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FAILURE TO PROVIDE EFFECTIVE AUDITS OF
FEDERAL GRANTS

HEARINGS
BEFORE A
SUBCOMMITTEE OF THE
COMMITTEE ON
GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES
NINETY-SIXTH CONGRESS
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(II)

CONTENTS

	Page
Hearings held on—	
July 30.....	1
July 31.....	29
Statement of—	
Antonio, James F., Missouri State auditor, representing the National Association of State Auditors, Comptrollers, and Treasurers.....	58
Brooks, Hon. Jack, a Representative in Congress from the State of Texas, and chairman, Legislation and National Security Subcommittee: Opening statement.....	1
Drayton, William, Jr., Assistant Administrator for Planning and Management, Environmental Protection Agency; accompanied by Malcolm Stringer, Director, Office of Credit.....	44
Knowles, Marjorie Fine, Inspector General, Department of Labor; accompanied by Edward Stepnick, Assistant Inspector General for Audit; and Gerald W. Peterson, Director of Audit Operations.....	36
Morris, Thomas D., Inspector General, Department of Health, Education, and Welfare; accompanied by Phil Kropatkin, Acting Assistant Inspector General for Audit.....	30
Staats, Elmer B., Comptroller General of the United States, General Accounting Office; accompanied by Donald L. Scantlebury, Director, Financial and General Management Studies Division; and George Egan, Associate Director.....	3
Stoehr, Eldon, president, National State Auditors Association.....	49
White, Dr. John Patrick, Deputy Director, Office of Management and Budget; accompanied by John Lordan, Director, Financial Management Division.....	17
Letters, statements, etc., submitted for the record by—	
Antonio, James F., Missouri State auditor, representing the National Association of State Auditors, Comptrollers, and Treasurers: Prepared statement.....	59-62
Drayton, William, Jr., Assistant Administrator for Planning and Management, Environmental Protection Agency: Submissions to additional subcommittee questions.....	48
Jones, Frank N., General Counsel, Community Services Administration: Prepared statement.....	63-67
Knowles, Marjorie Fine, Inspector General, Department of Labor: Prepared statement.....	42-43
Submissions to additional subcommittee questions.....	41
Morris, Thomas D., Inspector General, Department of Health, Education, and Welfare: Prepared statement.....	34-36
Stoehr, Eldon, president, National State Auditors Association: Prepared statement.....	51-58
Submissions to additional subcommittee questions.....	62
White, Dr. John Patrick, Deputy Director, Office of Management and Budget: OMB time schedule.....	26-27

APPENDIX

Additional material submitted for the record.....	69
(III)	

FAILURE TO PROVIDE EFFECTIVE AUDITS OF FEDERAL GRANTS

MONDAY, JULY 30, 1979

HOUSE OF REPRESENTATIVES,
LEGISLATION AND NATIONAL SECURITY SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:33 a.m., in room 2154, Rayburn House Office Building, Hon. Jack Brooks (chairman of the subcommittee) presiding.

Present: Representatives Jack Brooks, Frank Horton, John N. Erlenborn, and Arlan Stangeland.

Also present: William M. Jones, general counsel; Elmer W. Henderson, senior counsel; Richard Barnes, professional staff member; E. Jean Grace, clerk; John M. Duncan, minority staff director; James McInerney, minority professional staff, Committee on Government Operations, and Ronald O'Leyar, General Accounting Office detailee.

OPENING STATEMENT OF CHAIRMAN BROOKS

Mr. BROOKS. The subcommittee will come to order.

Today the subcommittee continues its review of the effectiveness of auditing in the Federal Government.

The Government relies on audits as the basic control to see that funds are spent as intended.

The Budget and Accounting Procedures Act of 1950 requires each Government agency to maintain a system of accounting and internal controls. The need for such controls to combat waste, fraud, mismanagement, and inefficiency was widely discussed last year when Congress passed the Inspector General Act of 1978.

During the next 2 days we will review the need for improvements in the important area of auditing Government assistance programs. Both the difficulty and importance of adequate auditing in this area can be better understood by the realization that during fiscal year 1979 it is estimated that 55 Federal agencies will distribute about \$85 billion in assistance funds through nearly 1,100 Federal programs. This Federal money will go to over 90,000 State and local Government units and numerous other entities such as hospitals, universities, and nonprofit organizations.

The General Accounting Office recently conducted a review of grant auditing at all levels of government. Its report titled, "Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling," found that auditing of Federal grants is so haphazard and

ineffective that unauthorized expenditures and the loss of public funds cannot be prevented.

Most of the grant recipients which GAO reviewed either were not audited at all or received audits that provided only partial or no insight into whether Federal funds were properly spent.

For example, one grantee received 23 grants from 5 Federal agencies over a 4-year period, yet the grants had never been audited.

In another case, neither HEW nor Labor ever determined whether over \$52 million of the public's funds given to one grantee was properly spent; yet in another agency grants as small as \$170 were audited.

GAO also noted that other recipients had been audited repeatedly by one or more agencies. The result was duplication of audits—a nuisance to the recipient with little or no benefit to the Government.

One Indiana city was subjected to more than 700 audits over just 5 years; yet altogether the audits still did not cover all the Federal funds.

Another grantee in Missouri was audited 10 times over 4 years; yet no one agency has an overall picture of how the grantee is administering its grant funds.

By concentrating on individual grants, rather than the total grant funds received by a recipient, the audit focus is too narrow to be effective. Auditors cannot be sure whose funds or assets they are reviewing. When auditors find improper practices in one grant, they do not determine how such practices affect other grants, even those of larger amounts.

These problems are not new. Many have been identified in past studies. Federal, State, and local officials have known about them for years and are anxious—well, some of them are anxious—for improvements in the system. But we can't expect the grantmaking agencies to solve these problems alone. Nor can we expect these agencies to solve the problems by working alone with the State and local governments and other recipients.

GAO has recommended that the Office of Management and Budget take stronger measures to insure that grant recipients receive single coordinated audits that satisfy the needs of all funding agencies. Whatever action OMB takes, I am convinced that it must be more than simply issuing additional directives.

The Federal Grant and Cooperative Act of 1977 which came out of the Government Operations Committee requires OMB to conduct a comprehensive study of Federal assistance programs. When completed, this study may contain some useful recommendations. However, we cannot allow the present situation to continue any longer. We need action now.

Today we will explore the problems facing Government officials and learn what plans and actions OMB has formulated to get the problems corrected. We will also give those directly involved in the grant process an opportunity to tell us what efforts they have already made to solve these problems and to discuss other possible remedies.

This is an important subject not just because billions of dollars are involved; it's just good business to make sure when you spend a dollar that you get the value you intended. It makes even more sense when billions of taxpayers' dollars are involved.

We welcome our first witness today, General Elmer B. Staats, the distinguished Comptroller General of the United States.

Mr. Staats has a Ph. D. from the University of Minnesota. He served many years in the Bureau of the Budget, including 7 years as its Deputy Director. He was appointed Comptroller General in 1966. He has served in numerous professional and advisory organizations. General, we appreciate the splendid cooperation and assistance that GAO has provided this subcommittee in this review.

Accompanying General Staats is Donald Scantlebury, who is Director, and George Egan, who is Associate Director of the Financial and General Management Studies Division of the General Accounting Office.

I would now like to present General Staats.

STATEMENT OF ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES, GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY DONALD L. SCANTLEBURY, DIRECTOR, FINANCIAL AND GENERAL MANAGEMENT STUDIES DIVISION; AND GEORGE EGAN, ASSOCIATE DIRECTOR

Mr. STAATS. Thank you very much, Mr. Chairman.

As you have already stated, Federal grant assistance to State, local, and nonprofit organizations has increased dramatically in the last 20 years, from \$7 billion in 1959, just 20 years ago, 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 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 and 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, or 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 sometimes 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 grantee's 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 grantee's 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 grantee's 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 auditing 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 specific requirements regarding when audit reports should be issued after the grant expires while other agencies require audits at certain times while the grant is still active.

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 insure 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 follow up 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 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 over-auditing 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 out of grant funds, non-Federal audits must follow Federal audit guidelines.

Third: The heads of Federal departments and agencies administering grants or 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 purposes 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.

I might add here that in visiting with a large number of State and local people one of the continuing complaints that we get is the fact that the Federal Government somehow cannot seem to get its act together in terms of who audits what and how the audits should be conducted. This is a source of a continuing problem with them. I am sure that State and local government people would applaud anything that you, the GAO, and the executive branch can do to straighten this situation out.

Mr. Brooks. Thank you very much, General. I have a few questions.

What role do you see for State and local auditors in the single audit concept?

Mr. STAATS. The State and local auditors are one of the ways which we can fill the audit gaps and provide for the single and coordinated audit of grant recipients.

We recognize that State governments and other funding organizations are at liberty to perform any kind of audit they wish to make within the jurisdictions that they have. However, we would like to see these audits designed so the results also satisfy the Federal requirements, particularly when the Federal Government pays for all or part of the bill.

In any case, we believe the Federal agencies should make maximum use of the work of State and local auditors and only do whatever additional work may be necessary.

I think the fact the State and local governments, through the audit forums, have had a chance to review this audit guide called "Guidelines for Financial and Compliance Audits of Federally Assisted Programs" indicates their willingness to accept this as a basic audit guide. I would assume that most of them, unless they are otherwise restricted by State law, would follow this.

It is our understanding also that the American Institute of CPA's, speaking for the independent public accounting organizations, has also pretty well accepted this as a guideline.

What we are saying here is that if we can all sing from the same sheet of music, it ought to cut down the costs and make the audits, whether conducted by Federal, State, or local governments or by independent firms, more useful and less expensive.

Mr. Brooks. What do you suggest to insure that the non-Federal audits follow the Federal audit guidelines?

Mr. STAATS. We have given this some thought. I know there will be disagreement on this point.

We are suggesting that unless they do it this way, unless they meet the Federal standards, why should the Federal Government pay for it? That is our view of that matter.

I appreciate the fact that others would say this is probably too harsh a treatment.

Mr. Brooks. Why would they think that is harsh, General? If they are going to do it in some fashion other than that which we find acceptable, why should we pay for it? Why would they feel that is harsh?

Mr. STAATS. That is our view.

Mr. Brooks. What is wrong with that? If a suit does not fit, why are you going to pay for it?

Mr. SCANTLEBURY. The other position is that there is some advantage to just having audit procedures made that would check the cash and check their general internal control system. However, we believe that ultimately we should work toward the goal of not paying anything unless they cover the Federal requirements so that we are sure the Federal money was spent properly.

Mr. Brooks. Just keep it. Just do not give it to them.

Which of the two—lack of audit coverage or duplication—do you feel is the most serious problem in grant auditing?

Mr. STAATS. I would like to ask my colleagues here to respond to that.

We feel that both of those represent serious problems, both the gaps in audit coverage as well as the fact that there is overauditing. Either situation is probably not acceptable.

Mr. SCANTLEBURY. I feel that the gaps perhaps are the most serious of the two problems. There is a lot of grant money out there that has never been subjected to the scrutiny of an audit.

As you know, in our earlier reports there were significant findings that were disclosed by some of the Federal audits that were made. These audits often disclosed that funds should be repaid to the Federal Government because they were not used for appropriate purposes by the grantees.

Therefore, I think the fact there are so many gaps indicates a serious problem—some funds that should be repaid to the Government are being retained by the grantees. We need to close those gaps.

Duplication is important, too, because you are spending audit resources doing the same job over again.

Mr. STAATS. If a grantee goes on from year to year and no one is around to audit him, he is going to take more chances. He is going to be less careful.

Mr. BROOKS. He is going to be less likely to get caught, too.

Mr. STAATS. It is really not a healthy situation to have that sort of thing develop.

Mr. BROOKS. What is being done to use GAO's "Guidelines for Financial and Compliance Audits of Federal Assistance Programs" as a standard guide for the single audit approach?

Mr. STAATS. As I mentioned in our statement, this was a cooperative effort. Like previous guidelines that we developed, we think it is important to consult with all the parties concerned to try to get agreement and consensus on something such as this. We are pleased that has been the result in this case to a very large degree.

When the OMB appears before you, I think they will bring you up to date with respect to some of the things they have done. They have taken our proposed guidelines and sent them around to the agencies for separate comments. If my understanding is correct, for the most part, they support the guidelines but there will be some minor modifications, I am told.

Mr. BROOKS. How frequently should grant recipients be audited for financial and compliance coverage?

Mr. STAATS. The 2-year rule is not bad. However, we argue here for some flexibility, depending upon the kind of grant that is involved.

The other side is that in some cases the law is overprescriptive. I believe in the case of the Community Services Administration, for example, there is a legal requirement for an audit of every single grant, however small, once a year. That does not provide enough flexibility. The 2-year rule generally strikes us as being about right.

Mr. BROOKS. What is your opinion of having a separate Federal audit agency to audit grant recipients?

Mr. STAATS. This is an old idea. It has been discussed at length ever since I have been Comptroller General.

However, we have come to the conclusion that the cognizant agency has many advantages to it. For one thing, I believe the fact that a cognizant agency is designated by the OMB representing the President gives the status to that audit which a separate agency would not have. A separate agency would tend to become a whipping boy, we fear.

However, the idea of a cognizant agency approach also seems to us to have the other advantage in that you at least select in each case the agency that has predominant interest in that particular program. I am talking about the particular program for which they are the cognizant agency. We think this has some advantages.

There is another point which would be of particular interest to you in view of your support for the Inspector General legislation. There ought to be a continuous feedback between the auditing function and the Inspector General function. I do not see how you could have that if you had a separate auditing agency in the nature of a DCAA type of operation.

Mr. BROOKS. I agree. I think it would be a big mess to have a separate agency. Who would be auditing them? They would be wandering all over the lot doing what they pleased. You would not have any

control over them. Where would they fit in? Would they be a part of the congressional branch or the executive branch? It would be tricky.

Mr. STAATS. One suggestion has been made on this point from time to time. That is that the Defense Contract Audit Agency do the entire job. DCAA, as you know, does do some auditing of grants for other agencies. However, we are talking about a situation here where you have 55 different agencies that make grants to State and local governments. To extend DCAA's role beyond what it is now, we seriously doubt that it would be wise to do that. It would tend to detract from their main job, which is to audit defense contracts.

The cognizant agency approach, it seems to us, would be about the best approach we can think about.

Mr. BROOKS. Mr. Erlenborn?

Mr. ERLBORN. Thank you, Mr. Chairman.

Mr. STAATS, thank you for your testimony. I think this is a problem that deserves the attention of the Congress. Let me talk to you for a few minutes about motivation.

In the private sector the manager is judged by performance. Pretty generally what they are looking at is income and expense. The manager tries to maximize income and minimize expense. The difference between the two is called profit. At the end of the period if he shows a good profit, he is considered a good manager. However, if he does not show a good profit or if he shows a loss, they get rid of him and put somebody else in there. Therefore, he has real motivation.

In the public sector how are people judged as to their success? Is it not generally by how much money they can dispense, how much they can increase the budget of the program that they manage, and how good they are at maximizing the outflow? I think that has some bearing on this question of auditing.

If the manager does a good job of resolving audits and recaptures some of that money that was improperly spent or disqualifies some recipient so that they do not get grants in the future, then that reduces the measure of his success. I am talking about the number of dollars he is successfully getting rid of through his agency.

Is there something to that view?

Mr. STAATS. Yes; I would agree. I would like to emphasize that what we are talking about here today goes only to the financial integrity with which funds are handled and the compliance with the rules and regulations that accompany that grant.

It does not go to the question of whether the money was well spent in terms of the most effective use of that money or whether it might have been spent in a more economic or efficient way. That has to be done largely by the sponsoring agency and the State and local agency working together. It would get into what we would call a performance audit or an audit of the program effectiveness.

I do not think you can deal with that part of a problem in the same way that we are dealing with the financial integrity and compliance with rules and regulations. That has to be a responsibility of every agency that is spending the money.

To get to your broader question, how do you get some incentive here on the part of program managers to spend that money in the most economic and efficient way, it is difficult anywhere in Government, particularly difficult when you are dealing with social programs where

the purpose basically is to get money into the hands of eligible recipients. They have so much money to spend. Their job is to get that money out.

Mr. ERLNBORN. If they do not spend it all, they are not going to get that increase in the budget next year.

Mr. STAATS. Yes; that is correct.

There are a number of things that have been done to try to substitute for the public official the kind of motivation that exists where there is a manager who is responsible for a profit center in a company. As you well point out, that performance can be measured largely in terms of production, his ability to cut costs, and what profit he shows for that particular profit center. Over a period of time if that performance is not good, then chances of surviving in that job would not be very high.

It is much more difficult to develop the same kinds of measurement for the performance of most people in Government. I do not see that as a blanket because there are situations in Government where people are in commercial-type operations where it can be measured in much the same way. However, by and large with the kinds of programs we are talking about here it is much more difficult.

Work measurement is one way to do it. Measure unit cost. In other words, measure how much it costs him and how his record is in relationship to a prior period of time. Measure his productivity. That is one kind of measurement that has been developed and can be used effectively.

Another kind of test is his ability to cut the cost of his personnel. In other words, get motivation on the part of his people. That becomes the function of a good manager.

There are no simple, magic solutions to this problem of how to get the same motivation.

In the productivity area, for example, in the Government we have recommended that if a manager is able to show a considerable increase in his productivity and cuts his cost, then somehow he ought to be given some credit for that. He ought to be able to share in some of the savings because the way it works now if he comes up through the budget process having cut his costs down, then they say that is great, "You can do better next time. We will take all that money away from you." It is disincentive rather than an incentive to do a good job in management.

Mr. ERLNBORN. I think motivation is very important. What we are talking about here and what we have talked about in earlier hearings was the abysmal record of agencies in recapturing funds for the Government that were improperly granted or loans that were not repaid and so forth.

I wonder if there ever is motivation for the granting agency to really perform the audit function or to institute those features necessary to recapture Federal funds that have been improperly spent. I wonder if the separate audit agency approach might have some validity to it in that the manager will not be judged as the overall granting agency is judged—by the size of his budget. Rather, the separate audit agency will be judged by a different criteria altogether—that is, how successfully they are performing the audit function.

However, a successful audit by HUD of a program that is meant to put money into the cities, rather than reflect credit on the agency,

might slow down the granting process, might disqualify some grantees, and therefore act against the best interest of HUD in improving its record of getting rid of the taxpayers' money as rapidly as possible.

Mr. STAATS. However, we have to keep in mind what we are addressing is the question of the financial integrity with which the funds are managed and the compliance with the statutory and agency rules and regulations that accompany that grant. This approach we are suggesting in no way relieves the agency that has the appropriation from performing the kind of audit that you are talking about.

Mr. ERLNBORN. I am talking about motivation. They may have the responsibility. However, what credit do they get for properly fulfilling that responsibility?

Mr. STAATS. I think the Inspector General legislation helps in this respect. It gives them more status. It gives them a right to report the results at a higher level. Of course, we are in the business of checking how well they do their jobs. That is one of our important roles.

Whenever we go into a program one of the first things we ask is what have the internal auditors done and what have the inspectors done. If we feel they are not doing their jobs adequately, then we have the responsibility of telling the Congress that.

Therefore, to some degree there is a built-in check here as to the integrity of the work of the internal auditors and the people who are handling the budgets for those agencies. Again, I do not see how a separate agency could very well do anything different with respect to the economy and efficiency of the management of those programs than can be done by the agency's auditors or by the GAO.

Mr. ERLNBORN. Maybe a few years ago but not today.

Mr. STAATS. It seems to me when you are talking about changing the way this gets done in an agency or changing the law under which they operate, then I think an independent agency would be pretty hard put to do that. I doubt if they would be very effective.

One of the reasons you have GAO in the legislative branch is to give the independence to it.

Mr. BROOKS. Mr. Stangeland?

Mr. STANGELAND. I would like to follow up a little bit on what Mr. Erlborn has been questioning.

I want to commend you on an excellent statement and commend the gentleman for addressing an area that I think has to be addressed.

I am aware of a recipient in my district who was audited in 1977. That was the first time in 7 years. It was a HUD grant. That is totally irresponsible.

When we talk about a separate agency, we would not be talking about anything a great deal different than the GAO, which is a separate, independent agency. It is responsible to Congress but can be objective in whatever it does. It has no ax to grind. It has no program to whitewash. It is a very objective, analytical agency coming in and telling us the facts. A separate audit agency would be similar.

If we go to a single audit and we have 10 different grant programs, then with the lead agency doing that single audit for those other 9 programs you would in effect, be having a separate audit, wouldn't you?

Mr. STAATS. That is right.

Mr. STANGELAND. Do you anticipate problems in a situation where you have a city getting HUD grants, HEW grants, Labor grants, and so forth with the Federal agency saying, "I understand the rules and regulations under which the grants are provided. Therefore, I ought to be the lead agency"? There could be a disagreement among the various Federal agencies as to who should be doing that single audit.

Mr. STAATS. There undoubtedly might be a difference of opinion here. What we have suggested is that the OMB take on the job of making that determination and working out any difference of opinion that might exist. In many cases it will not be a controversial matter at all. One agency will have the prime interest in it.

I suspect that one of the difficulties that may develop here would be, if you go to a cognizant agency approach, to allocate the resources that you need to take on that work. In some cases agencies will have more auditors than they need and in other cases not enough. OMB is in a very good position to make those adjustments agency by agency.

Mr. STANGELAND. You state in the beginning of your testimony that 20 years ago there was a grant assistance to the tune of \$7 billion and now it is \$85 billion. Is there any way to determine whether or not the audits 20 years ago were comparable to the audits today? Are we expending enough dollars with that magnitude of an assistance program to adequately assess what we are doing?

Mr. STAATS. In general, we feel that we are shorthand in terms of auditing staff in the agencies. We have recently issued a report with some analysis of what has happened with respect to the agencies' requirements for auditing staff. Overall it shows that they have been treated rather badly in terms of priorities in the budget.

Mr. STANGELAND. In other words, you are saying that the audit resources are inadequate to make this audit cognizance concept work?

Mr. STAATS. That has to be looked at agency by agency, but overall I think that is a fair statement.

Mr. STANGELAND. How can we be reasonably sure that the complex grant auditing issues which have been identified in your report can be finally resolved?

Mr. SCANTLEBURY. It is GAO's intention to work closely with the subcommittee to see that this happens. However, I think OMB has a good start. For the most part they have accepted the recommendations that we have made. They have started work to implement them.

OMB's resources may be somewhat limited to do this. I think they could bring all this about if they would draw on some of the agency audit staffs to assist them with some of the detail work that needs to be done to make this kind of general plan happen.

Mr. STAATS. Mr. Scantlebury is referring to the initial job of determining which agency should be the cognizant agency for which types of grants. The idea that we had just as a suggestion was that they augment the OMB staff temporarily by getting people detailed to OMB to help them out on that.

Mr. STANGELAND. In your studies did you finally determine how many agencies were employing outside auditing firms or consultants to do the audits for them? I will give you an example of what I am referring to.

We had a severe disruption of activities on the Red Lake Indian Reservation. There was a breakout or a real revolt. There was a tremendous amount of damage done. There was pressure and a request for auditing of Federal funds going to that reservation by Indians themselves.

The Inspector General of the Department of the Interior was to take the lead. We requested the Inspectors General of HUD, HEW, Labor, and I think maybe Commerce, although I am not positive about that now, to inspect or audit their Federal programs as well.

Now I am advised that the Department of Interior has asked the Department of Labor's Inspector General to contract with an independent, outside CPA to do the audit for all the agencies.

How much of this is going on? How prevalent is it?

Mr. SCANTLEBURY. There is a lot of contracting for audits by virtually every agency that has made grants. Some of the agencies have rather sizable audit staffs and do most of their own work. Others have very small audit staffs and contract most of it out. I do not have figures on just how much of the overall audit work the agencies perform is contracted out and how much is done by their own in-house audit staff. However, a considerable amount of it is contracted out.

Mr. STAATS. The basic point we feel strongly about is that when it is contracted out it ought to be in accordance with Federal requirements. In other words, if it is going to be paid for by the Federal Government, then it ought to meet Federal Government requirements and the Federal Government ought not to have to go in and do it again.

Second, we have had some cases where there have been findings by the outside auditor that are not included in the written report which have been communicated orally to the grantee but not to the Federal agency involved. There have been cases of fraud and matters of this type.

Mr. STANGELAND. I would hope that if we contract out and have an auditor audit a Federal grant program and a Federal agency does the contracting, that they would make certain that the auditing agency would follow the Federal guidelines and conduct that audit to the specifications of the Federal agency.

Would we be better off increasing our auditing staffs and eliminating the outside contracting program? Isn't that feasible?

Mr. STAATS. The auditing staff of the agencies ought to at least be adequate to make a judgment as to the quality of the outside audit. I do not think we would go so far as to say there should not be any contracting out. Certainly the Federal Government ought to have adequate staff to assure the quality of that outside audit.

Mr. SCANTLEBURY. There is another problem, too. Many of the audits are contracted for by the grantee. In many cases that is in accordance with the terms of the grant. When they hire the auditors, we need to have those audits also done to the Federal standards so that they cover areas of Federal interest because we pay for a substantial part of those audits as part of overhead charges.

Mr. STANGELAND. Thank you, Mr. Chairman.

Mr. BROOKS. Mr. Horton, the gentleman from New York, is a long-time friend of yours. You are all paperwork management advocates.

Mr. HORTON. Thank you, Mr. Chairman.

I am sorry I was late but we had a holding pattern and it took us an hour or more to get in here than it normally would take.

Mr. Chairman, Federal grants will amount to almost \$90 billion in fiscal 1980. Grant auditing is the basic control the Government has to prevent unauthorized expenditures by grantees. The Congress and agency management have continually provided for audits of grantees' records as the basic mechanism to keep funds from being spent for unauthorized purposes. Auditors also direct their attention to whether operations are conducted economically, efficiently, and effectively and often identify policy or procedural changes that can produce sizable reductions in expenditures without reducing the quality of Government services.

Unfortunately, the General Accounting Office in its review of grant auditing has concluded that Government agencies' auditing of the use of Federal grant funds is uncoordinated, ineffective, and inefficient. The methods of auditing grants are disorganized and do not afford grants the full protection of audits or optimize the use of audit resources.

Earlier this year the General Accounting Office testified before the subcommittee that its review of the audit activities of Government departments and agencies showed that the lack of a good system for resolving auditors' findings is costing the Government literally hundreds of millions of dollars annually—most of which grantees and contractors will keep, although they are not entitled to these funds under applicable laws or regulations. GAO estimated that about \$3.4 billion was potentially recoverable.

Mr. Chairman, let me commend you for holding these oversight hearings on grant auditing. We must have a better system of control over Federal grants in order to prevent unauthorized expenditures and loss of funds from fraud, abuse, and waste, which is costing the taxpayers millions of dollars.

I am pleased to have Comptroller General Staats appear before the subcommittee this morning. I have had the privilege of working with Mr. Staats for many years and I have a great admiration for his leadership and dedication. He has served with me on the Commission on Federal Paperwork and on the Procurement Commission.

Mr. Chairman, I do not have any questions at this time. I do feel it is important for us to look into this subject. I am sure the General Accounting Office has given us some valuable information this morning. I will read the testimony a little later.

Mr. STAATS. Mr. Chairman, I used the word "breakthrough" here. I believe the OMB has used the same term. These audit guidelines that our staff, working with the State and local people and with the Federal agencies, has developed is a breakthrough literally in terms of a longstanding problem. I believe everyone involved can take a good deal of credit for some real progress here. I think we are on the track now.

Mr. BROOKS. Thank you very much, General Staats, Mr. Scantlebury, and Mr. Egan. We appreciate your coming here.

Our next witness is John Patrick White, Deputy Director of the Office of Management and Budget.

Dr. White joined the Office of Management and Budget in November of 1978 as Deputy Director. Prior to that time he served a year

and a half as Assistant Secretary for Manpower Reserve Affairs and Logistics in the Department of Defense. His background includes 12 years with the Rand Corp. In addition, he served on the faculty at LeMoyne College, Syracuse, N.Y. He is an economist with a Ph. D. in economics from Syracuse.

He is accompanied by John Lordan, Director of the Financial Management Division of the Office of Management and Budget.

Dr. White, we welcome you here today and will appreciate your comments.

STATEMENT OF DR. JOHN PATRICK WHITE, DEPUTY DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET; ACCOMPANIED BY JOHN LORDAN, DIRECTOR, FINANCIAL MANAGEMENT DIVISION

Dr. WHITE. Mr. Chairman, I would like to read my brief statement. Then I would be delighted to answer any questions that you might have.

Mr. BROOKS. Without objection.

Dr. WHITE. Mr. Chairman and members of the subcommittee, we welcome this opportunity to discuss with you the question of grant auditing.

As you know, in fiscal year 1980 Federal grants will amount to almost \$90 billion, of which about \$84 billion will go to State and local governments. The remainder will go to other institutions such as universities, hospitals, and nonprofit organizations. Grant programs are carried out by practically every department and major agency of the Federal Government and affect virtually every segment of our society. With so much of the Federal tax dollar being spent by non-Federal organizations, the need for accountability and audit becomes critically important.

This administration is deeply committed to making Government more accountable. We have moved on every front to eliminate fraud, abuse, and waste, and to bring strong management control to Government. We view effective audit as an indispensable tool in building a more efficient Government.

President Carter, in his first year in office, called upon the heads of departments and agencies to improve their audit systems, particularly as they relate to grant programs. He urged them to upgrade audit planning and to:

Use their audit plans as a basis for making greater efforts to improve interagency cooperation on audits, to increase Federal coordination with State and local auditors, and to increase reliance on audits made by others.

We have pursued the President's direction in a number of ways. On May 7, 1979, we announced the launching of the financial priorities program. The purpose of the program is to resolve the major financial issues facing Government today. Two of those priority issues bear directly on the subject of these hearings—grant accountability and audit followup.

In announcing the program we pointed out that the priority issues had been selected in consultation with the Comptroller General, and that the program will be fully integrated with our regular budget review process. In testimony before this committee in March the Director pledged to "put the entire resources of OMB behind this effort."

The first step toward improving grant audits is to understand the existing problems. We have done this. The General Accounting Office and the joint financial management improvement program have also studied the question.

The major weakness is a lack of coordination by Federal agencies in their approach to grant auditing. Some programs are apparently being overaudited; others are not being audited at all. The result is an inconsistent standard of audit coverage, and a lack of knowledge by Federal agencies of the degree of accountability exercised over their funds.

The situation arises because agencies generally audit only their own grants, and because the Federal agencies have endorsed this approach by issuing scores of audit guides tailored to specific programs. To compound the problem, no one appears responsible for monitoring audits conducted by grantees.

To correct this situation, we are prepared to: require a single audit of the grantee which is acceptable to all funding sources; develop a uniform audit guide; and assign agencies the responsibility to monitor the system.

Let me summarize here what we have done so far to improve grant auditing.

Perhaps the most important step we have taken is the development—with the help of the General Accounting Office and the Federal agencies—of a single audit guide. Our proposed revision to Circular A-102, "Uniform Requirements for Grants to State and Local Governments," will implement this single audit concept and sets forth strengthened audit requirements for grant recipients.

In addition, we are now working with the grant-making agencies to identify the major compliance features that a standard audit should test, and we hope to publish these in conjunction with the final publication of the revised circular.

To strengthen audit followup procedures, we have proposed a revision to our governmentwide audit requirements, Circular A-73, "Audit of Federal Operations and Programs."

The revision was called for in a recent report of this committee, establishes procedures for resolving major disagreements between audit officials and program officials, and provides a maximum of 6 months to determine agency action on audit recommendations. It also calls for semiannual reports to the agency head on unresolved audit findings, and requires periodic evaluations of the agency followup system.

In addition, to centralize responsibility for resolving audit deficiencies noted in audit reports, we are revising Circular A-88, "Indirect Cost Rates, Audit, and Audit Followup at Educational Institutions."

The revision continues the existing policy of relying on a single "cognizant" agency to act for all agencies in auditing universities and in negotiating their indirect cost rates. It adds to those duties the responsibility to follow up on audits by assuring correction of systems deficiencies and by negotiating appropriate resolution of questioned costs. Both these functions would be carried out in close coordination with other affected agencies.

The proposed revision is based on recommendations made by an interagency task force, chaired by the Department of Health, Education, and Welfare. Its purpose is to enhance accountability for Federal

funds and to ease the administrative burden on universities by assuring that they will not have to negotiate separately with several Federal agencies on the same matter.

Our Circular 74-4, "Cost Principles for Grants to State and Local Governments," establishes similar arrangements, whereby a single agency negotiates and audits the indirect costs of State and local governments. We are considering expanding this concept to cover all costs.

Our thinking at this time is to designate a single Federal agency for each State agency and for each major city and county agency. Once we have assigned the major grant recipient organizations in this fashion, we believe we can work out alternative arrangements for smaller local jurisdictions. All this is provided for in our proposed revision to Circular A-102. The revision specifically identifies the responsibilities each Federal agency would have.

We believe that grant auditing will be enhanced by a strengthened Federal audit capability under the Inspector General Act of 1978. This act, for which Chairman Brooks and this committee provided such effective leadership, creates Offices of Inspectors General in 12 departments and agencies, bringing the total statutory Inspectors General to 14.

The President has directed that the significant features of the act be extended throughout the rest of the Federal Government. In doing so, the President emphasized to the heads of departments and agencies that "eliminating waste, fraud, and error should be as important to you as your program objectives."

The President has also recently established the Executive Group to Combat Fraud and Waste in Government. The Executive Group is expected to assure effective implementation of the Inspector General Act and take other steps to combat fraud and waste in programs of the Federal Government. The Deputy Attorney General serves as Chairman and I serve as Vice Chairman of the Group.

Its membership consists of the statutory Inspectors General, the Deputy Director of the Office of Personnel Management, the Special Counsel of the Merit Systems Protection Board, and representatives of the Federal Bureau of Investigation, Internal Revenue Service, and Postal Inspection Service. Other officials are brought in to work with the Executive Group as appropriate. The Department of Justice and the Office of Management and Budget provide the necessary staff support.

The Executive Group has established four substantive working committees dealing with specific issues of concern to the Inspector General program as a whole. The committees include: Audit and Systems; Training, Staffing, Management and Organization; Legislation and Congressional Relations; and Enforcement.

Each of the committees is currently working on a number of specific issues. The most relevant to today's topic, the Audit and Systems Committee, is addressing ways to improve interagency operations, working with GAO on revision of Federal audit guidelines, and examining the impact of Freedom of Information Act requirements on draft audit reports. It is also working on issues of computer security and program vulnerability analysis.

In conclusion, Mr. Chairman, we believe all these efforts, taken together, represent an unprecedented commitment by this administration to Federal accountability. But we know much remains to be done.

We expect to continue to work closely with the General Accounting Office on this, as well as with the National and Regional Intergovernmental Audit Forums and the joint financial management improvement program. We know that we can also count on the continued cooperation and support of this committee and other Members of the Congress.

We recognize that for many years Chairman Brooks and this subcommittee have been in the forefront of efforts to improve auditing in Government. Now we have an administration that is strongly committed to the same objective. Let us move ahead together than to see that needed improvements are put in place.

Mr. Chairman, that completes my statement. We will be pleased to answer any questions.

Mr. Brooks. Thank you, Dr. White.

How and when does OMB intend to designate cognizant Federal audit agencies for recipients other than State and local governmental entities?

Dr. WHITE. We are taking this a step at a time. Obviously the State and local governments are the first target because they are the largest recipients. Following that we will broaden the efforts in terms of other grantees. Therefore, our general approach will be to amend Circular A-110 which has to do with universities and then go on and assign oversight in terms of various groups other than the State and local governments. We think that will follow shortly after we get this in place.

Mr. Brooks. How will nonprofit organizations be handled in order to get a separate and single audit?

Dr. WHITE. I think what we will have to do is break them out into various classes. We are examining that now to see what is the best way to cut that up in order to get that kind of cognizance.

Mr. Brooks. Under the single audit concept does OMB intend to specifically define the organizational entities that must be audited?

Dr. WHITE. Yes; we do, Mr. Chairman. That is a critical part of following through in this exercise.

Mr. Brooks. Does OMB have a system for identifying multifunded recipients and the source of their funding so that the cognizant agencies, when you finally break them out, will know what funds are supposed to be audited?

Dr. WHITE. That is a part of this. We are working on that right now. I would like Mr. Lordan to expand on that.

Mr. LORDAN. We do not now have such a system, Mr. Chairman. The problem in the past in trying to develop one has been the incompatibility of agency systems. Each agency knows where its funds are going, but to make their systems entirely compatible with some central system has been a difficult problem.

Our approach right now is to see if we can focus on the major programs providing Federal aid to State and local government and in those limited number of programs see if we can more specifically identify the major recipients. Then in some central way we hope to pull that information together from existing agency systems.

We want to avoid the development of a complex and expensive OMB central system. We think we can do it by trying to pull together the best features of the existing agency systems rather than creating something entirely new.

Mr. Brooks. You understand that is not a definitive program to do that. This is a catch-as-catch-can program. You are still going to try to do it by pulling together from the various agencies what they have and see if that will work. Is that what you are telling me?

Mr. LORDAN. Mr. Chairman, I would not characterize it as catch-as-catch-can.

Mr. Brooks. It is utilization of the available resources. I know about that. Are you going to get it done?

Mr. LORDAN. We consider it a formal system. We can begin to get it done. We have to take the first step.

Mr. Brooks. I think it is a major problem for you.

Mr. LORDAN. Yes, sir.

Mr. Brooks. You may have to spend some real time and put some people on it. You cannot ask all these agencies to do it. If they had the brains to do it, they would have already done it. Maybe they have the brains to do it and deliberately are not doing it. There are all kinds of motivations. Some agencies do not really welcome objective analysis of how they function, by OMB, GAO, or the congressional legislative committees and last of all the congressional Appropriations Committees.

Be candid about it. Their objective is how to keep us from knowing what they do. They are very successful. They con you by the week and they con us by the year.

Mr. LORDAN. Mr. Chairman, at the outset of this effort we had what we thought was good cooperation from the agencies. Existing systems may prove to be adequate for this purpose. Our intention would be to take the first step this way and see how much of this we can accomplish in a cooperative vein with them. If that does not work, we certainly would be prepared to consider alternatives, including some kind of a more centralized system.

Mr. Brooks. That is probably what you will have to do. I hope it works out in a simplified fashion. Otherwise, you are going to have to really get after it to obtain this information or the whole effort will be haphazard. If we are just checking what they happen to turn up, that is not a worthwhile audit.

Dr. WHITE. We agree with that, Mr. Chairman.

Mr. Brooks. We have to know what that input is. We have to know what we are responsible for.

Dr. WHITE. Yes, sir.

Mr. Brooks. What do you believe should be done to insure that non-Federal audits of Federal funds follow Federal audit guidelines?

Dr. WHITE. We expect that the single audit guide will be a major breakthrough in terms of communication with them. Then the question becomes: If they do not, what happens? In that sense we look to the granting agencies who have a series of sanctions all the way up to withdrawal of grants or denial of future grants. We would like to work with the State and local governments in terms of this and escalate those sanctions as necessary, depending on what kind of cooperation we get.

Mr. Brooks. Will you escalate those sanctions including not paying for the audits?

Dr. WHITE. Yes, sir, if it comes to that. If we have that kind of an impasse, yes.

Mr. BROOKS. Catch one. Cut him off. Tell him you are not going to pay for it. There is no point in our paying for them if they do not meet our requirements.

Dr. WHITE. We agree.

Mr. BROOKS. If there is no benefit to us, why should we pay for them?

Dr. WHITE. We think that is right, Mr. Chairman. We want to work with those who want to work with us obviously.

Mr. BROOKS. Those who don't, pull the chain.

Dr. WHITE. Yes, sir.

Mr. BROOKS. There is no other way. If you catch a couple of them short, the rest of them will follow much more readily.

Do you believe that cognizant or other Federal agencies should be able to have additional audits of a grantee who has already had an organizationwide audit by State or other non-Federal auditors?

Dr. WHITE. Yes, sir, we think the cognizant agency can do the audit. Obviously we want to rely on audits done in their standard operating by these State and local governments. That is the best way to have our resources used most effectively to oversee those other audits.

Mr. BROOKS. If they are done by the guidelines?

Dr. WHITE. Yes, sir.

Mr. BROOKS. It would simplify the matter from your standpoint?

Dr. WHITE. Exactly.

Mr. BROOKS. You could have considerably less manpower involved in checking over Federal guideline audits done on these agencies. It would save you the trouble of doing it. You could just supervise those. You could look them over. You could look at the data and look at the conclusions. It would expedite considerably your evaluation.

Dr. WHITE. Yes, sir.

Mr. BROOKS. Will directions for Federal agencies be developed to insure that audits are made when needed and that the single audit concept is instituted?

Dr. WHITE. Yes, sir, they will, Mr. Chairman.

Mr. BROOKS. Otherwise they will not do it.

Dr. WHITE. That is correct.

Mr. BROOKS. I do not like to be difficult about it but you know that if you and Jim McIntyre do not lay out the program and tell them what is expected, then you can hardly expect the agencies to voluntarily and independently do these various things. They will not. They would do different things if you left it to them. Then you would be worse off.

Dr. WHITE. I think that is right, Mr. Chairman. Our experience in this area indicates that. We need to take some strong leadership.

Mr. BROOKS. They are willing to accept it. They just want to know what you expect.

Dr. WHITE. That is correct.

Mr. BROOKS. Has OMB considered any other approaches to getting single organizationwide audits such as separate audit agencies dedicated to audits of grant recipients?

Dr. WHITE. We have examined that carefully. I subscribe to the comments that the chairman made earlier.

It seems to us the critical involvement here has to be the agencies. With the implementation of the Inspectors General Act, we think they need to have a strong role in all this. As I indicated in my opening statement, we are working with them on a regular basis to see that that happens. To draw this into a single agency I think gets the departments off the hook and is not the way we would like to see it done.

Mr. BROOKS. I agree.

Does OMB intend to augment the standard audit guide to include specific items for review in the area of compliance?

Dr. WHITE. Yes, sir, we do. We are working on that now.

Mr. BROOKS. Mr. Horton?

Mr. HORTON. Thank you for coming, Dr. White.

Do you believe that the GAO audit guide is sufficient for use as a standard financial and compliance audit guide?

Dr. WHITE. Yes, sir, in general. We are working with GAO in upgrading it. We think we are making some adjustments and improvements. We are working closely with GAO. Between the two of us, we will have a good, usable system and a good guide.

Mr. HORTON. This sense of working with GAO as you progress will continue?

Dr. WHITE. Yes, sir, it certainly will.

Mr. HORTON. Is it realistic to expect that OMB with its present staff is going to be able to provide the overall direction and develop the systems that are needed to implement the single audit approach in a reasonable time frame?

Dr. WHITE. I think so, Mr. Horton. We do not have a lot of resources in these areas, nor in many other areas in which we have implemented very large changes. The ZBB process is a good illustration.

Our emphasis here has been putting out the guides and working with the interagency group from whom we are getting very good cooperation. I think we have enough resources. We are committed to make sure this is a success.

Mr. HORTON. I would urge if you feel that there is a question about that or a problem that you not hesitate. In my judgment this is a very important step. It will save a lot of money. We have had other examples where millions of dollars can be saved by additional staff.

For example, we are increasing the Federal bureaucracy by providing for the new Inspectors General and their staff. Yet, at the same time I think overall we are going to save billions of dollars for the taxpayers by that requirement for these additional personnel and for these additional offices.

That brings me to the last question I would like to ask. I am impressed that you are working with the Inspectors General.

Do you feel there is sufficient coordination between your office and the Inspectors General so that this particular area of grant auditing can be completely covered?

Dr. WHITE. I certainly do, Mr. Horton. I mentioned the executive group we have. We have had several meetings chaired by Mr. Civiletti. I have been at each of those. Most of them have lasted several hours. They have been both with the executive group and the overall group, including all the Inspectors General. We have established these four committees. We are supporting the committees strongly with our

staff and with the Justice staff. I have been very, very pleased with the takeoff we have had in terms of the implementation of the Inspectors General.

Mr. HORTON. Have you observed any specific result yet as a result of this? Is it too early?

Dr. WHITE. It is too early yet, Mr. Horton. However, I expect we will in the very near future.

One of the things that comes up when you get started is the whole range of questions that have to be answered, very important questions, in order to make this work. We have just gotten into that. I think we are going to be successful.

Mr. HORTON. Are the Inspectors General pretty much on board with regard to the single audit approach?

Dr. WHITE. Yes, sir, they are.

Mr. HORTON. We do not have any difficulties there?

Dr. WHITE. We do not. Obviously they are concerned that we get it right, as we are. We have had nothing but cooperation from them. It has worked out very well.

Mr. HORTON. Have you had any questions with regard to their adequacy of staff for the functions that they have to do?

Dr. WHITE. Yes, sir, we have. We are now reexamining the staffs of all the Inspectors General. We will be doing that in the 1981 budget process as well. It is a priority for us in the budget process this year.

Mr. HORTON. I assume your inclination is to provide them adequate resources and adequate personnel?

Dr. WHITE. It certainly is. As a matter of fact, this weekend I just approved an increase for one of the departments. They thought, and we agreed with them, they did not have enough staff in this area. We just approved an increase.

Mr. HORTON. Thank you very much.

Mr. BROOKS. Mr. Stangeland?

Mr. STANGELAND. Thank you, Mr. Chairman.

Dr. White, see if I understand what your proposals are and what your thinking is; on page 5 of your prepared testimony you say, "Our thinking at this time is to designate a single Federal agency for each State agency and for each major city and county agency."

Am I led to believe by that you would designate HEW to be the single lead audit agency for States, for example, maybe the Department of Labor for the cities, and maybe HUD for the counties? Do I understand it in that vein?

Dr. WHITE. Generally the way we would do it would be to have each major State grant recipient, such as their health department, and that would be HEW. If it were the State labor department, we would identify our Labor Department as the cognizant agency. We will not have a single one for each State. Probably in most States we will have various cognizant agencies' oversight by State departments. For cities and counties, depending on their size, we will either have one or more than one.

Mr. LORDAN. That is similar to the approach we have taken with regard to the indirect costs and negotiation of indirect cost rates with State and local governments. We have assigned the 450 or so identified State agencies that receive Federal aid. We have assigned them to the Federal agency with which they deal primarily.

At the local government level we have not taken the step of identifying each city agency or each county agency that is a recipient of Federal aid. The chairman alluded to that earlier in one of his questions. That is something that we are trying to do right now. We are trying to identify what are the major agencies at the local level that are receiving the lion's share of Federal aid. Our intention is to identify them and then to assign them to the appropriate Federal agency for cognizant purposes.

Mr. STANGELAND. Then HEW could be the single lead agency for New York but HUD might be the single lead agency for the State of Minnesota?

Mr. LORDAN. HEW would probably be the cognizant agency for the New York Health Department. The State of Minnesota Urban Agency would be assigned to HUD.

Mr. STANGELAND. I realize that, but under the single agency concept that single agency that has the largest amount of grants there would also be the auditing agency for all other grants in that State. Is that right?

Mr. LORDAN. No, sir. The intention would be to identify the subordinate units, the major city departments and agencies and the major State departments and agencies. Then cognizance would be assigned on an agency-by-agency basis rather than having an entire State assigned to one Federal agency or an entire city assigned to one Federal agency. When we get down to smaller jurisdictions, we think that will probably be the case. A smaller city or smaller county would be assigned to one agency.

Mr. STANGELAND. I understood Mr. Staats to say that there ought to be a single auditing agency for one unit of recipient, a State being a unit of recipient. A State might have 10, 25, or 50 various Federal grants but there would be a single auditing agency responsible to audit those State grants. However, you are talking about something a little bit different.

Mr. LORDAN. I think it is consistent with what General Staats said. We have been working with his staff on this.

Even below the State level within a State department, we have found that a State department of transportation, for example, although receiving its primary aid from our Federal Department of Transportation, might also be receiving planning money from HUD and development money from the Commerce Department. Therefore, even at the departmental level within a State or within a city there is more than one source of Federal aid.

We would be complying with the idea of one agency auditing on behalf of all, but we would be doing it at a level below the State level and below the city level.

Mr. STANGELAND. Maybe it is not feasible to eliminate all the duplication in auditing a State recipient because of the magnitude of the grants and the programs in which that State is participating, but you will not be following what I interpret to be the pure attitude of the GAO in saying that there ought to be a single grantee or grantor auditing all the grants so that he knows what is being plugged in and what is going on.

Mr. LORDAN. Once again, it is consistent with their view. It is a question of defining what is the organization that receives the Federal aid. If one defines it as a State, then you could say that there would

be more than one Federal agency auditing within the State; that is true.

However, if it were statewide it might be too big. If it were citywide for New York City, we think it might be too big to ask one Federal agency to do all the work. There is enough differentiation of work at the city level among city departments and at the State level among State departments to permit the identification of the major departmental recipients and then assign that department to a single Federal department.

Mr. STANGELAND. What kind of time frame are you looking at for implementation of the GAO recommendations?

Mr. LORDAN. There are many recommendations in their report. We think that particular one, the identification of the major recipients and then the assignment of cognizance, is something we can do by fall.

Mr. STANGELAND. I have no further questions. Mr. Chairman.

Mr. BROOKS. Thank you very much.

There is one further question I will ask you for the record, Dr. White. Please give us a time schedule on these implementations.

Dr. WHITE. Yes, sir.

Mr. BROOKS. We would like you to work that out and submit it for the record.

Dr. WHITE. We will be happy to do that, Mr. Chairman.

[The material follows:]

OMB TIME SCHEDULE

GAO RECOMMENDATIONS FOR AUDIT OF FEDERAL GRANTS

<i>Recommendation</i>	<i>Schedule</i>
1. GAO recommends that the Congress amend the Intergovernmental Cooperation Act of 1968 to prescribe standard audit requirements 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.	Congressional action required.
GAO recommends that the Director, Office of Management and Budget:	
2. 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).	Fall 1979, for major State and local recipients.
3. Hold periodic meetings with grant administering agencies to insure complete and successful implementation of the cognizant approach.	Preliminary meetings already being held. Followup will begin in Fall 1979.
4. Direct cognizant agencies to use a standard audit grade or a suitable replacement in auditing multifunded recipients.	July 11, 1979, proposed revision to Circular A-102, "Uniform Requirements for Grants to State and Local Governments," published in the Federal Register. Final version expected by October 1979.

OMB TIME SCHEDULE—Continued

GAO RECOMMENDATIONS FOR AUDIT OF FEDERAL GRANTS—continued

<i>Recommendation</i>	<i>Schedule</i>
5. Develop a nationwide system to identify Federal funding that grant recipients may receive.	Work underway. No completion date established yet.
6. Stipulate that to be paid for with grant funds, non-Federal audits must follow Federal audit guidelines.	No action planned unless cooperative efforts fail.

Mr. BROOKS. Thank you very much for coming down, Dr. White and Mr. Lordan. We appreciate your contribution to this important hearing.

It is a tough problem. You are going to have to hold their feet to the fire if you are going to get it done, but it can be done and it ought to be done. Whether this country is run by Democrats or Republicans, it is important to spend money and know what we do with it.

Dr. WHITE. Yes, sir, we agree with that. Thank you, Mr. Chairman.

Mr. BROOKS. This concludes today's hearings. We will resume tomorrow morning at 9:30. At that time we will have witnesses from the Department of HEW, the Department of Labor, the Environmental Protection Agency, and representatives of State auditors.

The subcommittee is adjourned.

[Whereupon, at 11:57 a.m., the subcommittee adjourned, to reconvene at 9:30 a.m., Tuesday, July 31, 1979.]

FAILURE TO PROVIDE EFFECTIVE AUDITS OF FEDERAL GRANTS

TUESDAY, JULY 31, 1979

HOUSE OF REPRESENTATIVES,
LEGISLATION AND NATIONAL SECURITY SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:38 a.m., in room 2154, Rayburn House Office Building, Hon. Jack Brooks (chairman of the subcommittee) presiding.

Present: Representatives Jack Brooks, Frank Horton, and Arlan Stangeland.

Also present: Elmer W. Henderson, senior counsel; Richard C. Barnes, professional staff member; E. Jean Grace, clerk; John M. Duncan, minority staff director; James McInerney, minority professional staff, Committee on Government Operations, and Ronald O'Leyar, General Accounting Office detailee.

Mr. Brooks. The subcommittee will come to order.

Today the subcommittee continues hearings on the failure to provide effective auditing of Government grant programs. Yesterday the Comptroller General described significant problems that had been found in a governmentwide review of grant auditing. He reported that the existing system of grant auditing is so haphazard and ineffective that unauthorized expenditures and the loss of public funds cannot be prevented.

The Deputy Director of the Office of Management and Budget described what they are doing to improve auditing of Government assistance programs. OMB shares a concern about poor conditions in grant auditing and told us about changes that have been made to improve the present situation. They agreed, however, that much remains to be done.

Today we will hear from some of the larger grantmaking agencies—the Departments of Health, Education, and Welfare; Labor; and the Environmental Protection Agency. We also will hear from a panel of representatives of State organizations with an interest in grant auditing. We are anxious to explore the problems Government officials experience with such management controls, to learn what efforts they have already made to solve these problems, and to discuss other remedies.

Our first witness this morning is Tom Morris, Inspector General of the Department of Health, Education, and Welfare. He has served in that position since it was created in February of 1977.

(29)

He has had a very distinguished career in both public service and private industry. During his service as Assistant Comptroller General of the United States he was responsible for the oversight of governmentwide audits concerned with financial management and other areas. He has also served as Assistant Secretary of Defense.

He is accompanied by Phil Kropatkin, Acting Assistant Inspector General for Audit.

Tom Morris is one of the perennial public servants who has always maintained the high regard and respect both of the executive department where he works and the Congress who looks after these efforts.

We are delighted to have you again. We certainly appreciate your statement.

In view of the situation we have on the floor today, I would really like for you to summarize your statement. Without objection, we will put the entire prepared statement in the record.

[See p.34.]

Mr. BROOKS. Congress is still meeting. We had a delay. I apologize to all of you who are witnesses, but the full committee had a rather long and interesting session this morning.

Mr. Morris, you may proceed.

STATEMENT OF THOMAS D. MORRIS, INSPECTOR GENERAL, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE; ACCOMPANIED BY PHIL KROPATKIN, ACTING ASSISTANT INSPECTOR GENERAL FOR AUDIT

Mr. MORRIS. Sir, I will briefly summarize my statement.

I would first mention a few things about the Audit Agency which is part of the Office of Inspector General. It has 1,000 people on its payroll but oversees the work of about 2,300 additional auditors in States and in CPA organizations which conduct audits of HEW programs.

We must cover through our audits, either internal or external, some 51,000 entities. This is a huge task. We are perhaps the largest granting organization in the Federal Government. Thus, these hearings are of great importance to us.

Let me make four points.

First, we essentially agree with the recommendations in the GAO report. We do think that the fragmentation must be overcome. We agree with the approach to a single audit cognizance mode of operation. The concept of a uniform audit guide is valid and needed, but we feel that this guide needs to fully address program compliance requirements as well.

We think that the implementation of the concepts that are laid out by both OMB and GAO are going to require central leadership of a very strong nature, both on the part of the Congress and on the part of OMB.

We would stress at the outset that we consider these to be very complex problems. The solutions appear simple in concept but their execution will take a great deal of planning, experimentation, and oversight.

We believe at the heart of the entire problem is the inadequacy of resources to do an adequate job. As I mentioned, we have about 1,000 auditors on our own staff. To do an adequate job, even a minimally

adequate job, we think we would need another 1,200. That would be very cost-effective in our opinion and save the Government on the order of \$100 million a year.

I would like to pause at this point, Mr. Chairman, and address your questions.

Mr. BROOKS. I thought it was a good statement. I appreciated your submitting it and explaining it. I have a couple questions which I hope you can answer. I know you can.

Should the single audit concept be applied to all your grant recipients, including nonprofit as well as Government organizations?

Mr. MORRIS. Yes, sir. We think the idea of a single approach is a sound one but must be worked out very carefully. We suggest the concept of an entity approach where homogeneous types of activities would be brought together. For example, university research audits, for which we have primary cognizance, is a sound entity concept. We would like to see that technique considered in the other areas as well.

Mr. BROOKS. In developing a standard audit guideline should OMB develop a list of requirements that must be complied with to establish whether the grantee has used the funds properly?

Mr. MORRIS. We think that OMB should provide the leadership to assure that compliance-type factors are part of the standard audit guide. The development of those factors, program by program, will require extensive participation by the agencies themselves working with OMB.

Mr. BROOKS. What problems have you, Mr. Morris, experienced in performing as a cognizant audit agency?

Mr. MORRIS. Our key problem, as I mentioned at the outset, has been resources. We do not think that either our agency or most of the agencies to whom we offer this kind of service have adequate resources to do the job.

Aside from that, we feel that our experience in the university field has been very satisfactory. We are not always able to satisfy all the needs of each of the agencies but we do our best to accommodate these. On the whole we've demonstrated that this concept works.

Mr. BROOKS. What problems do other agencies you audit for have with your cognizant audits?

Mr. MORRIS. On occasion their requirements for more detailed review of eligibility and other compliance-type factors may mean that their technical expertise is needed.

I am told, for example, that the Department of Agriculture's Smith-Lever Act, dating back to 1915, governs certain kinds of research grants to land grant universities. At times they must go in to complete that highly technical kind of audit.

Outside of that, we feel we have been able to serve well all users of our service of providing financial-type audits of the university research grant area.

Mr. BROOKS. The GAO reported that an Ohio grantee received over \$50 million of HEW funds and no audits were performed as required by OMB. What steps, if any, are you taking to have this particular grantee audited as well as others that might be in that category?

Mr. MORRIS. First of all, in that particular case, which is the Ohio Commission on Aging, I believe, we have scheduled an audit for our next fiscal year work program. The setting of priorities for audits and the frequency of audits is perhaps our most complex and challenging

management task. As I mentioned, we have about 51,000 entities to be audited. In any one year we issue or process some 5,000 to 6,000 reports. You can see that there inevitably is going to be a gap between what we can do in 1 year or 2 years or 3 years and that total universe.

We feel that bolstering our resources in the first place and making arrangements to share the audit workload among the Federal agencies is a very sound approach to this problem.

Mr. Brooks. Did you cover how you can assure yourself that the States will obtain an audit?

Mr. MORRIS. It is our responsibility to be certain that State agencies and State programs either be audited by our resources, or jointly with other agencies, or that they themselves obtain audits of their programs using our guidelines. We must both monitor and actually do the work.

I must acknowledge that we have not always done the monitoring job as well as we should. This is a lesson we are learning from our study of the GAO findings.

Mr. Brooks. Does HEW expect to develop a system that identifies all grant recipients which provides data on whether they were audited to satisfy Federal needs? Do you have it? Who did it?

Mr. MORRIS. Yes, sir. At present we have a system which identifies all grant recipients. However, that system does not enable us to determine whether the required audits are conducted. This is the area we must improve.

Currently we are concentrating on the 8,000 schools and universities that must be audited every 2 years with respect to student financial assistance programs. We are going to monitor them very closely. If this system works well, then we will extend it to all other primary grantee entities.

Mr. Brooks. I think you will find Mrs. Pat Harris an able administrator who will back you up and insist on that which is right and fair and above board. I think you will find her good on details and good on the broad spectrum of getting things accomplished. She will want to see that grants are audited properly and that money is spent for the purpose for which it was designated. I do not think she will take any wooden nickels in the operation. I think you will find her a delight to work for and to work with.

Mr. Stangeland?

Mr. STANGELAND. Thank you, Mr. Chairman.

I think you perhaps answered this question, Mr. Morris. Do you believe your staff resources are adequate for carrying out the cognizant agency responsibilities under the single audit approach?

Mr. MORRIS. No, sir.

Mr. STANGELAND. Did I understand you to say that you would require 1,200 more people?

Mr. MORRIS. That is our best analysis, sir, of the resources we would need in addition to the 1,000 we have today to do even a minimally optimal job. We can save the cost of these resources three times over. In other words, each auditor we add costs about \$30,000 per year. But he or she produces results worth about \$100,000 per year.

Mr. STANGELAND. Do you think that the single audit concept that is recommended by GAO would improve HEW's available audit resources and minimize overlapping of audit efforts so that you could get more mileage out of the people you presently have?

Mr. MORRIS. We think that—properly worked out through central analysis under OMB's leadership—more efficient use of our resources and other agency resources would result. On the other hand, unless we get more resources, we are still not going to be able to do an adequate job. We think that is important to stress.

Mr. STANGELAND. I would point to page 4 of your testimony. You state:

*** the identification of grantees requiring audit is a serious and continuing problem. The situation is incredibly complex due not only to the thousands of entities involved, but to the fact that many auditable grants are on a one-time, short-term basis.

Could you identify some grantees that do not require audits?

Mr. MORRIS. We have a system of assessing annually what we call the vulnerability or risk potential grantees. Each year's audit work plan addresses these high-risk, high-vulnerability situations and those where the dollars are greatest. Therefore, grantees selected for audit can vary from year to year.

For example, in the coming year we are going to give particular attention to community action agencies because we have encountered problems there. This year, we are stressing the student financial aid programs, which this committee under Chairman Fountain has so well pointed out has problems that need very intensive attention. We are going to require audits of all the schools, in respect to those programs, every 2 years.

This is the principle on which we try to plan our audit from year to year. However, some grantees which do not seem to pose problems may be deferred from audit year after year because they do not have the same priority.

Mr. STANGELAND. We heard last year in testimony before the Appropriations Committee that there was \$8 billion in HEW's budget that was unaccountable. They could not find it. Could you give us any indication of what percent of that \$8 billion might have been in grants or loss to grantees due to lack of an audit?

Mr. MORRIS. I do not identify any such finding. The only thing which my office contributed to was an inventory of estimates of opportunities for cost reduction, which totaled to between \$5.5 and \$6.5 billion. That was very heavily in the health care programs—about \$3.5 to \$4 billion—for things like cost containment, better attention to claims payment processes by using computers, and better policing of eligibility of medicaid clients. Things such as this are necessary to help save money. These were not losses in the sense of unaccountable dollars.

Mr. STANGELAND. Thank you. I have no other questions, Mr. Chairman.

Mr. Brooks. We want to thank you very much, Mr. Morris and Mr. Kropatkin. We appreciate your coming. We appreciate the determined effort that I know you are all making and will continue to make in behalf of the public. It is a pleasure to have people such as you here.

Mr. MORRIS. We appreciate your constructive leadership, Mr. Chairman.

Mr. Brooks. We liked your testimony. It will be very helpful because it is professional.

[Mr. Morris' prepared statement follows:]

STATEMENT OF THOMAS D. MORRIS, INSPECTOR GENERAL, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

Mr. Chairman and members of the subcommittee: We appreciate the opportunity to be here today to discuss the gaps, inconsistencies, and duplication which GAO believes exist today in grant auditing. My statement will deal principally with: The role of the HEW Audit Agency, and the measures we are taking to minimize the problems cited by GAO.

Also, we would very much like to offer our views on the pros and cons of the single audit concept.

The HEW Audit Agency, established in 1965, is HEW's central organization responsible for audits of all Department's programs, functions, and activities, including those conducted through grantees and contractors.¹ Since March 1977, the Agency has been organizationally located within the Office of Inspector General. We have a headquarters staff in Washington, D.C., and a field staff at each of the Department regional offices, with 42 branch offices. All agency staff, regardless of location, report to the Assistant Inspector General for Auditing who, in turn, is responsible to the Inspector General for the direction and performance of the audit function. At June 30, 1979, the full-time staff totaled 995 consisting of 924 professionals and 71 administrative and clerical personnel.

In total, there are about 51,000 entities accountable to HEW. During calendar year 1978, the Audit Agency issued 5,652 reports of which 4,226 covered HEW-financed programs and activities—1,459 were prepared by the Department's audit staff and 2,767 by other Federal audit staff, public accountants, and State auditors. The remainder were audits that we performed for other Federal agencies under OMB's system for audit cognizance. With respect to the latter, HEW is the primary Federal source of university contracts and grants, because of this the HEW Audit Agency was selected by OMB to be the single agency responsible for all Federal audit services at about 94 percent of the Nation's 2,500 colleges and universities. Audit cognizance for the remaining schools was assigned by OMB to the Defense Contract Audit Agency; the Department of the Interior; and the Department of Energy.

HEW Audit Agency reports covered a wide range of activities, involving thousands of diverse and geographically dispersed entities carrying out HEW's programs—State and local governments, educational institutions, hospitals, nursing homes, insurance companies, many types of other nonprofit organizations, as well as numerous departmental headquarters and field installations. In broad terms, the audits are designed to (1) consider whether Department operations are conducted economically and efficiently, and (2) provide a reasonable degree of assurance that funds are expended properly and for the purposes appropriated.

Some years ago, the HEW Audit Agency recognized that its in-house staff needed to be supplemented with outside resources to provide even minimum audit coverage to all the Department's programs, activities, grantees, and contractors. Currently, about 2,330 staff years of audit work are provided each year by outside resources we enlisted to help us close this gap. These include other Federal as well as non-Federal auditors.

We have thus, through necessity and choice, been constantly exposed to the many facets of the problems GAO has identified. The Audit Agency acts as the cognizant audit group in many instances—and as the recipient of audit reports prepared by others in many other instances. We are happy to share our experiences at both ends of this spectrum.

In a number of cases, Federal agencies—after receiving our reports on universities for which we have audit cognizance—have found it necessary to contact and/or visit the school for information beyond the normal scope of the audit and/or investigative work. Conversely, we have also found this necessary in audits performed for us by others. In each case, the reports covered audits that had been performed based on approved audit guides and met Federal standards and needs. I am pointing this out to show that even audit work meeting standards does not always meet each program manager's special needs. Thus, Inspectors General from time to time will find it necessary to use their own audit resources to meet their particular needs.

¹ Excepting a medium-sized audit staff concerned with and organizationally located within the Department's Child Support Enforcement Program. This arrangement was called for by legislation. (Public Law 93-647.)

We generally agree with GAO's analysis of the problems and need for improvements in the present systems of grant auditing. Simplification of these systems, elimination of "piecemeal" audits, coordination between Federal agencies and with State and local auditors, obtaining adequate audit coverage, obtaining adequate audit resources—each of these are major problems in themselves. In combination, they represent one of the most incredibly complex set of managerial, technical, and organizational situations imaginable.

In general, we believe that HEW and other Federal agencies have been conscientiously trying to carry out their individual audit responsibilities within legal and resource constraints. No single Federal audit agency acting alone can do much more to change the overall situation described in the GAO report. Congress and OMB must provide more centralized direction and management if significant changes are desired.

In the interim, we are working on the problems of ensuring that all grantees requiring audit are, in fact, audited—and that such audits are done in accordance with approved audit guides.

I might point out though, that the identification of grantees requiring audit is a serious and continuing problem. The situation is incredibly complex due not only to the thousands of entities involved, but to the fact that many auditable grants are on a one-time, short-term basis. The HEW Audit Agency is currently developing a computerized system for tracking and monitoring mandated non-Federal audits of student financial aid programs. If this appears workable, we will, of course, seriously consider expanding it on a phased bases to cover other types of grantees.

To avoid inconsistency and to ensure that audits performed by non-Federal auditors meet the manager's needs, audits must be done using Agency-approved audit guides. Guides have, and are being, developed for those HEW-administered programs we have judged most susceptible to audit by non-Federal auditors. These guides familiarize the auditor with significant program provisions: provide specific information on the nature and scope of the required audit; and full information on audit reporting requirements. An appropriate, standardized guide usable for audits of all Federally assisted programs would be of inestimable value. GAO's recent guide for auditing Federal grants and contracts "Guidelines for Financial and Compliance Audits of Federally Assisted Programs" is a major step in this direction. But more needs to be done. An audit using this single guide would not always result in auditors gathering—and subsequently reporting on—information that our program managers require to effectively manage their program. Without more specific information on individual programs, there would be no assurance that important program compliance requirements with financial implications will be addressed by the audit. Hopefully, as we gain experience, these can be woven into the GAO guide.

I would suggest that this concept of a uniform guide could be further tailored. One alternative would be to go for individual standardized guides for like entities. To elaborate: one standardized guide for universities and colleges; another guide for like programs administered by State agencies, and so on. The keystone of this concept is entities that are similar in nature and purpose would generally be more susceptible to audit through a standardized guide. This concept has been long recognized by the public accounting profession. The AICPA has developed guides for audits of like businesses / entities (i.e., department stores, insurance companies, etc).

In their report on this grant auditing maze, GAO rightly concluded that auditors must make maximum use of audits performed by non-Federal agencies. Also, that they ought do whatever additional work is felt necessary to see that grant funds are and have been expended as intended. We fully concur and have been working diligently at this.

On a formal and informal basis we have kept continuous liaison with Federal and non-Federal audit staffs with common interests to minimize the amount of audit effort required and to learn of problem areas. The HEW Audit Agency is currently working out arrangements with Department of Agriculture audit staff with respect to single administrative costs audits of State-administered Public Assistance and Food Stamp programs. We plan to undertake a similar approach with the Community Services Administration for audits of Community Action Agencies. Further, Audit Agency officials have been deeply involved in the work of the national and regional intergovernmental audit forums and have participated in several important joint Federal/State audits.

To summarize:

The concept of single audit cognizance is valid and needed.

The concept of a uniform audit guide is valid and needed—but we feel that this guide needs to more fully address program compliance requirements.

The concept (long in use by the public accounting profession), of separate audit guides for entities that are like in nature and purpose, is also worthy of consideration.

Implementing these concepts will require direction, management and support from OMB and the Congress.

Thank you for this opportunity to be here today, and I will be most happy to answer your questions.

Mr. Brooks. The next witness is Marjorie Fine Knowles, Inspector General of the Department of Labor.

Ms. Knowles, please come forward.

Prior to her appointment, she was Assistant General Counsel for the Inspector General Division in the Department of Health, Education, and Welfare. She is a Morris-trained operator. That speaks well for her.

She served 6 years on the faculty of the University of Alabama School of Law. She received an LL.B. from Harvard.

She is accompanied by Edward Stepnick, Assistant Inspector General for Audit, and Gerald W. Peterson, Director of Audit Operations.

Ms. Knowles, it is nice to see you again.

We are delighted to have you here. We would appreciate your comments.

**STATEMENT OF MARJORIE FINE KNOWLES, INSPECTOR GENERAL,
DEPARTMENT OF LABOR; ACCOMPANIED BY EDWARD STEPNIK,
ASSISTANT INSPECTOR GENERAL FOR AUDIT; AND GERALD W.
PETERSON, DIRECTOR OF AUDIT OPERATIONS**

Ms. Knowles. Mr. Chairman, we are delighted to be here. However, I am aware that following Tom Morris as a witness is a very difficult thing to do because Tom is so very knowledgeable about this area.

As you know, the Office of Inspector General at the Department of Labor is a new one. I would like to describe our reactions to the GAO report.

Mr. Brooks. You work for a fine man from Texas, Ray Marshall.

Ms. Knowles. Yes, sir, I do.

In the interest of time, I will not read my prepared statement but ask that it be entered into the record.

Mr. Brooks. Without objection.

[See p. 42.]

Ms. Knowles. I would like to summarize a few of the points, however.

First of all, I would like to say that we feel strongly about the issue raised in the GAO report. We feel it is the kind of issue which deserves top-level management attention. I think you, Mr. Chairman, and members of this committee share our commitment to the audit function as indispensable to management in the executive branch. We think the GAO report is a very constructive attempt to deal with an important function.

We think that we ought to all work toward the goal of the comprehensive governmentwide audit. Because we feel that the GAO report

did a good job in pointing out the need for that kind of goal, I would like to express some concerns that the Department of Labor has about the shape of that comprehensive single audit.

Our first concern is that audit retain its character as a high-level management tool and that the outcome of any such single audit retain its usefulness to Department managers in charge of the programs involved.

We share Mr. Morris' concern, as expressed in his prepared statement, that whatever audit is developed have sufficient attention paid to compliance features. We note that, in general, single audits tend to focus on financial audits. We are quite concerned that the compliance audit be included in whatever single audit is developed. That seems to be crucial both to departmental management and to my function as an Inspector General.

With respect to particular concerns of the Department of Labor, as you know, we have a very decentralized CETA system. We have approximately 460 CETA prime sponsors and 30,000 or so CETA subsponsors. We have the responsibility for auditing the CETA primes, and CETA primes have responsibility for auditing their subsponsors.

We feel very strongly that any organizationwide single audit must insure that adequate attention is given to the responsibility of the prime organization, the prime sponsor, to oversee the activities of the subsponsor and that that must become part of a comprehensive organizationwide audit.

I think Mr. Morris and I share this concern. Let me address briefly the question of resources.

The Department of Labor presently has 126 auditors to oversee, to manage, and to audit themselves, programs of approximately \$10 billion in CETA grant funds and \$17 billion in job service, unemployment insurance, and other Department of Labor programs.

Given these resources, it would be impossible for us to assume any greater responsibilities, such as a comprehensive governmentwide audit of a single entity. We agree that there will be savings, in terms of government resources, should this be adopted for a number of major entities. However, given our present resources, we cannot take on responsibility for single audits.

Let me tell you on a personal note that I have found, in my short term in this office that, the cooperation, the desire to cooperate, among the audit agencies in the executive branch has been terrific. The big problem that we all face is resources. It is the question of who pays.

We agree with Mr. Morris that what is needed here is strong, central leadership, the granting of audit cognizance, and the resources to carry through with that responsibility.

Mr. Chairman, that is a summary of my prepared statement. I would be delighted to answer any questions that I can with the assistance of my colleagues here.

Mr. Brooks. Thank you very much. I first yield to the distinguished member of this subcommittee, Mr. Stangeland.

Mr. STANGELAND. Thank you, Mr. Chairman.

My questions are not going to be quite as much on your statement or things we are discussing, but I am concerned as to how things are proceeding as far as the audit on the Red Lake Reservation. Is the Inspector General of Labor going to be the lead agency in that? Are you going to be contracting for an audit with an outside firm from Denver?

Ms. KNOWLES. Yes, sir. Let me explain how we plan to proceed on that. I am delighted that you raise that question because it is a good example of the problems that we have concerning resources.

We agreed with the Department of Interior that we would take the lead in conducting an audit of all Government funds—HEW, HUD, Interior, and Labor—in a given entity, if I may use that expression. We tend to forget these are people but for these purposes let's call it an entity.

The Department of Labor, having so few of our own auditors, conducts most of its audit business through CPA's. We will contract with a CPA firm to conduct that audit as soon as we can.

I hope that raises in your mind the question it immediately raised in my mind when Mr. Peterson and I discussed it: Who pays? It is not an item for which we have any money in our budget. We and the Department of Interior are presently negotiating about it. However, it has not yet been ironed out. It delays the process.

I must be candid with you. We could move much more quickly if these things were ironed out and planned ahead of time. We have had a request pending with OMB since last January for cognizance over native American programs, and another since last April for cognizance over the national farm workers' program.

Mr. STANGELAND. I am sorry, I was interrupted briefly.

What you are saying is that there is not a determination yet or a clear determination as to who is going to be the single lead agency?

Ms. KNOWLES. No, sir. It is clear that we will be the lead agency. We will assume responsibility for seeing that all Federal grant funds going into the Red Lake Reservation are audited. What we cannot agree to, because we do not have the power over the Department of Interior nor they over us, is who pays for how much of what. That is presently being negotiated.

Mr. STANGELAND. Is there a problem or do you foresee a problem in a uniform auditing procedure dealing with Interior funds, BIA funds, Labor funds, HUD funds, and this type of thing?

Ms. KNOWLES. I think you ought to hear from the most knowledgeable source, which is Mr. Peterson who has been actively involved in the planning of this audit.

Mr. PETERSON. As far as the actual conduct of the audit, I do not believe that there will be serious problems getting one audit for all the various agencies. No, I do not believe there is a problem.

Mr. STANGELAND. This is a prime example of a cognizant single agency audit.

Ms. KNOWLES. Precisely. That is why I pointed out to you that in January we asked for cognizance over all native American programs. We agree with Mr. Morris' point about the need for a strong, centralized leadership which will address the question of cognizance and the resources to carry it out. Just to give me cognizance with no resources is very hollow.

Mr. STANGELAND. I have one last question. I am not sure you will be able to answer it.

We called your office the end of last week asking expeditious signing of a contract. I am wondering how that is proceeding.

Ms. KNOWLES. We anticipate that the contract will be signed by the end of August. I am not pleased with our time frame on that. I hope

you are not pleased with it. However, we have 126 auditors for these huge programs.

Mr. STANGELAND. Thank you.

I thank the chairman for yielding me the time.

Mr. BROOKS. Ms. Knowles, I would suggest that you give us a little report on the funding problem on that particular issue, if you would. Perhaps Mr. Stangeland and I can discuss it with some of the people at OMB and bring it to their attention as a matter which they ought to resolve. That could be of some help to you.

Ms. KNOWLES. Yes.

Mr. BROOKS. We have the highest regard for Secretary Andrus, but it is something that is difficult for you to resolve between you.

Ms. KNOWLES. Exactly.

Mr. BROOKS. The OMB is the proper agency to do that because they are holding all your money and your throats.

Ms. KNOWLES. Precisely.

Mr. BROOKS. They are not very good on that throat holding, though. I find they are too easygoing.

I have a couple questions.

Ms. KNOWLES. Yes, sir.

Mr. BROOKS. What problems do you now have in auditing your grantees?

Ms. KNOWLES. The major problem we have is related to resources and staffing. We are totally unable to meet our obligations to conduct cyclical audits of Department of Labor's programs and grantees. We just plain do not have the money to do it.

Mr. BROOKS. Have you informed the Secretary of that? Are you going to try to make those kinds of representations to the Appropriations Committee in your budget, to the OMB for their approval, then via the President, to the Congress, and so forth? Are you taking those steps right now?

Ms. KNOWLES. We are, sir. With respect to the fiscal year 1981 budget submittal, the process has begun through our Department. We have asked for substantial increases in our audit capability. In addition, in response to questions from the Senate Appropriations Committee, we told them what we thought we would need. We hope that the conference committee will act favorably upon our fiscal year 1980 needs.

Mr. BROOKS. We are having a record vote in 15 minutes on the floor on the censure of Mr. Diggs. Therefore, we will have to leave in about 10 minutes. I would like to finish with the questions to you prior to that. Please answer them concisely. Then if you have anything that you want to add to them, you can do that for the record. We want them to be absolutely correct.

Ms. KNOWLES. Thank you.

Mr. BROOKS. Do you have any major concerns about the single audit approach?

Ms. KNOWLES. The only concerns I have, Mr. Chairman, are those I expressed at the beginning—that is, that they be adequate with respect to compliance, subgrantees, and the independence of auditors.

Mr. BROOKS. Do you believe that the single audit concept has been clearly defined?

Ms. KNOWLES. Well, sir, I believe it has been clearly defined in terms of what GAO thinks. I am not sure we think that it reaches far enough in terms of compliance and in terms of followthrough responsibilities.

My concern is that as Inspector General, after an audit is completed, we need to know who has responsibility for following through on the findings, not just the dollars involved. However, suppose an audit found insufficient internal controls. Does everyone follow that or does no one follow that? We need to make sure that this is thought through very carefully.

Mr. BROOKS. I would suggest that as Inspector General you take that up directly with the Secretary. That should be taken care of at the agency level without any outside intervention. Do that yourself on those audits. Then if you have any problems they ought to be submitted and be available to the legislative committee, to this committee, and to the Appropriations Committee.

We have found that findings requiring agencies to make constructive changes are sometimes ignored by the legislative committee and the agency. This committee has found that it is sometimes very helpful to bring that information to the appropriations subcommittee that handles that appropriation. It seems to get a more rapid response out of the appropriate agency if they discuss these findings which say they should do this and that it would save a amount of dollars while they are discussing the bill they have before them.

Ms. KNOWLES. Yes, sir.

Mr. BROOKS. They have neglected to do that and have done something else instead.

Ms. KNOWLES. My concern, Mr. Chairman, would be with a single audit, if one Federal department or agency was conducting an audit, that assignments be made clear as to followup which may impact on a number of different agencies.

Mr. BROOKS. Within the various agencies?

Ms. KNOWLES. Yes, sir.

Mr. BROOKS. That is a good point. Thank you.

I have three more questions. I will read them to you and let you answer them for the record, if you would, please.

Ms. KNOWLES. OK.

Mr. BROOKS. The first one is this: Do you believe a single audit guide could eventually replace the individual guides that you may develop for CETA and the Job Corps grants?

Ms. KNOWLES. I can answer that in one sentence, if you would like.

Mr. BROOKS. All right.

Ms. KNOWLES. We think only if it contained addendum with respect to compliance requirements. It would have to provide for specific compliance audits for each program.

Mr. BROOKS. Lord knows it is a fertile field. There has probably been as much fraud and corruption in CETA as any program we have ever dreamed up.

Ms. KNOWLES. We intend to find out.

Mr. BROOKS. The GAO reported two grantees got \$57 million from several Federal agencies, most of which consisted of Labor funds. Why didn't Labor take the lead to coordinate with other agencies to audit the grantees? Has any action been taken to make audit arrangements? That is Jackson County and the Ohio Commission.

Ms. KNOWLES. Yes, sir. I can answer very quickly on the Ohio Commission.

Mr. BROOKS. Time is killing us.

Ms. KNOWLES. OK.

Mr. BROOKS. The GAO found that the Job Corps Centers funded by several agencies, but mainly Labor, were generally inadequately audited. What has Labor done to insure that auditing of centers will improve?

Ms. KNOWLES. I would be glad to provide those answers for the record, Mr. Chairman.

[The material follows:]

Question. GAO reported that two grantees (one in Missouri and one in Ohio) received over \$57 million from several Federal agencies, much of which consisted of Labor funds. Why didn't Labor take the lead to coordinate with the other agencies to audit the grantees and has any action been taken to make audit arrangements?

Answer. One of the cited grantees, the Jackson County Employment and Training program in Missouri, has been audited subsequent to GAO's review. A final audit report was issued in March 1979. The Jackson County audit was delayed because of regional priorities, and our limited staff and funding. This audit covered only Department of Labor funds.

In some cases, Department of Labor grantees administer only DOL funds. In other cases, such as the Jackson County Employment and Training Program, other Federal agencies also fund the recipient. Arranging for an organization-wide audit in these cases has been difficult since there has been no uniform requirement for participation in such an audit and, frequently, agencies lack the funds needed to participate. As a result, we have had to perform audits of our own funds when an audit covering all Federal grants would have been desirable.

The other example cited by GAO was a sub-recipient of Department of Labor funds, the Ohio Commission on Aging. It has also been audited recently; three audit reports were issued in May 1979 as a result of an audit by Alexander Grant and Co. These audits were arranged by the DOL grantee administering the CETA Special Grants for Governors in Ohio; each of the reports covered a separate CETA subgrant.

These subgrantee audit reports procured by CETA prime sponsors are reviewed by our own regional offices to determine their acceptability in lieu of a Federal audit. If accepted, prime sponsor audits of subgrantees are relied on and used in our audit of the prime sponsor.

Many State departments on aging which administer DOL's Older Americans Act funds are predominately funded by HEW. We recently asked HEW to audit Labor's funds in conjunction with their audit of their own funds. In reply, HEW stated that, due to their lack of staff, we would have to audit our funds. Therefore, we plan to undertake such audits using CPAs, as soon as we have funds available. However, we will continue to work towards having a single audit of Federal grants in such situations.

Question. GAO found that Job Corps centers funded by several agencies, but mainly Labor, were generally inadequately audited. What actions has Labor taken to ensure auditing of centers will improve?

Answer. Originally, the Office of Economic Opportunity arranged for the audit of Job Corps centers with the Defense Contract Audit Agency, the Department of Agriculture, and the Department of Interior. This arrangement was continued when DOL took over responsibility for Job Corps centers in 1975, but proved unsatisfactory because program compliance audits were not being conducted. DOL recently developed audit guides which provide for complete financial and compliance audits.

Some Job Corps centers are operated by the Departments of Interior and Agriculture under an interagency agreement with DOL. DOL is arranging for the audit by CPA's of the 17 Department of Agriculture operated centers. No such agreement has yet been reached regarding the 11 Department of Interior operated centers.

In addition to these Job Corps centers, there are 47 centers which are operated by contractors of the Department of Labor. Thirty of these centers are currently being audited by CPA's hired by the Department of Labor. The remaining centers will be audited as soon as funds become available.

Mr. Brooks. You are very kind and gracious. However, even more important, you are intelligent and paying attention to business.

Mr. Stepnick and Mr. Peterson, we appreciate your being here. We are grateful for your contribution and your significant help.

Thank you very much.

Ms. Knowles. Thank you.

[Ms. Knowles' prepared statement follows.]

PREPARED STATEMENT OF MARJORIE FINE KNOWLES, INSPECTOR GENERAL, DEPARTMENT OF LABOR

Mr. Chairman and members of the subcommittee: I appreciate this opportunity to discuss with the committee the GAO report calling for implementation of the comprehensive, single audit approach. We support the recommendations in the report that Federal agencies should encourage the use of comprehensive audits that satisfy Federal requirements, that there must be increased coordination among Federal auditors, and that the greatest possible use should be made of non-Federal audits.

Let me state at the outset that the issues addressed in the GAO report are crucial and deserve the attention of high-level management. We are dealing with the fundamental issue of the establishment of mechanisms to obtain comprehensive, coordinated audits of grant recipients on a Governmentwide basis. I believe you share my view that audit is a key management tool. The very creation of my Office serves to highlight the significance of the audit function. In addition to assisting management, the audit function aids in the detection and prevention of fraud, abuse, and waste. It is in the context of the significance which I place on the audit function that I speak to you today.

The GAO review was undertaken as part of its commendable effort to expand and strengthen audit activities of Government departments and agencies. They reviewed 73 Government and nonprofit organizations that received Federal funds as grantees or subgrantees to determine the adequacy of: Audit coverage, Federal audit requirements, Federal agency audit planning, and coordination among various audit organizations.

Fifty-three of the recipients examined received funds from more than one Federal agency while 25 received funds from 5 or more Federal agencies. GAO found audit coverage of the recipients to be inconsistent. GAO attributed the inconsistency in financial and compliance audit coverage of Federal grants and grant recipients to a number of different, yet closely related, factors:

Audit requirements fixing the frequency of grant audits are inflexible;

Auditing one's own programs rather than coordinating with another audit group to obtain comprehensive, single audits of the recipients;

Poor use and possible shortages of audit resources; and

Failure to see that grantees make audits that satisfy Federal needs.

It is my objective to support fully the goal of developing the systems and procedures needed to implement the comprehensive, Governmentwide audit of grant recipients. However, I want to express my concern that the legitimate audit needs of Federal agencies must not be overlooked as the result of this process. As I have said, I view the audit process to be a key management tool. We must insure that any change in the audit process will permit audit results to be of use to program management; for example, to the program grant officer. Our other concerns are that we do not have sufficient resources to conduct and supervise Governmentwide audits; that these audits must include a review of a recipient's compliance with Department of Labor programmatic requirements; and that single audits must be conducted in sufficient detail to serve as a tool in identifying potential fraud, abuse, and waste.

The Office of Inspector General at the Department of Labor presently has 126 auditors to audit, manage and oversee the audit coverage of approximately \$10 billion in CETA grant funding and \$17 billion in job service, unemployment insurance and other program operations, per year. These resources are totally consumed by our priority tasks. It would be impossible for us to assume any greater responsibilities, such as a comprehensive Governmentwide audit of a given number of grant recipients, with our present audit resources.

With respect to insuring that a comprehensive single audit serve management and OIG concerns, it is important to keep in mind that the CETA program has 460 prime sponsors and approximately 30,000 subgrantees. In auditing the extensively decentralized CETA program, we have employed resources available in the Department, the private sector, and among State and local governments. For this audit effort, it is essential for the Department to determine the adequacy of the prime sponsors' compliance with applicable statutes and regulations, including their handling of their subgrantees. The Department is responsible for auditing the prime sponsors. The prime sponsors are responsible for auditing their subgrantees.

Our regional audit staff is responsible for determining the acceptability of these subgrantee audits through a program of desk reviews, workpaper reviews and onsite testing. Subgrantee audit reports are relied on and integrated into our audit of the prime sponsor. Before the Department of Labor needs will be satisfied by a single, comprehensive audit of a grantee, procedures must be established to insure that adequate compliance audit are conducted, in addition to financial audits, and that these audits include an examination of work done by subgrantees. Also, the auditors at all levels must be independent, in conformity with GAO and OMB guidelines on that subject.

I want to inform you that with respect to certain types of Department of Labor grants, we are attempting to get approval to conduct audits of all Federal funding of that recipient. We have requested that OMB allow us to audit, on a Governmentwide basis, the Native American programs. We have taken a similar initiative for the National Farmworkers programs. I hope that we can proceed with these efforts, which will provide a testing ground for organizationwide, Governmentwide audit concepts.

In summary, let me say that we are committed to working with other Federal agencies to achieve the goal of maximum use of audit resources to achieve optimum coverage of our audit universe. We hope to work towards that goal, bearing in mind our concern that the audits which are performed assist management in fulfilling its responsibilities, that the subgrantees are given adequate coverage, and that the granting of audit cognizance be done expeditiously, all with an eye toward the best utilization of our audit resources.

Let me add on a personal note that I have found, since being in this Office, that the audit agencies in other Federal departments have been eager to work with us. The stumbling block has always been who pays, the questions of resources. I would suggest in order to advance the goals we are discussing today, that that issue must be addressed.

I am grateful for the opportunity to discuss these matters with you and will be glad to answer any questions you may have.

Mr. Brooks. The committee will be in recess. When I return from voting on the floor, we will have as witnesses Mr. Drayton from the Environmental Protection Agency, Mr. Stoehr from the National State Auditors Association, and Mr. Antonio from the National Association of State Auditors, Comptrollers and Treasurers.

The committee will stand in recess.

[Recess taken.]

Mr. Brooks. The subcommittee will come to order.

Our next witness is Hon. William Drayton, Jr., Assistant Administrator for Planning and Management for the Environmental Protection Agency. He is a graduate of Harvard, Oxford, and Yale Law School. He studied at the John F. Kennedy School of Government at Harvard and Stanford Law School and also served as a management consultant with both public and private organizations.

He is accompanied by Malcolm Stringer, Director of the Office of Audit at EPA.

Gentlemen, we welcome you here today. We would appreciate your comments and your testimony.

STATEMENT OF WILLIAM DRAYTON, JR., ASSISTANT ADMINISTRATOR FOR PLANNING AND MANAGEMENT, ENVIRONMENTAL PROTECTION AGENCY; ACCOMPANIED BY MALCOLM STRINGER, DIRECTOR, OFFICE OF CREDIT

Mr. DRAYTON. Thank you, Mr. Chairman.

Mr. Stringer and I are delighted to be here to go over the GAO report, "Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling." I will confine my remarks to EPA's chief reactions to the report's major recommendations.

The job of auditing federally assisted programs has increased enormously. As the GAO pointed out in their report, federally assisted programs have grown from \$6.7 billion to about \$85 billion in the past 20 years. At EPA alone, grants for the construction of sewage treatment facilities—our, and I believe the Government's, largest construction program—had a funding level of \$1 billion in 1971 when EPA was established and has grown to \$4.2 billion in fiscal year 1979.

With respect to auditing resources, in 1971, our Office of Audit had approximately 55 work-years devoted to auditing. We now have an audit staff of 110. Further, we have embarked on an aggressive program to use annuitants and contract audit services. EPA has shown, I think, quite excellent and innovative leadership in developing this program under Mr. Stringer's direction. As a result, today we have more than tripled the number of work-years committed to auditing.

You have before you a number of recommendations for improving Federal auditing, including suggestions to change auditing processes and procedures and proposals for greater coordination. Let me briefly comment on several of these recommendations.

The GAO report recommends expanded application of the "single audit concept." As we understand this concept, audits would be mainly financial audits; that is, to determine if financial operations are properly conducted and to determine if financial reports are fairly reported. Some compliance auditing would also occur to see if major statutory and regulatory provisions are being obeyed.

Let me make some comments from EPA's point of view.

Our construction grants program—the program that requires the overwhelming bulk of our audit attention—is massive. We have over 13,000 grantees in every major city and most minor cities across the United States. The proper implementation of this program has a direct impact on the health of almost every citizen in the country. We think expanded use of single audits of multifunded grantees would help some agencies, but we believe a single audit would be of limited use to EPA in the construction grants area and could even cause more audits to be done than are actually needed, thereby increasing costs and/or reducing coverage unnecessarily.

There are two chief reasons we fear such a result.

First, a large share of construction grant recipients are separate governmental entities in the form of sewer districts or sewer departments within a municipality. They often cross the boundaries of several local government units. Their operations and accounting records are maintained independently from the records of normal city or county activities. Thus, a separate audit of a sewer district would often be required independent of an audit of other Federal grants awarded to a municipality.

Second, we understand the single audit concept to be primarily a financial audit with "major compliance terms" to be checked. We believe that we are doing a sufficient number of financial audits even though our construction grants audit program does very little financial auditing as the term is traditionally used.

We conduct mostly compliance audits which are heavily oriented toward the nonfinancial terms of the grant agreement, and we additionally do program results auditing. We check to see if the facility is actually being constructed; and after it is constructed, whether or not it works. We also ask whether or not it meets the required design criteria. Most of the costs we question are generated through compliance auditing.

We could and, in fact, do utilize a single audit with respect to accounting systems, internal controls, procurement systems, and the like, but we would still need a thorough compliance audit by our staff or our trained CPA firms. These audits are an additional management control EPA uses to insure the effectiveness of this massive program. If we were required to do closely specified financial audits instead, our tightly stretched audit staff could not make the sort of substantive contribution they now make to this key program.

I cite our reliance on compliance and program results auditing, not because I have any objections to a unified approach to financial auditing, but rather to point out that while the Federal presence in grant-assisted programs has grown, so has the level and complexity of responsibility that Federal agencies have taken on. Application of a single audit concept that would de facto squeeze out much of the compliance emphasis of our current audit program would be a step backward. It would, in effect, place us in a position of, on the one hand, setting environmentally acceptable standards for the construction of these plants but, on the other hand, making us unable to follow through to make sure that the health and safety of the public is, in fact, guaranteed.

I completely agree that we should do whatever we can to standardize our procedures and to reduce the "hassle factor" for grantees. At EPA, we have tried hard to do this in our permitting reforms. However, as that experience has demonstrated, we must proceed carefully and pragmatically. In particular, we should approach any flat rule with suspicion. Our audit staff needs flexibility to target and develop the most important cases and the most important parts of these cases.

We fully support the recommendations of the GAO with respect to removal of legislative requirements for regularly scheduled audits. Although our environmental statutes do not contain these types of requirements, we agree that here, too, lack of flexibility inherent in such provisions can seriously interfere with effective audit management.

We think that the reforms proposed by GAO regarding the single audit concept, the designation of "cognizant" or lead agencies, and the single audit guide, have the potential for practical application in the audits of our other grant programs.

Generally, we support the concept of designating certain agencies as "cognizant" in the audit of multifunded grantees. We believe, however, that this designation should be undertaken carefully and that everyone must recognize the increased burden on designated auditors if they are expected to be responsible for usable general compliance auditing.

Along these same lines, we believe that a standard audit guide is necessary if the concepts of conducting single audits and designating cognizant agencies are to work. As I stated earlier, however, I believe some programs, such as our wastewater treatment construction grants program, are so large and so complex that they do not lend themselves readily to these reforms nor to the development of a small handful of major compliance items to be included in a single audit guide.

One recommendation contained in the February 1979 joint financial management improvement program report was that a single Federal audit agency responsible for auditing all federally assisted programs be considered.

We, at EPA, do not endorse this concept at present, but we believe it deserves some further study. The success story in this area, much cited, is the Defense Contract Audit Agency. However, the business of auditing a multitude of Federal grants programs is, in many ways, dissimilar from defense contracting.

We believe that the best course of action for the present is to cautiously initiate the limited reforms presented in the GAO report and to give the newly appointed inspectors general a fair amount of time and experience with these reforms.

Incidentally, we expect—if all goes well—that EPA's new inspector general will be named within the next few weeks. In the event the suggested GAO reforms do not go far enough in alleviating the audit burden on both the Federal Government and on the grant recipients, then perhaps we may have to look to further steps.

Let me summarize by saying that this is a very tough problem. The answer alone is not more EPA auditors or more money to contract for outside auditing assistance. Nor is the answer the elimination of careful auditing of the actual construction of the wastewater treatment plants designed to insure that, to the greatest extent possible, the health of the American citizens will be protected.

I would caution that the problems are serious and that the answers to them may be complicated. While the basic direction of synthesizing where possible and developing a common approach will be highly useful, changes need to take into consideration the fact that the Federal role in many of these areas has become broader and more complex.

Mr. Chairman, that concludes my introductory remarks. If Mr. Stringer or I can be of any help in answering questions, we will be delighted to do so.

Mr. BROOKS. Those were your introductory remarks?

Mr. DRAYTON. My formal remarks.

Mr. BROOKS. You had me worried for a minute.

Mr. Stringer, I have a few questions for you. I want to submit a couple of questions for you and ask you about three.

Do you believe the single audit concept has been clearly defined?

Mr. STRINGER. Did you address that to me, sir?

Mr. BROOKS. Sure.

Mr. STRINGER. No, sir, we do not. We have many problems at EPA with what is actually meant by the "single audit concept"—primarily with what entails the entity to be audited. We think it needs to be defined at the lowest possible level so that all Federal agencies understand whether we are talking about a county, a municipality, or a

department or division with that municipality. Those are our primary problems with it.

Mr. BROOKS. Mr. Drayton, do you have any major concerns about the single audit approach?

Mr. DRAYTON. I would like to start by saying that the problem is clearly a real one.

Mr. BROOKS. Clearly a what?

Mr. DRAYTON. A real problem—there are too many independent excellent audit operations going on that overlap. We agree that the problem does need to be addressed. The lack of definition at the moment, I think, is probably more a function of OMB's still trying to work the problems through rather than anything fundamentally wrong with the idea of trying to get several audit programs to mesh better.

My caution would be that we should not try to be too global or too sweeping; we should take steps where it is practical. There may be some audit programs or portions of programs that just do not fit neatly into a pattern, where there is not a great deal of overlap between agencies, for example, or there are special requirements. As long as we continue this pragmatic process of developing this as has been going on over the last month, I am quite optimistic.

I agree with Mr. Stringer that neither the approach nor the entities to be covered have been clearly defined in a final form yet.

Mr. BROOKS. Does the EPA have a system to identify whether non-Federal audits that are performed satisfy EPA's needs?

Mr. DRAYTON. As I mentioned in the formal testimony, we have made a major investment in building up our non-Federal audit capacity through the contract CPA's and contracting with seven of the larger and better State agencies.

We do have a careful process of reviewing that work. We have 20 of our staff devoted to supervising the 80 contract CPA work-years, and where inadequate performance is encountered we have a policy of being quite strict in requiring that it be redone before we pay for it.

I might add that we have had some difficulty in the startup because many of the CPA firms are not experienced at the type of compliance work that we need and are not experienced at working with Federal statutes and regulations, let alone with wastewater treatment plants. I suspect that many of these auditors never imagined they were going to be spending this much time working on sewer plants when they went into their profession.

Mr. BROOKS. That is one of the best programs we ever had.

Mr. Horton?

Mr. HORTON. Thank you, Mr. Chairman.

Mr. Drayton, do you believe that the single audit concept should be applied to all grants including Government as well as nonprofit organizations?

Mr. DRAYTON. Yes, sir—with the caveat that I do not believe it should be applied to all grants but certainly across the categories you are suggesting—some private nonprofit, some State and local; but I think we ought to be careful about saying that all grants must be subject to it. There are some, such as our construction grants program, that should be approached carefully because of their peculiar qualities.

Mr. HORTON. Is your present staffing level adequate to develop the systems that are needed to implement the single audit approach?

Mr. DRAYTON. In part, that turns on what the single audit approach ultimately turns out to be. I am very concerned that the answer to that question may eventually be no, but that turns on the ultimate design.

For example, if we are required to follow up on the actions taken by other agencies to an audit on which we have lead responsibility, that is a major new workload that we have not even begun to contemplate how to deal with. We do not have a tracking system that would go into the Housing and Urban Development Department, for example.

I am also somewhat concerned that, to the degree that we are forced to undertake financial audits, particularly if there is a reasonably rigid and inflexible audit guide, we may be forced to divert some of the staff resources we now have working on the compliance aspect of those cases. That is why I am saying that it is very important to leave the audit staff with the flexibility to choose the most important projects and, within them, the highest payoff approaches.

When we do a compliance audit of one of the wastewater treatment plants, we do not ignore the financial results by any means. We use them, but we try to get quickly to what are the more important issues once we are convinced that adequate systems are in place.

I am somewhat concerned that if we are forced to follow a strict guide, we may have to invest 20 percent more of our time in items that we now judge to be of lower payoff.

Mr. HORTON. Thank you very much.

Thank you, Mr. Chairman.

Mr. BROOKS. Thank you very much, Mr. Horton.

Gentlemen, I want to thank you for coming down. We apologize for the rather extended stay. We enjoyed having you here.

Mr. DRAYTON. Thank you, Mr. Chairman.

Mr. BROOKS. Without objection, the further questions and their answers to be submitted for the record will be included at this point.

[Submissions to additional subcommittee questions follow.]

ENVIRONMENTAL PROTECTION AGENCY

Question 1. Do you believe the reporting of audit results would be a problem if the single audit approach is implemented?

Answer. Yes, we believe problems could arise. In order for the "single audit" concept to be of value, the audit report of a multi-funded grantee should show the details of financial information by individual grant, i.e., cost claimed under the grant and cost questioned and accepted.

Question 2. What can EPA do to require grant recipients to have audits that satisfy Federal needs?

Answer. When audits performed by, or on behalf of, grant recipients are deemed insufficient or deficient, we require the work to be corrected. We withhold final payment until the work is satisfactory.

Mr. BROOKS. Our next and last witnesses for today are Mr. Eldon Stoehr and Mr. James F. Antonio.

Mr. Stoehr is a legislative auditor for the State of Minnesota. He is president of the National State Auditors Association, and he is here representing that organization.

Mr. Antonio is the State auditor for the State of Missouri. He is here today representing the National Association of State Auditors, Comptrollers, and Treasurers.

Gentlemen, we welcome you.

Without objection, we will accept both of your statements for the record.

I will recognize either one of you for whatever comments you wish to make.

STATEMENT OF ELTON STOEHR, PRESIDENT, NATIONAL STATE AUDITORS ASSOCIATION

Mr. STOEHR. Thank you, Mr. Chairman.

I am Eldon Stoehr. On my right is Mr. Antonio.

We certainly appreciate the opportunity to be heard, especially in the face of the obvious other pressing issues that you have before you.

I consider it a privilege to be here, and I thank you for the opportunity.

As you mentioned, Mr. Chairman, Mr. Antonio and I represent two slightly different perspectives in that he is an elected auditor and I am a legislatively appointed auditor. We are similar in that we are independent auditors with a relationship to our State legislatures very similar to what GAO's relationship is to Congress. We think we are typical of State auditors generally.

We have, in addition to the testimony that we are summarizing here, submitted to your staff resolutions from the post audit section of the National Conference of State Legislatures, the full assembly of the National Conference of State Legislatures, the National Association of State Budget Officers, and a statement from the National Governors' Association, all supporting our legislative recommendations and encouraging greater reliance on non-Federal auditors.

We request that they also be entered, in their entirety, into the record.

Mr. BROOKS. Without objection, your full statement and the material you have just listed will be included in the record.

[See p. 51.]

Mr. STOEHR. We would also like to acknowledge the large number of capable and dedicated people in the Office of Management and Budget and other Federal audit agencies that we have ignored for reasons of brevity in addressing this subject this morning.

Also, we recognize that State auditors must assume some initiative and responsibility in bringing about the needed improvements in grant auditing. We have our shortcomings that we need not go into this morning, but we are addressing them in order to complement whatever the Federal actions for improvement may be.

We wholeheartedly agree with and support the concept of single audits of organizations as opposed to individual grants and contracts. Several States have advocated this for years, and many of them have made those positions known in Federal circles.

We also support and agree with sanctions for nonperformance by State auditors. Nonpayment is fine with us in those circumstances where it is warranted, but, in my opinion, there will be very few occasions that will require that action once State auditors have consistent and clear standards to perform by.

I think it is interesting to note that the proposed attachment P of OMB Circular A-102 covering audits of State and local government grantees, as it was recently published in the Federal Register, does

not include this provision for sanctions, and we think this should be considered in light of yesterday's testimony.

And, of course, before you have sanctions in the form of nonpayment, there needs to be provision for reimbursement to State auditors. This is an area that we feel needs some restatement and simplification. This subject was not specifically addressed yesterday either by Mr. Staats or Mr. White before this subcommittee, but it was brought out by both the JFMIP report and the Treasury Department's Carol Foryst report.

We are generally in agreement with the General Accounting Office's legislative recommendations, but we think they need to go further and be a little broader in content.

In 1965, the OMB Circular A-73 originally advocated cooperation and reliance between the various audit entities. In the intervening 15 years, there have been numerous reports citing ineffective implementation, and there have been as many statements by responsible officials that they were committed to correcting this. However, in June 1979, the General Accounting Office again reported with respect to OMB's efforts to solve these problems that,

Although the intent is clear and laudable, our review shows that agencies have generally not implemented them; moreover, they do not provide the overall direction and strong measures that are now needed to institute the single audit approach.

We agree with the General Accounting Office's conclusions and believe specific Federal legislation will be required to mandate the policies that the Federal executive branch has subscribed to for the past 15 years.

As evidence of the problems that we see with administrative action, as against the enactment of legislation, I would again refer you to the testimony of the Deputy Director of OMB yesterday. He noted that, in response to a recommendation the JFMIP report, OMB had set up an interagency working group to help them with technical issues. What was not mentioned was that two key implementation suggestions have not been followed: first, that State and local audit and program officials be included in the working group; and, second, that an individual should be hired to be detailed to the interagency group to help in managing the implementation of the report recommendations and to add continuity and permanence to that group.

We believe that these shortcomings will seriously affect the extent and timing of accomplishments, and they should be remedied.

Another disagreement is in relation to the cognizant audit agency approach. We favor a single grant audit management agency over the cognizant audit agency. The JFMIP report recommended that OMB determine the feasibility of a single audit agency, and from that we infer that the JFMIP, in its exhaustive review, found no such evaluation, and therefore its recommendation.

However, we do not understand why the JFMIP report suggested that the determination be deferred. We think it is logical to expeditiously evaluate all options before deciding to proceed with only one of them.

With that, Mr. Chairman, and with your permission, I would turn it over to Mr. Antonio who will make some additional comments on other areas.

Again, thank you for the opportunity to be here.

Mr. Brooks. Thank you.

[Mr. Stoehr's prepared statement with attachments follows:]

PREPARED STATEMENT OF ELDON STOEHR, PRESIDENT, NATIONAL STATE AUDITORS ASSOCIATION

Mr. Chairman and members of the committee: The community of State Auditors that I represent appreciates the efforts that made it possible for us to participate in these oversight hearings. I know there are many people at all levels of Government who would like to join me in voicing a strong plea for improvement in the administration of Federal grants in general, and in the audit of Federal grants in particular.

THE ROLE OF THE NATIONAL STATE AUDITORS ASSOCIATION

The National State Auditors Association, through its State Auditor Coordinating Committee, is the means for coordinating the post audit and program evaluation functions of the fifty states. SACC came into existence to support State auditors as they participate in the activities of the National Intergovernmental Audit Forum. Recently, we found it useful to expand SACC's role to represent State auditors as they react to the Federal legislative and regulatory processes.

STATE POST AUDIT RESPONSIBILITIES

The post audit function in State government is either statutory or constitutional, and is generally comparable to the role and authority of the Comptroller General of the United States and the General Accounting Office. State audit organizations have the responsibility for audit and/or program evaluations of the departments, agencies, and institutions of entire state governments as distinct from the internal audit of a single State agency. In many instances, the authority and the responsibility of State audit officials also includes the audit of local governments.

As an important component of the management and oversight systems of State governments, State auditors, along with our State colleagues in other fiscal functions, have worked to bring greater rationality to not only the audit function, but to the entire governmental fiscal system. Therefore, let me again say that we are very pleased to have this opportunity to express our strong support for improvements in Federal grant-in-aid policies, systems, and procedures.

PROBLEMS OF STATE OFFICES IN ADMINISTERING FEDERAL GRANTS-IN-AID

The records of the Congress and many of its committees are replete with statistics attesting to the explosive growth of Federal grants, and the enormous sums of money flowing to and through State and local governments for a myriad of purposes. Current reports speak of 80+ billion dollars being distributed to 50 states, 3,000 counties, and close to 90,000 local governments through some 600 Federal programs. The welter of administrative structures through which these programs are managed, the 10's of thousands of implementing rules and regulations that have been published, the uncertainties of Federal funding, and the staggering array of reports that are demanded, preclude rational planning and priority setting. This, in turn, contributes to the diminished effectiveness of State and local government administration of federally-assisted programs. These same conditions are intrinsically destructive to sound planning, management, and control practices in State and local government. They cause capable, well-intentioned people who are expected to "produce" in this environment to throw up their hands in despair.

PROBLEMS WITH THE COVERAGE AND APPROACH TO AUDITS OF FEDERAL GRANTS-IN-AID

It is a basic principle of effective management that when one spends large sums of money, particularly billions of dollars of taxpayers' money, one assumes a responsibility to assure that the money is being spent wisely, and for legitimate, authorized purposes. In the course of discharging this responsibility, Congress and the executive agencies have created yet another administrative nightmare that the General Accounting Office describes as "Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication that Needs Overhaul."¹ The GAO has impressive evidence to support this apt description.

¹ GAO report—"Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling" (GAO, FGMSD-79-37, June 15, 1979, p. 7).

In terms of audit duplication, GAO found instances where in a period of three years, grantees were audited more than 50 times, and where grantees have been audited by five or more different audit organizations. GAO found that such audits were generally "piece meal" audits in which each auditor satisfied the specific requirements of one agency, and paid little attention to the grantee's overall management practices or their effect on all federal grants being administered.

Unfortunately, most Federal grant audits today are "piece meal" audits and, as such, are not designed to detect inequitable charges or improper transfers of funds and equipment to, or between grants. In addition to being ineffective, "piece meal" audits are inefficient and wasteful because each team of auditors must become familiar with the grantee's operations, and each team reexamines the same accounting and internal control systems.

On the other hand GAO found large gaps in the audit coverage afforded Federal grants, reporting that:¹

"Although most grant recipients received audits, the audits were narrow in scope and did not provide either the Federal Government of the grantee with a meaningful overview of the grantees' financial controls and grant management capabilities;

"Many recipients received far less audit coverage than seemed appropriate—either no audits were made or coverage of their Federal grants suffered major gaps."

Federal officials cite the lack of audit resources as a major reason for gaps in audit coverage. In a report on HEW's audit of grants administered by institutions of higher education (FGMSD-79-44, July 19, 1979), "GAO concluded that HEW was trying to do too much with too few audit resources. As a result, audits were not conducted as frequently as they should have been and were omitted entirely at a number of institutions." HEW estimated that an additional 114 staff years annually would be required to do these audits on a 2-4 year basis. This shortfall is all the more serious since HEW has been designated by OMB as the "cognizant agency" to audit (on behalf of all Federal agencies) 98 percent of the institutions of higher education receiving Federal grants and contracts.

As was brought out at hearings on the Inspector General legislation, similar staff shortfall exists in all the Federal audit organizations. With the current emphasis on investigations and on Fraud and Abuse, there seems little likelihood of additional resources being allocated, or high priority being given to grant audits despite the fact that, as GAO brings out, such audits have a tremendous potential for cost savings. Bear this in mind when considering the OMB decision to implement GAO and JFMIP proposals to designate cognizant audit agencies for all grant audits. While the cognizant agency approach holds the promise of improvement, it will not expand the total pool of audit resources, and it will not facilitate the implementation of a government-wide grant audit priority system.

A shortage of resources is only one cause of the audit coverage problem. We concur with GAO that poor use of resources could also be a major cause.

There are a number of solutions proposed by GAO,² the Joint Financial Management Improvement Program, and the U.S. Treasury Department that we wholeheartedly support, and we also have a few of our own.

SOLUTIONS TO AUDIT COVERAGE PROBLEMS

One of the recommendations that has enormous potential for greater efficiency, as well as much greater effectiveness, is that Federal agencies require and rely on "single audits" of grant recipients (both primary recipients and sub-grantees). One audit would cover the financial and compliance aspects of all Federal grants administered by a recipient. The audit would be conducted on an "organization" basis to (1) determine the effectiveness of the financial management system and internal procedures that have been established to meet the terms and conditions of all grants administered, and (2) test the integrity of financial transactions and program operations.

We believe that periodic "single audits" of grantees would be advantageous from several standpoints—they would improve audit performance, reduce the impact on grantees and, by eliminating duplication, increase efficiency and expand the number of audits possible with a fixed staff of auditors.

¹ GAO report—"Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling" (GAO, FGMSD-79-37, June 15, 1979, p. 7).

² GAO—"Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling" (FGMSD-79-37, June 15, 1979).

JFMIP—Report on Audit of Federally Assisted Programs: A New Emphasis (February 1979).
TREAS—A Report on Federal Government Audits: Abuses and What Corrections are Needed (November 1975).

The Director of the Office of Management and Budget has endorsed the "single audit" concept and OMB is in the process of amending OMB Circular A-102 to set this out as Federal government policy.

It would seem as though we are on the verge of a major breakthrough,—and that our concerns are misplaced. Cautious type that we are, we look at the 15 year history of unsuccessful efforts by the Federal executive agencies to expand reliance on non-Federal audits, and we see nothing to convince us that history will not repeat itself. Let's take a look at that history.

INTERGOVERNMENT AUDIT RELIANCE

The benefits to be derived from Federal reliance on qualified non-Federal auditors (We favor reliance on independent State and local government auditors as against public accountants) are so obvious, that such reliance should be the rule rather than the exception.

However, despite an OMB Circular (A-73) dating back to 1965 that urges audit cooperation and inter-reliance, a 1977 Presidential memo that emphasizes inter-governmental audit coordination, and the obvious advantages of getting additional resources when they are in short supply, examples of such cooperation and reliance are minimal, and efforts to increase them have not been successful.

The 1965 version of OMB Circular A-73 was issued as a result of disclosures by the Congress of widespread deficiencies in auditing federally-assisted programs. It provided for reliance, to the maximum extent feasible, on audits made at State and local levels; coordination of all audits of grant programs administered under the jurisdiction of a single Federal Department; and cross-servicing arrangements between Federal agencies whereby one Federal agency would conduct grant audits for another.

Nine (9) years later, in 1974, GAO reported:³

"For the most part, however, benefits from coordinating Federal and State audits have been short of what is attainable."

"Even though they have substantial backlogs of audit work, most Federal auditors say they generally do not rely on State or local government audits because of the Federal Government's differing legal requirements, interests, audit guidelines, and reporting methods."

GAO recommended that GSA (which had assumed responsibility from OMB for administration of Circular A-73) take positive steps (1) to promote the use of State and local audits to satisfy Federal audit requirements, and (2) to revise Circular A-73 to include procedures that would increase intergovernmental audit cooperation.

GSA responded that they strongly endorsed initiatives for improved inter-governmental auditing, and were prepared to contribute to that effort *to the maximum extent possible* (italic added).

In noting GSA's reply, GAO observed that "Success or failure will largely depend on the administrator's vigorous leadership."

Five more years have passed and GAO has again undertaken a review to determine if OMB and Federal agency efforts to provide for grant auditing have been successful. The resulting report which is the subject of these hearings, "Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication that Needs Overhauling," vividly describes GAO's findings. With respect to OMB's efforts to solve the problems that persist so many years after Congress disclosed them, GAO said: "Although the intent of these policies is clear and laudable, our review shows that agencies generally have not implemented them. Moreover, they do not provide the overall direction and stronger measures that are now needed to institute the single audit approach."

LEADERSHIP PROBLEMS

I have purposely provided considerable detail so that you can understand why State Auditors doubt whether OMB and the Federal agencies can now bring about change by administrative measures. While I dislike resorting to overused, and perhaps abused phrases, I have no good alternative. We believe there is a leadership problem—one of style and fragmentation.

Look at the facts!

The GAO and JFMIP reports referred to earlier highlight the lack of progress by OMB and Federal program and audit officials in bringing about needed improvements in grant auditing. Both GAO and the JFMIP noted that the problems

³ Increased Intergovernmental Cooperation Needed for More Effective, Less Costly Auditing of Government Programs (B0176544, April 8, 1974, page 1).

they reported were not new. Most of them had been identified by Federal officials and addressed in earlier reports. Over the past 10-15 years OMB has relied, for the most part, on solving problems by issuing new or revised policy statements. While we all agree that there has been some action, I think it is fair to say that Federal agencies have not been willing to respond to such "passive" leadership. To us the facts are overwhelming!

Short of a basic change in OMB's concept of its leadership role, or a major change in Federal agency inclination to comply with OMB directives, nothing will happen. As a normally conservative group, we don't believe in miracles. We think Federal legislation will be required to mandate the policies that the Federal executive branch has subscribed to for the past 15 years. To start, the legislation should provide (1) for State and local independent auditors to have the option of performing financial and compliance audits of grantees and their subgrantees; (2) for the Federal government to establish a quality review process that will assure that such audits are properly performed and meet generally accepted auditing standards; (3) for intergovernmental reliance on the work of government audit organizations that are found to meet those standards; and (4) for appropriate sharing of audit costs.

FEDERAL REIMBURSEMENT FOR GRANT AUDITS

Setting new legislation aside for a moment, there is an urgent need for clarification and simplification of existing guidelines covering reimbursement to State and local governments for audit service. There are three reports⁴ that conclude reimbursement is necessary and appropriate. They also recommend the improvement of existing reimbursement procedures or the adoption of more effective alternatives. We believe that after appropriate review of this material you will reach a similar conclusion and trust that your report of these hearings will reflect a preference for direct Federal reimbursement to State and local auditors.

SINGLE GRANT AUDIT MANAGEMENT AGENCY

Returning now to my earlier observations about the adoption, government wide, of the cognizant audit agency concept, I would like to bring to the committee's attention a JFMIP recommendation that OMB determine the feasibility of establishing a single Federal agency to be responsible for managing all grant audits. We believe such a Federal agency is desirable. In fact, in light of Inspector General preoccupation with fraud and abuse, and the leadership problem I just described, it may be the only viable option. It also should reduce the confusion caused by there being as many varied interpretations of OMB circulars as there are Federal audit agencies involved in grant auditing.

We recognize that while there are these and other attractive advantages in having a single grant audit agency, there also are disadvantages, and that the relative cost/benefit must be weighed. This is neither the time nor the place to do that. Therefore to preclude wasting resources to implement the less effective option of cognizant audit agencies, and to avoid further delay in acting on GAO and JFMIP recommendations, we urge that OMB make that determination immediately.

STATE AUDITOR RESPONSIBILITY

We are well aware that the various reports mentioned earlier have focused on Federal program and audit management and glossed over the shortcomings of State auditors. We recognize that State auditors need to assume a much greater share of the responsibility for bringing about improvements in grant auditing . . . and we are committed to a concerted effort to that end.

CONCLUSION

We are also aware that we have focused on the failures and glossed over the dedicated efforts of a large number of capable people in OMB and the Federal audit agencies. For this we apologize, but we considered it necessary to hold our comments to a reasonable length.

Mr. Chairman, I again thank you on behalf of the National State Auditors Association. It has been a privilege to appear before this Committee.

I will try to answer any questions that you have.

⁴ GAO—Problems in Reimbursing State Auditors for Audits of Federally Assisted Programs (FGMSD-75-22, June 25, 1975).

JFMIP—See footnote 1, page 51.

TREAS—See footnote 2, page 52.

RESOLUTION III

JOINT FEDERAL-STATE AUDITING

Whereas, audits are an important component of the total State fiscal management process; and,

Whereas, in pursuit of timely, objective, and professional audits, State governments have expanded and enhanced their audit capabilities and,

Whereas, all States now have provision for the audit of State programs and agencies, which includes those State government functions financed in whole or in part with Federal funds; and,

Whereas, efforts have been made by the General Accounting Office and Office of Management and Budget to achieve the benefits that would jointly accrue from greater Federal reliance upon State government audits of programs involving Federal dollars by the elimination of duplication between State and Federal audit efforts; and

Whereas, these benefits include lower Federal administrative costs and the freeing of Federal agency internal audit resources for other audit coverage of Federal agencies and programs; and,

Whereas, Federal administrative agencies have failed to substantially implement the intent of executive management policies directing the encouragement of and reliance upon State audit efforts: Now, therefore, be it

Resolved, That the National Association of State Budget Officers: Support Federal legislation to provide for single, coordinated audit coverage of Federal agency funds including professionally qualified independent auditors of states, and where performed by the State mandatory reimbursement for the costs of the Federal share of such audits.

Adopted by the National Association of State Budget Officers, Albany, New York, July 26, 1979.

THE POST AUDIT SECTION OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES

RESOLUTION ON FEDERAL-STATE AUDIT COOPERATION AND REIMBURSEMENT

Whereas, the General Accounting Office, in a series of audits and evaluations of the management of federally assisted programs, has determined that these programs are not being adequately audited or evaluated by the various federal departments and funding agencies; and

Whereas, the federal management circulars on grant management, accounting and auditing have been poorly implemented and ineffectively enforced; and

Whereas, State governments have expanded and improved their audit capabilities to a professional level equal to or exceeding those of federal agencies; and

Whereas, State governments have provided for audits of state departments, agencies, and institutions, including those functions of state government that are financed in part or wholly with federal funds; and

Whereas, it is economical and efficient to perform single audits on multi-funded governmental entities, and for these single audits to be performed by those state auditors having the broadest authority, and for audits to be of entities and not of grants or contracts; and

Whereas, the National Intergovernmental Audit Forum, and the principals of the Federal Joint Financial Management Improvement Program, with the assistance and cooperation of the State Auditor Coordinating Council, have completed a study entitled "Audit of Federally Assisted Programs: A New Emphasis" which makes positive findings and recommendations about the auditing of federally assisted programs; and

Whereas, implementing the recommendations in this report will achieve benefits that would accrue from a greater federal reliance on audits performed by state audit organizations both through eliminating duplication of audit effort and through increasing obligation of both federal and state audit resources.

Whereas, Federal administrative agencies have failed to implement legislation and executive management policies which direct the encouragement of and reliance on state audit efforts; and

Whereas, State audit organizations audit federal programs and have difficulty receiving reimbursement sufficient to support an audit operation: Now, therefore, be it

Resolved, That the Federal-State Assembly of the National Conference of State Legislatures supports the findings in the report entitled "Audit of Federally

Assisted Programs; A New Emphasis" by the Joint Financial Management Improvement Program, and encourages the principals of the Joint Financial Management Improvement Program to proceed immediately with implementing the recommendations of the report. It is further

Resolved, That the appropriate committees of the Congress of the United States hold hearings on the report from the Joint Financial Management Improvement Program and on the recently released General Accounting Office reports, so that legislation may be considered that will provide for more effective accounting for and auditing of federally assisted programs executed by state and local governments.

San Francisco, California, July 23, 1979.

NATIONAL CONFERENCE OF STATE LEGISLATURES

RESOLUTION ON FEDERAL AUDIT PROCEDURES

Federal management circulars on grant management, accounting and auditing have been poorly implemented and ineffectively enforced. State governments have expanded and improved their audit capabilities to a professional level equal to or exceeding those of federal agencies. Therefore, NCSL urges the Congress to enact legislation which allows for reliance on audits prepared by state auditors; uniform guidelines for federal grant audits; reimbursement for audits of federal grants; and the acceptance of audits of governmental entities rather than only the audits of individual grants and contracts. This position is consistent with the report of the Joint Financial Management Improvement Program and numerous studies by the General Accounting Office.

San Francisco, California, July 27, 1979.

STATEMENT OF DEIRDRE RIEMER, STAFF DIRECTOR, COMMITTEE ON EXECUTIVE MANAGEMENT AND FISCAL AFFAIRS, NATIONAL GOVERNORS' ASSOCIATION

The adverse impact of federal grant administration on the management of state government has been a major concern of many Governors. In 1975, the Governors of North Carolina, West Virginia, Ohio, Utah, and Iowa complained to William Simon, then Secretary of the Treasury, about various problems they were experiencing with grant audits. As a result of Secretary Simon's interest, a study was made of the problems raised by the Governors, and a report titled "Federal Government Audit: Abuses and What Corrections are Needed" was issued in November 1975. The committee staff has a copy of that report.

The report is quite thorough in presenting the views of state officials. It prompted one-third of the Governors, many more state auditors, and public and private audit groups and associations to communicate their support and suggestions for change to the Treasury Department. As a result of later correspondence, meetings, and deliberations involving the Comptroller General and the Economic Policy Board, Secretary Simon referred the matter to the Joint Financial Management Improvement Program (JFMIP) for resolution. In the letter of referral dated September 7, 1976, (copy attached) Secretary Simon noted the following issues in need of prompt remedial action:

Broadening of audit coverage through increased use of state and local auditors;

Clarification of federal policy on reimbursing state and local governments for audit costs;

Promotion of full compliance with audit regulations; and

Elimination of unnecessary duplication of audit work.

The 1976 Treasury report repeated the findings of two General Accounting Office reports¹ issued in 1974. JFMIP undertook another two-year study of the subject and the report that resulted, "Report on Audit of Federally Assisted Programs: A New Emphasis" (February 1979), parallels the conclusions of the earlier three analyses.

The President addressed intergovernmental problems in a statement on reform initiatives he released on September 9, 1977. The statement echoes the concerns of the reports already referenced in my testimony. The President said:

"There is a substantial need for improved cooperation on audits. Since many grant recipients receive Federal funds from more than one program, many State and local governments often must submit to repeated audits of the same set of

¹ GAO reports—"Increased Intergovernmental Cooperation Needed for More Effective Less Costly Auditing of Government Programs" (B176544: April 6, 1974). "Problems in Reimbursing State Auditors for Audits of Federally Assisted Programs" (FGMSD-75-22: June 25, 1975).

accounting books by several Federal auditors—each of whom represents a different funding source. Many grant recipients are audited by state and local auditors as well.

"To make the audit process more orderly and predictable—and to help increase coordination among Federal state and local auditors—I am today ordering Federal executive departments and agencies to make their audit schedules systematically available to grant recipients and to state, local, and private auditors; to conduct single federal audits wherever possible; and to increase their reliance on State and local audits."

In June, GAO issued its report titled "Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling," the focus of these hearings. GAO itself emphasizes the fact that "few of the problems we have discussed are new. Most of them have been identified by Federal officials and addressed in our previous reports."

All the evidence on the audit problems raised by state officials points to one conclusion: There has been too much study, analysis, consideration, and discussion and far too little action.

My associates on the panel have commented on preferred alternatives and have suggested the timing of needed actions. I will therefore limit my comments on behalf of NGA to urging that action, not rhetoric, follow from these hearings and that serious consideration be given to mandating some of the longstanding federal audit policies through legislation.

For the information of the Subcommittee, I am attaching a resolution adopted by the National Governors' Association in July 1975 that is as timely now as it was then.

Thank you.

NATIONAL GOVERNORS' CONFERENCE RESOLUTION, JULY 1975

B-18, STATE-FEDERAL AUDITS

The audit process is an important management tool enabling state and local governments to evaluate program effectiveness and the use of public funds. Quality and effectiveness of state audit operations have increased significantly in this process.

All States by law must audit state program and expenditures. Federal auditors perform a like function for grant-in-aid programs. Frequently state and federal auditors conduct duplicative reviews of jointly funded programs. This process is both costly and time consuming.

Although Federal Management Circular 73-2 allows federal agencies to rely upon state audits, little progress has been made, largely due to resistance on behalf of federal agencies.

The National Governors' Conference urges the Federal Government to emphasize and support the use of state audits for federal grant-in-aid programs and to provide, as appropriate, financial assistance to state audit agencies.

THE SECRETARY OF THE TREASURY,
Washington, September 7, 1976.

Hon. ELMER B. STAATS,
Comptroller General of the United States,
Washington, D.C.

DEAR ELMER: Several months ago I brought to the attention of the Economic Policy Board a Treasury staff paper concerning the need for developing and implementing various reforms in the audit of Federal grants of funds to States. As a result, the Board agreed that a Task Force should be established to define the problems and objectives of audit reform and to develop options on the issue.

In studying the subject, the Task Force identified a number of audit areas in need of prompt remedial action. Possible improvements involve such significant matters as the clarification of Federal policy on reimbursing State and local governments for audit costs, the broadening of audit coverage through increased use of State and local auditors, the promotion of full compliance with audit regulations, the elimination of unnecessary duplication of audit work, and related items. These proposals are designed to improve the audit of Federal grants to States and strengthen the overall accountability for such funds—a major management goal of the character suggested in the President's memorandum of July 24 to various agencies on the subject of management initiatives.

To ensure proper implementation of appropriate audit reforms, I have concluded that the matter should be referred to the Joint Financial Management Improvement Program for resolution. This approach would provide a forum for achieving necessary cooperative action, in line with the JFMIP's primary mission of improving financial management activities throughout the Government. Accordingly, I would like to suggest that a JFMIP audit reform project be initiated as soon as possible. A similar letter is being sent to the other JFMIP principals.

Your views on this matter would be appreciated.

With best regards,
Sincerely yours,

WILLIAM E. SIMON,
Chairman, Economic Policy Board.

Mr. Brooks. Mr. Antonio?

**STATEMENT OF JAMES F. ANTONIO, MISSOURI STATE AUDITOR,
REPRESENTING THE NATIONAL ASSOCIATION OF STATE AUDITORS,
COMPTROLLERS, AND TREASURERS**

Mr. ANTONIO. Mr. Chairman, there are some additional matters of importance I would like to touch on, also some matters so important that I think they deserve some reemphasis.

Recently, the mayors of the Nation's largest cities met and agreed that President Carter's hopes for a balanced budget deserve support but, at the same meeting, urged the President to not cut back programs they feel vital to the life of the cities. It is a natural reaction, not a contradiction. No one wants to kill the Federal goose that lays the golden grants; they just want their share of the feed bill cut.

Getting rid of waste, duplication of effort, and overlapping programs has to be a natural first step. I am not talking about waste in welfare programs or duplication of effort between agencies or overlapping weapons programs; we are talking here today about auditing where duplication of effort and overlapping efforts by Federal, State, and local, and independent auditors leads to auditing that gives you less for more money.

The audit house must be put in order, and the single audit concept is being developed as a means to that end in the area of auditing Federal grants. But today it is a concept, nothing more.

The front cover of the Comptroller General's report delivered to you last month says it all: Grant auditing today is a maze of inconsistency, gaps, and duplication. It is a strong statement, but it is not news. There have been numerous GAO reports over the years on this subject, and 3 years ago Comptroller General Staats met with State and Federal auditors in New Orleans to tell them, "much also needs to be done to standardize Federal audit requirements."

For 10 years now, the joint financial management improvement program has been calling for action. We have a circular out now from OMB that says the single audit concept is to become policy. We could cite that as good news, except that the circular is a rewrite of a Bureau of the Budget document from 1965. Even that document followed 3 years' work here in the Congress looking at the Federal grant system and the auditing problems it was creating.

While the grant system grew and grew with cost increases matched only by the price of gasoline and homes in Montgomery County, the audit activities designed to control the system went from bad to worse.

Look at what we have today just in the area of audit guides. There are anywhere from 80 to 100 out today authored by more than a

dozen Federal agencies. They all take different approaches, not just in format, but also in the amount of information they call for. That makes mandated adoption of a single audit guide a big part of the answer to the problem we face.

Working with GAO, the Intergovernmental Audit Forum has developed a model. If and when we can agree on a final form for that guide, we will have gained ground—if and when.

Personally, I look for the Inspectors General to be prime movers in the effort to improve the situation. It is frustrating for a State auditor to try to do something about problems with Federal grants in the present set of circumstances. You incur the wrath of the grantee you are auditing and the granting Federal agency because you are making them look bad—and often come away feeling the Federal program people do not care or want to know about noncompliance.

With the IG's guaranteed independence and access to their agencies' top management, those of us at the State level will be able to report compliance and noncompliance with more hope.

The draft single audit guide and the IG program have to be considered positive factors, and I have a positive but realistic outlook that comes down to this: With a congressional push or two, we can do it. There is ample evidence that OMB simply does not have the clout to bring about the single audit concept.

I think the audit forums have been given an opportunity to help implement this single audit concept, and Federal, State, and local auditors have shown a surprising ability to work together through the forums. However, it must be remembered that the forums have no formalized clout, but you do.

Make the single audit concept the single audit law. Make the 15-year-old policy paper directing Federal agencies to avoid duplication of effort law rather than policy. You will anger only one group of people—people who spend their days inventing conflicting audit requirements no one can meet. Let us free up all those creative writers from inventing audit guides. They can be put back into the field auditing. To do that, we must have legislation which mandates action.

Federal, State, local, and independent auditors are ready to work together—I think at least most of them are—but we have to take a frank look at the record today, and the record indicates that without your action recommendations will remain recommendations and policy will never become reality.

Thank you, Mr. Chairman.

Mr. Brooks. I want to thank you very much for your comments.

Without objection, your full, written statement will be included in the record at this point.

[Mr. Antonio's prepared statement follows:]

PREPARED STATEMENT OF JAMES F. ANTONIO, C.P.A., STATE AUDITOR OF MISSOURI, REPRESENTING THE NATIONAL ASSOCIATION OF STATE AUDITORS, COMPTROLLERS, AND TREASURERS

Mr. Chairman and committee members: I am pleased that this committee has seen fit to hold hearings on the problems that we face in carrying out an effective Federal grant audit program.

I am the State Auditor of Missouri and believe my experiences in that state are fairly typical of the experiences of my peers in other states throughout the country. As an active participant in the organizations of State Auditors, I believe I can quite accurately express their concerns and frustrations.

Mr. William Snodgrass, Comptroller of the Treasury of Tennessee, and President of the National Association of State Auditors, Comptrollers and Treasurers, asked me to represent that organization here today.

DEMANDS FOR FISCAL ACCOUNTABILITY

Recently the Mayors of the nation's largest cities met, and agreed that President Carter's hopes for a balanced federal budget deserved support.

At that same gathering they also urged the President to not cut back on any of the programs they feel are vital to the life of their cities.

In Missouri, several of our state legislators this year called for a Constitutional Convention to mandate a balanced federal budget. Our General Assembly also voted for a hefty capital improvements program for the new fiscal year; and in Missouri we fund our capital improvements work with state revenue sharing dollars.

Reporters and columnists have been quick to point out these seeming contradictions, although they are not. They are natural reactions. No one wants to kill the federal goose that lays the golden grants, they just want their share of the feed bill cut.

Let us be a little kinder. And more positive. All across the country people are realizing that government is one of the villains in the inflation melodrama.

They are demanding that the fiscal house be put in order. And they want essential services maintained to the greatest extent possible.

If cuts have to be made, they want them done with surgical precision. In this exercise auditors fill the diagnostic role.

Government auditors, internal or independent, are the ones being called on for the straight information on where cuts can be made, where they should be made.

Their challenges are greater today than ever before.

CONTROLLING WASTE AND DUPLICATION

The first, and perhaps greatest challenge they face, is to help government get rid of waste, duplication of effort, and overlapping programs.

I am not talking about waste in welfare programs, duplication of effort in grant programs aiding cities, or over-lapping in weapons development between the branches of the armed services.

I'm talking about the duplication of effort in auditing, about the over-lapping work of federal, state, local and independent auditors. Simply put, we are wasting money.

At the same time auditors are being called on for more and more information and work by government decision makers, the audit house must be put in order.

PUTTING THE AUDIT HOUSE IN ORDER

For example, State auditors do not have a central source to turn to for information on what federal dollars are flowing to what units of government in the states.

By law my office audits most of the counties in Missouri, all but the 20 largest of the state's 114. There have been times when we've been well into our audit work and discovered by chance there was a federal grant being used by a county. They hadn't told us about it. They thought that because they got the money direct from Washington they didn't need to tell us about it or show us the books they kept. No matter that we asked them about their federal grants.

State auditors need an information source at the federal level. A source we can go to as a check against the information we get ourselves. A single source would be best, but even a single source on an agency by agency basis would be helpful.

I urge caution in setting up this central federal information source, so we don't end up with another good-sized agency which begins duplicating effort all over again.

If much of the aid to local government is going to come directly to them, not through the state, then that information source becomes more important.

Developing a central source for information would help the people on the federal side of thing in addition to helping us at the state level. They need it almost as much as we do.

Another pressing need is for the Federal agencies to come up with some common audit requirements. According to the report on audit of federally assisted programs of the joint financial management improvement project, there are about 80 federal audit guides in circulation today, issued by around 14 federal agencies. Senator Harrison Williams, in remarks this session introducing his bill to develop state and local government accounting standards, counted around 100 different guides.

Whether there are 100 or 80, the guides all take different approaches, not just in the reporting format they call for but also in the amount of information they call for.

My staff tells me there is no way our present reports can meet all of those guides' requirements. I can't afford the time needed to reshape an audit of a state agency or county to meet all those demands. I'd end up with a job cost greater than the budget of the auditee.

Here's another problem, different fiscal years. Between grant periods, and federal, state and local fiscal years there are many differences.

The solution is to let the audited entity be audited on its fiscal year, regardless of the federal granting agency's desired fiscal year or grant period.

It may not be as convenient as the federal agencies would like, but they will get usable information and it's more efficient. One audit-one fiscal period.

These are problems that can be solved, and solved quickly if we dedicate the efforts to the task. Our regional state-federal groups, the Intergovernmental Audit Forums, have worked with GAO to develop the model single audit guide needed. It has been in the hands of the federal agencies since the beginning of the year. Hopefully most agencies are already reporting their reaction to OMB.

BETTER ENFORCEMENT NEEDED

I think the Inspectors General Program will help with the problem also.

Once the IG's are in place and working. I think they will help bring about better and faster response when we find and report problems.

Grant enforcement right now is ineffective. From my viewpoint it is frustrating to incur the wrath of state and local government by pointing out non-compliance only to find out the federal program people don't care about non-compliance.

I know federal auditors don't run the program people but we do need to:

1. Condense grant requirements down to what's really important.

2. Then enforce what's really important.

The Inspector General Program should help.

With the IG's guaranteed independence and access to their agency's top management, we can report non-compliance or problems with the knowledge that the information is going to someone who won't just sit on the report to keep his boss from looking bad.

SINGLE AUDIT CONCEPT

Last, and probably most important, I want to talk about the single audit concept that is currently being developed as a means to remedy many of the grant audit problems and inefficiencies. Under the concept there would be a single financial and compliance audit of a recipient, covering all the recipient's funds.

State Auditors are the natural performers of many of the audits anticipated under the single audit concept. They are already in place and auditing many of the grant recipients. They are already auditing the state agencies and departments many of the grants flow through on the way down to the political subdivisions actually spending the money.

Needless to say—State auditors strongly support the single audit concept and believe they should be given the first option to perform such audits.

LEGISLATION NEEDED

The National Forum has been given an opportunity to help implement the single audit concept.

Federal, state, and local auditors have shown a surprising ability to work together through the Forums and have earned this opportunity.

However, it must be remembered that the Forum has no formalized clout. The Forums don't have the clout, but you do.

Make the single audit concept the single audit law.

Make the 15-year-old policy paper directing federal agencies to avoid duplication of effort in grant auditing law rather than policy.

You'll hurt and anger only one group of people—the people who spend their days inventing conflicting audit requirements that no one can meet. But we can find work for them. After all, GAO says close to \$200 billion in grant funds has gone unaudited over the past five years or so. Once we free up all those creative writers from writing audit guides, they can be put to auditing.

But to do that, we need legislation that mandates action.

State auditors are ready to work together . . . at least the great majority are.

But we have to stand on our record today. And our record indicates that without your action, recommendations will remain recommendations and policy will never become reality.

I thank the Committee for the opportunity to present these views on behalf of the National Association of State Auditors, Comptrollers and Treasurers.

Do you have any questions?

Mr. BROOKS. What do you believe, Mr. Antonio, are the major actions needed to improve coordination between State and Federal auditors?

Mr. ANTONIO. I think some of the things we have already talked about need to be referred to again here. The existence of a single grant information system, I think, is necessary; the single audit guide being agreed to is necessary; we are going to have to have some vehicle for cost reimbursement for the additional costs incurred at the State level for auditing. In addition, I think we would like to see one agency to interpret auditing standards; one agency to review quality of audit work being done at the State and local level; one agency to contract with non-Federal auditors; one agency which, in effect, has the mission of effective financial and compliance auditing of grants; and, accordingly, one agency head who can be removed if he is ineffective.

Mr. BROOKS. Are the State and local auditors willing to follow Federal audit guidelines?

Mr. ANTONIO. I think that is clearly the case. I think we have some auditors who are doing so now, but I think most are waiting to see what kind of a structure comes out of the deliberations and the results of things like the GAO report.

Mr. BROOKS. I have a couple of questions I would like to submit to you for the record, if I might, Mr. Stoehr.

Mr. STOEHR. Certainly.

Mr. BROOKS. Without objection, they will be included in the record at this point.

[Submissions to additional subcommittee questions follow:]

Question 1. How do you perceive State and Federal auditors' roles in the single audit concept?

Answer. State auditors would perform financial and compliance audits of Federal grants according to Federal guidelines. Federal auditors would exercise quality control of State audit work, follow up on findings reported by State auditors and perform audits for economy and efficiency as well as program effectiveness.

Question 2. Do you believe that State laws are a problem in bringing about improvement in grant auditing?

Answer. Generally no. Most States' statutes give auditors very broad powers to perform their audit function, and State auditors as a rule could legally perform Federal grant audits in compliance with Federal guidelines.

There may be some problem in the funding of the additional staff for Federal grant audits. State legislatures will have to provide appropriations for such staffing or establish some revolving fund mechanism to utilize reimbursements with some cash flow provision.

Mr. BROOKS. I want to say that the hearings have shown the need to improve auditing of Government grant programs. The failure of the Government to provide an effective system for auditing the billions of dollars involved in these programs cannot be allowed to continue. While grantmaking agencies can certainly make improvements, they will be unable to solve the problems alone. From what we have heard, we can conclude that the situation will not improve significantly unless OMB provides the strong leadership and direction that is needed.

The poor conditions in grant auditing exist largely because each agency continues to audit its own grants rather than coordinating its efforts with other agencies to obtain comprehensive single audits of the grant recipients. Everyone generally agrees that comprehensive financial and compliance audits should be performed. However, agencies have failed presently to effectively use available resources to obtain them.

OMB is taking steps to see that these comprehensive audits are made. They include policy changes and the development of standard audit guidelines. However, more needs to be done. Some very complex and challenging problems remain which OMB must resolve.

This subcommittee is going to closely monitor actions on these problems. We will ask OMB to establish milestones and target dates for accomplishing improvements and to report back to us on their progress.

The subcommittee, again, appreciates the fine work of the GAO in this most complex and critical area. Their work has contributed a great deal both to this hearing and to the effectiveness of auditing within the entire Federal Government. We look forward to their continuing involvement.

I would ask unanimous consent that a statement submitted by the Community Services Administration be made part of the record.

Without objection, it will be included in the record at this point.

[Mr. Jones' prepared statement and submissions to additional subcommittee questions follow:]

PREPARED STATEMENT OF FRANK N. JONES, GENERAL COUNSEL,
COMMUNITY SERVICES ADMINISTRATION

This statement is submitted as a compendium of the Community Services Administration's response to questions posed by the subcommittee and provided to me on July 12, 1979. It is our hope that the subcommittee will find these highlights useful and convenient.

The Division in CSA that is responsible for the program of grant audits is the External Audit Division, Office of Legal Affairs and General Counsel. The Division has 23 auditors and 10 clerical staff of which 20 auditors and 9 clericals are located in the 10 common regions. Three auditors and one clerical position are located in headquarters, Washington, D.C.

The CSA Act requires each grantee receiving assistance to have an annual audit. Most of these audits are done by certified public accountants who are engaged by the individual grantee. Staff audits, special request audits, and reviews of CPA's work are also independently conducted by the CSA External Audit Division.

All CPA reports are reviewed by our regional auditors to determine compliance with the CSA audit guide. If they do not comply with the CSA audit requirements, they are returned to the CPA for revision and/or supplemental information. The External Audit Division maintains reimbursable cross-servicing audit agreements with Department of Health, Education, and Welfare and the Defense Contract Audit Agency.

The current priorities of the Division are:

- (1) Reviewing independent public accountant's reports to determine compliance with our audit guide;
- (2) Systematically reviewing workpapers of independent auditors;
- (3) Complying with special requests from Congressional sources, program officials, CSA's Inspection Division, and United States Attorneys;
- (4) Continuing liaison with the U.S. General Accounting Office, and
- (5) Continuing maintenance of Audit Report Information System.

In fiscal year 1978, 1,790 audit reports were issued. These covered grant funds awarded of \$747,157,109.

The Community Services Administration is on record in its support of the single audit concept. As you know, this approach would reduce audit duplication and undue interruption of grantee activities. More importantly, it would present the financial health of a grantee's operations in one report and also be the vehicle for identifying and controlling cash transfers from one program to another. However, there are some impediments to this approach which we are prepared to discuss in detail if you so desire.

The major portion of CSA funding is directed to private non-profit organizations which receive funds from various Federal and non-Federal sources. However, we feel that the single audit approach should encompass private non-profit as well as governmental organizations.

The Economic Opportunity Act of 1964 amended requires an annual audit of all grants of assistance awarded by this Agency. We feel that this requirement inhibits flexibility in managing our audit resources, and we have taken action to introduce less restrictive language into our legislation.

It is our opinion that audit pronouncements and recommendations from OMB and the General Accounting Office and recommendations from the Subcommittee on Manpower and Housing are contradictory or at best confusing with regard to who shall hire the auditor—the grant recipient or the Federal agency. Hopefully, these hearings will clarify this point and provide for an exchange of ideas which will lead to innovations in the grant auditing milieu.

We appreciate this opportunity to provide the Subcommittee with these highlights which we are prepared to amplify with additional oral and written commentary.

CSA QUESTIONS

Question 1. What problems do you now have in obtaining audits of your grantees? Are audits satisfactory?

Answer. Although all of our grants provide instructions regarding the requirement for an audit, some grantees wait too long after the end of their program year to engage an independent auditor causing the audit report to be late. In addition, some grantees who may only be funded on a one-time basis may spend all funds and not be concerned with obtaining an audit since there is no expectation of receiving future funds. Also, in cases where portions of a program may be delegated by the grantee, the grantee may fail to require the delegate agency or subgrantee to obtain an audit that can be consolidated with the grantee's overall audit.

We believe that the audits that CSA receives are generally satisfactory to meet the needs of this Agency. This conclusion is based on the results of a Quality Assurance Program which was introduced in fiscal year 1978. Under this program, the External Audit Division systematically reviews the workpapers of the CPA that performed the grantee's audit. Also, in selected cases we will review the grantee's records which were reviewed by the CPA during his/her audit. In fiscal year 1978, we reviewed the work of 114 CPAs and found that about 97 percent of the audits were adequate while about 3 percent were considered to be substandard. In fiscal year 1979, we have continued this Quality Review Program and tentatively we are finding similar results.

Question 2. Do you believe that the annual audit requirement of the Economic Opportunity Act is causing duplication and unnecessary auditing?

Answer. In some rare cases, it may cause duplication and/or unnecessary auditing, but far more importantly it precludes CSA from taking a more flexible approach to auditing its grantees and also is a barrier to audit coordination with other Federal agencies and, to some degree, state audit organizations. It is also not in consonance with OMB Circulars A-102 and A-110 which permit auditing of grants not less frequently than every two years.

A case of duplicative audits may arise where more than one grantee organization delegates part of their program responsibility to the same subgrantee. At the time each prime grantee is audited, that grantee is responsible for having its delegate agency or subgrantee audited. If this occurs, the delegate agency may be audited more than one time.

A more flexible approach to auditing especially small dollar grants would be to audit a statistically prepared sample of these and project the results. From this approach, it could be determined whether more or less audit effort should be expended on these grants in future years. Having a statutory requirement for an annual audit of every grant is a hindrance to this type of flexibility.

Question 3. Do you believe that the single audit concept should be applied to all your grants, including government as well as nonprofit organizations?

Answer. Yes. The predominance of CSA funding is made to private non-profit organizations; however, many of these organizations receive funds from various Federal and non-Federal sources. These entities are generally referred to as multi-funded organizations and in our opinion, should be priority targets for the single audit approach.

Question 4. Do you have any major concerns about the single audit approach and, if so, would you briefly state what they are?

Answer. Yes, we do have some major concerns about the single audit approach; however, we also feel that these concerns can be overcome through firm direction from OMB to the executive agencies and through coordination among the funding sources involved. Following is a brief explanation of some of these concerns.

(a) There is a lack of uniformity of audit requirements in the enabling legislation for many domestic social programs. As a result, there are instances in which the legislation actually encourages duplicative audits. Examples of this are the Special Crisis Intervention Program (SCIP), and the Summer Youth Recreation Program funded by CSA in fiscal year 1977 and 1978. The SCIP program was for a 3-month period and it required a separate audit of each 3-month program rather than allowing these funds to be audited at the same time all of the grantee's programs were being audited. The grantees had to engage CPA firms to do separate audits of these energy grants which resulted in audit duplication and unnecessary disruption of the grantee's operations.

The Summer Youth Recreation Program also required a separate audit of each grant even though some of the grants were funded for less than \$500.

(b) At this time, there is no central point in the Federal Government where funding data are accumulated. Therefore, it is an arduous, if not impossible task to determine which grantees were funded, by whom, and for what dollar amount. These data must be obtained before any workable cognizant audit agreements can be arranged.

(c) There is a saturation of domestic programs which GAO states has reached the \$85 billion mark. All of the programs have differing legal and regulatory requirements. One major drawback to the single audit concept is that many of these requirements are not available to an auditor when he/she is performing the audit. Another ancillary problem that will also arise in doing a single audit is that the auditor will be forced, to a greater degree than at the present time, to rely on broad statistical sampling techniques. This will have to be done to keep the cost of auditing within reasonable limits. This may also result in a decrease in the detailed review of a grantee's transactions.

(d) At this time, no definitive cognizant assignments have been made for auditing domestic social programs. This must be done by OMB before the single audit concept becomes a reality. Without this firm direction, the single audit concept will continue to be a coordinative nightmare among the various funding sources.

Question 5. Do you believe that the single audit approach and the entities to be audited have been clearly defined?

Answer. I would say that much has been done to define these areas but more is needed. I think more discussion is needed on the definition of an entity; for example, if a grantee delegates part of its program to another entity (subgrantee), should the single audit cover all of the funds including those delegated to the subgrantee? This would not ordinarily pose an unsolvable issue, however, if a grantee delegates part or all of its program to as many as 140 different entities or subgrantees who may not even be located near the grantee or have the same accounting period as the grantee's, then the applicability of a single audit may be doubtful.

Another example of doubtful applicability of a single audit approach is a case in which CSA funds a grantee and the grantee delegates part of its program to the City Board of Education whose audit cycle may be every three years. When the grantee is audited, should the City Board of Education be audited as an entity or should only the grantee's funds be audited? The other alternative would be to wait until the City Board of Education is audited, although that audit may not be due for another year.

I believe a decision will have to be made to address the problem of auditing delegate agencies, subgrantees, or subrecipients.

Question 6. Do you believe non-Federal audits should follow Federal audit guidelines? What efforts should be made to make non-Federal audits follow the guidelines?

Answer. (a) Yes, if the guidelines are uniform and required to be consistently applied.

(b) Require as a condition of the grant agreement that the uniform audit guide shall be used before the audit will be acceptable.

Question 7. What attempts have you made to change the annual audit requirement under the Economic Opportunity Act and what is their status?

Answer. On November 9, 1978, the Director of CSA (copy of letter to OMB provided to Mr. Barnes on July 13, 1979) recommended changes to the Economic Opportunity Act. One of the changes was to require a grantee audit "not less frequently than every two years" rather than the current requirement for an audit of each grant annually.

A more comprehensive package on proposed legislative changes is currently being prepared by CSA and will be transmitted for consideration in the next authorization process involving the Community Services Administration.

Question 8. What are you doing to solve the conflict in CSA versus HEW guidelines where an audit report is required within 180 days of the end of the project year and HEW's regulation requires audit reports within 120 days of the end of the project year?

Answer. At this point, we have not discussed this difference with DHEW because of our request to be the cognizant audit agency for CSA funded Community Action Agencies. If this request is approved and cognizance is assigned to CSA, this is one of the areas that will need to be resolved.

Question 9. Do you believe the steps to have a single audit now being taken by OMB will resolve the problems you see in the audits of your grants? If not, what additional steps do you believe OMB needs to take?

Answer. OMB has taken steps to issue Circulars A-73 and A-102 encouraging cross-servicing audit agreements. However, I believe that OMB should be taking quick, decisive action to set up audit cognizant assignments especially in cases where it can be done without a great deal of coordination among the Federal agencies involved.

In addition, I believe OMB, GAO, and the House Subcommittee on Manpower and Housing should agree on a policy as to who shall engage the auditor to do audits of Federally assisted programs.

The GAO Standards (Yellow Book) state the following:

"When independent public accountants or other independent professionals are engaged to perform work that includes inquiries into compliance with applicable laws and regulations, efficiency and economy of operations, or achievement of program results, they should be engaged by someone other than the officials responsible for the direction of the effort being audited. This practice removes the pressures that may result if the auditor must criticize the performance of those who engaged him. To remove this obstacle to independence, governments should arrange to have such auditors engaged by officials not directly involved in operations to be audited."

Attachment P to OMB Circular A-102—audit requirements for grants to State and local Governments says the following:

"State and local governments may use their own procedures to arrange for independent audits, and to prescribe the scope of audits, provided the audits comply with the requirements set forth below. The provisions of this attachment do not limit the authority of Federal agencies to make audits of recipient organizations. However, if independent audits arranged for by State and local governments meet the requirements prescribed below, all Federal agencies shall rely on them, and any additional audit work should build upon the work already done."

The House Subcommittee on Manpower and Housing stated the following in its report on CSA, dated August 5, 1977:

"CSA should follow the Comptroller General's audit standards and hire the accounting firms that audit local poverty agencies * * *."

In a recent discussion (June 1, 1979) with GAO and OMB staff, I was informed that the GAO standards should not be interpreted to mean that the Federal funding agency should hire the auditor to audit funds awarded to grant recipients.

Question 10. In addition to the guidelines for grant recipients, do you think it is necessary to have comprehensive guidelines for Federal agencies to follow in implementing the single audit? If not, why?

Answer. I think there should be guidelines for Federal agencies to follow in implementing the single audit. However, I don't think the guidelines should be so comprehensive as to limit flexibility on the part of the cognizant audit agency.

The guidelines should include some instructions on (1) method of payment by the funding sources, i.e., will the funds for audit be included in each grant award or will there be a reimbursable arrangement among the funding sources to pay for the audit costs?; (2) audit cut-off date; since most funding sources have different program year ends; (3) deadline for submitting an audit report; and (4) time period during which corrective action shall be completed.

Mr. Brooks. In addition, I would ask unanimous consent that the record remain open for statements and information from other Government agencies. We look forward to the continuation and resolution of this matter within my lifetime.

The hearing is adjourned, subject to the call of the Chair.

[Whereupon, at 12 noon, the hearing was adjourned, to reconvene subject to the call of the Chair.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

ASSOCIATION OF GOVERNMENT ACCOUNTANTS,
Arlington, Va., September 11, 1979.

Hon. JACK BROOKS,
House of Representatives,
Washington, D.C.

DEAR MR. BROOKS: On Behalf of the members of the Association of Government Accountants, I would like to voice our encouragement and offer our support to you and your fellow members on the Subcommittee on Legislation and National Security in your efforts to further intergovernmental cooperation. Your recent subcommittee hearings on the proposed revision to OMB Circular A-102, Attachment P, Audit Requirements for State and local Governments, and indicated support of the single audit concept hopefully will encourage early promulgation of this necessary regulation.

Our Association has for several years participated in efforts directed to increasing intergovernmental cooperation. In this regard, we support the proposed revision to Attachment P, and the single audit concept. It is in the interest of helping to assure the realization of this concept that we suggest Attachment P be further revised to require the partial withholding of grantee payments until all financial management systems requirements, including that for internal audit, have been complied with. These requirements have long been included in Circular A-102, however due to a lack of specific financial incentive or penalty the requirements have not been complied with.

I would also like to record our concurrence in the need for additional audit resources expressed by the Inspectors General who provided testimony at the subcommittee hearings. Several Inspectors General have indicated a need for additional resources to meet the basic audit and investigative requirements included in the Inspector General Act. The additional requirement for assuming cognizant federal agency responsibilities will undoubtedly create additional audit staff shortages.

Again, we applaud your efforts and stand ready to assist you in any way our participation might be useful.

Sincerely,

FRANK S. SATO,
National President.

COUNTY OF SAN DIEGO,
OFFICE OF THE AUDITOR AND CONTROLLER,
San Diego, Calif., July 16, 1979.

Congressman JACK BROOKS,
Chairman, House Subcommittee on Legislation and National Security, Rayburn
House Office Building, Washington, D.C.

DEAR CONGRESSMAN BROOKS: It is my understanding that your Committee will be holding hearings July 30th and 31st in Washington D.C. on the subject of the need for legislation dealing with the fiscal administration of Federal assistance programs, particularly with respect to reforms of Federal audit programs. Although my schedule (and Proposition 13 fiscal constraints) preclude my being able to testify personally, I appreciate this opportunity to submit written testimony.

This subject is one of long-standing concern to local government fiscal administrators throughout the nation, as well as to policy makers. Enclosed is a copy of the latest legislative policy adopted by the San Diego County Board of Supervisors on this subject (attachment 'A').

The National Association of Counties has incorporated into its American County Platform a statement with respect to needs for Federal grant reforms and has also adopted a number of Resolutions addressing related subjects (attachment 'B').

The Joint Financial Management Improvement Program has recently completed a comprehensive study on the subject of Audit of Federally Assisted Programs. That study resulted in nine recommendations, some of which may require legislation for their implementation.

The National Intergovernmental Audit Forum was established by the U.S. Comptroller General in 1972 to review auditing problems between levels of government. The Forum has adopted a series of Position Statements designed to address problems and has unanimously approved all recommendations for audit improvement contained in the JFMIP study.

The General Accounting Office has identified significant problems in recent reports to Congress with respect to the fiscal administration and audit of Federal assistance programs.

The President has issued a series of Directives to Federal agencies calling for improvements in the administration and audit of assistance programs.

In spite of all of these identified problems and concerns, little tangible results have occurred. It appears that Congressional action is essential if we are to see progress in this most critical area. A number of bills which deal directly or indirectly with the subject are currently under consideration, including S2/HR2, S755, S878, S904, and S2621. Hearings on S904 are being held on July 26th and 27th. A copy of my testimony on that legislation is enclosed for your information (attachment 'C'). Also enclosed are copies of comments prepared by my office on S 755 and S 878 (attachment 'D').

In view of this broad level of interest, it appears that legislation is both desirable and necessary in order to get a clear statement of Congressional policy and direction. As opposed to addressing the issues as a part of other legislation (S 904) or in a piecemeal fashion, it appears that subject is of significant importance to warrant legislation which has the subject matter as its exclusive area of concern.

We invite your interest in this matter, and urge your favorable consideration in pursuing legislation either through consolidation of present proposals now under consideration, or through the development of comprehensive new legislation.

I again wish to thank you for this opportunity to provide input to your deliberations. Should you desire further amplification of any of these comments, please advise me.

Very truly yours,

GERALD J. LONERGAN,
Auditor and Controller.

Attachments.

ATTACHMENT A

BOARD OF SUPERVISORS POLICY, COUNTY OF SAN DIEGO, CALIF.

Subject.—Legislative policy; Intergovernmental cooperation and coordination of audit efforts; policy No. M-24.

Purpose.—To provide for improvement in the effectiveness and efficiency of all audits in San Diego County through better intergovernmental cooperation and coordination.

Background.—Audits of programs, functions, activities and systems are necessary tools of effective management. However, the level of materiality and the scope of audit are necessary ingredients to ensure the cost-effectiveness of audit efforts. It is considered necessary to recognize that it is almost not possible nor desirable to audit every aspect of governmental endeavor every year. Time constraints and insufficiency of resources alone preclude such an extensive effort. More importantly, however, the performance of an audit solely on the basis of the expiration of a specified period of time or other arbitrary requirements without consideration of such factors as:

- (a) Magnitude of auditee (Financial, programmatic, etc.);
- (b) Significant changes in organization and/or operations (both in size and scope);
- (c) Complexity of fiscal relationships;
- (d) Extent and nature of other auditor or previous audit findings;
- (e) General attitudes of Board of Supervisors, Chief Administrative Officer and public;
- (f) Extent of public awareness of activities or ability to evaluate effectiveness or results of operations; and
- (g) Feedback received

will eventually lead to a decrease in the effectiveness of auditing efforts and increased costs to both the auditing agency and the auditee.

One of the reasons we are experiencing difficulty in this area is because Federal and State agencies require audits of their grants and programs often quite arbitrarily and with little regard to the above mentioned criteria. While Presidential directives and current Congress activity are causing some improvement in this area, there is still a long way to go.

Policy.—In pursuit of the purpose expressed herein it is the Legislative Policy of the Board of Supervisors of the County of San Diego to support legislation at the Federal and State levels, as appropriate, which will:

1. Increase audit efficiency and effectiveness through Intergovernmental cooperation and coordination;
2. Eliminate arbitrary audit requirements and replace them with the judgment of independent auditors;
3. Increase audit effectiveness by more frequent use of such techniques as the unified audit approach; and
4. Standardize audit guides on order to reduce or eliminate the proliferation of different audit and reporting requirements by different agencies.

ATTACHMENT B

AMERICAN COUNTY PLATFORM AND RESOLUTIONS; 1978-79 NATIONAL ASSOCIATION OF COUNTIES

10.52 Federal Grant Reform—Congress and the Administration should realize that local governmental agencies are better equipped to implement federal programs in their local communities than are remote federal officials. The Congress and the Administration should therefore provide more flexibility to counties and other local agencies in the administration and utilization of federal grant programs and monies by:

- A. Regularly evaluating all federal aid programs in consultation with local officials to revise, consolidate and/or eliminate programs as needed.
- B. Consolidating existing categorical grant-in-aid programs into general "program area" block grants.
- C. Developing new programs based on the "block grant" concept, which requires comprehensive short and long range planning as the only criteria for grant utilization.
- D. Reducing the complexity of grant application and reporting procedures.
- E. Reducing the number and/or type of "strings attached" to federal grant programs.
- F. Requiring all agencies to comply with the federal government regulations which call for simplification and standardization of grant applications, procedures and recovery of direct and indirect costs.
- G. Improving cash flows to local units on grant and subvention programs through wider use of letter of credit and advances.

NATIONAL ASSOCIATION OF COUNTIES,
Washington, D.C.

RESOLUTION ON GRANT REFORM

(Passed by the Taxation and Finance Steering Committee, Mar. 11, 1979)

Whereas, the federal grants-in-aid system will disperse approximately \$82.9 billion in assistance to state and local governments in FY '80; and

Whereas, the federal grants-in-aid process has become increasingly more complex and costly to administer as a result of growing federal requirements and red tape; and

Whereas, counties recognize, as equal partners in the federal process, their responsibility to provide efficient and cost effective programs on the local level; and

Whereas, the Administration and Congress have recognized the need to secure reforms in this federal process as demonstrated by the Presidential Grant Reform Memorandum of September 9, 1977, and recent legislation in the Congress; and

Whereas, section 10.52 of our American County Platform states that Congress and the Administration should realize that local governmental agencies are better equipped to implement federal programs in their local communities than are remote federal officials. The Congress and the Administration should therefore provide more flexibility to counties and other local agencies in the administration and utilization of federal grant programs and monies by:

- A. Regularly evaluating all federal aid programs in consultation with local officials to revise, consolidate and/or eliminate programs as needed.

B. Consolidating existing categorical grant-in-aid programs into general "program area" block grants.

C. Developing new programs based on the "block grant" concept, which requires comprehensive short and long range planning as the only criteria for grant utilization.

D. Reducing the complexity of grant application and reporting procedures.

E. Reducing the number and/or type of "strings attached" to federal grant programs.

F. Requiring all agencies to comply with the federal government regulations which call for simplification and standardization of grant applications, procedures and recovery of direct and indirect costs.

G. Improving cash flows to local units on grant and subvention programs through wider use of letter of credit and advances: Now therefore be it

Resolved, That Congress and the Administration shall consider grant reform a major effort and secure passage of legislation which would streamline the grants process, reduce administrative and paperwork burdens on recipients, and provide for an equitable and efficient grants-in-aid system. Be it further

Resolved, That the essential element of such legislation must establish an appellate commission or body, composed of entirely local and state elected officials, with such body having over-ride statutory authority and the expressed purpose of reviewing and, for cause, granting relief in cases where existing statutes and regulations have resulted in undue delay or excessive expense in the grants-in-aid process.

RESOLUTION ON REGULATORY REFORM

(Passed by the National Association of Counties, Taxation and Finance Steering Committee, Mar. 11, 1979)

Whereas, county governments are concerned with the growing numbers of federal rules and regulations, and the process by which the federal government develops such regulations; and

Whereas, federal rules and regulations are often duplicative, conflicting and administratively costly to implement; and

Whereas, county governments believe that such costs are inconsistent with federal attempts to bring more fiscal control and management on the national level; and

Whereas, counties have actively participated in the A-85 consultation process and have consistently expressed their willingness to work as an equal partner in developing sound and efficient rules and regulations: Now therefore be it

Resolved, That Congress enact legislation to reform the regulatory process which would streamline agency rule making and reduce the administrative costs and burdens of federal regulations; such legislation shall provide for full consultation of local government in the development of regulations; and be it further

Resolved, That any such legislation shall include:

Regulations impacting grants-in-aid;

Five year review of regulations, including existing rules;

Economic and programmatic impact analysis; and alternatives for the rules;

One centralized office for management and control in each federal agency;

Early and meaningful comment; at least 60 days review period;

Any changes to the Administrative Conference of the United States to monitor the rule-making process should include the establishment of a state/city/county advisory body; and

Revised agency regulations shall contain economic impact analysis.

RESOLUTION SUPPORTING SUNSET LEGISLATION

(Passed by Taxation and Finance Steering Committee, July 8, 1978, Atlanta, Ga. Reaffirmed by Taxation and Finance Steering Committee on Mar. 11, 1979, Washington, D.C.)

Whereas, the National Association of Counties American County Platform includes language in support of frequent review of existing grant programs by the federal government; and

Whereas, the United States Senate is considering the "Program Reauthorization and Evaluation Act of 1978," which requires a 10 year review and evaluation of most ongoing federal programs; and

Whereas, it is the opinion of the National Association of Counties Taxation and Finance Steering Committee that major programs should be reviewed on a more

frequent basis than 10 years and would recommend at least a five year review of certain programs: Now, therefore be it

Resolved, That the Taxation and Finance Steering Committee go on record in support the concept of Sunset, and urges that certain programs be reviewed on a more frequent basis than 10 years, and would recommend that Congress consider a five year review of such programs.

ATTACHMENT C

COUNTY OF SAN DIEGO,
OFFICE OF THE AUDITOR AND CONTROLLER,
San Diego, Calif., July 16, 1979.

Re Senate bill 904.

Senator JAMES R. SASSER,
Chairman, Senate Committee on Intergovernmental Relations,
Washington, D.C.

DEAR SENATOR SASSER: Although I will be unable to be present to provide oral testimony during the July 26th and 27th hearings on S. 904, the opportunity to submit written testimony is sincerely appreciated.

Of particular interest and concern to those of us on the "firing line" in local government are the provisions of this legislation calling for grant reforms. This aspect of the bill was no doubt prompted by the growing concerns at all levels of government with the lack of effectiveness of the present patchwork system of grant fiscal controls.

A series of Presidential Directives calling for grant reforms by Federal agencies have been issued over the past two years. The recently issued Joint Financial Management Improvement Program Report on Audit of Federally Assisted Programs, which was two years in the making, clearly identifies the problems and provides a series of recommendations for corrective actions.

I have had the distinction of serving as a charter member of the National Intergovernmental Audit Forum, established by the U.S. Comptroller General in 1972. The Forum has adopted a number of Position Statements dealing with improving the effectiveness of auditing and has recently taken action to unanimously support all nine of the JFMIP recommendations contained in its recent report.

Recent reports by the General Accounting Office further articulate the need for reforms at the Federal level to improve grant fiscal management and auditing processes.

The National Association of Counties has for years called for Federal grant reforms as a part of its American County Platform and also through a series of Resolutions.

The San Diego County Board of Supervisors had adopted a formal policy (attachment 'A'), which addresses their concerns.

In addition to Senate Bill 904, there are currently five other items of legislation now before the Congress (S2/HR2, S755, S878, and S2621), all of which deal either directly or indirectly with the basic concerns involving Federal/local relationships. Congressman Jack Brooks has scheduled hearings on the need for legislation addressing Federal audit reforms and fiscal administration of Federal assistance programs. A copy of my written testimony to be submitted during these hearings is enclosed (attachment 'B').

This outpouring of expressed interest and recognition of problems perceived at all levels of government warrants action by Congress. The efforts of Federal administrative agencies to address and implement corrective actions have been less than successful. A strong legislative policy and directions by Congress is both necessary and timely if we are to obtain tangible results. Because of its national importance, we would urge that the Title III of S 904 be the subject of legislative action applicable to all Federal assistance programs, irrespective of the size or governmental level of the grant recipients.

To cite just one example of the problems we are forced to contend with daily as a result of the existing uncoordinated Federal approach to audits, there are now over 100 separate Federal audit guides which prescribe different and often times conflicting accounting and reporting requirements on grant recipients. Even in a large and sophisticated organization as ours, we find it difficult (and frequently impossible) to fully comply with all requirements. Surely, those smaller units of government must be experiencing chaos. The unnecessary costs involved in maintaining and auditing the myriad of accounting records involved must be staggering.

Many times, we see the costs to reconstruct records after the fact to satisfy audit requirements far exceed the actual dollar amounts of the audit disallowances at issue.

The costs of accounting for and auditing many piecemeal programs absorbs an abnormally high proportion of the costs of many programs—with no tangible benefits accruing to the stated purpose of the program itself.

At the request of Senator Danforth, we have previously prepared an analysis of the specific provisions of S 904. A copy of that earlier analysis is also attached for your consideration (attachment 'C').

Once again, I wish to express my appreciation for the opportunity to submit testimony on this important legislation, and I urge its early adoption.

Very truly yours,

GERALD J. LONERGAN,
Auditor and Controller.

Attachments.

SAN DIEGO COUNTY AUDITOR AND CONTROLLER COMMENTS ON S. 755

A. This bill exempts "interpretative rules", line 8, page 7 and page 26, line 12 from the provisions of this bill. Interpretive rules, although not defined within the context of this bill, could have significant impact upon the actions of local government. Interpretative rulings represent attempts to resolve controversy relative to specific legislative provisions. Controversy is usually not generated unless differing interpretations of legislation would result in material often fiscal, effects upon the parties affected. Proposed interpretative rules should be subject to the same provisions as the other administrative rules.

B. Page 7, line 18, the definition of "major rule" could be clearer if the following paragraphs (A), (B), and (C) were linked together with the word "or" e.g. (A) or (B) or (C).

C. Page 9, line 22, this section states that "an Agency may consider a series of closely related rules as one rule for the purposes of this section". Such a proviso could also allow an Agency to consider each rule separately and therefore exempt the rule from the "major rule" category. The Bill's procedure for "major" rules differs in scope from that used for other rules. The section should be changed to read "An Agency should consider a series of closely related rules as one rule for the purposes of this section."

D. Page 19, lines 5 thru 24. Rules selected for periodic review, other than rules having \$100,000,000 impact on the economy, is left up to the Agencies discretion. Agencies should be provided definitive guidelines for establishing which rules are to be reviewed and be required to review all rules falling within those guidelines.

E. Page 21, lines 7 thru 9, including "the cost and nature of any problems encountered by the Agency in obtaining compliance with the rule, policy, or practice" may not be indicative of the real cost of obtaining compliance. Local government and industry are often charged with insuring compliance and must develop elaborate monitoring systems to insure compliance e.g. Affirmative Action. This section could be changed to read "the cost and nature of any problems encountered by the Agency and other parties in obtaining compliance with the rule, policy, or practice."

SAN DIEGO COUNTY AUDITOR AND CONTROLLER COMMENTS ON S. 878

A. Uniform accounting requirements appear to be addressed in Title III, Section 7 (pages 25 and 26, lines 20 thru 24 and 1 thru 3 respectively). However this section states that Federal Agencies shall adopt and adhere to uniform provisions with respect to inconsistent requirements relating to financial administration, including accounting. There is no mention as to the type of inconsistencies referred to. One would suspect that the uniform accounting procedures to be adhered to are in respect to inconsistencies between Federal Agencies but not between Federal Agencies and local governments. While this section prescribes adherence to uniform provisions, the subsequent page 29, lines 15 thru 25, places responsibility for prescribing accounting records for integrated grant funding on any Federal Agency administering an integrated management fund. This seems somewhat inconsistent with a uniform accounting approach and needs to be clarified.

B. While uniform accounting requirements are mentioned in Title III as discussed above, such requirements are not specifically addressed in the preceding

sections of the bill e.g. Title VII, Section 703(A), page 4 and Title II, Chapter 10, paragraph 1003 (Page 12, line 2). In these sections the President designates an Agency responsible for overall financial and administrative requirements and provides for consolidation plans which will "specify in detail the terms and conditions under which the Federal Assistance Programs included in the plan shall be administered, such as matching, apportionment, financial management. . . .". You must assume from reading these sections that auditing and accounting would be addressed as "financial management". It would be clearer to have included auditing and accounting as specific terms in these two titles and sections.

C. It is impossible to tell from reading this bill what provisions are expected in the manner of uniform accounting requirement. Generally grant funds are provided for specific purposes and accounting categories are generated in response to these purposes. For instance, a cost category such as planning or land acquisition is restrictive in a system using traditional line item budgeting e.g. salaries and wages, services and supplies. Also each grant requires separate accountability for its expenditures. Thus a real problem exists to integrate separate grant accountability with fund accountability required by local governments.

The only real solution is a proliferation of funds for each grant, a practice discouraged by State Controller administrative codes. The end result of the need for separate grant accountability and local governments requirements for stewardship of revenues through funds is duplicative accounting records often maintained on a manual basis or through cost accounting systems lacking appropriate budgetary controls. All this is compounded by the fact that grant accounting periods frequently differ from the local governments fiscal year.

Hopefully, consolidation plans and uniform accounting provisions addressed in this bill will address these concerns as well as concerns between Federal Agencies.

D. Title V, Section 203 (page 38) provides the type of flexibility that local government needs. It is a very good approach. Often responses of contracting departments to suggested changes have indicated that specific units within a department are held accountable for specific programs by administering agencies. This section will defuse those arguments and strengthen departmental authority over programs.

THE STATE OF WASHINGTON,
OFFICE OF STATE AUDITOR,
Olympia, Wash., July 23, 1979.

Hon. JACK BROOKS,
Chairman, House Committee on Government Operations, Subcommittee on Legislation and National Security, Rayburn Office Building, Washington, D.C.

DEAR CONGRESSMAN BROOKS: I concur with the findings and recommendations of GAO Report FCMSD-79-37, dated June 15, 1979. The conclusion that Federal laws, policies and agency practices aimed at providing single, coordinated audit coverage for grants need overhauling is well founded. The audit function of this state has for some time been one which endorses and practices the single audit concept. However, our efforts are frequently defeated by the multitude of audit guidelines and report requirements prescribed by Federal agencies. It is understandable that certain compliance features may differ from grant to grant since it is frequently the compliance aspect of a grant which carries the intent of the legislature. I can accept this, but it is difficult at this level of government to understand the imposed variations concerning financial reporting requirements. A standard financial report for any grant, for any purpose, should satisfy the grantor agency's financial reporting requirements. In no case should the financial reporting requirement require more detailed information than that required by the manager of an activity at the local level.

If the single audit concept is to work the federal government must recognize state statutory requirements and allow for audits on a basis consistent with them. For example, Washington law provides for certain local entities to be audited on a three year basis (as a matter of actual practice most audits are conducted more frequently). Audits conducted on this basis review all financial transactions for that period regardless of the funding source be it federal, state or local. Any grant of federal funds during the three year period would thus be accounted for in the audit report. Federal agencies do not recognize this procedure and frequently require audits of grants on a special time frame not consistent with the three year period. This obviously creates scheduling and timing problems which reflect in inefficient use of audit resources.

Because Federal agencies have not accepted the concepts and provisions of A-102, we are faced with wide variations in grant management and the attendant audit requirements. At a minimum we are currently faced with 33 different and diverse agency audit regulations. I urge you to direct your efforts toward promulgation of the single audit concept and the reduction to the bare minimum of the multiplicity of reporting requirements and formats.

Very truly yours,

ROBERT V. GRAHAM,
State Auditor.

NATIONAL ASSOCIATION OF STATE AUDITORS,
COMPTROLLERS AND TREASURERS,
Nashville, Tenn., September 11, 1979.

Hon. JACK BROOKS,
Chairman, House Government Operations Committee,
Rayburn House Office Building, Washington, D.C.

DEAR CONGRESSMAN BROOKS: The National Association of State Auditors, Comptrollers and Treasurers (NASACT) at its annual meeting in Baltimore, Maryland on August 8, 1979 adopted Resolution No. 10 relative to certain audit reports of the General Accounting Office and the Joint Financial Management Improvement Program. A copy of that resolution is enclosed for your convenience.

It is my understanding that meetings have been held by yourself, as Chairman of the House Government Operations Committee. Senator James Sasser, who is Chairman of the Subcommittee on Intergovernmental Relations of the Senate Government Affairs Committee, has also held hearings relative to the same subject.

State fiscal officials consider this to be a matter of great importance to the management of both the federal and state governments. There is legislation in the Senate in the form of S. 878 and S. 904 which, if passed, will address many of the problems set out in current audit reports of the General Accounting Office relative to grant management and will implement some of the recommendations of the JFMIP report entitled, "Report on the Audits of Federally Assisted Programs: A New Emphasis".

Our association will appreciate any effort on your part to implement action in this area.

Very truly yours,

W. R. SNODGRASS,
President.

Enclosure.

NATIONAL ASSOCIATION OF STATE AUDITORS, COMPTROLLERS AND TREASURERS
RESOLUTION NO. 10

Whereas, the General Accounting Office, in a series of audits and evaluations of the management of federally assisted programs, has determined that these programs are not being adequately audited or evaluated by the various federal departments and funding agencies; and

Whereas, the federal management circulars on grant management, accounting, and auditing have been poorly implemented and ineffectively enforced; and

Whereas, state governments have expanded and improved their audit capabilities to a professional level equal to or exceeding those of federal agencies; and

Whereas, state governments have provided for audits of state departments; agencies, and institutions, including those functions of state government that are financed in part or wholly with federal funds; and

Whereas, it is economical and efficient to perform single audits on multifunded governmental entities, and for these single audits to be performed by those state auditors having the broadest authority, and for audits to be of entities and not of grants or contracts; and

Whereas, the National Intergovernmental Audit Forum, and the principals of the Federal Joint Financial Management Improvement Program, with the assistance and cooperation of the State Auditor Coordinating Committee, have completed a study entitled, "Audit of Federally Assisted Programs: A New Emphasis" which makes positive findings and recommendations about the auditing of federally assisted programs; and

Whereas, implementing the recommendations in this report will achieve benefits that would accrue from a greater federal reliance on audits performed by state audit organizations both through eliminating duplication of audit effort and through increasing obligation of both federal and state audit resources; and

Whereas, federal administrative agencies have failed to implement legislation and executive management policies which direct the encouragement of and reliance on state audit efforts; and

Whereas, state audit organizations audit federal programs and have difficulty receiving reimbursement sufficient to support an audit operation: Now, therefore, be it

Resolved, That the National Association of State Auditors, Comptrollers and Treasurers supports the findings in the report entitled "Audit of Federally Assisted Programs: A New Emphasis" by the Joint Financial Management Improvement Program, and encourages the principals of the Joint Financial Management Improvement Program to proceed immediately with implementing the recommendations of the report. Be it further

Resolved, That the appropriate committees of the Congress of the United States be requested to hold hearings on the report from the Joint Financial Management Improvement Program and on the recently released General Accounting Office reports, so that legislation may be considered that will provide for more effective accounting for and auditing of federally assisted programs executed by state and local governments.

This the 8th day of August 1979, at its Annual Convention assembled in Baltimore, Maryland.

Adopted: August 8, 1979.

Approved: August 8, 1979.

WILLIAM R. SNODGRASS,
President.

END