REPORT TO THE CONGRESS

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

Revenue Sharing Act Audit Requirements Should Be Changed

Department of the Treasury

All recipients of revenue sharing should be required to have a periodic financial audit conducted by an independent auditor, and the results of that audit should be made available to the public and the news media.

The Congress may wish to establish waiver guidelines to permit the Secretary to exempt small governments from this audit requirement.

The Congress should also eliminate most of the expenditure restrictions now in the Revenue Sharing Act. These restrictions offer no assurance of anything substantive being accomplished.

GGD-76-90

JULY 30, 1976

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

This report presents the results of our review of compliance auditing required under the revenue sharing program and suggests legislative changes for consideration by the Congress.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53); the Accounting and Auditing Act of 1950 (31 U.S.C. 67); and section 123 of the State and Local Fiscal Assistance Act of 1972 (86 Stat. 932, 934).

We are sending copies of this report to the Secretary of the Treasury; the Director, Office of Revenue Sharing; and the Director, Office of Management and Budget.

Elmer B. Staats

Comptroller General
of the United States

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ABBREVIATIONS

GAO	General Accounting Office
ORS	Office of Revenue Sharing

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

REVENUE SHARING ACT AUDIT REQUIREMENTS SHOULD BE CHANGED
Department of the Treasury

D I G E S T

Treasury's Office of Revenue Sharing is responsible for insuring that governments receiving funds under the Revenue Sharing Act comply with the act's restrictions and requirements. Audits for compliance have not been effective.

The Office has relied heavily on State and independent auditors to make financial and compliance audits required by the act. Its staff was too small to audit the more than 39,000 governments receiving revenue sharing funds.

Accordingly, the Office issued an audit guide in October 1973 to assist State and independent auditors by establishing standards and procedures acceptable to the Secretary of the Treasury. Reliance on audits by State and independent auditors has not worked for these reasons:

--There being no requirement that recipient governments be audited, many do not have financial and compliance audits of revenue sharing funds.

--If audits are made, they often do not include all steps outlined in the Office's audit guide.

--State and independent public accountants said they often lack the expertise to audit compliance matters.

Moreover, it does not seem meaningful to make compliance audits because many of the act's present restrictions are ineffective.

Recipients have wide latitude in using revenue sharing. They can use the funds as authorized by the act and use their own funds where compliance problems might occur. Instances of noncompliance detected by an

audit often have been rectified by accounting adjustments. These did not affect the overall operation of the recipient government or how the recipient's total resources were spent.

Recipients should be required to have an independent auditor make periodic financial audits of all of their funds. The Congress may want the audit requirement to apply to recipient governments above a specified size; for example, those with a population of at least 2,500 and/or those that receive revenue sharing funds totaling at least $50,000 annually.

The Office did not comment on the recommendation concerning financial audits, but it did say that if the Congress makes such a provision the dollar criteria in the report might be reasonable. The Office believes, however, that the population criteria would encompass such small governments as to be unreasonable and onerous. The revenue sharing and population figures cited by GAO were illustrative; GAO accepts that larger figures may be more appropriate.

The auditor's report should be made available to the public and the news media and the audit conducted in accordance with standards applicable to the financial and compliance element of the audit described in a booklet issued by the Comptroller General of the United States, "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."

Most of the act's expenditure restrictions should be eliminated. The act's requirement that expenditures be in accordance with local laws and procedures should be retained. The nondiscrimination provision should be expanded so that a recipient government cannot discriminate in any of its programs or activities, and comparative financial data showing the sources and uses of all funds for each major program or activity should be provided to the public for the prior, current, and budget years, along with notice and opportunity for the government's residents to give their opinions and recommendations on proposed expenditures. This opportunity could be given

in a public hearing or as the Secretary of the Treasury may authorize.

The Office did not comment on this recommendation.

If recipient governments were required to have audits of financial matters, the Office could redirect its audit group efforts and, using statistical sampling methods, concentrate on testing the adequacy of the recipient government's financial audits. Reviews for compliance with the nondiscrimination provision could be handled by specialists in the Office's civil rights branch.

The Office said that the monitoring of financial audits would require an expanded audit staff. However, based on the number of reviews of external audit reports completed by the present audit staff, GAO concludes the Office could achieve coverage at least as broad as under the current system.

CHAPTER 1

INTRODUCTION

The State and Local Fiscal Assistance Act of 1972, called the Revenue Sharing Act, expires December 31, 1976. Passage of the act in 1972 marked a new approach to giving Federal financial assistance to State and local governments. Under the program, $30.2 billion in Federal funds are dispersed automatically to all State governments and to over 39,000 local governments. Fewer administrative requirements and controls apply to revenue sharing than to other forms of Federal domestic aid.

The Congress limited the funding of the revenue sharing program to 5 years in order to review the act and to decide whether it should be continued or revised.

The Office of Revenue Sharing (ORS), Department of the Treasury, is responsible for administering the act, which includes distributing funds to State and local governments and establishing overall regulations for the program. The Revenue Sharing Act and the implementing regulations established certain procedures, prohibitions, and restrictions on using revenue sharing funds.

The act provides that each recipient shall:

--Create a trust fund in which funds received and interest earned will be deposited. Funds are to be spent in accordance with laws and procedures applicable to expenditures of the recipient's own revenues.

--Use fiscal, accounting, and audit procedures which conform to guidelines established by the Secretary of the Treasury.

--Not use funds in ways which discriminate on the basis of race, color, national origin, or sex.

--Not use funds either directly or indirectly to match Federal funds under programs which make Federal aid contingent upon the recipient's contribution, except under certain circumstances.

--Pay prevailing wage rates, as determined under the Davis-Bacon provision, on certain construction projects in which the costs are paid from the revenue sharing trust fund.

--Under certain circumstances, pay employees who are paid from the trust fund not less than prevailing pay rates.

--Periodically report to the Secretary of the Treasury on how it used its revenue sharing funds. The reports shall be published in the newspaper, and the recipient shall advise the news media of their publication.

Further, local governments may spend revenue sharing funds only within a specified list of priority areas.

Revenue sharing funds can be transferred from the recipient government to another government, agency, or organization, but such transfer does not release the money from any of the restrictions and prohibitions that applied to the original recipient. The original recipient is responsible for the proper use of revenue sharing funds which it transfers.

GOVERNMENTS RECEIVING REVENUE SHARING FUNDS

Revenue sharing funds are distributed to each State government and all general-purpose local governments within each State. Following are the number and types of local governmental units in the four States we reviewed.

Type of government	Number of governments			
	New York	California	Georgia	Minnesota
Counties	58	a/57	158	87
Municipalities	616	412	532	856
Townships	933	-	-	1,803
Indian tribes	9	57	-	11
Total	1,616	526	690	2,757

a/ City and county of San Francisco is shown as a municipality.

The distribution pattern of revenue sharing funds for the year ended June 30, 1974, using ORS' classification of governments as large, medium, or small based on the size of its annual revenue sharing payment, is shown below.

Annual revenue sharing payment	Number of governments			
	New York	California	Georgia	Minnesota
Over $4,000,000 (large)	7	25	3	3
$10,000 to $4,000,000 (medium)	1,191	426	387	405
Under $10,000 (small)	418	75	300	2,349
Total	1,616	526	690	2,757

ORS' APPROACH TO ITS COMPLIANCE RESPONSIBILITY

The Revenue Sharing Act specifies that the Secretary of the Treasury provide for such accounting and auditing procedures, evaluations, and reviews as may be necessary to insure full compliance with the act.

ORS has a five-part approach to fulfill this compliance responsibility.

1. Maximize use of existing State and private audits of recipient governments, augmented by ORS' audits of a few governments each year to verify the reliablity of audits completed by others.

2. Make extensive efforts to insure recipient governments know how to comply with the act. Informational material is provided directly to each recipient, and ORS works with professional associations and State governments to disseminate information.

3. Cooperate with other Federal agencies to obtain information on probable revenue sharing noncompliance, fraud, or relevant suits against recipient governments. Also help citizen and civil rights organizations to fully inform their membership about revenue sharing.

4. Advise the affected government and determine possible noncompliance. If noncompliance is found, work closely with that government to correct the noncompliance, taking legal action to recover funds or instituting court action when voluntary compliance is not achieved.

5. Manage the program, making it easy for each government to promptly comply with the act's requirements.

ORS prepared a booklet entitled "Audit Guide and Standards for Revenue Sharing Recipients" to help in administering the act's audit requirements. The guide, published in October 1973, was distributed to each recipient government and other interested organizations. The guide is to help auditors understand the special requirements for audits of revenue sharing funds and to establish audit standards and procedures which will be acceptable to the Secretary of the Treasury.

The audit guide was prepared under the assumption that all revenue sharing recipients have their financial transactions audited and that some phases of the revenue sharing requirements, such as reviewing internal control and auditing cash receipts and disbursements, will be performed as part of that audit. Therefore, ORS sees auditing revenue sharing funds as an extension of audit procedures rather than as an entirely separate and additional audit.

Through its cooperative State audit program, ORS is enlisting the assistance of State audit agencies to assure compliance with the act. Under the agreements being entered into by ORS and the individual States, the services of State audit agencies are being extended to cover revenue sharing audit requirements. ORS will accept the audits made by the cooperating State agencies.

Also, many local governments are audited periodically by independent public accounting firms. ORS will rely on these examinations when they are performed in accordance with generally accepted auditing standards and the audit guide.

ORS plans to audit each year a sample of those governments that have not been audited under either the cooperative State program or by independent public accountants.

ORGANIZATIONS RESPONSIBLE FOR AUDITING RECIPIENT GOVERNMENTS

The responsibility for auditing recipient governments often depends on the size of the governmental unit and applicable State laws. The audit is made by State auditing agencies, certified public accountants, licensed public accountants, or other organizations.

The larger governments in the four States usually had audits made in accordance with generally accepted auditing standards by a State auditing agency or certified public accountants. The smaller governments often did not have

any audits or the audits were not according to standards. These latter audits were often made by groups, such as town boards and bookkeeping firms. Audits must be made in accordance with generally accepted auditing standards and ORS' audit guide to be accepted by ORS.

The responsibility for auditing the recipient governments differed markedly in each of the four States.

New York

The New York State auditing agency audits all governments in New York State, including State agencies and over 1,600 local governments. The agency audits each unit of local government on a 2- or 3-year cycle. New York State and ORS agreed in May 1974 that the State extend, by using ORS' audit guide, its standard audits of localities and the State government to include revenue sharing funds.

California

There are three State agencies responsible for auditing State or State-controlled funds in California. All these agencies audit to safeguard State funds. None would audit a county or municipality except in conjunction with an audit of a State program or in response to a specific request.

A State official said that county boards of supervisors are required by State law to provide annual audits. The scope of these audits is not defined and may include all funds or be limited to one or two funds. Generally, counties are audited to the extent deemed necessary by the board of supervisors.

According to a State official, the State requires no auditing of municipalities. However, most municipalities are audited by certified public accountants.

Georgia

The Georgia State auditing agency is responsible for auditing State agencies receiving revenue sharing funds. Georgia and ORS signed an agreement in December 1974 providing for compliance audits of State agencies.

A State official said the Georgia State auditing agency is not required to audit local governments or to evaluate or supervise audits by others. If the Governor specifically requests, however, the State auditing agency

can audit a local government. He further stated that Georgia statutes permit local government officials to have their accounts audited if they deem it necessary. About 90 percent of the local governments receiving $10,000 or more in revenue sharing funds each year are audited by certified public accountants. About one-half of the municipalities receiving less than $10,000 each year have independent audits.

Minnesota

Minnesota's auditing is divided between two organizations--a legislative auditor is responsible for auditing State departments and other State agencies and a State auditor is responsible for auditing all counties and the 3 cities with populations exceeding 100,000. In October 1974, both departments agreed with ORS to expand their audits to include revenue sharing compliance matters.

The State auditor will also audit a municipality upon request of its council or citizens. He may also initiate an audit if he feels that public interest demands one, but this method is rarely used. The State auditor audits about 25 of 856 municipalities each year.

State statutes do not require annual audits of the municipalities' financial records. Although most larger communities are audited by certified public accountants, a survey by the State auditor's office showed that less than one-half of the State's municipalities have independent audits. In addition, the deputy State auditor estimated that less than 1 percent of the State's 1,803 townships are audited by an independent public accountant.

COST TO LOCAL GOVERNMENTS FOR AUDITING REVENUE SHARING FUNDS

The cost to make a financial and compliance audit of revenue sharing funds is nominal for large recipient governments but more burdensome for smaller recipients. We obtained the auditors' estimates of additional fees needed to extend their auditing procedures to financial and compliance matters relating to revenue sharing funds. Their estimated additional fees were as follows:

Estimated Average Added Cost of Auditing Revenue Sharing Funds of Local Governmental Units

State	Size of recipient government		
	Large	Medium	Small
New York	$2,100	$260	$260
California	4,880	590	210
Georgia	1,500	290	250
Minnesota	1,830	220	200

CHAPTER 2

ORS' RELIANCE ON OTHERS TO MAKE COMPLIANCE AUDITS HAS NOT BEEN EFFECTIVE

The ORS audit staff of 11 professionals cannot adequately audit the over 39,000 governments which receive revenue sharing funds. Thus, ORS uses audits of recipient governments made by State audit agencies and other independent public accountants.

We found that ORS' reliance on State and independent public accountants to make compliance audits had not been effective. Many recipient governments in New York, Georgia, California, and Minnesota did not have financial and compliance audits of revenue sharing funds, and those that were made were often incomplete.

MANY RECIPIENTS OF REVENUE SHARING FUNDS ARE NOT AUDITED

The Revenue Sharing Act requires the Secretary of the Treasury to provide for accounting and auditing procedures, evaluations, and reviews as may be necessary to insure that expenditures of revenue sharing funds comply fully with the act's requirements. The Secretary is authorized to accept an audit made by a State audit agency if he determines that the audit is reliable. This authority is expanded in ORS' regulations which state it is the Secretary's intention to rely, to the maximum extent possible, on audits of recipient governments by State auditors and independent public accountants; however, many recipients are not audited.

Local governments

In each of the four States, we questioned officials of large, medium, and small units of local government, as classified by ORS, to evaluate the effectiveness of existing State and public accountant audits.

In California, Georgia, and Minnesota, 15, 20, and 51 percent, respectively, of the governments that responded did not have periodic independent audits. Audits were often limited to reviewing financial transactions and statements.

In California, Georgia, and Minnesota, less than one-half of the 215 local governments had regular independent audits of revenue sharing funds that included both financial and compliance matters. In New York, however, the 29 local

governments we reviewed were audited by the State auditing agency and all audits included these matters. (See app. I.)

To determine the number of nationwide recipients having acceptable audits of revenue sharing funds, ORS included the question "Are your accounts audited?" in the entitlement period 5 planned-use report. The following chart summarizes the answers received:

	Recipient's annual revenue sharing payment			
	Over $4 million	$10,000 to $4 million	Under $10,000	Total
Accounts audited	117	15,087	14,268	29,472
Accounts not audited	0	532	5,035	5,567
No response	2	463	1,404	1,869
Total	119	16,082	20,707	36,908

Of those responding, 84.1 percent said that they were audited and 15.9 percent said they were not. However, 90.4 percent of the governments that were not audited received less than $10,000 annually. All respondents receiving over $4 million in revenue sharing reported their accounts were audited. The question was not answered on 5 percent of the use reports. Of these, 75.1 percent received less than $10,000 annually and all but 2 governments received less than $4 million annually.

State governments

Revenue sharing funds distributed to State governments were not audited according to ORS' audit guide in three of the four States reviewed--New York, Minnesota, and California--even though ORS had made agreements with two--New York and Minnesota.

New York State agreed with ORS to extend its audit procedures of the State departments and agencies to include the additional procedures contained in the audit guide. New York considers its entitlement as general revenue and reports that its uses of revenue sharing funds are in proportion to general fund expenditures. ORS has accepted the State's allocation method. A State official said that this allocation method prevents a separate audit of revenue sharing funds. He also said that the only applicable part of the audit guide is the civil rights section. Accordingly, the State auditing agency has scheduled a review of the State Division of Human Rights.

Minnesota transferred all its revenue sharing money to its general fund. Revenue sharing funds are not identified with any specific expenditure; rather, they represent a part of all expenditures within the general fund.

A State auditing agency makes financial audits of all State departments and agencies every 2 or 3 years. The State agreed in October 1974 to give ORS copies of all reports that showed noncompliance, but the State auditing agency had not audited any revenue sharing funds at the time of our visit.

Revenue sharing funds in California were allocated to education and welfare. School districts received most of the State's revenue sharing moneys. The State auditing agency has not audited any State agencies or school districts to insure compliance with the regulations.

The State auditing agency in Georgia is responsible for audits of State departments and agencies that receive and use revenue sharing funds. In accordance with the agreement between Georgia and ORS, the State will give ORS copies of reports indicating substantial noncompliance.

During fiscal year 1974, the State auditing agency made 41 audits of State agencies and departments. In five instances, the audit agency found noncompliance or possible noncompliance with ORS regulations. These reports were forwarded to ORS for corrective action. Four audit findings were due to noncompliance with the Davis-Bacon provision and one was due to the filing of an employment discrimination complaint.

COVERAGE OF COMPLIANCE MATTERS IS LACKING IN MANY AUDITS

We reviewed 117 audits for which the independent auditor indicated that the audit of revenue sharing funds included both financial and compliance matters. Generally, the audits provided good coverage of the financial matters and several of the compliance requirements. Audit coverage of other compliance items, however, was often lacking, especially those relating to the civil rights and Davis-Bacon provisions. Appendix II summarizes the financial/compliance audits in each of the four States and shows whether specific audit steps were covered.

Civil rights compliance

The Revenue Sharing Act provides that no person shall, on the basis of race, color, national origin, or sex, be

excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity funded, in whole or in part, with revenue sharing funds.

Although ORS' audit guide specifies a number of steps to determine a recipient government's compliance with the civil rights provisions, most audits are incomplete. For example, in New York, 28 of the 29 audits we reviewed omitted all audit steps relating to civil rights. In Minnesota all civil rights audit steps were omitted in seven of the eight audits made by the State agency. In California and Georgia individual audit steps were often not completed.

Although New York and Minnesota have audit agreements with ORS, the audit agencies in both States were omitting steps required under the civil rights section of the audit guide in nearly all of the audits we sampled.

Consequently, these agreements provide no assurance that the State auditing agency will detect and report possible civil rights noncompliance. ORS has publicly stated that both States have agreed to make their audits in accordance with the audit guide, thereby assuring compliance with the provisions of the Revenue Sharing Act.

Many accountants' reports issued on compliance matters by both State auditors and independent public accountants stated that the audit disclosed no areas of noncompliance, except for those specifically stated in the report. The accountants' reports did not reveal that the audit steps required under the guide's civil rights section were often omitted or not completed. Consequently, based on reports it received ORS could believe that all audit steps had been satisfactorily performed and that there had been no instances of noncompliance.

New York's State auditing agency generally waives the ORS audit guide civil rights steps. The agency said that it follows the guide only when it believes that civil rights may be a problem in a particular area. Before signing the cooperative agreement agency officials told ORS that they did not have the expertise to audit civil rights compliance. Agency officials gave the following reasons for their reluctance to audit in this area:

--The New York State Division of Human Rights is better equipped to provide ORS the information.

--Many of the civil rights steps are not applicable to small rural areas.

--Civil rights disclosures may cause political repercussions.

In California, the audit step requiring a determination of possible discrimination in the location of facilities financed with revenue sharing funds was omitted in 44 percent of the examinations. Some auditors said that they were not competent to do this type of auditing or that it could be better performed by government agencies. A partner for 1 CPA firm which audits approximately 45 governmental units in California said civil rights is "one big game." He said he audits to verify preconceived ideas that there is no discrimination.

Most of the auditors in Georgia restricted their audit of compliance with civil rights requirements to ascertaining whether discrimination complaints had been filed or litigation was pending. To obtain this information, they generally reviewed minutes of meetings, asked government officials about complaints, and obtained written or verbal statements from the recipient's attorney. The auditors believed that further work would be beyond their technical competence. The civil rights audit step to determine if the recipient is required to develop an Equal Opportunity Affirmative Action Compliance Program was applicable but omitted in 79 percent of the audits we reviewed. Some auditors complained that the audit guide was not specific enough regarding civil rights, and that the requirement to determine obvious discrimination in locating facilities financed by revenue sharing funds was ambiguous. Other auditors believed that reporting complaints that had been filed or were being litigated served no useful purpose.

In 97 percent of the examinations we reviewed in Minnesota, the civil rights audit step was omitted which required the auditor to check with the recipient's civil rights enforcement office to determine if any complaints have been filed. The Minnesota Department of Human Rights has civil rights enforcement responsibilities for the entire State and has knowledge of nearly all complaints or investigations. Nevertheless, a department representative stated that he had not received any inquiries from auditors regarding such information. Many auditors said they omitted the civil rights section or made only a partial audit because they did not consider civil rights to be a problem. They often cited the relatively few minorities in the population or the small number of recipient employees.

Compliance with Davis-Bacon provision

Our review showed that audit steps pertaining to the Davis-Bacon provision generally were not followed completely.

In the four States we reviewed, the omission of these audit steps ranged from a low of 33 percent in California to a high of 89 percent in Minnesota.

The Revenue Sharing Act provides that all laborers and mechanics, employed by contractors and subcontractors to work on any construction project of which 25 percent or more of the cost is paid with revenue sharing funds, shall be paid wage rates not less than rates prevailing for similar construction in the area as determined by the Secretary of Labor in accordance with the Davis-Bacon Act, as amended.

ORS regulations implementing this provision require that each contract exceeding $2,000 contain a provision stating the minimum wages to be paid various classes of laborers and mechanics as determined by the Secretary of Labor. Further, the contract must stipulate that the contractor shall pay wage rates not less than those stated in the specifications, regardless of any contractual relationships alleged to exist between the contractor and such laborers and mechanics. The contract further stipulates that so much of accrued payments as the contracting officer considers necessary may be withheld from the contract to pay to laborers and mechanics the difference between rates required by the contract and rates actually received.

New York State auditors generally were unfamiliar with the Davis-Bacon provision. They reviewed the recipient government's compliance in only 3 of the 10 applicable cases. There is, however, a similiar State law requiring a community to incorporate prevailing wage rates into all construction contracts. The State auditors do determine compliance with the State law.

California's State labor code requires payment of prevailing wages, by contractors or subcontractors, that equal or exceed those required by the Davis-Bacon provision. Some auditors said that their opinions on compliance with the Davis-Bacon provision were based on a review of compliance with the State code. The Davis-Bacon requirements are new concepts to many auditors, and ORS' audit guide is their first introduction to them. Some auditors reported that they had done considerable research to determine the specific requirements. Because such research increases an audit's cost, one auditor stated that he omitted these steps and qualified his opinion to that effect.

The auditors in Georgia did not review the recipient's compliance with the Davis-Bacon provision in five of the nine applicable instances. Several auditors said that these

provisions discourage bidding and increase construction project costs and, therefore, they were advising the recipient governments not to use revenue sharing funds for such projects. Other auditors said that neither they nor their clients were familiar with the act, its provisions, or the forms required.

The auditors in Minnesota did not determine if the recipient government was complying with the Davis-Bacon provision in 17 of the applicable 19 instances. Auditors often claimed that they omitted the section on the Davis-Bacon provision because either they did not believe it to be a problem or they had performed other audit steps which they considered adequate.

CHAPTER 3

COMPLIANCE AUDIT RECOMMENDATIONS RESULT IN LITTLE OR NO IMPACT ON RECIPIENT GOVERNMENTS

In chapter 2 we pointed out the problems the Office of Revenue Sharing has experienced in relying on others to make compliance audits. However, when compliance findings have been made and properly reported, corrective action usually required only simple adjustments, resulting in little or no impact on the operations of the recipient government or on how the total resources of the recipient were spent.

In addition to the compliance efforts discussed in chapter 2, ORS has developed a four-part approach to compliance auditing and has tried to combine these to obtain the broadest possible coverage of revenue sharing recipients.

This four-part approach includes:

--A review of audits by State and other independent auditors.

--A review of the workpapers supporting selected audits by independent public accountants.

--A review of small units of government using audit staffs of other organizations within the Department of the Treasury.

--An ORS field audit of recipient governments using ORS audit personnel.

This audit effort, however, also has not been effective. ORS' recommendations to bring a recipient into compliance have no greater effect on the recipient's operations than the audits and recommendations made by State audit agencies and other independent auditors.

REVIEWS BY STATE AND OTHER INDEPENDENT AUDITORS

The table on page 16 shows for each of the four States the number of financial-compliance audits we reviewed, compliance opinions issued, and types of audit findings.

Issuance of Compliance Opinion and Nature of Findings for Audits Reviewed by GAO

	New York	California	Georgia	Minnesota	Total
Financial-compliance audits	29	25	33	30	117
Audits having an opinion on compliance matters	29	22	9	13	73
Audits having findings relating to revenue sharing funds	8	7	1	9	25
Nature of audit findings:					
Accounting records not safeguarded	1	1	-	-	2
Inaccurate census data	1	4	-	5	10
Inaccurate allocation of interest	-	1	-	-	1
Trust fund not established	1	-	-	-	1
Use for nonpriority expenditures	1	1	-	-	2
Noncompliance with State and local law	2	1	-	-	3
Fiscal procedures do not conform to regulations	4	3	-	-	7
Inaccurate or missing use reports	1	3	-	1	5
Noncompliance with Davis-Bacon Act	-	2	1	1	4
Equal Employment Opportunity Commission records were not maintained	-	-	-	1	1
Civil rights actions pending	-	3	-	-	3
Lack of nondiscrimination policy	-	1	-	3	4
Noncompliance by secondary recipients	-	1	-	-	1
Total number of audit findings relating to revenue sharing funds (note a)	11	21	1	11	44

a/Total findings sometime exceed the number of audit reports with findings because some reports contain more than one finding.

In New York many of the findings could be corrected easily by changing the accounting procedures or budgeting process. For example, four audit findings were made because the accounting records did not permit adequate tracing of revenue sharing fund expenditures. Two findings were made because the town board did not follow the same appropriation policy for revenue sharing funds that it used for other revenues.

Correcting these problems had no effect on the use of revenue sharing funds or local resources that may have been freed by revenue sharing. They represent the type of finding an independent auditor would report as a result of a complete financial audit.

In California 7 of the 25 audits contained findings relating to revenue sharing funds. Audit reports for two of these audits had been issued in 1974, yet these reports had not been forwarded to ORS as of October 1975. These two reports contained seven audit findings, including three findings of possible noncompliance with the civil rights or Davis-Bacon provisions.

The audit reports forwarded to ORS contained a wide range of findings; however, most findings were strictly of a financial nature or could be easily resolved with accounting entries. These types of financial findings might be reported in any financial audit but have no real effect on the uses of revenue sharing or any other local resource.

In Georgia 32 of 33 financial-compliance audits did not reveal any finding relating to revenue sharing funds. In the other audit, the auditor discovered that the recipient had not complied with the Davis-Bacon provision in using revenue sharing funds for road construction. The recipient government had not obtained a wage determination from the Department of Labor, nor was such a determination incorporated in the contract specifications.

This noncompliance with the Davis-Bacon provision was not communicated to ORS and, hence, ORS did not initiate any corrective action. Although financial statements and an accountant's report were forwarded to ORS, these items did not show any noncompliance. The scope of the accountant's report was limited to financial matters relating to revenue sharing.

In Minnesota 6 of the 11 audit findings were not communicated to ORS as of October 1975. The six findings were contained in four separate reports, each issued before the end of July 1974. Included in the six findings not reported to ORS were three on civil rights, one on the Davis-Bacon provision, one on census data and a use report.

The remaining five audit findings included four on census data and one on a pending civil rights action. Other than the possible civil rights problems, all the findings can be resolved by making the appropriate accounting transactions or submitting additional forms or reports.

The table shows a total of 44 audit findings relating to revenue sharing. Most findings were insignificant, easily corrected, and had little or no effect on the recipient government's operations. The financial problems reported were generally the type that would be reported as a result of a complete certified public accountant examination.

REVIEWS BY ORS

We found no indication in ORS files that any of the corrective actions required by ORS resulted in the Federal Government being reimbursed for an expenditure or action considered to violate the Revenue Sharing Act or regulations. Even when the local revenue sharing trust fund was reimbursed, the local government merely transferred other available funds to the trust fund without any indication that this transfer affected the government's overall activities or operations.

A telephone survey of selected recipients supported this finding. The recipient claimed, in only one case, that a major significant change had occurred. ORS recommended that the county reimburse the trust fund and improve its accounting system. We were told the first recommendation was achieved by a simple transfer from the county's general fund. A representative of the certified public accounting firm that audits the county also said that the second recommendation encouraged the county to institute acceptable accounting procedures where none had existed. He added that the county is now "well on the way to an excellent accounting system."

The following examples are representative of the cases we reviewed:

--A State auditor found a violation of local law when $1,000 was given to a regional community center as a gift of public funds. The State auditor did not make a recommendation, but after reviewing the audit report, ORS recommended that (1) the recipient reimburse its revenue sharing trust fund for $1,000 spent in violation of local law and (2) the recipient provide ORS documents proving the action. The town complied, and ORS closed the case.

  A town official said that the reimbursement was made by transferring funds from the general fund to the local revenue sharing trust fund. The town considered the gift to be valid and charged the expenditure to other local funds.

--Another State auditor found that a village did not maintain a separate trust fund account for revenue sharing as required. After reviewing the case ORS recommended that the village establish a separate trust fund and the village mayor responded with a letter in which he promised to carry out the recommendation. The case was closed with no documentation in the file proving that corrective action had been taken.

--After auditing a small northwestern city, ORS recommended that the city document expenditures of $4,000 or reimburse the local revenue sharing trust fund for that amount. ORS also recommended that the city establish appropriate accounting procedures and records to more easily trace expenditures and distribute expenditures into priority categories. Finally, the report recommended that the city obtain from the Department of Labor a wage determination, as required by the Davis-Bacon provision, for a contract funded with revenue sharing money. If the wages paid under this contract did not meet or exceed the determined rate, retroactive adjustments must be made.

In response to these recommendations, the city documented the legality of the $4,000 expenditure, set up accounting procedures and records to properly classify expenditures into priority categories, and provided information to show that the wages paid under the questioned contract complied with the Davis-Bacon provision requirements. On the basis of documentation provided by city officials, ORS closed the case.

--In another case ORS auditors found that county officials had improperly transferred revenue sharing funds from the local revenue sharing trust fund into the general fund, and the auditors were unable to trace the funds beyond this point. The audit report recommended that the county reimburse the local revenue sharing trust fund for the amount of the improper transfer and provide that all future revenue sharing expenditures be traced to verify compliance with the Revenue Sharing Act.

County officials said they would improve the county's accounting procedures and provided evidence that the trust fund had been reimbursed.

--In another case ORS recommended that a county:

  --Improve its accounting system.

  --Reimburse the county's revenue sharing trust fund in the amount of $97,840.19 for improper disbursements and provide ORS with supporting evidence.

  --File an amended actual use report showing correct expenditures and publish this report in a local newspaper.

The county contracted with a certified public accountant to revise the accounting system to adequately control the expenditures of revenue sharing funds and to provide documentation to show that only $40,046.97 was spent in violation of the act. The county reimbursed its revenue sharing trust fund for this amount. The actual use report was corrected to show this adjustment and was published as required.

Reimbursements to the local revenue sharing trust funds are generally accomplished with accounting entries that change the source of funding but not the amounts expended in the various areas. Therefore they have little or no effect on the operations of the recipient. The ORS audit did cause improvements to be made in the county's accounting system. However, this result can be expected from a complete financial audit made by a certified public accountant.

CHAPTER 4

CONCLUSIONS, RECOMMENDATIONS, AND AGENCY COMMENTS AND OUR EVALUATION

CONCLUSIONS

ORS is responsible for insuring that governments receiving funds under the Revenue Sharing Act comply with the act's requirements. However, the compliance aspect of this effort has not been effective.

Recipient governments are not required to have an audit of revenue sharing funds. If an audit is made, there is no requirement that it follow the procedures prescribed in ORS' audit guide. However, unless the audit guide is followed, ORS will not use the audit report instead of an ORS audit. Recipient governments are deterred from auditing revenue sharing funds in accordance with the audit guide because they realize that (1) an additional cost is incurred for the audit and (2) if the audit should find violations, even inadvertent ones, punitive actions might result.

ORS relied considerably on existing State and independent public accountant audits to report noncompliance or possible noncompliance with the Revenue Sharing Act and regulations. Many recipient governments, however, do not have periodic independent audits. Further, many audits were financial audits that did not include compliance matters. The financial-compliance audits often did not include all the steps prescribed by ORS' guide for audits of revenue sharing. For example, audit steps relating to civil rights and the Davis-Bacon provisions were often omitted. The value of compliance audits is questionable because the recipient governments can easily displace local funds with revenue sharing funds, thus avoiding the requirements and restrictions.

Cooperative auditing agreements between ORS and various States do not assure that State agencies' audits will be satisfactorily extended to cover revenue sharing audit requirements. For example, the State auditing agencies in New York and Minnesota omitted the civil rights provisions of the audit guide in 35 of 37 audits we reviewed.

Although an independent auditor may claim that an audit was made according to the audit guide, there was no assurance that an opinion on compliance matters would be issued. Compliance opinions were not issued on 38 percent of the audits we reviewed in the four States. Unless the auditor issues an opinion on compliance matters and the

chief executive officer sends the report to ORS, ORS can not determine the character of the examination, the compliance problems found, and the degree of responsibility the auditor is taking.

One difficulty in relying on State and independent audits of recipient governments to carry out ORS' compliance responsibility is illustrated by one audit we reviewed. A certified public accounting firm made a financial and compliance audit of the revenue sharing funds of a Minnesota city. The firm issued both a financial and a compliance opinion. In its report, the certified public accounting firm revealed two areas in which it considered the city to be in noncompliance:

--The city had not established a formal policy concerning nondiscrimination in employment.

--The construction contract did not follow the requirements of the Davis-Bacon provision.

The certified public accounting firm issued its report to the city and recommended that a copy of the report be forwarded to ORS. The city did not forward the report to ORS nor did the city take any corrective action. The city later discharged the firm. A representative of the firm stated he believes that disclosure of the Davis-Bacon provision violation was the reason for the firm's discharge. He said that, in his experience, recipient governments oppose having a voluntary compliance audit if there are deficiencies that will be revealed.

Many independent auditors were unwilling to audit revenue sharing funds. Many auditors were reluctant to become involved in compliance areas because they believed they were not competent to do so. Further, compliance auditing is not always compatible with the client relationship. A disclosure of noncompliance could result in legal actions against the recipient or the incurrence of other costs to carry out new procedures, for example, to increase wage rates.

Our review work at ORS covered its entire range of compliance audit activity--including ORS field audits, mini audits, independent public accountant reviews, and ORS reviews of external audits.

The compliance problems that these audits reported were resolved with very little or no effect on the operations of the local governments.

The recommendation that sounds the most severe--reimburse the local revenue sharing trust fund--is actually easy to follow. The government's overall operations were not affected in any of the six recipient governments that were required to reimburse the local revenue sharing trust fund. In each case the corrective action was a paper adjustment. We found no cases where the recipient government had to reverse an expenditure or make a collection. All expenditures remained the same, only the source of the funding changed.

As pointed out in our reports entitled "Revenue Sharing: Its Use By and Impact on Local Government" (B-146285, Apr. 25, 1974), and "Revenue Sharing: An Opportunity for Improved Public Awareness of State and Local Government Operations" (GGD-76-2, Sept. 9, 1975), fund uses reflected by the financial records of a recipient government are accounting designations of uses. Such designations may not reflect the actual impact of the funds on the government. Because of the wide latitude recipients have in using revenue sharing funds, they can use the funds according to the act and then use their own funds in areas where compliance problems might occur. Given the realities of the situation, we question the necessity or desirability of retaining restrictions which can be easily circumvented.

We observed, however, that the audits were resulting in changes in financial controls and procedures which should improve the governments' ability to plan for and serve their citizenries. These changes, which typically result from financial audits made by independent auditors, included accounting system improvements, agreements to follow State or local laws in authorizing expenditures, and strengthening internal controls of fund expenditures. We believe these changes will improve the stewardship and increase accountability of government officials.

RECOMMENDATIONS

We recommend that State and local governments, which have been determined eligible by the Secretary of the Treasury to receive revenue sharing funds, be required to have all of their funds audited, at least once every 3 years, by an independent auditor or under another audit arrangement determined satisfactory by the Secretary of the Treasury. This requirement could apply to governments above a specified size, for instance those with a population of at least 2,500 and/or those that receive revenue sharing funds totaling at least $50,000 annually. We also recommend that the auditor's report be made available to the public and the news media and that the audit be made in accordance

with standards applicable to the financial and compliance element of the audit described in the booklet, "Standards for Audit of Governmental Organizations, Programs, Activities and Functions," issued by the Comptroller General of the United States.

Because many of the restrictions on the use of revenue sharing funds can be easily avoided by using the government's own revenues, the restrictions do not assure that anything substantive will be accomplished. We recommend that the Congress delete from the Revenue Sharing Act most restrictions on the use of the funds. We believe, however, that

--the requirement that expenditures be in accordance with local laws and procedures should be retained,

--the nondiscrimination provision of the act should be expanded so that a recipient government cannot discriminate in any of its programs or activities, and

--comparative financial data showing the sources and uses of all funds for each major program or activity must be provided to the public for the prior, current, and budget years, along with notice and opportunity for the public to give their opinions on proposed expenditures in a public hearing or as the Secretary of the Treasury may authorize.

If the recipient governments were required to have audits that were limited to financial matters, ORS could redirect the efforts of its audit group and, using statistical sampling methods, concentrate on testing the adequacy of the financial audits made for the recipient governments. Reviews for compliance with the nondiscrimination provision could be handled by specialists in ORS' civil rights branch.

AGENCY COMMENTS AND OUR EVALUATION

The Office of Revenue Sharing said it believed a review of its audit activities should be measured against its legally permissible functions; that is, enforcement of the present act's provisions. ORS added that it is obligated to enforce the act's provisions and that an evaluation of ORS audit efforts should not be based on proposals for change in the legislation.

This report cites examples which show that ORS is complying with the Revenue Sharing Act, and we recognize that ORS cannot audit beyond its legally permissible functions. The report does conclude, however, that ORS' approach toward

fulfilling its audit responsibilities has not been totally successful because many governments are not audited, the scope of many audits that were performed did not include compliance matters, and the financial-compliance audits that were performed often did not include all audit steps prescribed by ORS.

As indicated by ORS, our report mentions that, usually, corrective actions taken as a result of audit findings required only simple adjustments having little or no effect on the operations of the recipient government. The report contrasted these changes with corrective actions that resulted in significant changes in recipient governments' accounting procedures and improved their accountability. If adopted, our recommendations would eliminate the need for ORS to audit for compliance with ineffective restrictions on the use of revenue sharing and focus the audit effort in areas more likely to identify and correct substantive problems.

ORS also said that the report appears to reverse pervious GAO support of intergovernmental audit cooperation. Our recommendation that audits of recipient governments be performed by independent auditors indicates our support for intergovernmental audit cooperation. ORS has increased intergovernmental audit cooperation by encouraging recipient governments, and organizations that audit recipient governments, to expand the scope of their audits to include revenue sharing matters, and we believe these arrangements should continue. We are recommending that recipient governments be required to have their financial accounts audited. This recommendation should not require the designation of a different auditor if the existing audit is performed in accordance with generally accepted auditing standards which the ORS "Audit Guide" requires.

We are aware that, as ORS stated, the American Institute of Certified Public Accountants has determined that compliance auditing may be performed by a certified public accountant. However, many certified public accountant audits did not include all compliance procedures required by the ORS "Audit Guide." Typically, auditors told us they omitted these procedures (e.g., civil rights and Davis-Bacon) because they lacked experience or training in the areas.

ORS suggests that to perform the monitoring that we recommend--testing the adequacy of up to 39,000 audits through statistical sampling methods and reviewing the reports of audits of all governments--would require an audit staff many times the size of the present ORS audit staff.

Because our recommendations will shift the burden for audit away from the Secretary and on to the recipient governments, ORS should be able to redirect its audit staff's efforts and achieve coverage at least as broad as under the present system. ORS stated that its present audit staff has reviewed the performance of 15 State auditors and 37 independent public accountants and has examined over 10,000 external audit reports made either by State auditors or independent public accountants.

ORS stated that if revenue sharing recipients must have their accounts audited, such requirements should be limited, as we suggest, to governments receiving more than a stated annual amount of revenue sharing funds. ORS agreed, subject to further analysis, that the $50,000 criterion we suggested might be reasonable but felt the 2,500 population criterion encompassed such small governments as to be unreasonable and onerous. Bureau of the Census data shows that over 27,000 of the 36,000 municipalities and townships that receive revenue sharing have populations under 2,500. Based on the average per capita amount of revenue sharing funds paid to local governments nationwide, a government with a population of 2,500 would receive about $50,000 annually. Therefore, both criteria would tend to affect governments of the same size. Consequently, we fail to see why the dollar criterion might be reasonable while the population criterion is unreasonable and onerous. In any event, the criteria we cited were illustrative, and we accept that larger figures may be more appropriate.

CHAPTER 5

SCOPE OF REVIEW

We reviewed audits of 244 recipient governments in New York, California, Georgia, and Minnesota. We asked officials of each of the four States and the recipient local governments about audits that had been made of their operations and contacted the independent auditors, if any, of these governmental units to determine the nature and scope of their audits. The auditors contacted included representatives from State auditing agencies, certified public accounting firms, and other organizations. Where the auditor stated that an audit of revenue sharing funds had been made in accordance with the ORS audit guide, we interviewed the auditor and reviewed the audit report and selected working papers.

We obtained the views and additional information from other organizations, such as State certified public accounting societies and civil rights enforcement agencies.

We reviewed ORS files and records pertaining to ORS audits of recipient governments, reviews of independent public accountants' workpapers, mini audits, and reviews of audit reports issued by State auditors and other independent auditors (external audits). We selected a sample of the external audits and included all audits in the other three categories in our analyses. We discussed with local government officials the impact of actions taken in response to audit recommendations.

APPENDIX I

SUMMARY OF INDEPENDENT AUDITS REVIEWED IN

NEW YORK, CALIFORNIA, GEORGIA, AND MINNESOTA

State/Unit of local government	Auditing organization: State auditing agency	Certified public accountants	Public accountants	Other	Number of audits for which we contacted independent auditors	Total of audit: Financial/compliance	Financial only
New York:							
Large	2	-	-	-	2	2	-
Medium	14	-	-	-	14	14	-
Small	13	-	-	-	13	13	-
Total	29	-	-	-	29	29	-
California:							
Large	-	9	3	-	12	5	7
Medium	-	58	4	-	62	20	42
Small	-	5	-	-	5	-	5
Total	-	72	7	-	79	25	54
Georgia:							
Large	-	3	-	-	3	2	1
Medium	-	50	-	-	50	27	23
Small	-	12	2	3	17	4	13
Total	-	65	2	3	70	33	37
Minnesota:							
Large	2	1	-	-	3	3	-
Medium	6	38	7	-	51	24	27
Small	-	5	7	-	12	3	9
Total	8	44	14	-	66	30	36
Four State total:							
Large	4	13	3	-	20	12	8
Medium	20	146	11	-	177	85	92
Small	13	22	9	3	47	20	27
Total	37	181	23	3	244	117	127

The groups are defined on the basis of revenue sharing funds received annually:
Large--Over $4,000,000
Medium--Over $10,000 to $4,000,000
Small--Under $10,000

ANALYSIS OF THE SCOPE OF FINANCIAL-COMPLIANCE AUDITS

Audit step prescribed by audit guide	Percent of audits in which audit step completed											
	New York (29 audits)			California (25 audits)			Georgia (33 audits)			Minnesota (30 audits)		
	Done	Not done	Not applicable	Done	Not done	Not applicable	Done	Not done	Not applicable	Done	Not done	Not applicable
Verification of census data:												
All tests	100	-	-	92	8	-	64	36	-	77	23	-
Financial audit:												
Confirm entitlements	100	-	-	96	4	-	64	36	-	73	27	-
Cash and investments separate:												
Bank account verified	100	-	-	100	-	-	100	-	-	100	-	-
Investments verified	75	-	25	100	-	-	56	-	44	93	-	7
Interest income tested	75	-	25	100	-	-	75	-	25	86	7	7
Investments legal	75	-	25	100	-	-	66	-	34	100	-	-
Cash and investments commingled:												
Audit of pooled funds	100	-	-	100	-	-	100	-	-	100	-	-
Allocation of interest, etc.	78	22	-	100	-	-	-	-	100	93	7	-
Compliance audit:												
Separate trust fund or bank account	100	-	-	100	-	-	100	-	-	100	-	-
Priority expenditures	100	-	-	96	4	-	100	-	-	100	-	-
Observed same laws and procedures	100	-	-	100	-	-	100	-	-	97	3	-
Accounting conforms to regulations	100	-	-	100	-	-	97	3	-	100	-	-
Use reports submitted	93	7	-	100	-	-	55	45	-	83	17	-
Provisions relating to Davis-Bacon Act	10	24	66	56	28	16	12	15	73	7	57	36
Prevailing wage rates	21	3	76	40	16	44	12	3	85	17	23	60
Nondiscrimination provisions:												
EEOC report and records	3	97	-	64	36	-	18	64	18	13	87	-
Actions filed with enforcement agency	3	97	-	56	40	4	3	45	52	3	97	-
Actions filed with an internal office	3	97	-	52	28	20	6	45	49	27	73	-
Attorney's and representation letters	3	97	-	72	28	-	82	6	12	37	63	-
Affirmative action compliance program	3	97	-	56	36	8	9	79	12	10	90	-
Location discrimination	3	97	-	44	44	12	9	67	24	10	87	3
Formal employment policy	3	97	-	64	36	-	24	64	12	27	73	-
Matching funds requirements	100	-	-	60	12	28	48	-	52	47	7	46
Compliance by secondary recipients	-	-	100	20	4	76	3	-	97	10	13	77
Use reports published	93	7	-	96	4	-	79	21	-	97	3	-

APPENDIX II

SUGGESTED REVISIONS TO THE STATE AND LOCAL FISCAL ASSISTANCE ACT OF 1972

We suggest that sections 103 and 104 of the act be deleted.

* * * * *

We suggest that section 121 of the act be amended to read as follows:

Sec. 121 Reports, Publication and Public Hearings

(a) Reports. - Each unit of government which receives funds under subtitle A shall, before the beginning of its fiscal period, prepare a report summarizing all anticipated revenues and expenditures for the coming fiscal period, in accordance with guidelines developed by the Secretary of the Treasury. This report should include comparable information showing estimated and actual revenues and expenditures for the current and preceding fiscal periods, respectively.

(b) Publication. - Before the start of the recipient government's fiscal period the report shall be printed in a newspaper which is published within the State and has general circulation within the geographic area of the government or, when such publication is not practicable, by such other means as may be authorized by the Secretary. A copy of this report shall be submitted to the Secretary.

(c) Public hearings. - Each recipient government shall assure the Secretary that it will provide notice and opportunity for its residents to voice their recommendations and views on the report required under subsection (a) in a public hearing or in such other manner as the Secretary may authorize.

* * * * *

We suggest that section 122(a) of the act be amended to read as follows:

Sec. 122. Nondiscrimination Provision.

(a) In General. - No person in the United States shall on any ground prohibited by this act or any other act involving Federal assistance be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity of a State government or a unit of local government which receives funds under subtitle A of

this title. Prohibited grounds shall include, but not be limited to race, color, national origin, sex, religion, age, or physical or mental handicap.

* * * * *

We suggest that section 123 of the act be amended to read as follows:

Sec. 123. Miscellaneous Provisions.

(a) Eligibility Requirements. - In order to qualify for any payment under subtitle A for any entitlement period beginning on or after January 1, 1977, a State government or unit of local government must establish (in accordance with regulations prescribed by the Secretary) to the satisfaction of the Secretary that -

(1) it will provide for the expenditure of amounts received under subtitle A only in accordance with the laws and procedures applicable to the expenditure of its own revenues;

(2) it will--

(A) use fiscal, accounting and audit procedures which conform to guidelines established therefor by the Secretary (after consultation with the Comptroller General of the United States).

(B) provide to the Secretary (and to the Comptroller General of the United States), on reasonable notice, access to, and the right to examine, such books, documents, papers, or records as the Secretary may reasonably require for purposes of reviewing compliance with this title (or, in the case of the Comptroller General, as the Comptroller General may reasonably require for purposes of reviewing compliance and operations under subsection (c)(3)), and

(C) make such annual and interim reports (other than reports required by section 121) to the Secretary as he may reasonably require;

(b) Withholding of Payments. - If the Secretary determines that a State government or unit of local government has failed to comply substantially with any provision of subsection (a) or any regulations prescribed thereunder, after

giving reasonable notice and opportunity for a hearing to the Governor of the State or the chief executive officer of the unit of local government, he shall notify the State government or unit of local government that if it fails to take corrective action within 60 days from the date of receipt of such notification further payments to it will be withheld for the remainder of the entitlement period and for any subsequent entitlement period until such time as the Secretary is satisfied that appropriate corrective action has been taken and that there will no longer be any failure to comply. Until he is satisfied, the Secretary shall make no further payments of such amounts.

(c) Accounting, Auditing, and Evaluation. -

(1) In General. - The Secretary shall provide for such accounting and auditing procedures, evaluations, and reviews as may be necessary to assure that State governments and units of local government comply fully with the requirements of this title.

(2) Each State government and unit of local government that receives funds available under subtitle A for any entitlement period beginning on or after January 1, 1977, shall have its finances and accounts audited by an independent auditor pursuant to regulations promulgated by the Secretary after consultation with the Comptroller General. Such regulations may authorize the Secretary to waive the requirement for the audit, or for portions of the audit, if the Secretary determines that the cost of the audit would be excessive in relation to the entitlement available to a government under subtitle A. Such regulations shall require--

(A) that the audit be performed in accordance with standards published from time to time by the Comptroller General of the United States.

(B) that the audit be made at regular intervals but not less frequently than once every three years, and

(C) that copies of the auditor's report be submitted to the Secretary and be made available to the public and the news media for inspection and reproduction.

(3) Comptroller General Shall Review Compliance. - The Comptroller General of the United States shall make such reviews of the work as done by the Secretary, the State governments, and the units of local government as may be necessary for the Congress to evaluate compliance and operations under this title.

APPENDIX IV

OFFICE OF THE SECRETARY OF THE TREASURY

OFFICE OF REVENUE SHARING
2401 E STREET, N.W.
COLUMBIA PLAZA HIGHRISE
WASHINGTON, D.C. 20226

JUN 7 1976

Dear Mr. Lowe:

Thank you for the opportunity to review the draft report "Revenue Sharing Act Audit Requirements Should be Changed," submitted to this office on May 20, 1976.

The State and Local Fiscal Assistance Act of 1972 requires the Secretary of the Treasury to provide for accounting and auditing procedures, evaluations, and reviews as necessary to ensure that recipients are complying fully with the law. The Act permits the Secretary to accept audits conducted by States of both State and local governments, if their audit procedures are sufficiently reliable.

We believe that a review of the audit activities of the Office of Revenue Sharing should be measured against its legally permissable functions; that is, enforcement of the provisions of the present Act. An evaluation of ORS audit efforts should not be based on proposals for change in the implementing legislation.

The GAO draft report states that it is not meaningful to perform compliance audits because the restrictions imposed by the Act are ineffective. ORS is obligated to enforce the provisions of the Act as enacted by the Congress and makes no presumption that these provisions are ineffective.

The draft report appears to reverse previous GAO support of intergovernmental audit cooperation. Our decision to utilize such assistance was in accordance with Federal Management Circular (FMC) 73-2 issued by the General Services Administration, and with specific recommendations by the Comptroller General of the United States for such increased intergovernmental cooperation. The success of ORS in achieving such cooperation has been commended in reports of accounting organizations and in published reports by the General Accounting Office.

The Office of Revenue Sharing has an audit staff of 25 positions, of which 16 are auditors. The size of this staff is determined by Congress in the annual appropriations process. Given such limited resources and the requirements of the Act, we concluded that the only way in which an effective impact could be made on over 39,000 jurisdictions was to enlist the assistance of State auditors and Independent Public Accountants.

The Office of Revenue Sharing has entered into formal audit agreements with State auditors of 43 states and the District of Columbia. These State auditors are accountable for the audit of revenue sharing entitlement payments to 40 states, the District of Columbia and more than 15,000 units of local government. The GAO draft did not note that these agreements provided for the periodic review of the performance of State auditors in making these audits. To date 15 reviews have been made and in only 3 of those states did we find any deficiencies in work performance. Subsequent follow-up visits and review assured ORS that the work was being performed in a professional manner in two of the states.

With the assistance of the American Institute of Certified Public Accountants and other professional organizations and in consultation with the Comptroller General, ORS developed an "Audit Guide and Standards for Revenue Sharing Recipients." The purpose of the Guide is to assist State and local government auditors and public accountants in their understanding of the special requirements for audits of revenue sharing funds and to establish the audit standards and minimum procedures for audits which are acceptable to the Secretary of the Treasury.

To our knowledge, this is the first and, to date, only effort to provide a standard method for the auditing of virtually all units of State and local general government. The General Accounting Office draft notes that the use of this Guide has brought about an awareness of the need for improved financial systems by many of the General Revenue Sharing recipients.

Also, with the assistance of the American Institute of Certified Public Accountants, ORS developed a program for the review of the performance of Independent Public Accountants in making revenue sharing audits. We have made 37 such reviews, and in those cases where the IPA's had not made a compliance audit in accordance with the Guide, performance was corrected to acceptable standards with ORS audit staff assistance. Follow-up reviews indicated that corrective action was taken.

APPENDIX IV

As a result of the aggressive program of ORS to obtain audits on a voluntary basis, we have reviewed more than 10,000 external audit reports made either by State auditors or Independent Public Accountants. These reports revealed 369 instances of non-compliance which have been corrected or are being corrected.

In addition to the procedures discussed above, the Office of Revenue Sharing has developed a limited audit review of recipient governments receiving less than $10,000 per year in revenue sharing entitlements. Through the Office of Audit, Department of the Treasury, ORS has arranged for performance of these audits by auditors of the U. S. Customs Service. The Customs Service has a network of field offices to which auditors are assigned. Substantial savings have accrued in travel expense which otherwise would deplete the budget of the Office of Revenue Sharing located in Washington, D.C.

The GAO draft questions the ability and willingness of IPA's and State auditors to conduct compliance audits. ORS disagrees with this contention. The American Institute of Certified Public Accountants has determined that compliance auditing is within the realm of expertise of the CPA and believe this type of audit should be made. In fact, ORS has examined working papers of CPA's which demonstrate that they carried out all compliance procedures required by the Guide. The GAO draft also fails to note that it is common practice for IPA's to do a certain amount of compliance work to reveal any contingent liabilities. Further, when we receive an audit report from an IPA which states that the audit was made in accordance with the Guide but does not make a statement regarding compliance, ORS advises the IPA that unless we are informed to the contrary, we assume a compliance audit was made. ORS has received more than 8,000 acceptable audits from IPA's.

As GAO correctly states, the ORS audit Guide does provide audit steps for determining if there are any facts indicating possible non-compliance with the Civil Rights aspects of the Act. ORS recognizes that this process in itself does not assure compliance with the law. These audits are not intended to be the sole determinant of compliance in Civil Rights matters. A Civil Rights staff in ORS has primary accountability for this function. Therefore, any information concerning Civil Rights compliance gained from the performance of these audits serves as valuable additional input to the Civil Rights Division. ORS will continue to seek other methods to enhance the Civil Rights compliance activities.

The draft report also mentions that the GAO found no instance in which corrective action by ORS of violations of the Act and regulations resulted in the Federal Government being reimbursed for the amount of the expenditure. Section 123(a)3 of the Act provides that recipients found to have used funds other than for priority expenditures

> ". . . will pay over to the Secretary . . . an amount equal to 110 percent of any amount expended out of such trust fund in violation of this paragraph, unless such amount is promptly repaid to such trust fund (or the violation is otherwise corrected) after notice and opportunity for corrective action";

Almost all instances of non-compliance are a result of misunderstanding or lack of understanding of the requirements by recipients. The goal of ORS as required by the Act is to effect compliance, not obtain reimbursements for the Treasury. We find recipients are willing to follow our recommendations for corrective action.

Repeated throughout the GAO draft report is a statement that such corrective actions taken as a result of audit findings usually required only simple adjustments resulting in little or no impact on the operations of the recipient government. Audits performed by ORS, or through state agreements, are made to determine whether or not general revenue sharing funds were spent as required by the Act. ORS is not empowered to audit, or make recommendations on, the expenditure of other funds. In many instances enforcement actions taken by ORS required significant changes in the accounting procedures of the recipient government. Improvement in the accountability of these funds was only secured, in many cases, through these audits.

To correct what GAO suggests are weaknesses in the ORS audit procedures, the draft recommends that the law be amended to require periodic financial audits of all funds of State and local governments conducted by independent auditors. The suggested ORS audit function would be to use statistical sampling methods to test the adequacy of financial audits performed for the recipient government (and, presumably, to obtain corrective action where errors occur). To perform the monitoring that GAO recommends, through testing the adequacy of as many as 39,000 audits through statistical sampling methods and review of the reports of audits of all governments, would require an audit staff many times the size of the present ORS audit staff.

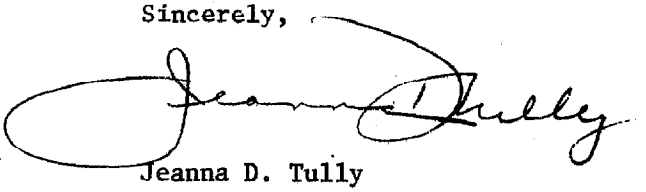
APPENDIX IV

Such a requirement would be inconsistent with the original intention of the Act and would represent significant new Federal involvement in State and local government activities. If, however, the Congress makes such a provision, any such requirement should be limited to governments receiving more than a stated annual amount of revenue sharing funds. The dollar criterion suggested by GAO in the draft report might, subject to further analysis, be a reasonable requirement, while the population criterion indicated encompasses such small governments as to be unreasonable and onerous.

ORS is justifiably proud of the innovative, effective and economical audit program that it has conducted and which produces more effective auditing per dollar expenditure than any other auditing program with which this office is familiar.

We would be pleased to discuss these comments and our observations with you.

Sincerely,



Jeanna D. Tully
Director
Office of Revenue Sharing

Mr. Victor L. Lowe
Director
General Government Division
General Accounting Office
Washington, DC 20548

PRINCIPAL OFFICIALS

RESPONSIBLE FOR ADMINISTERING ACTIVITIES

DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
SECRETARY OF THE TREASURY:		
William E. Simon	Apr. 1974	Present
George P. Shultz	June 1972	Apr. 1974
John B. Connally	Feb. 1971	June 1972
DIRECTOR, OFFICE OF REVENUE SHARING:		
Jeanna D. Tully	Mar. 1976	Present
John K. Parker (acting)	Aug. 1975	Mar. 1976
Graham W. Watt	Feb. 1973	Aug. 1975