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U.S. GENERAL ACCOUNTING OFFICE

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STATEMENT OF
CHARLES A. BOWSER, COMPTROLLER GENERAL
UNITED STATES GENERAL ACCOUNTING OFFICE

BEFORE THE

SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS

SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

ON

SENATE BILL 1510, UNIFORM SINGLE FINANCIAL

AUDIT ACT OF 1983

Mr. Chairman, we welcome this opportunity to appear today to discuss the subject bill which you introduced last week. I would like to commend you and the other sponsoring Senators for your leadership and initiative in addressing a very important issue.

I view the initiative to establish uniform single financial audit requirements for recipients of Federal assistance to be one of the most important financial management issues facing us today. I believe the bill covers the major concerns and issues currently involving the audit of Federal assistance, and if passed, this legislation will result in a more systemic approach to auditing recipients of Federal assistance and will result in better use of audit resources.

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In March 1982, I testified before the House Subcommittee on Intergovernmental Relations and Human Resources that I viewed the concept of a single audit on an entity basis to be superior to the more common past practice of auditing on a grant-by-grant basis. However, I pointed out that the concept as it was being administered by the Office of Management and Budget (OMB) through Attachment P to OMB Circular A-102 posed a number of problems that needed to be addressed. I further stated that, in retrospect, I believed the Federal Government had given birth to a single audit approach rather hastily without ensuring that the proper framework was in place to help ensure its success. As a result, I testified that legislation might be premature at that time.

Since that testimony, we have had numerous discussions with Federal, State, and local government officials as well as with independent public accountants. These discussions revealed strong support for the single financial audit approach of recipients of Federal assistance. However, many of these officials pointed out concerns and problems with the approach currently in practice.

During the last year, we have been conducting a study of the implementation of Attachment P to OMB Circular A-102. While the study is not yet complete, we believe that we have identified the major concerns and problems with the requirements of the attachment and its implementation. These include:

- A lack of clear understanding of what is to be achieved by Attachment P by the Federal officials;

- A wide variance in the scope and coverage of work performed in completed audits ranging from a limited number of grants tested to all grants of the entity being tested;
- Slow implementation of Attachment P by some recipients;
- Greater concern among the Federal officials of questioned cost than with system issues such as internal controls;
- Varying degrees of interpretation by Federal cognizant agencies on the materiality level necessary for testing; and
- Diffused system of cognizant agency assignments.

The approach developed by OMB to implement Attachment P could have been better organized. OMB originally assigned different cognizant agencies to individual State departments and local governments within a State, established general policies for the audits, and then left the actual implementation to the individual cognizant agencies. Our evaluation showed that the individual cognizant agencies were in different stages of implementing Attachment P and each was developing its own approach for implementation.

This approach has resulted in the cognizant agencies providing unclear and inconsistent advice as to the purpose and scope of the audit work to be done. Recognizing this problem, a series of orientation meetings was recently conducted in all Federal regions so that there would be a more uniform interpretation and implementation of Attachment P requirements.

In addition to the audit requirements contained in Attachment P, a number of other audit requirements exist for recipients

of Federal assistance. The State and Local Fiscal Assistance Act Amendments of 1980 require recipients of revenue sharing funds to have financial audits conducted. Also, a number of separate Federal statutory provisions currently exist in legislation requiring recipients of Federal assistance to have financial or financially related audits conducted. These latter audit requirements often differ as to the frequency and scope of the audits, the person responsible for conducting them, and the standards to be followed while conducting them.

Also, a number of bills are currently pending in both Houses of the Congress which involve various forms of Federal assistance. Those bills include financial and financially related audit requirements to be placed on recipients of the Federal assistance.

We believe that the number of various Federal statutory provisions and Federal executive requirements such as Attachment P, as well as the often differing financial and financially related audit requirements they contain, create a need for uniform crosscutting financial audit requirements for recipients of Federal assistance. We believe this need can best be filled through legislation such as Senate bill 1510.

Mr. Chairman, with your permission, I would like to comment today on portions of the bill and later furnish additional technical comments to the Subcommittee for its consideration.

SINGLE FINANCIAL AUDIT

The bill provides that each entity receiving Federal assistance for a fiscal year in excess of a given amount shall conduct at least biennially, but preferably annually, a single financial audit covering all of its funds. The bill also provides that the audits shall be made by independent auditors and conducted in accordance with those auditing standards issued by the United States General Accounting Office.

The bill defines the single financial audit as an audit conducted to determine and report:

- whether the financial statements of an audited entity present fairly the financial position and the results of financial operations in accordance with generally accepted accounting principles,
- whether the entity has complied with laws and regulations that may have a material effect upon the financial statements, and, last
- whether the entity has internal control systems to provide reasonable assurance it is managing Federal programs in compliance with laws and regulations.

These single financial audit provisions contain a number of important aspects. First, the audit must cover all of the funds of the entity being audited, not individual grants or programs. Second, the audit must be made by independent auditors and conducted

in accordance with the financial and compliance element of the "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions," issued by the General Accounting Office. Those standards incorporate the generally accepted auditing standards issued by the American Institute of Certified Public Accountants. Third, significant internal control systems shall be studied, evaluated, and reported on as part of the audit. And last, the single financial audit will serve as a basis, or as a building block, for performing further audit or evaluation work.

The single financial audit should contribute to overall improvements in the quality of the accounting, auditing, and internal control systems of the audited entity. Such audits will provide a foundation for assessing whether internal control systems are properly designed to protect the integrity of all funds received and are functioning as management intended. These single financial audits will result in written reports on whether the financial statements present fairly the financial position and the results of financial operations. Written reports will also be required of the (1) results of the study and evaluation of internal control systems and (2) the results of compliance testing made during the audit.

It is important to recognize, however, that this single financial audit focuses on the audited entity and its financial operations as a whole, rather than on the terms and conditions of each fund and program it administers. This audit should not--and actually cannot--be expected to provide detailed compliance and

program-specific information about each assistance fund or program that the entity administers.

SINGLE FINANCIAL AUDIT AS BUILDING BLOCK

However, as I indicated previously, an important benefit of the single financial audit is that it will serve as a basis, or as a building block, for performing further audit or evaluation work, such as economy and efficiency and program results audits, program evaluations, and in-depth program compliance testing when appropriate.

The bill clearly provides that in planning and performing any additional work at the entity, the Federal agencies and departments shall rely or build upon the results of the single financial audit.

RELATIONSHIP TO OTHER LAW (CROSSCUTTING
AUDIT REQUIREMENTS)

As I indicated a moment ago, because numerous and often differing financial and financially related audit requirements are placed on recipients of Federal assistance by Federal executive regulations and statutory provisions, uniform crosscutting financial audit requirements are needed.

I believe that this bill will alleviate much of the cost and paperwork currently required of Federal recipients due to the conflicting, redundant, and sometimes unreasonable audit requirements they must now follow. The bill will also provide for consistency and uniformity with regard to the audit requirements.

EXEMPTION FROM AUDIT REQUIREMENTS

We believe the provision in the bill to exempt from the audit provisions of this bill those recipients that receive small amounts of Federal assistance, is an important feature. However, we believe that the amount currently in the bill, \$25,000, might be too low and should either be increased to probably \$100,000, or higher or a provision should be added to the bill that would authorize OMB to review and change, as appropriate, the amount after consulting with Federal, State, local, and nonprofit officials. Another approach for identifying the exemption threshold for State and local governments would be to tie the threshold to the amount of revenue sharing funds received.

FEDERAL AUTHORITY AND RESPONSIBILITY

It is important to recognize that the various Federal inspectors general and the Federal program officials have certain oversight and monitoring authority and responsibilities concerning Federal assistance administered by State and local governments and nonprofit organizations.

This bill recognizes this authority and responsibility. The bill provides that the provisions contained therein do not limit the authority of Federal agencies and departments to conduct or contract for audits and evaluations of Federal assistance programs. The bill further provides that it does not limit the authority or responsibility of the Federal Government to enforce Federal law, regulations, procedures, or reporting requirements.

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Mr. Chairman, I believe this is a sound bill and addresses the major concerns and issues currently involving the audit of Federal assistance. We look forward to working with you, the Subcommittee, and the Congress concerning the proposed legislation and other suggestions and regulations that result from these hearings.

This concludes my prepared statement. I will be happy to respond to any questions you may have.