

GAO

Report to the Chairman, Committee on
Governmental Affairs, U.S. Senate

June 1994

SINGLE AUDIT

Refinements Can Improve Usefulness



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United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-257377

June 21, 1994

The Honorable John Glenn
Chairman, Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

This report discusses the influence of the Single Audit Act of 1984 on the financial management practices of selected state and local governments and recommends ways to improve the Act's usefulness. Our recommendations address the criteria for determining the entities and programs subject to single audit, the content and publication of single audit reports, and the impact of single audit reports. We are making recommendations to the Congress, the Secretary of the Department of Commerce, and the Director of the Office of Management and Budget.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the date of this letter. At that time, we will send copies of this report to all Members of the Senate Committee on Governmental Affairs and the House Committee on Government Operations as well as to other congressional committees and the Director of the Office of Management and Budget. We will make copies available to others upon request.

This report was prepared under the direction of David L. Clark, Jr., Director, Legislative Reviews and Audit Oversight Issues, who may be reached at (202) 512-9489, and Jerry C. Skelly, Assistant Director, Legislative Reviews and Audit Oversight Issues, who may be reached at (202) 512-9982 if you or your staff have any questions. Major contributors to this report are listed in appendix V.

Sincerely yours,

A handwritten signature in black ink that reads "Charles A. Bowsher". The signature is written in a cursive, flowing style.

Charles A. Bowsher
Comptroller General
of the United States

Executive Summary

Purpose

In 1993, the federal government provided \$195 billion to over 21,000 state and local government entities through more than 1,300 federal financial assistance programs. The single audit process, formalized in the Single Audit Act of 1984, is an important means by which the Congress, federal oversight officials, and program managers obtain information on whether the recipients of federal financial assistance properly account for the federal funds they receive, maintain adequate internal controls over those funds, and comply with federal program requirements. The Chairman, Senate Committee on Governmental Affairs, asked GAO to (1) illustrate the influence of the Single Audit Act of 1984 on the financial management practices of state and local government entities receiving federal funds, (2) identify issues that burden the current single audit process and limit the usefulness of single audit reports, and (3) develop workable solutions to improve the single audit process.

Background

In the early 1980s, the Congress became increasingly concerned about a basic lack of accountability in the federal financial assistance provided to state and local entities. That assistance grew from 132 programs costing \$7 billion in 1960 to over 500 programs costing nearly \$95 billion by 1981. In 1984, the Congress passed the Single Audit Act, which promoted more uniform, entitywide audit coverage than was achieved under the previous grant-by-grant audit approach. However, concerns about accountability over federal financial assistance have persisted under the single audit process.

We surveyed users of single audit reports, discussed the single audit process with representatives of state and local governments and other organizations, analyzed a sample of reports, and conducted research to identify issues to be addressed. Our analysis provided the foundation for developing proposals in February 1994 to improve the single audit process. We presented our proposals to federal program managers and representatives of state and local governments and other organizations who have a stake in the single audit process and considered their comments in developing our recommendations.

Results in Brief

According to state and local government officials GAO interviewed, the single audit process has contributed to improving their entities' financial management practices. They have installed new accounting systems, begun having annual comprehensive financial statement audits, adopted or accelerated the adoption of generally accepted accounting principles,

improved systems for tracking federal funds, strengthened administrative controls over federal programs, and increased oversight of entities to whom they distributed federal funds.

Despite these reported improvements, a number of issues burden the single audit process, hinder the usefulness of its reports, and limit its impact. Specifically, under the Act, entities and programs are selected for audit based on prescribed dollar thresholds, which have not changed since passage of the Act. Because the thresholds have not changed, many entities receiving relatively small amounts of federal assistance are subject to single audit, and many programs considered highly vulnerable to fraud, waste, and abuse are not. In addition, the Office of Management and Budget's (OMB) guidance for auditors conducting single audits has not been updated regularly.

According to oversight officials and program managers, several issues hinder the usefulness of single audit reports. Because the reports do not include summaries of the auditors' conclusions, the most important findings are not highlighted. In addition, single audit reports are to be issued within 13 months of the end of the period under review, but this time frame limits the usefulness of the reports to oversight officials and program managers. Entities' managers do not report on the adequacy of their internal control structures, thus limiting accountability over controls. The single audit reports also do not emphasize the federal government's strong and continuing interest in the results of single audits, and they include many findings that are clearly inconsequential.

Finally, the results of single audits are not being summarized or compiled so that oversight officials and program managers can easily access and analyze them to gain programwide perspectives and identify leads for follow-on audit work or program oversight.

GAO's Analysis

The Single Audit Act Has Contributed to Better Financial Management

The Single Audit Act has encouraged state and local government entities to review and revise their financial management practices. GAO visited 10 entities whose efforts to comply with the requirements of the Act led to numerous financial management improvements. Examples of improvements include the (1) institution of annual financial statement

audits in several entities, (2) installation of new accounting systems or enhancements of old ones, and (3) implementation of subrecipient monitoring systems.

Criteria for Determining Auditable Entities and Programs Have Not Changed

The criteria for determining which entities and programs are to be audited is based solely on dollar amounts, which have not changed since the Act's passage 10 years ago. Dollar thresholds were designed to ensure adequate audit coverage of federal funds without placing an undue administrative burden on entities receiving smaller amounts of federal money. In 1984, the criteria for entities ensured audit coverage for 95 percent of all direct federal assistance to local entities. Today, the same criteria cover 99 percent of all federal funds. If the thresholds were raised, audit coverage of 95 percent of federal funds could be maintained while exempting up to an additional 3,900 entities from the annual federal audit requirement.

The selection criteria for programs does not consider all risk factors. Thus, it does not always ensure that programs handling billions of dollars in federal assistance and identified by OMB as being high-risk receive any audit coverage. OMB's guidance for auditors conducting the single audits (the Compliance Supplement) does not reflect all current legal and program requirements because it has not been updated since 1990. If it were revised more regularly, it could help ensure that auditors examine the right areas and test compliance with the appropriate requirements.

Usefulness of Single Audit Reports Is Limited

Single audit reports contain a series of as many as seven or more separate reports, and significant information is scattered throughout the separate reports. If single audit reports had a summary of the auditor's conclusions highlighting the most important findings, users could find key information more easily.

Entities have 12 months from the end of the fiscal year to complete their single audits and another 30 days after completion of the audits to publish their reports. Of the officials we surveyed, 84 percent of the federal program managers and 64 percent of the state program managers believe this 13-month time frame is excessive. In fiscal year 1991, 44 percent of state and local entities were able to submit their reports within 9 months after the end of their fiscal years. At least 80 percent of the program managers interviewed supported shortening the reporting time frame to 9 months or less.

Program managers also told GAO that the single audit reports' usefulness would be enhanced by adding a manager's report on the entity's internal control structures and by addressing the report jointly to the audited entity and a federal agency. Requiring entity officials to report on their internal controls over federal programs would assist auditors in evaluating the entity's management of its programs. In addition, having joint addressees would underscore the federal government's strong and continuing interest in the results of single audits.

Finally, guidance leads auditors to report all findings in their single audit reports, no matter how inconsequential the findings may be. The reports could be made more useful for oversight officials and program managers if auditors were allowed to omit small clerical errors that do not indicate improper conduct or internal control failures.

Access to the Results of Single Audits Is Limited

GAO and offices of inspector general (OIGs) found that single audit reports contain meaningful information on entities' financial status and management of federal funds and provide leads for follow-on work. However, oversight officials and program managers do not have ready access to this information because many entities that receive funds indirectly from federal programs are not required to send the agencies copies of their single audit reports, and no one in federal or state government is tasked with compiling a centralized database on the results of single audits. Furthermore, the form and content of single audit reports has not been standardized to facilitate such a database compilation.

Recommendations

GAO is making specific recommendations to the Congress, Secretary of the Department of Commerce, and Director of the Office of Management and Budget to (1) change the criteria for selecting which entities and programs should be subject to single audit, (2) revise the form, content, and publication of single audit reports, and (3) improve oversight officials' and program managers' access to the results of single audits. The recommendations are provided at the end of chapters 3, 4, and 5.

Stakeholders' Response to GAO's Proposals

Most of the federal managers GAO interviewed supported its proposals to improve the single audit process. Most OIG officials who commented on GAO's proposals also supported the changes. Representatives of other stakeholder groups supported some of GAO's proposals, offered qualified support on other proposals, and opposed some of the suggested changes. Stakeholder responses are presented at length in the report after the discussion of each proposal.

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Abbreviations

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|--------|---|
| AICPA | American Institute of Certified Public Accountants |
| FDICIA | Federal Deposit Insurance Corporation Improvement Act |
| FCPA | Foreign Corrupt Practices Act |
| FMFIA | Federal Managers' Financial Integrity Act |
| FTA | Federal Transit Administration |
| GAAP | generally accepted accounting principles |
| GAO | General Accounting Office |
| GFOA | Government Finance Officers Association |
| HHS | Department of Health and Human Services |
| NASC | National Association of State Comptrollers |
| NSAA | National State Auditors Association |
| OIG | Office of Inspector General |
| OMB | Office of Management and Budget |
| SBA | Small Business Administration |
| SFFA | Schedule of Federal Financial Assistance |

Introduction

In 1993, over 1,300 federal financial assistance programs provided \$195 billion to about 21,000 state and local government entities. The single audit process is an important vehicle in informing federal oversight officials and program managers about state and local government stewardship of federal financial assistance. This process has fostered significant financial management improvements in many state and local entities.

The nearly 10 years of experience have shown that refinements can be made to strengthen the Act's usefulness.¹ This report examines the single audit process, highlights some of the key financial management improvements it has fostered, and discusses opportunities for improvement.

Background

During the 1970s, the poor accounting practices of state and local governments put into question the security of federal funds provided to those governments. New York City, for example, consistently overestimated its revenues, underestimated its expenses, never knew how much cash it had on hand, and borrowed repeatedly to finance its deficit spending.² Studies of local governments' financial reporting during the 1970s found a multitude of conflicting accounting bases and frequent omissions of key data which, under today's generally accepted accounting principles (GAAP), are required for meaningful financial disclosure.

In addition, several studies found that many local governments were not receiving independent audits. For example,

- a 1976 study by a major accounting firm found that approximately one-half of the larger cities did not receive financial statement audits,
- a 1979 study by the Council on Municipal Performance found that only 26 states vigorously enforced requirements that local governments receive audits in accordance with generally accepted auditing standards, and
- a 1979 study by a nonprofit accounting group found that only 30 percent of its sampled local governments in New York state had financial statements which had been examined by an independent auditor.

¹The National State Auditors Association issued a position paper on the single audit process in February 1993. The President's Council on Integrity and Efficiency Standards Subcommittee issued a report on improving the single audit process in September 1993.

²Since 1975, when its financial problems came to light, New York City has adopted GAAP and significantly improved its financial management.

In the early 1980s, the problems with state and local governments' accounting and auditing practices were of particular concern to the Congress, given the rapid rise in the amount of federal funds flowing to state and local governments. In 1984, federal financial assistance to state and local governments had grown to \$97 billion, more than doubling from what it was a decade before.

The federal government relied on grant audits to help gain assurance that state and local governments were properly spending federal financial assistance. These grant audits focused on whether the transactions of individual grants complied with program requirements. The audits usually did not address the entity's financial controls and were, therefore, unlikely to find systemic problems with an entity's management of its funds. Because programs established their own audit requirements, there were over 80 different audit guides.

Further, grant audits were conducted on an irregular, haphazard schedule, which resulted in large portions of federal funds being unaudited each year. The auditors conducting grant audits did not coordinate their work with the auditors of other programs. As a result, some entities were subject to numerous grant audits each year while other entities were not audited for long periods.³

The concept of the "single audit" was to replace multiple grant audits with one audit of an entity as a whole. The intent was to eliminate both the duplication that comes from having several different audits at the same entity and the gaps in audit coverage caused by haphazard audit schedules.⁴ Rather than being a detailed review of individual grants or programs, the single audit is an organizationwide financial and compliance audit that focuses on accounting and administrative controls. The single audit was meant to advise federal oversight officials and program managers on whether an entity's financial statements are fairly presented and to provide reasonable assurance that federal financial assistance programs are managed in accordance with applicable laws and regulations.

³For more information on problems with grant audits, see *Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling* (FGMSD-79-37, June 16, 1979).

⁴The Office of Management and Budget tried to administratively implement the single audit concept in 1979 by issuing Attachment P to Circular A-102. However, many entities did not follow this administrative requirement, and grant-by-grant auditing continued until single audits were mandated by the Single Audit Act of 1984.

Key Objectives and Requirements of the Single Audit Act

The objectives of the Single Audit Act are to

- improve the financial management of state and local governments receiving federal financial assistance;
- establish uniform requirements for audits of federal financial assistance provided to state and local governments;
- promote the efficient and effective use of audit resources; and
- ensure that federal departments and agencies, to the extent practicable, rely upon and use audit work done pursuant to the Act.

The Act requires each state and local entity that receives \$100,000 or more in federal financial assistance (either directly from a federal agency or indirectly through another state or local entity) in any fiscal year to undergo a comprehensive, "single" audit of its financial operations. The audit must be conducted by an independent auditor on an annual basis, except under specific circumstances where a biennial audit is allowed.⁵ The Act also requires entities receiving between \$25,000 and \$100,000 in federal financial assistance to have either a single audit or the financial and compliance audits required by the programs which provided the federal funds.⁶

Further, where state and local entities provide \$25,000 or more in federal financial assistance to other organizations ("subrecipients" of federal funds) they are required by the Act to monitor those subrecipients' use of the funds. Under the Act, this monitoring can consist of reviewing the results of each subrecipient's audit and ensuring that corrective action is taken on audit findings.

The auditor's responsibilities in conducting a single audit are to determine and report on whether (1) the entity's financial statements are presented in accordance with generally accepted accounting principles, (2) the entity's internal control systems provide reasonable assurance that federal funds are being managed in accordance with applicable laws and regulations, and (3) the entity complied with laws and regulations that may have a material effect on its financial statements or on its major federal assistance programs, as defined by the Act.

⁵Entities may arrange for biennial single audits if they were required by constitution or statute in effect when the Single Audit Act was enacted to conduct their audits less frequently than annually. They may also arrange for biennial single audits if the requirement for such less frequent audits was administrative, if they codified by January 1, 1987, a requirement for biennial audits. In either case, audits conducted biennially are to cover both years within the audit period.

⁶State and local entities receiving less than \$25,000 in federal funds in any fiscal year are not required to have an audit.

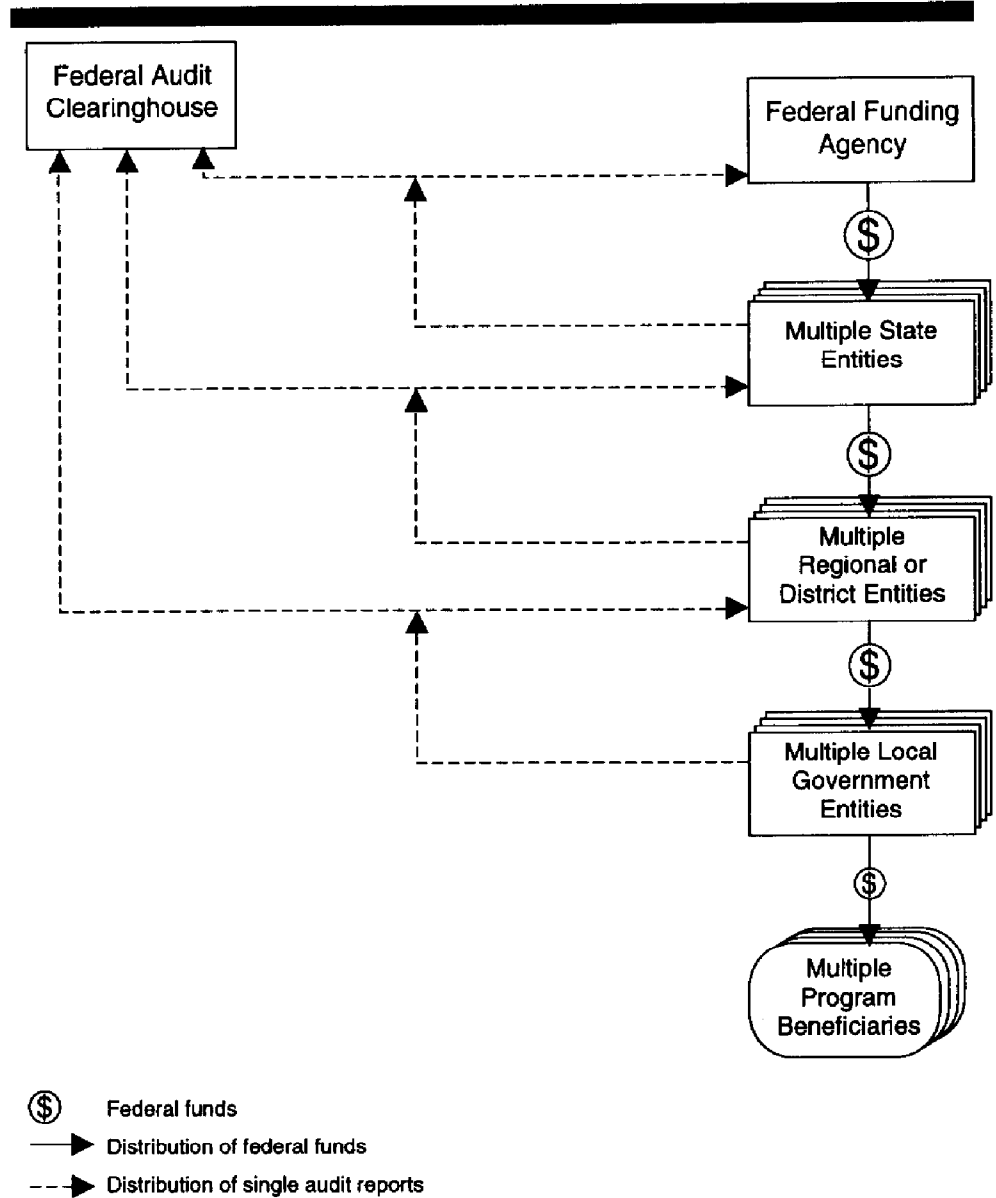
Reporting the Results of Single Audits

A single audit report conveys the results of an entity's audit to the federal government, other state and local entities, and the public. The single audit report consists of financial information prepared by the entity (primarily its general purpose financial statements and Schedule of Federal Financial Assistance) and the auditor's reports on the audit results. Under Office of Management and Budget (OMB) Circular A-128, which provides implementing guidance for the Act, recipients of federal funds are to submit copies of their reports to each federal agency that provided assistance, and subrecipients are to submit copies to the recipients from which they received federal funds. OMB Circular A-128 also requires recipients of more than \$100,000 in federal assistance to submit their single audit reports to the Federal Audit Clearinghouse in the Bureau of the Census.

Federal funds often flow from federal funding agencies to their ultimate beneficiaries through multiple state and local entities, but the entities' single audit reports are not always intended to flow back through the levels of distribution to federal oversight officials and program managers. (See figure 1.1.) If the entity under audit receives no direct federal funds, it is not required to send its single audit report to a federal funding agency. Many of the entities in the distribution chain do not get direct federal financial assistance; the funds arrive from other state and local entities.⁷

⁷Federal agencies may also send funds directly to entities below the state level. Entities which receive more than \$100,000 in federal assistance must submit copies of their single audit reports to the Clearinghouse.

Figure 1.1: Distribution Chain of Federal Funds and Single Audit Reports



Objectives, Scope, and Methodology

We conducted our review of the implementation of the Single Audit Act of 1984 in response to a request by the Chairman of the Senate Committee on Governmental Affairs. The objectives of our work were to (1) illustrate how the Act influenced the financial management practices of state and local government entities receiving federal funds, (2) identify issues that

burden the single audit process and limit the usefulness of single audit reports for overseeing federal funds, and (3) develop workable solutions to improve the single audit process.

To illustrate how the Act influenced financial management practices, we visited 10 state and local government entities whose officials said that the Act had helped bring about financial management improvements in their entities' operations. Specifically, we interviewed officials in the states of Georgia, Maine, Mississippi, Texas, and West Virginia; the counties of Hamilton, Tennessee, and Wake, North Carolina; the cities of Chicago and Los Angeles; and the Board of Education in Dalton, Georgia.

We judgmentally selected these entities because their managers believe that they have made financial management improvements in response to the Act and because they represent various geographic regions throughout the country. We discussed the reported improvements and the Act's influence on financial management practices with the entities' managers and auditors, reviewed the entities' single audit reports and related documents, and obtained views of officials in federal offices of inspector general about the entities' financial management improvements relative to single audits. Because comprehensive data on the condition of state and local financial management before passage of the Single Audit Act were not available, we could not make a quantitative comparison of those data to conditions since the Act's passage.

We surveyed users of single audit reports, discussed the single audit process with representatives of state and local governments and other organizations, analyzed a sample of reports, and conducted research to identify issues to be addressed. Our analysis provided the foundation for developing proposals in February 1994 to improve the single audit process. We presented our proposals to federal program managers and representatives of state and local governments and other organizations who have a stake in the single audit process and considered their comments in developing our recommendations.

To identify single audit issues, we sent questionnaires to 735 federal and state officials who administer federal financial assistance programs for 11 federal departments and the Environmental Protection Agency. These programs are listed in appendix I. We asked the officials to comment on the timeliness of single audit reports and their familiarity with and use of the auditors' reports on the financial statements, internal controls, and compliance with laws and regulations. We also asked for views on the use

of single audit reports as a program oversight tool. The federal and state officials who received our questionnaire were located in all 50 states and had been identified to us by the federal program offices in Washington, D.C., and state auditors' offices, respectively. We obtained a 79-percent response rate to our questionnaire.

To gain a better understanding of the content of single audit reports and the programs that qualify to receive audit testing during single audits, we reviewed a sample of 210 single audit reports randomly selected from all single audit reports submitted to the Federal Audit Clearinghouse during calendar year 1992. This sample consisted of 30 reports from each of the following categories of entities: (1) states, (2) counties, (3) municipalities and townships, (4) special districts, (5) Indian tribes, (6) school districts, and (7) regional organizations. We reviewed each single audit report to determine the number and type of auditors' reports they contained, the structure of the Schedule of Federal Financial Assistance (which is a required schedule in all single audit reports), the amount of federal financial assistance expended by the entities, and the programs that qualified to receive testing. We also reviewed single audit reports and Comprehensive Annual Financial Reports to determine whether state and local governments are reporting on internal controls.

To determine the extent to which single audit reports contain information that could be used for follow-on audit work and program oversight, we reviewed the content of the findings and financial statements of 100 randomly selected single audit reports for the seven categories of entities listed in the preceding paragraph. We also discussed with seven headquarters and five regional offices of inspector general how single audit reports are used as the basis for follow-on work.

To determine the timeliness of single audit reports submitted to the Federal Audit Clearinghouse, we compared entities' fiscal year-end dates and report processing dates in the Federal Audit Clearinghouse's database of single audit reports. The database included all single audit reports for fiscal years ending from December 31, 1990, to December 30, 1991, that the Clearinghouse had received between September 1991 and January 1994 (a 29-month period). These were the most recent data which could be used to assess the timeliness of single audit report submission to the Clearinghouse. We did not independently verify information in the database.

To analyze how the percentage of direct federal financial assistance covered during single audits would be affected by changing the dollar thresholds for requiring single audits, we analyzed preliminary Census data on the amount of direct federal funds received by local governments during 1992.⁸ In addition, we obtained background information from Census, such as the total amount of federal funds provided to state and local governments. Due to the magnitude of the Federal Audit Clearinghouse and other Census data, we did not independently verify information in the database.

To assess how the number of local government entities receiving single audits would be affected by changing the dollar thresholds for requiring single audits, we used federal financial assistance expenditure data obtained from our sample of 210 single audit reports because revenue data were generally not available. We projected the results of our sample to the universe of single audit reports submitted during calendar year 1992 and made estimates at a 95-percent confidence level.

To determine the feasibility of our proposed solutions in addressing single audit issues, we obtained views from a wide spectrum of federal program managers and organizations who are knowledgeable about single audits and are stakeholders in the single audit process. First, we discussed our proposals with 39 federal program managers who, according to their responses to our questionnaire on single audit issues, considered themselves knowledgeable about single audits. We judgmentally selected the managers to interview based on their geographic location. A list of the titles and programs of the federal managers we met with is in appendix II.

Second, we obtained the views of representatives of organizations which we believe are stakeholders in the single audit process. We met with and/or obtained written comments from representatives of the (1) American Institute of Certified Public Accountants, (2) Federal Grants Network, (3) Government Finance Officers Association, (4) National Association of State Comptrollers, (5) National State Auditors Association and various state auditors' offices, (6) President's Council on Integrity and Efficiency's Standards Subcommittee,⁹ and (7) Offices of Inspector General. OMB is currently revising its Circular A-133, which extends the single audit concept to institutions of higher education and other nonprofit

⁸Information on the amount of pass-through funds that state and local governments receive was not available.

⁹The Standards Subcommittee chair circulated our proposals to improve the single audit process to other offices of inspector general and conveyed their comments to us.

organizations, and intends to issue proposed revisions in July 1994. OMB then intends to use those revisions as a foundation for revising Circular A-128 later in 1994. Accordingly, we did not include OMB's views on our proposals in this report. A list of the titles of the officials we contacted is included in appendix III.

Throughout our study, we also obtained views on the single audit process from other interested parties, including national and regional intergovernmental audit forums, state societies of certified public accountants, universities, and state government officials from California, Delaware, Florida, Georgia, Maine, Mississippi, New York, North Carolina, Ohio, Pennsylvania, Tennessee, Texas, Utah, Virginia, and West Virginia. We also discussed the single audit process with local government officials in California, Georgia, Illinois, North Carolina, and Tennessee.

We conducted our audit from May 1991 through April 1994 in accordance with generally accepted government auditing standards.

State and Local Government Entities Report Financial Management Improvements

Prior to the Single Audit Act, the federal government did not have a consistent approach for promoting good entitywide financial management practices in the entities that received federal funds. Implementing the Act helped institutionalize fundamental elements of good financial management in state and local governments, such as preparing financial statements in accordance with GAAP, receiving annual comprehensive audits, assessing internal controls and compliance with laws and regulations, monitoring subrecipients, tracking federal funds, and correcting audit findings.

While we observed many financial management improvements that were related to the Single Audit Act, we recognize that the Act was only one of several factors bringing them about. Other factors—such as the establishment of the Governmental Accounting Standards Board, the governments' desires to improve their bond ratings, the commitment of the governments' managers to good financial management, and their ability to apply resources to procuring new systems and hiring necessary staff—were also important.

Single Audits Helped Entities Improve Financial Management

Management officials at 10 state and local governments we visited stated that the Single Audit Act helped encourage financial management improvements. First, single audits assess financial information related to an entity as a whole and its management of federal funds instead of focusing on an individual grant (a small portion of an entity's funds). State and local government officials also noted that because the audits are conducted every year and continue to report problems that are not corrected, they encourage financial management improvements far more than do grant audits.

Second, although the Single Audit Act did not require entities to use GAAP in preparing their financial statements, it encouraged the adoption of GAAP by requiring auditors to report whether entities' financial statements were presented in accordance with GAAP. The Act, through its implementing instructions also encouraged governments to improve their records on the use of federal funds by requiring that single audit reports include a Schedule of Federal Financial Assistance (SFFA) showing the total expenditures for each federal program.

Third, by requiring auditors to report on the entity's internal controls over federal programs, the Single Audit Act helped focus attention on the adequacy of the controls. By addressing internal controls, the Act helped

entities avoid audit findings in the future. The Act also promoted internal control over funds provided to subrecipients by requiring that entities monitor their subrecipients.

Lastly, under the grant audit approach, several years could pass between each audit an entity received; with single audits, entities are typically audited annually. The relative frequency of single audits helps ensure that problems are identified while they are still relevant instead of years after they occurred, as was the case with some grant audits. Also, the Act goes beyond problem identification because it requires managers to prepare yearly corrective action plans. Managers have an incentive to correct single audit findings because they know that unresolved findings will be publicly reported in the entity's single audit reports until corrected. Furthermore, receiving frequent audits helps educate managers about federal requirements because auditors discuss the requirements with managers during the audits and identify them in single audit reports.

Examples of Financial Management Improvements Influenced by Single Audits

Management officials at the 10 state and local governments we visited identified a number of financial management improvements they made that either were a direct result of or were influenced by the Single Audit Act. The improvements occurred as a result of entities' efforts to comply with Single Audit Act requirements, to correct single audit findings, and to generally strengthen financial management. The types of improvements included better audit coverage, adoption of GAAP financial reporting or enhanced ability to comply with GAAP requirements, increased tracking of federal funds, strengthened internal controls over federal programs, and improved subrecipient monitoring. The following examples illustrate the types of significant financial management improvements that managers attributed, at least in part, to the Act.

Audit Coverage Improved

By requiring annual comprehensive audits, the Act caused entities that were not audited or were audited infrequently to receive annual audits. For example, prior to the Act,

- West Virginia never received financial statement audits,
- Maine only received financial statement audits once every 4 years, and
- many subrecipients were not audited.

GAAP Reporting Enhanced

By requiring auditors to report whether entities' financial statements were prepared in accordance with GAAP, the Act prompted some entities to switch to GAAP financial reporting and influenced others to improve their ability to prepare GAAP-based statements. Examples include the following:

- West Virginia began preparing GAAP-based financial statements and installed a new statewide accounting system as a result of single audits.
- Los Angeles accelerated its switch to GAAP as a result of single audits.
- Mississippi installed a new accounting system which facilitated preparation of GAAP-based financial statements—due in part to single audits.
- Texas replaced its individual agency GAAP-based statements with a GAAP-based statement for the state as a whole.
- Georgia began preparing GAAP-based financial statements.

Increased Tracking of Federal Funds

OMB Circular A-128 (the Act's implementing instructions) requires entities to include in their single audit reports a schedule on all their federal expenditures categorized by program. Before this requirement was implemented, many entities did not track federal funds by program and were unaware of the amount of federal funds they received. To collect the data necessary to comply with federal fund reporting requirements, many entities improved their records on federal funds. For example,

- Maine; Mississippi; Chicago; Wake County, North Carolina; and the Dalton, Georgia Board of Education either installed new accounting systems or enhanced their accounting systems to allow tracking federal funds by federal program designations, and
- Chicago and Los Angeles established new procedures requiring central reporting of grant funds.

Internal Control Weaknesses Addressed

By focusing on internal controls over federal programs, single audits prompted entities to improve weaknesses in their controls. For example,

- Chicago improved internal controls over federal loan collections,
- Mississippi improved internal controls over federal cash and promulgated a policy requiring agency managers to conduct annual internal control evaluations, and
- the Dalton, Georgia Board of Education improved its internal controls over the school lunch program.

**Subrecipient Monitoring
Improved**

By requiring entities to monitor subrecipients of their federal funds, the Act helped increase the oversight of pass-through federal funds. For example,

- Los Angeles improved its tracking of federal funds provided to subrecipients and instituted a policy of withholding funds from subrecipients that did not comply with audit requirements;
- Georgia state department of education implemented a subrecipient monitoring system that tracks whether subrecipients have been audited and whether findings have been corrected;
- Texas began tracking subrecipient funding, receiving all subrecipient audits, and monitoring subrecipients' corrective action plans; and
- Hamilton County, Tennessee, established centralized oversight of subrecipient audits.

More detailed information on the financial management improvements of the 10 governments we visited are included in appendix IV.

Current Entity and Program Selection Criteria May Not Promote Most Effective Use of Single Audit Resources

The Act establishes criteria to determine which entities are required to have a single audit and which programs within those entities are to be tested. In doing so, the Act defines the single audit universe. Those criteria addressed concerns over the gaps and duplication of audit coverage under the former grant-by-grant approach, and have not changed since the Act's passage in 1984.

Recent experience has shown that the criteria may not promote the most effective use of single audit resources. The current thresholds for determining which entities must have an audit provide adequate coverage of the entities receiving the largest amounts of federal financial assistance. However, the thresholds could be raised to focus more on those recipients and to exclude many entities receiving relatively small amounts of assistance. Furthermore, the criteria for selecting for testing the major programs within those entities are based solely on dollar amounts expended and do not consider other risk factors.

In implementing the Single Audit Act, the Office of Management and Budget issued the Compliance Supplement for Single Audits of State and Local Governments, which identifies compliance requirements that should be considered in state and local government single audits. The Supplement's effectiveness is limited because it has not been updated since 1990 and has not kept pace with current laws, regulations, programs, or program requirements. (OMB is currently updating the Supplement again.)

Criteria for Selecting Entities to Be Audited Includes Many Recipients

By including dollar thresholds in the Act for selecting which entities must be audited, the Congress intended for the entities receiving the greatest amount of federal financial assistance disbursed each year to be audited while exempting entities receiving comparatively small amounts of federal assistance. The Act established two audit requirement thresholds:

- Entities that receive \$25,000 to \$100,000 in federal financial assistance in a fiscal year (either directly from the federal government or through another organization) must arrange at their discretion for either (1) the financial or financial and compliance audit required by each program or (2) a single audit.
- Entities that receive \$100,000 or more in federal assistance must have a single audit.

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In practice, the \$25,000 threshold is more important because many entities that receive between \$25,000 and \$100,000 have single audits.

In 1984, we assisted the Congress in establishing the Act's audit thresholds by estimating the extent of audit coverage over direct federal financial assistance to local governments under various threshold amounts. We reported¹ that setting the threshold for requiring single audits at \$100,000 would result in 95 percent of all direct federal financial assistance being covered by single audits.² As shown in table 3.1, our latest analysis shows that the \$100,000 threshold now covers 99 percent of all direct federal financial assistance to local governments while a \$300,000 threshold covers 95 percent.

Table 3.1: Coverage of Direct Federal Financial Assistance to Local Governments Under Alternative Single Audit Thresholds

| Threshold requiring single audits | Percentage of direct federal assistance covered |
|--|--|
| \$100,000 | 99.0 |
| 250,000 | 96.2 |
| 300,000 | 95.3 |
| 350,000 | 94.4 |
| 400,000 | 93.6 |
| 500,000 | 92.0 |
| 750,000 | 88.8 |
| 1,000,000 | 86.2 |

During our current review, we also analyzed data in a sample³ of single audit reports to determine how raising the Act's thresholds might affect the number of entities that have single audits. We estimate that if the \$25,000 threshold was raised to \$100,000, as many as 3,900 entities that had single audits would not be subject to an annual federal audit requirement.

The criteria for determining which entities must have single audits and which are exempt from audit has not changed since the Act was passed in

¹Study of Progress Made in Implementing the Single Audit Concept (GAO/AFMD-84-21, March 14, 1984).

²The analysis covers only local governments because state governments, which receive hundreds of millions or billions of dollars of federal financial assistance, would not be affected by the changes in thresholds being proposed.

³We based this analysis on local government single audit reports that we used to analyze the content of single audit reports and coverage of programs.

1984. According to our analysis, higher single audit thresholds would continue to ensure audit coverage for most of the federal financial assistance disbursed each year while removing audit requirements for many entities receiving comparatively small amounts of federal financial assistance.

Proposal: Adjust the Single Audit Thresholds

In our February 1994 proposal, we suggested that the Congress amend the Single Audit Act to raise the thresholds that trigger audit requirements.

- Raise the current threshold which requires entities to arrange for audits of federal financial assistance from \$25,000 to \$100,000.
- Raise the current threshold which requires entities to arrange for single audits from \$100,000 to \$250,000.
- Require OMB to review and, as necessary, raise the thresholds every 2 years.

Stakeholders' Response

More than 80 percent of the program managers we interviewed said that the single audit thresholds should be raised to at least the levels we proposed. While several program managers suggested that even higher thresholds should be established (for example, \$1,000,000 for mandating single audits), 6 percent of the managers said the current audit thresholds should be maintained. Others suggested that the Single Audit Act be modified to contain only one audit threshold. Entities whose federal financial assistance falls below the audit threshold would be exempt from mandatory audits.

Over 90 percent of the managers supported our proposal to require OMB to periodically assess the audit thresholds and adjust them as necessary. Some managers conditioned their support for the OMB authority upon stakeholders' involvement in the process.

Representatives of the other stakeholder groups strongly supported raising the audit thresholds. Several representatives felt the threshold for requiring single audits should be raised higher than \$250,000. Only the Department of Labor's Office of Inspector General opposed this proposal, stating that raising the audit threshold to \$250,000 would make it unlikely that entities receiving Job Training Partnership Act grants—which often flow through several tiers of governmental organizations—would be required to be audited.

Criteria for Selecting Which Programs Are to Be Tested Based Only on Dollar Amounts

The Act provides criteria, based upon the amount of program expenditures, for defining the programs to be tested for compliance with laws and regulations. Only these major programs are specifically required to be tested. The Act defines these programs using a sliding scale that relates each program's expenditures for the year to the entity's total expenditure of federal funds. For example, for an entity with \$100 million or less in total federal expenditures, programs are classified as major if they provide \$300,000, or 3 percent, of the entity's total federal expenditures for the year, whichever is greater. (Table 3.2 summarizes the scale the Act provides.)

Table 3.2: Schedule to Determine Major Programs Under the Single Audit Act

| Total state or local government expenditure of federal financial assistance | | Major program expenditures exceed |
|---|-------------|---|
| Minimum | Maximum | |
| \$7 billion | No limit | \$20 million |
| 6 billion | \$7 billion | 19 million |
| 5 billion | 6 billion | 16 million |
| 4 billion | 5 billion | 13 million |
| 3 billion | 4 billion | 10 million |
| 2 billion | 3 billion | 7 million |
| 1 billion | 2 billion | 4 million |
| 100 million | 1 billion | 3 million |
| 10 million | 100 million | 3 percent of federal financial assistance |
| 300,000 | 10 million | 300,000 |

During our review, we analyzed a random sample of single audit reports for 210 entities with total federal expenditures of over \$15 billion. We found that programs which met the major program criteria were few in number but accounted for 90 percent of the federal expenditures. Specifically, the 210 entities we reviewed administered 526 federally assisted programs. Of these programs, 83 percent (with total federal fund expenditures of over \$1 billion) never met the major program criteria. Only three programs met the major program criteria in each entity that operated the programs, and each was operated by five or fewer entities. The rest of the programs in our sample were classified as major in some, but not all, of the entities where they existed. (See table 3.3.)

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Table 3.3: Percentage of Time Programs Met Major Program Criteria

| | Percentages | | | | | | Total |
|--------------------|-------------|----------|----------|----------|---------|-----|-------|
| | 100 | 99 to 76 | 75 to 51 | 50 to 26 | 25 to 1 | 0 | |
| Number of programs | 3 | 2 | 9 | 34 | 38 | 440 | 526 |

Because the selection criteria in the Act is tied solely to dollars (expenditures), many "high-risk" programs vulnerable to fraud, waste, and abuse may not be subject to testing. For example, OMB has identified Federal Transit Administration (FTA) grants as being high-risk. In our sample of audit reports, 32 of the 210 entities operated FTA programs, yet only 5 (16 percent) met major program criteria, and thus qualified for mandatory audit testing.

The Act's major program criteria compels auditors to select for testing the programs for which the entity expends the largest amount of federal dollars. However, our work indicates this criteria does not always result in adequate audit coverage of programs that are vulnerable to fraud and abuse because it does not require the auditor to consider program risks in the selection process (for example, program complexities, changed program requirements, or previously identified problems). If the Act were amended, the mix of programs selected for testing could include selections based upon dollars and risk.

Proposal: Amend the Program Selection Criteria

In our February 1994 proposal, we suggested that the Single Audit Act be amended to (1) delete references to "major" federal programs and (2) require auditors to select and test transactions from programs based on the relative risk of the programs and the professional judgment of the auditor. However, the auditor would have been required to test programs which,

- in the aggregate, were the source of at least 50 percent of the total federal financial assistance during the audit year, and
- had significant deficiencies in internal controls or significant noncompliance with federal laws and regulations as determined by the auditor.

Stakeholders' Response

In discussions with stakeholders, an overwhelming majority of the federal managers interviewed agreed with our proposal. Nearly 90 percent supported the need for OMB to provide a framework for auditors to follow

in implementing risk-based program selection. The managers suggested several alternatives for revising the program selection criteria, including:

- randomly selecting some programs,
- testing programs on a cyclical basis, and/or
- requiring OMB to designate programs to be tested.

Representatives of all stakeholder groups supported the concept of risk-based program selection but held different views on its implementation. For example, representatives from the National State Auditors Association (NSAA) support basing program selection on risk rather than just dollars. Representatives of the Government Finance Officers Association and the National Association of State Comptrollers (NASC) also believe that using a risk-based approach is a good idea, but that auditors should be solely responsible for selecting programs to audit.

OIGs also generally supported using a risk-based approach. However, the Labor OIG opposed the idea out of concern that it would result in small dollar programs being less likely to receive audit coverage than they are under the current approach. The Labor OIG also stated that it is unrealistic to expect work done during single audits to provide assurances regarding high-risk programs.

Although representatives of the American Institute of Certified Public Accountants (AICPA) believe a risk-based approach is theoretically and fundamentally sound, they were strongly opposed to GAO's proposal for risk-based program selection. They were concerned about the expectations and costs associated with that proposal. The AICPA representatives said that without clear expectations of what should be audited, auditors would have difficulty estimating the amount of audit work that would be required when bidding on prospective audits and would also be subject to federal government questioning of their judgment after the audit was performed.

AICPA representatives observed that our proposal to require auditors to test federal programs that provide at least 50 percent of an entity's federal assistance could result in either a significant increase in audit costs or in auditor efforts to avoid testing smaller, high-risk programs. They also felt it could lead to significantly increasing the cost of single audits because the cost of compliance testing relates more directly to the number of federal programs tested than the percentage of federal dollars tested. The AICPA representatives said that, alternatively, auditors might continue to

select the largest federal programs for testing so they could achieve the 50 percent coverage at the lowest possible cost, thereby defeating the goal of having auditors focus on high-risk programs.

OMB's Compliance Supplement Has Not Kept Pace With Changes

The Compliance Supplement to OMB Circular A-128 identifies federal requirements and suggests audit procedures for testing compliance with laws and regulations. In doing so, it assists the entities' auditors in planning their single audits. Program managers and OIGs can influence the auditor's testing of compliance with laws, regulations, and requirements by submitting suggestions to OMB when it updates the Supplement.

Over the last 10 years, laws and regulations have changed, programs have been created and terminated, and audit approaches and testing methodologies have evolved. However, the Supplement (which OMB is currently revising) was issued in 1985 and revised only once, in 1990. Because of the infrequent updates, the Supplement has not kept pace with changing federal requirements.

During our review, we surveyed over 700 federal and state program managers. Over 70 percent of both federal and state managers believe it is important to improve the timeliness and extent of OMB's single audit guidance.

Some federal programs have a high inherent risk of noncompliance with requirements because of program design. For example, a program that is intended to generate revenue to further program goals could be risky because the revenue may be diverted. We believe that such information should be communicated to auditors conducting single audits and that the Compliance Supplement could be a vehicle to communicate the information.

Proposal: Increase Usefulness of the Compliance Supplement

In our February 1994 proposal, we suggested that OMB

- update the Supplement to Circular A-128 on a schedule that maintains the relevance of the information (the Act should specify the frequency),
- expand the Supplement to include all financial assistance programs identified by OMB as high-risk, and
- describe the inherent risk for each program included in the Supplement.

Stakeholders' Response

Representatives of the auditor-related stakeholder groups (AICPA, NSAA, and OIGs) strongly support the need to update the Compliance Supplement regularly (at least every 2 years) and to develop procedures for systematically adding new programs and requirements. One NSAA representative stated that matters that are no longer important should be deleted from the Compliance Supplement.

To measure the need to update the Compliance Supplement, we asked program managers the extent to which their program requirements changed over the preceding 5 years. Nearly 70 percent of the managers interviewed said that their program requirements changed significantly during that time. Program managers were divided in their views on the appropriate frequency for updating the Compliance Supplement. Fifty-seven percent said that the supplement should be updated at least every 2 years; another 28 percent suggested a 3-year updating cycle.

Conclusions

We believe that the Act's focus on causing broad audit coverage of federal financial assistance programs while exempting state and local governments that receive comparatively small amounts of such assistance from audit coverage is sound and should be maintained. Because the Act's dollar thresholds have not changed since 1984, however, the percentage of direct federal financial assistance to local governments that is audited has increased and, accordingly, audit resources are spent on comparatively small amounts of assistance in some cases. Consequently, we believe that the thresholds for requiring audits should be raised substantially.

The Act's major program criteria has supported the goal of promoting efficient use of audit resources: by selecting a relatively small number of programs, auditors can test transactions from programs that provide as much as 90 percent of an entity's federal financial assistance. However, under that approach, smaller, riskier federal programs are less likely to be selected for testing. Program officials and stakeholder groups support revising the current dollar-driven program selection criteria to consider risks.

We also support a risk-based approach. However, because of practical considerations raised by auditors, we revised our original proposal. We believe that both objectives of obtaining broad audit coverage of federal programs and exposing smaller, riskier programs to audit can be accomplished by (1) raising the Act's major program dollar criteria and

(2) requiring OMB to annually identify high-risk programs that must be tested in each entity that operates the programs.

Under this structured approach, all auditors who may compete for single audit engagements will have consistent information upon which to base their proposals. It would also provide a common understanding between an auditor conducting a single audit and oversight officials about which federal programs would be tested. This approach could be designed to not substantially increase audit work because adding high-risk programs that must be tested could be offset by reducing the number of major programs that must be tested.

We are not proposing specific selection criteria. We believe that OMB should develop the program selection criteria in consultation with program officials, auditors, and other stakeholders.

Furthermore, expanding and updating the Compliance Supplement on a regular cycle (at least every 2 years) would ensure that auditors have as current information as practicable about federal expectations for audits of federal programs. OMB could expand the Supplement to (1) include programs which have been identified as being high-risk or have experienced implementation problems and (2) describe the inherent risk for all included programs.

Recommendations

In order to exempt from audit those organizations that receive comparatively small amounts of federal assistance, we recommend that the Congress amend the Single Audit Act to raise the thresholds that trigger audit requirements. Specifically, we recommend that

- the threshold which requires entities to arrange for audits of federal financial assistance be raised from \$25,000 to \$100,000;
- the threshold which requires entities to arrange for single audits be raised from \$100,000 to \$300,000; and
- OMB be required to review the thresholds every 2 years and adjust them as necessary.

We also recommend that the Congress amend the Single Audit Act to

- require OMB to establish higher major program dollar thresholds and to adjust them as necessary and

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- require OMB to annually publish a list of federal programs that must be selected for testing, based on the risks associated with the programs.

We recommend that OMB

- update the Compliance Supplement to Circular A-128 at least every 2 years,
- expand the Supplement to include all financial assistance programs identified by OMB as high-risk, and
- describe the inherent risk for each program included in the Supplement.

Enhancing the Usefulness of Single Audit Reports

Single audit reports provide the results of independent auditors' tests of the entities' financial statements, internal controls, and compliance with laws and regulations. In contrast to traditional financial statement audits of state and local governments, single audits also report on compliance with laws and regulations related to federal financial assistance programs. However, neither the Act nor its implementing instructions prescribe the format for conveying the results of the auditors' tests and evaluations.

Over half of the 735 federal and state program managers we surveyed stated that they were familiar with single audit reports, but only 20 percent of the federal managers and 25 percent of state managers said that they used the reports to any great extent when carrying out oversight responsibilities. More significantly, less than 10 percent of the program managers relied on the reports to identify problem areas requiring their attention. (Despite the limited use made of these reports, the single audit process, as discussed in chapter 2, has encouraged state and local governments to improve their financial management.)

During our follow-up meetings with selected federal program managers, we were told that single audit reports could be made more meaningful and more useful by

- summarizing the auditors' determinations,
- being more timely,
- omitting clearly inconsequential findings,
- including a report by an entity's management on the status of its internal controls, and
- re-emphasizing the government's interest in single audit results.

Single Audit Reports Contain Many Separate Reports

The format of single audit reports limits their usefulness. They may contain multiple auditor's reports, but no overall summary of the significant information. It is not uncommon for a single audit report to contain seven auditor's reports: two reports on financial statement-related information, two reports on internal controls, and three reports on compliance with laws and regulations.

As a result, program managers and other users have to read through all the separate reports to learn whether the entity is managing its federal funds properly and whether there are problem areas that require attention. We believe single audit reports would be more useful if each contained an auditor's summary report highlighting the results of all the audit work.

Several state audit organizations (including California, Colorado, Florida, and Illinois) use summaries to highlight the single audit's results.

The Illinois Auditor General, for example, included a 5-page summary in a 1991 single audit for a state agency. The entire report was over 100 pages long, contained 46 findings, and was published in two volumes. The summary included a disclaimer of opinion on the entity's financial statements, a significant control finding related to federal financial assistance which highlighted four deficiencies, a significant control finding related to state issues, a description of major problems with the agency's payroll operation, and a discussion of the agency's failure to act on several key recommendations. The summary also included the Auditor General's recommendations for each of the summarized findings and a section profiling matters for consideration by the General Assembly.

OMB Circular A-128 suggests that a single audit report may consist of several auditor's reports. The AICPA identified nine types of reports that may be needed to fulfill Government Auditing Standards and the additional requirements prescribed by the Act and OMB Circular A-128. The different reports fall into two broad categories:

1. Reports Related to an Audit of an Entity's Financial Statements

- general purpose financial statements,
- internal control structure based on generally accepted government auditing standards, and
- compliance based on generally accepted government auditing standards.

2. Additional Reports to Fulfill Single Audit Requirements

- Schedule of Federal Financial Assistance,
- compliance with general requirements for federal financial assistance,
- compliance with specific requirements of major programs (may also include a report on non-major programs),
- internal control structures related to federal financial assistance,
- schedule of findings and questioned costs (where applicable), and
- illegal acts (issued only when instances are detected).

To gain an understanding of the range of separate auditors' reports contained in single audit reports, we analyzed a random sample of 210 single audit reports. Ninety-seven percent of the single audits in our sample contained from 4 to 11 separate auditors' reports. Sixty-eight

percent, or over two-thirds, of the single audits in our sample had 7 or more auditors' reports. (See table 4.1.)

Table 4.1: Number of Separate Auditors' Reports in Sample

| Number of reports | 1-3 | 4-6 | 7-8 | 9-10 | 11 | Totals |
|------------------------------|------------|------------|------------|-------------|-----------|---------------|
| Single audit reports sampled | 7 | 52 | 90 | 58 | 3 | 210 |
| Percent | 3 | 29 | 46 | 21 | 1 | 100 |

Single audit reports can vary considerably. For example, two states' arts commissions each received over \$485,000 in federal financial assistance for fiscal year 1991. One commission's single audit report included one auditor's report to fulfill Single Audit Act and related requirements, while the other commission's report contained eight auditor's reports: a report on the Arts Commission's general purpose financial statements, one on its internal control structures, four on its compliance with laws and regulations, one on its Schedule of Federal Financial Assistance, and one on miscellaneous findings.

In a similar example, one county received about \$1.5 million in federal financial assistance for fiscal year 1990. Its single audit report contained eight auditor's reports. In contrast, another county received over \$1.4 million in federal assistance for fiscal year 1991. Its single audit report contained four individual auditor's reports.

Proposal: Auditor's Summary Report

In our February 1994 proposal, we suggested that the Single Audit Act be amended to require that single audit reports include a summary of the auditor's determinations regarding the entity's financial statements, internal controls, and compliance with laws and regulations.

Stakeholders' Response

The prospect of auditors providing a summary document that highlights their determinations concerning the financial statements, internal controls, and compliance with laws and regulations gained nearly unanimous support by program managers we interviewed. Ninety-five percent of the managers interviewed were very supportive of the concept of an auditor's summary report. Some managers said that a summary report would save them time and enable them to quickly focus on the problems that the auditors found.

Most OIGs concurred with our proposal to require a summary auditor's report. The Environmental Protection Agency and Small Business

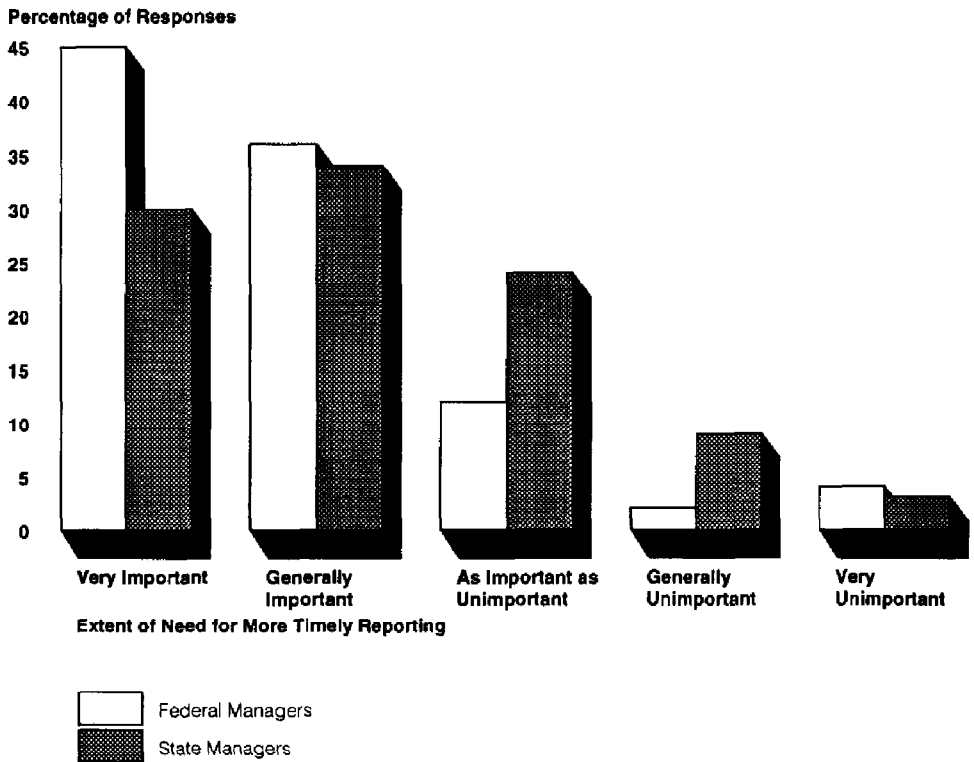
Most OIGs concurred with our proposal to require a summary auditor's report. The Environmental Protection Agency and Small Business Administration (SBA) OIGs opposed the proposal out of concerns over the costs and amount of guidance needed for a summary report. Some NASC representatives did not support the proposal because they believe it will create additional work and costs. The NSAA representatives said that some state auditors questioned whether having a summary report would solve the problem of single audit reports' poor readability. Government Finance Officers Association (GFOA) representatives believe the current number of auditor's reports are excessive and therefore oppose adding another. AICPA representatives also oppose adding another report but are committed to working with the federal government and others to reduce the number of reports.

Publication Time Frame for Single Audit Reports Could Be Shortened

OMB Circular A-128 provides that entities that are required to have a single audit must submit their reports to each organization that directly provided the federal financial assistance within 30 days after completion of the audits, but no later than 1 year after the end of the audit period without the agreement of the cognizant agency. However, in its "Questions and Answers on Single Audit Provisions of OMB Circular A-128," issued in November 1987, OMB states that entities have 12 months from the end of their fiscal year to complete their single audits and an additional 30 days to release their single audit reports.

When asked about the timeliness of single audit reports, 81 percent of the federal managers and 64 percent of the state managers identified the need for improved timeliness. (See figure 4.1.)

Figure 4.1: Views on Need to Improve the Timeliness of Single Audit Reporting

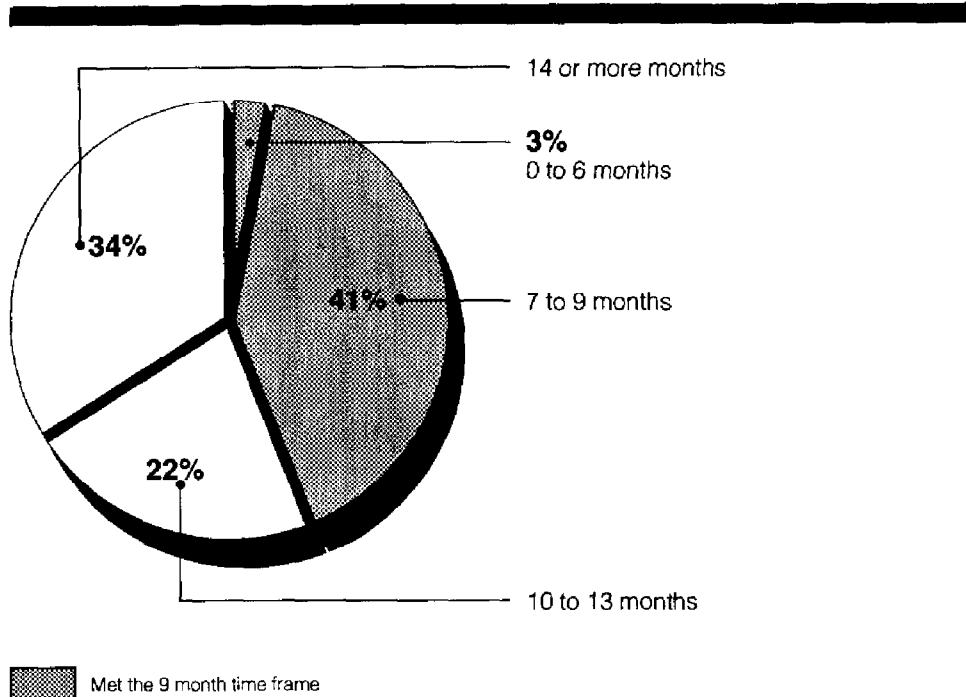


Other requirements for issuing reports that include audited governmental financial statements are shorter than the 13 months allowed for single audit reports. For example, the Chief Financial Officers Act of 1990 established a maximum time frame of 9 months for federal agencies to complete their financial statement audits, and pending amendments to the Act could cut the time frame to 6 months. (OMB administratively shortened the time frame for the audits to 5 months.) Similarly, the GFOA requires that member entities submit their audited financial reports within 6 months after the end of their fiscal years in order to be eligible for its Certificate of Achievement for Excellence in Financial Reporting.

While the 13-month time frame is the established standard, many entities submit their reports in significantly less time. As shown in figure 4.2, 44 percent of over 21,000 state and local entities submitted their single

audit reports for fiscal year 1991¹ to the Bureau of the Census Federal Audit Clearinghouse within 9 months after the end of their fiscal year.

Figure 4.2: Number of Months Entities Took to Submit Audit Reports to Census for Fiscal Year-end 1991



Proposal: Timing of Single Audit Reports

In our February 1994 proposal, we suggested that the Single Audit Act be amended to improve the timeliness of single audit reports submitted to federal and/or state funding agencies. We said that we were working with stakeholder groups to further refine this proposal.

Stakeholders' Response

Nearly 90 percent of the program managers told us that they are dissatisfied with the 13-month time frame for submission of single audit reports and supported a shorter time frame. Eighty-five percent of the managers strongly supported shortening the reporting time frame from 13 months to 9 months or less for state government single audits and from 13 months to 6 months for all other entities. Some conditioned their comments upon implementing our proposals to improve the single audit

¹Fiscal year 1991 was the most recent reporting period for which complete data was available from Census.

process. Several managers suggested that only one reporting time frame be established for all entities.

Representatives of stateholder groups held mixed views on shortening the reporting time frames. GFOA representatives noted that more timely reports could be more costly and that some entities are better able to produce timely financial data than others. One NSAA representative stated that state auditors recommend no change in the reporting time frames but indicated that a guideline of 9 to 10 months would be acceptable. Some state auditors object to shorter time frames because they conduct both statewide audits, which involve numerous state government components, and audits of local governments. However, one state auditor's office—which conducts hundreds of single audits of state and local government entities—said that it believes the 9-month reporting time frame for statewide single audits and 6-month time frame for local government single audits are good goals which they will aggressively pursue regardless of changes in federal requirements. As discussed in chapter 3, raising the thresholds which trigger audit requirements would significantly reduce the number of federally mandated audits and, thus, would make it easier for audit offices to complete audits in a more timely manner.

Management Reporting on Internal Controls Needed

The legislative history of the Act shows that single audits were intended to promote internal control improvements and identify the relative risks associated with the management of federal funds. Thus, single audits would serve as a foundation for directing federal oversight and for performing follow-on audits.

Single audits are intended to provide oversight officials with greater assurance than they had previously from grant audits that state and local governments are managing federal assistance programs in compliance with laws and regulations. This greater assurance is due principally to the single audits' emphasis on assessing the entities' internal controls over federal programs. We believe that single audits are not intended to provide program officials with a complete evaluation of actual compliance.

Many program officials, however, are not satisfied with the internal control reporting in single audits. Specifically, more than half of the officials responding to our questionnaire said that they found the reporting on internal controls to be of limited use in evaluating whether funds from their respective programs were properly managed by recipients.

We believe internal control reporting in single audits can be enhanced by making entity management responsible for reporting on internal controls, as has been done in other sectors. Program officials we talked with overwhelmingly supported this idea, saying that it would provide a better basis to evaluate entities' management of federal programs.

Attention Focused on Internal Controls

The single audit approach focuses attention on internal controls by (1) calling for instances where internal controls might not be adequate to be identified and (2) concentrating on preventing noncompliance with laws and regulations by correcting internal control problems. This preventive approach was intended to help ensure long-lasting improvements as well as serving as a bridge for further audits. Single audit reports would assist program officials in carrying out their managerial and program responsibilities by identifying entities whose internal controls do not provide reasonable assurance that they are operating federal programs in accordance with laws and regulations.

Single audits have identified many internal control issues. The 210 single audit reports we reviewed identified significant deficiencies in internal controls, including the inadequate safeguarding of assets, improper or inadequate financial records, inadequate controls to assure compliance with laws and regulations, and the failure of entities to carry out requirements under the Act related to ensuring that subrecipients (entities receiving federal funds from other entities) corrected identified problems in complying with laws and regulations.

Notwithstanding the fact that single audit reports identify significant internal control problems, the federal program officials we surveyed had mixed views on the extent to which single audit internal control reporting provides assurance of proper program management. Thirty percent said it provided assurance to a very great or a great extent, while 46 percent said it provided some or little assurance.

Other Sectors Have Improved Internal Control Reporting

During the past decade, other sectors have taken actions to improve internal control reporting and make it more useful to regulators and others. In most cases, management has been required to report on the effectiveness of its internal controls. In the federal government, the Federal Managers' Financial Integrity Act of 1982 (FMFIA) requires all executive agencies to report publicly on their internal controls.² FMFIA is

²The Chief Financial Officers Act of 1990 extends the FMFIA concept to government corporations.

built on the concept of management taking responsibility for knowing about problems and acting decisively to correct problems. Since passage of FMFIA, federal agency managers have identified thousands of significant internal control problems and developed and implemented plans to correct those problems.

In state government, a 1990 survey by the New York state government reported that at least 11 states had formal requirements for management reporting on internal controls. The study noted that in Rhode Island, state agency heads are required to submit an annual report on their internal controls to the governor, legislature, and auditor general and to identify in the report significant internal control problems and actions designed to correct those problems.

In 1992, state managers in Oregon (which was not included in the 1990 survey) reported in the state's comprehensive annual financial report that they were responsible for establishing and maintaining internal controls—including controls to assure that financial transactions are properly executed in accordance with legislative and management authorization. The Oregon managers reported that 48 of 95 state agencies identified internal controls needing improvement. The managers added that such reporting sets a "valuable benchmark for tracking future improvements" in internal controls.

In the commercial sector, the Foreign Corrupt Practices Act of 1977 (FCPA) requires Securities and Exchange Commission registrants to devise and maintain systems of internal controls. Since passage of FCPA, however, serious questions about strengthening that requirement have been raised repeatedly. We and others, such as the AICPA, have recommended that registrants be required to publicly report on their internal controls to better ensure they are in place and working effectively. In fact, we have affirmed that significant and lasting improvements in internal controls will not be achieved without requirements for management reporting. According to a 1992 report by several public sector organizations,³ the managers of one in every four public companies and 60 percent of the Fortune 500 companies already voluntarily report on internal controls in some fashion.

³Internal Control-Integrated Framework: Reporting to External Parties, Committee of Sponsoring Organizations of the Treadway Commission, August 1992. The sponsoring organizations were the American Institute of Certified Public Accountants, American Accounting Association, Institute of Internal Auditors, Institute of Management Accountants, and Financial Executives Institute.

We reported in 1991⁴ that serious internal control weaknesses that were a major cause of bank failures in 1988 and 1989 were the same as internal control weaknesses that contributed significantly to banks that failed in 1987. We called for bank management to evaluate and publicly report on the status of internal controls. In 1991, the Congress passed the Federal Deposit Insurance Corporation Improvement Act (FDICIA), which requires managers of federally insured banks and savings and loan institutions with assets of \$150 billion or more to publicly report on their internal control structure and procedures for financial reporting. FDICIA underscored the increasing importance of internal controls to the Congress and the responsibility the Congress believes the management of banks and savings and loan institutions have for ensuring a sound control environment.

**Proposal: Management
Internal Control Reporting**

In our February 1994 proposal, we suggested that the Single Audit Act be amended to require

- entities receiving federal financial assistance equal to or in excess of \$50 million in a fiscal year provide to their auditors a representation regarding the extent to which the entity has in place internal controls over federal financial assistance that meet each of four specified control objectives and
- auditors conducting single audits of such entities to attest to the fairness of such a representation, limited to the programs that the auditor tested.

The auditor's attestation, which would be in lieu of current internal control reporting requirements under the Act, would encompass only those programs in which the auditor tested controls.

We suggested that entities would address controls related to the following four objectives:

- assets are to be safeguarded against loss from unauthorized use or disposition;
- transactions are to be executed in accordance with laws and regulations;
- transactions are to be recorded, processed, and summarized in a manner to permit the preparation of financial statements and to maintain accountability for assets; and
- effective systems are to be in place to oversee and ensure that subrecipients manage federal funds in accordance with federal laws and regulations.

⁴Failed Banks: Accounting and Auditing Reforms Urgently Needed (GAO/AFMD-91-43, April 22, 1991).

The first three objectives are essentially the same as those in existing federal legislation, including FMFIA and the Single Audit Act. The fourth objective is important in the single audit context because programs such as those under the Job Training Partnership Act provide funds that cascade down several tiers of organizations before reaching the intended program beneficiaries.

Stakeholders' Response

Nearly three-fourths of the program managers we interviewed said that they would have significantly greater confidence in the operation of their programs by state and local governments if those entities were required to publicly report on their internal controls over that assistance. Their confidence would be strengthened if the auditors were also required to report on the fairness of the entity's internal control report. Forty-seven percent of the managers believed that all entities that receive federal financial assistance should be required to report on controls over that assistance. Another 32 percent believed that only entities that received over \$1 million should be required to report on internal controls. Twenty-one percent suggested that entities receiving over \$10 million in federal financial assistance should have to report on controls.

OIGs generally concurred with our proposal to require management reporting on internal controls. The SBA OIG opposed our proposal because it thought that implementing and ensuring compliance with the proposal would be difficult. Some representatives of the Federal Grants Network want single audit reports to contain stronger assurances on internal controls but did not support or oppose our specific proposal to accomplish that.

GFOA, NASC, and NSAA representatives opposed our proposal because they believe it would be costly. One NSAA representative said the proposal would create needless paperwork and expend state and local governments' resources without a readily apparent benefit. The representative suggested instead that federal funding agencies use their authority to withhold funds if a state or local government does not correct its poor internal controls. NASC representatives also expressed doubts about whether the proposal was workable. In particular, they questioned which level of state government management would be expected to make the representation on internal controls and whether that level (for example, a mayor or state agency head) could be expected to have extensive knowledge of a component unit's internal controls.

The AICPA representatives said their Board of Directors supports management reporting on internal controls over financial reporting for publicly held companies. However, because of the unique nature of state and local governments, the AICPA representatives believe a number of implementation issues would have to be resolved before mandating management control reporting for state and local governments.

Federal Government's Interest in Single Audits Not Always Emphasized

The Single Audit Act was passed as a result of long-standing congressional interest in ensuring that entities receiving federal financial assistance are held accountable for the management and distribution of federal funds. Because single audits are an important tool for monitoring the operation of federal financial assistance programs, the federal government has a strong and continuing interest in the results of single audits.

Oversight officials, program managers, and independent auditors believe that the single audit process is not working as well as it could. We believe that practitioners could improve the single audit process by preparing reports that are responsive to the strong federal interest in single audits.

Proposal: Emphasize Federal Interests

In our February 1994 proposal, we suggested that the Single Audit Act be amended to require that single audit reports (1) be addressed to the cognizant or general oversight agency in addition to the audited entity and (2) state the auditor's understanding that the federal government intends to rely on the audit report.

During the course of our work, we considered a number of other methods of emphasizing the federal interest in single audits and encouraging the audit community to recognize that interest in its work. For example, we considered recommending that a federal agency be a signatory to all contracts for single audit services along with the audited entity and the independent auditor.⁵ Such an arrangement would be another way of encouraging the auditor to recognize the federal government's interest in the audit and allow the federal government to directly influence the auditor's work. Further, in the procurement area, we considered recommending that federal regulations include more specific requirements

⁵A number of states contract for audit services using similar models. For example, in Tennessee, state law requires that all local governments contracting for audit services submit the contracts to the State Department of Audit for signature and approval.

for the procurement of audit services.⁶ Finally, we considered whether agencies need to make greater use of existing suspension and debarment authority.⁷ While such methods of emphasizing the federal interest may appeal to many involved in the single audit process, we are not prepared to advocate them at this time.

Stakeholders' Response

The program managers interviewed were interested in promoting closer relationships between the auditors conducting single audits and the federal government. Nearly 90 percent strongly supported amending the Single Audit Act to specifically state that the audits are conducted for the benefit of the federal government and requiring the auditors to jointly address the audit reports to the audited entity and a federal government representative.

The federal managers offered the following suggestions to improve the relationships between the federal government and auditors conducting single audits:

- require that single audit reports be addressed to all entities that provided funding,
- require state auditors to contract for audits of local governments and involve the federal government in contracting for state government single audits, and
- distribute the reports simultaneously to all federal agencies rather than delaying distribution until the cognizant federal agency releases the reports.

Three OIGs, as well as one NSAA representative, did not see a benefit to addressing single audit reports to federal agencies. GFOA representatives expressed concern that it could lead to federal encroachment on state and local procurement practices. Also, AICPA representatives opposed the proposal for a variety of reasons, including increased legal liability concerns and the fact that many other users have an interest in the audit. They pointed out that all but two of the AICPA illustrative auditor's reports

⁶In a 1987 report, we disclosed a strong interrelationship between a government's procurement process and the quality of audits. Our analysis of this interrelationship identified four attributes in procurement processes that consistently resulted in high quality audits: comprehensive solicitation, competition, technical evaluation, and written agreement. These concepts are embodied in current regulations regarding the procurement of audit services by grantees and subgrantees other than states.

⁷A 1986 Executive Order establishes federal agency suspension and debarment authority in the assistance context. Debarment precludes a person or entity from receiving further government contracts or assistance from any federal agency for the period of the debarment. Suspension is an interim action to prevent the government from doing business with a person or entity while an investigation or debarment proceeding is in progress.

for single audits call for the next to the last paragraph to state that the reports are intended for the audited entity and legislative or regulatory bodies such as the Congress or federal agencies. The two exceptions are the reports on the financial statements and the Schedule of Federal Financial Assistance. Furthermore, representatives of one state society of certified public accountants commented that the proposal would substantially increase legal liability and reduce the number of qualified auditors willing to accept single audit engagements.

Single Audit Reports Often Include Inconsequential Findings

The usefulness of the auditor's schedule of findings and questioned costs is diminished because the schedules often contain numerous inconsequential findings. These findings may divert attention from those that indicate a need for additional audit work or program oversight.

In the reports we reviewed, 610 of the federal findings (69 percent) were, in our judgment, inconsequential. Some program managers said that resolving these inconsequential findings is an inefficient use of their time. However, the Act and guidance leads auditors to disclose any instances of noncompliance, and makes no provision for those that are clearly inconsequential.

Many of the findings disclosed small clerical errors that did not indicate improper conduct or a significant internal control structure failure. Nearly 90 percent of the federal program managers we interviewed strongly supported allowing auditors to not report clearly inconsequential findings. Some called for OMB to provide guidance to the auditors. They cited examples of findings ranging from \$1 to \$30 that they thought were not cost-effective for the auditors to report or for the federal agency to resolve.

Conclusions

Effective single audit reports need to highlight important information and be provided to federal and state program managers in time for them to take appropriate action. The current single audit report format requires the user to read through numerous separate reports to unearth the findings, opinions, and assessments buried within. A summary of the auditor's conclusions concerning the reliability of the entity's financial statements, the adequacy of its internal control systems, and its compliance with laws and regulations and a discussion of other significant matters, including material findings, would greatly increase the usefulness

of the single audit report. Omitting findings that are clearly inconsequential would further increase single audit report usefulness.

If reports are not submitted promptly, financial data may no longer reflect current conditions, funds may no longer be available to offset disallowed costs, and program managers may not be able to resolve findings that occurred well over a year before publication of the problems. While timeliness alone does not guarantee that single audit reports will be useful, the reports' usefulness diminishes over time. Establishing a time frame of no more than 9 months after the close of the period under audit would address the need for more timely reporting while recognizing the practical difficulties of consolidating and auditing information from complex organizations such as state governments within a shorter time period.

Entity managers currently have little accountability for the adequacy of their internal control structures. To increase their accountability, managers could be responsible for reporting publicly on those structures, and the auditors conducting assessments of those structures could attest publicly to the reliability of the managers' statements. Although many program managers and stakeholder groups' representatives supported management internal control reporting by all entities, because of the potential cost of implementing the proposal, we believe that only entities that receive \$50 million or more in federal financial assistance should be required to publicly report on internal controls.

Furthermore, the auditors conducting single audits could emphasize their federal audience. The single audit reports could be (1) addressed jointly to the audited entity and the appropriate federal agency and (2) state that the auditors understand the federal government intends to rely on the audit reports.

Recommendations

To increase the usefulness of single audit reports, we recommend that the Congress amend the Single Audit Act to require that

- single audit reports include a summary of the auditor's determinations regarding the entity's financial statements, internal controls, and compliance with laws and regulations;
- single audit reports be transmitted to the appropriate federal agency, state or local government, and the Federal Audit Clearinghouse in the Bureau of the Census no later than 9 months after the end of the fiscal year under audit, or such shorter time specified by OMB;

Chapter 4
Enhancing the Usefulness of Single Audit
Reports

- entities receiving federal financial assistance equal to or in excess of \$50 million in a fiscal year publicly report the extent to which the entity has in place internal controls over federal financial assistance sufficient to safeguard assets, prepare accurate financial reports, comply with federal laws and regulations, and monitor subrecipients;
- auditors conducting single audits of such entities to attest to the fairness of such a representation, limited to those programs in which the auditors tested controls; and
- single audit reports (1) be addressed to the cognizant or other agency designated by OMB in addition to the audited entity and (2) state the auditor's understanding that the federal government intends to rely on the reports.

Also, we recommend that the Congress amend the Single Audit Act to relieve auditors from having to report inconsequential findings.

Improving the Impact of Single Audit Reports

Single audit reports contain meaningful information on entities' financial status and management of federal funds and can indicate where the entities have additional problems that need further audit or investigation. A single audit report should be viewed as a tool that raises questions rather than a document that answers all questions. Some offices of inspector general have used the reports to identify audit leads and areas needing program monitoring, but the reports could be used more extensively. The information could also be communicated to auditors conducting single audits through risk alerts or updates to the Compliance Supplement. However, oversight officials do not have ready access to information because the reports have limited distribution and the report data are not electronically compiled. About 21,000 entities submit single audit reports to the Federal Audit Clearinghouse, but no mechanism exists to make the report data readily accessible.

Single Audit Reports Provide Leads for Follow-on Audits and Program Oversight

The Single Audit Act states that federal agencies should coordinate, to the extent practicable, additional audits and ensure that such audits build upon those already conducted under the Act. Our review of 100 randomly selected single audit reports found that 69 contained information that we believe may warrant a follow-on audit. In past cases where OIGs have followed up, they have found substantial problems.

Leads from single audit reports for follow-on work can come from the entities' financial statements or auditors' findings. While all findings in single audit reports are supposed to be corrected by the entities, some findings can indicate problems that need further investigation to be fully understood and effectively resolved. Thus, single audit report information can indicate the possible need for follow-on audits.

Financial Statement Information as a Foundation for Follow-on Audits

Entities' financial statements can contain information indicating problems of concern to the federal government, such as possible overcharges or a failure to reimburse the federal government. Several OIGs have initiated follow-on audits based upon leads identified in financial statements from single audit reports. For example, the Department of Health and Human Service's (HHS) OIG follow-on audits identified \$360 million in cost containment recommendations in seven areas: pensions, internal service funds, self-insurance, cost allocation, state sales taxes, capital leases, and sick pay credits. Our review of 100 single audit reports identified audit leads for potential follow-up in three areas: pension plans, internal service

funds, and fixed assets. Illustrations of potential follow-on audits identified by OIGs and GAO follow.

Pension Plans

The HHS OIG conducted follow-on audits that identified \$88 million in inappropriate charges to federal programs. This occurred because governmental entities used pension plan contribution rates which exceeded actuarially determined rates. For example, one entity charged federally funded programs a significantly higher contribution rate than it charged programs funded from its general fund. The HHS OIG also found that some entities were inappropriately charging federal programs for interest costs on unfunded pension liabilities arising because the entity made smaller pension plan contributions than the actuarially determined requirements.

We identified 21 audit leads involving pension plans for potential follow-up by focusing on the pension plans' funding status. These leads were flagged for entities showing an unfunded pension benefit obligation¹ in the financial disclosures because these entities may be charging unallowable interest to federal programs.² In addition, we considered entities with large overfunded pensions to be candidates for follow-on work because they may be overcharging federal programs for plan contributions that exceed actuarially determined amounts.

Self-Insurance Funds

Through review of financial statement disclosures, the HHS OIG noted information regarding self-insurance activities which indicated a possible overcharge to federally funded programs. For example, some governments had large or increasing provisions for losses, reserves, or retained earnings in their self-insurance funds. OIG follow-on audits showed that some states had overcharged federal programs because (1) self-insurance funds were not established on an actuarially sound basis, (2) some premiums were not discounted to reflect investment income, and (3) fund surpluses were transferred for general fund uses. The OIG noted that such charges were not in compliance with federal cost principles and recommended that such charges to federal programs be disallowed.

¹Government accounting standards require that state and local government employers disclose a standardized measure of their obligation to a pension plan and compare this figure to the net value of plan assets accumulated to meet these obligations. The difference between the obligation and the net value of plan assets provides a standardized measure of the plan's funding status and is disclosed in the government employer's financial statements. The actual obligations of the plan tend to be larger than those developed using the standardized measure.

²Interest accrues on the unfunded actuarially accrued liability (UAAL) of a pension plan. Interest accruing on that portion of the UAAL that is the result of the governmental entity making contributions to the plan that are smaller than actuarially determined amounts are not allowable under federal cost principles.

Internal Service Funds

Internal service funds, which provide common services, such as automatic data processing and motor pools, should be operated on a cost reimbursement basis. As a result, these funds should not realize significant amounts of operating income or accumulate large retained earnings. The HHS OIG has issued 19 reports on internal service funds identifying nearly \$62 million in recommended cost containment.

By reviewing financial statement disclosures, the OIG noted that several states had built up excess retained earnings in their internal service funds. Follow-on audits showed that the states used billing rates that exceeded the costs of services provided to federal programs. The OIG recommended that the states restore these funds to federal programs.

We identified 11 potential internal service fund follow-on audit leads. We asserted that an internal service fund that had retained earnings which exceeded operating income by more than 10 percent would be an audit lead. In each of the 11 cases, the internal service funds' retained earnings (which ranged from \$130,000 to more than \$53 million) met this criterion. In one case, we contacted the state auditor who conducted the single audit and learned that a subsequent year's single audit had disclosed that the entity's internal service fund was overcharging federal programs.

Cost Allocation

The Department of Transportation OIG also used financial disclosures as the foundation for a follow-on audit of cost allocation. The OIG's audit recommended that a state government refund \$37 million to the Federal Aviation Administration for excessive transfers of airport revenues. The OIG follow-on audit found that the federal government's share of central service costs exceeded the total cost of providing the services to all users. The OIG also used information found during the follow-on audit to develop a risk alert for auditors' use in conducting single audits.

Sale of Assets

In reviewing financial statement disclosures, we identified 15 instances where entities disposed of fixed assets and received cash in return. In 2 cases, the reports indicated that federal funds were used to purchase the assets. Federal cost principles require that the federal government receive a share of the proceeds from the sale of assets that were purchased using federal grant monies. By reviewing financial disclosures to determine if governmental entities received proceeds from the sale of assets, federal agencies can identify follow-on audits that could lead to the recovery of federal funds.

**Findings Offer Basis for
Follow-on Audits and
Program Oversight**

OIGs have conducted follow-on audits as a consequence of findings contained in single audit reports. Auditors' findings may also indicate that the entities may have problems that need further audit coverage or oversight.

Subrecipient Monitoring

Of the 100 reports we reviewed, we identified 8 that contained findings on the entities' subrecipient monitoring that may warrant further investigation. Under the Single Audit Act, direct recipients of federal funds are responsible for monitoring subrecipients to ensure that they (1) expend federal funds in compliance with applicable laws and regulations and (2) promptly correct material noncompliance. Five of the entities with subrecipient monitoring findings either had not received audit reports from subrecipients or had not resolved audit findings for at least a year after they received the subrecipients' audit reports. In one case, the recipient had not resolved audit findings in 7 years. Follow-on audits of direct recipients may help to improve their internal controls over subrecipient monitoring and ensure that federal funds are safeguarded.

Cash Management

The Department of Education's OIG developed a follow-on audit based upon a finding concerning a state's education department maintaining unreported letter of credit advances from Education. The OIG found that the state was improperly drawing federal funds before it needed them for program operations. The follow-on audit resulted in the state refunding \$750,000 to the federal government.

**Proposal: Guidelines for
Use of Single Audits**

In our February 1994 proposal, we suggested that OMB, working through the President's Council on Integrity and Efficiency, develop guidelines for inspectors general to follow in (1) reviewing single audit reports for purposes of identifying emerging trends and concerns in the delivery and operations of federal programs and (2) working with program managers to help them make effective use of single audit report information.

Stakeholders' Response

Federal managers that we interviewed believe that OIGs could do more to assist them in effectively using single audit report information. Eighty percent of the managers said that OIG assistance in analyzing single audit report information would greatly help them. Several managers suggested that the OIGs provide training to program managers in how to use audit reports.

GFOA representatives concurred with this proposal, three OIGs opposed it, and other groups did not express an opinion. The Department of Housing and Urban Development's OIG is opposed to having OIGs routinely review single audit reports, and the SBA OIG believes that staff shortages in OIG offices will make the proposal impossible to implement. The Labor OIG opposed the proposal because it does not believe single audit reports contain relevant information.

Data on Single Audit Results Are Not Readily Accessible

Several factors make the data on single audit results not readily accessible to managers. First, federal agencies do not receive copies of single audit reports for many entities that receive funds from their programs. This occurs because entities are only required to submit single audit reports to the federal funding agencies when they receive federal funds directly from the agencies. (See figure 1.1 for an illustration of the flow of federal funds and single audit reports.) Therefore, while federal program managers are responsible for monitoring the use of their programs' funds, they only receive audit reports from a portion of the many entities that receive the money. Thus, they do not have easy access to information that would help in planning federal follow-on work.

Second, program managers told us that reviewing single audit reports to determine if additional oversight or follow-on audits are needed is time-consuming because the reports are long and difficult to read. We believe a summary auditor's report would help identify single audit reports that merit further review, but it will not eliminate the need to obtain detailed information from the single audit reports.

Third, the Federal Audit Clearinghouse, which is supposed to receive copies of single audit reports for entities that receive more than \$100,000 in federal assistance, maintains data on which entities have submitted reports but does not compile the results of all single audits that could be used to plan audit work and program monitoring. The Clearinghouse has collected expenditure data by federal program for a sample of governments. The results of all single audits could be made accessible if the results were compiled in an automated database. However, the data on the single audit reports the Clearinghouse receives are not standardized. Until they are, no useful database is possible.

We believe, and most program managers we interviewed concur, a single audit report database should include information on the federal programs each entity operates and the expenditures by program and in total. OMB

Circular A-128 requires entities to prepare a Schedule of Federal Financial Assistance (SFFA) that discloses the expenditures for each federal program an entity operates, but it does not prescribe a format for the SFFA. The AICPA has developed illustrations for preparing the SFFA; however, the AICPA illustrations are recommended but not required. Our work shows that the type of data included on different entities' SFFAs varies greatly.

We believe the Schedule could be the starting point for a database to (1) develop a profile of all entities operating particular programs, (2) analyze the effect that raising the Act's thresholds could have on the number of entities having single audits, (3) project the effect of changing major program criteria on the number of programs that would be subject to mandatory testing, and (4) determine the amount of expenditures by subrecipient governments.

During our review, we analyzed a random sample of 210 single audit reports and found that the SFFAs prepared by the entities in our sample contained from 3 to 10 different types of information. Almost all of the SFFAs identified the federal programs by name and program number and listed the programs' total expenditures. However, information that program managers told us would be very useful to them (the grant numbers and total award amounts) were only disclosed in 69 percent and 56 percent of the SFFAs, respectively. Information on the amounts of federal financial assistance that entities passed to other entities, which could help identify whether an entity is directly delivering services to program beneficiaries or enlisting the assistance of other entities, was only provided by 4 percent of the entities.

**Proposal: Expand the
Single Audit Database and
Standardize the SFFAs**

In our February 1994 proposal, we suggested that the Census Bureau Federal Audit Clearinghouse expand its single audit database to include data on

- key financial information from the Schedules of Federal Financial Assistance,
- the auditors' opinions on the financial statements and the Schedules of Federal Financial Assistance,
- any internal control representations by management and any attestation by auditors on those representations,
- reportable conditions and material weaknesses, and
- other significant matters.

We also proposed that OMB mandate the form and content of the Schedules of Federal Financial Assistance and require entities to use the same accounting basis in preparing the financial statements and the SFFAS.

Stakeholders' Response

Nearly two-thirds of the program managers interviewed said that a database of single audit information would be a significant help in comparing information about entities operating their programs. The same proportion of managers said that they would be particularly interested in information on the amount of questioned costs and the number and types of findings by program number. Eighty percent of the managers said they would like to use the database to identify all entities operating their programs that had serious internal control or noncompliance problems disclosed in single audit reports. A Clearinghouse official we talked with believes that a database of single audit report data could be established with a minimal investment of two or three additional analysts.

Some of the managers said the benefits of a database would be somewhat limited in a regional office because they manage few grantees. However, they said a database would probably be very helpful for the national office. Still others said that they thought that the database would not be helpful.

Four OIGs opposed establishing a single audit database because they think the information would not be useful and/or worth the expense. GFOA representatives concurred with the proposal, and the Commerce OIG strongly supported it in the belief that expanding the role of the Federal Audit Clearinghouse could alleviate the administrative burden on the OIGs. Representatives of other groups did not comment on the proposal.

Nearly 90 percent of the program managers strongly supported a proposal for OMB to prescribe the minimum form and content of the SFFAS. Some stated the importance of program manager involvement in OMB's decision-making process to ensure that the final design meets their needs.

Representatives of other stakeholder groups had differing reactions to the proposal to have OMB prescribe the form and content of the SFFA. GFOA representatives strongly supported the proposal, and AICPA representatives said that AICPA should play a role in prescribing the SFFA's form and content. One NSAA representative stated that many state auditors agreed with the need to standardize the SFFA but believe that OMB should be required to formally consult with affected parties before prescribing a new

form and content for the SFFA. Two OIGs opposed our proposal for OMB to prescribe the form and content of the SFFA. The HUD OIG opposed the proposal because it does not believe additional prescriptions are needed. The Department of Defense OIG also opposed the proposal, stating that prescribing the form and content of the SFFA might result in voluminous data being included in single audit reports and might limit Defense's ability to get entities to provide information supplementing the SFFA.

Conclusions

Data from single audit reports are useful in identifying entities where federal funds are vulnerable and where additional audit work is needed. However, with thousands of single audit reports, only limited efforts can be made to review individual reports and identify entities where follow-on work is needed. If key single audit report data were put in a standardized format and compiled in an electronic database, it could be readily used by OIGs and program managers to plan follow-on work.

Both the OIGs and GAO have identified information in single audit reports that can provide the foundation of follow-on audits or program manager oversight activities. Offices of inspector general, state auditors, and federal and state program managers could use single audit reports as an integral part of oversight of federal financial assistance programs.

Recommendations

To promote the use of single audit reports in planning future audit work, we recommend that OMB, through the President's Council on Integrity and Efficiency, develop guidelines for using summary report information from a central single audit clearinghouse to identify follow-on audits and reviewing single audit reports.

We recommend to the Secretary of the Department of Commerce that the Federal Audit Clearinghouse in the Bureau of the Census expand its single audit database to include information on:

- the Schedules of Federal Financial Assistance,
- the type of auditors' opinions on the financial statements and the Schedules of Federal Financial Assistance,
- the results of any internal control representations by management and any attestation by auditors on those representations,
- reportable conditions and material weaknesses, and
- other significant matters.

Chapter 5
Improving the Impact of Single Audit
Reports

To ensure that consistent financial information is available about the federal programs that state and local governments operate, we recommend that the Office of Management and Budget prescribe the form and content of the Schedules of Federal Financial Assistance in consultation with stakeholders.

Federal Programs Administered by Federal and State Managers Responding to GAO's Questionnaire on Single Audits

Farmers Home Administration programs, Department of Agriculture

Coastal Zone Management Administration Awards, Department of Commerce

Federal Family Education Loan Program, Department of Education

Weatherization Assistance for Low-Income Persons, Department of Energy

Medical Assistance Program (Medicaid), Department of Health and Human Services

Lower Income Housing Assistance Program, Department of Housing and Urban Development

Sport Fish Restoration, Department of the Interior

Drug Control and System Improvement Program (Formula Grant), Department of Justice

Job Training Partnership Act programs, Department of Labor

Federal Transit Administration programs, Department of Transportation

Veterans State Nursing Home Care, Department of Veterans Affairs

Hazardous Substance Response Trust Fund (Superfund), Environmental Protection Agency

Federal Managers Interviewed Concerning GAO's Proposals to Improve the Single Audit Process

Department of Energy

Region I (Boston, MA), Director, Boston Support Office

Region II (New York, NY), Deputy Director, New York Support Office

Region IV (Atlanta, GA), Contracts Specialist

Region VI (Dallas, TX), Director, Dallas Support Office

Region VII (Kansas City, MO), Contracting Officer

Region VIII (Golden, CO), Program Director

Department of Health and Human Services

Region I (Boston, MA), Supervisory Accountant, Medicaid Financial Management Branch

Region II (New York, NY), Chief, Medicaid Financial Management Branch

Region III (Philadelphia, PA), Chief, Medicaid Financial Management Branch

Region IV (Atlanta, GA), Associate Regional Administrator, Medicaid

Region V (Chicago, IL), Chief, Medicaid Financial Management Branch

Region VI (Dallas, TX), Chief, Medicaid Financial Management Branch

Region VIII (Denver, CO), Associate Regional Administrator, Medicaid

Department of Housing and Urban Development

Region I (Boston, MA), Director, Management Division, Public Housing

Region I (Manchester, NH), Financial Analyst

Region III (Philadelphia, PA), Director, Management Division

Region III (Washington, DC), Housing Management Specialist, Public Housing Division

Region VII (Kansas City, KS), Director, Management Division

Region VIII (Denver, CO), Financial Manager

**Appendix II
Federal Managers Interviewed Concerning
GAO's Proposals to Improve the Single
Audit Process**

**Department of the
Interior**

Region III (Arlington, VA), Chief, Financial Aid Division

Region IV (Atlanta, GA), Deputy Assistant Regional Director, Federal Aid

Region VIII (Lakewood, CO), Budget and Accounting Analyst, Division of
Federal Aid

Department of Justice

Headquarters (Washington, DC), Manager, Financial Services Branch

Department of Labor

Region III (Philadelphia, PA), Director, Office of Unemployment Insurance

Region V (Chicago, IL), Director, Office of Training and Employment

Region V (Chicago, IL), Financial Manager, Office of Training and
Employment

Region VII (Kansas City, MO), Deputy Regional Administrator, Office of
Employment and Training Services

Headquarters (Washington, DC), Chief, Office of Grants and Contracts
Management, Proactive Unit

**Environmental
Protection Agency**

Region VIII (Denver, CO), Deputy Director, Hazardous Waste Management
Division

**Farmers Home
Administration**

Region IV (Columbia, SC), Chief, Community and Business Programs

Region IV (Jackson, MS), Chief, Community and Business Programs

Region IV (Lexington, KY), Chief, Rural Housing

Region IV (Gainesville, FL), Chief, Community and Business Programs

Region V (Columbus, OH), Chief, Rural Housing

Region V (Columbus, OH), Chief, Community and Business Programs

Region VIII (Lakewood, CO), Chief, Community and Business Programs

**Appendix II
Federal Managers Interviewed Concerning
GAO's Proposals to Improve the Single
Audit Process**

**Federal Transit
Administration**

Region I (Cambridge, MA), Chief, Program Management Division

Region III (Philadelphia, PA), Director, Office of Project Management

Region IV (Atlanta, GA), Director, Office of Management and Technical Assistance

Stakeholder Group Representatives Contacted Concerning GAO's Proposals to Improve the Single Audit Process

American Institute of
Certified Public
Accountants

Chair, Government Accounting and Auditing Committee
Chair, Government Technical Standards Committee
Member, Auditing Standards Board
Vice-President, Federal Government Division

Government Finance
Officers Association

Chair, Committee on Accounting, Auditing, and Financial Reporting
Director, Technical Services Center

State Auditors

President, National State Auditors Association
Chair, National State Auditors Association Single Audit Committee
Various State Auditor Offices

National Association
of State Comptrollers

President
Executive Director

Federal Grants
Network

General Membership Meeting, April 1994

President's Council on
Integrity and
Efficiency

Chair, Standards Subcommittee¹

¹The Subcommittee Chair also conveyed written and oral comments from the Offices of Inspector General for the departments of Agriculture, Commerce, Defense, Education, Energy, Health and Human Services, Housing and Urban Development, Justice, Labor, State, and Transportation, and the Environmental Protection Agency, the Office of Personnel and Management, and the Small Business Administration.

Summary of Financial Management Improvements in the State and Local Governments Visited

Georgia

| | |
|---|-----------------------|
| Federal Financial Assistance Expenditures | \$3.5 billion in 1991 |
|---|-----------------------|

| | |
|----------------------------------|---|
| Conditions Prior to Single Audit | <ul style="list-style-type: none">• Federal grants received little audit coverage.• State's financial statements were audited on agency-by-agency basis.• State did not monitor administration of federal funds by subrecipients. |
|----------------------------------|---|

| | |
|---|---|
| Improvements Influenced by Single Audit | <ul style="list-style-type: none">• State now combines financial statement audits and grant audits in one audit.• State produces consolidated, GAAP-based financial statements on a statewide basis.• State education department implemented a subrecipient monitoring system which tracks whether subrecipients have been properly audited and whether corrective actions have been taken on audit findings.• State prepared a Schedule of Federal Financial Assistance for the first time. |
|---|---|

Maine

| | |
|---|-----------------------|
| Federal Financial Assistance Expenditures | \$814 million in 1991 |
|---|-----------------------|

| | |
|----------------------------------|--|
| Conditions Prior to Single Audit | <ul style="list-style-type: none">• State received financial statement audits once every 4 years and had never received a comprehensive audit of its internal controls.• State's compliance with federal laws and regulations was only audited during individual grant audits which meant many programs either never received compliance audits or received compliance audits once every 6 or 7 years.• State did not track federal grant moneys by federal program. |
|----------------------------------|--|

**Appendix IV
Summary of Financial Management
Improvements in the State and Local
Governments Visited**

**Improvements Influenced
by Single Audit**

- State conducts annual audits of its financial statements and internal controls.
- State enhanced its accounting system by adding a grant accounting module which enables it to track grant moneys by program and manage cash received from federal programs.

Mississippi

**Federal Financial
Assistance Expenditures**

\$1.9 billion in 1991

**Conditions Prior to Single
Audit**

- State had poor controls over federal funds because each state agency maintained its own funds and lumped federal grant moneys together.
- State did not comply with sound cash management practices which resulted in drawdowns from grant moneys regardless of the moneys' intended purpose, unreliable records on grant receipts and expenditures, and possible excessive federal fund balances.
- State's internal control systems had not been audited.

**Improvements Influenced
by Single Audit**

- State installed a new accounting system with a general ledger and the ability to track grants centrally by program.
- State improved its cash management practices, thereby reducing the number of funds with possible excessive balances.
- State promulgated policy requiring agency managers to conduct annual internal control evaluations.

Texas

**Federal Financial
Assistance Expenditures**

\$10 billion in 1991

**Appendix IV
Summary of Financial Management
Improvements in the State and Local
Governments Visited**

**Conditions Prior to Single
Audit**

- State's financial statements were prepared on an agency-by-agency basis and were not consolidated.
- State's federal financial assistance was accounted for on an agency-by-agency basis.
- State did not know whether subrecipients of federal funds had been properly audited or whether corrective actions had been planned.

**Improvements Influenced
by Single Audit**

- State now prepares financial statements on and receives financial audits of the entire state, including colleges and universities.
- State prepared its first Comprehensive Annual Financial Report for fiscal year 1990.
- State now prepares a Schedule of Federal Financial Assistance.
- State now tracks subrecipient funding, reviews all subrecipient audits, and monitors subrecipients' corrective action plans.
- State monitors program managers' implementation of corrective actions through subsequent single audits.

West Virginia

**Federal Financial
Assistance Expenditures**

\$1.5 billion in 1991

**Findings of First Single
Audit**

- State did not have meaningful financial data.
- State did not know how much it owed or how much of its debts it could pay when they came due.
- State had multimillion dollar discrepancies in its investment accounting systems and credited millions in unearned interest to investment accounts it managed for the state workers, pension funds, and third parties.
- State had not contributed to its pension funds over a 2-year period.

**Improvements Influenced
by Single Audit**

- State hired senior financial managers and installed new statewide, GAAP-based accounting system; state now has ready access to financial data on debts and obligations.
- State installed new accounting system for investments, hired qualified investment staff, and began monthly reconciliations of investment accounts.

**Appendix IV
Summary of Financial Management
Improvements in the State and Local
Governments Visited**

- State obtained actuarial estimates of its pension funds' future obligations, and began making regular pension contributions.
 - State prepared its first Comprehensive Annual Financial Report.
-

**Hamilton County,
Tennessee**

Federal Financial Assistance Expenditures \$9 million in 1991

- Conditions Prior to Single Audit**
- County did not know whether subrecipients were using federal grant moneys as intended.
 - County spent large amounts of time training grant auditors in its accounting system because the grant audits were conducted by different auditors each year.
-

- Improvements Influenced by Single Audit**
- County assigned the responsibility for monitoring subrecipients to a central office which advises county program officials on whether subrecipients are following federal grant requirements, tracks all findings in subrecipient audit reports, and works with subrecipients to obtain corrective action on audit findings.
 - County's single audits are usually conducted by the same auditors year after year, and this reduces the time county officials must spend training the auditors in the county's accounting system.
-

**Wake County, North
Carolina**

Federal Financial Assistance Expenditures \$14 million in 1991

- Conditions Prior to Single Audit**
- County did not have centralized records on federal funds and had to contact each county department for financial data to prepare the Schedule of Federal Financial Assistance.
-

**Appendix IV
Summary of Financial Management
Improvements in the State and Local
Governments Visited**

- County's accounting system only recorded cash-based data and had to be manually adjusted to produce GAAP-based financial statements.
 - County's federal funds were only audited on an individual grant basis and some grants had not been audited for 10 years.
-

**Improvements Influenced
by Single Audit**

- County installed a new accounting system that recorded financial data in accordance with generally accepted accounting principles and generated financial statements and Schedules of Federal Financial Assistance automatically.
 - County now receives annual single audits which cover internal controls over federal programs and compliance with federal laws and regulations and which allow program managers to correct problems soon after they occur.
-

Chicago, Illinois

**Federal Financial
Assistance Expenditures**

\$513 million in 1991

**Conditions Addressed by
Single Audit**

- City did not properly track repayments of federally funded loans made to city businesses nor was it following up on delinquencies.
 - City only had records on individual grants and did not track the amount of federal funds by program number.
 - City found it difficult to obtain records for and resolve findings from grant audits that often covered several years' transactions.
 - City did not require many of its subrecipients to receive annual audits.
-

**Improvements Influenced
by Single Audit**

- City created an office to track loan repayments, contacted all borrowers to verify its loan records, and instituted procedures for notifying delinquent borrowers and resolving repayment problems.
 - City enhanced its accounting system by adding the ability to track federal funds by program number.
 - City established procedures requiring central reporting of grant funds.
 - City required its subrecipients to receive entitywide annual audits.
-

Los Angeles, California

Federal Financial Assistance Expenditures \$178 million in 1991

Conditions Prior to Single Audit

- City did not know the total amount of federal funds it had received because federal receipts and expenditures were not always identified as such in the accounting system.
- City passed federal moneys to roughly 220 subrecipients who, due to the grant-by-grant audit approach, often went several years without being audited.
- City's subrecipients had difficulty resolving audit findings on transactions that occurred years before the audit.

Improvements Influenced by Single Audit

- City established a central office to monitor federal funds, required city departments to report receipt of all federal funds, and improved its tracking of federal moneys in its accounting system.
- City required subrecipients to have an annual audit, improved its tracking of funds provided to subrecipients, and instituted a policy of withholding funds from subrecipients who did not comply with its audit requirement.
- City accelerated efforts to adopt GAAP-based financial reporting.

Board of Education, Dalton, Georgia

Federal Financial Assistance Expenditures \$1.6 million in 1991

**Appendix IV
Summary of Financial Management
Improvements in the State and Local
Governments Visited**

**Findings of Early Single
Audit**

- Board did not track federal funds for individual programs which could have resulted in federal funds not being used as intended.
- Eligibility requirements in school lunch program were not being followed.

**Improvements Influenced
by Single Audit**

- Board installed a new accounting system that tracks revenues and expenditures by program.
- Board strengthened internal controls over lunch program.

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