

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

(c) Public hospitals and public colleges and universities may be excluded from State and local audits and from the requirements of this part. However, if such entities are excluded, audits of these entities shall be made in accordance with statutory requirements and the provisions of Circular A-133, "Audits of Higher Education and Other Nonprofit Institutions," as set forth in 24 CFR part 45.

(d) The auditor shall determine whether:

(1) The financial statements of the government, department, agency or establishment present fairly its financial position and the results of its financial operations in accordance with generally accepted accounting principles;

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

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

[51 FR 39086, Sept. 27, 1986 (interim rule) and 51 FR 30480, Aug. 27, 1986 (final rule), as amended at 57 FR 33254, July 27, 1992]

§ 44.4 Frequency of audit.

Audits shall be made annually unless the State or local government has adopted, by January 1, 1987, a constitutional or statutory requirement for less frequent audits. For those governments, the cognizant agency shall permit biennial audits, covering both years, if the government so requests. It shall also honor requests for biennial

audits by governments that have an administrative policy calling for audits less frequent than annual, but only for fiscal years beginning before January 1, 1987.

§ 44.5 Internal control and compliance reviews.

The independent auditor shall determine and report on whether the organization has internal control systems to provide reasonable assurance that it is managing Federal assistance programs in compliance with applicable laws and regulations.

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

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

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

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

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

(2) The review shall include the selection and testing of a representative number of charges from each major Federal assistance program. The selection and testing of transactions shall be based on the auditor's professional judgment considering such factors as the amount of expenditures for the program and the individual awards; the newness of the program or changes in its conditions; prior experience with