



United States  
General Accounting Office  
Washington, D.C. 20548

Accounting and Information  
Management Division

B-261558

June 19, 1995

Mr. Norwood Jackson, Jr.  
Deputy Controller  
Office of Federal Financial Management  
Office of Management and Budget

Dear Mr. Jackson:

We appreciate the opportunity to comment on the March 17, 1995, *Federal Register* notice containing proposed revisions to Office of Management and Budget (OMB) Circular A-133, "Audits of Institutions of Higher Education and Other Non-Profit Institutions." Our responses to questions raised in the *Federal Register* notice and our comments on the proposed revisions to the circular are included in the enclosure to this letter. We previously provided detailed technical and editorial suggestions to your staff.

The *Federal Register* notice states OMB's intention to propose changes to Circular A-133 as a precursor to proposing changes to the Single Audit Act of 1984. Our June 1994 report<sup>1</sup> on implementation on the single audit process by state and local governments included a series of recommendations to amend the Single Audit Act and implementing guidance. Our comments are based upon our review as well as our views on implementation of the single audit process by non-profit institutions.

There are four points we wish to emphasize in commenting on the proposed revision to Circular A-133. First, as we recommended in our June 1994 report on the single audit process, entities that receive over \$50 million in federal financial assistance should publicly report on the effectiveness of their internal controls over federal financial assistance. Such reporting would underscore the importance of internal controls as well as the responsibility of the management of large entities for establishing and maintaining effective controls. Federal program managers we talked with during our review of the single audit process overwhelmingly supported this kind of management reporting, with over half of the managers we surveyed saying that they found current

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<sup>1</sup>Single Audit: Refinements Can Improve Usefulness (GAO/AIMD-94-133, June 21, 1994).

internal control reporting in single audits of limited use in evaluating whether funds from their respective programs were properly managed by recipients.

Second, we oppose a triennial approach for single audits. Our report on the single audit process included several recommendations to revise the form and content of single audit reports to make them more useful to oversight officials and program managers. Under a triennial approach, the benefit of those revisions would be lost for 2 out of every 3 years for audits of many entities because they would not have single audits during those years. Additionally, the triennial audit approach could confuse users about the audit reports because an entity could have two different types of audit reports under the circular--a financial statement audit in accordance with *Government Auditing Standards* and a single audit. We do, however, support other proposals to reduce the burden of the single audit process, such as raising the audit threshold to exempt thousands of entities from audit requirements.

Third, we oppose the proposal to exempt entities from submitting a copy of their audit reports if they had no findings relative to federal programs. All entities subject to the circular's audit provisions should submit a record copy of their audit report because, among other things, the financial statements provide valuable information. The audit report should be readily available for review by federal agency personnel. As discussed in our June 1994 report, offices of inspectors general and GAO reviews of financial statements contained in audit reports identified potential areas for further review involving, among others, pension plans, cost allocation, and asset sales. Although federal agencies are subject to financial statement audits conducted under the Chief Financial Officers Act of 1990, as amended, single audit reports are important because of the significant amount of federal funds that are expended by nonfederal entities.

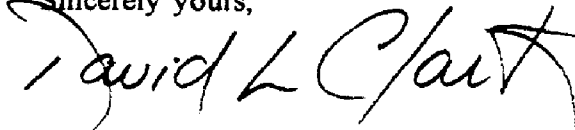
Fourth, we believe the circular should be revised to require summary reporting on the results of single audits. A summary is valuable to highlight important information and to enable program managers to quickly focus on the problems that auditors found. Ninety-five percent of the program managers we interviewed during our review of the single audit process were very supportive of summary reporting.

We commend OMB and its staff for their efforts to improve the usefulness of single audits. Overall, we believe the proposed revisions to Circular A-133 are generally consistent with the recommendations in our 1994 report on the single audit process.

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Please contact me at (202) 512-9489 or Jerry Skelly, Assistant Director, at (202) 512-9982 if you have any questions about our comments.

Sincerely yours,

A handwritten signature in black ink that reads "David L. Clark". The signature is written in a cursive style with a large, sweeping initial "D".

David L. Clark  
Director, Legislative Reviews  
and Audit Oversight

Enclosure

**COMMENTS ON PROPOSED REVISION OF A-133**

The following sections respond to questions raised in the *Federal Register* notice and provide comments on the circular's provisions.

**A-133 Revisions**

We support OMB's stated intention to propose changes to Circular A-133 as a precursor to proposing changes to the Single Audit Act of 1984 and implementing guidance, such as OMB Circular A-128, "Audits of State and Local Governments." Expanding the Single Audit Act to encompass educational institutions and other non-profit organizations now covered by Circular A-133 would enable OMB to consolidate its two circulars which currently provide guidance for implementing the single audit process.

**Management Reporting on Internal Controls**

We support requiring entities to report on the status of their internal controls over federal financial assistance. Such actions are consistent with the intent of the Single Audit Act to help prevent noncompliance with federal requirements rather than simply report findings of noncompliance. In our June 1994 report on the single audit process, we recommended that entities receiving \$50 million or more in federal assistance publicly report the extent to which they have in place internal controls over federal financial assistance sufficient to safeguard assets, prepare accurate financial reports, comply with federal laws and regulations, and monitor subrecipients. We suggest that the management internal control report focus on federal awards and be based upon the objectives presented in the Committee of Sponsoring Organizations of the Treadway Commission's (COSO)<sup>1</sup> *Internal Control--Integrated Framework* concerning the effectiveness and efficiency of operations, reliability of financial reporting, and compliance with laws and regulations. Increased management attention to internal controls should improve the control environment and ultimately reduce audit costs because auditors would be able to place greater reliance on the entity's internal controls.

**Triennial Audit Approach**

We oppose a triennial audit cycle, which would allow certain entities to have a financial statement audit conducted under *Government Auditing Standards* for the first 2 years of the cycle and a single audit for the 3rd year, on either a permanent or trial basis. In our 1994 report on the

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<sup>1</sup>COSO consists of the American Institute of Certified Public Accountants, the American Accounting Association, the Institute of Internal Auditors, the Institute of Management Accountants, and the Financial Executives Institute.

single audit process, we recommended, among other things, improving the form and content of single audit reports by requiring that

- single audit reports include a summary of the auditor's determinations regarding the entity's financial statements, internal controls, and compliance with laws and regulations;
- management of entities that receive \$50 million or more in federal financial assistance publicly report on the status of internal controls over federal financial assistance and the auditor attest to the management report; and
- single audit reports be addressed to a federal agency and state the auditor's understanding that the federal government intends to rely on the reports.

Such improvements, if enacted, would not apply to financial statement audits conducted solely under *Government Auditing Standards*. Consequently, the triennial audit approach would prevent the benefit of those revisions for 2 out of every 3 years for audits of many entities because the entities would not have a single audit during those years.

Furthermore, the triennial audit approach would diminish the testing of federal programs because auditors would only be required to test compliance with major program requirements every 3 years, rather than annually as is currently required. It would also be inconsistent with Circular A-133's proposed risk-based approach, which we support, for selecting programs for audit testing based, in part, on the results of single audits for the immediately preceding 2 years. Under the triennial approach, entities would not have single audits for the preceding 2 years. Additionally, the triennial audit approach could confuse users about the audit reports because an entity could have two different types of audit reports under the circular--a financial statement audit in accordance with *Government Auditing Standards* and a single audit.

#### **Frequency of Audit**

We oppose the provision in paragraph 8 of the proposed circular which would allow entities that elect to have a program audit to opt for biennial audits that cover both years. Program managers contacted during GAO's single audit review were highly critical of the 13-month time frame presently allowed for single audits. Program managers would not be well-served by extending the audit period to cover 24 months and allowing an additional 9 months to conduct and report on the audit.

#### **Audit Threshold**

We support the proposal in paragraph 2 of the proposed circular to establish one threshold to determine whether an entity must arrange for an audit under the circular, rather than the two thresholds in the current circular. We also support the proposed circular in establishing the

threshold at \$300,000. Our report on implementation of the single audit process stated that a \$300,000 threshold would result in coverage of 95 percent of all direct federal financial assistance to local governments that receive single audits. Such a threshold would significantly reduce the burden of the single audit process by exempting thousands of entities from mandatory federal audit coverage.

However, we suggest changing the basis for the threshold from the amount of federal awards that an entity **receives** to the amount of federal funds the entity **expends**. That change would eliminate some of the confusion that could arise because the current circular uses the amount of federal awards an entity **receives** to determine which entities are subject to audit requirements and the amount an entity **expends** to determine which programs must be tested.

### **Risk-Based Program Selection**

We support the proposal in paragraph 1 and appendixes 1 and 2 of the proposed circular to adopt a risk-based approach to select programs for testing. The risk-based approach should be required for all entities. Our report on the single audit process stated that the program selection criteria compel auditors to select for testing the programs for which the entity expends the largest amount of federal dollars. However, our work indicated that these criteria do not always result in adequate audit coverage of programs that are vulnerable to fraud and abuse because they do not require the auditor to consider program risk in the selection process.

### **Schedule of Federal Awards**

We support the proposal to prescribe the minimum content for the schedule of federal awards. Such actions would result in uniform data and thus improve the usefulness of the information to program managers and others. Furthermore, standardizing the schedule in terms of the data and how they are presented is a prerequisite to collecting the data electronically in a database, which would greatly improve the accessibility and usefulness of the information.

We stated in our June 1994 report on the single audit process that compiling a database of information from the schedules could provide the foundation for (1) developing a profile of entities operating particular programs, (2) analyzing the effect that raising the threshold could have on the number of entities subject to the circular, (3) projecting the effect of changing the percentage of expenditures that would be subject to testing, and (4) determining the amount of expenditures by subrecipient organizations.

We suggest that the proposed circular be expanded to require entities to identify, in their schedules of federal awards, funds that they pass to subrecipients. The subrecipient funding information would give insights about the type of audit testing that would be performed. Disclosing funds passed to subrecipients would help program managers know the type of specific tests that an auditor was likely to have performed--or not performed--for a particular program.

**Audit Findings**

We support the proposal in paragraph 13 to require that all findings and questioned costs be presented in a single schedule. We suggest that the provision specifically require that the schedule also include findings related to the audit of the financial statements. Also, we agree with the proposed requirements in paragraph 13 for the minimum information that must be presented for audit findings, but we are concerned about establishing a \$10,000 threshold for reporting questioned costs, particularly considering the wide array of entities covered by the circular and the varied nature of findings.

**Auditor's Reporting**

We believe that the circular should require a summary of the auditor's determinations to increase the usefulness of the single audit reports. The proposed circular implies that auditors should prepare three reports when conducting single audits. Such a reduction in the number of reports from the seven or more that auditors customarily include in single audit reports is of paramount importance to increasing the usefulness of single audits. Program managers we interviewed during our review of the single audit process overwhelmingly supported a single auditor's report with a summary that highlights the auditor's determinations concerning the financial statements, internal controls, and compliance with laws and regulations.

**Report Submission**

We support the proposal in paragraph 16 that shortens the reporting period to 9 months after the end of the audit period, expands the role of the central clearinghouse, and provides for the clearinghouse to pilot test electronic filing of reports. However, we oppose the proposal to exempt entities with no audit findings related to direct-funded federal programs from submitting audit reports because it would send the incorrect message that the federal government is not interested in the results of single audits. The audit reports for all entities subject to the circular's audit provisions should be readily available for review by federal agency personnel.

Findings do not provide the only relevant information in audit reports. Financial statement disclosures, which under the proposed circular many entities would not be required to submit, can also provide the foundation for oversight activities. Offices of inspectors general and GAO reviews of financial statements contained in audit reports identified potential areas for further review involving, among others, pension plans, cost allocation, and asset sales. Although federal agencies are subject to financial statement audits conducted under the Chief Financial Officers Act of 1990, as amended, single audit reports are important because of the significant amount of federal funds that are expended by nonfederal entities.

ENCLOSURE

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### **Auditor Restriction**

The *Federal Register* notice asks for comments on whether Circular A-133 should prohibit an entity from selecting to conduct audits under the circular an auditor that prepared the entity's indirect cost proposal, cost allocation plan, or disclosure statement when the indirect costs charged are greater than 5 percent of (1) expenditures for all federal programs or (2) expenditures of any program that currently meets the major program definition. We would not oppose such a restriction since it could help bolster confidence in the auditor's independence and the reliance placed on the audit.

### **Information Collection Requirements**

We support the proposal to require nonfederal entities to extract and submit to the federal clearinghouse information from single audit reports that would be helpful to program managers, inspectors general, and others in conducting oversight activities for federal programs. Reviews of single audit reports by offices of inspectors general and GAO have demonstrated that single audit reports often contain information that could be the foundation for oversight of an individual entity or a program. Capturing key information in a database that would be accessible by federal agencies would enable them to target the specific reports that merit further review. During our review of the single audit process, a clearinghouse official told us that a database of single audit report data could be established with a minimum investment of two or three additional analysts.

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