

BY THE COMPTROLLER GENERAL

**Report To The Chairman,
Committee On Government Operations,
House Of Representatives
OF THE UNITED STATES**

**Study Of Progress Made In Implementing
The Single Audit Concept**

Achieving adequate audit coverage through detailed grant-by-grant audits is costly and very difficult. The single audit concept emphasizes an entity-wide audit utilizing reviews of internal controls rather than relying solely on detailed audits of each grant. However, this concept has not been successfully implemented through OMB's Circular A-102, Attachment P. Implementation of the concept would be enhanced by

- a clear definition of and agreement on the purpose and scope of the audit,
- exempting those governments receiving small amounts of federal assistance, and
- consolidation of existing multiple federal financial audit requirements which conflict with the single audit concept.

GAO believes that legislation is needed to correct these problems and provide the permanency needed for successful implementation of this important reform. GAO further believes that legislation is needed to better define the management role of cognizant agencies that oversee implementation of the single audit. Legislation addressing these issues is pending in the Senate and the House of Representatives.



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

B-176544

The Honorable Jack Brooks
Chairman
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

This report is in response to certain recommended areas of study made in the House Committee on Government Operations' Report No. 97-917, October 1, 1982, Improving the Financial Management and Auditing of Federal Assistance Programs: The Single Audit Concept. Our recent study in 10 states included an overall assessment of the implementation of the Office of Management and Budget (OMB) Circular A-102, Attachment P, as well as the issues identified in the Committee's report. Attachment P "Audit Requirements" pertains to grants to states and local governments. (See app. I for statement on objective, scope, and methodology.)

In response to a GAO report, Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling, FGMSD-79-37, June 15, 1979, the Subcommittee on Legislation and National Security of the House Committee on Government Operations held hearings on the feasibility of adopting the single audit concept. This concept emphasizes a review of internal controls of the state or local entities being audited rather than a detailed audit of each grant. Achieving adequate audit coverage through detailed grant-by-grant audits would be costly and very difficult. The single audit approach also provides an improved audit base for performing additional selected audits such as those concerning detailed compliance issues, economy and efficiency, or program results.

In October 1979, OMB responded to the hearings by issuing Attachment P to Circular A-102 in an effort to implement the single audit concept through administrative regulations. Under the provisions of this attachment, state and local government entities receiving federal assistance are required to provide for a single organization-wide financial and compliance audit. However, neither the circular nor related policies have clearly defined the single audit concept.

OMB assigned various cognizant agencies to oversee the implementation of the circular at the state level and local level. A federal cognizant agency is the federal organization responsible for managing the overall implementation of the circular. Various departments and agencies under a state or local government were assigned to different federal cognizant agencies. For a limited number of state and local governments, OMB assigned a lead cognizant

agency to provide a single focal point to coordinate the management of the single audit on behalf of other cognizant agencies.

We found that a major problem still impeding progress in implementing the circular is the lack of a clear definition and common agreement on the scope of the audit. We also found a diffusion of responsibility in the current cognizant agency system.

We found that transition to the single audit has been slow and difficult, partially due to the evolution of policies and procedures that have resulted in varying interpretations of Attachment P over a 4-year period. Although recent emphasis by OMB and the inspectors general has resulted in some progress, much more needs to be done to fully implement the single audit. We believe the Congress should enact legislation to:

- Clearly define what is to be achieved by the audit, and, in particular, emphasize the study and evaluation of internal control systems over federal assistance, the extent and purpose of transaction testing, and the concept of building on the financial statement audit in any additional audits and evaluations of federal programs.
- Reduce the burden on local governments by exempting from single audit requirements those receiving relatively small amounts of federal assistance.
- Consolidate existing multiple federal financial audit requirements for state and local governments through legislatively mandated uniform financial audit requirements for all federal financial assistance programs.

We further believe that legislation is needed to better define the management role of the cognizant agency in order to minimize existing diffusion of responsibility. We believe legislation, which addresses these four issues, is needed to resolve the conflicting demands of federal, state, and local officials as well as of existing federal statutes. Also, as noted in a recent GAO study,¹ government-wide management improvement initiatives generally achieve more lasting results if carried out through a legislative mandate.

PROGRESS IN IMPLEMENTING ATTACHMENT P

While some progress has been made in implementing Attachment P audits, more needs to be done. Our analysis in 10 states showed that as of June 30, 1983, the majority of audits completed, in process, or planned related to state departments and agencies. Relatively few audits pertained to local governments. We found that each of the 10 states had performed or planned to perform Attachment P audits, but as of January 1983, only an average of 20

¹Selected Government-Wide Management Improvement Efforts--1970 to 1980, GAO/GGD-83-69, Aug. 8, 1983.

percent of their general purpose local governments (cities and counties) had audits completed, in process, or planned. These local governments had populations in excess of 50,000 and comprised 67 out of 330 of the largest local governments in the 10 states. Since most federal grant funds are spent by local governments, most federal grant funds in these states were not audited in accordance with the requirements of Attachment P. (For example, in 6 of 10 states where data were available, about 67 percent of federal funds was spent at the local level.)

DEFINING THE PURPOSE OF THE AUDIT

Federal, state, and local government officials have had a continuing dialogue concerning what is to be achieved by the single audit. The discussions revolve around two different, but basic, approaches for ensuring compliance with laws and regulations. Attachment P and the cognizant agencies have had little success in trying to resolve this debate.

The traditional federal approach has been one of after-the-fact detection of noncompliance through the testing of numerous transactions for an individual grant or a number of grants. The other approach concentrates on preventing noncompliance by ascertaining whether internal controls are in place and functioning to help ensure compliance with federal laws and regulations. This approach is supplemented by transaction and compliance testing based on the degree of reliance the auditor can place on the internal control system.

For example, the debate over what is to be achieved by the single audit is currently taking place in a state included in our review. The state auditor and a federal regional inspector general have exchanged letters clearly indicating their different interpretations of Attachment P. Substantive differences focused on the extent of transaction testing as well as on a number of other issues.

An example that illustrates the problems with the traditional detection approach was reflected in an audit, in which we participated, at one department of a state. The state auditor requested GAO staff to participate in the audit so that both staffs could benefit from the application of the single audit concept. In that audit, 17 of 93 federal grants representing 84 percent of the total federal grant expenditures of \$9 million were reviewed. A detailed transaction testing of these grants identified many individual problems associated with each grant. We believe that the cause of these problems was related to the absence of internal administrative control systems over all federal grants. The audit, however, was not directed at evaluating the internal control systems so that weaknesses could be identified and recommendations made to improve the systems to help prevent future problems.

We found a wide diversity in the sampling methods auditors used for selecting federal grants at the local level. At one extreme, even though the internal controls were not relied upon, 4

out of 98 grants were sampled. This resulted in the audit coverage of 36 percent of federal funds received. At the other extreme, 55 out of 62 grants were sampled. This resulted in the coverage of 86 percent of federal funds received even though the internal controls were sufficient. In these and four other cases we examined, it was unclear as to how the sample selection method and extent of transaction testing were related to the study of internal controls over federal grants. (See app. II which summarizes the diversity of sample selection methods.)

We believe emphasis on the preventive approach is clearly preferable since it would help ensure long lasting improvements by treating the causes of noncompliance as well as serve as a more efficient and effective basis for further audits or evaluations. Moreover, such an approach, by identifying those instances where controls may not be adequate, would assist federal managers in fulfilling their managerial and programmatic responsibilities by giving them reasonable assurance that an entity's systems can provide proper accountability over federal programs. This information would be communicated by the results of the compliance report and the internal control report resulting from the single audit and would give federal managers a basis for acting to have the systems improved or doing additional audit work. This internal control aspect of the single audit should be clearly enunciated in any single audit legislation.

DIFFUSED FEDERAL COGNIZANT AGENCY SYSTEM

OMB's assignment of cognizant agencies at the state level has diffused federal responsibility for management of the single audit on a statewide basis. In 1980, OMB assigned various cognizant agencies for 800 different departments at the state level, with the exception of Montana which was assigned a single cognizant agency for the entire state. In 1982, OMB assigned various cognizant agencies for local governments with a population in excess of 50,000. At the option of the local government, a lead agency could be designated to coordinate all single audit work. However, for most local governments (those with populations of less than 50,000), OMB did not specifically establish which agency would be cognizant.

Our study found that the cognizant agency system did not, in most states

- designate a lead or single federal agency to be responsible for coordination of the single audit within a state,
- facilitate the development of a plan for implementing the single audit at federal, state, and local levels of government,
- provide uniformity within a state on the technical aspects of the audit, or
- facilitate the development of a plan to monitor audits performed.

A possible approach to resolving these problems is being implemented in several states. OMB's assignment of one federal cognizant agency to each of 15 states provides a single focal point for the states to relate to in carrying out their audit responsibilities. These assignments were made for state departments and agencies and did not include local governments.

EXEMPTING SOME LOCAL GOVERNMENTS

All local governments receiving federal assistance are currently required to have an Attachment P audit. Nationwide, this provision could require about 82,700 governmental agencies (comprised of 38,900 general purpose local governments and 43,800 special purpose governments) to have an audit, even though many of these governments receive only small amounts of federal funds.

Many federal officials have expressed an interest in exempting local governments receiving small amounts of federal assistance from Attachment P audit requirements. Thresholds suggested, in terms of federal assistance received, range from \$10,000 to \$25 million. Our analysis suggests that \$100,000 would be a reasonable threshold because it provides audit coverage to local governments receiving most federal assistance, yet reduces the burden on a significant number of local governments now required to have an Attachment P audit. (See app. III.)

UNIFORM CROSSCUTTING AUDIT REQUIREMENTS

In addition to the requirements in Attachment P, about 30 federal statutory financial audit requirements exist which require grantees to ensure that audits are performed. These audit requirements often differ in the frequency and scope of the audits, the organization responsible for conducting the audit, and the audit standards to be followed, and make it difficult to combine audit efforts.

We believe uniform crosscutting financial audit requirements for recipients of federal assistance are needed to consolidate multiple statutory financial audit requirements, and thereby facilitate the accomplishment of the single audit. For example, the audit requirements for the nine block grants authorized under the Omnibus Budget Reconciliation Act of 1981 differ in certain respects from those of Attachment P and elicit the concern of state officials who are required to meet these requirements. Under Attachment P, state and local governments are required to have an audit every 2 years, whereas, four of the nine block grants require an annual audit. If a state or local government chooses to do the single audit every 2 years, it still must perform a separate audit for the four block grants in the year in which the single audit is not performed. If the audit periods for all statutory audit requirements were the same, federal audit requirements, including those for block grants, could be covered in the single audit, thus eliminating the need for additional separate audits.

We recently briefed your office on the status of our study of all audit provisions contained in federal statutes. We are now preparing a report on that study for you and the Chairman of the Senate Committee on Governmental Affairs. That report will include attachments detailing the programs to which the provisions apply.

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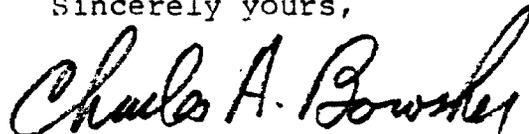
At this time, the President's Council on Integrity and Efficiency is continuing its studies of Attachment P. The council issued an interim report on the status of implementation on August 17, 1983, and is continuing to study user needs including those of federal managers. Also, OMB is modifying Attachment P. These efforts will contribute to further valuable knowledge and improvements. In our opinion these efforts will not, however, remove the major obstacles which continue to impede implementation. These obstacles include the need for crosscutting legislation, obtaining agreement on purpose and scope, need for a clear role for the cognizant agency, and an agreed upon threshold amount. We believe that legislation will provide the impetus to increase the likelihood for the more rapid progress and permanency needed in this important reform.

We view the concept of a single audit on an entity basis to be superior to the more common practice of auditing on a grant-by-grant basis. However, because the issues involved in implementing the concept are complex and involve the conflicting demands of federal, state, and local officials as well as of existing federal statutes, legislative direction is needed to help resolve these issues.

Subsequent to our review, the Senate approved single audit legislation and you introduced the Single Audit Act of 1984. We believe enactment of single audit legislation will go a long way toward resolving the issues discussed in this report and will ultimately lead to successful implementation of the single audit concept.

As arranged with your office, unless you publicly announce its contents earlier, we will not distribute this report until 30 days from its date. At that time we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,



Comptroller General
of the United States

OBJECTIVE, SCOPE, AND METHODOLOGY

In April 1982, GAO initiated a study of the current status of federal efforts to implement the single audit concept. The objective of this study was to identify concerns and problems impeding implementation and to develop suggestions for the Congress to remove obstacles to progress. In October 1982, the House Committee on Government Operations recommended in its report (No. 97-917, Oct. 1, 1982, Improving the Financial Management and Auditing of Federal Assistance Programs: The Single Audit Concept) that GAO evaluate various aspects of the cognizant agency system and potential cost impact of the single audit concept.

Our overall assessment disclosed the continuance of several major obstacles to successful implementation. As discussed in this report these problems include the need for crosscutting legislation, obtaining agreement on purpose and scope, and an agreed upon threshold amount. These obstacles also need resolution before the management role of the cognizant agency system can be better evaluated.

Our study did not address the potential cost impact of the single audit since this analysis is being performed as part of a comprehensive study of Attachment P by a committee of the President's Council on Integrity and Efficiency. We will monitor the results of this study.

We focused our work in 10 states which were selected to represent a cross section of amounts of federal assistance. As indicated in the table on page 8, the 10 states received about 30 percent of fiscal year 1981 federal assistance to all states and contained about 35 percent of all general purpose local governments in the United States.

We analyzed available reports and literature on the single audit concept and discussed concerns of the Congress and executive branch with a large number of governmental and private sector officials. We interviewed state and federal officials involved in the audit process and obtained statistical and other data to study audit organizations, resources, and single audit activity for the 10 states and local governments in each state. We reviewed several completed single audit reports and related audit programs and workpapers.

We undertook a special study to identify audit requirements in all federal statutes. The results of that study will be sent in a separate report to the Chairmen of the House Committee on Government Operations and Senate Committee on Governmental Affairs.

The statistics we used in our review to demonstrate the value of audit thresholds came from data bases developed and maintained by the Bureau of the Census, the Evaluation Committee of the President's Council on Integrity and Efficiency, and individual state governments. For the data bases obtained from the President's Council, we have obtained and reviewed the methodology and

questionnaires used to collect the data. We did not attempt to verify the source data of the Bureau of the Census because it appeared consistent with information obtained from the other two data bases.

Our study included statistical data obtained by the Evaluation Committee of the President's Council on Integrity and Efficiency for local governments on a state-by-state basis as of January 1983. Additional data was obtained by the Evaluation Committee to show overall progress as of September 30, 1983. However, that data was not readily available on a state-by-state basis and could not be related to the 10 states nor to the local governments within those states.

<u>State</u>	<u>1981 federal grants</u>		<u>No. of local general purpose governments</u>
	<u>Amount</u>	<u>Rank</u>	
	---millions---		
California	\$ 10,007	2	483
Michigan	4,107	6	1,859
Ohio	3,725	7	2,345
Florida	2,867	10	457
Wisconsin	2,298	11	1,921
Minnesota	1,773	18	2,736
Kentucky	1,433	23	536
Colorado	1,021	27	329
Iowa	961	28	1,054
North Dakota	317	46	1,780
Total	<u>\$ 28,509</u>		<u>13,500</u>
Total all states	<u>\$ 94,306</u>		<u>38,872</u>

The study was performed in accordance with generally accepted government auditing standards. We did not forward this report to OMB or to the federal inspectors general for comment.

DIVERSITY OF SAMPLE SELECTION METHODS
FOR SINGLE AUDIT OF SIX LOCAL GOVERNMENTS

<u>Description</u>	<u>A</u> <u>(City)</u>	<u>B</u> <u>(County)</u>	<u>C</u> <u>(City)</u>	<u>D</u> <u>(County)</u>	<u>E</u> <u>(County)</u>	<u>F</u> <u>(County)</u>
Internal control	Reviewed accounting controls systems but did not test to determine if systems worked. Relied on substantive testing of transaction because it was more cost effective. Did not review administrative controls over federal grants.	Performed detailed review of accounting and administrative internal control systems and tested transactions to determine if systems worked.	Performed detailed review of accounting and administrative internal control systems and tested transactions to determine if systems worked.	Performed detailed review of accounting internal control systems and tested transactions to determine if systems worked.	Performed detailed review of accounting and administrative internal control systems and tested transactions to determine if systems worked.	Performed detailed review of accounting and administrative internal control systems and tested transactions to determine if systems worked.
<u>Sample selection</u>						
Grants reviewed	4	10	55	62	26	10
Universe	98	62	62	156	182	39
Percent reviewed	4	16	89	40	14	26
Fed. funds reviewed	\$28.6 million	\$69.5 million	\$23.2 million	\$239.5 million	\$ 65.0 million	\$51.5 million
Universe	\$80.0 million	\$75.3 million	\$26.6 million	\$257.9 million	\$485.0 million	\$57.2 million
Percent reviewed	36	93	86	93	13	90
Selection method	Selected all federal grants exceeding 5% of the total federal grants received.	Based on a rotation policy which ensured that all grants over \$100,000 are tested every year and all other grants are tested on a 5- or 9-year cycle, depending on the materiality of the grant.	Selected all except the seven that were not listed in OMB compliance supplement.	Used a judgmental stratified sample. All federal grants over \$1 million, 25% of those between \$50,000 and \$1 million, and 10% of those under \$50,000.	Used a stratified sample. Selected all grants over \$200,000 and at least 1 grant from every federal agency providing funds to the county.	Randomly selected transactions which resulted in 5 programs (5 grants) being tested. Additional transactions were judgmentally selected from 2 programs (5 grants).

EXEMPTING SOME LOCAL GOVERNMENTS SIGNIFICANTLY REDUCES
NUMBER OF AUDITS WITHOUT SACRIFICING AUDIT COVERAGE

Our analysis of nationwide data obtained from the Bureau of the Census on direct federal assistance received by all local governments showed that most local governments receive a relatively small amount of money. A significant number of audits of local governments could be eliminated while still providing audit coverage of those which receive most of the direct federal assistance within a particular state.

The following chart for both special (such as water and sewer districts and school districts totaling about 43,800) and general purpose local governments (about 38,900 counties and municipalities) shows that a threshold in the range of \$100,000 appears to be reasonable. This threshold would provide coverage of local governments receiving 95 percent of the federal assistance while requiring 20 percent of the entities to be audited.

<u>Local Governments Covered Under Thresholds</u>				
<u>Threshold</u>	<u>Number of governments</u>	<u>Percent</u>	<u>Federal funds^a</u>	<u>Percent</u>
			--millions--	
ALL	82,637	100.00	\$ 28,104	100.00
\$ 25,000	25,657	31.05	\$ 27,147	96.60
\$ 100,000	15,973	19.33	\$ 26,626	94.74
\$ 300,000	8,344	10.10	\$ 25,261	89.89
\$ 500,000	5,699	6.90	\$ 24,234	86.23
\$1,000,000	3,219	3.90	\$ 22,484	80.00

^aFunding data represents fiscal year 1981 for general and special purpose local governments, except for school districts which represent fiscal year 1980 data.

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