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SINGLE AUDIT

Refinements Can Improve Usefulness

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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss proposed amendments to the Single Audit Act of 1984. The single audit is an important means by which the Congress, federal oversight officials, and program managers obtain information on whether the recipients of federal assistance properly account for the federal funds they receive, maintain adequate internal controls over those funds, and comply with program requirements. The single audit, which has gained widespread acceptance throughout the country, has helped foster fundamental financial management improvements and strengthened accountability at state and local governments and nonprofit organizations receiving federal assistance.

The 12 years of experience with the Single Audit Act have shown that refinements can be made to strengthen the usefulness of single audits while at the same time reducing the burden on state and local governments and nonprofit organizations.¹ The proposed amendments, which we strongly support, address these refinements. Today, I would like to provide some perspective on the importance of the Single Audit Act, highlight the results of our most recent assessment of the act's implementation which recommended ways to improve the single audit process,² and address the specific amendments that are now being considered.

Perspectives on Why the Single Audit Act Was Enacted

During the 1970s, the poor accounting practices of state and local governments put into question the security of federal funds provided to those governments. The 1975 New York City financial crisis focused increased attention on this problem. It was found that New York City consistently overestimated its revenues, underestimated its expenses, never knew how much cash it had on hand, and borrowed repeatedly to finance its deficit spending. Compounding the poor accountability practices prevalent at that time, for the most part, state and local governments were not receiving independent financial statement audits.

In the early 1980s, the Congress became increasingly concerned about a basic lack of accountability for federal assistance provided to state and local governments. The assistance grew from 132 programs costing \$7 billion in 1960 to over 500 programs costing nearly \$95 billion by 1981.

¹Nonprofit organizations are not covered by the Single Audit Act but have single audits pursuant to OMB Circular A-133, "Audits of Institutions of Higher Education and Other Nonprofit Organizations."

²Single Audit: Refinements Can Improve Usefulness (GAO/AIMD-94-133, June 21, 1994).

In 1984, when the Single Audit Act was signed into law, federal assistance to state and local governments had risen to \$97 billion, more than doubling what it was a decade before.

Before passage of the act, the federal government relied on audits of individual grants to help gain assurance that state and local governments and nonprofit organizations were properly spending federal assistance. These audits focused on whether the transactions of specific grants complied with their program requirements. The audits usually did not address financial controls and were, therefore, unlikely to find systemic problems with an entity's management of its funds. Further, grant audits were conducted on a haphazard schedule, which resulted in large portions of federal funds being unaudited each year. The auditors conducting grant audits did not coordinate their work with the auditors of other programs. As a result, some entities were subject to numerous grant audits each year while others were not audited for long periods.³

As a solution, the concept of the single audit was created to replace multiple grant audits with one audit of an entity as a whole. Rather than being a detailed review of individual grants or programs, the single audit is an organizationwide audit that focuses on accounting and administrative controls. The single audit was meant to advise federal oversight officials and program managers on whether an entity's financial statements are fairly presented and to provide reasonable assurance that federal assistance programs are managed in accordance with applicable laws and regulations. At the time the Single Audit Act was enacted, it received strong bi-partisan support in the Congress and from state and local governments.

The objectives of the Single Audit Act are to

- improve the financial management of state and local governments receiving federal financial assistance;
- establish uniform requirements for audits of federal financial assistance provided to state and local governments;
- promote the efficient and effective use of audit resources; and
- ensure that federal departments and agencies, to the extent practicable, rely upon and use audit work done pursuant to the act.

³For more information on problems with grant audits, see GAO report, *Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling* (FGMSD-79-37, June 16, 1979).

The act requires each state and local entity that receives \$100,000 or more in federal financial assistance (either directly from a federal agency or indirectly through another state or local entity) in any fiscal year to undergo a comprehensive, single audit of its financial operations. The audit must be conducted by an independent auditor on an annual basis, except under specific circumstances where a biennial audit is allowed.⁴ The act also requires entities receiving between \$25,000 and \$100,000 in federal financial assistance to have either a single audit or a financial audit required by the programs that provided the federal funds.⁵

Further, where state and local entities provide \$25,000 or more in federal financial assistance to other organizations (“subrecipients” of federal funds) they are required by the act to monitor those subrecipients’ use of the funds. This monitoring can consist of reviewing the results of each subrecipient’s audit and ensuring that corrective action is taken on instances of material noncompliance with applicable laws and regulations.

The Single Audit Has Contributed Greatly to Better Financial Management

Over the past 12 years, single audits have clearly proved their worth as important accountability tools over the hundreds of billions of dollars that the federal government provides to state and local governments and nonprofit organizations each year. As discussed in our June 1994 report, the Single Audit Act has encouraged recipients of federal funds to review and revise their financial management practices. This has resulted in the state and local governments institutionalizing fundamental reforms, such as (1) preparing annual financial statements in accordance with generally accepted accounting principles, (2) obtaining annual independent comprehensive audits, (3) strengthening internal controls over federal funds and compliance with laws and regulations, (4) installing new accounting systems or enhancing old ones, (5) implementing subrecipient monitoring systems that have greatly improved oversight of entities to whom they have distributed federal funds, (6) improving systems for tracking federal funds, and (7) resolving audit findings.

⁴Entities may arrange for biennial single audits if, when the Single Audit Act was enacted, they were required by constitution or statute then in effect to conduct their audits less frequently than annually. They may also arrange for biennial single audits if the requirement for such less frequent audits was administrative at the time the act was enacted and was codified by January 1, 1987. In either case, audits conducted biennially are to cover both years within the audit period.

⁵State and local entities receiving less than \$25,000 in federal funds in any fiscal year are not required to have a financial audit.

The single audit process has proven to be an effective way of promoting accountability over federal assistance because it provides a structured approach to achieve audit coverage over the thousands of state and local governments and nonprofit organizations that receive federal assistance. Moreover, particularly in the case of block grants—where the federal financial role diminishes and management and outcomes of federal assistance programs depend heavily on the overall state or local government controls—the single audit process provides accountability by focusing the auditor on the controls affecting the integrated federal and state funding streams.

At the same time, areas of improvement in the single audit process have been identified through the thousands of single audits conducted annually and a consensus has been developed on the needed solutions. I would now like to highlight these areas and strongly support the proposed amendments you are considering which would strengthen the single audit process. Last December we testified before the Senate Governmental Affairs Committee⁶ in support of changing the Single Audit Act. Those changes are reflected in S.1579, the Single Audit Act Amendments of 1996—a bill which is identical to the amendments you are now considering. Today, I will focus on the two main areas of improvement:

- ensuring adequate coverage of federal funds without placing an undue administrative burden on entities receiving smaller amounts of federal funds; and
- making single audits more useful to the federal government.

Ensuring Adequate Audit Coverage While Reducing Burden

The criteria for determining which entities are to be audited is based solely on dollar amounts, which have not changed since the Act's passage in 1984. The initial dollar thresholds were designed to ensure adequate audit coverage of federal funds without placing an undue administrative burden on entities receiving smaller amounts of federal assistance. In 1984, the dollar threshold criteria for entities ensured audit coverage for 95 percent of all direct federal assistance to local governments. Today, the same criteria cover 99 percent of all federal assistance to local governments. As a result, some local governments that receive comparatively small amounts of federal assistance are required to have financial audits.

⁶Financial Management: Continued Momentum Essential To Achieve CFO Act Goals (GAO/T-AIMD-96-10, December 14, 1995).

If the thresholds were raised, as is proposed in the amendments, audit coverage of 95 percent of federal funds to local governments could be maintained while roughly 4,000 local governments that now have single audits would be exempt in the future. More than 80 percent of the federal program managers we interviewed in preparing our 1994 report favored raising the thresholds to at least the levels proposed in the amendments. We strongly support the proposed change and believe it strikes the proper balance between cost-effective accountability and risk.

Entities that fall below the audit threshold would still be required to maintain and provide access to records of the use of federal assistance. Also, those entities would continue to be subject to monitoring activities which could be accomplished through site visits, limited scope audits, or other means. Further, federal agencies could conduct or arrange for audits of the entities.

The act's current criteria for selecting programs to be covered as part of a single audit focuses solely on dollars expended and does not consider all risk factors. In our 1994 report, we noted that less than 20 percent of the programs in our sample met the selection criteria regardless of whether they would be considered high risk. However, those few programs provided 90 percent of the entities' federal expenditures. At the same time, programs that could be considered risky because of their complexities, changed program requirements, or previously identified problems would not have to be covered. The proposed amendments would require OMB to develop a risk-based approach to target audit resources at the higher risk programs as well as focusing on the dollars expended. We strongly support this change and note that the overwhelming majority of federal managers we interviewed agreed with this proposal.

Enhancing the Usefulness of Single Audits

The proposed amendments include two primary changes to enhance the content and timeliness of single audit reports.

First, single audit reports contain a series of as many as seven or more separate reports, and significant information is scattered throughout the separate reports. Presently, there is no requirement for a summary although several state auditors (for example, California's state auditor) prepare summary reports.

In this regard, as discussed in our 1994 report, 95 percent of the federal program managers we interviewed were very supportive of summary

reports. Managers said that a summary report would save them time and enable them to more quickly focus on the most important problems the auditors found. The proposed amendments address this need by requiring auditors to provide a summary of their determinations concerning the audited entity's financial statements, internal controls, and compliance with federal laws and regulations. We support their enactment.

Second, entities now have 13 months from the end of the fiscal year to submit their single audit reports to the federal government. The proposed amendments would shorten this to 9 months. The amendments would require OMB to establish a transition period of at least 2 years for entities to comply with the shorter time frame. After the transition period, federal agencies could authorize an entity to report later than 9 months, consistent with criteria issued by OMB. We strongly support these provisions. Of the officials we surveyed, 84 percent of the federal program managers and 64 percent of the state program managers believe the 13-month time frame is excessive. Moreover, in fiscal year 1991, 44 percent of state and local governments were able to submit their reports within 9 months after the end of their fiscal years. Over time, I hope that it will be the rule, rather than the exception, for the audit reports to be submitted in less than 9 months.

Additional Provisions

The proposed amendments would also expand the Single Audit Act to include nonprofit organizations, thereby placing all entities receiving federal funds under the same ground rules. Presently, the Single Audit Act applies only to state and local governments while nonprofit organizations are administratively required to have single audits under OMB Circular A-133, "Audits of Institutions of Higher Education and Other Nonprofit Organizations." OMB is in the final stages of revising Circular A-133 to parallel the requirements of the proposed amendments to the Single Audit Act. The proposed amendments would provide a statutory basis for consistent, common requirements for state and local governments and nonprofit organizations. We strongly support this change.

The proposed amendments would also reinforce one of the goals of the act to use single audits as the foundation for other audits. Combined with summary reporting, the ability of federal agencies to review single audit working papers, and make necessary copies, can provide valuable information in their oversight of federal assistance programs.

In closing, a number of organizations have worked for some time in gaining consensus on how to make the single audit process as efficient and effective as possible. The proposed amendments you are now considering represent that consensus and have broad support among stakeholder groups, including the National State Auditors Association and the President's Council on Integrity & Efficiency which represents the federal inspectors general. The Single Audit Act has been very successful. The amendments build on that success based on lessons learned and changed conditions over the past 12 years. We encourage the enactment of the proposed amendments and commend the Subcommittee for focusing on this important issue. Mr. Chairman, we would be pleased to work with the Subcommittee as it considers the amendments to the Single Audit Act. I would be happy to answer any questions that you or members may have at this time.

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