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SINGLE AUDIT

Efforts Underway To
Implement 1996
Refinements

Statement of David L. Clark, Jr.
Director, Audit Oversight and Liaison
Accounting and Information Management Division



Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the status of efforts to implement the Single Audit Act Amendments of 1996. These amendments refined the single audit requirements enacted 12 years earlier, in 1984. The 1996 refinements and the Office of Management and Budget's (OMB) implementing guidance provide the underpinnings to improve the auditing for the more than \$300 billion annually of federal assistance provided to nonfederal entities.

As a result of the 1996 amendments, uniform requirements are now in place for all federal grant recipients--state and local governments, colleges and universities, hospitals, and nonprofit entities. Many of the audit burdens previously facing these governments and nonprofit organizations have been reduced and the audits will be more effective because they will focus on the programs that present the greatest financial risk to the federal government.

The changes embodied in the 1996 refinements were developed through the collaborative efforts of the many stakeholders in the single audit process, including OMB, the federal inspectors general, federal and state program managers, the state auditors, the public accounting profession, and us. This Subcommittee played an important role by supporting the legislation needed to enact those changes.

Today, I would like to provide a perspective on the importance of the 1996 amendments, describe some of the actions taken to implement them, and discuss ways in which the refinements will continue to evolve and benefit future single audit efforts. Because of phased-in effective dates in the law and in the OMB implementing guidance, it is too early to fully assess the effectiveness of refinements. However, this hearing should help to keep attention on the refinements and ensure that the momentum achieved thus far in implementing the 1996 amendments continues.

Evolution of the 1996 Refinements

The concept of the single audit was created to replace multiple grant audits with one audit of an entity as a whole. The single audit is an organizationwide audit that focuses on internal control and the recipient's compliance with laws and regulations governing the federal financial assistance received. The objectives of the Single Audit Act, as amended, are to

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- promote sound financial management, including effective internal controls, with respect to federal awards administered by nonfederal entities;
 - establish uniform requirements for audits of federal awards administered by nonfederal entities;
 - promote the efficient and effective use of audit resources;
 - reduce burdens on state and local governments, Indian tribes, and nonprofit organizations; and
 - ensure that federal departments and agencies, to the maximum extent practicable, rely upon and use audit work done pursuant to the act.

We studied the single audit process, and in June 1994, we reported¹ on financial management improvements resulting from single audits, areas in which the single audit process could be improved, and ways to maximize the usefulness of single audit reports. We recommended refinements to improve the usefulness of single audits through more effective use of single audit resources and enhanced single audit reporting, and in March 1996, we testified² before this Subcommittee on the proposed refinements.

Subsequently, in July 1996, the refinements to the 1984 act were enacted. The 1996 amendments were effective for audits of recipients for fiscal years ending June 30, 1997, and after. The refinements cover a range of fundamental areas affecting the single audit process and single audit reporting, including provisions to

- extend the law to cover all recipients of federal financial assistance,
- ensure a more cost-beneficial threshold for requiring single audits,
- more broadly focus audit work on the programs that present the greatest financial risk to the federal government,
- provide for timely reporting of audit results,
- provide for summary reporting of audit results,
- promote better analyses of audit results through establishment of a federal clearinghouse and an automated database, and
- authorize pilot projects to further streamline the audit process and make it more useful.

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

²Single Audit: Refinements Can Improve Usefulness (GAO/T-AIMD-96-77, March 29, 1996).

OMB's Role

In June 1997, OMB issued Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. The Circular establishes policies to guide implementation of the Single Audit Act 1996 amendments and provides an administrative foundation for uniform audit requirements for nonfederal entities that administer federal awards. OMB also issued a revised OMB Circular A-133 Compliance Supplement.

The Compliance Supplement identifies for single auditors the key program requirements that federal agencies believe should be tested in a single audit and provides the audit objective and suggested audit procedures for testing those requirements. We reported in our 1994 report that the Compliance Supplement had not kept pace with changes to program requirements, and had only been updated once since it was issued in 1985. We recommended that the Compliance Supplement be updated at least every 2 years. OMB is now updating this supplement on a more regular basis. The initial Compliance Supplement for audits under the 1996 amendments was issued in June 1997. A revision was issued for June 1998 audits in May 1998, and a revision for June 1999 audits was just recently finalized.

We commend OMB for its leadership in developing and issuing the guidance and the collaborative efforts of the federal inspectors general, federal and state program managers, the state auditors, and the public accounting profession in working with OMB proactively to ensure that the guidance effectively implements the 1996 refinements.

Key Refinements and Actions to Implement Them

Highlighted below are several of the key refinements and some of the actions taken to implement them.

Law Extended to All Recipients

The 1984 act did not cover colleges, universities, hospitals, or other nonprofit recipients of federal assistance. Instead, audit requirements for these entities were established administratively in a separate OMB audit circular, which in some ways was inconsistent with the audit circular that covered state and local governments. For example, the criteria for determining which programs received detailed audit coverage were different between the circulars.

The 1996 amendments expanded the scope of the act to include nonprofit organizations. To implement the 1996 amendments, OMB combined the two audit circulars into one that provided consistent audit requirements for all recipients.

More Cost-Beneficial Thresholds

The 1996 refinements and OMB Circular A-133 require a single audit for entities that spend \$300,000 or more in federal awards, and exempt any entity that spends less than that amount in federal awards.³ Also, the threshold is based on expenditures rather than receipts.

The Congress intended for the entities receiving the greatest amount of federal financial assistance disbursed each year to be audited while exempting entities receiving comparatively small amounts of federal assistance. To achieve this, a \$100,000 single audit threshold was included in the 1984 act.⁴ The fixed threshold, however, did not take into account future increases in amounts of federal financial assistance. As a result, over time, audit resources were being expended on entities receiving comparatively small amounts of federal financial assistance.

In 1984, we reported that setting the threshold for requiring single audits at \$100,000 would result in 95 percent of all direct federal financial assistance being covered by single audits. In 1994, we reported that coverage at the same 95 percent level could be achieved with a \$300,000 threshold.

Also, the refinements require the Director of OMB to biennially review the threshold dollar amount for requiring single audits. The Director may adjust upward the dollar limitation consistent with the Single Audit Act's purpose. We supported such a provision when the amendments were being considered by the Congress. Exercising this authority in the future will allow the flexibility for the OMB Director to administratively maintain the single audit threshold at a reasonable level without the need for further periodic congressional intervention.

³If a recipient receives funds under only one program, the Single Audit Act amendments allows the option of a program-specific audit instead of a single audit.

⁴The 1984 act included a \$25,000 threshold but gave each entity that received between \$25,000 and \$100,000 in federal assistance an option to have separate audits of each of its federal assistance programs or a single audit. The 1996 amendments eliminated the dual thresholds.

As a result of these changes, audit attention is focussed more on entities receiving the largest amounts of federal financial assistance, while the audit burden is eliminated for many entities receiving relatively small amounts of assistance. For example, Pennsylvania reported that this change will still provide audit coverage for 94 percent of the federal funds spent at the local level in the state, while eliminating audit coverage for approximately 1,200 relatively smaller entities in the state.

Broader Risk-Based Focus

The 1996 amendments require auditors to use a risk-based approach to determine which programs to audit during a single audit. The 1984 act's criteria for selecting entities' programs for testing were based only on dollar amounts.

The 1996 amendments require OMB to prescribe the risk-based criteria. OMB Circular A-133 prescribes a process to guide auditors based not only on dollar limitations but also on risk factors associated with programs, including

- entities' current and prior audit experience with federal programs;
- the results of recent oversight visits by federal, state, or local agencies; and
- inherent risk of the program.

For practical reasons related to the audit procurement process, OMB Circular A-133 allowed auditors to forgo using the risk criteria in the first year audits under the 1996 amendments. Therefore, the risk-based approach will be fully implemented in the second cycle of audits under the 1996 amendments, which started with audits for fiscal years ending June 30, 1998, and is currently in progress. When fully and effectively implemented, this refinement is intended to give auditors greater freedom in targeting risky programs by allowing auditors to use their professional judgment in weighing risk factors to decide whether a higher risk program should be covered by the single audit.

Timely Reporting

Under the 1984 act, OMB guidance provided entity management with a maximum of 13 months from the close of the period audited to submit the audit report to the federal government. The 1996 refinements reduce this maximum time frame to 9 months after the end of the period audited. The amendments provide for a 2-year transition period for meeting the 9-month submission requirement.

OMB's guidelines call for the first audits subject to the revised reporting time frame to be those covering entities' fiscal years beginning on or after July 1, 1998, and ending June 30, 1999, or after. This means that March 31, 2000, will be the first due date under the new time frame.

When fully implemented, this change will improve the timeliness of single audit report information available to federal program managers who are accountable for administering federal assistance programs. The Congress and federal oversight officials will receive more current information on the recipients' stewardship of federal assistance funds they receive.

Summary Reporting

The 1996 amendments require that the auditor include in a single audit report a summary of the auditor's results regarding the nonfederal entity's financial statements, internal controls, and compliance with laws and regulations. This should allow recipients of single audit reports to focus on the message and critical information resulting from the audit. OMB Circular A-133 requires that a summary of the audit results be included in a schedule of findings and questioned costs.

In 1994, we reported that neither the Single Audit Act nor OMB's implementing guidance then in effect prescribed the format for conveying the results of the auditors' tests and evaluations. At that time, we found that single audit reports contained a series of as many as eight or more separate reports, including five specifically focused on federal financial assistance, and that significant information was scattered throughout the separate reports.

OMB Circular A-133 provides greater flexibility on the organization of the auditor's reporting than was previously provided. Taking advantage of this flexibility, the American Institute of Certified Public Accountants has issued guidance for practitioners conducting single audits that allows all auditor reporting on federal assistance programs to be included in one report and a schedule of findings and questioned costs.

Better Basis for Analyses

The 1996 refinements call for single audit reports to be provided to a federal clearinghouse designated by the Director of OMB to receive the reports and to assist OMB in carrying out its responsibilities through analysis of the reports. The Bureau of the Census was identified as the Federal Audit Clearinghouse in OMB Circular A-133.

In our 1994 report, we noted that data on the results of single audits were not readily accessible and discussed the benefits of compiling the results in an automated database. The clearinghouse has developed a database and is now entering data from the single audit reports it has received. As this initiative progresses, it is expected to become a valuable source of information for OMB, federal oversight officials, and others regarding the expenditure of federal assistance.

Pilot Projects

The 1996 amendments allow the Director of OMB to authorize pilot projects to test ways of further streamlining and improving the usefulness of single audits. We understand that OMB has recently approved the first pilot project under this authority. This first pilot, which was proposed by and will be carried out by the State of Washington, provides for auditing the state education agency and all school districts in the state as one combined entity, rather than having about 200 separate single audits. The Washington State Auditor's office has submitted a statement for the record that describes in more detail the pilot project.

Our preliminary view is that the pilot has the potential to both streamline the audit process and to provide a single report that is more useful to users than the approximately 200 reports it will replace. We fully support testing options for streamlining and increasing the effectiveness of single audits and will monitor this and any other pilot projects that are approved in the future.

We are committed to overseeing the successful implementation of the 1996 amendments, working closely with all stakeholders in the single audit process and periodically providing information to the Congress on the progress being made on all of the refinements. Mr. Chairman, this concludes my statement. I will be glad to answer any questions you or other Members may have at this time.

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