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BY THE COMPTROLLER GENERAL  
Report To The Chairman,  
Legislation And National Security Subcommittee,  
Committee On Government Operations  
House Of Representatives  
OF THE UNITED STATES

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# Audits Of Federal Programs: Reasons For The Disparity Between Costs Questioned By Auditors And Amounts Agencies Disallow

A large disparity exists between the hundreds of millions of dollars in federal contract and grant costs questioned by auditors, and the much smaller totals that program managers eventually disallow and contractors and grantees are required to repay to the government. GAO reviewed the way questioned costs are resolved at six major federal agencies. In many cases, program officials appropriately allowed costs and permitted auditees to retain the amounts questioned. However, GAO questioned the procedures employed to allow costs in about 25 percent of the decisions it examined. Even though GAO questions the procedures used in deciding to allow costs, this does not mean the previously allowed costs are now due the government because later a proper basis for allowing costs may be established.

GAO also believes that the way semiannual reports to the Congress by inspectors general present these costs may contribute to the notion that more funds should be returned to the government. Some of these reports portray disallowed costs as "savings," when they in fact may not ultimately result in savings at all.

GAO makes recommendations that address these issues



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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON D C 20548

B-214155

The Honorable Jack Brooks  
Chairman, Legislation and National  
Security Subcommittee  
Committee on Government Operations  
House of Representatives

Dear Mr. Chairman:

This report is in response to your September 13, 1982, request that we determine why such a large disparity exists between costs questioned by auditors and the amounts disallowed by program managers. This report discusses (1) the different reasons for the disparity, (2) our views on the appropriateness of the procedures used by program management in making decisions on auditors' findings, and (3) the reporting of audit resolution information.

Our review focused on the audit resolution process followed at six federal agencies--the Departments of Agriculture, Education, Health and Human Services, Labor, Transportation, and the Environmental Protection Agency.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

A handwritten signature in cursive script that reads "Charles A. Bowsher".

Comptroller General  
of the United States



COMPTROLLER GENERAL'S  
REPORT TO THE CHAIRMAN,  
LEGISLATION AND NATIONAL  
SECURITY SUBCOMMITTEE  
COMMITTEE ON GOVERNMENT  
OPERATIONS  
HOUSE OF REPRESENTATIVES

AUDITS OF FEDERAL PROGRAMS:  
REASONS FOR THE DISPARITY  
BETWEEN COSTS QUESTIONED  
BY AUDITORS AND AMOUNTS  
AGENCIES DISALLOW

D I G E S T

When auditors review federal programs, including grants and contracts, they recommend the return of money believed to be improperly spent. Their recommendations are reviewed by program managers, who may agree or disagree with the auditors. If they agree, corrective action should be taken, and the questioned costs should be "disallowed"--that is, the auditees cannot have federal funds pay for these costs. If the program managers disagree with the auditors and have appropriate support for these decisions, the questioned costs should be "allowed," and the auditee can be reimbursed for these costs with federal funds.

If auditors disagree with program managers' decisions to allow costs, the auditors are required under Office of Management and Budget (OMB) Circular A-50 to report these disagreements to the agency's audit follow-up official, who has personal responsibility for ensuring these disagreements are resolved. Circular A-50 and the Comptroller General's audit resolution standard, which is part of the Comptroller General's Standards for Internal Controls in the Federal Government, provide the basic guidance for the entire audit resolution process. (See p. 2.)

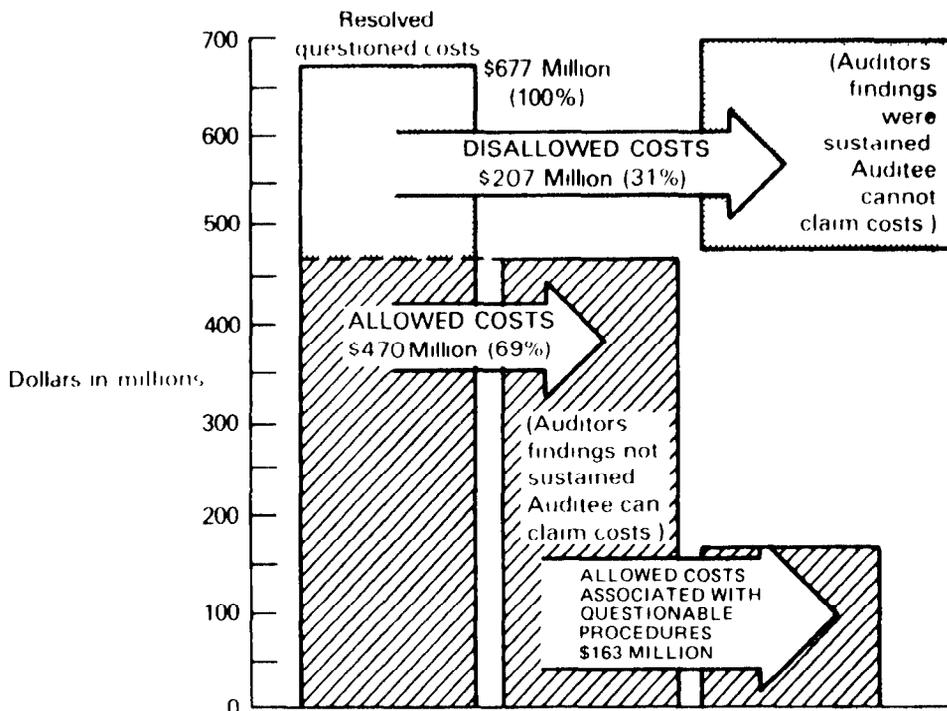
The Chairman of the House Committee on Government Operations' Legislation and National Security Subcommittee asked GAO to find out the reasons for the large disparity between the hundreds of millions of dollars in federal contract and grant costs questioned by auditors, and the much smaller totals program managers eventually disallow and subsequently contractors and grantees are asked to repay to the government. The Chairman said this disparity raised serious questions about the quality of the auditing and the appropriateness of program officials' decisions to allow questioned costs.

To answer the Chairman's questions, GAO reviewed the way questioned costs are resolved at six federal agencies--the Departments of Agriculture

(USDA), Education, Health and Human Services (HHS), Labor, and Transportation (DOT), and the Environmental Protection Agency (EPA). GAO looked at a sample of 325 audits involving 586 decisions to resolve questioned costs totaling \$677 million. (See p. 4.)

As the following chart shows, \$207 million of the \$677 million questioned by auditors was initially disallowed, and \$470 million was allowed.

How questioned costs were resolved<sup>a</sup>



<sup>a</sup> "Resolved" as defined by OMB

In general, GAO found proper procedures were used to reach decisions in allowing costs. This does not necessarily mean that the auditors were not justified in initially questioning these properly allowed costs since, for example, the auditees may subsequently provide supporting documentation for a claim. However, GAO questions the procedures used by program officials in 112 decisions involving \$163 million in allowed costs. But this does not mean these amounts are now due the government. This is because of several reasons, such as reaudit or further documentation from the auditee, that may establish a proper basis for allowing costs. (See pp. 8-10.)

SOME PROCEDURES FOR DECIDING  
TO ALLOW COSTS ARE QUESTIONABLE

GAO questions the way program managers resolved some of the auditors' findings and recommendations concerning allowed costs because the managers

- did not hold the auditee accountable for correcting the program deficiencies that were identified,
- did not adequately address the issues raised by the auditors, or
- did not adequately explain or justify their decisions in writing.

Program managers followed some questionable procedures to reach their decisions. Summaries of these procedures follow:

- Allowing questioned costs because of a proposed future audit. GAO questions the use of this procedure to allow costs because some of the proposed reaudits may never be performed and those actually performed may not address the issues or costs originally questioned.
- Allowing questioned costs because the auditee submitted a plan of action to correct the deficiency detected by the auditors. GAO believes it is improper to use corrective action plans to excuse an auditee's liability for past improper expenditures or to allow questioned costs before the corrective action is taken.
- Using special provisions to allow costs. Although at times the use of this procedure may be proper, GAO questions its use when it overlooks the issues raised by the auditors. For example, GAO found that program officials in the Department of Labor can allow questioned public-service employment costs under certain conditions, one of which is that the magnitude of the cost allowed cannot be substantial. (See p. 36.) However, the regulation did not specify how to determine what is "substantial." This special provision was used to allow about \$18.2 million in questioned costs. However, program officials did not adequately explain how they decided \$18.2 million was not a substantial amount of money. While agency management may have considerable discretion to allow costs based on special provisions in laws and regulations, GAO believes the exercise of such discretion must be clearly justified by the circumstances and documented in writing.

--Allowing questioned costs on the basis of administrative actions. For example, in an audit of a Department of Education grantee, program officials allowed over \$200,000 in findings because another office in the Department was investigating the case. GAO believes that allowing the costs and closing the audit based on this administrative action should not have taken place until a determination could be made based on the case's merits. (See p. 37.)

--Allowing questioned costs on the grounds the auditee provided some additional documentation (which GAO reviewed and found inadequate) or provided a "certification" that the questioned costs were appropriately incurred in lieu of supporting documentation.

--Allowing questioned costs without providing--as required by OMB guidance--a written justification as to why the program official disagreed with the auditors. (See pp. 10-15.)

#### AUDITOR ERRORS CAUSED SOME QUESTIONED COSTS TO BE ALLOWED

GAO did not attempt to review audit quality or the work performed by auditors in the 325 cases in its sample. However, in reviewing the written justifications for program managers' decisions to allow costs, GAO noted audit-quality problems, such as errors caused by miscalculations or auditors misinterpreting program regulations and the records of auditees. Program managers cited these errors as the reason for approving \$4.9 million in questioned costs. However, GAO does not know the extent of any other problems related to audit quality because its review did not focus on this matter. (See pp. 15-16.)

#### AUDIT RESOLUTION PROCESS NEEDS MORE AUDITOR PARTICIPATION

Of the \$207 million in questioned costs originally disallowed, \$44 million was subsequently allowed--\$25 million by program officials and \$19 million through appeal actions. GAO found inspectors general (IGs) do not always follow up after initially agreeing with program officials on a course of action. (See p. 20.) GAO believes this illustrates the need for auditors to have a greater role in seeing that their recommendations are followed up by corrective action, as is required by the Comptroller General's audit resolution standard.

GAO found audit resolution was not generally viewed as a shared process between program officials and

auditors, and auditors were not always aware of decisions made on their questioned costs. Not being aware, they did not elevate to higher authority those decisions with which they might have disagreed.

The Federal Managers' Financial Integrity Act of 1982 requires the Comptroller General to prescribe standards to ensure the prompt resolution of audit findings. According to the Comptroller General's standard, issued under the act, audit resolution occurs only after the actions agreed to are completed within established time periods. However, OMB considers auditors' findings and recommendations to be resolved when a course of action is decided. GAO believes this difference in definition results in agencies considering auditors' findings and recommendations to be resolved prematurely. Because the act clearly expresses Congress' intent that GAO set the governmentwide audit resolution standard, GAO believes OMB should revise its definition to conform to GAO's requirement that audit findings are not considered resolved until the actions agreed to are completed. (See pp. 19-23.)

DATA PROVIDED TO THE CONGRESS  
BY AUDITORS SOMETIMES MAKES  
DISALLOWED COSTS APPEAR TO BE SAVINGS

The semiannual reports to the Congress by IGs may contribute to the notion that more funds should be returned to the government. Some reports to the Congress portray disallowed costs as "savings." Disallowed costs do not necessarily equate to savings for several reasons. For example, the auditee may provide additional documented support after the costs are disallowed, and the program official may ultimately allow the costs. Another example in which disallowed costs may later become allowed would be when the program official's decision is overturned on a legal appeal. (See pp. 24-29.)

RECOMMENDATIONS

GAO recommends the Secretaries of USDA, Education, HHS, Labor, and DOT and the EPA Administrator

--ensure program officials make decisions on auditors' questioned costs based on the issues raised by the auditors and

--eliminate or constrain the use of reaudits, certifications, and corrective action plans to allow questioned costs.

GAO recommends the head of each federal department and agency with an internal audit organization or

office of inspector general (OIG) review that agency's audit resolution procedures and, where the above deficiencies exist, implement policies and procedures to correct them.

GAO further recommends the OMB Director incorporate the Comptroller General's audit resolution standard into Circular A-50, and establish definitions of questioned cost and savings for reporting purposes.

Other recommendations concerning audit resolution are contained in the body of this report. (See pp. 17, 18, 23, 30.)

#### AGENCY COMMENTS AND GAO'S EVALUATION

GAO did not obtain official agency or OIG comments on this report. However, GAO discussed its findings with agency officials involved in the audit resolution process and OIG officials.

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#### ABBREVIATIONS

CETA	Comprehensive Employment Training Act
CPA	Certified Public Accountant
DOT	Department of Transportation
EPA	Environmental Protection Agency
GAO	General Accounting Office
HHS	Department of Health and Human Services
IG	Inspector General
NIH	National Institutes of Health
OHDS	Office of Human Development Services, Department of Health and Human Services
OIG	Office of Inspector General

OMB	Office of Management and Budget
PCIE	President's Council on Integrity and Efficiency
USDA	Department of Agriculture



## CHAPTER 1

### INTRODUCTION

Auditors review federal programs and issue reports which frequently recommend the return to the federal government of money believed to be improperly spent. Considerable attention has been focused in recent years on how government agencies resolve auditors' findings and recommendations, and collect audit-related debts.

We conducted this review at the request of the Chairman of the Legislation and National Security Subcommittee of the House Committee on Government Operations. The Chairman asked us to determine why such a large disparity exists between costs questioned by auditors and the amounts which agency program managers determine grantees and contractors should return.

#### WHAT IS AUDIT RESOLUTION?

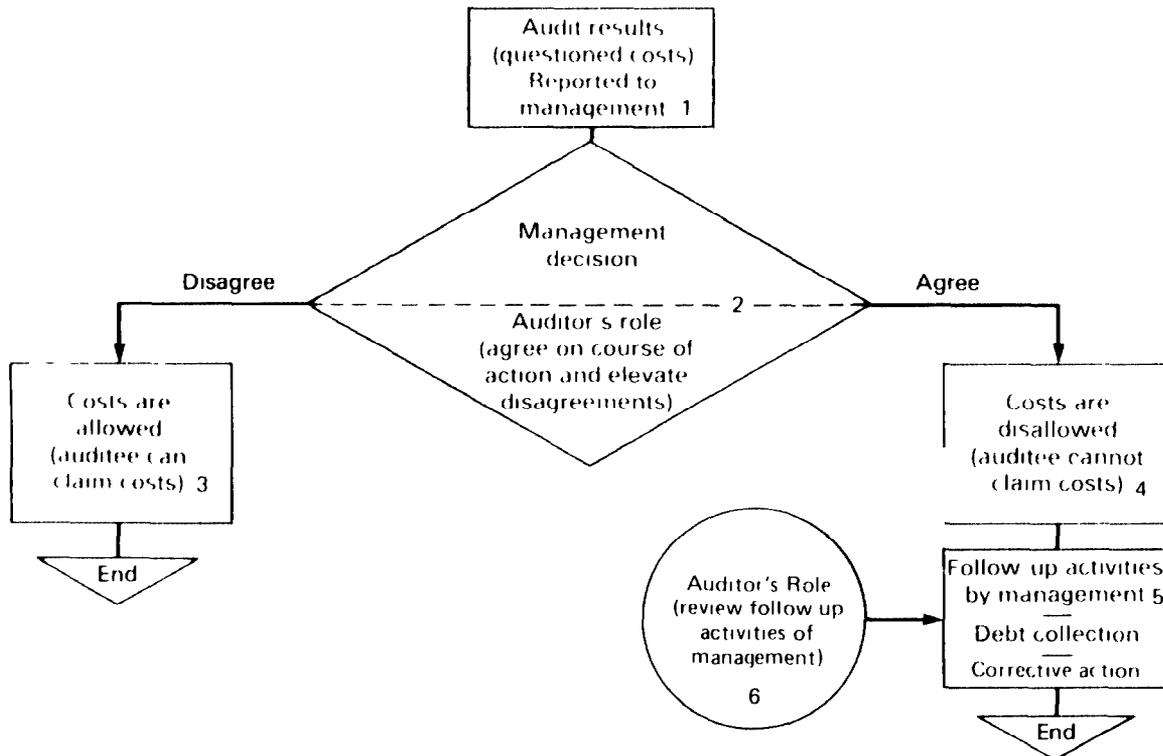
The term "audit resolution" is defined differently by the Office of Management and Budget (OMB) and us. According to our definition, the audit resolution process includes two parts--first, evaluating the audit finding and deciding on a course of action, and second, ensuring that corrective action actually takes place. OMB's definition embodies only the first step in the process.

Although we differ on the definition of audit resolution, we have used OMB's definition for the purpose of this review. Therefore, whenever the term "resolution" is used in this report it refers to OMB's definition, not ours. We did this because the agencies we reviewed followed OMB's definition of audit resolution in accounting for and reporting on the process.

According to OMB Circular A-50, audit resolution occurs when the auditor and agency management agree on the action to be taken on reported findings. When management agrees with the auditors' findings, resolution is followed by corrective actions taken by management to carry out recommendations. When management disagrees with the auditors, the costs questioned by the auditors are "allowed" and can be claimed by the auditee.

All audit findings do not involve potential recovery of funds. Many recommend procedural changes or other improvements intended to upgrade the economy, efficiency, or effectiveness of agency operations, thus saving future costs. The audit resolution process and resulting corrective actions, as outlined in OMB Circular A-50 and the Comptroller General's Standards for Internal Controls in the Federal Government, should proceed as described in the following diagram and narrative:

## Audit Resolution Process



- 1 In a report to agency management, auditors question any expenditures that appear to violate laws or regulations. These "questioned costs" must then be resolved.
- 2 Program managers review both audit reports and auditee comments and agree with auditors on a course of action to resolve the questioned costs. The result is a decision by program managers to "allow" or "disallow" the expenditures. Disagreements between auditors and program officials on resolving questioned costs are settled by higher-level management.
- 3 When program managers decide the expenditures were proper, which means the auditor's "questioned costs" are not sustained, the grantee or contractor can consider these eligible costs; thus they are "allowed costs" and no further action is required.
- 4 When program managers decide the expenditures were indeed improper--the auditor's findings are sustained--the grantee or contractor cannot consider these questioned costs to be eligible; thus they are "disallowed costs."
- 5 Managers notify the grantee or contractor that the costs are disallowed and, unless successfully appealed, must be returned to the government. Managers also establish an accounting record of the debt, require other necessary corrective action, and follow up on corrective actions to ensure compliance.

- 6 The Comptroller General's Standards for Internal Controls in the Federal Government includes a standard under which auditors are to review management's follow-up activities to ascertain that corrective action is taken.

#### PAST ACTIONS TO STRENGTHEN AUDIT RESOLUTION

The House Committee on Government Operations has long recognized the importance of effective auditing and its role in achieving sound financial management in the federal government. In recent years, the Legislation and National Security Subcommittee of the House Committee on Government Operations has taken an active role to improve the quality of governmental auditing. In particular, it has placed considerable emphasis on the need to resolve or take appropriate action on audit findings promptly.

This is our fourth report, in a series that began in 1978, on how government agencies follow up and resolve findings identified in the audit process. Our first report<sup>1</sup> identified nearly 1,000 audit reports at 34 agencies containing unresolved findings involving more than \$4.3 billion in potential recoveries, penalties, revenues, or savings. The second report<sup>2</sup> showed the problem had worsened. The third report<sup>3</sup> showed agencies had not developed adequate systems to properly settle audit-related debts.

The Legislation and National Security Subcommittee has held a number of hearings on audit resolution and debt collection. Hearings on the results of our three reviews were held in March 1979, February 1981, and February 1982. In addition, the House Committee on Government Operations issued a report in June 1979 on the failure of federal departments and agencies to follow up and resolve audit findings.

The Congress enacted the Supplemental Appropriations and Rescission Act of 1980 (Public Law 96-304), which includes a requirement that executive agencies resolve pending audit findings and recommendations quickly and any new ones involving questioned costs within 6 months after receipt of the final audit report. In October 1981, the House Committee on Government Operations issued a follow-up report, entitled Continued Failure of Departments and Agencies to Take Effective Action on Audit Findings. In February 1982, the Committee issued a report, Failure of Federal Departments

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<sup>1</sup>More Effective Action Is Needed on Auditors' Findings--Millions Can Be Collected or Saved (FGMSD-79-3, Oct. 25, 1978).

<sup>2</sup>Disappointing Progress in Implementing Systems for Resolving Billions in Audit Findings (AFMD-81-27, Jan. 23, 1981).

<sup>3</sup>Federal Agencies Negligent in Collecting Debts Arising From Audits (AFMD-82-32, Jan. 22, 1982).

and Agencies to Collect Audit-Related Debts, after its Legislation and National Security Subcommittee held hearings on audit-related debts. In 1983, we issued the Comptroller General's Standards For Internal Controls in the Federal Government as required by the Federal Managers' Financial Integrity Act of 1982 (Public Law 97-255). Under our audit resolution standard, auditors are to review management's follow-up activities to ascertain that corrective action is taken.

The executive branch, which is also concerned about audit resolution problems, has attempted to strengthen the audit resolution process. In September 1982, OMB issued a revised Circular A-50 that provides policy guidance on audit follow-up. In August 1983, OMB published a brief study, entitled Improving the Quality of Audit Resolution, which reported that only 40 percent of auditors' findings are resolved in the government's favor. OMB concluded auditors, auditees, and program managers could be wasting their time, and the government was recovering less than it should from these audits.

Although some progress has been made in the audit resolution area (see p. 22), the Committee on Government Operations believes OMB and federal departments and agencies still do not give audit resolution the priority treatment it should receive. The Committee's concerns, as stated in House Report No. 97-727 (Aug. 12, 1982), are as follows:

"The Committee is also concerned about what appears to be a process which favors the auditee in the resolution of billions of dollars in questioned costs. The GAO's estimate of \$14.3 billion in unresolved audit findings as of July 1980 contained \$9.3 billion in unresolved Energy regulatory findings which would not result in funds returned to the Government. Nearly all of the remaining five billion dollars in monetary audit findings were apparently resolved as of September 30, 1981, yet only \$278 million in costs determined to be unallowable over a three-year period were collected as of June 30, 1981.

"This large disparity seems to indicate a serious deficiency in the audit resolution process. Either auditors are questioning costs which should not be questioned or agency management is allowing costs which should be disallowed, or both."

Because of these concerns, the Chairman of the Legislation and National Security Subcommittee asked us to determine why such a large disparity exists between the amounts of costs questioned by auditors and the amounts disallowed by program managers.

#### OBJECTIVES, SCOPE, AND METHODOLOGY

This review's objectives were to (1) determine the reasons for the disparity between questioned costs and disallowed costs, (2)

evaluate the appropriateness of the procedures used by program management in making decisions on auditors' findings, and (3) assess the effect of various Office of Inspector General (OIG) reporting systems on the disparity.

To accomplish these objectives, we evaluated the audit resolution process at the regional offices and headquarters of six federal agencies--the Departments of Agriculture (USDA), Education, Health and Human Services (HHS), Labor, and Transportation (DOT), and the Environmental Protection Agency (EPA). We judgmentally selected agencies having both a large annual volume of audit reports and large amounts of monetary findings arising from grant and contract audits.

We did not attempt to assess the quality of audits that led to the questioned costs in our sample. Audit-quality assessment requires extensive analysis of documentation along with an in-depth review of the audit organization itself. These reviews apply a top-down approach in assessing the activities of an inspector general (IG) or a federal audit organization to determine (1) if duties and responsibilities as specified in laws and regulations are carried out, and (2) if the work is performed in accordance with generally accepted professional standards.

Although our review focused on how agency management officials handled the auditors' findings and recommendations, we did find cases where auditors questioned costs which should not have been questioned. However, the amounts were relatively minor in relation to the total questioned costs we reviewed. (See p. 15.)

Our audit work was conducted primarily from November 1982 through November 1983. We judgmentally selected and analyzed 325 audits involving 586 audit findings resolved in fiscal years 1981 and 1982. The audits were of individual grants and contracts. Within each audit in our sample, we examined up to three individual findings of \$10,000 or more from both the questioned costs and unsupported cost categories. However, if the audit report contained more than three such findings, we examined only three.

We selected fiscal years 1981 and 1982 because we were analyzing how costs were resolved, and these years were the latest we could select with the expectation that most of the questioned costs in the audits had been resolved.

The audits examined how funds were spent and programs were administered by grantees and contractors. The audits were performed by agency IG auditors and their predecessors, independent public accountants including certified public accountants (CPAs), and state and local government auditors. The grantees and contractors included state and local governments, educational institutions, hospitals, and private industry.

Additional details on the methodology used in selecting the audit sample are explained in appendix I. Summary data describing the sample follow:

Our Analysis of Agency Audits

<u>Federal agency</u>	<u>Number of audits selected</u>	<u>Number of audit findings</u>	<u>Amount of questioned costs resolved<sup>a</sup></u>		<u>Costs allowed</u>		<u>Costs disallowed</u>	
			<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
			-- --(millions)-- --				(millions)	
USDA	47	80	\$ 99.3		\$83.7	84	\$ 15.6	16
Education	35	57	76.4		63.8	84	12.6	16
HHS	70	123	177.2		47.5	27	129.7	73
Labor	35	80	81.8		63.2	77	18.6	23
EPA	71	126	33.6		25.7	76	7.9	24
DOT	<u>67</u>	<u>120</u>	<u>208.7</u>		<u>186.3</u>	89	<u>22.4</u>	11
Total	<u>325</u>	<u>586</u>	<u>\$677.0</u>		<u>\$470.2</u>	69	<u>\$206.8</u>	31

<sup>a</sup>"Resolved" as defined by OMB.

For each audit in the sample, we reviewed the audit report and documentation in the audit resolution files. We also interviewed OIG and program officials in the agencies' regional offices and headquarters. After determining the reasons for any disparity between questioned costs and disallowed costs for each finding, we assessed the appropriateness of the procedures employed by program managers in deciding to allow questioned costs. We did not attempt to decide in each case whether the auditors or the program managers were correct as a matter of law or policy when they disagreed over the merits of a decision to disallow costs. Instead, we limited our review to deciding whether the auditors and program officials followed appropriate procedures in resolving audit findings. Our assessment was based on applicable OMB guidance contained in OMB Circular A-50 revised in September 1982. This revised circular incorporated audit resolution guidance previously included in OMB Circular A-73. Our assessment was also based on laws, agency policies and program regulations, and our professional judgment.

We have identified as questionable those audit resolution procedures that we considered inappropriate. A questionable procedure, in our opinion, was one that did not address the issues

raised by the auditors, was not supported by appropriate justification, or did not hold the auditee accountable for correcting the program deficiencies that were identified. Although we have questioned the procedures used by program managers in deciding to allow costs, this does not mean that the related allowed costs are now due the government. This is because of several reasons, such as reaudit or further documentation from the auditee, that may establish a proper basis for allowing costs. In this report we are showing allowed costs in relation to questionable procedures to indicate the amount of money involved.

We included in the questionable category only those cases where documentation on file or discussion with agency personnel strongly pointed to inadequate decisionmaking.

In addition, we

- examined the role of the auditor in the audit resolution process as described by OMB and the expanded role provided under the Comptroller General's audit resolution standard,
- examined how accurately the respective OIGs' reporting systems recorded the data from each sample case and how that data were presented in the OIG's semiannual reports to the Congress, and
- gathered statistics on the audit resolution process at 19 federal agencies. Such data for fiscal year 1983 is presented in appendix II.

This review was made in accordance with generally accepted government auditing standards. We did not obtain agency comments on the matters discussed in this report. However, issues in the report were discussed with responsible agency officials.

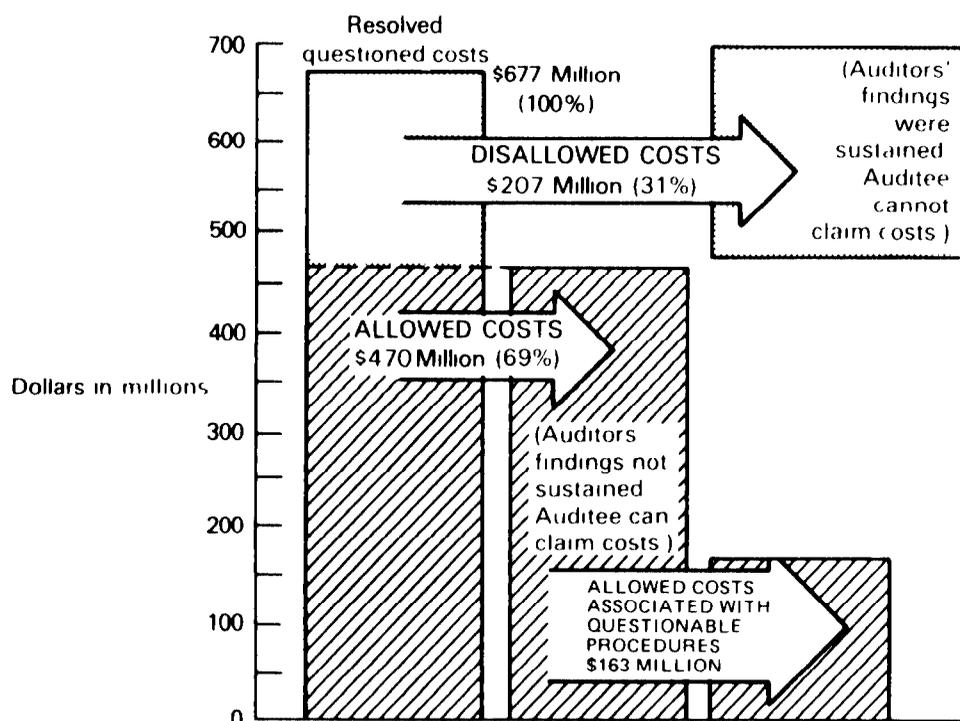
## CHAPTER 2

### AUDITORS' QUESTIONED COSTS ARE NOT ALWAYS SUSTAINED

Hundreds of millions of dollars that auditors identify as questionable expenditures by the federal government's grantees and contractors are not sustained by program officials responsible for making decisions on these costs. In many cases, program officials appropriately disagree with auditors' recommendations or have additional information affecting their decision and, consequently, do not seek recovery of funds. In other cases, the procedures employed by program officials in deciding to overturn the auditors' recommendations are questionable.

The following graph shows that the total resolved questioned costs for the sample audits was \$677 million with \$470 million resolved in favor of the grantees and contractors. We questioned the procedures followed by program officials in their decisions to allow \$163 million of the \$470 million. The remaining \$207 million was initially disallowed, sustaining auditors' findings, and the grantees or contractors should have returned this amount. However, program officials and appeals actions, as discussed in chapter 3, later reduced this amount.

How questioned costs were resolved<sup>a</sup>



<sup>a</sup>"Resolved" as defined by OMB.

In this chapter, we discuss why we believe program officials' disagreements with the auditors' recommendations may be appropriate in some cases and inappropriate in others.

MOST DECISIONS TO ALLOW COSTS  
WERE MADE APPROPRIATELY

Auditors question costs for two main reasons. One, they consider some costs not eligible because they believe a law, regulation, or grant or contract provision is violated. Two, they question costs because adequate documentation is not available from the auditee. In either case, program officials may appropriately reach a different conclusion than the auditors even though the auditors were justified in initially questioning the costs.

Program officials appropriately allow costs in many cases because they interpret the laws, regulations, and grant provisions differently than the auditors and provide adequate support for their views. In other instances, auditees provide additional and sufficient documentation to justify the questioned costs. In still other cases, program officials may view the auditors' questioned costs as a "best judgment" about what amount is due back to the government. Program officials may not agree with the amount or may determine that the auditor was wrong, and establish a different amount which, in the judgment of the program official, is reasonable.

Sometimes, program officials use special provisions in the law or regulations to allow questioned costs, as shown in the following example:

--HHS auditors questioned about \$24 million paid to the New Jersey Department of Human Services because the services were provided to mentally retarded recipients residing in facilities that were not in compliance with federal standards, and the Department had not obtained approval of an extension for meeting compliance standards. In 1982, the Secretary of HHS decided to allow the costs under a provision in the agency's Grants Administration Manual that allows retroactive approvals of transactions under certain conditions. In this example, the auditors were proper in questioning the costs because an extension had not been obtained, and the Secretary acted within his authority by allowing the costs.

In examining federal contracts and grants, auditors must assess whether the auditee has complied with the requirements of the grant or contract. Program officials must then determine what action to take on the auditors' recommendations. They may use their judgment to establish the exact amount due the government. In some instances program officials may not seek to recover funds, but instead only require the auditee's improved performance under the grant. One official we interviewed stated that ultimately it

is more important to improve grantee operations than collect money, especially when grantees are 100 percent federally funded and have no money to repay the government.

Frequently, when auditors question costs, the auditee assembles additional documentation to support the costs. If such support proves acceptable to program officials, the costs are allowed. However, the auditors were not wrong to question the costs, and if the support submitted by the grantee was sufficient, the program officials were not wrong in allowing the costs.

SOME PROCEDURES FOR DECIDING  
TO ALLOW COSTS WERE QUESTIONABLE

Our sample included 586 decisions on audit findings, including 424 to allow questioned costs. Out of the 424 decisions to allow \$470 million, we believe the audit resolution procedures followed in 112 decisions, totaling \$163 million in allowed costs, were questionable. Although we have questioned the procedures used by program managers in deciding to allow questioned costs, this does not mean the related allowed costs are now due the government. Our purpose in showing the allowed costs in relation to the questioned procedures is to indicate the amount of money involved. We have identified as questionable those audit resolution procedures that we considered inappropriate. A questionable procedure, in our opinion, was one that did not hold the auditee accountable for correcting the program deficiencies identified, address the issues raised by the auditors, or was not supported by appropriate justification. (See table 1 on the next page.)

TABLE 1

REASONS WE QUESTIONED THE PROCEDURES USED TO ALLOW COSTS

<u>Reason</u>	<u>No. of occurrences</u>	<u>Amount (million)</u>
Did not hold the auditee accountable for correcting the program deficiencies that were identified		
Planned reaudit is insufficient reason for allowing costs	21	\$72.9
Corrective action plans were inadequate	13	11.5
Did not adequately address the issues raised by the auditors		
Eligibility of costs was inadequately addressed	22	40.1
Administrative decision was inappropriate	25	21.8
Was not supported by appropriate justification		
Written justification was insufficient for the decision made	16	5.8
Documentation or auditee certifications were inadequate	<u>15</u>	<u>10.4</u>
Total	<u>112</u>	<u>\$162.5</u>

Case examples are presented in this chapter to illustrate each point. Additional examples are included in appendix III.

Planned reaudit

At each agency we audited, program officials allowed questioned costs because of proposed future audits. For example:

--An EPA audit of a grant to the Ohio Pollution Control Agency questioned about \$720,000 because the auditee's accounting system was deficient. Although program officials agreed with the auditors, they allowed the questioned costs based on a proposed reaudit. However, a regional OIG official

told us these costs will never be reaudited because the OIG's work plan no longer includes audits of this type of grant.

We question the procedure followed to allow the costs in such cases because the proposed reaudit may never be performed or may not address the original questioned costs. We believe decisions on the questioned costs should remain unresolved until they have been reaudited, at which time a final decision can be made.

### Corrective action plans

When questioned costs relate to program or management deficiencies requiring remedial action on the auditee's part, program officials sometimes require the auditee to develop a corrective action plan. Generally, these plans are intended to correct the deficiency that caused the questioned costs so it will not recur. We reviewed examples of corrective action plans used to allow questioned costs and found they do not necessarily protect the government's interest. For example, the corrective action was not always carried out by the auditee. Furthermore, the plans did not fully address the issue of the auditee's liability arising from past deficiencies, which may entitle the government to a return of funds.

We also questioned the substance of some corrective action plans because they only consisted of auditees' promises to do better or assertions that improvements had been implemented without a written corrective action plan which management could use to clearly measure improvements. Following is an example of a corrective action plan that we believe did not adequately safeguard federal funds:

--A Department of Labor audit of Los Angeles County questioned about \$4.2 million for failure to meet the training requirement of a grant program. The program official allowed the cost based on a corrective action plan that promised to monitor training and provide technical assistance to subgrantees. However, the plan gave no specific details on the action to be taken.

We believe corrective action plans may be useful in getting auditees to improve performance or correct deficiencies, but these plans should be substantive and appropriate to the circumstances. For example, these plans should be in writing and provide for specific remedial actions tied to deadline dates.

Corrective action plans should not be used to allow costs in cases where the auditee has a responsibility to the government for past deficiencies. In such cases, we believe the questioned costs generally should be either disallowed or considered unresolved until the auditee takes the needed corrective action. We believe program managers have a responsibility to follow up on the implementation of these plans.

In setting standards for audit follow-up systems, OMB Circular A-50 requires agencies to specify criteria for proper resolution and corrective action on audit recommendations. These criteria should provide for written plans for corrective action with specified action dates where appropriate. The agency audit follow-up official is responsible for ensuring that systems of audit follow-up, resolution, and corrective action are documented and in place, and that corrective actions are actually taken.

#### Eligibility of costs

In some cases, we found that program officials did not adequately address the cost eligibility issues which the auditors had raised, and we questioned their decisions to allow the costs. The following example illustrates this point:

--State auditors questioned costs of \$18,598 for repair and maintenance of existing facilities which were not allowed under EPA regulations. Program officials said they allowed the costs because they were necessary to ensure the project's functional integrity. The program officials did not discuss the costs' eligibility questioned by the auditors. Therefore, we questioned the procedures to allow the expenses. In response to our assessment, a program official agreed that these costs were ineligible and allowed erroneously.

#### Administrative decisions

Program officials in all six agencies we audited closed some audits administratively--that is, they decided to allow costs based primarily not on the issues raised by the auditors but for other reasons, including the deadline imposed by the 1980 Supplemental Appropriations and Rescission Act, which required agencies to resolve their unresolved audit backlogs by September 30, 1981. However, in its report on the legislation the Senate Committee on Appropriations cautioned agencies against resolving audits improperly by summarily rejecting audit findings to reduce the backlog. Nevertheless, at least one agency did close audits simply to meet the deadline, and we found some decisions were made by using questionable audit resolution procedures.

Another example of administrative closure follows:

--In two Department of Education audits, ineligible grantee expenditures were allowed because the agency intended to seek passage of legislation which would make the pertinent provision retroactive to the audited period, but such an amendment was not enacted. We questioned this decision because an uncertain future event was used to allow the costs.

We believe program officials should not overlook the issues raised by the auditors, but deal effectively with them in making their determinations on questioned costs.

### Written justification

OMB Circular A-50 requires written justification from program officials when their decisions disagree with the auditors. However, in some audits, program officials did not adequately justify or explain their decisions in writing. For example,

- A Department of Labor audit of the Las Vegas/Clark County Consortium questioned about \$3.8 million. However, the final determination resolved only about \$300,000, leaving \$3.5 million unaccounted for. The program official who resolved this audit has left the Department. Current officials said the unresolved costs were deferred to a subsequent audit, but the files we reviewed contained no explanation regarding the disposition of the \$3.5 million. We question this decision because the written justification required by OMB Circular A-50, which should have been in the files to justify the allowance, was not there.

OMB Circular A-50 stresses the need for proper documentation by requiring agency program officials to explain fully in written comments their reasons for disagreeing with the auditors. When the disagreement is based on interpretation of law, regulation, or the authority of officials to take or not take action, the response must include the legal basis. We believe OMB's guidance is useful in reinforcing the need for program officials to justify in writing their decisions to allow costs questioned by the auditors.

### Documentation or auditee certifications

When program officials are resolving questioned costs, they often receive additional documentation from auditees to support the claimed costs. The officials review this documentation to the extent they consider necessary to assess the costs questioned and to make a determination on allowability. However, we found that for some audits, the documentation reviewed by program officials appeared insufficient to support the auditee's total claim, but nevertheless was used to allow the costs. For example,

- An EPA audit of the Georgia Department of Natural Resources questioned about \$5.9 million in costs, which represented salaries, fringe benefits, travel, and motor vehicle expenses for a 3-year period, because the grantee's financial management system did not accurately and completely disclose financial results of each grant program or program element. EPA managers reviewed and validated documentation to support about \$2.3 million in costs for only 1 of the 3 years covered by the audit, and allowed costs for the other years on that basis. In this case, we believe program officials should have reviewed, at least on a sample basis, the

\$3.6 million in costs for the other 2 years, which represents a significant portion of the questioned costs. A 1-year review may not have established the reasonableness of these costs, especially considering the problems in the grantee's financial management system.

When auditees cannot provide data to support the questioned costs, program officials will accept auditee certifications that all of the claimed costs were spent appropriately. For example,

--In a CPA audit of a grant to HHS's Office of Human Development Services, auditors questioned costs of \$274,000 because of inadequate supporting documentation. Program officials allowed the costs based on written certifications by the grantee. An OIG official we interviewed disagreed with this decision because use of such certifications could be self-serving and, therefore, require confirmation by an independent source. We question the decision because the auditee should have provided appropriate documentation to justify the costs.

We believe program officials have a responsibility to thoroughly review the documentation provided by auditees to justify claimed costs. The officials should also have the auditors review the additional documentation to ensure its relevancy and that it is not the same data initially provided to the auditors. Only adequate documentation and thorough review can put program officials in a position to make valid determinations on the questioned costs.

We believe auditee certifications should not be used in place of documentation to support program officials' decisions to allow cost, except in circumstances where the auditee could not be expected to have the necessary supporting documentation, such as when the auditee's records have been destroyed by a fire. Certifications should not be accepted because the auditee does not routinely maintain the accounting and financial management systems required to support claims for government funds. This use of certifications could remove the auditees' incentive to maintain required financial accounting systems. OMB Circular A-50 on audit follow-up does not discuss the use of certifications in the audit resolution process. We believe guidance is needed to describe the limited circumstances under which agencies may allow auditee costs by accepting certifications in lieu of documentation.

#### QUESTIONED COSTS WERE ALLOWED BECAUSE OF AUDITOR ERRORS

As discussed in chapter 1, we did not attempt in our sample to assess the quality of the audits that led to the questioned costs. However, in reviewing decisions on questioned costs, we found 10 instances in which questioned costs were allowed because of auditor errors. These errors involved about \$4.9 million in questioned costs, ranging from \$594 to about \$3 million. The errors resulted from miscomputations and misinterpretations of program regulations

and auditee records. The instances of auditor error we found had already been identified and properly resolved by program officials and the auditors to protect auditee and government interests. The following example illustrates the kind of error we found. Similar examples are in appendix III.

--An HHS audit of the New York Department of Social Services questioned about \$4.5 million in training and development costs because the New York agency did not meet federal criteria for allocating training and staff development costs between federal and nonfederal programs. Program officials allowed about \$3 million of this amount pointing out that the auditors had interpreted the regulations incorrectly because they used the wrong criteria. The auditors agreed they had misinterpreted the regulations and, therefore, the program officials' decision to allow these costs was correct.

### CONCLUSIONS

Most decisions by program officials to allow or disallow auditors' questioned costs were reasonable and properly safeguarded the government's funds. However, we questioned the procedures employed to reach some decisions. A questionable procedure, in our opinion, did not address the issues raised by the auditors, was not supported by appropriate justification, or did not hold the auditee accountable for correcting the program deficiencies that were identified.

Some changes are needed in the procedures that program officials use to resolve questioned costs. We believe agencies should no longer allow costs based on a planned reaudit. Such reaudits, if conducted at all, may not address the original issues or monies questioned. Program officials also need additional guidance on the use of auditee certifications as a basis for allowing costs. The certifications should be accepted only in circumstances where the auditee could not be expected to have the necessary supporting documentation.

In our opinion, corrective action plans are used improperly when they excuse an auditee's liability for past deficiencies. A plan is intended to improve performance or to correct the deficiency that caused the questioned costs so it will not recur in the future. However, it does not address the issue of misspent funds that should be returned to the government.

We also object to using a corrective action plan to allow cost even if the plan discusses the deficiency that caused the auditors to initially question the cost. We believe costs could be allowed once the plans have been properly implemented and assurances made that past deficiencies have been corrected. In the meantime the questioned costs should remain unresolved.

Agency management should ensure that program officials deal effectively with the program deficiencies cited by auditors as the

basis for questioning auditee costs. While agency management may have considerable discretion to allow costs based on special provisions in a law or regulation, we believe the exercise of such discretion must be clearly justified by the circumstances and documented in writing. Agency management should seek to ensure that all decisions to allow costs, which are contrary to auditors' findings, are legally proper and reasonable in terms of safeguarding the use of government funds.

Our review found auditors sometimes made errors in calculations or misinterpreted regulations and auditee records.

Since fiscal years 1981-82, when the audits in our sample were resolved, OMB has issued a revised Circular A-50 on audit follow-up. But some additional guidance is needed to strengthen the procedures in Circular A-50 for issues we identified that are not now addressed.

Clear and complete guidance on proper audit resolution procedures will facilitate swift and reasonable decisions on questioned costs. High-quality decisions enhance the effectiveness of the audit effort, ensure the accountability of federal funds, and contribute to improved performance by federal grantees and contractors. Additional guidance on audit resolution and follow-up is needed to ensure high-quality determinations on auditors' questioned costs.

#### RECOMMENDATIONS

We recommend the Secretaries of USDA, Education, HHS, Labor, and DOT, and the EPA Administrator implement policies and procedures that:

- Ensure that administrative actions and special procedures or waivers, used to allow questioned costs, are used with discretion, in compliance with the law, and not used to merely expedite the resolution of the case without considering the issues raised by the auditors.
- Where reaudit is required to make determinations, consider questioned costs unresolved until the reaudit can be completed and a final determination can be made.
- Eliminate the use of corrective action plans to allow costs when these costs represent the auditee's liability for past deficiencies.
- Consider questioned costs as being unresolved, rather than allowing them, when related to a deficiency requiring remedial action by the auditee, pending implementation of a corrective action plan addressing the deficiency.
- Limit auditee certifications to circumstances where the auditee could not be expected to have the necessary supporting documentation.

--Ensure that program officials, in accordance with OMB Circular A-50, document in writing their decisions to allow costs.

We recommend the head of each federal department and agency with an internal audit organization or OIG review that agency's audit resolution procedures and, where these deficiencies exist, implement policies and procedures to correct them.

We recommend the OMB Director ensure that these recommendations are incorporated into Circular A-50.

## CHAPTER 3

### AUDIT RESOLUTION PROCESS NEEDS MORE AUDITOR PARTICIPATION

Both federal and nonfederal auditors have a responsibility to see that their recommendations are properly resolved. According to the Comptroller General's audit resolution standard, auditors must see that their recommendations are followed up by corrective actions. Unless auditors fulfill these responsibilities, valuable time and resources spent on audit effort may be wasted by inappropriate audit resolution decisions or ineffective follow-up actions. Our standard for audit resolution contains two parts--(1) evaluating the audit finding and deciding on a course of action then (2) ensuring that corrective action has taken place. (See p. 1.) The auditor has a role in both parts of the process--a role that currently some auditors are not fulfilling.

Our review showed auditors are sometimes unaware of program officials' decisions on questioned costs or not involved in later changes to those decisions. We believe auditors need more involvement in the entire resolution process, especially

--in agreeing on a course of action and elevating disagreements to a higher official and

--determining that actions which were agreed upon have actually taken place.

### AUDITORS NEED MORE INVOLVEMENT IN RESOLVING QUESTIONED COSTS AND FINDING OUT IF ACTION WAS TAKEN

OMB Circular A-50 states that agency managers and auditors share responsibility for audit follow-up. Auditors either agree or disagree with program officials on a course of action leading to resolution of the questioned costs. Disagreements are to be settled by higher authority. However, we found audit follow-up was not always seen by either auditors or program officials as a shared responsibility, but was considered solely management's responsibility. Most auditors did not routinely review program officials' decisions on questioned costs. In fact, four of the agencies we reviewed issued final decisions on questioned costs without securing the auditors' agreement or disagreement to the action taken.

Only two of the six agencies had established procedures requiring an auditor's review of program officials' final decisions on questioned costs. The other four either did not require such review or had procedures they did not enforce consistently.

Our review also disclosed auditors were sometimes unaware that, even though program officials had agreed to the auditors'

findings and disallowed the questioned costs, these decisions were later changed and the costs allowed. Auditors need to follow up to find out that proposed corrective actions are carried out.

Our review illustrates the need for more auditor follow-up. For example, in the sample of audits we selected, we found cases in which program officials initially agreed with auditors to disallow costs. Later, program officials and appeal actions reduced the amount of disallowed costs by \$44 million.<sup>4</sup> We found IGs do not always follow up after initially agreeing with program officials on a cause of action.

According to OMB guidance, audit follow-up responsibility should go to an official who usually is a high-level agency manager outside the audit organization. The person is responsible for ensuring that

- systems of audit follow-up, resolution, and corrective action are documented and in place,
- prompt responses are made to all audit reports,
- disagreements are resolved,
- corrective actions are actually taken, and
- semiannual reports on the audit resolution process are sent to the agency head.

OMB guidance provides no follow-up role for auditors on their recommendations beyond agreeing or disagreeing on a course of action. However, under the Comptroller General's audit resolution standard, auditors are responsible for following up on audit findings and recommendations to find out whether resolution has been achieved. In 1983, in response to the Federal Managers' Financial Integrity Act of 1982, the Comptroller General issued Standards for Internal Controls in the Federal Government to guide executive agencies in establishing and maintaining internal control systems. Included, as specifically required by the Act, is the audit resolution standard which also directs that managers act promptly and responsively on all auditors' findings and recommendations. Under the standard auditors are to see that resolution has been achieved.

NEED TO CLARIFY WHEN FINDINGS  
AND RECOMMENDATIONS ARE RESOLVED

We and OMB have directed federal agencies to promptly resolve audit findings and recommendations. However, OMB's guidance focuses on the program officials' role whereas our standard focuses on the auditors' continuing responsibility. Since our standard for

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<sup>4</sup>Approximately \$25 million was reduced by program officials and the remaining \$19 million was the result of appeal actions.

audit resolution requires agency actions beyond those called for by OMB, some confusion exists about when a finding or recommendation is actually resolved.

In the opinion of the House Committee on Government Operations, hundreds of millions of dollars of debt go uncollected because agencies fail to take aggressive action to recover misspent funds after the program managers and auditors agree to specific action. The failure to take such action may be the result of agencies prematurely considering audit findings and recommendations to be "resolved" under OMB's definition.

The Committee has emphasized that audit findings be considered unresolved until the action agreed to is completed, including the recovery of any disallowed costs. However, under OMB's instructions, agencies are reporting audit findings as resolved prior to the completion of corrective actions.

OMB Circular A-50 defines audit resolution as the point at which auditors and agency management officials agree on the action to be taken on reported audit findings and recommendations, or in the event of disagreement, the point at which the audit follow-up official determines the matters are resolved. Findings and recommendations are to be resolved within a maximum of 6 months. Corrective action complying with such decisions is to proceed as rapidly as possible, and it is the responsibility of the agency's "audit follow-up official" to ensure that such action is taken.

On the other hand, under our internal control standard, issued under the Federal Managers' Financial Integrity Act, audit resolution occurs only after actions agreed to are completed within established time periods. Furthermore, under our internal control standards, the auditors are to follow up on audit findings to see they are resolved.

The Federal Managers' Financial Integrity Act of 1982 clearly expresses the Congress' intent to have us set the governmentwide standard about what steps constitute audit resolution.<sup>5</sup> The act directs the Comptroller General to prescribe standards to ensure the prompt resolution of audit findings (31 U.S.C. S 3512 (b) (2) (1982)).

Under the Act, each executive agency head establishes internal accounting and administrative controls to ensure compliance with the standards prescribed by the Comptroller General's Standards for Internal Controls in the Federal Government.

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<sup>5</sup>Hearing of the Legislation and National Security Subcommittee, House Committee on Government Operations, on the Federal Managers' Accountability Act of 1981, Mar. 11, 1981, pp. 75-76.

Given the statutory framework of the Federal Managers' Financial Integrity Act, we believe OMB should revise Circular A-50 and related agency instructions to conform to the Comptroller General's standard on audit resolution--that is, audit findings should not be considered resolved until the actions agreed to are completed. Auditors should also find out whether such resolution has been achieved. OMB should continue to require prompt agreement by program officials and auditors on a course of action with respect to question costs, but should re-define that requirement as one step in the audit resolution process.

#### AGENCIES ARE IMPROVING THEIR AUDIT RESOLUTION PROCEDURES

In each of the six agencies we reviewed, revised guidelines had already been approved or drafted, which should contribute to better audit resolution. For example, at EPA managers are not permitted to make any final decisions on questioned costs over \$100,000 until any disagreements between the IG and agency officials are settled. USDA's audit follow-up regulation states that the OIG will determine when an audit is resolved, closed, or both, and will notify program officials.

#### CONCLUSIONS

A fundamental objective of auditing is to improve the management of federal activities and functions by evaluating auditee performance and recommending actions that ensure the proper and efficient use of federal funds. Auditors' recommendations must receive proper resolution to achieve this desired result. We agree that, although audit resolution is a shared process, agency officials have the primary role. Although Circular A-50 does not fully reflect the auditor's role, under the Comptroller General's audit resolution standard, there is a follow-up role for the auditor to find out whether management takes the actions that were agreed upon.

We believe auditors should review program officials' decisions on questioned costs and ask higher-level management to settle any disagreements. Disagreements should be considered by the audit follow-up official before final letters of determination are sent to auditees. Also, auditors should be informed of program officials' decisions to reduce disallowed costs. After resolution, both program officials and auditors have a role in follow-up to find out whether the findings and recommendations, including the recovery of funds and completion of corrective action, are adequately carried out.

We agree with the Committee on Government Operations that the confusion over the definition of audit resolution has caused audit findings to be considered resolved prematurely--that is, before corrective action has taken place. We believe OMB should revise its Circular A-50 to incorporate the Comptroller General's audit resolution standard which states audit resolution is not completed until corrective action has been taken.

## RECOMMENDATIONS

We recommend the Secretaries of USDA, Education, HHS, Labor, and DOT, and the EPA Administrator ensure that disagreements between program officials and auditors over the resolution of questioned costs are considered by the audit follow-up official, as required by OMB, before a final decision is made on the case.

We recommend the head of each federal department and agency with an internal audit organization or OIG determine whether a similar problem exists in that agency, and if it does, we recommend that they take the same corrective action.

We recommend IGs and heads of internal audit organizations:

- Ensure the requirements in the Comptroller General's audit resolution standard for following up on findings and recommendations are met.
- Ensure compliance with OMB Circular A-50 requirements for reviewing program officials' responses to audit reports and reporting disagreements to the audit follow-up official.

We recommend the OMB Director revise the definition of audit resolution in OMB Circular A-50 to conform with the Comptroller General's standard.

## CHAPTER 4

### AUDITORS SHOULD PROVIDE THE CONGRESS

#### BETTER DATA ON THE AUDIT RESOLUTION PROCESS

The disparity between questioned and disallowed costs can be partly attributed to problems in the systems established for reporting audit resolution data to the Congress. These problems include

- the lack of a uniform definition of questioned cost,
- the portrayal of disallowed costs as savings, and
- the lack of uniform guidelines on the information the reports should contain.

When an audit finding moves through the resolution process, it produces three types of quantifiable information essential to understanding the results of the process. They are (1) questioned costs, (2) allowed and disallowed costs, and (3) funds returned to the government.

The Inspector General Act of 1978 (Public Law 95-452) requires an IG, in a semiannual report to the Congress, to summarize the OIG's activities. The report includes the significant problems disclosed and recommendations for corrective action, and identifies each significant recommendation made in previous semiannual reports on which corrective action has not been completed. Although all the IGs in our review include information about audit resolution in their semiannual reports, the information is not consistent. The Congress would be better informed on the results of the audit resolution process if IGs used uniform definitions of questioned cost and disallowed cost and provided more complete and uniform statistical data in their reports.

#### A STANDARD DEFINITION OF QUESTIONED COST WOULD PROVIDE THE CONGRESS MORE UNDERSTANDABLE INFORMATION

We found IGs differ in defining and categorizing questioned costs. This makes comparing data difficult; but more importantly, it provides confusing information to the Congress. Sometimes data are overstated. For example, our sample review showed that reports to the Congress overstated questioned cost by over \$61 million, or about 13 percent, mainly because IGs sometimes report questioned costs for findings that could only result in management improvements, not recovery of federal funds. Of the \$61 million we found overstated, about \$51 million was in this category. We also found cases where IGs questioned a cost in the audit report, but either did not report the cost to the Congress or classified the cost as a management improvement. Most of these latter cases were the result of oversights.

## Inconsistent definitions of questioned cost

OMB Circular A-50 does not define questioned cost or advise agencies on categorizing questioned costs for reporting purposes. Lacking this guidance, each IG defines questioned cost and many different definitions result.

During the period we audited, we identified three categories of terms IGs use to classify and report questioned costs.

(1) Cost questioned

This category is used by HHS, DOT, and EPA to report ineligible costs because a law, regulation, or grant/contract provision is violated; used by Labor and Education to report costs that are inadequately supported (unsupported) by documentation; and used by USDA to report both ineligible and unsupported costs.

(2) Cost recommended for disallowances

Labor and Education use this category to report ineligible costs.

(3) Set aside/no opinion/unresolved cost

EPA, HHS, and DOT use this category to classify unsupported costs. Only EPA reports this cost category to the Congress.

One can easily become confused by the various ways IGs categorize questioned costs. An unsupported cost can be classified as either a set aside, no opinion, unresolved, or a questioned cost depending on the particular IG. An ineligible cost can be classified as a questioned cost or a cost recommended for disallowance. The questioned cost category includes both ineligible and unsupported costs at USDA.

Also, EPA, HHS, DOT, and USDA quantify and report management improvement findings. Although implementation of such findings may save money through improved future operations, we do not consider them questioned costs. We believe questioned costs involve outlays which auditors believe should not be charged to the program, and potentially may be paid back to the government.

We believe the Congress should not have to interpret IG reports based on different classification systems. Questioned costs should be uniformly classified and the two main questioned cost categories should be reported to Congress. The two categories are:

- costs ineligible for federal participation because a law, regulation, or grant or contract provision is violated and
- costs inadequately documented at the time of the audit.

The IGs at the six agencies we audited reported ineligible questioned costs to the Congress and, with the exception of DOT and HHS, inadequately documented questioned costs. The questioned costs an IG does or does not choose to report directly affect the disparity between questioned and disallowed cost.

PORTRAYING DISALLOWED COSTS  
AS SAVINGS IS MISLEADING

In their semiannual reports to the Congress covering fiscal years 1981 and 1982, the six IGs we reviewed reported about \$217 million of disallowed costs for the cases we reviewed. However, we consider that a maximum of \$156 million, or 72 percent, are potential savings to the government. This rate is probably too high, however, because a portion of the total amount is under appeal. The potential return may be further reduced through acceptable reduction actions under the Federal Claims Collection Standards.<sup>6</sup>

Five of the six IGs we reviewed do not inform the Congress that disallowed costs may be reduced or revised, and four IGs still portray disallowed cost as government savings. However, actual savings only occur when funds are recovered or withheld from the auditee. The use of disallowed costs in IG reporting systems is shown in the following examples:

Case 1

For DOT, disallowed cost represents "measurable dollar savings or quantifiable improvements." However, in a report we issued in August 1983,<sup>7</sup> we found that of \$126 million the IG reported as potential savings from 60 reports issued between October 1979 and March 1982, only \$44 million had been recovered. Action on more than \$23 million was still pending, and no action had been taken on the remaining \$59 million.

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<sup>6</sup>The Federal Claims Collection Standards, issued jointly by the Comptroller General and the Attorney General under section 3 of the Federal Claims Collection Act of 1966 (31 U.S.C. 3711), prescribe standards for the administrative collection, compromise, termination of agency collection, and the referral to us and the Department of Justice for litigation, of civil claims by the federal government for money or property. The standards describe the circumstances in which government claims may be disposed of for less than the full amount claimed.

<sup>7</sup>Review of Selected Operations of the Department of Transportation's Office of Inspector General (GAO/RCED-83-116, Aug. 23, 1983).

## Case 2

HHS calls disallowed cost, "cost savings," even though in our sample over 63 percent of their disallowed cost from fiscal years 1981 and 1982 were actually under appeal. Appeals may take years to resolve and can result in a decision favorable to the auditee, thereby negating the auditee's debt.

## Case 3

EPA terms disallowed cost, "measurable cost benefits." However, of \$3.1 million reported in our sample as savings for fiscal years 1981 and 1982, \$1.9 million, or 61 percent, had been recovered or withheld from the auditee as of October 1983. Most of the outstanding disallowed cost was either under appeal or uncollected.

## Case 4

USDA reports disallowed cost as part of "total savings or cost avoidance" even though, during a recent reporting period, over \$13 million of their audit debt was either waived, compromised, or reduced for other reasons.

As these examples illustrate, disallowed costs are generally portrayed as savings. However, disallowed cost is not savings. According to the OMB definition, disallowed cost is incurred cost questioned by the audit organization which management has agreed should not be charged to the government. While OMB defines disallowed cost, it does not provide a definition of savings.

Most IGs use different terms that portray disallowed cost as government savings, cost avoidance, or measurable benefits. We have made a similar point before in our reviews<sup>8</sup> of reports prepared by the President's Council on Integrity and Efficiency (PCIE), which was established by executive order in March 1981 to strengthen the IG program and spearhead the administration's campaign to reduce fraud and waste in federal programs and operations. Every 6 months the Council publishes a report that highlights the IGs' governmentwide activities; it is intended to provide a basis for ensuring the influence and effectiveness of these organizations. The PCIE report currently uses a category titled "management commitments to seek recoveries and adjustments," which we believe directly parallels disallowed cost. PCIE reports previously labeled this category "audit recoveries," which, as our reviews and the previous discussion have shown, is misleading.

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<sup>8</sup>Validity and Comparability of Quantitative Data Presented by the President's Council on Integrity and Efficiency on Inspectors General Activities (GAO/AFMD-82-78, May 18, 1982) and Budget Implications of Savings Reported in the Third Summary Report Issued by the President's Council on Integrity and Efficiency (GAO/AFMD-83-14, Oct. 18, 1982).

The difference between management commitments and recoveries during a reporting period can be significant. For example, during a recent reporting period, USDA and Education listed management commitments of almost \$45 million but recovered \$8 million, or less than 18 percent of the reported commitments.

#### Audit-related debt collection information should be reported

We believe the IGs' semiannual reports should also contain the amounts of audit-related debt returned to the government but only USDA, HHS, and Education now report these amounts.

OMB Circular A-50 gives an agency-designated audit follow-up official responsibility for ensuring development and implementation of systems to track monetary collections resulting from audits. This requirement went into effect in September 1982, but not all agencies have implemented such a system.

Although IGs are not responsible for maintaining records about monetary collections, this information could be furnished by the audit follow-up official to the IGs for inclusion in the IGs' semiannual reports. USDA already does this. Its audit-resolution regulation requires program offices to provide the IG with data on the status of collections arising from audits. The IG then incorporates the data into the semiannual report.

#### AUDIT RESOLUTION INFORMATION NEEDS TO BE COMPLETE AND UNIFORM

Although the Inspector General Act of 1978 requires semiannual reports, the Congress allows the IGs to determine how to report information required by the act. As we said earlier, IGs at the agencies we reviewed discuss audit resolution but there is no consistency in the information reported. We believe more audit resolution information needs to be reported; and to be of the greatest use, this information should be reported uniformly by all IGs.

Although the act does not provide specific guidance on what information to report, the Senate Committee on Appropriations has requested certain information. In its report on the Supplemental Appropriations and Rescission Act of 1980, the Committee directed IGs to summarize unresolved audits in their semiannual reports to the Congress. The summary should report on two categories of information: unresolved audits at the beginning of the reporting period and audits issued during the period. Information provided to the Congress should include the age of the unresolved audits, the number of audits issued, amount of questioned costs, number resolved during the period, and the amounts of money allowed, disallowed, and returned to the government.

None of the six IGs provide all the information the Committee requested. While all six IGs provide varying degrees of information on questioned and disallowed cost, only USDA, HHS, and Education provide information on amount of audit-generated debt actually returned to the government.

The following table, based on the semiannual reports for the 6 agencies we reviewed, shows the need for compliance with reporting requirements and more uniform reporting of data. The table summarizes the Committee's information needs and compares those needs to the information provided.

<u>Type of information requested</u>	<u>Information provided</u>					
	<u>EPA</u>	<u>USDA</u>	<u>Education</u>	<u>Labor</u>	<u>DOT</u>	<u>HHS</u>
Unresolved audits at start of period and audits issued during period, as 2 separate categories	Yes	No	No	No	No	No
Age of unresolved audits beginning of period	Yes	No	No	No	No	1
Number of audits resolved during period	Yes	Yes	Yes	Yes	Yes	No
Amount of questioned cost	Yes	Yes	Yes	Yes	2	2
Amount of disallowed cost	Yes	Yes	Yes	Yes	Yes	Yes
Amount of actual recoveries	No	Yes	Yes	No	No	Yes

<sup>1</sup>For period we examined HHS reported no unresolved audits at the beginning of the period.

<sup>2</sup>DOT and HHS do not report unsupported questioned costs.

CONCLUSIONS

Data reported to the Congress do not adequately or accurately reflect the results of the audit resolution process. The problem is partly definitional and partly the result of incomplete reporting.

While OMB provides a clear definition of disallowed cost, none is provided for questioned cost or savings. Lacking guidance, IGs define these terms in their own ways, and some definitions of questioned cost are inconsistent with each other.

Not all IGs use the OMB definition of disallowed cost. Some IGs use terms that inappropriately portray the amount of disallowed

cost as a savings to the government. However, disallowed cost merely represents an incurred cost questioned by auditors, which management has decided should not be charged to the government, and it is only an interim point in the audit resolution process. As such, disallowed cost frequently changes, but the Congress is not informed of this. Savings do not occur until funds are actually returned to the government. Although IGs do not track amounts returned to the government, their agencies are required to maintain systems to accumulate this type of data and should be able to provide the information to the IGs.

In our opinion, using uniform definitions and a uniform reporting format would enhance the comparability of audit resolution information. Comparability helps to contrast audit resolution results among agencies and also within an agency. Thus, it assists the Congress in measuring agency progress on resolving audit recommendations and federal agencies in exercising audit resolution responsibilities.

### RECOMMENDATIONS

In order to provide the Congress with more complete and uniform audit resolution data, we recommend the OMB Director revise Circular A-50 to

- establish standard definitions of questioned cost and savings for reporting purposes and
- assign responsibility to agency audit follow-up officials for providing IGs with the results of collection action taken on audit-related debt.

In accordance with standard OMB definitions, we recommend IGs

- report all information requested by the Senate Committee on Appropriations contained in their report on the Supplemental Appropriations and Rescission Act of 1980 and
- clearly state that reported disallowed cost is subject to reduction.

ADDITIONAL DETAILS ON SCOPE AND METHODOLOGY

At the six agencies we evaluated, we used agency-supplied universe data of audits with total monetary findings of at least \$25,000. At some agencies, we limited our review to major agency programs such as the Labor Department's Comprehensive Employment and Training Act (CETA) program and the USDA's Food and Nutrition Service. Some of the audits we analyzed were performed by predecessor audit organizations before OIGs were established.

Our sample of 325 audits was selected from 10 agency locations that were geographically dispersed. We sampled the work of two regional offices each from USDA, EPA, HHS, and DOT; one Labor regional office; and Education's headquarters office. Each individual sample consisted of approximately 35 audits - 25 drawn randomly and 10 drawn based on the highest dollars of questioned costs after the random drawing. Exceptions include EPA-Atlanta where the sample was 36 cases, DOT-New York where the sample was 32 cases, and USDA-Hyattsville, Maryland, where the sample was 12 cases. The sample's details are found on pages 6 and 32.

Within each audit in our sample, we examined up to three individual findings of \$10,000 or more from both the questioned costs and unsupported cost categories. However, if the audit report contained more than three such findings, we examined only three. Altogether, we evaluated 586 decisions totaling about \$677 million from a universe of 19,161 audits totaling about \$1.8 billion in questioned costs. We also examined how accurately the OIG's reporting system recorded the data from each sample case and how that data was presented in the OIG's semiannual reports to the Congress.

Audit Resolution<sup>a</sup> of Our Sample Cases for Six Federal Agencies  
by Type of Auditor for FY 1981 and 1982

<u>Type of auditor</u>	<u>Number of audits</u>	<u>Percent of all agency audits reviewed</u>	<u>Amount of resolved costs</u>	<u>Amount of allowed costs</u>	<u>Amount of costs disallowed</u>	<u>Percent of resolved costs allowed</u>	<u>Percent of resolved costs disallowed</u>
			----- (millions) -----				
OIG	164	50.5	\$493.7	\$315.9	\$177.8	64	36
Other federal	25	7.7	94.5	81.6	12.9	86	14
Independent public accountants	108	33.2	75.2	66.1	9.1	88	12
State and local governments	<u>28</u>	<u>8.6</u>	<u>13.6</u>	<u>6.6</u>	<u>7.0</u>	49	51
Total	<u>325</u> =====	<u>100.0</u> =====	<u>\$677.0</u> =====	<u>\$470.2</u> =====	<u>\$206.8</u> =====	69	31

<sup>a</sup>"Audit resolution" as defined by OMB.

DATA ON MONETARY AUDIT FINDINGS RESOLVED  
DURING FISCAL YEAR 1983 BY CIVILIAN AGENCIES<sup>a</sup>

<u>Agency</u>	<u>Number of audit reports</u>	<u>Resolved questioned costs</u>	<u>Allowed costs</u>	<u>Disallowed costs</u>
		- - - - -(millions) - - - - -		
USDA	1161	\$413.89	\$269.78	\$144.11
Commerce	409	33.16	21.37	11.79
Education	2361	111.60	48.80	62.80
Energy <sup>b</sup>	660	13.99	7.36	6.63 <sup>e</sup>
HHS	728	250.56	28.22	222.34
Housing and Urban Development	781	199.18	87.75	111.43
Interior	109	12.50	6.57	5.93
Justice	159 <sup>c</sup>	7.13	6.51	.62 <sup>e</sup>
Labor	728 <sup>d</sup>	181.83	94.13	87.70
State	2	.05	.03	.02
DOT	395	179.40	47.56	131.84
Treasury	2	.04	.00	.04
Agency for International Development	70	16.10	6.47	9.63
EPA	1664	25.02	5.73	19.29
General Services Adminis- tration	87	17.01	6.90	10.11
National Aeronautics and Space Administration	252	21.40	8.85	12.55
Small Business Administra- tion	4	.03	.00	.03
Veterans Administration	11	18.22	.05	18.17
Office of Personnel Management	28	12.59	7.51	5.08
Total	<u>9611</u>	<u>\$1513.70</u>	<u>\$653.59</u>	<u>\$860.11</u>

- <sup>a</sup>"Audit resolution" as defined by OMB. Data were gathered by a data collection instrument which agencies completed. EPA provided its data by computer tape. The data include audit reports prepared by OIGs, other federal auditors, independent public accountants, and state and local auditors. We did not audit this data. As stated in chapter 4, IGs do not use uniform definitions of questioned costs and disallowed costs. Data are qualified by footnotes.
- <sup>b</sup>All data are based on the year audits entered the Department of Energy's follow-up system, not on year they were resolved. Data include monetary, nonmonetary, and interim audits, and estimates.
- <sup>c</sup>Includes interim and final audit reports. Some final reports may not include monetary findings.
- <sup>d</sup>Data are based on date report was issued, not on date resolved.
- <sup>e</sup>Represents recovered costs.

EXAMPLES OF CASES WE REVIEWEDEXAMPLES OF ALLOWANCES WE QUESTIONPlanned reaudit

- In an audit of an EPA grant to the Van Buren Board of County Road Commissioners in Michigan, auditors questioned about \$166,000 because access to records was denied and financial procedures were questionable. Agency managers allowed the costs based on plans to reaudit once access to records was obtained. We believe allowing costs based on a planned reaudit is improper because the proposed subsequent reaudit may never be performed or may not address the original questioned costs.
- An OIG audit of a USDA Food and Nutrition Service grantee questioned about \$1.2 million in reimbursement claims because of problems in the grantee's accounting system. Program officials allowed the costs based on a proposed reaudit which we believe is improper for the reasons stated in the previous case.

Corrective action plan

- DOT's audit of Westchester County, New York, questioned a grant of over \$150,000 used to purchase bus stop signs which had not been installed. Program officials allowed the costs. The grantee was asked to provide within 6 months a detailed inventory list and certification of which signs were being used. Although more than a year had passed since that decision, the grantee had not furnished the list. Thus, program officials did not know if the signs were installed, but had taken no action to recover the costs. We believe the corrective action plan was not effective in getting the desired results. We believe the procedure to allow the costs was questionable because the costs should not have been allowed until the planned corrective action had taken place.
- A Department of Education audit questioned over \$1.9 million in loan funds. Collection of over \$1.8 million in loans was doubtful due to the auditee's poor collection practices and over \$60,000 in loan funds were retained by collection agencies as fees, which the auditors believed was prohibited by the program regulations. Although no corrective action plan was developed, program officials disallowed only \$32,000 of the funds because they believed the auditee was making a good effort to correct past deficiencies and some retention of collections by a collection agency is not unusual. We believe that allowing cost without a formal corrective action plan that documents the auditee's remedial actions tied to deadlines, is a questionable procedure.

Eligibility of costs

- In an EPA audit, the OIG questioned about \$765,000 because the grantee incurred the costs before the grant award. The grantee stated the costs were incurred at EPA's request and, therefore, should be eligible for grant participation. The grantee requested a waiver of the questioned costs, but program officials decided the waiver was unnecessary because, based on agency policy, the costs were eligible. The costs were allowed although an agency headquarters official stated the agency had no written policy making the costs eligible. Program officials could not cite the agency policy which regarded the costs as eligible. We consider the procedure to allow the costs questionable because program officials did not adequately explain why the costs were eligible.
- In the Department of Labor's CETA program, program officials can allow questioned public-service employment costs under certain conditions, one of which is that the magnitude of the cost allowed cannot be substantial. However, the regulation did not specify how to determine what is "substantial." This provision was used in one audit to allow about \$18.2 million in costs questioned because Honolulu, the CETA grantee, could not document the eligibility of program participants. We question the procedure used because program officials did not adequately explain how they decided \$18.2 million was not a substantial amount of money.
- A Department of Education audit of the Puerto Rico Department of Education questioned about \$12.3 million in expenditures because the auditors said program requirements were violated. The total amount was recorded as allowed. The auditee filed about a \$12.3 million lawsuit over another unrelated issue. Without adequately addressing the substantive issue raised by the auditors the agency negotiated a settlement agreement which provided that the auditee would drop the lawsuit and the Department would not disallow the questioned costs. We question the decision to regard these costs as allowed. By characterizing the costs as allowed, for purposes of the settlement, program managers undermine the validity and integrity of the auditors' original determination that the government should not be charged these amounts. We believe that since program officials never made a decision disagreeing with the audit findings, the questioned costs should have been reported as disallowed. In this case, it would also be appropriate to report why the amounts were not recovered--that is, they were used to settle an unrelated suit with the grantee.

Administrative decision

- In three audits of a Metropolitan Atlanta Rapid Transit Authority construction project funded by DOT, transportation auditors questioned about \$10.5 million and classified as unauditible about \$5.9 million, primarily for improprieties

in allocating project costs. Program officials allowed the costs. According to officials, under the contract terms the government would not participate in costs above a specified limit which the contractor was expected to exceed. Consequently, the amount of questioned and unaudited costs, if sustained, would not likely result in funds returned to the government. We question the procedure used in this case because the findings were not resolved based on the issues raised by the auditors. We believe the integrity of the audit finding requires that the propriety of the costs be determined, even if the amounts cannot be recovered.

--An audit of a grant made by HHS's Office of Human Development Services (OHDS) questioned \$17,000 because the grantee failed to satisfy matching requirements. OHDS officials allowed the costs because the grantee had been terminated. We question this procedure because OHDS officials did not determine the cost's allowability but decided instead on the basis of the termination, although the grantee might have owed money to the government.

--In an HHS audit of a National Institutes of Health (NIH) contractor, auditors reported a hospital under contract did not document about \$34,000 in costs related to salaries and wages. The costs were initially charged to other activities and subsequently transferred to this contract. The auditors questioned whether the costs were distributed accurately. NIH program officials allowed the costs, which they said resulted from "system deficiencies." We question the procedure used to allow the costs because it inadequately dealt with the auditee's deficiency that was the basis for the auditors' original questioning of the costs.

--In an audit of a Department of Education grantee, program officials allowed over \$200,000 in findings because another office in the Department was investigating the case. We believe the audit should not have been closed until a determination could be made based on the case's merits.

#### itten justification

--A CPA audit of an EPA grantee questioned \$72,593 in grantee costs because during the final inspection EPA engineers had determined the costs were ineligible. The costs were related to equipment which had not been operated in 4 years. The grantee disagreed with this assessment. Program officials notified the grantee on two occasions they agreed with the auditors' assessments that the costs were ineligible. In the final determination letter to the grantee, however, the program official stated that these costs were eligible for EPA reimbursement. We question this procedure because we could not find documentation to support EPA's basis for allowing the costs. EPA officials said they remembered

negotiating with the grantee over several months and finally reinstated the costs. However, no documents were available to support this decision.

#### Documentation or auditee certifications

- In an audit of a Department of Education grantee, agency auditors could not decide the reasonableness of about \$13.1 million in expenditures because the grantee had an inadequate financial management system. But program officials allowed the costs, based on reconstructed workpapers submitted by the auditee, even though the auditors found numerous problems with the grantee's data when they examined it. We believe the procedure to allow the costs was questionable because, in our opinion, program officials did not adequately address the auditors' issues.
- In a Department of Education audit, auditors questioned over \$5 million in contract expenditures by the University of Pittsburgh because it did not meet federal requirements for supporting documentation. Resolution officials allowed the costs when the university certified the costs were accurate, valid, and commensurate with work performed. We question the use of certifications in lieu of records which the auditee was required to maintain.

#### EXAMPLES OF AUDITOR ERRORS

- A city auditor conducting an audit of the Human Resources Administration in New York City made a mistake in calculating the amount of an HHS grantee's in kind contributions which caused the auditor to overstate the questioned costs by \$993,000. Program officials originally sustained the costs, but afterward discovered the error and reduced the disallowance by the amount of the error.
- An OIG audit of the Wisconsin Department of Natural Resources, an EPA grantee, questioned \$69,710 of grantee costs because the grantee failed to obtain prior approval for certain purchases. Later, in a memo to program officials, the OIG stated that these costs were questioned as a result of an error by the auditor.



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