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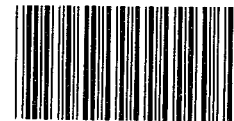
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STATEMENT OF

ELMER B. STAATS

COMPTROLLER GENERAL

OF THE UNITED STATES



109995

BEFORE THE

SUBCOMMITTEE ON LEGISLATION AND NATIONAL SECURITY #15dc
COMMITTEE ON GOVERNMENT OPERATIONS

HOUSE OF REPRESENTATIVES

CONCERNING OUR REPORT ON THE

[PROBLEMS INVOLVED WITH GRANT AUDITING]

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to appear before the Subcommittee to testify on the views of the General Accounting Office relating to problems involved with grant auditing. With me today are Mr. Donald L. Scantlebury, Director; and Mr. George L. Egan, Associate Director of our Financial and General Management Studies Division.

Mr. Chairman, as you have stated, Federal grant assistance to State, local, and nonprofit organizations has increased dramatically in the last 20 years, from 7 billion dollars in 1959 to 85 billion in 1979. Along with this increased funding has been the significant increase in the number of Federal programs, approximately 1,100 at the current time. The

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Congress and the Executive Departments rely on audits of financial transactions and compliance with applicable laws and regulations as the basic control to see that these funds are spent as Congress intended and to prevent loss of funds from fraud and abuse.

Because Federal assistance programs and grants continue to grow in number and complexity, we reviewed the audit experience of grant recipients with particular attention to:

- audit coverage of grantees' financial controls and their compliance with grant terms;
- Federal audit requirements provided in laws, OMB circulars, and agency regulations;
- Federal agency audit planning and programming systems; and
- coordination among various audit organizations--
Federal, State, and local.

Our review has shown that grant auditing is indeed what we called it in our recent report, "A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling." The review, which resulted in that report was directed toward the audit experience of 73 grant recipients during fiscal years 1974 through 1977, disclosed that 80 percent of the recipients' \$3.7 billion in Federal funds was not audited by or on behalf of the Federal agencies. This test was not based on

a statistical sample, since the information to develop such statistics is not available. However, if what we found is typical of the approximately \$240 billion in grants awarded during the period, it is possible that the Government did not audit or have audited nearly \$192 billion of these grants.

Moreover, most of these grantees did not have audits made by their own auditors that would serve Federal needs. Of the 73 grant recipients we reviewed, 17 either were not audited at all, or suffered such major gaps in audit coverage that we could not consider them audited. Of the remaining 56 audited, 51 (over 90 percent) received audits that provided only partial or no insight into whether Federal funds were properly spent. For the most part, these audits were made to satisfy State or other non-Federal requirements. Only one grant recipient received a single comprehensive audit.

The number of times a recipient was audited some- times varied widely--from no audits to more than 50. One grantee, for example, received 23 grants from 5 Federal agencies. None of the grants provided in calendar years 1974 through 1977 was audited. In contrast, a grantee funded by 5 Federal agencies was audited 19 times by 6 different audit organizations between June 1975 and October 1977. These problems associated with grant auditing occur primarily because grant recipients receive

individual grants from numerous Federal and State agencies with differing audit requirements. The ideal situation in auditing these grant programs would be to have a single audit of a recipient. ✓

This ideal is far from being achieved. In general, agencies audit only their own grants. Let me elaborate a little here. A Federal grantee may have anywhere from one to several hundred grants. In many cases, the system used in accounting for the grant is only a part of the grantees overall accounting system. For instance, a city that is a grantee may have 35 grants but the accounting records relating to them are only a part of the total city accounting system. Under current auditing practices, a Federal auditor who came in to make an audit would, in all likelihood, direct his work toward only one of the 35 grants. However, his audit would usually include some tests of the grantees' procedures for handling all of its cash receipts and disbursements, computing and allocating payroll costs and a variety of similar accounting procedures. The next Federal auditor who came to this city would probably audit another grant but would audit some of the same procedures over again. ↑

When we speak of a single audit we mean one audit that ✓ would cover all grants that the entity has. Such an audit, among other things, would test the grantee's system for complying with Federal restrictions on the use of the funds

and related matters, but a detailed audit of each grant would not be made. Any Federal auditor could review such an audit and rely on it if he felt the grantee's system provided reasonable assurance that Federal funds were properly safeguarded and spent for authorized purposes. If he had reason to believe this was not so, he could make a separate audit and perform such additional audit procedures as might be needed to supplement those performed in the single audit.

The disorganized approach to grant auditing that is currently practiced costs time and money. The Government can lose millions of dollars through gaps in audit coverage. Unnecessary costs also can result from duplication of effort and from performing audits too often of grants too small to warrant more than an occasional audit. Also, numerous audits unnecessarily disrupt the grantees' staff.

The past efforts to improve grant auditing have generally been ineffective. This has been caused by a number of different, yet closely related factors. The major factors are:

- inflexibilities and inconsistencies in grant audit laws and agency regulations,
- the uncoordinated Federal approach to grant auditing that allows each Federal agency to issue guidelines and conduct specific grant audits to meet its own needs without

coordinating the work with other agencies,
--the failure of the Government to see that
its grantees make or have audits made that
satisfy Federal needs, and
--the poor use and possible shortage of audit
resources.

With regard to inflexible audit requirements, the Congress, OMB, and individual Federal agencies require audits to be made at set intervals. OMB requires grantees to secure financial and compliance audits at least once every 2 years. The Congress requires certain grant programs to be audited periodically, at intervals ranging from 1 to 3 years. Some agencies have imposed tight requirements regarding when audit reports should be issued while other agencies require audits at certain times.

Our position that mandatory audits are less productive than discretionary audits is longstanding. In this and prior reviews we have found that mandating the frequency and timing of grant audits limits the flexibility of grant managers and auditors to adjust audit coverage to ensure that the most productive use is made of audit resources. Where mandated requirements were enforced, the grant programs were audited again and again regardless of the dollar amount of the grant or its size in comparison with other grants administered by the recipient. Often, the audits were repeated even though previous audit findings were

minimal and diminished in significance with each additional audit.

Audit requirements imposed on individual grant programs have also pushed agencies to focus on grants rather than on recipients, and have made cooperative arrangements between funding agencies more difficult.

Now, let me turn to the problem of each Federal agency auditing its own grants instead of coordinating its audit needs with those of other agencies. The Government has not established firm requirements or developed the mechanisms to see that such audit needs are combined and that single audits of grant recipients on a Government-wide basis are made. The lack of such requirements, added to an agency's overriding concern for its own grants as opposed to those of other agencies, explains why agencies continue to conduct narrowly scoped audits of their own grants without regard for the interests of other Federal agencies.

Agencies simply do not have the information necessary to effectively coordinate single audits. Under the current approach, agencies with the predominant financial interest in the audit are encouraged to collaborate with other Federal agencies to work out mutually agreeable audit arrangements. However, agencies are left to do this solely on a voluntary basis with limited information about who funds or audits which grantees.

The many different audit guides for performing and reporting grantee audits have also posed a major problem. Their number is often cited as one of the major factors limiting both reliance on other audit work and coordination among Federal agencies or among Federal and State agencies in auditing multifunded recipients. Federal agencies have developed over 80 audit guides which detail the nature and scope of audits and the format and distribution of audit reports. A few agencies have one audit guide for all their grant programs; however, most have separate guidelines tailored to specific grant programs, but not for all of their programs.

The large number of guidelines and the fact they are grant oriented rather than entity oriented are not the only problems posed. The guides also contain divergent audit approaches, a variety of audit steps, and different reporting formats which vary both in presentation and the amount of information required. This causes problems for State and local auditors and independent public accountants because they must learn new rules for every type of grant they audit.

Some progress has been made in solving this problem. GAO in cooperation with the Intergovernmental Audit Forum and various Federal agencies has taken the lead in developing an audit guide--"Guidelines for Financial and Compliance Audits of Federally Assisted Programs"--for

comprehensive financial and compliance audits of multifunded grant recipients. The Intergovernmental Audit Forums were organized, at the suggestion of GAO, with membership of Federal, State, and local auditors. There is a National Forum and 10 regional forums. These State and local auditors as well as Federal auditors have participated in the development of this guide. This guide, which OMB has now asked agencies to review, recognizes the need for a limited amount of compliance testing and suggests some tests that should be included in a financial audit, such as eligibility of recipients and matching fund requirements. The guide may need revision as experience is gained, but we consider it a good start toward getting away from the confusion that now exists because of the many audit guides now in use.

Another problem is that Federal auditors are not using or overseeing audits which their grantees have had made by independent public accountants or others. They simply do not obtain and examine these audits. Many cite the lack of audit resources for not doing so. Others simply do not determine if non-Federal organizations are auditing their grants and if results of these audits could satisfy Federal needs. In fact, non-Federal auditors often have not made audits required by grant agreements unless Federal agencies specifically request them, and when they have been made, the audits frequently do not determine whether Federal

funds were spent for their intended purposes. Notwithstanding some deficiencies in the scope of their work from a Federal viewpoint, these audits would shed some light on the adequacy of the grantees internal controls and accounting procedures.

The principal reason Federal agencies cited for not auditing all grants or reviewing audits made for grantees by their auditors was a shortage of Federal audit resources. Federal auditors said that they do not have enough auditors to regularly audit all their grant recipients. Even though they know that grantees are not making audits and question the usefulness of the audits that grantees secure, they do not have the resources to followup with their own audits.

Although Federal officials cite the lack of audit resources as a major reason for gaps in audit coverage, conditions might be significantly improved if the agencies made better use of their existing resources. For instance, if agencies implemented single, coordinated audits of recipients, a great deal of wasteful duplication would be eliminated while providing a better look at the grantee's overall performance. Such coordinated audits would require fewer auditors to plan, perform, and report on audits of large multifunded grantees.

The four agencies which make up the Joint Financial Management Improvement Program--GAO, OMB, Treasury and the Office of Personnel Management--established a special

task force to make an independent study to to determine how Federal, State, and local audit organizations could work together more effectively. Although this study had a broader scope than our own, many of its recommendations were very similar. It too, strongly endorsed the single audit concept.

We consider the problem in grant auditing a very serious one that badly needs attention. Unless this problem is corrected, many grants will continue to evade the scrutiny which the audit system is designed to provide. In other cases we will spend funds unnecessarily in overauditing some grantees' records. We have given the matter much thought and recommend the following action to bring about a logical and orderly system for auditing Federal grants.

First, we recommend that the Congress amend the Intergovernmental Cooperation Act of 1968 to prescribe standardized audit requirements which would be applicable to all Federal grants. The amendment should rescind existing laws for regularly scheduled audits of individual grants by particular organizations and allow Federal agencies flexibility in judging audit need. The amendment should designate a reasonable time interval within which grant recipients must be audited.

Second, we recommend that the Director, Office of Management and Budget:

- designate cognizant Federal agencies for making single audits of multifunded recipients

(responsibility for auditing specific types of recipients, such as hospitals and colleges, could be divided among several agencies, if the burden was too great for one agency),

- hold periodic meetings with grant administering agencies to insure complete and successful implementation of the cognizance approach,
- direct cognizant agencies to use a standard audit guide or a suitable replacement in auditing multifunded recipients,
- develop a nationwide system to identify Federal funding that grant recipients may receive, and
- stipulate that to be paid for with grant funds, non-Federal audits must follow Federal audit guidelines.

Third, the heads of Federal departments and agencies administering grants ^Ron OMB should:

- establish procedures to insure that grantees under their cognizance have the required audits made in accordance with the standards prescribed by the Comptroller General.
- assure that their auditors make maximum use of audits arranged by non-Federal agencies

and only do whatever additional work may be necessary to see that grant funds are spent for the intended purpose and are otherwise safeguarded, and

--assure continuous liaison with non-Federal audit staffs with common interest to minimize the amount of audit effort required and to learn of problem areas.

I am pleased to say that the Director of the Office of Management and Budget generally endorsed the findings of our report. He pointed to the President's September 1977 memorandum calling for improved coordination of grant audits; the passage of the Inspector General Act of 1978; and OMB's work with us, the National Intergovernmental Audit Forum, and State and local governments. He also strongly endorsed the recommendation to rescind existing laws requiring audits of individual grants. Further, he agreed that use of a single audit guide would be a major breakthrough in auditing federally assisted programs.

We received comments from the 11 agencies reviewed. The agencies agreed, at least in principle, with our recommendations to the departments and agencies. Although some agencies expressed concerns, only the Department of the Interior did not favor our recommendation that the Office of Management and Budget formally designate one

agency as responsible for the audit of each grantee. The Department felt that duplication would result if agencies perform additional audits to meet special needs. To achieve a coordinated audit approach, we believe the designation of cognizant agencies is essential. When special audits are necessary, the cognizant agency should ordinarily do the work using its prior audit work and this should help avoid duplication of effort.

Prompt action needs to be taken to turn this disorganized situation into a systematic and logical system for performing these audits.

This concludes my formal presentation, Mr. Chairman. We would be pleased to try to answer any questions you may have.