Budget "to review the range of Federal grant-in-aid programs to determine . . . areas in which a basic consolidation of grant-in-aid authorizations, appropriations, and statutory requirements should be carried out." That effort is now underway. Experience gained under the Joint Funding Simplification Act will be of great assistance in the development of a workable grant consolidation program.

Sincerely,

CHARLES L. SCHULTZE,
Director.

[Circular No. A–73]

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., August 4, 1965.

To the heads of Executive Departments and establishments.
Subject: Audit of Federal grants-in-aid to State and local governments.

1. *Purpose.* This Circular sets forth policies to be followed in the audit of Federal grants-in-aid to State and local governments. The primary objectives of this Circular are to promote improved audit practices, and to achieve more efficient use of manpower through improved coordination of the efforts of Federal, State, and local government audit staff. To the extent appropriate, the policies should also be applied to contracts with, and loans to, State and local governments.

2. *Coverage.* This Circular applies to all Federal agencies responsible for administering programs that involve grants-in-aid to State and local governments.

3. *Audit policies.* Federal agencies are responsible for providing adequate audit coverage of grant programs, as a constructive aid in determining whether Federal funds have been applied effectively and in a manner that is consistent with related Federal laws, program objectives, and underlying agreements.

a. *Determination of audit requirements.* Each Federal agency conducting grant programs will establish audit policies for guidance of its internal or independent auditors. For this purpose, the agency will review its individual grant programs to determine the coverage, frequency, and priority of audit required for each program. Such review should include consideration of the following factors:

(1) The dollar magnitude and duration of the grant program.

(2) The extent of Federal matching requirements.

(3) The Federal management needs to be met, as developed in consultation with the responsible program officials.

(4) Prior experience in auditing the program, including the adequacy of the financial management system and controls.

The audit policies of Federal agencies will provide for relying, to the maximum extent feasible, on internal or independent audits performed at the State and local levels and for appropriate use of the principles of statistical sampling.

b. *Scope of individual audits.* To assist in deciding on the scope of Federal audit required for each grant program, determinations will be made of the adequacy of the internal management control system employed by the grantee—including consideration of whether the accounting records are maintained, and reports are prepared, in accordance with generally accepted accounting principles, and whether audits are carried out in accordance with generally accepted auditing standards. This involves an evaluation of the grantee's organizational arrangements, financial systems, and facilities for audit and other reviews. The aim is to determine whether the management controls provide an effective system that promotes efficient administration and satisfies governing laws and regulations, the audit service is provided on a timely basis by qualified staff, and the auditors have sufficient independence of operations to permit a comprehensive and objective service to management.

Where grantee practices are considered to be acceptable under such standards, Federal audits will be oriented toward establishing the adequacy of the system and controls in operation, supported by a testing of transactions to verify the reliability of the system.

Where the grantee's internal management control system does not meet these standards, Federal agencies will encourage the grantee to review existing practices and bring about necessary improvements, and will cooperate by lending such assistance as may be feasible in developing an appropriate system and orienting grantee staff.

Each Federal agency will make available—on request from another Federal agency—the results and findings of previous audits that identify the adequacy of