

objective and could be feasibly implemented, particularly with respect to the application of a risk-based audit approach to determine major programs, described in the following section. Respondents are also encouraged to comment whether the triennial audit approach should be: (1) Implemented with the revised Circular, (2) phased in using pilot projects, or (3) applicable to non-profit organizations receiving more or less than a specified amount of Federal awards and, if so, what level of Federal awards you recommend (e.g., \$10,000,000).

B. New Risk-Based Approach To Determine Major Programs

A revised process for determining major programs is proposed in Appendices 1 and 2. Currently the determination of major programs, the programs which receive primary audit coverage under the Circular, is based solely on the dollar amount of a Federal program's expenditures. Under this proposal, major programs are determined based on a risk assessment considering prior audit experience, oversight performed by Federal agencies and others, and the inherent risk of the Federal program. Also, a provision is made to require Federal programs that in aggregate have expenditures that total at least 50 percent of total Federal program expenditures to be covered as major programs. This 50 percent minimum is reduced to 25 percent for non-profit organizations meeting the criteria in Appendix 3 and classified as low-risk auditees. Respondents are encouraged to comment whether the Circular should be revised to permit organizations that qualify as low-risk auditees to reduce the scope of audit below the 50 percent minimum and, if so, whether the proposed 25 percent minimum is appropriate for low-risk auditees.

The proposed risk-based approach requires the use of judgment by auditors in determining major programs. However, several controls are included in the revised Circular to mitigate the risk of insufficient audit coverage of Federal programs including:

(1) The requirement that Federal programs with aggregate expenditures of at least 50 percent of total Federal program expenditures be covered as major programs (25 percent for low-risk auditees);

(2) The provision that allows Federal agencies and pass-thru entities to require an auditee to have a particular Federal program audited as a major program in lieu of conducting or contracting for additional audits,

provided that the requesting agency agrees to pay the full incremental cost;

(3) The requirement that Federal programs with Federal expenditures exceeding three percent of total Federal expenditures or \$300,000, whichever is greater, (Type A programs) shall be covered as major programs at least once every three years; and

(4) The inclusion of a model or process for auditors to use to determine major programs is provided in Appendices 1 and 2.

The objective of this change to a risk-based approach is to focus the audit effort on areas of greatest risk of noncompliance, provide audit coverage to high-risk programs previously below the dollar threshold of major programs, and permit reduction of audit effort when previous audits have not shown problems. An alternative to this risk-based approach would be to continue using the current approach of determining major programs based solely on dollar amount of a Federal program's expenditures and implement voluntary pilot projects to test the risk-based approach. Respondents are encouraged to comment whether the risk-based approach should be implemented with the revised Circular or phased in using pilot projects.

C. Required Level of Internal Control Testing

Clarification is provided in paragraph 12, "Scope of Audit," that the level of testing the auditor is required to perform on the internal control structure over major programs is based upon the auditor's planning for a low assessed level of control risk. Respondents who are auditors are encouraged to comment and provide examples of how many transactions they are currently testing for major programs and how many transactions they would expect to test based upon the proposed revision.

D. Guidance on the Schedule of Federal Awards

Guidance is added in paragraph 13, "Financial Statements and Auditor's Reporting," on the minimum requirements for the Schedule of Federal Awards. Since GAO's single audit study recommended that OMB prescribe the form and content of the schedule, respondents are encouraged to comment whether the revised Circular should prescribe additional requirements for the schedule and a description of such additional requirements.

E. Attestation on Internal Controls and Compliance

GAO's single audit study recommended that, for entities receiving in excess of \$50 million a year in Federal awards, the entity should publicly report the extent to which the entity has in place internal controls over Federal awards and that the auditor should attest to the fairness of such a representation. Similarly, others have suggested to OMB that the work on compliance for Federal awards be an engagement under the American Institute of Certified Public Accountants' (AICPA) Statement on Standards for Attestation Engagements (SSAE) No. 3, "Compliance Attestation." Under a SSAE No. 3 engagement, management must perform an evaluation of the entity's compliance with the specified requirements and make an assertion about compliance. Respondents are encouraged to comment as to whether organization-wide and program-specific audits should require a management assertion and auditor attestation for internal controls and/or compliance. The proposed revision does not require a management assertion or auditor attestation on internal controls or compliance.

F. Modified Requirements Related to Audit Findings

The proposed revisions in paragraph 13, "Financial Statements and Auditor's Reporting," provide for reporting of audit findings related to Federal awards in a single schedule of findings and questioned costs, set thresholds for which audit findings will be included in the audit report, describe what information the auditor should include in an audit finding, and provide for audit follow-up on audit findings. Paragraph 14, "Audit Findings Follow-up," clarifies the non-profit organization's responsibility for follow-up on audit findings which includes preparing a corrective action plan for current audit findings and a summary schedule of prior audit findings. Paragraph 15, "Management Decision," provides guidance to improve the audit resolution process.

G. Other Modified Requirements and Guidance

The definition of non-profit organization in paragraph 1 is changed to include non-profit hospitals. However, under paragraph 3, "Basis for Determining Awards Received," Medicaid and Medicare are normally excluded from awards received. Paragraph 3 also provides guidance on