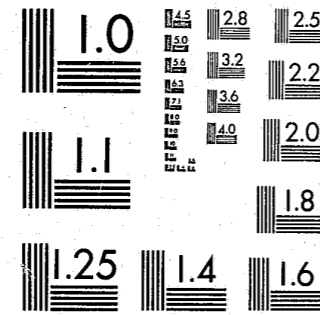


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X

FAILURE TO PROVIDE EFFECTIVE AUDITS  
OF FEDERAL GRANTS

SIXTH REPORT

BY THE  
COMMITTEE ON GOVERNMENT  
OPERATIONS

69467



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(II)

LETTER OF TRANSMITTAL

HOUSE OF REPRESENTATIVES,  
Washington, D.C., November 1, 1979.

HON. THOMAS P. O'NEILL, Jr.,  
*Speaker of the House of Representatives,*  
Washington, D.C.

DEAR MR. SPEAKER: By direction of the Committee on Government Operations, I submit herewith the committee's sixth report to the 96th Congress. The committee's report is based on a study made by its Legislation and National Security Subcommittee.

JACK BROOKS, *Chairman.*

(III)

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(v)

FAILURE TO PROVIDE EFFECTIVE AUDITS OF  
 FEDERAL GRANTS

NOVEMBER 1, 1979.—Committed to the Committee of the Whole House on the  
 State of the Union and ordered to be printed

Mr. Brooks, from the Committee on Government Operations,  
 submitted the following

SIXTH REPORT

BASED ON A STUDY BY THE LEGISLATION AND NATIONAL SECURITY SUBCOMMITTEE

On October 30, 1979, the Committee on Government Operations approved and adopted a report entitled "Failure To Provide Effective Audits of Federal Grants." The chairman was directed to transmit a copy to the Speaker of the House.

I. SUMMARY

This report is a result of a study by the Subcommittee on Legislation and National Security on the effectiveness of auditing Government assistance programs. The report is based on hearings<sup>1</sup> conducted by the subcommittee and a review<sup>2</sup> performed by the General Accounting Office. The hearings included witnesses representing the General Accounting Office (GAO); Office of Management and Budget (OMB); Department of Labor; Department of Health, Education, and Welfare; Environmental Protection Agency; National State Auditors Association; and National Association of State Auditors, Comptrollers and Treasurers.

The present system of auditing Federal grants is not effective in preventing unauthorized expenditures and the loss of funds. In a review of 73 grant recipients, GAO found that 80 percent of their Federal funds were not audited at all by Federal agencies. When

<sup>1</sup> Subcommittee hearings on "Failure To Provide Effective Audits of Federal Grants," hereinafter referred to as hearings.

<sup>2</sup> GAO report entitled, "Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling."

audits were performed, they often provided only partial insight into whether grant funds were properly spent. In addition, audits often were so narrowly focused that auditors could not be sure whose funds or assets they were reviewing. And many recipients were repeatedly audited, resulting in duplication of effort with little or no benefit to the Government.

The subcommittee found that problems in grant auditing exist largely because each agency audits its own grants rather than coordinating its efforts with other agencies to obtain comprehensive financial and compliance audits of the grant recipients. Conditions are aggravated by the inconsistency in Federal laws and agency regulations, along with the inefficient use and possible shortage of audit resources.

The hearings demonstrated conclusively that a new approach is needed to obtain single, coordinated audits of grant recipients on a Government-wide basis. Such a system would determine for all funding agencies whether Federal funds are properly safeguarded and spent for authorized purposes. Federal agencies would be expected to rely on the audit and not duplicate its work, but agencies could perform such additional audit procedures as might be needed to supplement the single audit. Witnesses generally agreed that this approach should be applied to all grant recipients—nonprofit as well as government organizations.

Audit requirements in Federal laws and regulations are sometimes conflicting and reduce the productivity of audits and hinder audit coordination. Grants are audited again and again, regardless of the dollar amount of the grant or its size in comparison with other grants administered by the recipient. Agencies are prevented from combining audit efforts by requirements that audits or audit reports be done at certain times.

There are many complex and challenging problems to solve before the single audit can be fully implemented. Grant-making agencies cannot solve these problems alone. The success of this approach will depend on firm direction by OMB to develop the overall policies and mechanisms needed to implement it. To make improvements promptly, OMB needs to work closely with the executive agencies and draw upon the agency staff for help with the detailed work involved.

There was unanimous agreement among the Federal officials who testified that OMB should designate Federal agencies that will have responsibility for the single audit at selected grant recipients. This appears to be the most feasible course of action at this time instead of creating a separate Federal audit agency to carry out these audits. OMB has supported this approach, which is known as audit cognizance, and intends to designate Federal agencies for both nonprofit and governmental grant recipients.

A standard audit guide—instructions for performing and reporting on audits—is needed to obtain single audits on a government-wide basis. OMB is working with the Federal agencies and the GAO to develop a guide for this purpose. The difficult task is to develop specific items to determine whether the grant recipient has spent its Federal funds for authorized purposes. These compliance factors will have to be acceptable to grant-making agencies and therefore will have to be worked out carefully in close cooperation with the agencies.

Centralized information is needed on multifunded recipients and the funds they receive, in order for OMB to assign audit cognizance on a systematic and equitable basis, and for insuring that all funds are audited. OMB plans to identify the major grant recipients in the major programs providing Federal aid to State and local governments. However, OMB needs to make a firm commitment of resources, calling upon the agencies to provide the staffing it needs, to develop a centralized information system identifying both nonprofit and government organizations receiving grants. It should show who funds them and how much they received.

To fill the huge gaps in audit coverage, OMB and executive agencies should make maximum use of non-Federal audit work. A problem, however, is that in many cases non-Federal audits, which the grant recipient is required to obtain with grant funds, are not being made, or are not properly tailored to satisfy Federal needs. Controls are needed to insure that these audits are made when required and that they follow Federal audit guidelines.

GAO recommended at the hearings that payments for audits not meeting Federal guidelines be withheld. The National State Auditors Association agreed to this sanction, but OMB believed such a policy may be too harsh at this time. However, it agreed to the need for agencies to impose sanctions requiring non-Federal audits to satisfy Federal needs. The Committee believes such a policy is needed now so that better use can be made of existing resources to determine if Federal money is spent properly.

Witnesses before the Subcommittee said the principal reason for the lack of auditing is the shortage of Federal audit resources. While the single audit and better use of non-Federal audit work will significantly improve the resource situation, it may not solve the total problem. Overall, there is a need to determine whether there is adequate staff within the Federal audit organizations, including those of the Inspector General offices, to carry out the single audit concept without reducing other essential work.

## II. FINDINGS

1. Auditing of Federal grants is haphazard and ineffective. Most of the organizations receiving grants are not audited at all by Federal agencies. Other grant recipients are audited repeatedly with little or no benefit to the Government because the audits do not include inquiry into many matters about which the Government is concerned. Also, the audit focus is usually too narrow to be effective.

2. When it has a grantee's records audited, a Federal agency usually audits only its own grants without coordinating its audit needs with those of other agencies. When the auditors find practices that have a detrimental effect on the grant or grants they are auditing, they do not determine how those practices affect other grants.

3. Agencies cannot combine audit efforts because of inflexible requirements for audits or audit reports at certain times.

(a) Federal laws and agency regulations are sometimes conflicting, which reduces the productivity of audits and hinders audit coordination.

(b) Mandated audit requirements result in grants being audited repeatedly, regardless of the dollar amount.

4. The Office of Management and Budget policy guidance on grant auditing has not been effective. In addition, OMB has not taken a strong enough role in establishing the mechanisms and structure to eliminate the poor conditions that exist.

5. The lack of standard audit guidelines has posed a major problem in coordinating the audits of grant recipients. Federal agencies have over 80 different audit guides containing a variety of audit steps, making coordination very difficult.

6. Agencies lack the means and information needed to coordinate audit efforts. There is no systematic way of assigning audit responsibility to Federal agencies and identifying multifunded recipients and the source of their funding. Under the current approach, agencies are encouraged to work out audit arrangements on their own without knowing who funds or audits which grant recipients.

7. A major reason for gaps in audit coverage is the inefficient use of audit resources. The current approach of agencies auditing only their own grants creates duplication and requires many auditors to plan, perform, and report on audits of large multifunded grant recipients. A single, coordinated audit of the grant recipient could eliminate duplication and require fewer auditors. In addition, non-Federal audits, which are required by OMB and paid for with grant funds, are often not being made or not tailored to satisfy Federal needs.

8. Gaps in audit coverage may also be caused by the lack of adequate Federal audit resources. Agencies' officials have stated that the reason they do not oversee non-Federal audits or make audits themselves is because of the shortage of staff and funds.

### III. RECOMMENDATIONS

1. The Director of the Office of Management and Budget should establish policy guidance and mechanisms to implement single, coordinated financial and compliance audits of grant recipients on a government-wide basis. These should, as a minimum, include the following:

(a) Written policies for Federal agencies, state and local governments, and nonprofit grant recipients, which provide consistent and coordinated guidance to insure that the audits are made when needed and are uniformly instituted.

(b) A logical system to designate Federal agencies for audit cognizance over selected governmental and nonprofit organizations receiving Federal assistance. Such designations should be reassessed periodically, at least once every three years. Each agency would be responsible for insuring appropriate financial and compliance audit coverage of the recipients under its cognizance.

(c) A standard guide for auditing multifunded grant recipients, including carefully worked out compliance tests acceptable to grant-making agencies.

(d) A requirement that non-Federal audits must follow Federal audit guidelines as one of the conditions for payment of Federal funds.

(e) A centralized information system on multifunded grant recipients, covering both governmental and nonprofit organizations, that identifies who they are and what Federal funds they receive.

2. The Director of the Office of Management and Budget should require each agency to establish a system for maximizing the use of non-Federal audits of the grant recipients under its cognizance. The system should provide for:

a means of knowing when audits required under OMB Circulars A-102 and A-110 are made or should be scheduled;

controls to insure that the required audits comply with the single audit and other acceptable Federal audit requirements;

procedures to evaluate non-Federal audit work and to insure that the grant recipient is properly audited; and

A liaison with non-Federal audit staffs to minimize the amount of audit work required.

3. The Director of the Office of Management and Budget should provide for prompt implementation of the single audit concept by working closely with the Federal agencies and by augmenting his staff with agency staff to accomplish the task.

4. The Director of the Office of Management and Budget should determine whether there is adequate staff within the Federal audit organizations, including those of the Inspector General Offices, to carry out the new single audit approach without reducing other essential work. He should advise the Committee on Government Operations of the Inspector General Staffing needs for each agency no later than March 31, 1980.

5. The Director of the Office of Management and Budget should take steps to remove the inconsistencies in Federal laws and regulations that hinder audit coordination. He should advise the appropriate Committees in Congress of changes needed in existing laws no later than March 31, 1980.

### IV. INTRODUCTION

#### A. HISTORICAL INTEREST IN EFFECTIVE AUDITING

The need for effective auditing in the Federal Government departments and agencies has long been recognized by the Committee on Government Operations. In 1950, this committee's predecessor, the Committee on Expenditures in the Executive Departments, reported the Budget and Accounting Procedures Act (31 U.S.C. 67). This act provides a complete framework for bringing the budgeting, accounting, and auditing procedures of the Federal Government up to date. Among other provisions, this act requires the head of each Government department and agency to establish and maintain a system of accounting and internal controls over all funds, property, and other assets for which it is responsible. All departments and agencies are required by the act to establish internal auditing operations.

The Congress continues to recognize the need for effective auditing. The 95th Congress passed the Inspector General Act of 1978, reported by the Committee on Government Operations, which created Offices of

Inspectors General in 12 Federal departments and agencies. The Offices of the Inspectors General are responsible for (1) conducting and supervising audits and investigations of department and agency programs and operation; (2) providing leadership and recommending policies to promote economy, efficiency, and effectiveness in the administration of Government programs and operation; (3) preventing and detecting fraud and abuse in such programs and operations; and (4) keeping the head of the establishment and the Congress fully and currently informed about problems and deficiencies relating to the administration of such programs and the necessity for and progress of corrective action. Offices of Inspectors General had already been created by legislation in the Department of Health, Education, and Welfare and the Department of Energy. Fiscal year 1980 planned resources in the statutory Offices of Inspectors General include over 5,000 positions at a cost of \$200 million.

The Subcommittee on Legislation and National Security held hearings on the effectiveness of the Army Audit Agency on July 27, 1977, and the committee issued a report, November 3, 1977. A hearing on the Air Force Audit Agency and the Naval Audit Service was held February 7, 1978, and a report was issued on October 2, 1979. Hearings on the failure of Government departments and agencies to follow up and resolve audit findings were held on March 21 and 22, 1979, and a report was issued on June 18, 1979. In addition, the subcommittee has requested the GAO to review the Offices of Inspectors General of the Departments of the Air Force, Army, Navy including the Marines, and the Defense Logistics Agency. These reviews are to be completed by the end of 1979.

#### B. INEFFECTIVENESS OF GRANT AUDITING

Pursuant to the Budgeting and Accounting Act of 1950 (31 U.S.C. 67) the General Accounting Office recently performed a review of grant auditing at all levels of the government. It was conducted to determine how the Government is providing for audits of Federal assistance programs, which have increased from \$6.7 billion in 1959 to an estimated \$85 billion in 1979.

Its review covered the audit experience of 73 government and non-profit organizations that were grant recipients during the fiscal years 1974 through 1977. It also encompassed six State audit offices and the Federal audit and grants management headquarters of the following Federal agencies: ACTION; Community Services Administration (CSA); Environmental Protection Agency (EPA); Department of Agriculture; Department of Health, Education, and Welfare (HEW); Department of Housing and Urban Development; Department of Labor; and Department of Transportation.

GAO also did limited work at the Departments of Commerce and Interior, and at the Veterans' Administration.

GAO found that auditing of Federal grants is so haphazard and ineffective that unauthorized expenditures and the loss of funds cannot be prevented.<sup>3</sup> Most of the 73 grant recipients GAO reviewed were not

<sup>3</sup> GAO report entitled "Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling," pp. 7-16.

audited at all or received audits that provided only partial or no insight into whether Federal funds were properly spent. About 80 percent of the recipients' Federal funds were not audited at all by Federal agencies. For example, 1 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.

In other cases, GAO noted that 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. For example, one Indiana city was subjected to more than 700 audits in five years; yet altogether the audits still did not cover all the grant funds.

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

Many of the problems in grant auditing are not new. Federal, State and local officials have known about them for years. GAO attributes the lack of effective efforts to improve grant auditing to a number of different, yet closely related factors. The major factors cited were:

Inflexibility and inconsistency in grant audit 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.

In a separate study, the four agencies which make up the Joint Financial Management Improvement Program (JFMIP)—GAO, OMB, Treasury, and the Office of Personnel Management—established a special task force to make an independent study<sup>4</sup> to determine how Federal, State, and local audit organizations could work together more effectively. Although this study had a different scope than GAO's review, many of its findings and recommendations were similar.

As part of its oversight responsibility, the Subcommittee on Legislation and National Security held hearings on July 30 and 31, 1979, on the need for improvements in the area of auditing government assistance programs. Elmer B. Staats, Comptroller General of the United States, discussed the findings of the GAO report, and John Patrick White, Deputy Director of the Office of Management and Budget, discussed the efforts of his office to improve auditing of government assistance program. Testimony dealing with department and agency problems in grant auditing and their efforts or suggestions to solve these problems was provided by Thomas D. Morris, Inspector General

<sup>4</sup> A JFMIP report entitled "Report on Audits of Federally Assisted Programs: A New Emphasis."

of the Department of Health, Education, and Welfare; Marjorie Fine Knowles, Inspector General of the Department of Labor; William Drayton, Jr., Assistant Administrator of Planning and Management for the Environmental Protection Agency; Eldon Stoehr, President of the National State Auditors Association; James F. Antonio, Missouri State Auditor, representing the National Association of State Auditors, Comptrollers and Treasurers.

## V. DISCUSSION

### A. NEW APPROACH IN GRANT AUDITING

The problems associated with grant auditing begin when grant recipients receive individual grants from numerous Federal and State agencies with differing audit requirements. Poor results are obtained when each agency continues to audit its own grants rather than coordinating its efforts with other agencies.

Under the current approach, a Federal agency usually concerns itself with its own grants, although these grants may make up only a small part of a grant recipient's operations. When the Federal agency performs or hires another auditor to perform an audit, usually only one grant out of a number that the recipient may have is audited, even though the recipient's other grants may be much larger. When the auditors find practices that badly affect the grant they are auditing, they still do not ordinarily determine how these practices may affect the other grants of the recipient. The other grants may never be audited at all. To make things worse, an audit usually includes some tests of the grantee's procedures for handling all of its cash receipts and disbursements, such as computing and allocating payroll costs. If another Federal auditor visits the same grantee, he might well examine some of these same procedures again.

This approach to grant auditing wastes time and money. In its report, GAO noted that the Government can lose millions of dollars through gaps in audit coverage. Unnecessary costs can also result from duplication of effort and repeated audits of grants too small to warrant more than an occasional audit. In addition, the audit focus is often too narrow to be effective in preventing unauthorized expenditures and the loss of public funds.

The hearings demonstrated conclusively that a new approach must be taken for auditing grants—one that will effectively use existing resources in obtaining financial and compliance audits on a grant recipient basis rather than on a grant-by-grant basis. Such an audit approach was commonly referred to as the single audit concept. The concept envisions one audit that would cover all grants at an entity. It would determine for all funding agencies whether the system at such an entity provided reasonable assurance that Federal funds were properly safeguarded and spent for authorized purposes. Witnesses generally agreed that Federal agencies should be expected to rely on the single audit and not duplicate its work. However, it was recognized that it, after examining the single audit, the Federal agency determined that that audit was poorly performed or did not include audit steps necessary to the agency's needs, the agency should perform or have performed such additional audit procedures as might be needed.

Testimony by both Federal and State officials fully supported the single audit concept. It was similarly supported in resolutions adopted by the National Association of State Budget Officers and the National Conference of State Legislators. The concept also has been strongly endorsed by the JFMIP study mentioned earlier.

The Committee believes the single audit concept should be applied to all grant recipients, nonprofit as well as government organizations. A similar position was reflected in testimony submitted by the Department of Health, Education, and Welfare, the Department of Labor, the Environmental Protection Agency and the Community Services Administration. With respect to this issue, Frank N. Jones, CSA's Assistant Director for Legal Affairs and General Counsel, submitted the following statement for the hearings:

The predominance of CSA funding is made to private nonprofit 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.

EPA did make an exception in the case of its construction grants. However, the Committee believes even this program should be covered by single, coordinated audits of the grant recipients. As one of its recommendations, GAO also proposed that the single audit approach be applied, whenever possible, to all grant recipients.

The Committee believes that an audit cognizant approach—where a single agency would have audit responsibility for selected multi-funded grant recipients—appears to be the most feasible course of action for implementing single audits at this time. This also was the unanimous position of the Federal officials who testified. Furthermore, Federal agency responses to the Committee on the GAO report generally agreed with this approach.

Audit cognizance has already been used on a limited basis. When testifying in support of this concept, Inspector General Morris stated that HEW's audit cognizance has demonstrated that it works well. 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 of about 94 percent of the nation's 2,500 colleges and universities.

The alternate approach of having a separate Federal audit agency responsible for audits of grant recipients was also raised during the hearings. This idea has been discussed by Federal and non-Federal officials for years. The JFMIP report recommended that OMB determine the feasibility of establishing such an agency. However, the Committee's position is that it would be unwise at this time to establish such an agency since the audit cognizance approach appears to be the best way to use existing resources. It should therefore be given a chance to work before studying alternatives.

The Committee has several reasons for believing that a separate audit agency is not the best solution for improving auditing of Government grants. First, there is a question as to whether the separate audit agency could be effective. The question arises because a separate agency's audits may not have the same weight as the audits of a cog-



nizant agency designated by OMB, representing the President. Another advantage of the cognizant agency approach, pointed out by Comptroller General Staats, is that the agency having a predominant interest in a particular program can be selected as the cognizant agency. Therefore, the audit responsibility could be placed where there probably is the most interest and need. In addition, there should be a close working relationship between the auditing and the Inspector General functions. This relationship would be difficult to maintain with a separate auditing agency.

OMB subscribed to this opinion in testimony before the Subcommittee. Deputy Director White stated:

It seems to us the critical involvement here has to be the agencies. With the implementation of the Inspector 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.

The Committee believes that the establishment by statute of Offices of Inspectors General, in fourteen departments and agencies, will enhance and strengthen Federal grant auditing. The Inspectors General will play an important role in seeing that appropriate audit coverage is provided to eliminate waste, fraud, and error in grant programs. The President has directed that the significant features of the Inspector General Act be extended throughout the Federal government. In so doing, the President emphasized to the heads of departments that "eliminating waste, fraud, and error should be as important to you as your program objectives."

#### *Inflexible audit requirements*

Congress, OMB, and the individual agencies have imposed audit requirements which are conflicting and therefore reduce the productivity of audits and hinder audit coordination. Congress requires certain grant programs to be audited periodically, at intervals ranging from one to three years. OMB Circulars A-102 and A-110 require certain grant recipients to secure audits at least once every two years. Some agencies have imposed tight requirements regarding when audit of its grants should be made, while other agencies have not.

The Subcommittee found that mandated audit requirements resulted in grants being audited repeatedly 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. For example, one city was subjected to at least 13 audits of its Federal funds over 4 years—6 of the 13 audits were mandated for one program representing only 3 to 8 percent of the city's Federal funds.

Two agencies affected by mandatory requirements are CSA and HEW. CSA is required by the Community Services Act of 1974 to make, or have made, an audit of each Community Action Program grant at least once annually. This has resulted in unproductive auditing. For example, recipients receiving as little as \$170 a year were audited, resulting in excessive costs with little or no benefit. GAO reviewed 525 audit reports on 131 Community Services grant recipients and found no dollar findings for about half of the audits. Furthermore, CSA could not coordinate audits of its Community Action grants with HEW's Head Start grants because of arbitrary agency rules. CSA requires audit reports within 180 days of the end of the project year and HEW requires them within 120 days. The Subcommittee believes HEW and CSA should resolve this matter at the earliest possible time.

CSA has recognized the problem caused by the annual audit requirement and initiated action to correct it. In reference to a letter to OMB, Frank N. Jones, Assistant Director for Legal Affairs and General Counsel at CSA, stated for the record:

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.

Mandating audit requirements which conflict with OMB guidance and hinder coordination should be avoided. The Committee believes that restrictive audit requirements should be removed. OMB and agencies should take steps to schedule audits and establish reporting requirements so that coordinated audits can be performed with reasonable frequency.

#### B. OMB POLICIES AND LEADERSHIP

The problems in grant auditing are neither new nor easily solved. Many Federal, state, and local officials have known about them for years, and would like to see improvement in the system. But the Committee has found that grant-making agencies cannot solve these problems alone. Nor can these agencies solve the problems by working alone with state and local governments and other recipients. In testimony before the Subcommittee, Inspector General Morris of HEW described the current situation as the result of an incredibly complex set of managerial, technical, and organizational problems. He stated:

In general, we believe that HEW and other federal agencies have been conscientiously trying to carry out their individual audit responsibility within legal and resource restraints. No single federal audit agency alone can do much more to change the overall situation. . . .

OMB has issued various circulars with the primary objective of coordinating audits. The circulars have instructed agencies to:

work out cross-servicing arrangements where one agency audits for another, and rely on other Federal and non-Federal audits whenever possible (Circular A-73);

select one agency to audit universities and certain other recipients' overhead costs (Circular A-110); and  
 have one audit of a multifunded grant recipient as part of a joint grant application (Circular A-111).

The Subcommittee found that the OMB circulars have not been effective. The substantial evidence of the GAO and JFMIP reports, along with testimony before the Subcommittee by both Federal and state officials, confirms this point. For example, GAO cited in its report that a multifunded Indiana city was subjected to over 700 audits in a five-year period. GAO also reported that cross-servicing and audit cognizance are seldom used, and that Federal agencies seldom know about audits made by other Federal or non-Federal auditors. The circulars also do not provide the overall direction or leadership that is now needed to institute the single audit approach. This fact was brought out by witnesses for both the Federal and non-Federal sectors. Generally, the Committee notes that the Government has failed to establish firm requirements and develop the mechanisms to see that audit needs are combined.

The hearings demonstrated conclusively that OMB needs to play a stronger role before the complex grant auditing issues will be resolved. Among other things, the OMB needs to develop new instructions for its circulars to obtain single, coordinated audits on a government-wide basis. In testimony before the Subcommittee, OMB stated that it has recently taken action to change its circular A-102, "Uniform Requirements for Grants to State and Local Governments". The revision is an attachment to implement the single audit. It sets forth strengthened audit requirements for governmental grant recipients, and incorporates standard audit guidelines by reference.

The Committee believes this is a move in the right direction, but more is needed. Additional instructions should be developed covering Federal agencies and other grant recipients as well. This must be done so that agencies and all recipients will know what is expected. However, this is still not enough. More importantly, the Committee believes OMB must take the lead to fully define the single audit approach and develop the mechanisms needed to implement it.

The hearings demonstrated that this approach will have to be worked out very carefully to satisfy agency requirements. Witnesses for HEW, EPA, and Labor all expressed their concerns with respect to this point. Labor's Inspector General Majorie F. Knowles, stated:

It is my objective to support fully the goal of developing the system and procedures needed to implement the comprehensive government-wide audit of grant recipients. However, I want to express my concern that the legitimate audit needs of Federal agencies must not be overlooked as a result of this process.

Specific concerns associated with the need for clear definitions were raised by several witnesses. These concerns included, among others, the need for:

- specific identification of the grant recipients or organizational entities that must be audited;
- directions for Federal agencies to follow to insure that audits are made when needed and the single audit is uniformly instituted;

- specific audit procedures in the area of compliance, that is, what items would determine whether the recipient is complying with grant requirements;
- mechanisms for reimbursing Federal and non-Federal auditors for the work performed;
- defining the reporting provisions, including the format for the single audit report; and
- defining responsibility for followup and resolution of audit findings and recommendations.

OMB recognizes the need for strong, responsible management. In testimony before the Subcommittee, Deputy Director White stated:

Grant programs are carried out by practically every department and major agency in the Federal government and affect virtually every segment of our society. With so much of the tax dollar being spent by non-Federal organizations, the need for accountability and audit becomes critical.

Referring to the problems in grant auditing, he also stated:

To correct the 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.

President Carter has called on the heads of departments and agencies to improve their audit systems, particularly as they relate to grant programs. To carry out the President's directions, OMB launched the Financial Priorities Program on May 9, 1979. The purpose of the program is to resolve the major management issues facing Government today. A priority issue that bears directly on the subject is grant accountability. In testimony before the Subcommittee, Deputy Director White stated:

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."

It is important for OMB to make significant improvements in grant auditing in the near future. The Committee believes that OMB's resources may be too limited to do this because of the magnitude of the work involved. Therefore, it encourages OMB to draw upon agency staff for help, especially with regard to accomplishing the detail work that must be done. During the hearings, Deputy Director White agreed to provide the Subcommittee with a time schedule on accomplishing the work.

#### *Standard audit guidelines*

There are no standard audit guidelines—instructions for performing and reporting on audits—that agencies can use to obtain single audits on a government-wide basis. This has posed a major problem. In its report, GAO stated that Federal agencies have developed over 80 different audit guides, making coordination very difficult.<sup>5</sup> Most of

<sup>5</sup> GAO report entitled "Grant Auditing: A Maze of Inconsistency, Gaps, and Duplications That Needs Overhauling," p. 20.

the guides are grant oriented instead of recipient oriented, and contain a variety of audit steps and divergent audit reporting formats. This means that Federal agencies may need to develop new guidelines whenever they combine audit needs, and that State and local auditors and independent public accountants must learn new rules for every type of grant they audit.

Speaking before the Subcommittee with regard to the number of different audit guides, Mr. James F. Antonio, representing the National Association of State Auditors, Comptrollers, and Treasurers stated:

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

The lack of a standard guide also does not provide the necessary instruction to grant recipients to assure that non-Federal audits satisfy Federal needs. In the absence of any guidelines, GAO found that non-Federal auditors often report only limited information of Federal grants received by the grantee. For example, some audit reports did not identify Federal monies by grant number, grant program, individual grant amount, or by other information that would make the audit report of more use to Federal grant managers.

GAO, in cooperation with OMB and the Intergovernmental Audit Forms<sup>6</sup> have developed an audit guide—Guidelines for Financial and Compliance Audits of Federally Assisted Programs—for comprehensive financial and compliance audits of multifunded recipients. The Committee learned that OMB has adopted it as the single audit guide, has sent it to the Federal grant-making agencies for comment and is now putting it into final form for use as the standard audit guide. OMB is also working with the Federal agencies on this project. An important objective is the development of specific items in the area of compliance to determine whether the grant recipient has spent its Federal funds for authorized purposes. In testimony, Deputy Director White stated:

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 requirements for grant recipients.

He also stated:

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 circulars.

The Committee realizes that developing a standard guide acceptable to all funding agencies will be difficult but believes it must be done.

<sup>6</sup> 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.

Witnesses for HEW, EPA, and Labor all expressed a similar concern about whether the compliance requirements included in such a guide would satisfy their needs. If the standard audit guide is to be effective, the Committee believes that the compliance factors will have to be worked out carefully with full participation by the grant-making agencies themselves.

*Means for coordinating audits*

There is no systematic way of assigning audit responsibility to cognizant agencies and identifying multifunded recipients and the source of their funding. The Committee found that, under the current approach, agencies are encouraged to work out arrangements on their own without knowing who funds or audits which grant recipients. Some agencies have their own systems for identifying their own funds, but the systems do not provide the information necessary to effectively coordinate single audits with other agencies.

The hearings demonstrated that the success of the audit cognizance approach will depend largely on firm directives by OMB to designate cognizant agencies and identify the multifunded grant recipients, including who funds them and how much they receive. Witnesses from both the Federal and non-Federal sectors emphasized that without such central direction cognizant arrangements will be unworkable and the single audit concept will be a coordinative nightmare. It is impractical to expect the numerous grant-making agencies to coordinate among themselves in selecting the agency that would have audit cognizance over grant recipients. OMB must assign audit responsibility on some systematic and equitable basis that may take into consideration such things as the amount of funding and available resources to carry out the workload. In addition, assignments should be reassessed on a periodic basis, at least once every 3 years, to allow for adjustments from changes in grant funding and audit priorities.

Information is needed on multifunded recipients and the funds they receive. Such information would have to be centralized to be effectively and efficiently used. Otherwise, each agency would have to contact all other agencies to accumulate the information. This would be impractical and duplicative.

The information on Federal funding also is needed by Federal and non-Federal auditors to insure that all funds are audited. This is illustrated in a statement for the hearings by James Antonio, the State Auditor of Missouri, who represented the National Association of State Auditors, Comptrollers, and Treasurers:

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.

OMB intends to start by designating cognizant agencies for governmental and nonprofit organizations. In testimony before the Subcommittee, Deputy Director White stated:

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, we think, probably cognizant oversight in terms of various classes of groups other than the State and local governments. We think that will follow shortly after we get this in place.

OMB's commitment to developing information on Federal funding of grant recipients is not as firm. It realizes there is a difficult problem. As a first step, it hopes to identify the major grant recipients in major programs providing Federal aid to State and local governments. By using existing agency systems, OMB hopes to pull this information together in some central way.

The Committee believes OMB must take stronger measures with a firm commitment of resources to develop a centralized information system. This problem is not new. GAO pointed out the need for a nationwide grant information system in an earlier report issued in September 1977. What is needed now is a firm commitment. OMB should call upon the agencies to provide the staffing it needs and should fully utilize existing information systems. The information should be comprehensive, covering both governmental and nonprofit organizations, to provide for full implementation of the single audit.

#### C. USE OF AUDIT RESOURCES

The principal reason that witnesses before the Subcommittee gave for agencies not auditing grants or reviewing audits made by non-Federal auditors was a shortage of resources. They generally acknowledged that coverage by their own auditors and by non-Federal auditors is inadequate. But they claimed that their limited audit staffs and funds prevented them from doing much about it.

The lack of any auditing at all is the most serious problem in grant auditing. The GAO report disclosed that 80 percent of the recipients' Federal funds sampled were not audited by or on behalf of the Federal agencies, meaning that unauthorized expenditures and the loss of public funds cannot be prevented. It therefore becomes a major concern of the Subcommittee.

Implementation of single, coordinated audits on a government-wide basis should significantly improve the resource situation. It will eliminate wasteful duplication and require fewer auditors to plan, perform, and report on audits of large, multifunded grant recipients. At the same time, it would provide a better look at the grantee's overall performance. In addition, if non-Federal audits are better tailored to satisfy the single audit requirement, it will reduce the amount of work for Federal auditors. However, resource needs will ultimately depend on how the single audit concept is implemented.

OMB has required grant recipients to obtain audits at least once every two years since 1972. In July 1976 and September 1977, OMB changed its Circulars A-110 and A-102 to make these audits more useful. The changes require grant recipients to have organization-wide,

financial and compliance audits. The audits are paid for with grant funds and performed by non-Federal auditors, including State and local auditors and independent public accountants. Federal agencies are instructed to use these audits to the greatest extent possible but to do any additional work that is required to satisfy Federal needs.

The Committee found that in many cases these non-Federal audits are either not made or are poorly used, yet they provide an immense audit resource. Testimony demonstrated that agencies do not have systems to tell them whether the audits have been made. There is also a lack of instructions and controls to assure that the audits satisfy Federal audit requirements. This is a widespread problem—in the GAO report, audit directors of the major grant-making agencies were quoted as stating that they have no controls to insure that grantees obtain audits to satisfy Federal needs.

OMB should make maximum use of the audits required by its A-110 and A-102 Circulars. The Committee's view is that these audits could be performed when required and tailored to largely satisfy the single audit requirement if instructions and controls were established to do so. To satisfy the single audit requirement, it is particularly important that Federal guidelines are followed in performing these audits. This would be the best way to use existing resources to significantly improve grant audit coverage.

With respect to implementing single audits, this position was acceptable to the National State Auditors Association. In testimony before the Subcommittee, Eldon Stoehr, President of the Association stated:

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.

He also stated:

We also support and agree with sanctions for non-performance by State auditors. Nonpayment is fine with us in these 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.

OMB has recently proposed a revision to its Circular A-102 as a step to tailor non-Federal audits to satisfy the single audit. It establishes audit requirements for State and local governments receiving Federal assistance. The objective in establishing the proposed requirements is to insure that (1) grantees' audits are made on an organization-wide basis, rather than on a grant-by-grant basis, and (2) such audits meet standards that will be acceptable to all Federal grantor agencies.

The Committee believes the proposed change in Circular A-102 is a step in the right direction. But OMB should continue its efforts by developing an overall, coordinated structure for obtaining single audits, including instructions for Federal agencies as well as nonprofit grant recipients, so that the maximum use can be made of the audit

work by Federal, State, and local auditors as well as public accountants.

It is essential to fill audit gaps by making maximum use of existing resources. Therefore, it is the Committee's view that the government should not pay for audits unless they follow Federal guidelines to determine whether Federal funds were spent properly.

The hearings demonstrated the willingness of non-Federal auditors to assume some initiative and responsibility in bringing about the needed improvements in grant auditing. The Committee believes that Federal agencies should make the maximum use of such cooperative efforts to fill the audit gaps and provide for the single and coordinated audit of grant recipients.

While the single audit concept will improve the resource situations, it may not solve the total problem. The Committee is concerned about the adequacy of Federal audit resources, a matter which has become even more important with the passage of the Inspector General Act of 1978. In prior reports, GAO has stated that some Federal audit staffs are too small. GAO also recently issued a report to the Congress<sup>7</sup> which said the problem is hampering the efforts of two Offices of Inspector General and will create problems in many of the other Inspector General offices.

OMB is questioning the adequacy of the Inspector General offices for carrying out their functions. In testimony before the Subcommittee, Deputy Director White stated:

We are now reexamining the staffs of all the Inspectors General. We will be doing that in the 1981 budget review process as well. It is a priority for us in the budget process this year.

The Committee firmly supports adequate staffing and funding for Federal audit organizations, including those within the Office of Inspectors General. The audit functions and the new Inspectors General Offices stand to save billions of dollars for the taxpayers. OMB should determine the appropriateness of the Federal agencies' audit staffs and provide this information to the Federal agencies and to this Committee.

## VI. CONCLUSIONS

The hearings of the Subcommittee have shown conclusively the need to improve auditing of Government grant programs. The Government does not have an effective system for auditing the billions of dollars included in these programs. Changes to improve the situation present very complex and challenging problems which will require a new approach to how the Federal agencies audit grants.

The Committee believes 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. Conditions are aggravated by the inconsistency of Federal laws and agency regulations along with the inefficient use and possible shortage of audit resources.

<sup>7</sup> "Federal Civilian Audit Organizations Have Often Been Unsuccessful in Obtaining Additional Staff," FGMSD 79-43, July 27, 1979.

While grant-making agencies can certainly make improvements, they will be unable to solve the problems alone. The hearings demonstrated that the situation will not improve significantly unless OMB provides the strong leadership and direction that is needed.

OMB needs to develop the policies and structure to accomplish coordinated financial and compliance audits on a grant recipient basis rather than on a grant-by-grant basis. Such audits should be acceptable to all funding agencies, whose auditors and program officials would be expected to rely on them and only do what additional audit work is necessary. Although OMB is preparing a change to its policies and developing a standard audit guide, it still needs to make further changes in its policies and develop new instructions for Federal agencies. More importantly, OMB must take the lead to eliminate inconsistent audit requirements which hamper coordination. It must also fully define the single audit approach, and develop the mechanisms needed to implement it. A structure needs to be developed that places maximum reliance on non-Federal auditors to perform the audits. It should provide for the right of Federal auditors to perform additional work as needed and to judge the quality of the outside audits. OMB also needs to assign audit responsibility to cognizant Federal agencies and determine whether there is adequate staff within the Federal audit organizations, including those of the Inspectors General Offices, to carry out this approach without reducing other essential work.

The most controversial change needed in OMB policy guidance is a stipulation that Federal agencies not pay for audits that do not follow Federal audit guidelines. Comptroller General Staats identified this as an important change. He believes it is needed to insure that Federal guidelines are followed so that it can be determined that Federal money was spent properly. He pointed out that many non-Federal audits the Government pays for are of little use to Federal agencies because they do not satisfy Federal audit requirements. OMB's position is that this action may be too harsh at this time. But it recognizes the need for agencies to use some sanctions requiring non-Federal audits to satisfy Federal needs.

The Committee agrees with GAO on this issue and fully supports the recommended change. It is an economical and practical way to deal with the present situation of scarce resources. It would increase the likelihood that non-Federal audits would follow the standard guidelines being developed to implement single audits. This would make audits of grant recipients more useful and less expensive.

The Committee believes that OMB needs to take prompt action to turn the currently disorganized situation into an effective and logical system for performing grant audits. To accomplish this, the Committee believes OMB needs to work closely with the Federal agencies and draw from agency staffs to complete the detailed work that has to be done.

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