those errors to the entire population may suggest that there are likely questioned costs that are material. In this example, the auditor should consider the noncompliance to be material and should report a finding or expand the scope of the audit and apply additional audit procedures.

### ***Federal Agency Consideration of Findings and Questioned Costs***

- 6.56 The auditor's designation of a cost as questioned does not necessarily mean that a federal grantor agency will disallow the cost. In most instances, the auditor is unable to determine whether a federal awarding agency or pass-through entity will ultimately disallow a questioned cost, because the agency or entity has considerable discretion in these matters.
- 6.57 Circular A-133 defines a management decision as the evaluation by the federal awarding agency or pass-through entity of the audit findings and corrective action plan (see paragraphs 2.26 and 10.68 through 10.70 for a further discussion of the corrective action plan) and the issuance of a written decision as to what corrective action is necessary. Circular A-133 allows a federal awarding agency or pass-through entity receiving an auditor's report indicating findings and questioned costs six months after receipt of the audit report to issue such a decision. The nature of the questioned costs, as well as the amounts involved, are considered by the awarding agency or pass-through entity in issuing a management decision and deciding whether to disallow them. In addition, most federal awarding agencies have established appeal and adjudication procedures for questioned costs. Because of the discretion allowed in resolving these matters, all questioned costs are subject to uncertainty regarding their resolution.

## **Reporting the Findings**

6.58 Circular A-133 requires the auditor to consider a different level of materiality for the purposes of reporting audit findings (see paragraphs 3.36 through 3.38 for a further discussion). Circular A-133 requires the auditor, in addition to providing an opinion on compliance, to include the following items, among other things, in the schedule of findings and questioned costs (see paragraph 10.56 for a complete listing of the items that are required to be included):

- 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 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*.
- Known questioned costs that are greater than \$10,000 for a type of compliance requirement for a major program (see paragraph 6.22 for a listing of the fourteen types of compliance requirements). Known questioned costs are those specifically identified by the auditor.
- Known questioned costs when likely questioned costs are greater than \$10,000 for a type of compliance requirement.
- Known questioned costs that are greater than \$10,000 for a federal program that is not audited as a major program (see paragraph 10.63 for a further discussion).

The reporting of findings is discussed in greater detail in paragraphs 10.63 and 10.64.

## **Reporting the Likely Questioned Costs**

6.59 As noted before, in evaluating the effect of questioned costs on the opinion on compliance, the auditor considers both known questioned costs and the best estimate of the total costs questioned (likely questioned costs) for each major program. Known and likely questioned costs also need to be considered

when audit findings are reported. In addition to reporting known questioned costs greater than \$10,000 in the schedule of findings and questioned costs, the auditor is also required to report known questioned costs when likely questioned costs are greater than \$10,000. For example, if the auditor specifically identifies \$7,000 in questioned costs but, based on his or her evaluation of the effect of questioned costs on the opinion on compliance, the auditor estimates that the total questioned costs are in the \$50,000–\$60,000 range, the auditor would report a finding that indicates the known questioned costs of \$7,000. See paragraph 10.63 for a further discussion.

### **Findings That Cannot Be Quantified**

6.60 The auditor may discover instances of noncompliance that cannot be quantified. The auditor's responsibility for reporting such findings can best be described through an example. Assume that the auditor encounters a pass-through entity that consistently fails to provide its subrecipients with federal award information. Circular A-133 requires the auditor to consider all findings in relation to a type of compliance requirement (in the example provided, subrecipient monitoring is the relevant type of compliance requirement) or an audit objective identified in the *Compliance Supplement*. The pertinent audit objective included in the *Compliance Supplement* and relating to the example provided here 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 would be material in relation to the audit objective and, therefore, should be reported as an audit finding. In addition, the auditor should also consider whether reportable conditions exist and require reporting with respect to subrecipient monitoring.

### **Performing Follow-Up Procedures**

#### **Auditee Responsibilities for Audit Follow-Up and for the Summary Schedule of Prior Audit Findings**

6.61 Circular A-133 states that the auditee is responsible for follow-up and corrective action on all audit findings. The follow-

up required by Circular A-133 is facilitated by the requirement that the auditee prepare a summary schedule of prior audit findings (see paragraphs 2.21 and 10.68). This schedule reports the status of all audit findings included in the prior audit's schedule of findings and questioned costs relative to federal awards. It also includes audit findings reported in the prior audit's summary schedule of prior audit findings that were not identified as either (1) fully corrected, (2) no longer valid, or (3) not warranting further actions. Circular A-133 states that a valid reason for considering an audit finding as not warranting further action is that *all* of the following have occurred:

- Two years have passed since the audit report in which the finding occurred was submitted to the federal clearinghouse.
- The federal agency or pass-through entity is not currently following up with the auditee on the audit finding.
- A management decision was not issued.

6.62 Circular A-133 also states the following with regard to the auditee's schedule of prior audit findings:

- When audit findings were fully corrected, the summary schedule need only list the audit findings and state that corrective action was taken.
- When audit findings were not fully corrected or were only partially corrected, the summary schedule must describe the planned corrective action as well as any partial corrective action taken.
- When the corrective action taken is significantly different from the 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 must provide an explanation.
- When the auditee believes the audit findings are no longer valid or do not warrant further actions, the reasons for this position must be described in the summary schedule (see paragraph 6.61).

## **Auditor Responsibilities for Follow-Up on Previously Reported Findings**

6.63 Circular A-133 requires the auditor to follow up on prior audit findings, perform procedures to assess the reasonableness of the 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. The auditor should also perform audit follow-up procedures regardless of whether a prior audit finding relates to a major program in the current year. The auditor's reporting responsibilities are further discussed in chapter 10.

### **Auditor Follow-Up Procedures**

6.64 To follow up on previous audit findings, the auditor should obtain the auditee's summary schedule of prior audit findings and should review its contents with appropriate members of management. Although in many cases the procedures performed in the current audit will provide a basis for the auditor to assess the schedule, the auditor may find it necessary to perform procedures directed specifically at the status of prior audit findings. In these cases, the following procedures are to be considered:

- Inquiry of auditee management and program personnel
- Review of management decisions issued by federal awarding agencies or pass-through entities to the auditee (see paragraph 6.57)
- Observation of an activity that has been redesigned to address a prior-year finding
- Testing of similar current-year transactions

### **Audit Follow-Up for Findings Reported, as Required by Government Auditing Standards**

6.65 As noted in paragraph 3.14, *Government Auditing Standards* establishes an additional fieldwork standard, which requires the auditor to follow up on known material findings and recommendations from previous audits that could



affect the financial statement audit to determine whether the auditee has taken timely and appropriate corrective actions. The auditee's schedule of prior audit findings is only required to include the status of prior-year findings relative to federal awards. However, there may be certain financial statement audit findings required to be reported under *Government Auditing Standards* that are included in the summary schedule of prior audit findings (because they also relate to federal awards). Also, although not required, some auditees may decide to include the status of other financial statement audit findings (that is, those that are not related to federal awards) in the schedule. For those financial statement audit findings included in the summary schedule of prior audit findings, the auditor's assessment of the reasonableness of the schedule (described in paragraphs 6.63 and 6.64) would meet the audit follow-up requirements of *Government Auditing Standards*. For financial statement audit findings that are not included in the schedule, the auditor should follow up on the findings to determine their status. See paragraph 10.62 for a discussion of the auditor's responsibility to report the status of uncorrected material findings and recommendations from prior audits that affect the financial statement audit.

### **Corrective Action Plan**

- 6.66 Circular A-133 also requires that upon completion of the audit, the auditee prepare a corrective action plan that identifies the contact person responsible for corrective action, indicates the corrective action planned, the anticipated completion date or, if the auditee does not agree with the finding, an explanation and specific reasons why the auditee disagrees. The auditor may find the auditee's corrective action plan useful in performing audit follow-up (in addition to the auditee's summary schedule of prior audit findings) because it may provide a preliminary indication of the corrective steps planned by the auditee.

### **Disputes or Unresolved Findings**

- 6.67 There may be times when, as part of the follow-up on prior findings, the auditor determines that (a) a previous finding is the subject of a dispute between the auditee and the

federal awarding agency or pass-through entity or (b) the federal awarding agency or pass-through entity has not addressed the finding by issuing a management decision. In these situations, if the finding relates to a current-year major program, the auditor should report similar transactions of the current year as findings and questioned costs until either the dispute is resolved or the initial finding no longer warrants further action under Circular A-133 as described in paragraph 6.61. However, if the auditor no longer believes that there is noncompliance because of additional evidence obtained in the current year, similar transactions need not be reported as findings.

## **Management Representations Related to Federal Awards**

6.68 As part of an audit under Circular A-133, the auditor should obtain written representations from management about matters related to federal awards. Therefore, in addition to the management representations obtained in connection with an audit of the financial statements as discussed in paragraph 4.40, the auditor should obtain written representations from management concerning the identification and completeness of federal award programs, representations concerning compliance with compliance requirements, and identification of known instances of noncompliance.

### **Suggested Representations**

6.69 The auditor should consider obtaining the following written representations in a single audit:<sup>2</sup>

- Management is responsible for complying, and has complied, with the requirements of Circular A-133.
- Management has prepared the schedule of expenditures of federal awards in accordance with Circular A-133

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

and has included expenditures made during the period being audited for all awards provided by federal agencies in the form of grants, federal cost-reimbursement contracts, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance.

- Management is responsible for complying with the requirements of laws, regulations, and the provisions of contracts and grant agreements related to each of its federal programs.
- Management is responsible for establishing and maintaining effective internal control over compliance for 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 its federal programs.
- Management has identified and disclosed to the auditor the requirements of laws, regulations and the provisions of contracts and grant agreements that are considered to have a direct and material effect on each federal program.
- Management has made available all contracts and grant agreements (including amendments, if any) and any other correspondence that have taken place with federal agencies or pass-through entities and are related to federal programs.
- Management has complied, in all material respects, with the compliance requirements in connection with federal awards except as disclosed to the auditor.
- Management has identified and disclosed to the auditor all amounts questioned and any known noncompliance with the requirements of federal awards, including the results of other audits or program reviews.
- Management's interpretations of any compliance requirements that have varying interpretations have been provided.

- Management has made available all documentation related to the compliance requirements, including information related to federal program financial reports and claims for advances and reimbursements.
- Federal program financial reports and claims for advances and reimbursements are supported by the books and records from which the basic financial statements have been prepared, and are prepared on a basis consistent with that presented in the schedule of expenditures of federal awards.
- The copies of federal program financial reports provided to the auditor are true copies of the reports submitted, or electronically transmitted, to the federal agency or pass-through entity, as applicable.
- If applicable, management has monitored subrecipients to determine that they have expended pass-through assistance in accordance with applicable laws and regulations and has met the requirements of Circular A-133.
- If applicable, management has issued management decisions on a timely basis after their receipt of subrecipients' auditor's reports that identified non-compliance with laws, regulations, or the provisions of contracts or grant agreements, and has ensured that subrecipients have taken the appropriate and timely corrective action on findings.
- If applicable, management has considered the results of subrecipient audits and has made any necessary adjustments to their own books and records.
- Management is responsible for and has accurately prepared the summary schedule of prior audit findings to include all findings required to be included by Circular A-133.
- Management has provided the auditor with all information on the status of the follow-up on prior audit findings by federal awarding agencies and pass-through entities, including all management decisions.

- Management has accurately completed the appropriate sections of the data collection form.
- If applicable, management has disclosed all contracts or other agreements with the service organizations.
- If applicable, management has disclosed to the auditor all communications from the service organization relating to noncompliance at the service organization.
- Management has disclosed any known noncompliance occurring subsequent to the period for which compliance is audited.
- Management has disclosed whether any changes in internal control over compliance or other factors that might significantly affect internal control, including any corrective action taken by management with regard to reportable conditions (including material weaknesses), have occurred subsequent to the date as of which compliance is audited.

## **Refusal to Furnish Written Representation**

6.70 Management's refusal to furnish all written representations that the auditor considers necessary in the circumstances constitutes a limitation on the scope of the audit sufficient to require a qualified opinion or disclaimer of opinion on the auditee's compliance with major program requirements. The auditor should also consider the effects of management's refusal on his or her ability to rely on other management representations.

## **State and Local Government Compliance Auditing Considerations**

6.71 An auditor may also be engaged to test and report on compliance with state and local laws and regulations in addition to the testing and reporting requirements imposed by *Government Auditing Standards* and Circular A-133. Although such auditing is outside the scope of this SOP, such a requirement may specify compliance tests, similar to those in a single audit. When this is the case, auditors

should consult state or local government officials or other sources concerning the nature and scope of the required testing. However, state or local government funds should be distinguished from pass-through federal funds. When a single audit is conducted, pass-through federal funds are considered part of the federal awards received. See paragraphs 3.47 through 3.49 for a brief discussion of state and local compliance requirements.

## **CHAPTER 7**

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### **Determination of Major Programs**

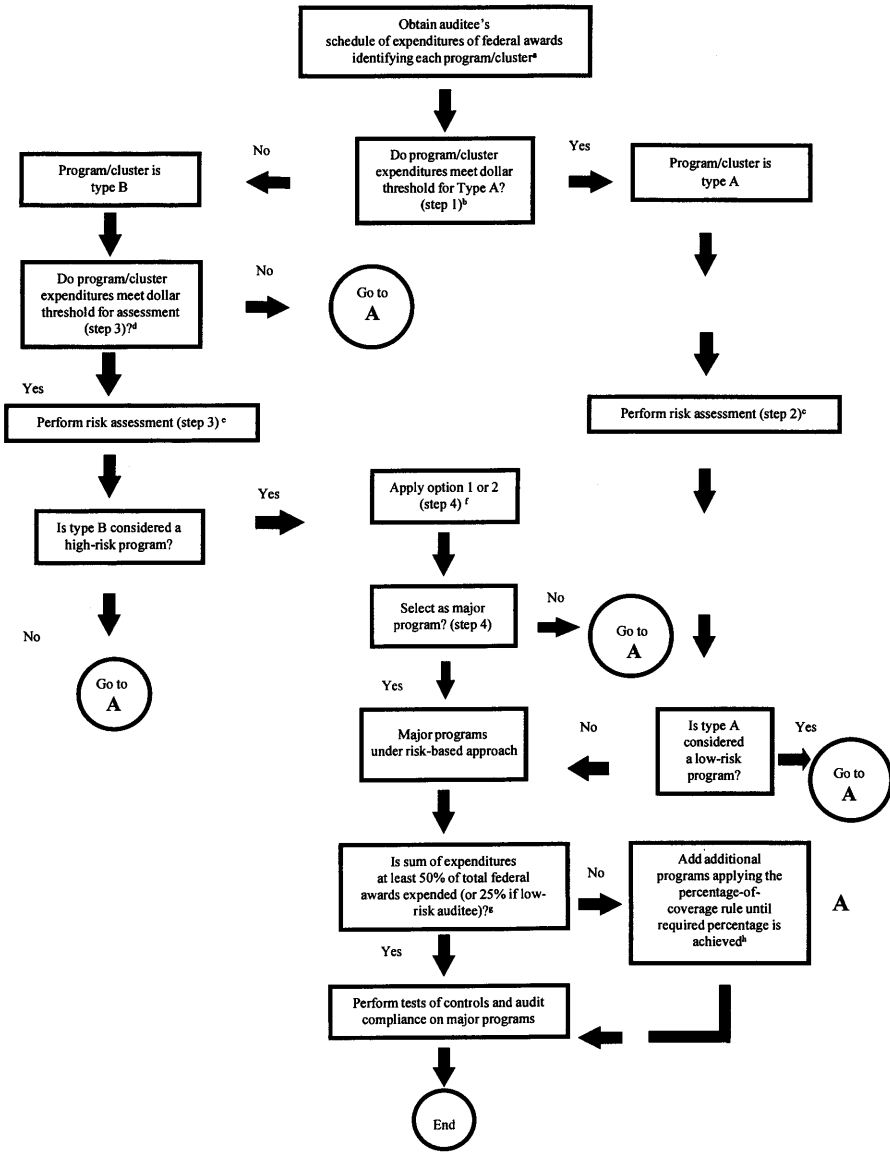
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- 7.1 As noted in paragraph 2.22, Circular A-133 requires the auditee to identify in its accounts all federal awards received and expended and the federal programs under which they were received. The auditee is also required to prepare a schedule of expenditures of federal awards for the period covered by its financial statements (see chapter 5 for a further discussion of the requirements related to this schedule). However, Circular A-133 places the responsibility for identifying major programs on the auditor, and it provides the criteria to be used in applying a risk-based approach to determining major programs. The risk-based approach is designed to focus the single audit on higher-risk programs. See paragraph 7.20 for a description of when the auditor can deviate from the use of risk criteria.
- 7.2 The auditor's determination of the programs to be audited is based on an evaluation of the risk of noncompliance occurring that could be material to an individual major federal program. In evaluating such risk, the auditor considers, among other things, the current and prior audit experience with the auditee, the oversight exercised by federal agencies and pass-through entities, and the inherent risk of the federal programs. The auditor should use professional judgment and the guidance in sections 520, 525, and 530 of Circular A-133 in the risk assessment process. In addition, the auditor should consider the need to discuss the nature of federal programs with the management of the auditee and of the federal or state agency that provided the funds to the auditee.

### **Applying the Risk-Based Approach**

- 7.3 The guidance on the risk-based approach is organized here as provided in Circular A-133 and consists of the following

# EXHIBIT 7.1 Flowchart Illustration of Applying the Risk-Based Approach for Determining Major Programs



- a. See paragraph 1.18 for the definition of federal programs, including clusters.
- b. See paragraphs 7.4 through 7.9 for a detailed discussion of step 1.
- c. See paragraphs 7.10 through 7.13 for a detailed discussion of step 2.
- d. See paragraphs 7.14 through 7.16 for a detailed discussion of step 3.

*continued*



- e. Before performing the risk assessment, the auditor should consider whether option 1 or option 2 will be selected under step 4 because it will affect whether risk assessments need to be performed on all type B programs or only some type B programs. See paragraph 7.15.
  - f. The number of type B high-risk programs identified as major programs is either—
    - *Option 1*: one-half of the number of type B high-risk programs, unless this number exceeds the number of low-risk type A programs identified in step 2. In this case, the auditor would be required to audit as major the same number of high-risk type B programs as low-risk type A programs. Under this option, the auditor is expected to perform risk assessments on all type B programs that exceed the threshold for type B.
    - *Option 2*: one high-risk program for each low-risk type A program. This option does not require the auditor to perform risk assessments on all type B programs. See paragraphs 7.17 through 7.20 for a detailed discussion of step 4, including option 1 and option 2.
  - g. There may be instances when the auditee includes certain noncash assistance (such as loan guarantees or loans) in the notes to the schedule of expenditures of federal awards (see paragraph 5.13). The auditor should be sure to include such noncash assistance as part of total federal awards expended when performing this calculation.
  - h. The additional programs/clusters selected (marked “A” on the flowchart) to meet the percentage-of-coverage rule are audited as major programs in addition to type A and type B programs identified in steps 1 through 4. See paragraph 7.24 for a further discussion of the percentage-of-coverage rule.
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steps (see exhibit 7.1 for a flowchart illustration of applying the risk-based approach for determining major programs):

- Step 1—determination of type A and type B programs (paragraphs 7.4 through 7.9)
- Step 2—identification of low-risk type A programs (paragraphs 7.10 through 7.13)
- Step 3—identification of high-risk type B programs (paragraphs 7.14 through 7.16)
- Step 4—determination of programs to be audited as major (paragraphs 7.17 through 7.20)

## **Step 1—Determination of Type A and Type B Programs**

- 7.4 To determine which federal programs are to be audited as major (see step 4), the auditor must first identify federal programs as being either type A or type B as defined in Circular A-133. In general, type A programs are larger federal programs and type B programs are smaller federal programs. The auditor should obtain the schedule of expenditures of federal awards from the auditee to assist in the identification of type A and type B programs. The schedule of expenditures of federal awards, prepared by the auditee, includes all cash and noncash awards either on the face of

the schedule or in the notes to the schedule. Auditors should note that for purposes of determining major programs, a cluster of programs should be considered as one program (see paragraphs 1.18, 1.19, 2.18, 5.6, and 8.30 for a further discussion of a cluster of programs).

### **Type A Program Criteria**

7.5 The larger federal programs are labeled as type A. The criteria that Circular A-133 establishes for identifying Type A programs are presented in table 7.1.

**TABLE 7.1 Criteria for Identifying Type A Programs**

When Total Federal Awards Expended* Are—	A Type A Program Is Any Program With Federal Awards Expended That Exceed the Larger of—
More than or equal to \$300,000 and less than or equal to, \$100 million	\$300,000 or 3% (0.03) of federal awards expended
More than \$100 million and less than or equal to \$10 billion	\$3 million or 0.3% (0.003) of federal awards expended
More than \$10 billion	\$30 million or 0.15% (0.0015) of federal awards expended

\*Includes both cash and noncash awards.

### **Type B Program Criteria**

7.6 Federal programs that do not meet the type A criteria are considered type B programs.

### **Effect of Large Loans and Loan Guarantees on Identification of Type A Programs**

7.7 The various types of noncash awards, including loans and loan guarantees, and how they are valued are discussed in chapter 5. Circular A-133 states that when the auditor applies the dollar criteria shown in table 7.1 to identify type A programs, the inclusion of large loans and loan guarantees should not result in the exclusion of other federal programs as type A programs. Auditors should note that this requirement relates only to loans and loan guarantees and not to any other large noncash awards. When a federal program providing loans or loan guarantees *significantly affects* the

number or size of type A programs, the auditor should consider the loan or loan guarantee program a type A program and exclude its values in determining other type A programs. The auditor should use professional judgment in determining whether type A programs would be *significantly* affected in this situation.

7.8 The example in table 7.2 demonstrates this concept by showing the identification of type A programs as well as the effect of loans and loan guarantees on that identification process.

**TABLE 7.2 Identification of Type A Programs and the Effect of Loans and Loan Guarantees**

Program/Federal Grantor	Federal Awards Expended (\$000)
Cash program A—U.S. Department of Labor	\$ 1,335
Cash program B—U.S. Department of Health and Human Services	3,000
Cash program C-1—U.S. Department of Education	175
Cash program C-2—U.S. Department of Education	280
Cash program D—U.S. Department of Housing and Urban Development (a pass-through grant from a local government)	<u>310</u>
Subtotal—cash federal awards expended	\$ 5,100
Commodities program E—U.S. Department of Agriculture (a pass-through grant from a state)	<u>2,000</u>
Subtotal—cash and commodities federal awards expended	\$ 7,100
Loan program F—U.S. Department of Housing and Urban Development	33,500*
Loan guarantee program G—U.S. Department of Agriculture	<u>57,000*</u>
Total federal awards expended	<u>\$97,600</u>

\* In accordance with Circular A-133, loans and loan guarantees include new loans made during the year, plus prior-year loans for which the federal government imposes continuing compliance requirements, plus any interest subsidy, cash, or administrative cost allowance received. See paragraphs 5.14 and 5.15 for additional information.

7.9 In table 7.2 the auditee has \$97,600,000 in total federal awards expended. Therefore, an application of the criteria in table 7.1 would indicate that type A programs would be those that expended federal awards equal to or greater than \$2,928,000 (3 percent of \$97,600,000), or programs B, F, and G. However, when large loan and loan guarantee pro-

grams F and G are excluded from the base amount of the total federal awards expended in the calculation, the type A programs would be those programs that expended federal awards equal to or greater than \$300,000 (the larger of \$213,000 [3 percent of \$7,100,000], or \$300,000). Therefore, under the second calculation programs A, B, D, E, F, and G would be type A programs. If the auditor, in his or her professional judgment, concludes that the difference in the number or size of type A programs is significantly affected by the inclusion of the loans and loan guarantees (which in this example would be likely due to the significant increase in type A programs), the auditor would identify programs A, B, D, E, F, and G as type A programs. The auditor should consider contacting the cognizant or oversight agency for audit if the auditor is unsure about whether to exclude loan or loan guarantees when determining type A programs.

## **Step 2—Identification of Low-Risk Type A Programs**

7.10 After completing step 1, the auditor should perform a risk assessment of each type A program to identify those that are low-risk. Circular A-133 includes certain conditions that, when met, indicate that a type A program may be low-risk.

### **General Conditions for Low-Risk Type A Programs**

7.11 Type A programs may generally be considered low-risk if both of the following conditions are met: (a) the program has 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 (b) in the most recent audit period, the *program* had no audit findings (see paragraph 10.63 for a description of audit findings).

### **Auditor Judgment in Determination of Low-Risk Type A Programs**

7.12 Circular A-133 permits the auditor to conclude, based on professional judgment, that a type A program is low-risk even though (a) in the prior audit period it may have had known or likely questioned costs greater than \$10,000 for a type of compliance requirement, (b) known fraud has been identified, or (c) the summary schedule of prior audit findings ma-

terially misrepresents the status of a prior audit finding. For example, consider a situation in which the funds expended under a federal program in the prior year totaled \$10 million, there were known questioned costs of \$11,000 that related to one isolated instance, and there were no additional likely questioned costs. In this example, the auditor, based on professional judgment, could decide that the program is low-risk in the current year. In making the final determination of whether a type A program is low-risk, the auditor should also consider the risk criteria in paragraphs 7.26 through 7.36, the results of audit follow-up, and whether any changes in the personnel or systems affecting a type A program have significantly increased its risk. Based on all of this information, the auditor would apply professional judgment in determining whether a type A program is low-risk.

### **Type A Program Not Considered Low-Risk at Request of Federal Awarding Agency**

- 7.13 A federal awarding agency may request that a type A program for certain recipients not be considered low-risk so that it would be audited as a major program. For example, it may be necessary for a large type A program to be audited as major each year for particular recipients, to allow the federal agency to comply with the Government Management Reform Act of 1994. In this instance, Circular A-133 requires the federal awarding agency to obtain approval from the OMB. Furthermore, the federal awarding agency must notify the recipient and, if known, the auditor at least 180 days prior to the end of the fiscal year end to be audited. (See also paragraph 7.35 for a discussion of the federal agency or pass-through entity option to identify federal programs as higher risk in the *Compliance Supplement*.)

### **Step 3—Identification of High-Risk Type B Programs**

- 7.14 After completing steps 1 and 2, the auditor should identify type B programs that are high-risk, using professional judgment and the risk criteria discussed in paragraphs 7.26 through 7.36. Except for known reportable conditions in internal control or instances of noncompliance, a single risk criteria would, in general, seldom cause a type B program to be considered high risk.

**7.15** Before beginning step 3, the auditor should—

- a. Consider whether there are low-risk type A programs. When there are no type A programs identified as low-risk (either because there are no type A programs or because none of the type A programs are low-risk), the auditor is not required to perform step 3. Instead, the auditor would audit as major enough type B programs to meet the percentage-of-coverage rule (see paragraph 7.24). When there are type A programs, but none are low-risk, the auditor would audit as major all type A programs plus any additional type B programs needed to meet the percentage-of-coverage rule. In either case, any programs requested to be audited by a federal agency or pass-through entity must be audited as a major program and would be included in determining whether the percentage-of-coverage rule has been met (see paragraph 7.21).
- b. Consider whether option 1 or option 2 will be used in step 4 (see paragraphs 7.18 through 7.19 for a detailed description of each option). The auditor's decision of which option to choose will likely be based on audit efficiency and will affect how many type B programs are subject to risk assessment. The auditor should consider the following discussion before deciding whether to use option 1 or option 2.
  - Under option 1, the auditor is required to perform a risk assessment on all type B programs (excluding small type B programs as discussed in paragraph 7.16). In comparison with option 2, option 1 will likely require the auditor to perform more type B program risk assessments, but may also result in the auditor having to audit fewer major programs. For example, assume that an auditee has four low-risk type A programs and ten type B programs that exceed the amount specified in table 7.3. Also assume that the auditor chooses option 1. In this scenario, the auditor would be required to perform a risk assessment on all type B programs. If the auditor

finds that only four type B programs are high-risk, the auditor would only be required to audit two of the four high-risk type B programs as major (one-half of the number of high-risk type B programs).

- Under option 2, the auditor is only required to identify high-risk type B programs up to the number of low-risk type A programs. In comparison with option 1, option 2 will likely require the auditor to perform fewer type B risk assessments, but may also result in the auditor having to audit more major programs. For example, assume that an auditee has four low-risk type A programs and ten type B programs that exceed the amount specified in table 7.3. Assume also that the first four type B programs subject to risk assessment are determined by the auditor to be high-risk. In this scenario, the auditor may choose option 2, identify the four high-risk type B programs as major, and not perform risk assessments on the remaining six type B programs. Using the same example but assuming that the auditee only has one low-risk type A program (instead of four), the auditor would be required to audit one type B program as major under either option 1 or 2. In this scenario, option 2 would likely be the most efficient choice for the auditor since the auditor would only need to perform type B program risk assessments until one high-risk type B program was identified (under option 1 the auditor would be required to perform a risk assessment on all type B programs).

### ***Criteria for Performing Risk Assessments on Type B Programs***

- 7.16 An auditor is not expected to perform risk assessments on relatively small federal programs. Therefore, Circular A-133 only requires the auditor to perform risk assessments on type B programs that exceed the larger of the criteria shown in table 7.3.

**TABLE 7.3 Criteria for Performing Risk Assessments on Type B Programs**

When Total Federal Awards Expended* Are—	Perform Risk Assessment for Type B Programs That Exceed the Larger of—
More than or equal to \$300,000 and less than or equal to \$100 million	\$100,000 or 0.3% (0.003) of federal awards expended
More than \$100 million	\$300,000 or 0.03% (0.0003) of federal awards expended

\*Includes both cash and noncash awards.

## **Step 4—Determination of Programs to Be Audited as Major**

### **Criteria for Major Programs**

7.17 After completing steps 1 through 3, the auditor identifies the major programs. At a minimum, Circular A-133 requires the auditor to audit all of the following as major programs:

- All type A programs, except those identified as low-risk under step 2 (see paragraphs 7.10 through 7.13)
- High-risk type B programs as identified under either of the two options described in paragraph 7.18
- Programs to be audited as major based on a federal agency request (in lieu of the federal agency conducting or arranging for additional audits; see paragraph 7.21 for further information)
- Additional programs, if any, that are necessary to meet the percentage-of-coverage rule described in paragraph 7.24

### **Two Options Available for Identifying High-Risk Type B Programs**

7.18 Section 520(e)(2) of Circular A-133 provides two options for identifying high-risk type B programs:

- *Option 1.* Under option 1, the auditor is expected to perform risk assessments of all type B programs that exceed the amount specified in table 7.3, and to audit at least one-half of the high-risk type B programs as



major, unless this number exceeds the number of low-risk type A programs identified in step 2 (that is, 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, consider an auditee that has ten low-risk type A programs, and fifty type B programs above the amount specified in table 7.3. Under this option, the auditor would be required to perform risk assessments of the fifty type B programs. Assume that based on that assessment, the auditor determines that there are twenty-five high-risk type B programs. One-half of the twenty-five high-risk type B programs is 12.5, which rounds up to thirteen programs. Under this option, the auditor would audit thirteen of the high-risk type B programs as major; however, since the cap in this example is ten (that is, the number of low-risk type A programs), the auditor is only required to audit ten high-risk type B programs as major.

- *Option 2.* 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 in step 2. Under this option the auditor would not be required to perform risk assessments for any type B program when there are no low-risk type A programs (that is, 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 programs are identified (that is, ten is the number of low-risk type A programs). The auditor would then audit as major the ten type B programs identified as high-risk. 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 on additional Type B programs until ten high-risk programs are identified.

7.19 The auditor may choose option 1 or option 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 (see paragraph 7.15). Circular A-133 encourages the auditor to use an approach that provides an opportunity for different high-risk type B programs to be audited as major over a period of time.

### ***Deviation From Use of Risk Criteria***

7.20 For first-year audits, Circular A-133 allows auditors to deviate from the above-described risk assessment process. A first-year audit is defined as the first year an entity is audited under the June 30, 1997, revision to Circular A-133 or as the first year of a change in auditors. This exception allows the auditor to elect to determine major programs as all type A programs plus any type B programs as are necessary to meet the percentage-of-coverage rule described in paragraph 7.24. Under this option, the auditor is not required to perform steps 2, 3, and 4. However, to ensure that a frequent change of auditors would not preclude the audit of high-risk type B programs, this election for first-year audits may not be used more than once every three years. Auditors should consider whether this exception is an option during the planning phase of the single audit (see also paragraphs 3.28 and 3.29 for a discussion of initial-year audit considerations).

## **Other Considerations Regarding the Risk-Based Approach**

### **Federal Agency Requests for Additional Major Programs**

7.21 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 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 a request by informing the federal agency whether the program would otherwise be audited as a major program using the risk-based approach and, if it would not, informing the agency of the estimated

incremental cost. The federal agency must 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 on the federal agency's request, and the federal agency agrees to pay the full incremental costs, then the auditee must have the program audited as a major program. This approach may also be used by pass-through entities for a subrecipient.

## **Documentation of Risk Assessment in the Working Papers**

7.22 Circular A-133 requires the auditor to document in the working papers the risk assessment process used in determining major programs. It is therefore necessary for the auditor to document adequately, as required by GAAS and *Government Auditing Standards*, the determination of major programs (see the discussion of working paper requirements in paragraphs 3.16 through 3.18 and 3.22 through 3.23).

## **Auditor Judgment in the Risk Assessment Process**

7.23 Circular A-133 states that when the determination of major programs is performed and documented by the auditor in accordance with the circular, the auditor's judgment in applying the risk-based approach to determine major programs is presumed correct. Challenges by federal agencies and pass-through entities should only be made for clearly improper use of the guidance in Circular A-133. It should be noted, however, that federal agencies and pass-through entities may provide the auditor with guidance about the risk of a particular federal program, which the auditor should consider when determining major programs.

## **Percentage-of-Coverage Rule**

7.24 Circular A-133 requires the auditor to audit, as major programs, federal programs with federal awards expended that, in the aggregate, encompass at least 50 percent of the total federal awards expended. However, if the auditee meets the criteria for a low-risk auditee (see paragraph 7.25), the auditor is only required to audit as major programs federal programs with federal awards expended that,

in the aggregate, encompass at least 25 percent of the total federal awards expended. To comply with this requirement, the auditor should compute the total federal awards expended for the major programs, determined under step 4, as a percentage of the total federal awards expended. If the total does not equal 50 percent (or 25 percent in the case of a low-risk auditee) of the total federal awards expended, the auditor should select additional programs (either type A or type B) to equal 50 percent (or 25 percent in the case of a low-risk auditee) and test them as major programs. The selection of additional programs to meet the percentage of coverage is based on the auditor's professional judgment. When selecting additional programs to meet the percentage-of-coverage rule, the auditor may select programs without regard to risk assessment. If loans or loan guarantees are major programs, these programs may be used for purposes of meeting the percentage-of-coverage rule. Furthermore, when a federal agency or pass-through entity requests and pays for a program to be audited as major (see paragraph 7.21), that program may also be used for purposes of meeting the percentage-of-coverage rule.

## **Low-Risk Auditee Criteria**

7.25 Circular A-133 establishes certain conditions for determining whether an auditee is low-risk. An auditee that meets all of the following conditions for each of the preceding two years (or in the case of biennial audits, the preceding two audit periods) qualifies as a low-risk auditee and is eligible for the reduced audit coverage discussed in paragraph 7.24:

- a. Single audits were performed on an annual basis in accordance with Circular A-133. An auditee 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 may provide a waiver.

- c. There were no deficiencies in internal control over financial reporting that were identified as material weaknesses under the requirements of *Government Auditing Standards*. However, the cognizant or oversight agency for audit may judge that any identified material weaknesses do not affect the management of federal awards and may 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, the preceding two audit periods) in which they were classified as type A programs:
  - Material weaknesses in the internal control over compliance
  - Noncompliance with the provisions of laws, regulations, contracts, or grant agreements that have a material effect on the type A program
  - Known or likely questioned costs that exceed 5 percent of the total federal awards expended for a type A program during the year

## **Criteria for Federal Program Risk**

7.26 The auditor's risk assessment should be based on an overall evaluation of the risk of noncompliance occurring which could be material to the federal program being evaluated. Circular A-133 indicates that the auditor should use professional judgment and consider certain criteria to identify risk in federal programs. As a part of the risk assessment, the auditor may also wish to discuss a particular federal program with auditee management and with the federal agency or pass-through entity. The criteria for federal program risk that are identified in Circular A-133 are discussed in the following sections.

### **Current and Prior Audit Experience**

7.27 The auditor should consider his or her prior experience with the auditee and the results of audits performed in the past. The following specific factors that should be considered:

- Weaknesses in the internal control over compliance for federal programs (paragraph 7.28)
- Federal programs administered under multiple internal control structures (paragraph 7.29)
- A weak system for monitoring subrecipients when significant parts of federal programs are passed through to subrecipients (paragraph 7.30)
- The extent to which computer processing is used (paragraph 7.31)
- Prior audit findings (paragraph 7.32)
- Federal programs not recently audited as major (paragraph 7.33)

### ***Weaknesses in Internal Control Over Federal Programs***

7.28 In assessing program risk, the auditor should consider internal control over compliance for federal programs (see chapter 8 for detailed guidance on internal control over compliance for federal programs). Weak internal control over compliance for federal programs is an indication of higher risk. Consideration should also be given to the control environment over federal programs and to such factors as the expectation of management's adherence to applicable laws and regulations and the provisions of contracts and grant agreements. The auditor may also consider the competence and experience of the personnel who administer federal programs. In instances in which the staff are new or do not have experience with a program, consideration should be given to assessing the program at a higher level of risk.

### ***Federal Programs Administered Under Multiple Internal Control Structures***

7.29 Federal programs administered by multiple internal control structures may have a higher risk. This often occurs when multiple operating units are involved in the administration of federal programs. An example of this would be a university that has several campuses administering a federal program. When assessing risk, the auditor should consider whether any internal control weaknesses are isolated in a

single operating unit (that is, one college campus) or are pervasive throughout the entity. If the identified weaknesses are isolated, and absent other weaknesses, the auditor could still potentially reach the conclusion that the program is low-risk. The final determination would be based on the auditor's judgment.

### **Weak System for Monitoring Subrecipients**

- 7.30 Consideration should be given to the extent that federal programs are passed through to subrecipients. If the auditee passes a significant portion of a federal program to subrecipients and the auditor has identified that the auditee has a weak system for monitoring subrecipients, the auditor should consider assigning a higher risk to the program. Alternatively, if the auditee passes a significant portion of programs to subrecipients and the auditee has an effective system in place to monitor the subrecipients, the auditor should consider assigning a lower level of risk to the program.

### **Extent to Which Computer Processing Is Used**

- 7.31 When assessing risk, the auditor should consider the extent to which computer processing is used to administer federal programs, as well as the complexity of that processing. A complex system does not always indicate higher risk. On the other hand, a newly installed system that has not been tested in the past, or a recently modified system, may indicate higher risk. Auditors should refer to SAS No. 31, *Evidential Matter*, as amended by SAS No. 80, Amendment to SAS No. 31, *Evidential Matter* (AICPA, *Professional Standards*, vol. 1, AU sec. 326), for guidance when significant auditee information is transmitted, processed, maintained, or accessed electronically.

### **Prior Audit Findings**

- 7.32 As a part of the risk assessment, the auditor should consider prior audit findings. These findings may be the result of previous single audits by independent auditors or of compliance or financial audits performed by internal auditors or government auditors in conjunction with the federal awarding agency's monitoring activities. The auditor should consider assessing a higher risk for programs for which prior

audit findings have a significant impact on a federal program or for which no corrective action has been implemented since the findings were identified.

### ***Federal Programs Not Recently Audited as Major***

7.33 Federal programs that have not recently been audited as major programs may be of higher risk than federal programs recently audited as major. For example, many type B programs may never have been audited as major programs in the past. A higher level of risk would likely be assessed on such programs than on those programs that have been consistently audited as major programs without audit findings.

### **Oversight Exercised by Federal Agencies and Pass-Through Entities**

7.34 The oversight exercised by federal agencies or pass-through entities could indicate risk. An important factor in assessing risk is the results of recent audits performed by federal agencies or pass-through entities. For example, recent monitoring or other reviews that were performed by an oversight entity and that disclosed no audit findings may indicate lower risk, whereas monitoring that disclosed significant findings could indicate higher risk. However, the auditor should understand the scope of the review that was performed. Reviews performed by federal agencies or pass-through entities vary widely as to coverage and intensity.

7.35 Circular A-133 states that federal agencies, with the concurrence of the OMB, may identify federal programs that are high-risk. This identification will be provided by the OMB in the *Compliance Supplement*. For example, the U.S. Department of Health and Human Services has identified the Medicaid Assistance Program as a program of higher risk in the *Compliance Supplement*. Although such an identification by a federal agency does not preclude an auditor from determining that a program is low-risk (for example, because prior audits have shown strong internal control and compliance), the auditor should consider it as part of the risk assessment process.



## **Inherent Risk of the Federal Programs**

7.36 As part of the risk assessment, the auditor needs to consider the inherent risk of federal programs. Inherent risk is the risk that material noncompliance with requirements applicable to a major program could occur, assuming there is no related internal control. Programs with higher inherent risk may be of a higher risk for the purpose of determining major programs. Circular A-133 provides examples of program characteristics with potentially higher inherent risks; these are discussed in paragraphs 6.8 and 6.9.

## CHAPTER 8

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# Consideration of Internal Control Over Compliance for Major Programs

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- 8.1 Circular A-133 establishes requirements for additional audit procedures and reporting relative to the auditor's consideration of internal control over compliance for major programs. These requirements are beyond those of a financial statement audit conducted in accordance with GAAS and *Government Auditing Standards*. The auditor's consideration of internal control over financial reporting is discussed in chapter 4. In this chapter, the additional considerations of internal control over compliance for major programs are discussed. The reporting on internal control over compliance for major programs is discussed in paragraph 8.3 and chapter 10.

### **Summary of Circular A-133 Requirements Related to Internal Control Over Compliance for Federal Programs**

#### **Auditee Responsibilities**

- 8.2 Circular A-133 requires the auditee to maintain internal control over compliance for 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.

#### **Auditor Responsibilities**

- 8.3 In addition to the requirements of GAAS and *Government Auditing Standards*, Circular A-133 requires the auditor to—
- Perform procedures to obtain an understanding of internal control over compliance for federal programs

that is sufficient to plan the audit to support a low assessed level of control risk for major programs.

- Plan the testing of internal control over compliance for major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program.
- Perform testing of the internal control over compliance as planned.
- Report on internal control over compliance describing the scope of the testing of internal control and the results of the tests and, where applicable, referring to the separate schedule of findings and questioned costs. This schedule includes, where applicable, a statement that reportable conditions in internal control over compliance for major programs were disclosed by the audit and whether any such conditions were material weaknesses.

## **Auditor Responsibility for Internal Control Over Compliance for Programs That Are Not Major**

8.4 The auditor has no responsibility under Circular A-133 to obtain an understanding of internal control over compliance for programs that are not considered major, or to plan or perform any related testing of internal control over compliance for those programs except for any procedures the auditor may choose to perform as part of the risk assessment process in determining major programs (see chapter 7). However, the auditor should note that a program that is not considered major could still be material to the financial statements. In this situation, in conjunction with the financial statement audit, the auditor may need to obtain an understanding of the internal control over financial reporting that is relative to the program. The auditor's consideration of internal control over financial reporting is discussed in chapter 4.

## **Circular A-133 Definition of Internal Control Over Federal Programs**

8.5 Circular A-133 defines internal control over federal programs as follows.

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:
  - a. Permit the preparation of reliable financial statements and federal reports;
  - b. Maintain accountability over assets; and
  - c. Demonstrate compliance with laws, regulations, and other compliance requirements;
2. Transactions are executed in compliance with:
  - a. Laws, regulations and the provisions of contracts or grant agreements that could have a direct and material effect on a federal program; and
  - b. 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.

## **Control Objectives**

- 8.6 SAS No. 55, *Consideration of Internal Control in a Financial Statement Audit*, as amended by SAS No. 78, *Consideration of Internal Control in a Financial Statement Audit: An Amendment to SAS No. 55*, states that there are three categories of internal control: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. These distinct but somewhat overlapping categories have differing purposes and allow a directed focus to meet the needs of the auditee and others regarding each separate purpose. For purposes of this SOP, controls relevant to the audit of the financial statements are referred to as “internal control over financial reporting” and are encompassed in the report on internal control over financial reporting that is required by *Government Auditing Standards* (see paragraphs 10.38 through 10.40). Controls relevant to an audit of compliance with requirements applicable to major federal programs

are referred to collectively in this SOP “as internal control over compliance” and are encompassed in the report on internal control over compliance required by Circular A-133 (see paragraphs 10.46 through 10.49). See paragraphs 4.11 and 4.12 for a more detailed discussion.

## **Auditor’s Consideration of Internal Control Over Compliance for Each Major Program**

8.7 The auditor’s consideration of internal control over compliance for each major program is similar to the consideration of internal control over financial reporting in a financial statement audit as described in SAS No. 55, as amended by SAS No. 78. In his or her consideration of internal control over compliance, the auditor—

- Obtains an understanding of internal control over compliance for federal programs that is sufficient to plan the audit, by performing procedures to understand (a) the design of controls relevant to the compliance requirements for each major program and (b) whether they have been placed in operation (note that although Circular A-133 requires the auditor to perform procedures to obtain an understanding of internal control over compliance for federal programs that is sufficient to plan the audit to support a low assessed level of control risk for major programs, it does not actually require the achievement of a low assessed level of control risk).
- Assesses control risk for the assertions relevant to the compliance requirements for each major program. The auditor uses the knowledge provided by the understanding of internal control over compliance and the assessed level of control risk to determine the nature, timing, and extent of substantive tests for assertions relevant to the compliance requirements for each major program. Compliance auditing is discussed in chapter 6.

8.8 An understanding of the internal control over compliance and an assessment of control risk may be performed concurrently in an audit. Similarly, based on the assessed level

of control risk that the auditor expects to support and on audit efficiency considerations, the auditor often plans to perform some tests of controls concurrently with obtaining an understanding of controls.

## **Obtaining an Understanding of Internal Control Over Compliance for Major Programs**

### **Understanding Compliance Assertions and Identifying Relevant Controls**

- 8.9 As noted in paragraph 8.3, the auditor is required to perform procedures to obtain an understanding of internal control over compliance for federal programs that is sufficient to plan the audit to support a low assessed level of control risk for major programs. The determination of major programs is discussed in chapter 7. The auditor needs to understand the assertions relevant to the compliance requirements for each major program. Those assertions will determine the types of controls the auditor needs to consider in a single audit. In identifying controls relevant to specific assertions, the auditor should consider that the controls can have either a pervasive effect on many assertions or a specific effect on an individual assertion depending on the nature of the particular internal control component involved. An entity generally also has controls relating to objectives that are not relevant to specific assertions and that therefore need not be considered in a Circular A-133 audit.
- 8.10 In obtaining an understanding of controls, the auditor should consider the guidance in paragraphs 41 through 43 of SAS No. 55, as amended by SAS No. 78 (AICPA, *Professional Standards*, vol. 1, AU secs. 319.41–.43). This includes performing procedures to provide sufficient knowledge of both the design of the relevant controls pertaining to each of the five internal control components (that is, control environment, risk assessment, control activities, information and communication, and monitoring) and whether they have been placed in operation. The auditor ordinarily obtains this knowledge through previous experience with the entity and through such procedures as

inquiries of appropriate management, supervisory, and staff personnel; an inspection of the entity's documents and records; and his or her observation of the entity's activities and operations. The nature and extent of the procedures performed generally vary from entity to entity and are influenced by the size and complexity of the entity, the auditor's previous experience with the entity, the nature of the particular control, and the nature of the entity's documentation of specific controls.

- 8.11 Entities may use the same controls for more than one federal program and for similar transactions (for example, cash disbursements). Accordingly, those controls will often provide assurance regarding the achievement of the compliance objectives related to some or all federal program transactions and assets.

## **OMB Compliance Supplement Internal Control Guidance**

- 8.12 When determining the assertions relevant to the compliance requirements for each major program of the entity, the auditor should consider referring to the discussion on internal control found in part 6 of the *Compliance Supplement*. The *Compliance Supplement* provides a general discussion of the control objectives, components, and activities that are likely to apply to the fourteen types of compliance requirements (see the discussion of the types of compliance requirements in paragraph 6.22). This guidance is not a checklist of required internal control characteristics; it is intended, instead, to assist the auditor in planning and performing the single audit. However, the auditee is responsible for designing and implementing internal control that is sufficient to provide 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. Control activities beyond those discussed in the *Compliance Supplement* may need to be designed and implemented by the auditee to meet this responsibility. Similarly, the auditor is responsible for evaluating internal control over compliance, to plan the audit to support a low assessed level of control risk for each major program. The au-

ditor may need to perform tests of internal control over compliance that are related to control objectives and activities in addition to those discussed in the *Compliance Supplement*.

## **Multiple-Component Considerations**

- 8.13 Federal programs are often administered by several organizational components within an auditee. Each component may maintain separate internal control over compliance that is relevant to the programs, or parts of the programs, that the component administers. In these situations, the auditor should perform procedures to obtain an understanding of the internal control over compliance that is separately maintained by organizational components and that is relevant to each material part of a major program, and should plan and perform testing of those controls as discussed in this chapter (see also paragraphs 6.34 and 7.29 for other multiple-component considerations).

## **Subrecipient Considerations**

- 8.14 Many entities that are pass-through entities for federal awards make subcontract or subgrant awards and disburse their own funds, as well as federal funds, to subrecipients. The auditor of the pass-through entity has certain considerations related to the entity's internal control over the monitoring of subrecipients. See paragraph 9.23 for a discussion of the audit considerations of federal pass-through awards.

# **Planning and Performing Testing of Internal Control Over Compliance for Major Programs**

## **Assessing Control Risk**

- 8.15 After obtaining an understanding of internal control over compliance for major programs, the auditor makes a preliminary assessment of control risk for the assertions relevant to the compliance requirements for each major program (see also the related discussion in paragraphs 6.7 through 6.12). Control risk is the risk that material noncompliance that could occur in a major program will not be prevented or



detected on a timely basis by the auditee's internal control over compliance. The assessment of control risk is the process of evaluating the effectiveness of an entity's internal control over compliance in preventing or detecting material noncompliance with the compliance requirements for each major program. In assessing control risk, the auditor should consider the guidance in paragraphs 45 through 57 of SAS No. 55, as amended by SAS No. 78 (AICPA, *Professional Standards*, vol. 1, AU secs. 319.45–.57). The auditor should consider the preliminary assessment of control risk when he or she designs the nature and extent of tests of compliance. The Circular A-133 requirement to plan the testing of internal control over compliance to support a low assessed level of control risk is discussed in paragraphs 8.16 through 8.19. The auditor's responsibilities when the internal control over compliance is ineffective in preventing or detecting non-compliance are discussed in paragraphs 8.20 through 8.22.

### **Planning the Testing of Internal Control Over Compliance for Major Programs to Support a Low Assessed Level of Control Risk**

- 8.16 Circular A-133 requires the auditor to plan the testing of internal control over compliance for major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program. Professional standards do not define or quantify a low assessed level of control risk. A low assessed level of control risk can only be understood in relative terms when it is compared with maximum or moderate levels. Therefore, the auditor exercises professional judgment to determine the procedures necessary to obtain a low level of control risk. The auditor should consider the purpose of the requirement to plan the tests of controls to achieve a low assessed level of control risk (that is, federal agencies want to know if conditions indicate that auditees have not implemented adequate internal control over compliance for federal programs to ensure compliance with applicable laws and regulations).
- 8.17 Assessing control risk at below the maximum level involves (a) identifying specific controls relevant to specific assertions

that are likely to prevent or detect material misstatements in those assertions and (b) performing tests of controls to evaluate the effectiveness of such controls.

- 8.18 When the auditor assesses control risk at below the maximum level, the auditor should obtain sufficient evidential matter to support that assessed level of control risk. The type of evidential matter, its source, its timeliness, and the existence of other evidential matter related to the conclusions to which it leads all bear on the degree of assurance the evidential matter provides. In obtaining evidential matter, the auditor should consider the guidance in paragraphs 64 through 78 of SAS No. 55, as amended by SAS No. 78 (AICPA, *Professional Standards*, vol. 1, AU secs. 319.64–.78).
- 8.19 Paragraph 4.32 of *Government Auditing Standards* provides the following additional guidance related to the assessment of control risk:
- The lower the auditors' assessment of control risk, the more evidence they need to support that assessment.
  - Auditors may have to use a combination of different kinds of tests of controls to get sufficient evidence of a control's effectiveness.
  - Inquiries alone generally will not support an assessment that control risk is below the maximum.
  - Observations provide evidence about a control's effectiveness only at the time observed; they do not provide evidence about its effectiveness during the rest of the period under audit.
  - Auditors can use evidence from tests of controls done in prior audits (or at an interim date), but they have to obtain evidence about the nature and extent of significant changes in policies, procedures, and personnel since they last performed those tests.

### **Existence of Ineffective Internal Control in Preventing or Detecting Noncompliance**

- 8.20 When internal control over compliance for some or all of the compliance requirements for a major program are likely

to be ineffective in preventing or detecting noncompliance, the auditor is not required to plan and perform tests of internal control over compliance as described in paragraphs 8.3, 8.16, and 8.23. If the internal control over compliance is deemed likely to be ineffective, Circular A-133 requires the auditor to assess control risk at the maximum and consider whether any additional compliance tests are required because of ineffective internal control. The auditor is also required to report a reportable condition (including whether such condition is a material weakness) as part of the audit findings (see paragraphs 10.46, 10.56, and 10.63 for a discussion of how reportable conditions should be reported).

8.21 The assessment of the effectiveness of internal control over compliance in preventing or detecting noncompliance is determined in relation to each individual type of compliance requirement for each major program or to an audit objective identified in the *Compliance Supplement*. For example, controls over requirements for eligibility may be ineffective because of a lack of segregation of duties. In this case, the auditor would be required to—

- Report the lack of segregation of incompatible duties as it relates to eligibility as a reportable condition (note that the reportable condition could be a material weakness).
- Assess the control risk related to requirements for eligibility at the maximum.
- Consider the lack of effective control when designing the nature, timing, and extent of procedures designed to test compliance with requirements for eligibility of the major program. In most cases, the extent of testing would need to be expanded.

8.22 In planning the tests of controls, the auditor will need to consider the results of tests performed in prior years. If the results of the prior year tests of controls prevented a low level of control risk assessment, the auditor may consider expanded testing in the next audit period. That consideration should include the testing of any changes in internal control over compliance that were intended to eliminate deficiencies noted in the previous year. If, however, the

auditee has made no changes to its internal control over compliance, the auditor may determine that controls are not likely to be effective and may choose not to plan and perform tests of controls. In this situation, a reportable condition should be reported (see paragraph 8.20).

## **Performing Tests to Evaluate the Effectiveness of Controls**

8.23 As noted in paragraph 8.3, Circular A-133 requires the auditor to perform testing of internal control over compliance as planned (see paragraphs 8.20 through 8.22 for an exception related to ineffective internal control over compliance). Tests of controls should include the types of procedures described in paragraphs 34 and 35 of SAS No. 55, as amended by SAS No. 78 (AICPA, *Professional Standards*, vol. 1, AU secs. 319.52 and 319.53). Tests of controls, which are directed toward either the effectiveness of the design or the operation of a control, may include such steps as (a) inquiries of appropriate personnel, including grant and contract managers; (b) the inspection of documents and reports; (c) the observation of the application of the specific controls; and (d) the reperformance of the application of the controls by the auditor. The auditor should perform such procedures (unless control is likely to be ineffective) regardless of whether he or she would otherwise choose to obtain evidence to support an assessment of control risk below the maximum level.

## **Evaluating the Results of Tests of Controls**

8.24 If, when evaluating the results of tests of controls, the auditor is not able to support a low assessed level of control risk for major programs, the auditor is not required to expand his or her testing of internal control over compliance. The auditor may choose not to perform further tests. In this situation, the auditor would assess control risk at other than low, design tests of compliance accordingly, and consider the need to report an audit finding (see paragraph 10.63). In general, a reportable condition or a material weakness will need to be reported. Similarly, the auditor may decide to expand the testing of internal control over compliance,

but that decision would be based on whether the auditor considered expanded internal control testing to be more efficient than additional tests of compliance. The auditor should consider whether, based on the testing performed, control risk can be assessed at below the maximum to reduce substantive tests of compliance. If it cannot, the auditor should assess control risk at the maximum level.

## **Reportable Conditions and Material Weaknesses Related to Federal Programs**

8.25 For purposes of reporting on internal control over compliance for federal programs, the definitions of a reportable condition and a material weakness, which are similar to those in SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit*, are as follows:

- *A reportable condition* is a matter coming to the auditor's attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in the auditor's judgment, could adversely affect an entity's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants.
- *A material weakness* in internal control over compliance is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

8.26 In performing a single audit, the auditor should be aware that reportable conditions and material weaknesses are to be considered as they relate to a type of compliance requirement for each major program or to an audit objective identified in the *Compliance Supplement*. Furthermore, certain conditions may be reportable conditions for a major program and not be considered reportable conditions as they relate to the assertions of management in the financial statements.

## Documentation Requirements

- 8.27 The auditor should document his or her understanding of the auditee's internal control components that was obtained to plan the audit, and should document the basis for his or her conclusions about the assessed level of control risk related to the internal control over compliance for major programs. If the auditor has not performed tests of controls relevant to certain requirements or programs, as discussed in paragraphs 8.20 through 8.22, then the rationale for omitting such tests should be documented.
- 8.28 As noted in paragraphs 3.16 through 3.18, *Government Auditing Standards* includes an additional standard that requires working papers to contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditor's significant conclusions and judgments.
- 8.29 The form and extent of this documentation is influenced by the size and complexity of the auditee, as well as the nature of the auditee's internal control over compliance. For example, the documentation of the understanding of internal control over compliance of a large, complex entity may include flowcharts, questionnaires, or decision tables. For a small entity, however, the documentation may be less extensive. In general, the more complex the internal control over compliance and the more extensive the procedures performed, the more extensive the auditor's documentation.

## Program Cluster Considerations

- 8.30 An entity may have separate controls related to individual federal programs that are treated as one program "cluster" under a Circular A-133 audit (for example, SFA and R&D—see paragraphs 1.18, 1.19, 2.18, 5.6, and 7.4 for a discussion of program clusters). In this case, when evaluating whether an identified deficiency is a reportable condition, the auditor should consider the significance of the deficiency in relation to the overall major program (program cluster). Following are some examples:
- Significant deficiencies in specific controls over the time cards of college work-study students would likely

be considered a reportable condition when college work-study program expenditures are significant in relation to SFA programs.

- Significant deficiencies in controls over a single campus or department of a university where a significant amount of research was administered would likely be a reportable condition when considered in relation to the total expenditures of R&D programs.
- A deficiency in an SFA or R&D program that was clearly insignificant to SFA or R&D, respectively, as a whole would not necessarily be considered a reportable condition.

## CHAPTER 9

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# Audit Considerations of Federal Pass-Through Awards

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### Introduction

9.1 Many nonfederal entities receiving federal awards make pass-through payments of federal awards to other entities that are considered subrecipients. The amount of those payments may be material to the pass-through entity's financial statements, individual major programs, or both. The auditor's consideration of pass-through federal awards in an audit of both pass-through entities and subrecipients of federal awards under Circular A-133 is discussed in this chapter. The auditee's and auditor's responsibilities with respect to activities carried out by vendors is also discussed in this chapter. An auditee with multiple federal funding agreements may be a pass-through entity in regard to some awards, a subrecipient in regard to other awards, and a vendor with respect to other agreements.

### Definitions

- 9.2 Circular A-133 includes the following definitions that are relevant to pass-through awards:
- *Federal award*—federal financial assistance and federal cost-reimbursement contracts that nonfederal 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.
  - *Nonfederal entity*—a state, local government, or non-profit organization (NPO).
  - *Recipient*—a nonfederal entity that expends federal awards received directly from a federal awarding agency to carry out a federal program.



- *Pass-through entity*—a nonfederal entity that provides a federal award to a subrecipient to carry out a federal program.
- *Subrecipient*—a nonfederal entity that expends federal awards received from a pass-through entity to carry out a federal program but does not include an individual who is a beneficiary of such a program. A subrecipient may also be a recipient of other federal awards directly from a federal awarding agency.
- *Vendor*—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.

## **Applicability of Circular A-133**

- 9.3 Circular A-133 applies to both recipients expending federal awards received directly from federal awarding agencies and subrecipients expending federal awards received from a pass-through entity. Accordingly, both recipients and subrecipients that expend \$300,000 or more in federal awards are required to have a single or program-specific audit in accordance with Circular A-133 (see chapter 11 for a detailed discussion of program-specific audits).
- 9.4 The determination of when a federal award is expended is based on when the activity related to the award occurs. With respect to federal awards passed through to subrecipients, the activity that requires the pass-through entity to comply with laws, regulations, and the provisions of contracts or grant agreements is the disbursement of funds to subrecipients. The activity that requires subrecipients to comply with laws, regulations, and the provisions of contracts or grant agreements is the expenditure of the pass-through award.
- 9.5 Payments received by a vendor for goods or services provided in connection with a federal program are not considered federal awards. Furthermore, Medicaid payments to a subrecipient for providing patient care services to Medicaid-eligible individuals are not considered federal awards ex-

pended under Circular A-133 unless a state requires the funds to be treated as federal awards expended because reimbursement is on a cost-reimbursement basis.

- 9.6 If a pass-through entity provides federal awards to subrecipients, the pass-through entity must monitor the subrecipients' activities to provide reasonable assurance that the subrecipients administer federal awards in compliance with federal requirements. As part of the compliance audit, the auditor of the pass-through entity must test and report on subrecipient monitoring (which is one of the fourteen types of compliance requirements in the *Compliance Supplement*—see paragraph 6.22) when federal awards passed through to subrecipients are material to a major program (see paragraphs 9.24 through 9.35). If the federal awards provided are immaterial or relate to a program that is not considered major, the auditor of the pass-through entity has no additional compliance auditing responsibilities related to the funds passed through to subrecipients.
- 9.7 Most of this chapter focuses on compliance auditing considerations for auditors of pass-through entities. However, paragraphs 9.43 through 9.47 provide additional considerations for auditors of subrecipients.

## **Pass-Through Entities, Subrecipients, and Vendors**

### **Subrecipient Status Versus Vendor Status**

- 9.8 The responsibilities for compliance with federal program requirements and the applicable compliance requirements to be tested by the auditor are significantly different for pass-through entities, subrecipients, and vendors. Guidance on distinguishing between a subrecipient and a vendor is provided in section 210 of Circular A-133 and is summarized in paragraphs 9.9 through 9.11.

### **Characteristics Indicative of a Federal Award Received by a Subrecipient**

- 9.9 According to Circular A-133, characteristics indicative of a federal award received by a subrecipient are when the entity

(see paragraph 9.12 for examples of the relationship between pass-through entities and subrecipients)—

- Determines who is eligible to receive what federal financial assistance.
- Has its performance measured against whether the objectives of the federal program are met.
- Has responsibility for programmatic decision making.
- Has responsibility for adherence to applicable federal program compliance requirements.
- Uses the federal funds to carry out a program of the entity as compared to providing goods or services for a program of the pass-through entity.

### ***Characteristics Indicative of a Payment for Goods or Services Received by a Vendor***

9.10 According to Circular A-133, the characteristics indicative of a payment for goods or services received by a vendor are when the entity (see paragraph 9.13 for examples of the relationship between recipients and vendors)—

- Provides the goods and services within normal business operations.
- Provides similar goods or services to many different purchasers.
- Operates in a competitive environment.
- Provides goods or services that are ancillary to the operation of the federal program.
- Is not subject to the compliance requirements of the federal program.

### ***Use of Judgment in Determining Subrecipient or Vendor Status***

9.11 Circular A-133 states that there may be unusual circumstances or exceptions to the listed characteristics in paragraphs 9.9 and 9.10. 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. In some cases, it may be difficult to determine whether the relationship with the entity is that of a subrecipient or of a vendor. The federal cognizant agency for audit, the oversight agency for audit, or the federal awarding agency may be of assistance in making these determinations.

## **Description of Relationships**

### ***Pass-Through Entity and Subrecipient***

9.12 Following are examples of a typical relationship between a pass-through entity and a subrecipient:

- A state department of education (pass-through entity) receives a federal award and is responsible for administering and disbursing the federal award to local school districts (subrecipients) according to a formula or some other basis.
- A regional planning commission (pass-through entity) receives a federal award for the feeding of elderly and low-income individuals, and the award is disbursed to NPOs (subrecipients) to support their feeding programs.
- A hospital (subrecipient) receives a federal award from a university (pass-through entity) to conduct research.
- A theater group (subrecipient) receives a federal award from a state arts commission (pass-through entity) to support a summer arts series.

### ***Recipient and Vendor***

9.13 Following are examples of a typical relationship between a recipient and a vendor:

- A local government (recipient) receives a federal award to provide mental health services in a designated area. Some of the funds are paid to a contractor (vendor) to repair a leaking roof.

- A county (recipient) receives a federal award to operate a Head Start program and pays a NPO (vendor) to provide temporary clerical services.
- An NPO (recipient) receives a federal award to run a preschool and pays a medical doctor (vendor) to perform health screening on a per-student basis.
- An NPO (recipient) receives a federal award to operate a child care center and pays a not-for-profit clinic (vendor) to perform physical exams.

### ***Entity Is Both a Subrecipient and a Pass-Through Entity***

9.14 There are instances in which an entity can be both a subrecipient and a pass-through entity as shown in the following examples:

- A local government receives a pass-through federal award from a state government agency (the local government is a subrecipient) and further passes through a portion of the federal award to an NPO (the local government is also a pass-through entity) to administer a federal program.
- A not-for-profit area agency receives a pass-through federal award from a state (the not-for-profit area agency is a subrecipient) and further passes through a portion of the federal award to a for-profit health care provider (the not-for-profit area agency is also a pass-through entity). See paragraph 9.40 for a discussion of a pass-through entity's responsibilities when the subrecipient is a for-profit entity.

## **Vendor Compliance Considerations**

### ***Auditee's Responsibilities***

9.15 Circular A-133 states that in most cases, the auditee's compliance responsibility for a vendor 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. A program's compliance requirements normally do not pass through to vendors. However, the auditee is responsible for ensuring compliance for

vendor transactions that are structured such that the vendor is responsible for program compliance or the vendor's records must be reviewed to determine compliance.

### ***Auditor's Responsibilities***

- 9.16 When vendors are responsible for program compliance, the auditor should determine whether vendor transactions are in compliance with laws, regulations, and the provisions of contracts or grant agreements if such transactions are material to a major program of the auditee. In such a case, the auditor would normally evaluate a vendor's compliance by reviewing the auditee's records and the results of the auditee's procedures for ensuring compliance by the vendor. When the auditor cannot obtain sufficient assurance from reviewing the auditee's records and procedures, the auditor should consider the need to report a reportable condition. The auditor will also ordinarily need to perform additional procedures to determine compliance. These procedures may include testing the vendor's records or obtaining reports on compliance procedures performed by the vendor's independent auditor.
- 9.17 Prior to performing a single or program-specific audit, it is important for the auditor to understand the nature of the auditee's vendor relationships, whether the vendors are responsible for program compliance, the auditee's procedures for ensuring vendor compliance, and whether it will be necessary for the auditor to test vendor records. The auditor should consider including such information in the communication used to establish an understanding with the auditee (see paragraphs 3.6 through 3.7). If subsequent to undertaking a single or program-specific audit the auditor becomes aware of a significant vendor relationship that will require the auditor to perform additional procedures on vendor records, the auditor should inform the auditee that the requirements of Circular A-133 will not be met unless additional procedures are performed. If the auditee or vendor precludes the auditor from performing such additional procedures, the auditor should qualify his or her opinion or disclaim an opinion because of a scope limitation (see paragraphs 10.43 through 10.45 for a further discussion of scope limitations).

## **Single Audit Considerations of Pass-Through Entities**

9.18 The following matters are relevant to planning and conducting a single audit of a pass-through entity:

- Pass-through entity responsibilities (see paragraph 9.19)
- Audit planning considerations (see paragraphs 9.20 through 9.22)
- Consideration of internal control over compliance (see paragraph 9.23)
- Subrecipient monitoring (see paragraphs 9.24 through 9.35)
- Reporting considerations (see paragraphs 9.36 through 9.39)
- For-profit subrecipients (see paragraph 9.40)
- Non-U.S.-based entities (see paragraph 9.41)
- A state's designation of a cluster of programs (see paragraph 9.42)

### **Pass-Through Entity Responsibilities**

9.19 A pass-through entity is responsible for ensuring that subrecipients expend awards in accordance with applicable laws, regulations, and provisions of contracts or grants. Circular A-133 requires a pass-through entity to perform the following for the federal awards it provides to subrecipients:

- Identify the federal awards made by informing each subrecipient of the CFDA title and number, the award's name and number, the award year, whether the award is for R&D, and the name of the federal agency. When some of this information is not available, the pass-through entity should provide the best information available to describe the federal award.
- Advise subrecipients of the 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.

- 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.
- Ensure that subrecipients expending \$300,000 or more in federal awards during the subrecipient's fiscal year have met the audit requirements of Circular A-133 for that fiscal year.
- Issue management decisions on audit findings within six months after receipt of subrecipients' audit reports, and ensure that subrecipients take appropriate and timely corrective action.
- Consider whether subrecipient audits necessitate the adjustment of the pass-through entity's own records.
- Require subrecipients 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 Circular A-133.
- Keep subrecipients' report submissions (or other written notification when the subrecipient is not required to submit a reporting package) on the file for three years from the date of receipt (see paragraphs 9.47, 10.76 and 10.78).

## **Audit Planning Considerations**

### ***Impact of Pass-Through Federal Awards on the Determination of Major Programs***

- 9.20 As noted in paragraph 9.4, the determination of when a federal award is expended is based on when the activity related to the award occurs. With respect to federal awards provided by a pass-through entity to subrecipients, the federal awards are deemed to be expended by the pass-through entity when the funds are disbursed to subrecipients, regardless of when subrecipients expend the federal



funds. Accordingly, the amount of federal funds disbursed to subrecipients should be included in the total expenditures of federal awards of the pass-through entity and in the determination of the pass-through entity's major programs (see chapter 7 for a more detailed discussion of the determination of major programs).

### ***Pass-Through Entity Request for a Program to Be Audited as a Major Program***

9.21 When a subrecipient expends \$300,000 or more of federal awards, Circular A-133 permits the pass-through entity to request that the program be audited as a major program in lieu of the pass-through entity conducting or arranging for additional audits. If the pass-through entity makes such a request, it is required to pay the full incremental cost for such an audit (see paragraph 2.19 for additional information).

### ***Materiality***

9.22 The auditor of the pass-through entity should compare the amount of federal funds passed through to subrecipients with the total expenditures for each individual major program or cluster to determine if the amount is material. The auditor's consideration of materiality is a matter of professional judgment and is influenced by the auditor's perception of the needs of a reasonable person who will rely upon the auditor's work. When the amount of federal funds passed through to subrecipients is material in relation to the major program being audited, the greater the need for the auditor to test the subrecipient-monitoring requirements. It should be noted that some federal programs are designed in such a manner that subrecipient expenditures are intended to be material to the pass-through entity's award. For example, the Community Services Block Grant requires a state to subgrant at least 90 percent of the state's award.

### **Consideration of Internal Control Over Compliance**

9.23 As part of performing procedures to obtain an understanding of internal control over compliance for federal programs that is sufficient to plan the audit of the pass-through entity to support a low assessed level of control risk for major programs, the auditor should consider the pass-through entity's

internal control over compliance used to monitor subrecipients (see chapter 8 for an additional discussion of considerations concerning internal control over compliance). Tests of internal control over compliance used to monitor subrecipients may include inquiry, observation and inspection of documentation, or a reperformance by the auditor of some or all of the monitoring procedures identified in paragraph 9.28. The nature and extent of the tests performed will vary depending on the auditor's assessment of inherent risk, understanding of the internal control over compliance, materiality, and professional judgment. Auditors should consider referring to part 6 of the *Compliance Supplement*, which describes (among other things) certain characteristics of internal control over compliance that, when present and operating effectively, may ensure compliance with program requirements for subrecipient monitoring. The results of the auditor's testing of internal control over compliance assist in determining the nature, timing, and extent of subrecipient monitoring compliance testing.

## **Subrecipient Monitoring**

- 9.24 The Single Audit Act requires the pass-through entity to monitor subrecipients' use of federal awards through site visits, limited scope audits, or other means. Since the pass-through entity is held accountable for federal awards administered by their subrecipients, the pass-through entity needs to establish an appropriate subrecipient-monitoring process and to decide what, if any, additional monitoring procedures may be necessary to ensure the subrecipients' compliance. Arrangements for subrecipient monitoring should be made by the pass-through entity in its agreements with subrecipients.
- 9.25 Auditors must consider subrecipient monitoring in a compliance audit of an entity that disburses to subrecipients federal awards that are material to a major program (see the discussion of materiality in paragraph 9.22). The auditor should consider whether the pass-through entity monitors subrecipients and has established internal control over compliance that provides reasonable assurance that subrecipients are 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 the pass-through entity's major programs.

### **Compliance Supplement Guidance**

9.26 One of the fourteen types of compliance requirements included in the *Compliance Supplement* is subrecipient monitoring. The *Compliance Supplement* identifies several audit objectives for subrecipient monitoring. According to the *Compliance Supplement*, in a single audit of a pass-through entity, the auditor should determine whether the pass-through entity—

- Identified the federal award's information and compliance requirements to the subrecipient.
- Monitored the subrecipient's activities to provide reasonable assurance that the subrecipient administered federal awards in compliance with federal requirements.
- Ensured that the required audits were performed, and required appropriate corrective action concerning monitoring and audit findings.
- Evaluated the impact of subrecipient activities on the pass-through entity.

9.27 The *Compliance Supplement* also identifies the suggested audit procedures for testing the compliance audit objectives for pass-through entities (see paragraph 6.44 for a further discussion of suggested audit procedures). The auditor may consider coordinating the subrecipient-related tests performed as part of activities allowed or unallowed (tests that subrecipient agreements were for allowable activities), cash management (tests of cash reports submitted by subrecipients), eligibility (tests that subawards were made only to eligible subrecipients), and procurement (tests of suspension and debarment certifications) with the tests of subrecipient monitoring.

### **Pass-Through Entity Monitoring Procedures**

9.28 The monitoring procedures used by the pass-through entity may include on-site visits, reviews of documentation

supporting requests for reimbursement, and limited-scope audits. Section 230(b)(2) of Circular A-133 defines limited-scope audits as agreed-upon procedures engagements that are conducted in accordance with either GAAS or the AICPA attestation standards, and 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. Following are other monitoring procedures that a pass-through entity may perform:

- Reviewing grant applications submitted by subrecipients to determine that—
  - Applications are filed and approved in a timely manner
  - Each application contains the condition that the subrecipient comply with the federal requirements set by the federal agency
- Establishing internal control over compliance to provide reasonable assurance that—
  - Funds are disbursed to subrecipients only on an as-needed basis
  - Funds are disbursed to subrecipients only on the basis of approved, properly completed reports submitted on a timely basis
  - Refunds that are due from subrecipients are billed and collected in a timely manner
  - Subrecipients and other entities and individuals receiving federal funds meet eligibility requirements
- Reviewing financial and technical reports received from subrecipients on a timely basis and investigating unusual items
- Reviewing subrecipient audit reports, to evaluate them for completeness and for compliance with applicable laws and regulations
- Evaluating audit findings; issuing appropriate management decisions, if necessary; and determining if

an acceptable plan for corrective action has been prepared and implemented

- Reviewing previously detected deficiencies and determining that corrective action was taken

### ***Monitoring When the Subrecipient Has a Single or Program-Specific Audit***

9.29 As noted in paragraph 9.3, subrecipients that expend \$300,000 or more in federal awards are required to have a single or program-specific audit in accordance with Circular A-133. If subrecipients have a single or program-specific audit, the pass-through entity's receipt and review of the results of that audit and its action on related findings may be sufficient to meet the subrecipient-monitoring requirements of Circular A-133. However, it is more likely that the receipt and review of such audit results should be merely one tool that should be used by the pass-through entity as part of a comprehensive subrecipient-monitoring process. Pass-through entities should be aware that a single audit is likely to provide varying degrees of assurance concerning a particular program. For example, a pass-through award may not have been tested as a major program as part of a subrecipient's audit. For this reason, the pass-through entity should consider the testing and results of the single audit of the subrecipient to determine what effect those results should have on other monitoring procedures employed by the pass-through entity.

9.30 In many cases, the pass-through entity will not have received all the subrecipient audit reports covering the time period being audited at the pass-through entity in time to incorporate the results into its own audit. The reports for the pass-through entity and the subrecipient are not required to be issued simultaneously, but the pass-through entity is required to have internal control over compliance in place, to determine that subrecipient audit reports have been received and that corrective action is taken after the receipt of the subrecipient's audit. If the subrecipient's audit report is current, it need not cover the same period as the pass-through entity's audit. If the pass-through entity has an effective system for monitoring subrecipients,

its auditor should be able to rely on the subrecipient's audit cycle, even if it is not coterminous with the pass-through recipient's fiscal year.

### **Considering Risk Factors When Developing Monitoring Procedures**

9.31 The preamble to Circular A-133 states that the OMB expects pass-through entities to consider various risk factors (such as the relative size and complexity of the federal awards administered by subrecipients, the entity's prior experience with each subrecipient, and the cost-effectiveness of various monitoring procedures) in developing subrecipient-monitoring procedures. For example, if a pass-through entity provides a large percentage of the only federal award it expends to ten subrecipients that each expend less than \$300,000 in federal awards annually, 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.

### **Unallowable Audit Costs**

9.32 For subrecipients that expend less than \$300,000 in federal awards annually, the cost of any audits or attestation engagements (other than the limited-scope audits paid for and arranged by a pass-through entity as described in paragraph 9.28), are not allowable costs and, therefore, cannot be charged to any federal award. Accordingly, Circular A-133 would prohibit the cost of a financial statement audit conducted in accordance with GAAS or *Government Auditing Standards* 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.

The allowability of audit costs is discussed in greater detail in paragraph 2.12.

### ***When the Subrecipient Monitoring System Is Not Sufficient***

- 9.33 The auditor may determine that the pass-through entity's subrecipient-monitoring system is not sufficient to ensure subrecipient's compliance with laws, regulations, and the provisions of grants and contracts. In this situation, the auditor should report a reportable condition (and possibly a material weakness) and consider whether the insufficient monitoring system represents an instance of noncompliance that should be reported as a compliance finding. The effect of the noncompliance on the opinion on compliance for major programs is primarily a function of the pervasiveness of the lack of monitoring and the materiality of subrecipient funding to a program. For example, if the pass-through entity did not perform subrecipient-monitoring procedures and 90 percent of the program was passed through to subrecipients, an opinion modification would likely be warranted. This would likely be the case even if the scope of the audit was expanded to include additional audit procedures to determine that the subrecipients actually complied with laws and regulations.
- 9.34 There may be instances in which the pass-through entity asks the auditor to perform additional procedures to determine the compliance of a subrecipient (such as conducting tests of records at the subrecipient's site). This would be considered an expansion of the scope of the audit. The auditor should be aware that such an expansion of the scope of the audit would not be sufficient to remedy the reportable condition (or material weakness) and, if applicable, noncompliance of the pass-through entity's monitoring system. However, an expansion of the scope of the audit may remedy the noncompliance related to the type of compliance requirement being tested (for example, eligibility).
- 9.35 The auditor should also consider any implications of an insufficient subrecipient-monitoring system on the opinion on the financial statements. If amounts passed through to subrecipients are considered material to the financial statements

of the pass-through entity, the auditor should determine whether the report on the financial statements should be modified. Before making this determination, the auditor should take into consideration any evidential matter that may be available to the auditor (such as subrecipients' Circular A-133 audit reports and other financial reports that may have been submitted to the pass-through entity) that could indicate that the subrecipients administered the program in compliance with laws and regulations. Further, the auditor should also consider whether it is necessary to report an internal control or compliance finding in the report issued to meet the requirements of *Government Auditing Standards*.

## **Reporting Considerations**

### ***Schedule of Expenditures of Federal Awards***

9.36 Circular A-133 states that, to the extent practical, pass-through entities should identify in the schedule of expenditures of federal awards the total amount provided to subrecipients from each federal program (see chapter 5 for an additional discussion of the schedule). If a pass-through entity is unable to identify amounts provided to subrecipients, the auditor should consider whether a reportable condition (and possibly a material weakness) should be reported. The auditor should also consider whether material noncompliance (for subrecipient monitoring) that is required to be reported as an audit finding has occurred.

### ***Evaluation of Audit Findings***

9.37 Circular A-133 requires the auditor to 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*, whether or not the finding can be quantified. For example, the auditor may discover that a pass-through entity consistently failed to provide its subrecipients with federal award information, including applicable compliance requirements. The pertinent audit objective included in the *Compliance Supplement* and 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.

### ***Effect of Subrecipients' Noncompliance on the Pass-Through Entity's Report***

- 9.38 The instances of noncompliance reported in subrecipients' audit reports are not required to be included in the pass-through entity's audit report. However, the auditor of the pass-through entity should consider the effects of reported instances of subrecipient noncompliance or indications of weaknesses in the pass-through entity's subrecipient-monitoring system that could have a material effect on each of the pass-through entity's major programs.

### ***Adjustment of Pass-Through Entity Financial Records and Reports***

- 9.39 Questioned costs at the subrecipient level that are found to be unallowable by the pass-through entity may require the pass-through entity to adjust its financial records and its federal expenditure reports. The total of allowable program costs in excess of required expenditure levels and the requirements of individual programs regarding the timing of claims will affect whether the pass-through entity will need to reflect a liability to the awarding agency in its financial statements. As part of the finding-resolution process, the pass-through entity should estimate the total unallowable costs that are associated with each subrecipient finding and consider the need to adjust financial records and federal expenditure reports. The failure of the pass-through entity to adjust its records and federal reports should be considered by the auditor in forming an opinion on compliance for major programs.

### **For-Profit Subrecipients**

- 9.40 Since Circular A-133 does not apply to for-profit subrecipients, the pass-through entity is responsible for establish-

ing requirements, as necessary, to ensure compliance by for-profit subrecipients. Circular A-133 states that 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. The auditor's responsibilities related to for-profit subrecipients are similar to those of not-for-profit subrecipients, see paragraphs 9.24 through 9.35 (as applicable) for a further discussion of subrecipient monitoring.

## **Non-U.S.-Based Entities**

9.41 Circular A-133 does not apply to non-U.S.-based entities expending federal awards received either directly as a recipient or indirectly as a subrecipient (see paragraph 2.6 for a further discussion of non-U.S.-based entities). Therefore, the responsibilities that a pass-through entity and its auditor have for a non-U.S.-based entity are the same as those for a for-profit subrecipient (see paragraph 9.40).

## **State Designation of a Cluster of Programs**

9.42 Circular A-133 includes a provision that allows a state to designate as a cluster a grouping of closely related programs that share common compliance requirements. When designating a cluster of programs, a state is required by Circular A-133 to identify the federal awards included in the cluster and to advise subrecipients of the compliance requirements applicable to the cluster. See paragraphs 1.18, 1.19, 2.18, 5.6, 7.4, and 8.30 for additional discussion of clusters.

## **Circular A-133 Audit Considerations of Subrecipients**

9.43 Auditors of subrecipients should be aware that subrecipients have additional considerations under Circular A-133. These considerations are related to additional compliance requirements established by the pass-through entity, infor-

mation included in the schedule of expenditures of federal awards, audit findings, and the submission of the report.

## **Additional Compliance Requirements Established by Pass-Through Entities**

9.44 Federal awards are normally distributed to subrecipients only on the basis of properly completed and approved awards. These written agreements require subrecipients to comply with the requirements of the federal agency and, in some instances, additional requirements established by the pass-through entity. Hence, in addition to providing an audit satisfying the requirements of Circular A-133, the auditor may be engaged to test compliance with requirements specified by the pass-through entity.

## **Information Included in the Schedule of Expenditures of Federal Awards**

9.45 For federal awards received as a subrecipient, the schedule of expenditures of federal awards is required to include the name of the pass-through entity and identifying number assigned by the pass-through entity. Circular A-133 states that to make the schedule easier to use, subrecipients may choose to provide information requested by federal awarding agencies and pass-through entities, although this information is not required. Chapter 5 includes more detailed information about the schedule.

## **Audit Findings**

9.46 Audit findings (for example, internal control findings, compliance findings, questioned costs, or fraud) that relate to the same issue should be presented as a single audit finding. Circular A-133 states that where practical, audit findings should be organized by federal agency or pass-through entity (see chapter 10 for an additional discussion of audit findings).

## **Submission of Report**

9.47 Section 320(e) of Circular A-133 has additional report-submission responsibilities for subrecipients. When a subre-

recipient is not required to submit a reporting package to the pass-through entity (because it has no audit findings or the summary schedule of prior audit findings does not report the status of any audit findings), the subrecipient is required to provide written notification of this to the pass-through entity. The required contents of the written notification and the submission of the report by subrecipients are discussed in paragraph 10.76.

## CHAPTER 10

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# Auditor Reporting Requirements and Other Communication Considerations in a Single Audit

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### Overview

- 10.1 In this chapter the auditor's reporting requirements and other communication considerations in a single audit under Circular A-133 are discussed. The auditor's reporting requirements in a program-specific audit are discussed in chapter 11.
- 10.2 The auditor's reporting responsibilities in a single audit are driven by the three levels of auditing standards and requirements: GAAS, *Government Auditing Standards*, and Circular A-133. These standards and requirements expand the level of auditor responsibility from reporting on an auditee's financial statements to also reporting on internal control and on compliance. The auditor has additional reporting responsibilities for the audit of the financial statements in accordance with *Government Auditing Standards* (see chapter 4), and for the compliance audit applicable to major programs in accordance with Circular A-133 (see chapters 6 through 8). The auditor also has additional communication considerations under GAAS and *Government Auditing Standards* related to matters noted in the single audit.

### Circular A-133 Requirements

#### *Auditor's Reports*

- 10.3 Circular A-133 requires the auditor's report(s) to include—
- An opinion (or disclaimer of opinion) on whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP) (see paragraph 10.12)

for a discussion of the basis of accounting) and an opinion (or a disclaimer of opinion) on 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.

- A report on the internal control related to the financial statements and on the internal control related to major programs. This report must describe the scope of testing of internal control and the results of the tests and, where applicable, must refer to the separate schedule of findings and questioned costs.
- 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 must also include an opinion (or a disclaimer of opinion) on whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on each major program, and where applicable, must refer to the separate schedule of findings and questioned costs.
- A schedule of findings and questioned costs (see paragraphs 10.55 through 10.67).

The auditor's reports recommended in this SOP are described in paragraphs 10.8 through 10.10 below.

### **Data Collection Form**

- 10.4 Circular A-133 also requires the auditor to complete applicable sections and sign a data collection form that summarizes the auditor's results, findings, and questioned costs (see paragraphs 10.71 through 10.73).

### **Other Communication Considerations**

- 10.5 The auditor has certain additional communication considerations under GAAS and *Government Auditing Standards* related to internal control, noncompliance, fraud, illegal acts, and other matters noted in the single audit (see paragraphs 10.13 through 10.30).

## Reporting Package

- 10.6 The auditee is required to submit a reporting package that includes the following:
- Financial statements and a supplementary schedule of expenditures of federal awards (see chapters 4 and 5);
  - Auditor's reports (see paragraphs 10.8 through 10.10);
  - A summary schedule of prior audit findings (see paragraphs 10.68 through 10.70); and
  - A corrective action plan (see paragraphs 10.68 through 10.70).
- 10.7 Although not part of the reporting package, the report submission to the Federal Audit Clearinghouse (FAC) must also include the data collection form described in paragraphs 10.71 through 10.73. The requirements for report submission are discussed in paragraphs 10.74 through 10.79.

## Recommended Auditor's Reports

- 10.8 Reporting on a financial statement audit and on the compliance requirements applicable to each major program involves varying levels of materiality and different forms of reporting. Circular A-133 states that 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 the circular. In an effort to make the reports understandable and to reduce the number of reports issued, this SOP recommends that the following reports be issued:
- a. An opinion on the financial statements and on the supplementary schedule of expenditures of federal awards (see paragraph 10.35 through 10.37)<sup>1</sup>
  - b. A report on compliance and on internal control over financial reporting based on an audit of financial statements performed in accordance with *Govern-*

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1. Note that in certain circumstances the auditor may report on the schedule of expenditures of federal awards in his or her report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with Circular A-133. See paragraph 10.36 for a further discussion.

*ment Auditing Standards* (see paragraphs 10.38 through 10.40)

- c. A report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with Circular A-133 (see paragraphs 10.46 through 10.54)
- d. A schedule of findings and questioned costs (see paragraphs 10.55 through 10.67)

10.9 Example reports are provided in appendix D of this SOP. As noted previously, those reports combine reports on compliance and internal control at the financial statement audit level and at the major program compliance audit level. Auditors need to understand the intended purpose of the reports and should tailor the reporting to the specific auditee situation. Because the reports issued to comply with Circular A-133 involve varying levels of materiality and different forms of reporting, auditors should exercise care in issuing reports to ensure that they meet all of the varying reporting requirements of GAAS, *Government Auditing Standards*, and Circular A-133. The basic elements of each of the recommended reports are discussed later in this chapter. Professional judgment should be exercised in any situation not specifically addressed in this SOP.

10.10 Table 10.1 provides a matrix depicting the recommended auditor's reports in a single audit required by GAAS, *Government Auditing Standards*, and Circular A-133.

**TABLE 10.1 Recommended Reporting in Single Audits**

Report	Required by—		
	GAAS	<i>Government Auditing Standards</i>	Circular A-133
Opinion (or disclaimer of opinion) on financial statements and supplementary schedule of expenditures of federal awards	X	X	X
Report on compliance and on internal control over financial reporting based on an audit of financial statements		X	X



Report	Required by—		
	GAAS	Government Auditing Standards	Circular A-133
Report on compliance and internal control over compliance applicable to each major program (this report must include an opinion [or a disclaimer of opinion] on compliance)			X
Schedule of findings and questioned costs			X

## **Reporting on the Financial Statements and Supplementary Schedule of Expenditures of Federal Awards in Accordance With GAAS and Government Auditing Standards**

10.11 In this section the reporting and additional communication requirements under GAAS and *Government Auditing Standards* that are related to a financial statement audit and the supplementary schedule of expenditures of federal awards are discussed.

### **Basis of Accounting**

10.12 Circular A-133 and *Government Auditing Standards* do not prescribe the basis of accounting that must be used by auditees to prepare their financial statements and the schedule of expenditures of federal awards. However, auditees are required to disclose the basis of accounting and the significant accounting policies used in preparing the financial statements and the schedule of expenditures of federal awards. The auditee must also be able to reconcile amounts presented in the financial statements to related amounts included in the schedule of expenditures of federal awards. The auditor is required to report whether the financial statements are presented fairly in all material respects in conformity with 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 (see paragraphs 4.3 and 10.13 for a discussion of the auditor's responsibilities when the auditee prepares its financial statements in conformity with a comprehensive basis of accounting other than GAAP).

## GAAS Requirements

- 10.13 The applicable reporting requirements are established in SAS No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 508). For an auditee that prepares its financial statements in conformity with a basis of accounting other than GAAP, auditors should follow the guidance in SAS No. 62, *Special Reports*. In reporting on the supplementary schedule of expenditures of federal awards, auditors should follow the guidance in SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1, AU sec. 551). Auditors may also refer to the AICPA Audit and Accounting Guides *Not-For-Profit Organizations*, *Audits of State and Local Governmental Units*, *Health Care Organizations*, and *Audits of Colleges and Universities*<sup>2</sup> for additional guidance on reporting on the financial statements of specific industries. See also paragraphs 10.17 through 10.30 for a discussion of additional reporting and communication requirements.
- 10.14 SAS No. 61, *Communication With Audit Committees*, requires the auditor to determine that certain matters related to the conduct of an audit are communicated to those who have responsibility for the oversight of the financial reporting process. Matters to be communicated include (among other things) the auditor's responsibilities, significant accounting policies, management judgments and accounting estimates, significant audit adjustments, disagreements with management, and difficulties encountered in performing the audit. In addition to the SAS No. 61 requirements described above, *Government Auditing Standards* also requires the auditor to communicate certain information to the audit committee. See paragraph 10.16 for a further discussion.

## Government Auditing Standards Requirements

- 10.15 *Government Auditing Standards* requires that in addition to reporting on the financial statements, the auditor report

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2. Auditors should note that although *Audits of Colleges and Universities* has been superseded by *Not-for-Profit Organizations*, it continues to be applicable in a governmental environment (that is, public institutions).

on (1) compliance with laws, regulations, and provisions of contracts and grant agreements that could have a direct and material effect on the financial statements amounts and (2) the scope of testing of the auditee's internal control over financial reporting and on the results of the tests.

10.16 The reporting standards for financial audits in *Government Auditing Standards* contain five additional reporting standards for financial statement audits beyond GAAS (see also paragraphs 3.19 through 3.21):

- a. Auditors should communicate certain information related to the conduct and reporting of the audit to the audit committee or to the individuals with whom they have contracted for the audit. Such matters include the auditor's responsibility in a financial statement audit, as well as the nature of any additional testing of internal control and compliance required by laws or regulations. To help audit committees and other responsible parties understand the limitations of auditors' responsibilities for testing and reporting on internal control and compliance, auditors should contrast those responsibilities with other financial related audits of controls and compliance. The communication may be oral or in writing. If the information is communicated orally, the auditor is required to document the communication in the working papers (see paragraphs 5.5 through 5.10 of *Government Auditing Standards* and paragraphs 3.19 through 3.20 of this SOP for a further discussion).
- b. When the report on the financial statement is submitted to comply with a requirement for an audit in accordance with *Government Auditing Standards*, audit reports should state that the audit was made in accordance with generally accepted government auditing standards. This SOP recommends the following language be included in the auditor's report to meet this requirement: "we conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*

issued by the Comptroller General of the United States.”<sup>3</sup> *Government Auditing Standards* also acknowledges that an auditee may need a financial statement audit for purposes other than to comply with a requirement calling for an audit in accordance with *Government Auditing Standards*. For example, the auditee may need a financial statement audit to issue bonds. In this case, *Government Auditing Standards* permits auditors to issue a separate report on the financial statements conforming only to the requirements of GAAS (see paragraphs 5.11 through 5.14 of *Government Auditing Standards*).

- c. The report on the audit of the financial statements should either (1) describe the scope of the auditor’s testing of compliance with laws and regulations and internal control and present the results of those tests or (2) refer to separate reports containing that information (see paragraphs 5.15 through 5.28 of *Government Auditing Standards*). The financial statement reporting recommended in this SOP (appendix D, examples 1 and 1a), illustrates the second option to refer to a separate report on compliance with certain provisions of laws, regulations, contracts, and grants and on internal control over financial reporting. In presenting the results of tests, the auditor should report fraud, illegal acts, other material noncompliance, and reportable conditions in internal control (see paragraphs 10.17 through 10.30). In some circumstances, the auditor should report fraud and illegal acts directly to parties external to the audited entity (see paragraphs 10.23 through 10.25).
- d. If certain information is prohibited from general disclosure (that is, prohibited from general disclosure by federal, state, or local laws or regulations), the audit report should state the nature of the information omitted and the requirement that makes the omission necessary (see paragraphs 5.29 through 5.31 of *Government Auditing Standards*).

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3. The standards applicable to financial audits include the general, fieldwork, and reporting standards described in chapters 3, 4, and 5 of *Government Auditing Standards*.

- e. Written audit reports are to be submitted by the audit organization to the appropriate officials of the auditee and to the appropriate officials of the organizations requiring or arranging for the audit (including external funding organizations), unless legal restrictions prevent it.<sup>4</sup> Copies of the reports should also be sent to other officials who have legal oversight authority or who may be responsible for acting on audit findings and recommendations and to others authorized to receive such reports. Unless restricted by law or regulation, copies should be made available for public inspection (see paragraphs 5.32 through 5.35 of *Government Auditing Standards*).

## **Fraud, Illegal Acts, and Other Noncompliance**

### **GAAS Requirements**

10.17 In SAS No. 54, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1, AU sec. 317.17), the auditor's responsibilities with respect to the consideration of illegal acts,<sup>5</sup> including communications with the audit committee or others with equivalent authority or responsibility are discussed.<sup>6</sup> Paragraph 17 of SAS No. 54 requires the auditor to assure himself or herself that the audit committee or others with equivalent authority and responsibility are adequately informed with respect to illegal acts that come to the auditor's attention. The auditor need not communicate matters that are clearly inconsequential and may reach agreement in advance with the audit committee on the nature of such matters to be communicated. The communication should describe the act, the circumstances of its occurrence, and its effect on the financial statements. If senior management is involved, the auditor should communicate directly with the audit committee. The communication may be oral or written. If the communication is oral, the auditor should document it. Paragraphs 4.24 through 4.31 summarize the

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4. Note that when public accountants are engaged, the engaging organization should ensure that the report is distributed appropriately.

5. SAS No. 54 defines the term *illegal acts* as violations of laws or government regulations.

6. For auditees that do not have audit committees, the phrase "others with equivalent authority and responsibility" may include the board of directors, the board of trustees, or the owner in owner-managed entities.

other requirements of SAS No. 54. The auditor should also consider the effect of any noncompliance on the financial statements, and should modify the auditor's report on those financial statements as necessary in accordance with SAS No. 58.

10.18 The auditor's responsibilities for communications about fraud to management, the audit committee, and others based on a financial statement audit in accordance with GAAS are discussed in SAS No. 82, *Consideration of Fraud in a Financial Statement Audit*. Whenever the auditor has determined that there is evidence that fraud may exist, that matter should be brought to the attention of an appropriate level of management. This is generally appropriate even if the matter might be considered inconsequential, such as a minor defalcation by an employee at a low level in the auditee's organization. Fraud involving senior management and fraud that causes a material misstatement of the financial statements should be reported directly to the audit committee. The disclosure of possible fraud to parties other than the auditee's senior management and its audit committee is ordinarily not part of the auditor's responsibility and would ordinarily be precluded by the auditor's ethical or legal obligations of confidentiality unless the matter is reflected in the auditor's report. The auditor should recognize, however, that in the following circumstances a duty to disclose outside the auditee may exist:

- To comply with certain legal and regulatory requirements
- To a successor auditor when the successor makes inquiries in accordance with SAS No. 84, *Communications Between Predecessor and Successor Auditors*
- In response to a subpoena
- To a funding agency or other specified agency in accordance with the requirements for audits of entities that receive governmental financial assistance (see paragraphs 10.23 through 10.25)

10.19 When the auditor, as a result of the assessment of the risk of material misstatement due to fraud, has identified risk factors that have continuing control implications (whether

or not transactions or adjustments that could be the result of fraud have been detected), the auditor should consider whether these risk factors represent reportable conditions that relate to the auditee's internal control and that should be communicated to senior management and the audit committee (see paragraphs 10.26 through 10.30). The auditor may also wish to communicate other risk factors that are identified, when the auditee can reasonably take actions to address the risk.

- 10.20 In paragraphs 38 through 40 of SAS No. 82 (AICPA, *Professional Standards*, vol. 1, AU secs. 316.38–40), the communication requirements of SAS No. 82 are further discussed. In paragraphs 4.32 through 4.37 of this SOP, the other requirements of SAS No. 82 are summarized. See paragraphs 6.7 through 6.12 for a discussion of the auditor's consideration of fraud risk in an audit of an auditee's compliance with specified requirements applicable to its major programs.

### **Government Auditing Standards Requirements**

- 10.21 With regard to fraud and illegal acts, *Government Auditing Standards* requires auditors to report relevant information (in writing) when the auditor concludes, based on evidence obtained, that fraud or an illegal act has occurred or is likely to have occurred.<sup>7</sup> Auditors do not need to report information about fraud or illegal acts that is clearly inconsequential. Therefore, auditors are required to present in the report the same fraud and illegal acts that they report to audit committees under GAAS (see paragraphs 10.17 through 10.20). *Government Auditing Standards* also requires auditors to report other noncompliance (for example, a violation of a contract provision) that is material to the financial statements. In presenting fraud, illegal acts, or other noncompliance that are required to be reported, auditors should follow the report contents standards in chapter 7 of *Government Auditing Standards* for objectives, scope, and methodology; audit results; the views of responsible officials; and report presentation standards (as appropriate).

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7. The term *fraud*, as used in SAS No. 82, is synonymous with *irregularities* as used in *Government Auditing Standards*. Therefore, in discussing the requirements of *Government Auditing Standards*, this SOP will use the term *fraud* instead of the term *irregularities*.

10.22 When auditors detect fraud, illegal acts, or other noncompliance that do not meet the criteria in paragraph 5.18 of *Government Auditing Standards* for reporting (summarized in paragraph 10.21), paragraph 5.20 of *Government Auditing Standards* requires auditors to communicate those findings to the auditee, preferably in writing. If auditors have communicated those findings in a management letter to top management, they should refer to that management letter when they are reporting on compliance. Auditors should document in their working papers all communications to the auditee about fraud, illegal acts, or other noncompliance.

### **Direct Reporting of Fraud and Illegal Acts**

10.23 Paragraphs 5.21 through 5.25 of *Government Auditing Standards* provide guidance on the direct reporting of fraud and illegal acts. *Government Auditing Standards* requires that in addition to any legal requirements for the direct reporting of fraud or illegal acts, auditors must report fraud or illegal acts directly to parties outside the auditee in the following two circumstances (auditors should meet these requirement even if they have resigned or been dismissed from the audit):

- a. The auditee may be required by law or regulation to report certain fraud or illegal acts to specified external parties (for example, to a federal inspector general or a state attorney general). If auditors have communicated such fraud or illegal acts to the auditee, and it fails to report them, then auditors should communicate their awareness of that failure to the auditee's governing body. If the auditee does not make the required report as soon as practicable after the auditors' communication with its governing body, then the auditors should report the fraud or illegal acts directly to the external party specified in the law or regulation.
- b. When fraud or an illegal act involves assistance received directly or indirectly from a government agency, auditors may have a duty to report it directly if management fails to take remedial steps. If



auditors conclude that such failure is likely to cause them to depart from the standard report on the financial statement or resign from the audit, then they should communicate that conclusion to the auditee's governing body. Then, if the auditee does not report the fraud or illegal act as soon as practicable to the entity that provided the government assistance, the auditors should report the fraud or illegal act directly to that entity.

- 10.24 In both of these situations, auditors should obtain sufficient, competent, and relevant evidence (for example, by confirmation with outside parties) to corroborate assertions by management that it has reported fraud or illegal acts. If they are unable to do so, the auditors should report the fraud or illegal acts directly, as discussed previously.
- 10.25 Paragraph 4.16 of *Government Auditing Standards* reminds auditors that under some circumstances, laws, regulations, or policies may require them to report indications of certain types of fraud or illegal acts promptly to law enforcement or investigatory authorities. When auditors conclude that this type of fraud or illegal act either has occurred or is likely to have occurred, they should ask those authorities, legal counsel, or both, if reporting certain information about that fraud or illegal act would compromise investigative or legal proceedings. Auditors should limit their reporting to matters that would not compromise those proceedings, such as information that is already a part of the public record.

## **Internal Control Over Financial Reporting**

- 10.26 SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit*, provides guidance in identifying and reporting conditions that relate to an auditee's internal control observed during an audit of financial statements. In addition to providing guidance on communicating reportable conditions and identifying material weaknesses in the internal control over financial reporting, SAS No. 60 states that because timely communication may be important, the auditor may choose to communicate significant matters related to the internal control over financial re-

porting during the course of the audit rather than after the audit is concluded.

- 10.27 Written reporting on internal control matters under *Government Auditing Standards* is based on the auditor's consideration of the internal control over financial reporting as required by SAS No. 55, *Consideration of Internal Control in a Financial Statement Audit*, as amended by SAS No. 78, *Consideration of Internal Control in a Financial Statement Audit: An Amendment to SAS No. 55*. The report does not express an opinion on the auditee's internal control over financial reporting, but rather describes the extent of the work performed, as required by SAS No. 55. The report includes the requirements of SAS No. 60, as well as the additional requirements of *Government Auditing Standards*.
- 10.28 With regard to matters noted in an audit that relate to the internal control over financial reporting, paragraph 5.26 of *Government Auditing Standards* requires auditors to report deficiencies in internal control that they consider to be reportable conditions as defined by SAS No. 60. Paragraph 17 of SAS No. 60 prohibits the auditor from issuing a written report representing that no reportable conditions were noted during an audit. The illustrative report in example 2 of appendix D provides recommended language that satisfies the requirements of *Government Auditing Standards* when no reportable conditions are noted during an audit. In reporting reportable conditions, auditors are required to identify those that are individually or cumulatively material weaknesses. Auditors should follow the report contents standards in chapter 7 of *Government Auditing Standards* when reporting reportable conditions or material weaknesses. The illustrative report in example 2a of appendix D provides recommended language that satisfies the requirements of *Government Auditing Standards* when reportable conditions (whether or not they are considered to be material weaknesses) are noted during an audit.
- 10.29 Paragraph 5.28 of *Government Auditing Standards* states that when auditors detect deficiencies in the internal control that are not reportable conditions, they should communicate those deficiencies to the auditee, preferably in writing. If the auditors have communicated those deficiencies in

internal control in a management letter to top management, they should refer to that management letter when they report on internal control (examples 2 and 2a of appendix D illustrate such a reference to the management letter). All communications to the auditee about deficiencies in the internal control should be documented in the working papers.

10.30 The following table summarizes the differences between SAS No. 60 and *Government Auditing Standards* with respect to reporting internal control matters.

	<i>Government Auditing Standards</i>	SAS No. 60
When is reporting required?	In every financial statement audit	When reportable conditions are noted
What is the form of the report?	Written	Oral or written, preferably in writing
Should the auditor separately identify those reportable conditions that are significant enough to be material weaknesses?	Yes	Permitted but not required

### **Reporting When Portions of a Governmental Reporting Entity Do Not Have an Audit in Accordance With *Government Auditing Standards***

10.31 Since the implementation of Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*, it is becoming more frequent for governments that are required to have an audit in accordance with *Government Auditing Standards* to include as part of the reporting entity component units that are not required to have such an audit. When this occurs, the auditor should consider modifying his or her report on the financial statements and also the report issued to meet the requirements of *Government Auditing Standards*.

10.32 With regard to the report on the financial statements of the reporting entity, if a material component unit or fund is not required to have an audit in accordance with *Government Auditing Standards* and the report on the financial statements is required to state that the audit was performed in accordance with *Government Auditing Standards*, the auditor should modify the scope paragraph of the report on the financial statements to indicate the portion of the re-

porting entity that was not audited in accordance with *Government Auditing Standards*. Example wording that could be used in this situation follows:

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of [name of fund or component unit] were not audited in accordance with *Government Auditing Standards*. An audit includes examining...

10.33 With regard to the report issued on compliance and on the internal control over financial reporting based on an audit of financial statements performed in accordance with *Government Auditing Standards*, the auditor should modify the scope paragraph of example 2 or 2a of appendix D to indicate the portion of the reporting entity that was not audited in accordance with *Government Auditing Standards*. Example wording that could be used in this situation follows:

We have audited the financial statements of Example Entity as of and for the year ended June 30, 19X1, and have issued our report thereon dated August 15, 19X1. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The financial statements of [name of fund or component unit] were not audited in accordance with *Government Auditing Standards*.

## **Implementing Regulations of Certain Federal Awarding Agencies May Define Entity to Be Audited Differently Than GAAP**

10.34 The regulations implementing Circular A-133 may define the entity to be audited for single audit purposes differently than the reporting entity would be defined in accordance with GAAP. For example, SOP 94-3, *Reporting of*

*Related Entities by Not-for-Profit Organizations*, requires presentation of consolidated financial statements when one NPO (the parent) controls the voting majority of the Board of and has an economic interest in another NPO. If the regulations of the federal agency that provides federal awards to the parent define the entity for single audit purposes to consist of only the parent, audited parent-only financial statements instead of consolidated financial statements must be submitted to comply with these regulations. If consolidated financial statements are not also prepared as required by GAAP, the auditor should consider whether other than an unqualified opinion due to a material departure from GAAP should be expressed on the parent-only financial statements. See paragraphs 35 through 60 of SAS No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 508.35–.60) for guidance on reporting when there is a departure from GAAP.

## **Opinion on the Financial Statements and on the Supplementary Schedule of Expenditures of Federal Awards**

### ***Report Requirements***

10.35 The auditor's standard report on the financial statements and on the supplementary schedule of expenditures of federal awards identifies the financial statements audited in an opening (introductory) paragraph, describes the nature of an audit in a scope paragraph, and expresses the auditor's opinion on the financial statements and supplementary schedule of expenditures of federal awards in separate opinion paragraphs. The basic elements of the report are—

- a. A title that includes the word *independent*.
- b. A statement that the financial statements identified in the report were audited.
- c. A statement that the financial statements are the responsibility of the auditee's management and that the auditor's responsibility is to express an opinion on the financial statements based on his or her audit.

- d. A statement that the audit was conducted in accordance with GAAS and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.<sup>8</sup>
- e. A statement that those standards require that the auditor plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.
- f. A statement that an audit includes—
  - Examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements.
  - Assessing the accounting principles used and significant estimates made by management.
  - Evaluating the overall financial statement presentation.
- g. A statement that the auditor believes that the audit provides a reasonable basis for his or her opinion.
- h. For a government, an opinion on whether the financial statements present fairly, in all material respects, the financial position of the auditee as of the balance sheet date, and the results of its operations and the cash flows of its proprietary fund types and nonexpendable trust funds for the period then ended in conformity with GAAP; for a not-for-profit organization, an opinion on whether the financial statements present fairly, in all material respects, the financial position of the auditee as of the date of the statement of financial position, and the changes in its net assets and its cash flows for the period then ended in conformity with GAAP.<sup>9</sup>
- i. A reference to the separate report on compliance with certain provisions of laws, regulations, contracts, and grant agreements and on the internal control

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8. See note 3.

9. If an auditee prepares its financial statements in conformity with a comprehensive basis of accounting other than GAAP, the auditor is still required to express or disclaim an opinion and should follow the reporting in SAS No. 62, *Special Reports*.

over financial reporting prepared in accordance with *Government Auditing Standards*.<sup>10</sup> If this reporting is included in the report on the financial statements, this reference is not required (this SOP recommends separate reporting). See paragraph 10.16.

- j. A description of the accompanying supplementary information (for example, the schedule of expenditures of federal awards, combining and individual fund and account group financial statements and schedules, etc.). This identification may be by descriptive title or by page number of the document.
- k. A statement that the accompanying supplementary information, including the schedule of expenditures of federal awards required by Circular A-133, is presented for purposes of additional analysis and is not a required part of the financial statements.<sup>11</sup> See paragraph 10.36.
- l. An opinion on whether the accompanying supplementary information is fairly stated, in all material respects, in relation to the financial statements taken as a whole.
- m. The manual or printed signature of the auditor's firm.
- n. The date of the audit report.

### ***Reporting on the Schedule of Expenditures of Federal Awards***

10.36 This SOP recommends that the auditor report on the schedule of expenditures of federal awards in the report on the financial statements. However, some entities do not present the schedule with the financial statements (that is, a separate single audit package is issued). In such a circumstance, the required reporting on the schedule may be

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10. See paragraphs 10.15 through 10.16 and 10.21 through 10.30 for a discussion of reporting on compliance and on the internal control based on a financial statement audit in accordance with *Government Auditing Standards*.

11. If the report on the financial statements is issued for an audit that is not subject to Circular A-133 (that is, an audit in accordance with GAAS and *Government Auditing Standards* only), this reference to the schedule of expenditures of federal awards and Circular A-133 should be deleted.

incorporated in the report issued to meet the requirements of Circular A-133. Examples 3 (note 34) and 3a (note 40) of appendix D, illustrate how to incorporate the reporting on the schedule into the Circular A-133 report. See also paragraphs 10.50 through 10.52 for information on dating the reports in this situation and paragraph 10.13 for a further discussion of reporting on the schedule.

- 10.37 Examples of the auditor's opinion on the financial statements and on the supplementary schedule of expenditures of federal awards are presented in examples 1 and 1a of appendix D.

### **Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards***

- 10.38 This SOP recommends that the reporting on the scope of the auditor's testing of compliance and on the internal control over financial reporting based on an audit of the financial statements as required by *Government Auditing Standards* be combined in one report (see paragraphs 10.8 through 10.10).

- 10.39 The basic elements of the auditor's standard report on compliance and on the internal control over financial reporting (see paragraph 4.12) based on an audit of the financial statements in accordance with *Government Auditing Standards* are—

- a. A statement that the auditor has audited the financial statements of the auditee and a reference to the auditor's report on the financial statements, including a description of any departure from the standard report.
- b. A statement that the audit was conducted in accordance with GAAS and with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.<sup>12</sup>

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12. See note 3.



- c. A statement that as part of obtaining reasonable assurance about whether the auditee's financial statements are free of material misstatement, the auditor performed tests of the auditee's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts.
- d. A statement that providing an opinion on compliance with those provisions was not an objective of the audit and that, accordingly, the auditor does not express such an opinion.
- e. A statement that notes whether the results of tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*<sup>13</sup> and, if they are, describes the instances of noncompliance or refers to the schedule of findings and questioned costs in which they are described.<sup>14</sup>
- f. If applicable, a statement that certain immaterial instances of noncompliance were communicated to management in a separate letter.<sup>15</sup>
- g. A statement that in planning and performing the audit, the auditor considered the auditee's internal control over financial reporting in order to determine the auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control over financial reporting.
- h. If applicable, a statement that reportable conditions were noted and the definition of a reportable condition.

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13. See paragraph 10.21 for a discussion of noncompliance matters that need to be reported under *Government Auditing Standards*.

14. For an audit that is not subject to Circular A-133 (that is, in accordance with *Government Auditing Standards* only), any reportable instances of noncompliance, reportable conditions, and material weaknesses can either be described in the body of the report or the report can refer to a separate schedule that summarizes the findings noted. This statement should be modified accordingly. For an audit in accordance with Circular A-133, all findings, including those required to be reported under *Government Auditing Standards*, must be included in the schedule of findings and questioned costs.

15. See paragraph 10.22 for a discussion of reporting other noncompliance matters to top management in accordance with *Government Auditing Standards*.

- i. If no reportable conditions are noted, a statement that the auditor's consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses; if reportable conditions are noted, a statement that the auditor's consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.
- j. If applicable, a description of the reportable conditions noted or a reference to the schedule of findings and questioned costs in which the reportable conditions are described.<sup>16</sup>
- k. The definition of a material weakness.
  - l. If applicable, a statement about whether the auditor believes any of the reportable conditions noted are material weaknesses and, if they are, describes the material weaknesses noted or refers to the schedule of findings and questioned costs in which they are described.<sup>17</sup> If there are no reportable conditions noted, a statement is made that no material weaknesses were noted.
- m. If applicable, a statement that other matters involving the internal control over financial reporting were communicated to management in a separate letter.<sup>18</sup>
- n. A statement that the report is intended for the information of the audit committee, management, specified legislative or regulatory bodies, federal awarding agencies, and (if applicable) pass-through entities.<sup>19</sup>

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16. See note 14.

17. See note 14.

18. See paragraph 10.29 for a discussion of other internal control matters to be communicated to top management in accordance with *Government Auditing Standards*.

19. For an audit that is not subject to Circular A-133 (that is, in accordance with *Government Auditing Standards* only), the reference to federal awarding agencies and pass-through entities should be deleted.

If the report is a matter of public record, a statement should be added that the report is a matter of public record and its distribution is not limited.<sup>20</sup>

- o. The manual or printed signature of the auditor's firm.
- p. The date of the auditor's report.

10.40 Examples of the auditor's report on compliance and on the internal control over financial reporting based on an audit of the financial statements in accordance with *Government Auditing Standards* are included in examples 2 and 2a of appendix D.

## **Reporting on a Compliance Audit of Major Federal Programs**

10.41 In this section the auditor's reports that are issued based on a compliance audit of major programs in accordance with Circular A-133 are discussed. The report on compliance with requirements applicable to major programs expresses the auditor's opinion on whether the auditee complied with the requirements that, if noncompliance occurred, could have a direct and material effect on a major program. Although the guidance in SAS No. 58 addresses reporting on audited financial statements, auditors may find its guidance useful when reporting on a compliance audit of major programs.

## **Material Instances of Noncompliance**

10.42 When the audit of an auditee's compliance with requirements applicable to a major program detects material instances of noncompliance with those requirements, the auditor should express a qualified or adverse opinion. The auditor should state the basis for such an opinion in the report (see examples 3a and 5 of appendix D). The auditor should also consider the cumulative effect of all instances of noncompliance on the financial statements. See paragraphs 6.13 through 6.16 for a further discussion of material instances of noncompliance.

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20. When the report is not a matter of public record because of legal or other restrictions, this statement should not be added.

## Scope Limitations

- 10.43 Testing an auditee's compliance with laws, regulations, and the provisions of contracts or grant agreements (referred to as "compliance requirements") requires the auditor to make a comply/noncomply decision about an auditee's adherence to those compliance requirements. The auditor is able to express an unqualified opinion only if he or she has been able to apply all the procedures the auditor considers necessary in the circumstances. Restrictions on the scope of the audit—whether imposed by the client or by circumstances such as the timing of the auditor's work, an inability to obtain sufficient competent evidential matter, or an inadequacy in the accounting records—may require auditors to qualify their opinion or to disclaim an opinion. In these instances, the reasons for such a qualification or disclaimer of opinion should be described in the auditor's report. Furthermore, the auditor should consider the effects of such instances on his or her ability to express an unqualified opinion on the financial statements. See example 4 of appendix D for an illustration of a qualified opinion on compliance due to a scope limitation. \*
- 10.44 The auditor's decision to qualify or disclaim an opinion because of a scope limitation depends on his or her assessment of the importance of the omitted procedure(s) to his or her ability to form an opinion on compliance with requirements governing each major program. This assessment will be affected by the nature and magnitude of the potential effects of the matters in question and by their significance to each major program. When restrictions that significantly limit the scope of the audit are imposed by the client, the auditor generally should disclaim an opinion on compliance.
- 10.45 When disclaiming an opinion because of a scope limitation, the auditor should indicate in a separate paragraph all of the substantive reasons for the disclaimer. The auditor should state that the scope of his or her audit was not sufficient to warrant the expression of an opinion. The auditor should not identify the procedures that were performed or include a paragraph describing the characteristics of an audit (that is, the scope paragraph); to do so may tend to

overshadow the disclaimer. In addition, the auditor should disclose any reservations he or she has regarding compliance with applicable laws and regulations.

## **Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With Circular A-133**

### ***Report Requirements***

- 10.46 The basic elements of the auditor's standard report on compliance with requirements applicable to each major program and on the internal control over compliance (see paragraph 4.12) in accordance with Circular A-133 are—
- a. A statement that the auditor has audited the compliance of the auditee with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that are applicable to each of its major programs.
  - b. A statement that the auditee's major programs are identified in the summary of the auditor's results section of the accompanying schedule of findings and questioned costs (see paragraph 10.56).
  - c. A statement that compliance with the requirements of laws, regulations, contracts, and grants applicable to each of the auditee's major federal programs is the responsibility of the auditee's management, and that the auditor's responsibility is to express an opinion on the auditee's compliance based on the audit.
  - d. A statement that the audit of compliance was conducted in accordance with GAAS, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States,<sup>21</sup> and Circular A-133.
  - e. A statement that those standards and Circular A-133 require that the auditor plan and perform the audit to obtain reasonable assurance about whether non-compliance with the types of compliance require-

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21. See note 3.

ments that could have a direct and material effect on a major federal program occurred.

- f. A statement that an audit includes the examining, on a test basis, evidence about the auditee's compliance with those requirements and performing of such other procedures as the auditor considered necessary in the circumstances.
- g. A statement that the auditor believes that the audit provides a reasonable basis for the auditor's opinion.
- h. A statement that the audit does not provide a legal determination of the auditee's compliance with those requirements.
- i. If instances of noncompliance are noted that result in an opinion modification, a reference to a description in the accompanying schedule of findings and questioned costs, including—
  - The reference number(s) of the finding(s).
  - An identification of the type(s) of compliance requirements and related major program(s).
  - A statement that compliance with such requirements is necessary, in the auditor's opinion, for the auditee to comply with the requirements applicable to the program(s).
- j. An opinion on whether the auditee complied, in all material respects, with the types of compliance requirements that are applicable to each of its major federal programs.
- k. If applicable, a statement that the results of the auditing procedures disclosed instances of noncompliance that are required to be reported in accordance with Circular A-133 and a reference to the schedule of findings and questioned costs in which they are described.<sup>22</sup>
- l. A statement that the auditee's management is responsible for establishing and maintaining effective

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22. See paragraph 10.63 for a discussion of the audit findings that are required to be reported under Circular A-133.

internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs.

- m. A statement that in planning and performing the audit, the auditor considered the auditee's internal control over compliance with requirements that could have a direct and material effect on a major federal program, to determine the auditing procedures for the purpose of expressing an opinion on compliance and to test and report on the internal control over compliance in accordance with Circular A-133.
- n. If applicable, a statement that reportable conditions were noted and the definition of a reportable condition.
- o. If applicable, a reference to a description of reportable conditions noted in the accompanying schedule of findings and questioned costs, including the reference number of the finding(s).
- p. If no reportable conditions are noted, a statement that the auditor's consideration of the internal control over compliance would not necessarily disclose all matters in internal control that might be material weaknesses; if reportable conditions are noted, a statement that the auditor's consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.
- q. The definition of a material weakness.
- r. If applicable, a statement about whether the auditor believes any of the reportable conditions noted are material weaknesses and, if they are, a reference to a description of the material weaknesses in the schedule of findings and questioned costs, including the reference number of the finding(s). If there are no reportable conditions, a statement is made that no material weaknesses were noted.

- s. A statement that the report is intended for the information of the audit committee, management, specified legislative or regulatory bodies, federal awarding agencies, and (if applicable) pass-through entities. If the report is a matter of public record, a statement should be added that the report is a matter of public record and its distribution is not limited.<sup>23</sup>
- t. The manual or printed signature of the auditor's firm.
- u. The date of the auditor's report.

### ***Option to Report on the Schedule of Expenditures of Federal Awards***

10.47 This SOP recommends reporting on the schedule of expenditures of federal awards in the report on the financial statements. However, in certain circumstances (for example, when a separate single-audit package is issued), the required reporting on the schedule may be incorporated into the report described in paragraph 10.46. See paragraph 10.36 for a further discussion. Examples 3 (note 34) and 3a (note 40) of appendix D, illustrate this reporting option.

### ***No Requirement to Refer to Management Letter***

10.48 It is important to note that all audit findings required to be reported under Circular A-133 must be included in the schedule of findings and questioned costs (see paragraphs 10.55 through 10.56). A separate letter (that is, management letter) may not be used to communicate such matters to top management in lieu of reporting them as audit findings in accordance with Circular A-133. Since all reportable findings are included in the schedule, there is no requirement for the auditor to refer to the management letter in the report described in paragraph 10.46.

10.49 An example of the auditor's report on compliance with requirements applicable to each major program and on the internal control over compliance in accordance with Circular A-133 is presented in examples 3, 3a, 4, and 5 of appendix D.

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23. When the report is not a matter of public record because of legal or other restrictions, this statement should not be added.



## Other Reporting Considerations

### Dating of Reports

- 10.50 Since the report on the supplementary schedule of expenditures of federal awards indicates that the auditor is reporting “in relation to” the basic financial statements, it should carry the same date as that on the report on these statements. Furthermore, since the report on compliance and internal control over financial reporting, as required by *Government Auditing Standards*, relates to the audit of the financial statements and is based on the GAAS audit procedures performed, it should also carry the same date.
- 10.51 The auditor’s report on compliance and on the internal control over compliance related to major programs, as required by Circular A-133, should ordinarily have the same date as that of the other reports, but may carry a later date, because some of the audit work to satisfy Circular A-133 requirements may be done subsequent to the work on the financial statements. When this is the case, the reporting required by Circular A-133 should be dated at the later date (that is, when the fieldwork required to support the report on the audit of compliance is completed). The auditor should perform subsequent events procedures from the date of the report on the financial statements to the date of the report on the compliance audit in accordance with section 560, “Subsequent Events” of SAS No. 1 (AICPA, *Professional Standards*, vol. 1, AU sec. 560). If, after issuing the report on the financial statements, the auditor becomes aware of instances of noncompliance that could be material to such statements, he or she should follow the guidance in section 561, “Subsequent Discovery of Facts Existing at the Date of the Auditor’s Report” of SAS No. 1 (AICPA, *Professional Standards*, vol. 1, AU sec. 561).
- 10.52 This SOP recommends reporting on the schedule of expenditures of federal awards in the report on the financial statements. However, as noted in paragraphs 10.36 and 10.47, there may be circumstances in which the auditor reports on the schedule in the report on compliance and the internal control over compliance issued to meet Circular

A-133 requirements. In this situation, the report issued to meet Circular A-133 requirements must be dated the same as the report on the financial statements. This is because the report on the schedule is “in relation to” the basic financial statements. If using the same date is not possible because the work to satisfy Circular A-133 requirements is not complete as of the date of the financial statement report, the auditor has two options:

- a. The auditor can dual date the report issued to meet Circular A-133 requirements. The date relating to the portion of the report pertaining to the schedule of expenditures of federal awards would be the same as the date of the financial statement report. The date pertaining to the remainder of the report would be the date on which the work done to satisfy Circular A-133 requirements is completed. Refer to, section 530 “Dating of the Independent Auditor’s Report,” of SAS No. 1 (AICPA, *Professional Standards*, vol. 1, AU sec. 530).
- b. The auditor can issue a separate report on the schedule of expenditures of federal awards, dated the same date as that of the financial statement report.

In some instances, the auditor may be engaged to issue a stand-alone opinion on the schedule either as part of the report issued to meet the requirements of Circular A-133 or separately (dated the same as the Circular A-133 report). The auditor should follow the guidance in SAS No. 58 when issuing such a report.

## **Other Auditors**

- 10.53 When more than one independent auditor is involved in a single audit performed under Circular A-133, the auditor should refer to guidance in paragraphs 12 and 13 of SAS No. 58 (AICPA, *Professional Standards*, vol. 1, AU secs. 508.12–.13) regarding an opinion on financial statements based in part on the report of another auditor, as well as section 543, “Part of Audit Performed by Other Independent Auditors,” of SAS No. 1 (AICPA, *Professional Standards*, vol. 1, AU sec. 543).

## **When the Audit of Federal Awards Does Not Encompass the Entirety of the Auditee's Operations**

10.54 If the audit of federal awards did not encompass the entirety of the auditee's operations expending federal awards, the operations that are not included should be identified in a separate paragraph following the first paragraph of the report on major programs (see also the discussion in paragraph 3.25). An example of such a paragraph follows:

Example Entity's general-purpose financial statements include the operations of the [*identify component unit or department*], which received [*include dollar amount*] in federal awards which is not included in schedule during the year ended June 30, 19X1. Our audit, described below, did not include the operations of [*identify component unit or department*] because [*state the reason for the omission, such as the component unit engaged other auditors to perform an audit in accordance with OMB Circular A-133*].

## **Schedule of Findings and Questioned Costs**

10.55 Circular A-133 requires the auditor to prepare a schedule of findings and questioned costs, which should include the following three sections:

- a. A summary of the auditor's results
- b. Findings relating to the financial statements which are required to be reported in accordance with *Government Auditing Standards*
- c. Findings and questioned costs for federal awards

## **What Should Be Reported**

10.56 Specifically, Circular A-133 requires the schedule of findings and questioned costs to contain—

- a. A summary of the auditor's results, which must include—
  - The type of report the auditor issued on the financial statements of the auditee (that is, unqualified

opinion, qualified opinion, adverse opinion, or disclaimer of opinion).

- 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.<sup>24</sup>
  - A statement on whether the audit disclosed any noncompliance that is material to the financial statements of the auditee.
  - Where applicable, a statement that reportable conditions in the internal control over major programs were disclosed by the audit and whether any such conditions were material weaknesses.<sup>25</sup>
  - The type of report the auditor issued on compliance for major programs (that is, unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).
  - A statement on whether the audit disclosed any audit findings that the auditor is required to report under section 510(a) of Circular A-133 (see paragraph 10.63).
  - An identification of major programs.
  - The dollar threshold used to distinguish between type A and type B programs as described in section 520(b) of Circular A-133 (see paragraphs 7.4 through 7.9).
  - A statement on whether the auditee qualified as a low-risk auditee under section 530 of Circular A-133 (see paragraph 7.25).
- b. Findings relating to the financial statements which are required to be reported in accordance with Gov-

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24. Auditors should note that SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit*, precludes an auditor from issuing a written report representing that no reportable conditions were noted during an audit. Therefore, the sample schedule of findings and questioned costs included in appendix E uses the term “none reported” to indicate that no reportable conditions were included in the auditor’s report (versus “none,” which would imply that there were no reportable conditions).

25. See note 24.

*ernment Auditing Standards* (see the discussion in paragraphs 10.57 through 10.62 for further detail).

- c. Findings and questioned costs for federal awards, which must include audit findings as defined in section 510(a) of Circular A-133 (see paragraph 10.63). Circular A-133 also requires the following with regard to this section of the schedule:
- Audit findings (for example, internal control findings, compliance findings, questioned costs, or fraud) that 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.
  - Audit findings that relate to both the financial statements and the federal awards 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. For example, a material weakness in internal control that affects the auditee as a whole, including its federal awards, should usually be reported in detail in the section of the schedule of findings and questioned costs that is related to the financial statements, with a summary identification and reference given in the section related to federal awards. Conversely, a finding of noncompliance with a federal program law that is also material to the financial statements should be reported in detail in the federal awards section of the schedule, with a summary identification and reference given in the financial statement section.

## **Findings Relating to the Financial Statements**

10.57 As noted before, Circular A-133 requires the schedule of findings and questioned costs to include a section that reports the findings relating to the financial statements (note that these findings must also be addressed in the auditor's report issued to meet the requirements of *Government Auditing Standards*—see paragraphs 10.15 and

10.16 and 10.21 through 10.30). This section of the schedule should include all reportable conditions in the internal control over financial reporting and other findings relative to the audit of the financial statements that are required to be reported by GAAS and *Government Auditing Standards*, including those that do not affect federal awards. In addition to requiring auditors to report reportable conditions in the internal control over financial reporting, *Government Auditing Standards* requires auditors to report all but clearly inconsequential fraud and illegal acts that the auditor concludes, based on the evidence obtained, either occurred or are likely to have occurred. *Government Auditing Standards* also requires the auditor to report other noncompliance (for example, violations of the provisions of contract or grant agreements) that is material to the financial statements (see paragraphs 10.21 and 10.22).

10.58 In reporting reportable conditions, fraud, illegal acts, and other noncompliance, auditors should place their findings in proper perspective. This perspective is both quantitative and qualitative. To give the reader a basis to judge the prevalence and consequences of these conditions, the instances that are identified should be related to the universe or the number of cases examined and be quantified in terms of dollar value, if appropriate. Reportable conditions that are—either individually or in the aggregate—material weaknesses should be so identified.

10.59 *Government Auditing Standards* suggests that well-developed findings generally include the following elements:

- Criteria (what should be)
- The condition (what is)
- The effect (the difference between what is and what should be)
- The cause (why it happened)

10.60 *Government Auditing Standards* recognizes reportable conditions and noncompliance identified by the auditor may not always have all of the elements fully developed. However, to provide sufficient information to users to permit them to determine the effect and cause in order to take prompt and

proper corrective action, auditors should identify at least the criteria, condition, and possible asserted effect.

- 10.61 In presenting reportable conditions, fraud, illegal acts, and other noncompliance, auditors should follow the report content standards in chapter 7 of *Government Auditing Standards* that pertain to objectives, scope, and methodology; audit results; the views of responsible officials; and the reports presentation standards (as appropriate). Auditors may provide less extensive disclosure of fraud and illegal acts that are not material in either a quantitative or qualitative sense.
- 10.62 *Government Auditing Standards* also requires the auditor to report the status of uncorrected material findings and recommendations from prior audits that affect the financial statement audit (see paragraph 6.65 for a discussion of the auditor's responsibility for audit follow-up under *Government Auditing Standards*). The auditor should report the status of uncorrected material findings and recommendations from prior audits that affect the financial statement audit. Material findings and recommendations from previous audits that are repeated as current-year findings should be identified as repeat findings. If there are uncorrected findings from previous audits that are not repeated as current-year findings, their status should also be reported by the auditor. In either case, this information should be provided for in the section of the schedule of findings and questioned costs related to the financial statements.

### **Audit Findings Reported—Federal Awards**

- 10.63 Section 510(a) of Circular A-133 requires the auditor to report as audit findings in the schedule of findings and questioned costs—
- a. Reportable conditions in the 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 to an audit objective identified in the *Compliance Supplement*. The auditor should identify reportable conditions

that are individually or cumulatively material weaknesses (see paragraphs 8.25 and 8.26).

- b. Material noncompliance with the provisions of laws, regulations, contracts, or grant agreements that are 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* (see paragraphs 6.51 through 6.60 for a further discussion of the evaluation and reporting of noncompliance ).
- c. Known questioned costs that 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 should consider the best estimate of the total costs questioned (likely questioned costs), not just the questioned costs specifically identified (known questioned costs). The auditor should also report (in the schedule of findings and questioned costs) known questioned costs when likely questioned costs are greater than \$10,000 for a type of compliance requirement for a major program. For example, if the auditor specifically identifies \$7,000 in questioned costs but, based on his or her evaluation of the effect of questioned costs on the opinion on compliance, estimates that the total questioned costs are in the \$50,000–\$60,000 range, the auditor should report a finding that identifies the known questioned costs of \$7,000. Although the auditor is not required to report his or her estimate of the total questioned costs, the auditor should include information to provide proper perspective for judging the prevalence and consequences of the questioned costs.
- d. Known questioned costs that are greater than \$10,000 for programs that are not audited as major. Since (except for audit follow-up) the auditor is not



required to perform audit procedures for federal programs that are not major, the auditor will normally not find questioned costs. However, if the auditor does become aware of questioned costs for a federal program that is not audited as a major program (for example, as part of audit follow-up or other audit procedures) and the known questioned costs are greater than \$10,000, then the auditor should report this as an audit finding.

- e. 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 (for example, a scope limitation that is not otherwise reported as a finding).
- f. 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 *Government Auditing Standards* (see paragraphs 10.23 through 10.25).
- g. 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 section 315(b) of Circular A-133 materially misrepresents the status of any prior audit finding (see paragraphs 10.68 through 10.70).

## **Detail of Audit Findings—Federal Awards**

10.64 Section 510(b) of Circular A-133 requires that audit findings should 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 specific information that Circular A-133 requires in audit findings consists of (as applicable)—

- a. Identification of the federal program and specific federal award including the CFDA title and number, the federal award number and year, the name of federal agency, and the name of the applicable pass-through entity. When information such as the CFDA title and number or the federal award number is not available, the auditor should provide the best information available to describe the federal award.
- b. The criteria or specific requirement upon which the audit finding is based, including the statutory, regulatory, or other citation.
- c. The condition found, including facts that support the deficiency identified in the audit finding.
- d. Identification of questioned costs and how they were computed.
- e. Information to provide a proper perspective for judging the prevalence and consequences of the audit findings, (for example, whether the audit findings represent an isolated instance or a systemic problem). Where appropriate, the instances identified should be related to the universe and the number of cases examined and be quantified in terms of the dollar value.
- f. 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.
- g. Recommendations to prevent future occurrences of the deficiency identified in the audit finding.
- h. To the extent practical, the views of responsible officials of the auditee when there is disagreement with the audit findings. If the auditee's corrective action plan is available and contains the views of the responsible officials, the auditor can indicate in the finding that the auditee disagreed with the finding and refer to the details of the auditee's position in the corrective action plan. However, if the auditor does

not agree with the auditee's position, the auditor should state his or her reasons for rejecting it.

## **Other Preparation Guidance**

- 10.65 Each audit finding in the schedule of findings and questioned costs should include a reference number to allow for easy referencing of the audit findings during follow-up. One option for assigning reference numbers is to use the last two digits of the fiscal year being audited as the first two digits of each reference number, followed by a numeric sequence. For example, findings identified and reported in the audit of fiscal year 199X would be assigned reference numbers 9X-1, 9X-2, etc.
- 10.66 A schedule of findings and questioned costs must be issued for every single audit, regardless of whether any findings or questioned costs are noted. This is because Circular A-133 requires that one section of the schedule summarize the audit results (see paragraphs 10.55 through 10.56). In a situation in which there are no findings or questioned costs, the auditor should prepare the summary of auditor's results section of the schedule and indicate in the other required sections that no matters were reportable.
- 10.67 Appendix E contains an illustrative schedule of findings and questioned costs.

## **Summary Schedule of Prior Audit Findings and Corrective Action Plan**

- 10.68 The auditee is responsible for follow-up and corrective action on all audit findings. As part of this responsibility, the auditee is required to prepare a summary schedule of prior audit findings. The auditee is not required to prepare a summary schedule of prior audit findings if there are no matters reportable therein. However, to best serve the needs of federal agencies and to avoid any potential future misunderstanding or allegation of nonconformity with the requirements of Circular A-133, the auditee may consider preparing in this circumstance a summary schedule that indicates that no matters are reportable. The auditee is also required to prepare a corrective action plan for each of the

current-year audit findings. The summary schedule of prior audit findings and the corrective action plan, which are both part of the reporting package, must include the reference numbers the auditor assigns to audit findings in the schedule of findings and questioned costs. This numbering (or other identification) should include the fiscal year in which the finding initially occurred.

- 10.69 The auditor is required to 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 section 500(e) of Circular A-133 (see paragraphs 6.61 through 6.65).
- 10.70 The auditor has no responsibility for the corrective action plan; however, the auditor may be separately engaged by the auditee for assistance in developing appropriate corrective actions in response to audit findings. The auditor may find the auditee's corrective action plan useful in performing follow-up on prior audit findings (in addition to the schedule of prior audit findings), because it may provide an indication of the corrective steps planned by the auditee.

## **Data Collection Form**

- 10.71 Circular A-133 requires the auditee to complete and sign certain sections of a data collection form that states whether the audit was completed in accordance with Circular A-133 and provides information about the auditee, its federal programs, and the results of the audit. This form is not part of the reporting package (see paragraph 10.7). The information required to be included in the form, however, represents a summary of the information contained in the reporting package, including the auditor's reports and the auditee's schedule of expenditures of federal awards.
- 10.72 The auditor is also required to complete certain sections of the form, including information on the auditor and information on the results of the financial statement audit

and the audit of federal programs. The auditor is also required to sign a statement in the 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, and that the content of the form is limited to the data elements prescribed by the OMB. As part of completing the form, the auditor is asked to date it. The date that is entered by the auditor should be the date on which he or she completes and signs the form. The wording of the auditor's statement section of the form indicates that no additional procedures were performed since the date of the audit reports. This wording alleviates the auditor from any subsequent-event responsibility with regard to the timing of the completion of the form and the completion of the audit. The form includes detailed instructions, which should be carefully followed by the auditor.

- 10.73 The data collection form and related instructions are available on the OMB's home page at [www.whitehouse.gov/WH/EOP/OMB/Grants](http://www.whitehouse.gov/WH/EOP/OMB/Grants) (note that this address is "case sensitive," that is, upper- and lowercase letters must be as shown). A copy of the form and instructions can also be obtained from the Federal Audit Clearinghouse at (888) 222-9907. The form number is SF-SAC.<sup>26</sup>

## **Submission of Reporting Package and Data Collection Form**

- 10.74 The submission of the data collection form and the reporting package, including the audit reports, is the responsibility of the auditee. The data collection form and the reporting package must be submitted by the auditee within the earlier of thirty days after the receipt of the auditor's reports 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, it should be noted

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26. As of the issuance of this SOP, the Federal Audit Clearinghouse is developing the data collection form in various word processing packages, as well as a process for electronic submission. Auditors can review the Federal Audit Clearinghouse home page at <http://harvester.census.gov/sac> for the most current information on these developments.

that Circular A-133 includes a delayed implementation date for report-submission deadlines. For fiscal years beginning on or before June 30, 1998, the audit must be completed and the data collection form and reporting package must be submitted within thirty days after the receipt of the auditor's reports, or thirteen months after the end of the audit period.

## **Submission to Clearinghouse**

10.75 All auditees must submit to the federal clearinghouse designated by the OMB the data collection form and one copy of the reporting package (see paragraph 10.6 for a description) for (a) the federal clearinghouse to retain as an archival copy and (b) 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 when 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.

## **Submission by Subrecipients**

10.76 In addition to the requirements in paragraph 10.75, auditees that are also subrecipients must submit to each pass-through entity one copy of the reporting package 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 when the summary schedule of prior audit findings reported the status of any audit findings relating to federal awards that the pass-through entity provided. When a subrecipient is not required to submit a reporting package to a pass-through entity, the subrecipient must instead provide written notification to the pass-through entity that—

- An audit of the subrecipient was conducted in accordance with Circular A-133 (including the period covered by the audit and the name, amount, and CFDA number of the federal awards provided by the pass-through entity).

- The schedule of findings and questioned costs disclosed no audit findings relating to the federal awards that the pass-through entity provided.
- The summary schedule of prior audit findings did not report on the status of any audit findings relating to the federal awards that the pass-through entity provided.

A subrecipient may submit a copy of the reporting package to a pass-through entity to comply with this notification.

## **Requests for Copies**

10.77 In response to a request by a federal agency or pass-through entity, auditees should submit the appropriate copies of the reporting package and, if requested, a copy of any management letters issued by the auditor.

## **Report Retention Requirements**

10.78 Auditees are required to keep one copy of the data collection form and the reporting package on file for three years from the date of submission to the federal clearinghouse designated by the OMB. Pass-through entities should keep subrecipients' submissions on file for three years from the date of receipt.

## **Clearinghouse Address**

10.79 The name and address of the federal clearinghouse currently designated by the OMB are as follows: Federal Audit Clearinghouse, Bureau of the Census, 1201 E. 10th St., Jeffersonville, IN 47132.

## **Freedom of Information Act**

10.80 In accordance with the principles of the Freedom of Information Act (U.S. Code title 5, section 552), audit agency and nonfederal reports issued to grantees and contractors are available, if they are requested, to members of the press and the general public, to the extent that the information contained in them is not subject to exemptions of

the act that the cognizant agency for audit chooses to exercise. Accordingly, the auditor should not include names, social security numbers, other personal identification, or other potentially sensitive matters in either the body of the report or any attached schedules.



## CHAPTER 11

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### Program-Specific Audits

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- 11.1 A program-specific audit is an audit of an individual federal program (rather than a single audit of an entity's financial statements and federal programs). Section 235 of Circular A-133 provides guidance on program-specific audits.

#### **Use of a Program-Specific Audit to Satisfy Circular A-133 Audit Requirements**

- 11.2 Circular A-133 states that when an auditee expends federal awards under only one federal program (excluding research and development) 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 performed in accordance with section 235 of the circular.<sup>1</sup> Therefore, the auditor should determine whether there is a financial statement audit requirement before performing a program-specific audit. A program-specific audit may not be elected for research and development unless all 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 a program-specific audit in advance.

#### **Program-Specific Audit Requirements**

- 11.3 Circular A-133 requires program-specific audits to be subject to the following sections of Circular A-133 as they may apply to program-specific audits, unless contrary to the pro-

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1. An example of a situation where a program-specific audit would not be allowed would be a not-for-profit college that receives SFA (and no other federal awards). This is because the Higher Education Act of 1965, as amended, requires institutions that receive SFA to undergo an annual financial statement audit.

visions of section 235 of Circular A-133, a federal program-specific audit guide, or the program's laws and regulations:

- Purpose; definitions; audit requirements; basis for determining the federal awards expended; subrecipient and vendor determinations; relation to other audit requirements (sections 100 through 215(b))
- Frequency of audits; sanctions; audit costs (sections 220 through 230)
- Auditee responsibilities; auditor selection (sections 300 through 305)
- Follow-up on audit findings (section 315)
- Submission of report (sections 320(f) through 320(j))
- Responsibilities of federal agencies and pass-through entities; management decisions (sections 400 through 405)
- Audit findings and audit working papers (sections 510 through 515)

Program-specific audits are also subject to other provisions, referred to in section 235 of the circular.

## **Availability of Program-Specific Audit Guides**

11.4 In many cases, a federal agency's Office of Inspector General will have issued a program-specific audit guide that provides guidance on internal control, compliance requirements, suggested audit procedures, and audit reporting requirements for a particular federal program. The auditor should contact the Office of Inspector General of the federal agency to determine whether such a guide is available and current. When a current program-specific audit guide is available, the auditor should follow *Government Auditing Standards* and the guide when performing a program-specific audit. However, if there have been significant changes made to a program's compliance requirements and the related program-specific audit guide has not been updated with regard to the changes, the auditor should follow section 235 of Circular A-133 and the *Compliance Supplement* in lieu of an outdated guide. If

a guide is current with regard to a program's compliance requirements but has not been updated to conform to current authoritative standards and guidance (such as current revisions of GAAS or *Government Auditing Standards*), the auditor should follow current applicable professional standards and guidance in lieu of the outdated or inconsistent standards and guidance in the guide.

- 11.5 When a program-specific audit guide is not available, the auditee and the auditor have basically the same responsibilities for the federal program as they have for an audit of a major program in a single audit as discussed in chapters 6 and 8 of this SOP.

### **Auditee's Responsibilities When a Program-Specific Audit Guide Is Not Available**

- 11.6 In addition to having the responsibilities included in the sections of Circular A-133 that are described in paragraph 11.3, the auditee is required to prepare the following:
- The financial statements for the federal program, which include, 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 section 315(b) of Circular A-133 (see paragraphs 10.68 through 10.70)
  - If applicable, a corrective action plan consistent with the requirements of section 315(c) of the circular (see paragraphs 10.68 through 10.70)

### **Auditor's Responsibilities When a Program-Specific Audit Guide Is Not Available**

#### **Audit Scope and Requirements**

- 11.7 Circular A-133 requires the auditor to—

- Perform an audit of the financial statement(s) for the federal program in accordance with *Government Au-*

*ding Standards* (see chapter 4 of this SOP for guidance on financial statement audits). See paragraph 11.10 for a further discussion of *Government Auditing Standards*.

- Obtain an understanding of the internal control over compliance and perform tests of the internal control over compliance for the federal program, so that they are consistent with the requirements of section 500(c) of the circular for a major program (see chapter 8 of this SOP for guidance on the internal control considerations for major programs).
- 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 section 500(d) of the circular for a major program (see chapter 6 of this SOP for guidance on the compliance-auditing considerations for major programs).
- Follow up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings that has been prepared by the auditee, and when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding, report this as a current-year audit finding, in accordance with the requirements of section 500(e) of the circular (see paragraphs 10.69 through 10.70).

## **Auditor's Reports**

### **Circular A-133 Requirements**

11.8 Circular A-133 states that the auditor's reports may be in the form of either combined or separate reports and may be organized differently from the manner described below. The auditor's reports should state that the audit was conducted in accordance with GAAS, *Government Auditing Standards*, and Circular A-133 and should include the following:

- An opinion (or disclaimer of opinion) on whether the financial statement(s) of the federal program are pre-

sented fairly in all material respects in conformity with the stated accounting policies

- A report on the internal control related to the federal program, which describes the scope of the testing of the internal control and the results of the tests
- A report on compliance, which includes an opinion (or a disclaimer of opinion) on whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on the federal program
- A schedule of findings and questioned costs for the federal program, which includes a summary of the auditor's results relative to the audit of the federal program in a format consistent with the requirements for the summary of auditor's results in section 505(d)(1) of the circular, as well as findings and questioned costs for federal awards consistent with the requirements of section 505(d)(3) of the circular (see paragraph 10.55 and 10.56)

### ***Recommended Auditor's Reports***

11.9 In an effort to make program-specific audit reporting understandable and to reduce the number of reports issued, this SOP recommends that the following reports be issued for a program-specific audit (a) an opinion on the financial statement(s) of the federal program and (b) a report on compliance with requirements applicable to the federal program and on the internal control over compliance in accordance with the program-specific audit option under OMB Circular A-133. See the following paragraph for a discussion of the possible issuance of a third report to meet the reporting requirements of *Government Auditing Standards*. Illustrations of program-specific audit reports are included in examples 6 and 6a of appendix D.

### ***Reporting in Accordance With Government Auditing Standards***

11.10 If the financial statement(s) of the program only present the activity of the federal program, the auditor is not required to issue a separate report to meet the reporting re-

quirements of *Government Auditing Standards*. This is because, in many cases, by definition the financial statements of the program consist only of the schedule of expenditures of federal awards. In this situation, examples 6 and 6a of appendix D, would meet the financial, compliance, and internal control over compliance reporting requirements of both *Government Auditing Standards* and Circular A-133. However, it should be noted that the auditor always has the option of issuing a separate *Government Auditing Standards* report (in addition to the two reports described in paragraph 11.9). Although it is not as common, the financial statement(s) of the federal program may present more than the program's activity (for example, a municipal sewer district issues financial statements that include both normal operations and the federal program activity related to a grant for the purpose of building a new sewage-treatment facility). In this situation, the auditor should issue a separate *Government Auditing Standards* report (example 2 or 2a of appendix D), and modify it so that it refers only to the financial statement(s) of the federal program.

## **Submission of Report**

### **Timing of Submission**

11.11 Circular A-133 requires the audit to be completed and the reporting required by sections 235(c)(2) and 235(c)(3) of the circular to be submitted, within the earlier of thirty days after the receipt of the auditor's reports 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 unless a different period is specified in a program-specific audit guide.<sup>2</sup> Unless restricted by law or regulation, Circular A-133 requires the auditee to make copies of the report available for public inspection.

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2. It should be noted that Circular A-133 includes a delayed implementation date for deadlines for the submission of reports. For fiscal years beginning on or before June 30, 1998, the audit must be completed and the required reports submitted within the earlier of thirty days after the receipt of the auditor's report or thirteen months after the end of the audit period.

## **Submission When a Program-Specific Audit Guide Is Available**

11.12 When a program-specific audit guide is available, the auditee must submit to the federal clearinghouse designated by the OMB (see paragraph 10.79) the data collection form prepared in accordance with section 320(b) of the circular (see paragraphs 10.71 through 10.73), as applicable for a program-specific audit, and must also submit the reporting that is required by the program-specific audit guide which is to be retained as an archival copy. The auditee must also submit to the federal awarding agency or pass-through entity the reporting required by the program-specific audit guide.

## **Submission When a Program-Specific Audit Guide Is Not Available**

11.13 When a program-specific audit guide is not available, the reporting package for a program-specific audit consists of the following:

- The financial statement(s) of the federal program
- A summary schedule of prior audit findings (see paragraphs 10.68 through 10.70)
- A corrective action plan (see paragraphs 10.68 through 10.70)
- The auditor's report(s) described in paragraphs 11.8 through 11.10

11.14 The data collection form, as applicable to a program-specific audit, and one copy of the reporting package must be submitted to the federal clearinghouse designated by the OMB (see paragraph 10.79), to be retained as an archival copy. Furthermore, when the schedule of findings and questioned costs discloses audit findings or the summary schedule of prior audit findings reports the status of any audit findings, the auditee must submit one copy of the reporting package to the federal clearinghouse on behalf of the federal awarding agency or, in the case of a subrecipient, directly to the pass-through entity. When a subrecipient is not required to submit a reporting package to the

pass-through entity, the subrecipient is instead required to provide written notification to the pass-through entity, consistent with the requirements of section 320(e)(2) of Circular A-133 (see paragraph 10.76). A subrecipient may submit a copy of the reporting package to the pass-through entity, to comply with the notification requirement.



## **APPENDIX A**

# **Single Audit Act Amendments of 1996**

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*[Appendix A begins on the following page.]*

Public Law 104-156  
104th Congress

An Act

July 5, 1996  
[S. 1579]

To streamline and improve the effectiveness of chapter 75 of title 31, United States Code (commonly referred to as the "Single Audit Act").

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

Single Audit Act  
Amendments of  
1996.  
31 USC 7501  
note.

**SECTION 1. SHORT TITLE; PURPOSES.**

(a) **SHORT TITLE.**—This Act may be cited as the "Single Audit Act Amendments of 1996".

(b) **PURPOSES.**—The purposes of this Act are to—

- (1) promote sound financial management, including effective internal controls, with respect to Federal awards administered by non-Federal entities;
- (2) establish uniform requirements for audits of Federal awards administered by non-Federal entities;
- (3) promote the efficient and effective use of audit resources;
- (4) reduce burdens on State and local governments, Indian tribes, and nonprofit organizations; and
- (5) ensure that Federal departments and agencies, to the maximum extent practicable, rely upon and use audit work done pursuant to chapter 75 of title 31, United States Code (as amended by this Act).

**SEC. 2. AMENDMENT TO TITLE 31, UNITED STATES CODE.**

Chapter 75 of title 31, United States Code, is amended to read as follows:

**"CHAPTER 75—REQUIREMENTS FOR SINGLE AUDITS**

"Sec.

"7501. Definitions.

"7502. Audit requirements; exemptions.

"7503. Relation to other audit requirements.

"7504. Federal agency responsibilities and relations with non-Federal entities.

"7505. Regulations.

"7506. Monitoring responsibilities of the Comptroller General.

"7507. Effective date.

**"§ 7501. Definitions**

"(a) As used in this chapter, the term—

"(1) 'Comptroller General' means the Comptroller General of the United States;

"(2) 'Director' means the Director of the Office of Management and Budget;

"(3) 'Federal agency' has the same meaning as the term 'agency' in section 551(1) of title 5;

“(4) ‘Federal awards’ 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;

“(5) ‘Federal financial assistance’ means assistance that non-Federal entities receive or administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance, but does not include amounts received as reimbursement for services rendered to individuals in accordance with guidance issued by the Director;

“(6) ‘Federal program’ means all Federal awards to a non-Federal entity assigned a single number in the Catalog of Federal Domestic Assistance or encompassed in a group of numbers or other category as defined by the Director;

“(7) ‘generally accepted government auditing standards’ means the government auditing standards issued by the Comptroller General;

“(8) ‘independent auditor’ means—

“(A) an external State or local government auditor who meets the independence standards included in generally accepted government auditing standards; or

“(B) a public accountant who meets such independence standards;

“(9) ‘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;

“(10) ‘internal controls’ 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:

“(A) Effectiveness and efficiency of operations.

“(B) Reliability of financial reporting.

“(C) Compliance with applicable laws and regulations;

“(11) ‘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, any other instrumentality of local government and, in accordance with guidelines issued by the Director, a group of local governments;

“(12) ‘major program’ means a Federal program identified in accordance with risk-based criteria prescribed by the Director under this chapter, subject to the limitations described under subsection (b);

“(13) ‘non-Federal entity’ means a State, local government, or nonprofit organization;

“(14) ‘nonprofit organization’ means any corporation, trust, association, cooperative, or other organization that—

“(A) is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest;

“(B) is not organized primarily for profit; and

“(C) uses net proceeds to maintain, improve, or expand the operations of the organization;

“(15) ‘pass-through entity’ means a non-Federal entity that provides Federal awards to a subrecipient to carry out a Federal program;

“(16) ‘program-specific audit’ means an audit of one Federal program;

“(17) ‘recipient’ means a non-Federal entity that receives awards directly from a Federal agency to carry out a Federal program;

“(18) ‘single audit’ means an audit, as described under section 7502(d), of a non-Federal entity that includes the entity’s financial statements and Federal awards;

“(19) ‘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; and

“(20) ‘subrecipient’ means a non-Federal entity that receives Federal awards through another non-Federal entity to carry out a Federal program, but does not include an individual who receives financial assistance through such awards.

“(b) In prescribing risk-based program selection criteria for major programs, the Director shall not require more programs to be identified as major for a particular non-Federal entity, except as prescribed under subsection (c) or as provided under subsection (d), than would be identified if the major programs were defined as any program for which total expenditures of Federal awards by the non-Federal entity during the applicable year exceed—

“(1) the larger of \$30,000,000 or 0.15 percent of the non-Federal entity’s total Federal expenditures, in the case of a non-Federal entity for which such total expenditures for all programs exceed \$10,000,000,000;

“(2) the larger of \$3,000,000, or 0.30 percent of the non-Federal entity’s total Federal expenditures, in the case of a non-Federal entity for which such total expenditures for all programs exceed \$100,000,000 but are less than or equal to \$10,000,000,000; or

“(3) the larger of \$300,000, or 3 percent of such total Federal expenditures for all programs, in the case of a non-Federal entity for which such total expenditures for all programs equal or exceed \$300,000 but are less than or equal to \$100,000,000.

“(c) When the total expenditures of a non-Federal entity’s major programs are less than 50 percent of the non-Federal entity’s total expenditures of all Federal awards (or such lower percentage as specified by the Director), the auditor shall select and test additional programs as major programs as necessary to achieve audit coverage of at least 50 percent of Federal expenditures by the non-Federal entity (or such lower percentage as specified by the Director), in accordance with guidance issued by the Director.

“(d) Loan or loan guarantee programs, as specified by the Director, shall not be subject to the application of subsection (b).

**“§ 7502. Audit requirements; exemptions**

“(a)(1)(A) Each non-Federal entity that expends a total amount of Federal awards equal to or in excess of \$300,000 or such other amount specified by the Director under subsection (a)(3) in any fiscal year of such non-Federal entity shall have either a single audit or a program-specific audit made for such fiscal year in accordance with the requirements of this chapter.

“(B) Each such non-Federal entity that expends Federal awards under more than one Federal program shall undergo a single audit in accordance with the requirements of subsections (b) through (i) of this section and guidance issued by the Director under section 7505.

“(C) Each such non-Federal entity that expends awards under only one Federal program and is not subject to laws, regulations, or Federal award agreements that require a financial statement audit of the non-Federal entity, may elect to have a program-specific audit conducted in accordance with applicable provisions of this section and guidance issued by the Director under section 7505.

“(2)(A) Each non-Federal entity that expends a total amount of Federal awards of less than \$300,000 or such other amount specified by the Director under subsection (a)(3) in any fiscal year of such entity, shall be exempt for such fiscal year from compliance with—

“(i) the audit requirements of this chapter; and

“(ii) any applicable requirements concerning financial audits contained in Federal statutes and regulations governing programs under which such Federal awards are provided to that non-Federal entity.

“(B) The provisions of subparagraph (A)(ii) of this paragraph shall not exempt a non-Federal entity from compliance with any provision of a Federal statute or regulation that requires such non-Federal entity to maintain records concerning Federal awards provided to such non-Federal entity or that permits a Federal agency, pass-through entity, or the Comptroller General access to such records.

“(3) Every 2 years, the Director shall review the amount for requiring audits prescribed under paragraph (1)(A) and may adjust such dollar amount consistent with the purposes of this chapter, provided the Director does not make such adjustments below \$300,000.

“(b)(1) Except as provided in paragraphs (2) and (3), audits conducted pursuant to this chapter shall be conducted annually.

“(2) 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 chapter biennially. Audits conducted biennially under the provisions of this paragraph shall cover both years within the biennial period.

“(3) Any nonprofit 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 chapter biennially. Audits conducted biennially under the provisions of this paragraph shall cover both years within the biennial period.

“(c) Each audit conducted pursuant to subsection (a) shall be conducted by an independent auditor in accordance with generally accepted government auditing standards, except that, for the

purposes of this chapter, performance audits shall not be required except as authorized by the Director.

“(d) Each single audit conducted pursuant to subsection (a) for any fiscal year shall—

“(1) cover the operations of the entire non-Federal entity;

or

“(2) at the option of such non-Federal entity such audit shall include a series of audits that cover departments, agencies, and other organizational units which expended or otherwise administered Federal awards during such fiscal year provided that each such audit shall encompass the financial statements and schedule of expenditures of Federal awards for each such department, agency, and organizational unit, which shall be considered to be a non-Federal entity.

“(e) The auditor shall—

“(1) determine whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles;

“(2) determine 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;

“(3) with respect to internal controls pertaining to the compliance requirements for each major program—

“(A) obtain an understanding of such internal controls;

“(B) assess control risk; and

“(C) perform tests of controls unless the controls are deemed to be ineffective; and

“(4) determine whether the non-Federal entity has complied with the provisions of laws, regulations, and contracts or grants pertaining to Federal awards that have a direct and material effect on each major program.

“(f)(1) Each Federal agency which provides Federal awards to a recipient shall—

“(A) provide such recipient the program names (and any identifying numbers) from which such awards are derived, and the Federal requirements which govern the use of such awards and the requirements of this chapter; and

“(B) review the audit of a recipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to Federal awards provided to the recipient by the Federal agency.

“(2) Each pass-through entity shall—

“(A) provide such subrecipient the program names (and any identifying numbers) from which such assistance is derived, and the Federal requirements which govern the use of such awards and the requirements of this chapter;

“(B) monitor the subrecipient's use of Federal awards through site visits, limited scope audits, or other means;

“(C) review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to Federal awards provided to the subrecipient by the pass-through entity; and

“(D) require each of its subrecipients of Federal awards to permit, as a condition of receiving Federal awards, the independent auditor of the pass-through entity to have such

access to the subrecipient's records and financial statements as may be necessary for the pass-through entity to comply with this chapter.

“(g)(1) The auditor shall report on the results of any audit conducted pursuant to this section, in accordance with guidance issued by the Director.

Reports.

“(2) When reporting on any single audit, the auditor shall include a summary of the auditor's results regarding the non-Federal entity's financial statements, internal controls, and compliance with laws and regulations.

“(h) The non-Federal entity shall transmit the reporting package, which shall include the non-Federal entity's financial statements, schedule of expenditures of Federal awards, corrective action plan defined under subsection (i), and auditor's reports developed pursuant to this section, to a Federal clearinghouse designated by the Director, and make it available for public inspection within the earlier of—

“(1) 30 days after receipt of the auditor's report; or

“(2)(A) for a transition period of at least 2 years after the effective date of the Single Audit Act Amendments of 1996, as established by the Director, 13 months after the end of the period audited; or

“(B) for fiscal years beginning after the period specified in subparagraph (A), 9 months after the end of the period audited, or within a longer timeframe authorized by the Federal agency, determined under criteria issued under section 7504, when the 9-month timeframe would place an undue burden on the non-Federal entity.

“(i) If an audit conducted pursuant to this section discloses any audit findings, as defined by the Director, including material noncompliance with individual compliance requirements for a major program by, or reportable conditions in the internal controls of, the non-Federal entity with respect to the matters described in subsection (e), the non-Federal entity shall submit to Federal officials designated by the Director, a plan for corrective action to eliminate such audit findings or reportable conditions or a statement describing the reasons that corrective action is not necessary. Such plan shall be consistent with the audit resolution standard promulgated by the Comptroller General (as part of the standards for internal controls in the Federal Government) pursuant to section 3512(c).

“(j) The Director may authorize pilot projects to test alternative methods of achieving the purposes of this chapter. Such pilot projects may begin only after consultation with the Chair and Ranking Minority Member of the Committee on Governmental Affairs of the Senate and the Chair and Ranking Minority Member of the Committee on Government Reform and Oversight of the House of Representatives.

#### “§ 7503. Relation to other audit requirements

“(a) An audit conducted in accordance with this chapter shall be in lieu of any financial audit of Federal awards which a non-Federal entity is required to undergo under any other Federal law or regulation. To the extent that such audit provides a Federal agency with the information it requires to carry out its responsibilities under Federal law or regulation, a Federal agency shall rely upon and use that information.

“(b) Notwithstanding subsection (a), a Federal agency may conduct or arrange for additional audits which are necessary to carry out its responsibilities under Federal law or regulation. The provisions of this chapter do not authorize any non-Federal entity (or subrecipient thereof) to constrain, in any manner, such agency from carrying out or arranging for such additional audits, except that the Federal agency shall plan such audits to not be duplicative of other audits of Federal awards.

“(c) The provisions of this chapter do not limit the authority of Federal agencies to conduct, or arrange for the conduct of, audits and evaluations of Federal awards, nor limit the authority of any Federal agency Inspector General or other Federal official.

“(d) Subsection (a) shall apply to a non-Federal entity which undergoes an audit in accordance with this chapter even though it is not required by section 7502(a) to have such an audit.

“(e) A Federal agency that provides Federal awards and conducts or arranges for audits of non-Federal entities receiving such awards that are in addition to the audits of non-Federal entities conducted pursuant to this chapter shall, consistent with other applicable law, arrange for funding the full cost of such additional audits. Any such additional audits shall be coordinated with the Federal agency determined under criteria issued under section 7504 to preclude duplication of the audits conducted pursuant to this chapter or other additional audits.

“(f) Upon request by a Federal agency or the Comptroller General, any independent auditor conducting an audit pursuant to this chapter shall make the auditor’s working papers available to the Federal agency or the Comptroller General as part of a quality review, to resolve audit findings, or to carry out oversight responsibilities consistent with the purposes of this chapter. Such access to auditor’s working papers shall include the right to obtain copies.

**“§ 7504. Federal agency responsibilities and relations with non-Federal entities**

“(a) Each Federal agency shall, in accordance with guidance issued by the Director under section 7505, with regard to Federal awards provided by the agency—

“(1) monitor non-Federal entity use of Federal awards, and

“(2) assess the quality of audits conducted under this chapter for audits of entities for which the agency is the single Federal agency determined under subsection (b).

“(b) Each non-Federal entity shall have a single Federal agency, determined in accordance with criteria established by the Director, to provide the non-Federal entity with technical assistance and assist with implementation of this chapter.

“(c) The Director shall designate a Federal clearinghouse to—  
“(1) receive copies of all reporting packages developed in accordance with this chapter;

“(2) identify recipients that expend \$300,000 or more in Federal awards or such other amount specified by the Director under section 7502(a)(3) during the recipient’s fiscal year but did not undergo an audit in accordance with this chapter; and

“(3) perform analyses to assist the Director in carrying out responsibilities under this chapter.



**“§ 7505. Regulations**

“(a) The Director, after consultation with the Comptroller General, and appropriate officials from Federal, State, and local governments and nonprofit organizations shall prescribe guidance to implement this chapter. 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.

“(b)(1) The guidance prescribed pursuant to subsection (a) shall include criteria for determining the appropriate charges to Federal awards for the cost of audits. Such criteria shall prohibit a non-Federal entity from charging to any Federal awards—

“(A) the cost of any audit which is—

“(i) not conducted in accordance with this chapter;

or

“(ii) conducted in accordance with this chapter when expenditures of Federal awards are less than amounts cited in section 7502(a)(1)(A) or specified by the Director under section 7502(a)(3), except that the Director may allow the cost of limited scope audits to monitor subrecipients in accordance with section 7502(f)(2)(B); and

“(B) more than a reasonably proportionate share of the cost of any such audit that is conducted in accordance with this chapter.

“(2) The criteria prescribed pursuant to paragraph (1) shall not, in the absence of documentation demonstrating a higher actual cost, permit the percentage of the cost of audits performed pursuant to this chapter charged to Federal awards, to exceed the ratio of total Federal awards expended by such non-Federal entity during the applicable fiscal year or years, to such non-Federal entity's total expenditures during such fiscal year or years.

“(c) Such guidance shall include such provisions as may be necessary to ensure that small business concerns and business concerns owned and controlled by socially and economically disadvantaged individuals will have the opportunity to participate in the performance of contracts awarded to fulfill the audit requirements of this chapter.

**“§ 7506. Monitoring responsibilities of the Comptroller General**

“(a) The Comptroller General shall review provisions requiring financial audits of non-Federal entities that receive Federal awards that are contained in bills and resolutions reported by the committees of the Senate and the House of Representatives.

“(b) If the Comptroller General determines that a bill or resolution contains provisions that are inconsistent with the requirements of this chapter, the Comptroller General shall, at the earliest practicable date, notify in writing—

“(1) the committee that reported such bill or resolution;

and

“(2)(A) the Committee on Governmental Affairs of the Senate (in the case of a bill or resolution reported by a committee of the Senate); or

“(B) the Committee on Government Reform and Oversight of the House of Representatives (in the case of a bill or resolution reported by a committee of the House of Representatives).

**“§ 7507. Effective date**

“This chapter shall apply to any non-Federal entity with respect to any of its fiscal years which begin after June 30, 1996.”.

31 USC 7501  
note.

**SEC. 3. TRANSITIONAL APPLICATION.**

Subject to section 7507 of title 31, United States Code (as amended by section 2 of this Act) the provisions of chapter 75 of such title (before amendment by section 2 of this Act) shall continue to apply to any State or local government with respect to any of its fiscal years beginning before July 1, 1996.

Approved July 5, 1996.

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**LEGISLATIVE HISTORY—S. 1579 (H.R. 3184):**

**HOUSE REPORTS:** No. 104-607 accompanying H.R. 3184 (Comm. on Government Reform and Oversight).

**SENATE REPORTS:** No. 104-266 (Comm. on Governmental Affairs).

**CONGRESSIONAL RECORD**, Vol. 142 (1996):

June 14, considered and passed Senate.

June 18, considered and passed House.

**WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS**, Vol. 32 (1996):

July 5, Presidential statement.

## **APPENDIX B**

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### **OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations**

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*[Appendix B begins on the following page.]*

**Franklin D. Raines,**  
Director.

1. OMB rescinds Circular A-128 July 30, 1997.

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

[Circular No. A-133 Revised]

**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.  
\_\_\_\_.220 Frequency of audits.  
\_\_\_\_.225 Sanctions.  
\_\_\_\_.230 Audit costs.  
\_\_\_\_.235 Program-specific audits.

**Subpart C—Auditees**

\_\_\_\_.300 Auditee responsibilities.  
\_\_\_\_.305 Auditor selection.  
\_\_\_\_.310 Financial statements.  
\_\_\_\_.315 Audit findings follow-up.  
\_\_\_\_.320 Report submission.

**Subpart D—Federal Agencies and Pass-Through Entities**

\_\_\_\_.400 Responsibilities.  
\_\_\_\_.405 Management decision.

**Subpart E—Auditors**

\_\_\_\_.500 Scope of audit.  
\_\_\_\_.505 Audit reporting.  
\_\_\_\_.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 addressee that:

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

#### § 201.210 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.

#### § 201.215 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 addressee 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 addressee 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 addressee, 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 § 200.520 and, if not, the estimated incremental cost. The Federal agency shall then promptly confirm to the addressee 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 addressee shall have the program audited as a major program. A pass-through entity may use the provisions of this paragraph for a subrecipient.

#### § 200.220 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.

#### § 200.225 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.

#### § 200.230 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 § 200.200(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 § 200.400(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.

#### § 200.235 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 addressee 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 addressee 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 § 200.315(b), and a corrective action plan consistent with the requirements of § 200.315(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 § 200.500(c) for a major program;

(iii) Perform procedures to determine whether the addressee 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 § 200.500(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 addressee, 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 § 200.500(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 § 320.505(d)(1) and findings and questioned costs consistent with the requirements of § 320.505(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 § 320.320(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 § 320.320(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 § 320.320(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 addressee 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 addressee shall also prepare a schedule of expenditures of Federal awards for the period covered by the addressee's financial statements. While not required, the addressee 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 addressee 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 addressee is responsible for follow-up and corrective action on all audit findings. As part of this responsibility, the addressee shall prepare a summary schedule of prior audit findings. The addressee 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 addressee 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 addressee on the audit finding; and

(iii) A management decision was not issued.

(c) *Corrective action plan.* At the completion of the audit, the addressee 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 addressee 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 addressee shall make copies available for public inspection.

(b) *Data Collection.* (1) The addressee shall submit a data collection form which states whether the audit was completed in accordance with this part and provides information about the addressee, 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 addressee (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).

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

(viii) The dollar threshold used to distinguish between Type A and Type B programs as defined in § 520(b).

(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.

(xii) 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 addressee 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 addressee 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 addressee 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 addressee, 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 addressee 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 (f) 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 addressee 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 addressee 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 addressee 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 additree 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 additree 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) of this section, the auditor is encouraged to use an approach which provides an opportunity for different high-risk Type B programs to be audited as major over a period of time.

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

(f) *Percentage of coverage rule.* The auditor shall audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 50 percent of total Federal awards expended. If the additree meets the criteria in § 530 for a low-risk additree, 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 additree 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 additree 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:** Provisional OMB Circular A-133 Compliance Supplement is available from the Office of Administration, Publications Office, room 2200, New Executive Office Building, Washington, DC 20503.

[FR Doc. 97-16965 Filed 6-27-97; 8:45 am]

BILLING CODE 3110-01-P

## APPENDIX C

# Illustrative Schedules of Expenditures of Federal Awards

Example Entity  
Schedule of Expenditures of Federal Awards<sup>1</sup>  
For the Year Ended June 30, 19X1<sup>2</sup>

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number <sup>3</sup>	Pass-Through Entity Identifying Number <sup>4</sup>	Federal Expenditures <sup>5</sup>
U.S. Department of Agriculture:			
Summer Food Service Program for Children—Commodities	10.559		\$ 46,000
<i>Total U.S. Department of Agriculture</i>			<i>\$ 46,000</i>
U.S. Department of Housing and Urban Development:			
Community Development Block Grant—Entitlement Grants (note 2)	14.218		\$1,235,632
Section 8 Rental Voucher Program	14.855		<u>800,534</u>

*continued*

1. To meet state or other requirements, auditees may decide to include certain nonfederal awards (for example, state awards) in this schedule. If such nonfederal data are presented, they should be segregated and clearly designated as nonfederal. The title of the schedule should also be modified to indicate that nonfederal awards are included.
2. Additional guidance on the schedule is provided in chapter 5 which includes a discussion of the identification of federal awards, the general presentation requirements governing the schedule, pass-through awards, noncash awards, and endowment funds. Chapter 5 also includes a discussion of the auditor's responsibility for reporting on the schedule.
3. When the CFDA number is not available, the auditee should indicate that the CFDA number is not available and include in the schedule the program's name and, if available, other identifying number.
4. When awards are received as a subrecipient, the identifying number assigned by the pass-through entity should be included in the schedule.
5. Circular A-133 requires that the value of 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 be included in either the schedule or a note to the schedule. Although it is not required, Circular A-133 states that it is preferable to present this information in the schedule (versus the notes to the schedule). If the auditee presents noncash assistance in the notes to the schedule, the auditor should be aware that such amounts must still be included in part III of the data collection form.

**Example Entity**  
**Schedule of Expenditures of Federal Awards**  
**For the Year Ended June 30, 19X1**  
**(continued)**

<b>Federal Grantor/Pass-Through Grantor/Program or Cluster Title</b>	<b>Federal CFDA Number</b>	<b>Pass-Through Entity Identifying Number</b>	<b>Federal Expenditures</b>
<i>Total U.S. Department of Housing and Urban Development</i>			\$2,036,166
U.S. Department of Education:			
Impact Aid	84.041		\$ 372,555
Bilingual Education	84.288		<u>28,655</u>
Subtotal Direct Programs			\$ 401,210
Pass-Through Program From:			
State Department of Education— Title I Grants to Local Educational Agencies	84.010	23-8345-7612	<u>\$1,239,398</u>
<i>Total U.S. Department of Education</i>			\$1,640,608
<i>Total Expenditures of Federal Awards</i>			<u>\$3,722,774</u>

The accompanying notes are an integral part of this schedule.

**Example Entity**  
**Notes to the Schedule of Expenditures of Federal Awards**  
**For the Year Ended June 30, 19X1**

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*Note 1. Basis of Presentation<sup>6</sup>*

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Example Entity and is presented on the [*identify basis of accounting*]. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the [*general-purpose or basic*] financial statements.

*Note 2. Subrecipients<sup>7</sup>*

Of the federal expenditures presented in the schedule, Example Entity provided federal awards to subrecipients as follows:

Program Title	Federal CFDA Number	Amount Provided to Subrecipients
Community Development Block Grant—Entitlement Grants	14.218	\$423,965

- 
6. This note is included to meet the Circular A-133 requirement that the schedule include notes that describe the significant accounting policies used in preparing the schedule.
7. Circular A-133 requires the schedule of expenditures of federal awards to include, to the extent practical, an identification of the total amount provided to subrecipients from each federal program. Although this example includes the required subrecipient information in the notes to the schedule, the information may be included on the face of the schedule as a separate column or section, if that is preferred by the auditee.

**Example Entity University**  
**Schedule of Expenditures of Federal Awards<sup>8</sup>**  
**For the Year Ended June 30, 19X1<sup>9</sup>**

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number <sup>10</sup>	Pass-Through Entity Identifying Number <sup>11</sup>	Federal Expenditures <sup>12</sup>
<i>Student Financial Aid—Cluster:</i>			
U.S. Department of Education:			
Federal Pell Grant Program	84.063		\$ 8,764,943
Federal Supplemental Educational Opportunity Grant	84.007		974,873
Federal Work-Study Program	84.033		575,417
Federal Perkins Loan Program (note 2)	84.038		<u>1,548,343</u>
<i>Total U.S. Department of Education</i>			\$11,863,576
U.S. Department of Health and Human Services:			
Nursing Student Loans (note 2)	93.364		\$ 823,582
<i>Total U.S. Department of Health and Human Services</i>			\$ 823,582
<i>Total Student Financial Aid</i>			\$12,687,158
<i>Research and Development—Cluster:<sup>13</sup></i>			
U.S. Department of Defense:			
Department of Army	N.A.		\$ 87,403
Office of Naval Research	N.A.		<u>73,107</u>
Subtotal Direct Programs			\$ 160,510
Pass-Through Programs From:			
XYZ Labs—Effects of Ice on Radar Images	N.A.	4532	\$ <u>11,987</u>
<i>Total U.S. Department of Defense</i>			\$ 172,497
National Science Foundation:			
National Science Foundation (note 3)	N.A.		\$ 432,111

8. See note 1.

9. See note 2.

10. See note 3.

11. See note 4.

12. See note 5.

13. For R&D, Circular A-133 requires that total federal awards expended must be shown either by individual award or by federal agency and major subdivision within the federal agency. This example illustrates the federal agency and major subdivision option.

**Example Entity University**  
**Schedule of Expenditures of Federal Awards**  
**For the Year Ended June 30, 19X1**  
**(continued)**

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
Pass-Through Programs From:			
ABC University—Atmospheric Effects of Volcano Eruptions	N.A.	Abe97-8	\$ 25,987
<i>Total National Science Foundation</i>			\$ 458,098
U.S. Department of Health and Human Services:			
National Institutes of Health	N.A.		\$ 675,321
Administration on Aging (note 3)	N.A.		<u>234,987</u>
Subtotal Direct Programs			\$ 910,308
Pass-Through Programs From:			
ABC Hospital—Heart Research	N.A.	5489-5	\$ 432,765
State Health Department— Food Safety Research	N.A.	SG673-45	<u>123,987</u>
Subtotal Pass-Through Programs			\$ 556,752
<i>Total U.S. Department of Health and Human Services</i>			\$ 1,467,060
<i>Total Research and Development</i>			\$ 2,097,655
<i>Other Programs:</i>			
U.S. Department of Energy:			
Educational Exchange—University Lectures and Research	82.002		\$ 17,823
<i>Total U.S. Department of Energy</i>			\$ 17,823
U.S. Department of Education:			
TRIO Talent Search	84.044		\$ 308,465
Safe and Drug-Free Schools and Communities	84.184		<u>59,723</u>
Subtotal Direct Programs			\$ 368,188
Pass-Through Programs From:			
State Department of Education—Vocational Education Basic Grant	84.048	874-90-5473	\$ 3,115
State Department of Education—Tech-Prep Education	84.243	25-8594-2167	<u>176,885</u>
Subtotal Pass-Through Programs			\$ 180,000

*continued*

**Example Entity University**  
**Schedule of Expenditures of Federal Awards**  
**For the Year Ended June 30, 19X1**  
**(continued)**

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
<i>Total U.S. Department of Education</i>			\$ 548,188
<i>Total Other Programs</i>			\$ 566,011
<i>Total Expenditures of Federal Awards</i>			<u>\$15,350,824</u>

N.A. = Not Available

The accompanying notes are an integral part of this schedule.

**Example Entity University**  
**Notes to the Schedule of Expenditures of Federal Awards**  
**For the Year Ended June 30, 19X1**

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*Note 1. Basis of Presentation*<sup>14</sup>

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Example Entity University and is presented on the [identify basis of accounting]. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the [general-purpose or basic] financial statements.

*Note 2. Loans Outstanding*<sup>15</sup>

Example Entity University had the following loan balances outstanding at June 30, 19X1. These loan balances outstanding are also included in the federal expenditures presented in the schedule.

Cluster/Program Title	Federal CFDA Number	Amount Outstanding
Federal Perkins Loan Program	84.038	\$1,268,236
Nursing Student Loans	93.364	\$ 763,127

*Note 3. Subrecipients*<sup>16</sup>

Of the federal expenditures presented in the schedule, Example Entity University provided federal awards to subrecipients as follows:

Program Title	Federal CFDA Number	Amount Provided to Subrecipients
National Science Foundation	N.A.	\$236,403
Administration on Aging	N.A.	\$138,095

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14. See note 6.

15. This note is intended to meet the Circular A-133 requirement that loans or loan guarantees outstanding at year end be included in the schedule.

16. See note 7.



# APPENDIX D

## Illustrative Auditor's Reports

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- D.1 This appendix contains examples of the reports issued under GAAS, *Government Auditing Standards*, and Circular A-133 in various circumstances for a single audit. Also included are examples of the reports issued for a program-specific audit.
- D.2 As discussed in chapter 10, reporting on a financial statement audit and on the compliance requirements applicable to each major program involves varying levels of materiality and different forms of reporting. Circular A-133 states that 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 the circular. In an effort to make the reports understandable and to reduce the number of reports issued, this SOP recommends that the following reports be issued for a single audit (the basic elements of each of the recommended reports are discussed in chapter 10):
- An opinion on the financial statements and on the supplementary schedule of expenditures of federal awards
  - A report on compliance and on the internal control over financial reporting based on an audit of financial statements performed in accordance with *Government Auditing Standards*
  - A report on compliance with requirements applicable to each major program and on the internal control over compliance in accordance with Circular A-133
- D.3 Furthermore, as discussed in chapter 11, this SOP recommends that the following reports be issued for a program-specific audit (see paragraph 11.10 for a discussion of the possible issuance of a separate report to meet the reporting requirements of *Government Auditing Standards*): (a) an opinion on the financial statement(s) of the federal program

and (b) a report on compliance with requirements applicable to the federal program and on the internal control over compliance in accordance with the program-specific audit option under Circular A-133.

- D.4 Auditors need to understand the intended purpose of the reports and should tailor the reporting to the specific auditee's situation. Because the reports issued to comply with Circular A-133 involve varying levels of materiality and different forms of reporting, auditors should exercise care in issuing reports to ensure that they meet all of the varying reporting requirements of GAAS, *Government Auditing Standards*, and Circular A-133. Professional judgment should be exercised in any situation not specifically addressed in this SOP.
- D.5 The following example auditor's reports illustrate the types of reports to be issued in selected situations. Chapters 10 and 11 of this SOP include discussions of certain of the situations and the resulting reports contained herein. For additional guidance the auditor should refer to SAS No. 58, *Reports on Audited Financial Statements*.
- D.6 The following is a list of the example reports in this appendix:

Example No.	Title
1	Unqualified Opinion on General-Purpose Financial Statements and Supplementary Schedule of Expenditures of Federal Awards—Governmental Entity
1a	Unqualified Opinion on Financial Statements and Supplementary Schedule of Expenditures of Federal Awards—Not-for-Profit Organization
2	Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i> ( <i>No Reportable Instances of Noncompliance and No Material Weaknesses</i> [ <i>No Reportable Conditions Identified</i> ])
2a	Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i> ( <i>Reportable Instances of Noncompliance and Reportable Conditions Identified</i> )
3	Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 ( <i>Unqualified Opinion on Compliance and No Material Weaknesses</i> [ <i>No Reportable Conditions Identified</i> ])

Example No.	Title
3a	Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 ( <i>Qualified Opinion on Compliance and Reportable Conditions Identified</i> )
4	Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 ( <i>Qualified Opinion on Compliance—Scope Limitation for One Major Program, Unqualified Opinion on Compliance for Other Major Programs, Reportable Conditions Identified</i> )
5	Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 ( <i>Adverse Opinion on Compliance for One Major Program, Unqualified Opinion on Compliance for Other Major Programs, and Material Weaknesses Identified</i> )
6	Unqualified Opinion on the Financial Statement of a Federal Program in Accordance With the Program-Specific Audit Option Under OMB Circular A-133
6a	Report on Compliance With Requirements Applicable to the Federal Program and on Internal Control Over Compliance in Accordance With the Program-Specific Audit Option Under OMB Circular A-133 ( <i>Unqualified Opinion on Compliance and No Material Weaknesses [No Reportable Conditions Identified]</i> )

## **Example 1. Unqualified Opinion on General-Purpose Financial Statements and Supplementary Schedule of Expenditures of Federal Awards—Governmental Entity<sup>1</sup>**

### Independent Auditor's Report

[Addressee]

We have audited the accompanying general-purpose financial statements of the City of Example, Any State, as of and for the year ended June 30, 19X1, as listed in the table of contents. These general-purpose financial statements are the responsibility of the City of Example's management. Our responsibility is to express an opinion on these general-purpose financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*,<sup>2</sup> issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the general-purpose financial statements referred to above present fairly, in all material respects, the financial position of the City of Example, Any State, as of June 30, 19X1, and the results of its operations and the cash flows of its proprietary fund types and nonexpendable trust funds for the year then ended in conformity with generally accepted accounting principles.

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1. Auditors may also refer to the AICPA Audit and Accounting Guide *Audits of State and Local Governmental Units* for additional guidance on reporting on the general-purpose financial statements of a government.

2. The standards applicable to financial audits include the general, fieldwork, and reporting standards described in chapters 3, 4, and 5 of *Government Auditing Standards*.

In accordance with *Government Auditing Standards*, we have also issued our report dated [date of report] on our consideration of the City of Example's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.<sup>3</sup>

The accompanying schedule of expenditures of federal awards<sup>4</sup> is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the general-purpose financial statements. Such information has been subjected to the auditing procedures applied in the audit of the general-purpose financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the general-purpose financial statements taken as a whole.<sup>5</sup>

[Signature]

[Date]

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3. The following paragraph should be deleted if the schedule of expenditures of federal awards is not presented with the general-purpose financial statements (that is, a separate single audit package is issued). In such a circumstance, the required reporting on the schedule may be incorporated in the report issued to meet the requirements of Circular A-133. See notes 34 and 40 for additional guidance.
  4. If the auditor is reporting on additional supplementary information (for example, combining and individual fund and account group financial statements and schedules), this paragraph should be modified to describe the additional supplementary information. The example reports in appendix A of the AICPA Audit and Accounting Guide *Audits of State and Local Governmental Units* and SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1, AU sec. 551) provide useful guidance.
  5. When reporting on the supplementary information, the auditor should consider the effect of any modifications to the report on the general-purpose financial statements. Furthermore, if the report on supplementary information is other than unqualified, this paragraph should be modified. Guidance for reporting in these circumstances is described in paragraphs 9 through 11 and 13 through 14 of SAS No. 29 (AICPA, *Professional Standards*, vol. 1, AU secs. 551.09-.11 and 551.13-.14).

## Example 1a. Unqualified Opinion on Financial Statements and Supplementary Schedule of Expenditures of Federal Awards—Not-for-Profit Organization<sup>6</sup>

### Independent Auditor's Report

[Addressee]

We have audited the accompanying statement of financial position of Example NFP as of June 30, 19X1, and the related statements of activities and cash flows<sup>7</sup> for the year then ended. These financial statements are the responsibility of Example NFP's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*,<sup>8</sup> issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Example NFP as of June 30, 19X1, and the changes in its net assets and its cash flows for the year then ended in conformity with generally accepted accounting principles.

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6. Auditors may also refer to the AICPA Audit and Accounting Guide *Not-For-Profit Organizations* for additional guidance on reporting on the financial statements of a not-for-profit organization.

7. If the not-for-profit organization is a voluntary health and welfare organization, this phrase should be modified to state "and the related statements of activities, functional expenses and cash flows."

8. See note 2.

In accordance with *Government Auditing Standards*, we have also issued our report dated [date of report] on our consideration of Example NFP's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.<sup>9</sup>

The accompanying schedule of expenditures of federal awards<sup>10</sup> is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.<sup>11</sup>

[Signature]

[Date]

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9. See note 3.

10. If the auditor is reporting on additional supplementary information (for example, a comparison of actual and budgeted expenses), this paragraph should be modified to describe the additional supplementary information. SAS No. 29 provides useful guidance.

11. See note 5.

**Example 2. Report on Compliance and on Internal Control Over Financial Reporting<sup>12</sup> Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards (No Reportable Instances of Noncompliance and No Material Weaknesses [No Reportable Conditions Identified])<sup>13</sup>**

[Addressee]

We have audited the financial statements of Example Entity as of and for the year ended June 30, 19X1, and have issued our report thereon dated August 15, 19X1.<sup>14</sup> We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*,<sup>15</sup> issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Example Entity's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance

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12. See paragraph 4.12 for a description of internal control over financial reporting.
  13. The auditor should use the portions of examples 2 and 2a that apply to a specific auditee situation. For example, if the auditor will be giving an unqualified opinion on compliance but has identified reportable conditions, the compliance section of this report would be used along with the internal control section of example 2a. Alternatively, if the auditor will be giving a qualified opinion on compliance but has not identified reportable conditions, the internal control section of this report would be used along with the compliance section of example 2a.
  14. Describe any departure from the standard report (for example, a qualified opinion, a modification as to consistency because of a change in accounting principle, or a reference to the report of other auditors).
  15. See note 2.



that are required to be reported under *Government Auditing Standards*.<sup>16, 17</sup>

### Internal Control Over Financial Reporting

In planning and performing our audit, we considered Example Entity's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.<sup>18</sup>

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16. See paragraphs 5.18 and 5.19 of *Government Auditing Standards* for the criteria for reporting.
  17. If the auditor has issued a separate letter to management to communicate matters that do not meet the criteria for reporting in paragraph 5.18 of *Government Auditing Standards*, this paragraph should be modified to include a statement such as the following: "However, we noted certain immaterial instances of noncompliance, which we have reported to management of Example Entity in a separate letter dated August 15, 19X1." This reference to management is intended to be consistent with paragraph 5.20 of *Government Auditing Standards* which indicates that communications to "top" management should be referred to.
  18. If the auditor has issued a separate letter to management to communicate other matters involving the design and operation of the internal control over financial reporting, this paragraph should be modified to include a statement such as the following: "However, we noted other matters involving the internal control over financial reporting, which we have reported to management of Example Entity in a separate letter dated August 15, 19X1." This reference is not intended to preclude the auditor from including other matters in the separate letter to management. Furthermore, the reference to management is intended to be consistent with paragraph 5.28 of *Government Auditing Standards* which indicates that communications to "top" management should be referred to.

This report is intended for the information of the audit committee, management, [*specify legislative or regulatory body*], and federal awarding agencies and pass-through entities.<sup>19</sup> However, this report is a matter of public record and its distribution is not limited.<sup>20</sup>

[*Signature*]

[*Date*]

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19. If this report is issued for an audit that is not subject to Circular A-133, this sentence should be modified as follows: "This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]."
20. If the report is not a matter of public record, this sentence should be deleted.

**Example 2a. Report on Compliance and on Internal Control Over Financial Reporting<sup>21</sup> Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards (Reportable Instances of Noncompliance and Reportable Conditions Identified)<sup>22</sup>**

[Addressee]

We have audited the financial statements of Example Entity as of and for the year ended June 30, 19X1, and have issued our report thereon dated August 15, 19X1.<sup>23</sup> We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*,<sup>24</sup> issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Example Entity's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*<sup>25</sup> and which are described in the accompanying schedule of findings and questioned costs as items [list the reference numbers of the related findings, for example, 97-2 and 97-5].<sup>26</sup>

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21. See note 12.

22. See note 13.

23. See note 14.

24. See note 2.

25. See note 16.

26. If the auditor has issued a separate letter to management to communicate matters that do not meet the criteria for reporting in paragraph 5.18 of *Government Auditing Standards*, this paragraph should be modified to include a statement such as the following: "We also noted certain immaterial instances of noncompliance, which we have reported to management of Example Entity in a separate letter dated August 15, 19X1." This reference to management is intended to be consistent with chapter 5, paragraph 5.20, of *Government Auditing Standards*, which indicates that communications to "top" management should be referred to.

## Internal Control Over Financial Reporting

In planning and performing our audit, we considered Example Entity's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Example Entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items [*list the reference numbers of the related findings, for example, 97-1, 97-4, and 97-8*].

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.<sup>27, 28</sup>

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27. If conditions believed to be material weaknesses are disclosed, the report should identify the material weaknesses that have come to the auditor's attention. The last sentence of this paragraph should be replaced with language such as the following: "However, of the reportable conditions described above, we consider items [*list the reference numbers of the related findings, for example, 97-1 and 97-8*] to be material weaknesses."

28. If the auditor has issued a separate letter to management to communicate other matters involving the design and operation of the internal control over financial reporting, this paragraph should be modified to include a statement such as the following: "We also noted other matters involving the internal control over financial reporting, which we have reported to management of Example Entity in a separate letter dated August 15, 19X1." This

This report is intended for the information of the audit committee, management, [*specify legislative or regulatory body*], and federal awarding agencies and pass-through entities.<sup>29</sup> However, this report is a matter of public record and its distribution is not limited.<sup>30</sup>

[*Signature*]

[*Date*]

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reference is not intended to preclude the auditor from including other matters in the separate letter to management. Furthermore, the reference to management is intended to be consistent with paragraph 5.28 of *Government Auditing Standards* which indicates that communications to “top” management should be referred to.

29. If this report is issued for an audit that is not subject to Circular A-133, this sentence should be modified as follows: “This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*].” All references to the schedule of findings and questioned costs should also be removed, and instead, a description of the findings should be included in the report.

30. See note 20.

**Example 3. Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (Unqualified Opinion on Compliance and No Material Weaknesses [No Reportable Conditions Identified])<sup>31</sup>**

[Addressee]

Compliance

We have audited the compliance of Example Entity with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 19X1. Example Entity's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Example Entity's management. Our responsibility is to express an opinion on Example Entity's compliance based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*,<sup>32</sup> issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about

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31. The auditor should use the portions of examples 3 and 3a that apply to a specific auditee situation. For example, if the auditor will be giving an unqualified opinion on compliance but has identified reportable conditions, the compliance section of this report would be used along with the internal control section of example 3a. Alternatively, if the auditor will be giving a qualified opinion on compliance but has not identified reportable conditions, the internal control section of this report would be used along with the compliance section of example 3a.

32. See note 2.

Example Entity's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with those requirements.

In our opinion, Example Entity complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 19X1. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items *[list the reference numbers of the related findings, for example, 97-3 and 97-6]*.<sup>33</sup>

#### Internal Control Over Compliance

The management of Example Entity is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Example Entity's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be

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33. When there are no such instances of noncompliance identified in the schedule of findings and questioned costs, the last sentence should be omitted.

detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.<sup>34</sup>

This report is intended for the information of the audit committee, management, [*specify legislative or regulatory body*], and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.<sup>35</sup>

[*Signature*]

[*Date*]

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34. As noted in notes 3 and 9, there may be instances in which it would be appropriate to report on the schedule of expenditures of federal awards in this report (that is, a separate single audit package is issued). In such a circumstance, a new section should be added immediately following this paragraph as follows:

Schedule of Expenditures of Federal Awards

We have audited the [*general-purpose or basic*] financial statements of Example Entity as of and for the year ended June 30, 19X1, and have issued our report thereon dated August 15, 19X1. Our audit was performed for the purpose of forming an opinion on the [*general-purpose or basic*] financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the [*general-purpose or basic*] financial statements. Such information has been subjected to the auditing procedures applied in the audit of the [*general-purpose or basic*] financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the [*general-purpose or basic*] financial statements taken as a whole.

Describe any departure from the standard report (for example, a qualified opinion, a modification as to consistency because of a change in accounting principle, or a reference to the report of other auditors). Auditors should also refer to notes 5 and 11 for additional guidance.

35. See note 20.



**Example 3a. Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (Qualified Opinion on Compliance and Reportable Conditions Identified)<sup>36</sup>**

[Addressee]

Compliance

We have audited the compliance of Example Entity with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 19X1. Example Entity's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Example Entity's management. Our responsibility is to express an opinion on Example Entity's compliance based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*,<sup>37</sup> issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether non-compliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Example Entity's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with those requirements.

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36. See note 31.

37. See note 2.

As described in item [*list the reference numbers of the related findings, for example, 97-10*] in the accompanying schedule of findings and questioned costs, Example Entity did not comply with requirements regarding [*identify the type(s) of compliance requirement*] that are applicable to its [*identify the major federal program*]. Compliance with such requirements is necessary, in our opinion, for Example Entity to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, Example Entity complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 19X1.<sup>38</sup>

### Internal Control Over Compliance

The management of Example Entity is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Example Entity's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect Example Entity's ability to administer a major federal program in accordance with the applicable requirements of

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38. When other instances of noncompliance are identified in the schedule of findings and questioned costs as required by Circular A-133, the following sentence should be added: "The results of our auditing procedures also disclosed other instances of non-compliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items [*list the reference numbers of the related findings, for example, 97-3 and 97-6*]."

laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items [*list the reference numbers of the related findings, for example, 97-7, 97-8, and 97-9*].

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that non-compliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.<sup>39, 40</sup>

This report is intended for the information of the audit committee, management, [*specify legislative or regulatory body*], and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.<sup>41</sup>

[*Signature*]

[*Date*]

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39. See note 27.

40. See note 34.

41. See note 20.

**Example 4. Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (Qualified Opinion on Compliance—Scope Limitation for One Major Program, Unqualified Opinion on Compliance for Other Major Programs, Reportable Conditions Identified)**

[Addressee]

Compliance

We have audited the compliance of Example Entity with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 19X1. Example Entity's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Example Entity's management. Our responsibility is to express an opinion on Example Entity's compliance based on our audit.

Except as discussed in the following paragraph, we conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*,<sup>42</sup> issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Example Entity's compliance with those requirements and performing such other procedures as we considered necessary

42. See note 2.

in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with those requirements.

We were unable to obtain sufficient documentation supporting the compliance of Example Entity with [*identify the major federal program*] regarding [*identify the type(s) of compliance requirement*], nor were we able to satisfy ourselves as to Example Entity's compliance with those requirements by other auditing procedures.

In our opinion, except for the effects of such noncompliance, if any, as might have been determined had we been able to examine sufficient evidence regarding Example Entity's compliance with the requirements of [*identify the major federal program*] regarding [*identify the type(s) of compliance requirement*], Example Entity complied, in all material respects, with the requirements referred to above that are applicable to each of its other major federal programs for the year ended June 30, 19X1.<sup>43</sup>

### Internal Control Over Compliance

The management of Example Entity is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Example Entity's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect

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43. See note 38.

Example Entity's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as *items* [list the reference numbers of the related findings, for example, 97-7, 97-8, and 97-9].

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that non-compliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.<sup>44, 45</sup>

This report is intended for the information of the audit committee, management, [specify legislative or regulatory body], and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.<sup>46</sup>

[Signature]

[Date]

44. See note 27.

45. See note 34.

46. See note 20.

**Example 5. Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (Adverse Opinion on Compliance for One Major Program, Unqualified Opinion on Compliance for Other Major Programs, and Material Weaknesses Identified)**

[Addressee]

Compliance

We have audited the compliance of Example Entity with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 19X1. Example Entity's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Example Entity's management. Our responsibility is to express an opinion on Example Entity's compliance based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*,<sup>47</sup> issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Example Entity's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not

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47. See note 2.

provide a legal determination of Example Entity's compliance with those requirements.

As described in items [*list the reference numbers of the related findings, for example, 97-10, 97-11, and 97-12*] in the accompanying schedule of findings and questioned costs, Example Entity did not comply with requirements regarding [*identify the types of compliance requirements*] that are applicable to its [*identify the major federal program*]. Compliance with such requirements is necessary, in our opinion, for Example Entity to comply with requirements applicable to that program.

In our opinion, because of the effects of the noncompliance described in the preceding paragraph, Example Entity did not comply in all material respects, with the requirements referred to above that are applicable to [*identify the major federal program*]. Also, in our opinion, Example Entity complied, in all material respects, with the requirements referred to above that are applicable to each of its other major federal programs for the year ended June 30, 19X1.<sup>48</sup>

#### Internal Control Over Compliance

The management of Example Entity is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Example Entity's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect

48. See note 38.



Example Entity's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items [*list the reference numbers of the related findings, for example, 97-7, 97-8, and 97-9*].

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items [*list the reference numbers of the related findings, for example 97-8 and 97-9*] to be material weaknesses.<sup>49</sup>

This report is intended for the information of the audit committee, management, [*specify legislative or regulatory body*], and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.<sup>50</sup>

[*Signature*]

[*Date*]

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49. See note 34.

50. See note 20.

## **Example 6. Unqualified Opinion on the Financial Statement of a Federal Program in Accordance With the Program-Specific Audit Option Under OMB Circular A-133**

### Independent Auditor's Report

We have audited the accompanying schedule of expenditures of federal awards for the [*identify the federal program*] of Example Entity for the year ended June 30, 19X1. This financial statement is the responsibility of Example Entity's management. Our responsibility is to express an opinion on the financial statement of the program based on our audit.<sup>51</sup>

We conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*,<sup>52</sup> issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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51. In many cases, the financial statements of the program will consist only of the schedule of expenditures of federal awards (and notes to the schedule), which is the minimum financial statement presentation required by section 235 of Circular A-133. If the auditee issues financial statements that consist of more than the schedule, this paragraph should be modified to describe the financial statements. Also refer to paragraph 11.10 for a discussion of the possible necessity to issue a separate report to meet the reporting requirements of *Government Auditing Standards*.

52. See note 2.

In our opinion, the schedule of expenditures of federal awards referred to above<sup>53</sup> presents fairly, in all material respects, the expenditures of federal awards under the [*identify the federal program*] in conformity with generally accepted accounting principles.<sup>54, 55</sup>

[*Signature*]

[*Date*]

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53. If the auditee issues financial statements that consist of more than the schedule, this sentence should be modified to identify the results displayed in the financial presentation.
54. The auditor should follow the guidance in SAS No. 62, *Special Reports* when the auditee prepares the financial statement of the program in conformity with a basis of accounting other than GAAP.
55. If a separate report is issued to meet the reporting requirements of *Government Auditing Standards* (see paragraph 11.10), an additional paragraph should be added as follows: "In accordance with *Government Auditing Standards*, we have also issued our report dated [*date of report*] on our consideration of Example Entity's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants."

**Example 6a. Report on Compliance With Requirements Applicable to the Federal Program and on Internal Control Over Compliance in Accordance With the Program-Specific Audit Option Under OMB Circular A-133<sup>56</sup> (Unqualified Opinion on Compliance and No Material Weaknesses [No Reportable Conditions Identified])<sup>57</sup>**

[Addressee]

Compliance

We have audited the compliance of Example Entity with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to [identify the federal program] for the year ended June 30, 19X1. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of Example Entity's management. Our responsibility is to express an opinion on Example Entity's compliance based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*,<sup>58</sup> issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on [identify the federal program]

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56. This is an example of a report on a program-specific audit under Circular A-133 when no federal audit guide applicable to the program being audited is available. When a federal audit guide applicable to the program is available, Circular A-133 requires that the auditor follow the reporting requirements of that federal audit guide (see paragraph 11.4 for a discussion of the auditor's responsibility when a program-specific audit guide is not current).

57. If issuing a qualified or adverse opinion on compliance, the auditor should modify the compliance section of this report to be consistent with the wording used in examples 3a or 5, accordingly. If reporting reportable conditions, including material weaknesses, the auditor should modify the internal control section of this report to be consistent with the wording used in example 3a.

58. See note 2.

occurred. An audit includes examining, on a test basis, evidence about Example Entity's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with those requirements.

In our opinion, Example Entity complied, in all material respects, with the requirements referred to above that are applicable to its [*identify the federal program*] for the year ended June 30, 19X1. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items [*list the reference numbers of the related findings, for example, 97-1 and 97-2*].<sup>59</sup>

#### Internal Control Over Compliance

The management of Example Entity is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Example Entity's internal control over compliance with requirements that could have a direct and material effect on its [*identify the federal program*] in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a

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59. See note 33.

major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended for the information of the audit committee, management, [*specify legislative or regulatory body*], and the federal awarding agency and pass-through entity. However, this report is a matter of public record and its distribution is not limited.<sup>60</sup>

[*Signature*]

[*Date*]

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60. See note 20.

# APPENDIX E

## Illustrative Schedule of Findings and Questioned Costs

Example Entity  
Schedule of Findings and Questioned Costs  
For the Year Ended June 30, 19X1

### Section I—Summary of Auditor's Results

#### Financial Statements

Type of auditor's report issued: [unqualified, qualified, adverse, or disclaimer]

Internal control over financial reporting:

- Material weakness(es) identified?             yes     no
- Reportable condition(s) identified that are not considered to be material weaknesses?             yes     none reported

Noncompliance material to financial statements noted?             yes     no

#### Federal Awards

Internal control over major programs:

- Material weakness(es) identified?             yes     no
- Reportable condition(s) identified that are not considered to be material weakness(es)?             yes     none reported

Type of auditor's report issued on compliance for major programs: [unqualified, qualified, adverse, or disclaimer]<sup>1</sup>

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?             yes     no

*continued*

1. If the audit report for one or more major programs is other than unqualified, indicate the type of report issued for each program. For example, if the audit report on major program compliance for an auditee having five major programs includes an unqualified opinion for three of the programs, a qualified opinion for one program, and a disclaimer of opinion for one program, the response to this question could be as follows: "Unqualified for all major programs except for [name of program], which was qualified and [name of program], which was a disclaimer."

**Example Entity**  
**Schedule of Findings and Questioned Costs**  
**For the Year Ended June 30, 19X1**  
**(continued)**

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Identification of major programs:<sup>2</sup>

*CFDA Number(s)*<sup>3</sup>

*Name of Federal Program or Cluster*<sup>4</sup>

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Dollar threshold used to distinguish

between type A and type B programs:

§ \_\_\_\_\_

Auditee qualified as low-risk auditee?

\_\_\_\_\_ yes \_\_\_\_\_ no

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2. Major programs should generally be identified in the same order as reported on the schedule of expenditures of federal awards.
  3. When the CFDA number is not available, include other identifying number, if applicable.
  4. The name of the federal program or cluster should be the same as that listed in the schedule of expenditures of federal awards. For clusters, auditors are only required to list the name of the cluster and not each individual program within the cluster.



**Example Entity**  
**Schedule of Findings and Questioned Costs**  
**For the Year Ended June 30, 19X1**  
**(continued)**

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**Section II—Financial Statement Findings**

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*[This section identifies the reportable conditions, material weaknesses, and instances of noncompliance related to the financial statements that are required to be reported in accordance with paragraphs 5.18 through 5.20 of Government Auditing Standards. Auditors should refer to those paragraphs, as well as the reports content section of chapter 7 of Government Auditing Standards, for additional guidance on preparing this section of the schedule.*

*Identify each finding with a reference number.<sup>5</sup> If there are no findings, state that no matters were reported. Audit findings that relate to both the financial statements and federal awards should be reported in both section II and section III. However, the reporting in one section may be in summary form with a reference to a detailed reporting in the other section of the schedule. For example, a material weakness in internal control that effects an entity as a whole, including its federal awards, would generally be reported in detail in this section. Section III would then include a summary identification of the finding and a reference back to the specific finding in this section. Each finding should be presented in the following level of detail, as applicable:*

- *Criteria or specific requirement*
  - *Condition*
  - *Questioned costs*
  - *Context<sup>6</sup>*
  - *Effect*
  - *Cause*
  - *Recommendation*
  - *Management's response<sup>7</sup>*
- 

*continued*

- 
5. A suggested format for assigning reference numbers is to use the last two digits of the fiscal year being audited, followed by a numeric sequence of findings. For example, findings identified and reported in the audit of fiscal year 1997 would be assigned reference numbers of 97-1, 97-2, etc.
  6. Provide sufficient information for judging the prevalence and consequences of the finding, such as the relation to the universe of costs and/or the number of items examined and quantification of audit findings in dollars.
  7. See paragraphs 5.18 through 5.20 and 7.38 through 7.42 of *Government Auditing Standards* for additional guidance on reporting management's response.

**Example Entity**  
**Schedule of Findings and Questioned Costs**  
**For the Year Ended June 30, 19X1**  
**(continued)**

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**Section III—Federal Award Findings and Questioned Costs**

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*[This section identifies the audit findings required to be reported by section 510(a) of Circular A-133 (for example, reportable conditions, material weaknesses, and instances of noncompliance, including questioned costs). Where practical, findings should be organized by federal agency or pass-through entity.*

*Identify each finding with a reference number.<sup>8</sup> If there are no findings, state that no matters were reported. Audit findings that relate to both the financial statements and federal awards should be reported in both section II and section III. However, the reporting in one section may be in summary form with a reference to a detailed reporting in the other section of the schedule. For example, a finding of noncompliance with a federal program law that is also material to the financial statements would generally be reported in detail in this section. Section II would then include a summary identification of the finding and a reference back to the specific finding in this section. Each finding should be presented in the following level of detail, as applicable:*

- *Information on the federal program<sup>9</sup>*
  - *Criteria or specific requirement (including statutory, regulatory, or other citation)*
  - *Condition<sup>10</sup>*
  - *Questioned costs<sup>11</sup>*
  - *Context<sup>12</sup>*
  - *Effect*
  - *Cause*
  - *Recommendation*
  - *Management's response<sup>13</sup>*
- 

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8. See note 5.

9. Provide the federal program (CFDA number and title) and agency, the federal award's number and year, and the name of the pass-through entity, if applicable. When this information is not available, the auditor should provide the best information available to describe the federal award.

10. Include facts that support the deficiency identified in the audit finding.

11. Identify questioned costs as required by sections 510(a)(3) and 510(a)(4) of Circular A-133.

12. See note 6.

13. To the extent practical, indicate when management does not agree with the finding, questioned cost, or both.

## **AICPA Single Audit Working Group**

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