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STATEMENT OF
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BEFORE THE
SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS AND HUMAN RESOURCES
HOUSE COMMITTEE ON GOVERNMENT OPERATIONS
ON
THE DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
[HEW] AUDITING PROCESS AND THE ACCOUNTABILITY
OF COLLEGES AND UNIVERSITIES FOR THE FISCAL MANAGEMENT
OF FEDERAL GRANT AND CONTRACT RESEARCH FUNDS]

Hr 01505

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the efficacy of the Office of Management and Budget's (OMB) Circular A-21, "Cost Principles for Educational Institutions", as a measure for improving the management of Federal funds by grantee educational institutions and the effectiveness of the Department of Health, Education, and Welfare's (HEW) auditing process. I would like to relate the need for maintaining accountability for public funds at educational institutions to some recent audit work done by the General Accounting Office (GAO).

Need for Accountability

GAO has always supported the need for maintaining

accountability for public funds regardless of how or to whom they are made available. The Comptroller General recently addressed this issue in a speech before the National Graduate University's Nineteenth Institute on "Federal Research Grants: Maintaining Public Accountability Without Inhibiting Creative Research." I understand that this speech will be inserted into the record but I would like to emphasize a few of the points.

Public pressure for accountability in Government has increased significantly in recent years. This pressure for financial accountability applies to all programs of the Government, and colleges and universities are not any different than any other institutions which receive public funds--public money must be accounted for. Public pressure for fiscal accountability of funds made available for university research is especially called for because the public often has little understanding of what the research actually entails. Fiscal controls at least offer some degree of assurance that funds are being used as intended on authorized research.

We recognize that precise, uniformly categorized, accounting systems may not be appropriate for university research, with its emphasis on individual autonomy. The key issue is how to assure appropriate stewardship for funds spent in support of research, without imposing excessive controls, direction, and administrative burden on research grantees.

There is an equal need for university cognizance and understanding of the Government's role with respect to accountability for public funds. University officials also need to thoroughly appraise their present financial procedures to assure compliance with existing Federal requirements, as well as to present university views concerning proposed changes to these requirements. Mutual cooperation between the universities and Federal agencies is a must if acceptable solutions to accountability are to be found.

OMB Circular A-21

OMB's revised Circular A-21 "Cost Principles for Educational Institutions" issued in February 1979 provides specific principles on distribution methods, identification and assignment of indirect costs, and standards for selected items of costs. However, this Circular like its predecessor merely establishes the principles for determining costs applicable to grants, contracts, and other agreements with educational institutions. For the Circular to be effective the accounting practices of the individual educational institution must support the accumulation of costs as required by the principles, and must provide for adequate documentation to support costs charged to grants and contracts. In addition the cognizant Federal agencies involved in negotiating indirect cost rates and the

auditing of them must assure that institutions are generally applying the cost principles on a consistent basis.

In the past the accounting practices of some educational institutions did not support the accumulation of costs chargeable to Federal grants and contracts as required by the principles. Our review of the effectiveness of HEW's auditing of these costs charged by educational institutions disclosed this problem as one of the factors impacting on the effectiveness of such audits.

The provisions of the Circular become effective October 1, 1979, and institutions are required to implement them as of the start of their fiscal year beginning after that date. We, along with other Federal agencies, were consulted on the provisions of the Circular before its issuance. We believe that if they are properly implemented and coupled with effective auditing, they should provide the degree of accountability of public funds needed to ensure that the Federal Government bears its fair share of total costs.

Effectiveness of the HEW
Audit Agency

Now I would like to discuss briefly Federal audits of funds made available to institutions of higher education. Each year the Federal Government provides financial support to over 2,500 institutions of higher education in the form of grants and contracts for research and development; facilities and equipment; fellowships and traineeships;

and general support.) During fiscal years 1974 through 1976 Federal support amounted to about \$14.4 billion and was provided by 14 Federal agencies including the Departments of Health, Education, and Welfare; Agriculture; Defense; and Energy; the National Science Foundation; and the National Aeronautics and Space Administration.

Under a cross-servicing arrangement, HEW is responsible for auditing Federal funds provided to almost all of the 2,500 institutions and for providing the results of these audits to funding agencies.

We evaluated the results of audits made during fiscal years 1974 through 1976 at the 20 institutions that received the most Federal support during fiscal year 1975 and for which HEW was assigned auditing responsibility. These 20 institutions received over \$3.7 billion of Federal support during the three fiscal years. Our primary objective was to determine the adequacy of HEW's audit coverage of Federal grants and contracts administered by these institutions.

Although HEW devotes a substantial portion of its auditing resources to auditing Federal funds administered by institutions of higher education, ^{It was} we concluded that some of the audits are not as effective as they could be because:

- they were not timely;
- the auditors in some cases could not, because

of an inadequate university accounting system, render an opinion on the allowability of costs charged to Federal grants and contracts; and

--characteristics of a quality audit with respect to scope of coverage, sufficiency of evidence, completeness of reporting, and supervision of staff were lacking in some instances.)

TIMELINESS OF AUDITS

To be effective and of maximum use to management, an audit must be timely; that is, it must be conducted with reasonable frequency. OMB has defined reasonable frequency as annually, but not less frequently than every 2 years. However, we found that some institutions are not audited that often, and others may not be audited at all.

For example, the audit agency's Denver office is responsible for auditing approximately 75 institutions. Although it had established a 3-year cycle for auditing the larger institutions; between 1970 and early 1977, it had performed direct-cost audits at only 15, or about 20 percent, of its assigned institutions.

Similarly the New York regional office is responsible for auditing approximately 300 institutions, about 100 of which have appreciable amounts of research funds. A regional official told us that because of other priorities,

only two or three direct-cost audits can be performed in any one year.

Similar statistics could be cited for the Chicago and Boston regional offices.

University Accounting Systems

Some of the audit agency's audits are not as effective as they could be because, as a result of inadequate university accounting systems, its auditors are unable to determine the amount of unallowable costs charged to Federal grants. In such situations the auditors are forced to simply report that they cannot render an opinion on the allowability of the funds. In some cases, the amount of the funds on which the auditor could not render an opinion was significant. For example, we reviewed a direct-cost audit for one university that covered 3 fiscal years between July 1, 1972, and June 30, 1975. During this period, the university administered over \$111 million in Federal grants and contracts. In its final report, the audit agency stated that the university could not adequately support personal service costs of \$53.7 million charged to Federal grants and contracts because such charges were based primarily on budget estimates and anticipated efforts rather than, as required by Federal regulation, on after-the-fact certification of the charges by knowledgeable personnel. As a result, the audit agency was unable to render an opinion on the allowability of

the costs. Because this audit did not reach a conclusion on the allowability of 48 percent of the audited funds, there is no certainty that valid charges were made to Government grants.

Again, this problem was not limited to one university. At another the audit agency reported that it could not render an opinion on the propriety of \$34 million of salaries and wages charged to Federal grants and contracts during the period July 1, 1969, through June 30, 1972. The report on a third stated that an opinion on the allowability of approximately \$58 million in payroll charges to grants and contracts during the period July 1, 1971, through June 30, 1975, could not be expressed.

The magnitude of this problem can be seen in the audit agency's fiscal year 1977 statistics. During that year it audited \$1.2 billion in Federal grants and contracts to institutions of higher education. The agency reported that of the \$1.2 billion audited, expenditures of \$419.7 million were not adequately documented. Stated another way the audit agency believed that 35 percent of all expenditures it audited were not properly documented.

Officials of the audit agency informed us that they were seriously concerned about their ability to render an opinion on the allowability of cost items because of inadequacies in the accounting systems of some educational

institutions. In fact, the Assistant Inspector General for Audit informed us that HEW is considering the feasibility of imposing sanctions when institutions do not correct system deficiencies that would require auditors to disclaim an opinion on the allowability of charges to Federal grants.

AUDIT QUALITY

The last problem discussed in our report is the quality of HEW audits of universities. All auditors are guided by auditing standards concerning the quality and scope of audit efforts and the characteristics of a professional and meaningful audit report. Standards are used as both a guide for and a measure of the quality of audit performance. Thus, auditing standards are the key to audit quality. The American Institute of Certified Public Accountants (AICPA) and the Comptroller General of the United States have issued separate statements of auditing standards.

The AICPA standards apply to those audits that are made to express an opinion on an organization's financial statements. The extent of testing of accounting and related records is determined by the auditor, based on professional judgment and experience.

GAO standards incorporate AICPA standards; but require a broader inquiry into grantee compliance with Federal laws and regulations than is required by AICPA standards. In evaluating the quality of HEW's audits of institutions

of higher education, we used the GAO standards because Federal audit policy requires that audit performance be in line with those standards.

We found that HEW's audits of Federal funds administered by institutions of higher education are not always as effective as they could be because they lacked some of the characteristics of a quality audit with respect to such matters as audit scope, amount of evidence gathered, the completeness of audit reports, and supervision of audit staff. This lessened the usefulness of the audit results.

Report Recommendations

We recognized that a shortage of audit resources has significantly contributed to these shortcomings and thus recommended that the Inspector General assess the priorities to which his audit staff is assigned to see if additional effort could be devoted to university audits.

In addition, we recommended that the Secretary of HEW

- establish a cycle for auditing the institutions assigned to it that will result in more timely audits;

- audit in sufficient depth to establish the allowability of costs claimed by institutions;
- and

- insure that audits are conducted in accordance with the GAO standards.

Agency Comments

In response to our report the Inspector General of HEW stated that

- The Department has not been able to implement a firm cycle for auditing institutions of higher education because of insufficient audit resources.
- The Audit Agency will continue to try to develop effective "extended" audit procedures to close the "accountability gap" created by unauditible university systems.
- The Audit Agency will provide new policy guidance on audit technicalities to improve future audits.

He also said that recently, additional audit work has been done or scheduled at four universities.

Relative to the accountability gap, the Inspector General said that HEW has a major program of reform underway to include (1) simpler Federal regulations without loss of safeguards, (2) improved procedures for the prompt resolution of audit findings, (3) early audit review service on proposed changes in institutions' accounting systems, and (4) sanctions against institutions and individuals when corrective actions are not taken in a reasonable time period.

In summation, we believe that the implementation of A-21 coupled with timely and effective auditing and reporting should provide greater accountability of public funds at educational institutions.

This concludes our prepared testimony, Mr. Chairman.