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BY THE COMPTROLLER GENERAL

# Report To The Congress

OF THE UNITED STATES

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## Grant Auditing: A Maze Of Inconsistency, Gaps, And Duplication That Needs Overhauling

Government agencies' auditing of the use of Federal grant funds is uncoordinated, ineffective, and inefficient.

About 80 percent of grant funds in GAO's sample had not been audited at all by Federal agencies. Others had been audited repeatedly. This occurred because each Federal agency audits its own grants without coordinating coverage with other funding agencies.

This report recommends overhauling Federal laws, policies, and agency practices to provide single, coordinated audit coverage of grant recipients. It makes recommendations to the Congress, the Office of Management and Budget, and the executive branch, which should improve coordination and assure that grant recipients are audited when necessary with results acceptable to all funding agencies.





COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

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To the President of the Senate and the  
Speaker of the House of Representatives

This report shows that methods for auditing grants are disorganized and do not afford grants the full protection of audits or optimize the use of audit resources. It contains recommendations for changes in legislation, Office of Management and Budget policies, and agency regulations and practices. These changes would amend certain inflexible audit requirements and give agencies more control in scheduling audits and determining who is to perform them. The changes would also place a greater responsibility on the Office of Management and Budget and the operating agencies for assuring that grantees are audited periodically, and that grantees receiving funds from more than one Federal agency are audited by one organization to satisfy the needs of all the Federal agencies.

We made this review as part of our current effort to expand and strengthen audit activities of Government departments and agencies.

We are sending copies of this report to the Director, Office of Management and Budget, and to the heads of other departments and agencies.

*James B. Stacks*  
Comptroller General  
of the United States

D I R E S T

Federal grants will total about \$85 billion in fiscal 1979. The Government relies on audit as the basic control to see that these funds are spent as the Congress intended and to prevent unauthorized expenditures and loss of funds from fraud and abuse. Accordingly, the Congress and agencies have consistently provided for audits of grantees' records.

Important as grant auditing is, GAO found that Federal agencies' approaches to it are not coordinated and do not provide effective surveillance of these public funds or optimize the use of audit resources.

The ideal in auditing grant programs is to have a single audit of a recipient that would be acceptable to all the funding organizations. This audit should assure that the recipient's financial records and controls are adequate and check for compliance with important terms of the grants received. Such audits would be made periodically when needed. Funding organizations would then be free to perform additional audits of economy and efficiency and program results as deemed necessary.

This ideal is far from being achieved. In general, agencies audit only their own grants. They do not completely review grant recipients' financial controls and pay little attention to how a recipient's grant management practices affect other Federal grants, even those of much larger amounts. Under this narrow approach, the auditors are unlikely to detect improper charges or transfers of funds and equipment to the grant. Moreover, Federal agencies do not provide for audits of many grants while providing for repeated audits of other grants with minimal results.

This disorganized approach to grant auditing costs time and money. The Government can lose millions of dollars through gaps in audit coverage. Unnecessary costs result from duplication of effort and from performing audits too often of grants too small to warrant more than an occasional audit. Also, numerous audits unnecessarily disrupt the grantee's staff.

Through a review of the audit experience of 73 grant recipients during fiscal 1974 through 1977, GAO found that 80 percent of the recipients' \$3.7 billion in Federal funds was not audited by or on behalf of the Federal agencies. This test was not based on a statistical sample, since the information to develop such statistics is not available. However, if this percentage were applied to the approximately \$240 billion in grants awarded during the period, it is possible that the Government did not provide audits for nearly \$192 billion.

Of the 73 grant recipients GAO reviewed, 17 either were not audited at all, or suffered such major gaps in audit coverage that GAO could not consider them audited. Of the remaining 56 audited, 51 (over 90 percent) received audits that provided only partial or no insight into whether Federal funds were properly spent. For the most part, these audits were made to satisfy State or other non-Federal requirements. Only one grant recipient received a single comprehensive audit. (See p. 8.)

The number of times a recipient was audited sometimes varied widely--from no audits to more than 50. One grantee, for example, received 23 grants from 5 Federal agencies. None of the grants provided in calendar 1974 through 1977 was audited. In contrast, a grantee funded by 5 Federal agencies was audited 19 times by 6 different audit organizations between June 1975 and October 1977. (See pp. 9 and 12.)

ACTIONS NEEDED TO IMPROVE  
GRANT AUDITING

Few of these problems in grant auditing are new. GAO's review indicated that the attempts which the Office of Management and Budget, Federal and State agencies, and grantees have made to solve these problems have largely been ineffective.

The general ineffectiveness of past efforts to improve grant auditing is caused by a number of different, yet closely related factors. The major factors are:

- inflexibilities and inconsistencies in grant audit laws and agency regulations,
- the uncoordinated Federal approach to grant auditing that allows each Federal agency to issue guidelines and conduct specific grant audits to meet its own needs without coordinating the work with other agencies,
- the poor use and possible shortage of audit resources, and
- the failure of the Government to see that its grantees make or have audits made that satisfy Federal needs.

Federal laws and agency regulations require some grants to be audited repetitively, at specific intervals, providing the auditors with no flexibility to change the time or scope of the audit work. The executive branch has not instituted (1) a system for coordinating and assigning responsibility for comprehensive audits of grant recipients, (2) a standardized grant audit guideline for Government-wide use, or (3) controls and requirements to insure that non-Federal audits paid for with grant funds better satisfy Federal needs.

The Government needs to expand audit coverage of grant recipients through the use of coordinated single audits. This audit approach eliminates duplication of effort and reduces

auditing of many compliance items, while providing a better look at the grantee's overall performance.

### CONCLUSION

GAO believes the continuing problems in grant auditing will only be solved by an overhaul of existing Federal laws, policies, and practices. This can be done by (1) establishing a new and more flexible approach to grant auditing and (2) developing new structures for the conduct of coordinated, single audits of grantee institutions. The Congress needs to enact new grant audit legislation, and the Office of Management and Budget should strengthen its policies to institute this approach.

### RECOMMENDATIONS

GAO recommends that the Congress amend the Intergovernmental Cooperation Act of 1968 to prescribe standard audit requirements applicable to all Federal grants. The amendment should rescind existing laws for regularly scheduled audits of individual grants by particular organizations and allow Federal agencies flexibility in judging audit need. The amendment should designate a reasonable time interval within which grant recipients must be audited.

GAO recommends that the Director, Office of Management and Budget

- designate cognizant Federal agencies for making single audits of multifunded recipients (responsibility for auditing specific types of recipients, such as hospitals and colleges, could be divided among several agencies),
- hold periodic meetings with grant administering agencies to insure complete and successful implementation of the cognizant approach,
- direct cognizant agencies to use a standard

audit guide 1/ or a suitable replacement in auditing multifunded recipients,

- develop a nationwide system to identify Federal funding that grant recipients may receive, and
- stipulate that to be paid for with grant funds, non-Federal audits must follow Federal audit guidelines.

GAO recommends that the heads of Federal departments and agencies administering grants

- establish procedures to insure that grantees under their cognizance have required audits that include steps necessary to satisfy Federal as well as their own needs,
- assure that their auditors make maximum use of audits arranged by non-Federal agencies and only do whatever additional work may be necessary to see that grant funds are spent for the intended purpose and are otherwise safeguarded, and
- assure continuous liaison with non-Federal audit staffs with common interest to minimize the amount of audit effort required and to learn of problem areas.

AGENCY COMMENTS  
AND OUR EVALUATION

The Director of the Office of Management and Budget expressed great concern over the findings of this report and commented on recent actions to improve grant auditing. He also strongly endorsed the recommendation to rescind existing laws requiring audits of individual grants and endorsed the use of a single audit guide. (See pp. 31 and 32.)

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1/A guide has been developed by GAO, the Office of Management and Budget, and the Intergovernmental Audit Forum which could serve this purpose.

The Office of Management and Budget felt that it would be too severe at this time to stipulate that to be paid for with grant funds, non-Federal audits must follow Federal audit guidelines. (See pp. 32 and 33.) GAO's review showed that many non-Federal audits are of little use to Federal agencies and it believes that the least expensive way to satisfy Federal needs is to expand the audits already being made. (See pp. 11 and 21-23.)

GAO received comments from the 11 agencies it reviewed. The agencies agreed, at least in principle, with GAO's recommendations to the departments and agencies. Although some agencies expressed concerns, only the Department of the Interior did not favor GAO's recommendation that the Office of Management and Budget require formal audit cognizance. The Department felt that duplication would result if agencies perform additional audits to meet special needs. To achieve coordinated, comprehensive audits, GAO believes the designation of cognizant agencies is essential. When special audits are necessary, they should be coordinated to avoid duplication of effort.



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ABBREVIATIONS

CSA	Community Services Administration
EPA	Environmental Protection Agency
GAO	General Accounting Office
HEW	Department of Health, Education, and Welfare
HUD	Department of Housing and Urban Development
OMB	Office of Management and Budget

## CHAPTER 1

### INTRODUCTION

The Federal Government funds a variety of domestic assistance programs in such areas as health, law enforcement, and environmental protection. In fiscal 1979, an estimated \$85 billion will be provided to the governments of all 50 states, 3,000 counties, and nearly 90,000 local jurisdictions. In addition, numerous other entities, such as hospitals, universities, and nonprofit organizations, will benefit from this funding. This Federal assistance takes many forms, including grants-in-aid, direct payments, loans, loan guarantees, subsidies, insurance, and nonfinancial aids. It is provided through nearly 1,100 Federal programs and a variety of administrative structures. Most assistance--about 600 of the 1,100 programs--is offered in the form of grants-in-aid.

When the Government spends money through grantees, it has less control over those funds and how they are spent than it has over expenditures by its own organizations. Grant auditing is a function which is used to provide greater assurance that funds are spent wisely and for authorized purposes. For this reason, the Congress and the various executive agencies have continually provided for audits of grantees' records to prevent unauthorized expenditures and loss of funds.

### AUDIT AUTHORITY

Requirements for grant audits are specified in legislation, Office of Management and Budget (OMB) Circulars, and Federal agencies' regulations. By requiring agencies to have effective control systems, the Congress directed in the Accounting and Auditing Act of 1950 that Federal agencies should audit, or have audits made of non-Federal institutions that receive or spend Federal funds. To insure that grant recipients properly safeguard the funds and use them for intended purposes, the Congress has required, through legislation that certain grantees' records be audited at periodic intervals.

### POLICIES FOR GRANT AUDITING

Federal assistance has increased from \$6.7 billion in fiscal 1959 to an estimated \$85 billion in fiscal 1979. Managing limited audit resources to adequately cover the audit of these increasing expenditures has become more and more difficult. As a result, OMB has established policies that are intended to improve grant audit and administrative

practices and to result in more efficient use of staff resources. The policies provide that:

- Federal agencies are to prepare an audit plan and set their own priorities and requirements for audit frequency and coverage. (OMB Circular A-73.)
- Federal agencies are to rely on the work of non-Federal auditors whenever possible. (OMB Circular A-73.)
- Federal grantor agencies are to work out cross-servicing arrangements where one agency conducts audits for the others. (OMB Circular A-73.)
- One Federal agency will do all the necessary auditing of direct and indirect costs at a single educational institution. (FMC 73-6.)
- State and local units of government must to be audited by internal auditors or certified public accountants at least once every 2 years. (OMB Circular A-102.)
- Colleges, universities, hospitals, and other non-profit grantees are required to be audited by internal auditors or certified public accountants at least once every 2 years. (OMB Circular A-110.)

Also, Federal agencies may approve one joint grant application for grantees receiving funds from more than one agency. As part of the application process, one lead agency is selected to administer the grant and have the grantee's operations audited. (OMB Circular A-111.)

To strengthen grantees' financial management systems, OMB has, since 1972, required grantees to have audits conducted. To make such audits more useful to Federal agencies, OMB recently clarified in circulars A-110 and A-102, effective in July 1976 and September 1977, that the audits being made were to be organizationwide, financial and compliance audits. OMB also requires State auditors to audit grants administered by States, and a few Federal agencies require certain programs to be audited by State agency internal auditors. According to OMB guidance, Federal agencies are expected to use this work to the furthest extent possible. However, OMB has made clear that such audits do not relieve Federal agencies of their audit responsibilities. After reviewing the reports and workpapers, Federal auditors are to do any additional work that is required to satisfy Federal needs.

## GRANT AUDITING STRUCTURE

Each agency that provides Federal money to a grantee is responsible for seeing that appropriate audits are made of the grantee's records or activities. These audits may be performed by Federal auditors, State and local auditors, or by certified public accountants.

Auditors involved in evaluating the administration of Federal grants may concern themselves with any or all of four aspects of grant management:

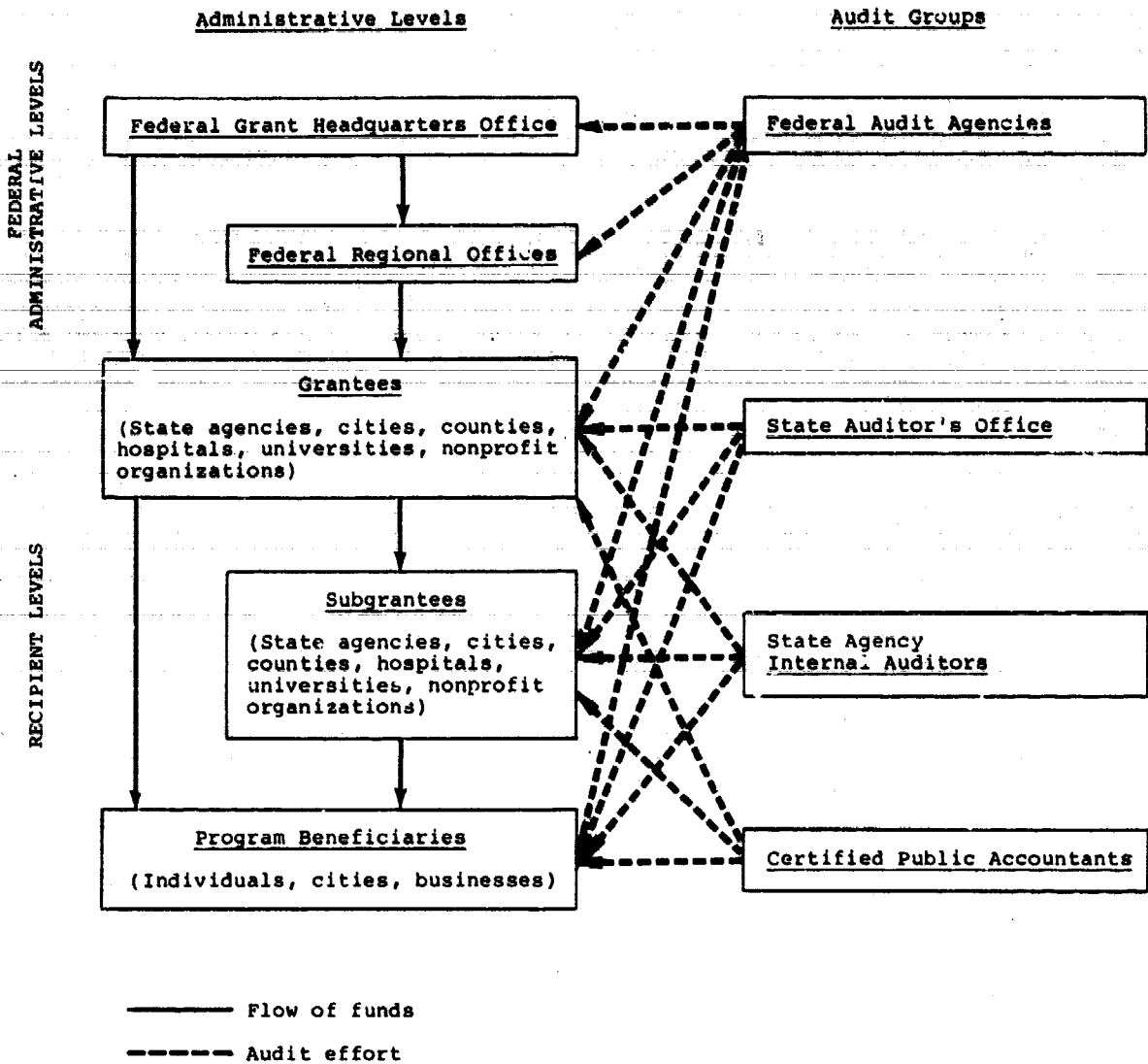
- The adequacy of accounting records, internal controls over assets, and financial reporting.
- Compliance with specific laws, requirements, prohibitions, or limitations unique to each Federal grant program.
- The efficiency and economy with which grant funds have been expended, for such things as personal services, property, facilities, and supplies.
- The grantee's effectiveness in achieving desired program results (e.g., Have the children's reading skills been improved? Have air pollution levels been reduced? If so, by how much?).

Each of these aspects of grant management may be audited separately (e.g., a financial audit) or in combination (e.g., a financial and compliance audit). For the most part, grant auditors have focused their attention on the first two aspects--on assuring that financial records and controls are adequate and that grant funds are spent for intended purposes.

The likelihood that a grant will be audited depends on the number of Federal agencies with which a grant recipient deals, the number of grants it receives, and the number of administrative levels through which grant funds are routed. An institution receiving one grant directly from the headquarters of a Federal agency might anticipate one audit, whereas a multifunded institution receiving grants from numerous agencies could be subject to one or more audits by each agency.

The following diagram illustrates, for each recipient level, the variety of administrative structures that exist and the groups that can perform audits. The diagram shows that grants may be administered directly by agency headquarters or

**ADMINISTRATIVE AND AUDIT  
STRUCTURES FOR FEDERAL GRANTS**



by a combination of headquarters and regional field offices. Under many Federal assistance programs, grants are made to States and to local agencies, which in turn pass all or portions of the funds to subgrantees or directly to program beneficiaries.

#### PURPOSE AND SCOPE OF THIS REVIEW

Because Federal assistance programs and grants continue to grow in number and complexity--generally faster than audit resources are growing--we conducted a Government-wide review to determine if OMB and agency efforts to provide for grant auditing have been successful. Specifically, we reviewed the audit experience of grant recipients to assess the adequacy of

- audit coverage of grantees' financial controls and their compliance with grant terms;
- Federal audit requirements provided in laws, OMB circulars, and agency regulations;
- Federal agency audit planning and programming systems; and
- coordination among various audit organizations-- Federal, State, and local.

We coordinated and cooperated with the Joint Financial Management Improvement Program, which conducted a concurrent grant audit study.

Our findings and conclusions are based on work done at Federal audit and grants management headquarters of the following Federal agencies:

- ACTION
- Community Services Administration (CSA)
- Environmental Protection Agency (EPA)
- Department of Agriculture
- Department of Health, Education, and Welfare (HEW)
- Department of Housing and Urban Development (HUD)
- Department of Labor
- Department of Transportation

We also did limited work at the Departments of Commerce and the Interior, and at the Veterans Administration--we conducted field examinations in Federal Regions V, VII, and X, and in six State audit offices.

To determine the nature and extent of audit coverage at the grantee level, we reviewed the audit experience of 73 Government and nonprofit organizations that received Federal funds as grantees or subgrantees 1/ during fiscal 1974 through 1977. These recipients were located in Indiana, Kansas, Missouri, Ohio, Oregon, and Washington, and were selected on the basis of having received funding from 1 or more of 30 grant programs administered by the eight Federal agencies mentioned above. (See app. II.) Their Federal funding over the 4-year period was as follows:

--43 received between \$1 million and \$50 million.

--22 received between \$100,000 and \$1 million.

--6 received over \$50 million.

--2 received less than \$100,000.

Overall, the 73 recipients were multifunded, receiving funds as follows:

--53 received funds from more than one Federal agency.

--25 received funds from five or more Federal agencies.

--63 received funds from some source other than the Federal Government.

Over 90 percent of the recipients received grant funding from two or more programs, with some of those receiving many grants from a single agency. For instance, one university in our sample received grants from nearly 100 different assistance programs administered by HEW.

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1/Throughout this report, we refer to both grantees and subgrantees as "recipients" or "grantees."



## CHAPTER 2

### AUDIT COVERAGE OF FEDERAL GRANTS RANGES

#### FROM NONEXISTENT TO EXCESSIVE

Audit coverage of Federal grant recipients is inconsistent, ranging from nonexistent or insufficient to excessive. Overall, we found that 1/

- although most grant recipients received audits, the audits were narrow in scope and did not provide either the Federal Government or the grantee with a meaningful overview of the grantees' financial controls and grant management capabilities;
- many recipients received far less audit coverage than seemed appropriate--either no audits were made or coverage of their Federal grants suffered major gaps; and
- some grant recipients were being audited far more often than seemed necessary.

A major problem of grant auditing is that Federal agencies usually audit their own grant programs without concern for grant programs of other agencies. They do not completely review grant recipients' financial controls and pay little attention to how a recipient's grant management practices affect other Federal grants. On the other hand, non-Federal organizations, such as State governments and nonprofit organizations, will usually provide for audits of financial records and controls but seldom review those records for compliance with Federal grant requirements. Neither approach provides adequate coverage and consequently the audits are seldom useful to others. Moreover, Federal agencies and grantees do not ever audit many grants, and yet provide for repeated audits of others with minimal results.

#### THE COORDINATED, SINGLE AUDIT IS FAR FROM BEING ACHIEVED

The ideal in grant program auditing is for the single audit of a recipient to be acceptable to all the funding organizations. Such an audit should assure that the

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1/The following groupings are not mutually exclusive; some recipients are in more than one category.

recipient's financial records and controls are adequate and should check for compliance with important terms of the grants received. Such audits would be made when needed. Funding organizations would then be free to perform additional audits of economy and efficiency and of program results as deemed necessary.

This ideal is far from being achieved. Audit coverage of grants received by the 73 recipients in our sample ranged from no audit whatsoever to many narrowly scoped audits that failed to provide a meaningful overview of the recipient's use of Federal funds. Overall, this condition was noted for 72 of the 73 recipients we reviewed. As a result, the majority of recipients received no audits or audits of uncertain value to the Federal Government.

None of the recipients received what we considered to be a true economy and efficiency or program results audit of their grants, although some audits touched on these areas. However, for the purposes of this review, we did not consider an audit inadequate if it did not cover economy and efficiency or program results. We evaluated only the extent of financial and compliance auditing.

GRANTEES RECEIVED MANY AUDITS  
NARROW IN SCOPE AND OF UNCERTAIN  
VALUE THAT CAUSED DUPLICATION

Although Federal audit policy seeks to have each audit satisfy the needs of as many agencies as possible, most auditing of grant recipients is not done with an eye toward minimizing duplication. Frequently, several different organizations audit the same grant to satisfy the specific requirements of only one agency, while paying little attention to the recipient's grant management practices and how they affect all Federal grants. Such audit coverage is, at best, piecemeal.

This piecemeal approach both provides little assurance that Federal funds are properly safeguarded and causes duplication of effort. Piecemeal auditing has two drawbacks. First, auditors frequently do not detect inequitable charges or improper transfers of funds and equipment to the Federal grant when they do not see the total picture, and second, auditors cannot determine how improper practices affecting one grant may affect other grants and programs. Also, some duplication is inherent in such a piecemeal approach because each team of auditors visiting a grantee ordinarily must examine the same accounting and internal control systems. Besides the obvious waste of the auditors' time and effort,

the more auditors reviewing the same grant, the less likely they will be able to develop a familiarity with a grantee's operations and thus the more likely they will disrupt the grantee's staff.

The following chart shows, for the 73 recipients in our sample, the number of audits that grant recipients underwent and the number of different organizations performing the audits for fiscal 1974-1977 grant funds.

<u>Audits performed</u>	<u>Sample recipients</u>	<u>Organizations auditing at each grantee</u>	<u>Sample recipients</u>
more than 50	4		
21 to 50	3	5 or more	10
11 to 20	8	4	6
5 to 10	19	3	5
2 to 4	28	2	25
1 audit	6	1	22
none	<u>5</u>	none	<u>5</u>
	<u>73</u>		<u>73</u>

Examples of entities that received many grant-oriented audits that were narrow in scope follow.

--A grantee in Missouri receiving funds from ACTION, the Community Services Administration, and from the Departments of HEW, Agriculture, HUD, Treasury, and Labor, as well as from other State and local funding sources, underwent 10 audits over a period of 4 years. However, all 10 audits were focused primarily on individual grants; none were comprehensive--they did not cover all the financial and compliance controls over all Federal grants received by the grantee. HEW, according to a grantee official, is now requiring the grantee to secure one audit of all funding and operations to get a better picture of how the grantee is administering its Federal funds.

--Six different audit organizations (Federal, State, city, and three certified public accounting) audited one nonprofit recipient 19 times between June 1975

and October 1977. Each audit covered either one program or a group of programs funded by a single agency. Although all of the grantee's funds were audited at least biennially, none of the audits covered the grantee's entire operation. Officials of the grantee and of the certified public accounting firms said that this resulted in some duplication or overlap among the various audits; for example, one of the public accounting firms performed 10 of the audits, each of which required a separate review of the grantee's payroll system.

--The activities of a large, multifunded Indiana city were subjected over a 5-year period to more than 700 audits, none of which provided comprehensive coverage of the city's financial management procedures. The city's deputy comptroller said that, to satisfy HUD requirements that each grant in certain HUD programs be audited, many of the audits were made of the city's subgrantees, including city departments. Although the city and its subgrantees had spent nearly \$1.6 million in grant funds on audits, HUD area officials recognized the need for a single, more comprehensive audit of one of its programs. However, a city official estimated that the audit would cost about \$105,000 and, believing that HUD programs had been audited enough, was against the audit. In July 1978, a city official told us HUD dropped the requirement for the single audit. In addition, 116 of those audits had been made of the city's Comprehensive Employment and Training Act program, which was funded by the Department of Labor, and in 1977 the city contracted with a public accounting firm to perform a comprehensive financial audit of its operations.

--A department of another large city had been subjected to at least 13 audits of its Federal grant funds during fiscal 1974 through 1977. It received funds for 29 programs administered by 7 Federal agencies. Although the Community Services Administration's grants accounted for only 3 to 8 percent of the department's funding each year, it received the most frequent coverage--6 of the 13 audits. In contrast, according to city officials, some larger grants from HEW and Agriculture were not audited. Four other Federal grants to the department were audited at least once during the period. None of the 13 Federal program audits performed at the departmental level nor a State audit of the city resulted in comprehensive financial and compliance coverage of the department's Federal funds.

MANY RECIPIENTS RECEIVED FAR LESS  
AUDIT COVERAGE THAN APPROPRIATE

The 73 grant recipients in our sample received about \$3.7 billion in Federal funds during fiscal 1974 through 1977. Over the 4 years, 80 percent of this amount was not audited by or on behalf of Federal agencies. Our test was not based on a statistical sample, since the information to develop such statistics is not available. However, if this same ratio is true for the approximately \$240 billion in grants awarded during the period, the possibility exists that the Government did not provide for audits of nearly \$192 billion.

Of the 73 grant recipients, 5 received no audit coverage of any type during the 4-year period. The coverage of 12 other recipients suffered such major gaps that, for all practical purposes, we could not consider it as an audit. Of the remaining 56 that received an audit or audits, 51 (over 90 percent) received no compliance audit coverage or such coverage was only partial. We consider this of the utmost significance because the audit is not fully useful to Federal agencies when grant expenditures are not audited against grant terms. In fact, most of these audits were made by non-Federal auditors to satisfy other than Federal requirements.

Grant relationships are similar in many respects to Federal contracts. Thus, as in auditing contracts, it is essential in auditing grants to make sure that grantees are satisfying the terms of their grants, as well as to see that grantees' financial records and controls are adequate. This means making sure, for example, that eligibility requirements are met, that the intended service or product is being provided or purchased, that cost allocations are proper and direct charges are reasonable, and that matching requirements are met. In short, it means seeing that grant funds are spent for their intended purpose. When these conditions of an audit are not met, the Federal Government could lose millions of dollars that could otherwise be collected or saved.

Because of the gaps in audit coverage, the ability of audits to insure the proper expenditure of hundreds of millions of dollars in Federal funds was either limited or nonexistent. For example:

--No Federal audit coverage was provided an Ohio grantee receiving \$52.5 million from HEW and Labor. During fiscal 1974 through 1977, the grantee received \$50.4 million from HEW and \$2.1 million from Labor.

- No audits were made of a Washington State grantee that received about \$5.5 million from 5 Federal agencies under 23 grants. According to a Department of Energy official, the most recent audit of any grants was in 1973.
- Almost no Federal audit coverage was provided a Washington State grantee receiving \$15 million in Federal funds. Only \$126,000 of \$1.6 million in ACTION funds were audited, and HEW grant funds of \$13.4 million were not audited during the 4-year review period.
- Officials of a grantee in Missouri said they had never been audited to assure proper management of about \$4.5 million in Federal funds received in fiscal 1975 through 1977. The grantee was an employment office receiving funds from Labor, the Community Services Administration, and ACTION.
- A Missouri grantee received only limited Federal audit coverage of \$7.7 million of funds from Labor and Agriculture during fiscal 1974 through 1977. The Agriculture funds, amounting to \$132,875, were audited; \$7.6 million in Labor funds were not audited.
- Almost \$3.5 million in grants at a transit district in Oregon had not received any Federal compliance audit coverage. In 1971 the grantee received an Urban Mass Transit Administration grant for \$427,000. As of May 1978 the grant had not yet received the federally required closeout audit even though the estimated closeout date was September 1, 1972. Furthermore, when the grant is finally closed out, the audit may be of limited use as a management tool because any findings will likely be outdated. Subsequent Urban Mass Transit grants of about \$3 million have also escaped compliance audits.

#### PROGRAM COVERAGE IS ALSO IRREGULAR

Audit coverage on a Federal program basis is, in some cases, as inconsistent as coverage of individual grantees. Some programs appeared to receive little or no audit coverage at any administrative or delivery level; in other programs, nearly every grant was audited. For example:

- An HEW official said that since 1973, no audits had been made of the Department's Public Health Service grant program which provided about 1,500 mental hospital improvement grants of up to \$100,000 each from 1964 through 1977.

--An EPA audit official told us that grants of less than \$100,000 for nonconstruction programs are never audited, although the sum of these grants may be significant. In addition, recipients of EPA "208" planning funds in region V receive almost no audit coverage by EPA. For example, region V grant managers told us that 37 of these grant recipients receiving a total of \$150 million in 1975 had not been audited. A grant manager said that EPA auditors may perform audits when the grants are closed out, which may not be for 3 or more years after the grants are started. The chief of the water planning division branch in region V said they are concerned about audit coverage but have not asked their grantees to secure audits as required by OMB.

--The Department of Labor's director of audit operations indicated that the Job Corps program had received only limited audit coverage. Labor audit records indicated that only 1 of 60 Job Corps centers had been adequately audited during fiscal 1976 and 1977. Audits of the other 59 Job Corps centers may have taken place but generally were not comprehensive enough to be considered adequate. Our review work at two Job Corps centers showed that Job Corps funds at both centers were not adequately audited. One center received financial audits but no compliance audit; audits at the other center were made of indirect administrative rates at the corporate headquarters of the contractor operating the center, but no audit of any type was made of the Job Corps grant operation itself.

#### Some grant programs get total coverage

While some large programs receive limited or no coverage, virtually total coverage was achieved in the following instances:

- HEW funds approximately 1,250 Headstart grantees nationally, and, according to a headquarters Headstart management official, all funds are audited annually.
- The Community Services Administration generally obtains annual audits on each of its grants. Of 13 entities in our sample that had received such funding, all except one had been audited.

--HUD's disaster assistance grant program received extensive audit coverage, sometimes to the point of unreasonable duplication. The region X Federal disaster assistance director told us that grants of \$25,000 or more are required to be audited by the State. In cases where a State audit staff is not on an "approved list," audits will be made by both State and HUD auditors on all claims of \$50,000 or more. 1/ One State auditor said that his auditors and HUD's auditor's check the same details. In region X, two of the States were on the approved list and two were not.

**CHAOTIC AUDITING WASTES TIME AND MONEY  
AND DOES NOT PROTECT FEDERAL FUNDS**

A lot of time and money is spent on audits that are not fully useful. In this regard, piecemeal financial/compliance audits that narrowly focus on individual grants provide little assurance that funds are properly safeguarded. These piecemeal audits combine with disorganized auditing to cause unnecessary costs by inherent duplication in performing audits too often and of grants too small to warrant more than an occasional audit, if any. Piecemeal auditing leaves serious gaps when auditors find improper practices affecting one grant but do not determine how such practices affect other grants or programs. Overauditing grants disrupts the grantees' operations; auditors take up grantees' time which might be better spent on other important matters, such as accomplishing the work designated under Federal programs.

In our judgment, a piecemeal audit will not likely reveal whether funds or other assets have been improperly transferred between grants or programs. Many State and Federal officials said interfund transfers happen frequently, and grantees and auditors find that the piecemeal approach to audits often precludes finding out whether such transfers are appropriate or not. Further, such audits will not likely reveal all improper costs charged to the grant.

In the past, we have reported instances where piecemeal auditing failed to disclose improper charges and fund

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1/HUD's response to the draft report stated that its auditors now audit claims for which State audits are not approved--those in excess of \$250,000.



transfers by a grantee. One of our reports to OMB 1/ cited the example of a private nonprofit foundation that received \$53 million in Federal funding from January 1967 to April 1974 from 10 assistance programs but received mainly piecemeal audit coverage. The foundation received at least 67 audits by Federal, State, and local government audit organizations. Sixty-four of the audits dealt with Federal grants, 58 of which were single grant audits. The piecemeal audits generally failed to identify that the grantee was (1) charging excessive costs to programs, (2) arbitrarily allocating costs among Federal accounts, (3) billing improper amounts to Federal programs, and (4) improperly transferring other funds between programs. In contrast, 2 of the 67 audits were more comprehensive, multiple grant audits that were valuable in discussing these deficiencies.

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1/"Administration of Federal Assistance Programs--A Case Study Showing Need for Additional Improvement," HRD-76-91, July 29, 1976.

## CHAPTER 3

### FACTORS CAUSING THE INCONSISTENCY IN AUDIT COVERAGE

The inconsistency in financial and compliance audit coverage of Federal grants and grant recipients is caused by a number of different, yet closely related factors. The major factors are:

- inflexible audit requirements fixing the frequency of grant audits;
- the prevalent agency practice of auditing one's own grants and grant programs rather than coordinating with another audit group to obtain comprehensive, single audits of the recipients;
- the poor use and possible shortages of audit resources; and
- the failure of the Government to see that its grantees make audits that satisfy Federal needs.

### REQUIREMENTS FOR AUDITING SPECIFIC GRANTS AT SET INTERVALS CREATE EXCESSIVE AUDITING AND HINDER AUDIT COORDINATION

The Congress, OMB, and individual Federal agencies require audits to be made at set intervals. OMB requires grantees to secure financial and compliance audits at least once every 2 years. The Congress requires certain grant programs to be audited periodically, at intervals ranging from 1 to 3 years. Some agencies have imposed tight requirements on when audit reports should be issued and require audits at certain times.

Our position that mandatory audits are less productive than discretionary audits is longstanding. In this and prior reviews we have found that mandating the frequency and timing of grant audits limits the flexibility of grant managers and auditors to adjust audit coverage to ensure that the most productive use is made of audit resources. Where mandated requirements were enforced, the grant programs were audited again and again regardless of the dollar amount of the grant or its size in comparison with other grants administered by the recipient. Often, the audits were repeated even though previous audit findings were minimal and diminished in significance with each additional audit.

Audit requirements imposed on individual grant programs have also pushed agencies to focus on grants rather than on recipients, and have made cooperative arrangements between funding agencies more difficult. The most restrictive time-frame for one program must be met, yet this may conflict with the needs of other agencies.

### Agencies are affected by inflexible requirements

One Federal agency that is seriously affected by inflexible audit requirements is the Community Services Administration. It is required by law to make, or have made, an audit of each Community Action Program grant at least once annually. To comply, the agency requires each grant recipient to secure an annual audit.

According to the agency's audit director, this annual audit requirement has hindered CSA's attempts to coordinate auditing with other Federal agencies and has forced his organization to spend the majority of its time seeing that such audits are made regardless of the results. For example, recipients receiving as little as \$170 a year have had to obtain annual audits, the cost of which is excessive and the value of which is doubtful.

Our review of 525 audit reports on 131 Community Service grant recipients in region X showed no dollar findings for about half of the audits. Audit findings decreased over time for some recipients, including one where the auditors questioned costs of \$19,786 the first year, \$1,469 the second year, and questioned no costs for the next 4 years. Nonetheless, Community Services has continued the mandated audits regardless of their productivity or the extent that the grantee had been audited.

Another program adversely affected by a mandatory audit requirement is the Child Support Enforcement Program which is administered by HEW's Office of Child Support Enforcement. The authorizing act, Public Law 93-647, requires HEW to establish an organizational unit which should "not less than annually, conduct a complete audit of the programs established under such plans \* \* \*." To meet this requirement, HEW plans to employ about 130 auditors at an annual cost of about \$4.8 million. In a prior report to the Congress, 1/we commented that this

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1/"New Child Support Legislation--Its Potential Impact and How to Improve It," MWD-76-63, Apr. 5, 1976.

audit requirement was duplicative and too specific and that an annual audit might not be needed after a recipient had established an effective child support program.

#### Agency policies add to the problem

The effects of mandated requirements are compounded by arbitrary agency rules. This is best illustrated by a non-profit grantee in Ohio that received grants from both the Community Services Administration and HEW. Both agencies must have the programs that are involved audited annually, but Community Services required audit reports within 180 days of the end of the project year and HEW required them within 120 days. Until 1977, the grantee's finance director said that a 90-day extension had been received from HEW to permit the Community Action and HEW Headstart grants to be audited simultaneously. In 1977 HEW refused to grant the extension, and two separate audits were made.

In June 1978 a headquarters Headstart official said that discussions were being held with OMB, Community Services, and HEW officials to allow 1 audit for the 881 community action agencies receiving HEW grants. The problem was which audit guide to use--HEW's or Community Services'.

#### Federal agencies need some flexibility in scheduling audits

Audits must be scheduled, but imposing requirements on individual grants is not the answer. A better approach is to prescribe some time parameters, such as from 1 to 3 years, within which agencies would be able to apply judgment in scheduling audits. This latitude should be applied to audits of recipients, not grants. While annual audits may be needed in cases perceived as high risk, it appeared to us that OMB's 2-year requirement was adequate for most of the recipients and programs covered by our review.

Accordingly, we believe that Federal laws and agency regulations mandating audits at specific intervals need to be revised and made consistent with broader, Government-wide requirements. OMB needs to redirect its guidance to Federal agencies requiring them to assure that Federal grant funds received by a recipient are audited at reasonable intervals.

FEDERAL AGENCIES AUDIT THEIR  
OWN GRANTS INSTEAD OF COORDINATING  
FOR COMPREHENSIVE SINGLE AUDITS

The Government has not instituted firm requirements or developed the mechanisms to obtain comprehensive, coordinated audits of grant recipients on a Government-wide basis. This lack of requirements, added to an agency's overriding concern for its own grants as opposed to those of other agencies, explains why agencies continue to conduct narrowly scoped audits of their own grants without regard for the interests of other Federal agencies. OMB requirements for getting cooperative audits have been advanced with little success as discussed in chapter 4.

The Government has no systematic  
method for assigning audit responsibility

Agencies do not have the information necessary to effectively coordinate comprehensive audits. Under the current approach, agencies with the predominant financial interest in the audit are encouraged to collaborate with other Federal agencies to work out mutually agreeable audit arrangements. Agencies are left to do this solely on a voluntary basis without comprehensive information about who funds or audits which grantees.

In September 1977, we reported to the Office of Management and Budget <sup>1/</sup> that no nationwide grant information system exists to account for all Federal funding and audits that grant recipients may receive. Some agencies have fairly comprehensive systems to account for their own funds or audits, but these systems do not identify the funding or audits from other agencies.

Agencies cannot properly coordinate with each other without a systematic method of assigning responsibility for audit coverage of multifunded recipients. Even with nationwide grant information, it would be highly unlikely that all Federal agencies that were working individually without OMB involvement would be able or desire to work out coordinated, single audits of multifunded recipients on a Government-wide basis. A more practical approach would be to have OMB assign audit responsibility to the agencies administering the grants.

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<sup>1/</sup>"Need for More Effective Cross Servicing Auditing Arrangements," FGMSD-77-55, Sept. 26, 1977.

## Agencies' many different audit guides hinder coordination

The many different audit guides for performing and reporting grantee audits have posed a major problem. Their number is often cited as one of the major factors limiting both reliance on other audit work and coordination among Federal agencies or among Federal and State agencies in auditing multifunded recipients. Federal agencies have developed over 80 audit guides which detail the nature and scope of audits and the format and distribution of audit reports. A few agencies have one audit guide for all their grant programs; however, most have separate guidelines tailored to specific grant programs, but not for all of their programs.

The large number of guidelines and the fact they are grant oriented rather than comprehensive are not the only problems posed. The guides also contain divergent audit approaches, a variety of audit steps, and different reporting formats which vary both in presentation and the amount of information required.

## The lack of guidelines also causes problems

A lack of audit guidelines can also reduce the usefulness of audits. When no guidelines exist, auditors are expected to design their own approach using generally accepted auditing standards. When public accountants and State auditors do this for Federal agencies, we found that they usually audit only the grantees' financial statements. No compliance tests are performed, and, therefore, the scope of the audit is inadequate for Federal purposes. For example, we noted that many grantees receive audit reports stating that the auditor's opinions are qualified because other Federally paid auditors are expected to review such major items as indirect costs or compliance with eligibility requirements. Such qualifications are so major that the original audit reports are of little use to either the grantee or the grantor agency. When compliance items are not checked, Federal auditors must then schedule their own compliance audits of the same grantees, which often results in some duplication because their audits usually cover previously examined financial matters.

When no audit guidelines were available, we found that non-Federal auditors often reported only limited information on Federal grants received by the grantee. For example,

some audit reports did not identify Federal monies by grant number, grant program, individual grant amount, or by other identification that would make the audit report of more use to Federal grant managers. Some reports did not even identify the Federal agencies that provided funding, but rather listed only a total figure for Federal grant revenues.

#### Standard audit guidelines are being developed

GAO, OMB, and the Intergovernmental Audit Forum have taken the lead in developing an audit guide--"Guidelines for Financial and Compliance Audits of Federally Assisted Programs"--for comprehensive financial and compliance audits of multifunded grant recipients. This guide, which OMB has asked agencies to comment on, recognizes the need to limit the number of compliance tests and suggests some tests that should be included in a financial audit. This guide may need revision as experience is gained.

#### FEDERAL AUDITORS ARE NOT AUDITING OR OVERSEEING GRANTEE AUDITS

The gaps in audit coverage can be explained in several ways. The primary reason for the gaps is that most Federal agencies are not regularly auditing or overseeing audits of their grant programs and recipients. Many cite the lack of audit resources. Others simply do not determine if non-Federal organizations are auditing and if their results could satisfy Federal needs. In fact, non-Federal auditors are not always making required audits unless Federal agencies specifically request them, and their audits seldom determine whether Federal funds were spent for their intended purposes.

#### FEDERAL AGENCIES CITE THE LACK OF AUDIT RESOURCES AS THE CAUSE OF GAPS

The principal reason Federal agencies cited for insufficient audit coverage was a shortage of Federal audit resources. Federal auditors said that they do not have enough auditors to regularly audit all their grant recipients. Even though they know that grantees are not making audits and question the usefulness of the audits that grantees secure, they do not have the resources to follow up with their own audits.

A few Federal agencies watch closely to see that at least some of their programs are audited. Community Services checks to see that all grantees secure audits but does little or no followup auditing to cover deficiencies. HEW makes sure grantees of its Headstart program secure audits. HUD not only checks State audits of its disaster assistance

grants, but makes followup audits when it judges that the State auditors' work is not satisfactory. However, as mentioned earlier, HUD sometimes goes farther than we believe is warranted.

GAO believes the poor use of resources could be the problem

Although Federal officials cite the lack of audit resources as a major reason for gaps in audit coverage, conditions might be significantly improved if the agencies made better use of their existing resources. For instance, agencies implemented single, coordinated audits of recipients, wasteful duplication would be eliminated, and the need to audit many compliance items would be reduced, all while providing a better look at the grantee's overall performance. Coordinated audits would thus require fewer auditors to plan, perform, and report on audits of large multifunded grantees.

In addition, non-Federal audits could be better coordinated and used to satisfy Federal requirements. Comprehensive guidelines could be used to tailor non-Federal audits to satisfy overall Federal needs. Further, one cognizant audit group could oversee non-Federal audits and determine whether the work can be used by Federal managers more efficiently than several groups from different agencies.

To help expand audit coverage with existing resources, audits, which non-Federal organizations arrange and pay for with grant funds, must better satisfy Federal needs. The present practice of paying for audits that make little pretense at meeting Federal needs is uneconomical. One action that is needed is to provide grantees with an audit requirement that cites the grant terms to be examined. Another is to maintain close coordination with grantees and their auditors. These would be appropriate responsibilities for the cognizant Federal audit agency.

Agencies lack controls needed to insure that grantees obtain audits to satisfy Federal needs

State governments and other funding organizations are at liberty to audit any organizations that receive Federal grants. Likewise, grantees have the management prerogative to make or secure audits of their operations. The intent of Federal policy is not to change this. However, if the Government is going to pay for such audits, the audits should be done in such a way that the results satisfy Federal needs. We recognize that additional training of non-Federal auditors may be required to achieve this.



Five audit directors in ACTION, Agriculture, EPA, HEW, and Transportation said they have no controls to insure that grantees obtain audits to satisfy OMB requirements. Grantees are expected to schedule audits within a required period and make sure that they are performed to satisfy Federal needs. The officials said, however, that procedures had not been developed to monitor the scheduling and performance of the audits.

Most grantees do not arrange for audits to satisfy Federal needs. The audits are primarily made to satisfy non-Federal needs and requirements. Because the auditors usually do not examine whether the grantee has complied with the terms of the grants, the audits are of little use to Federal agencies.

Although we were unable to establish it with certainty, grantees apparently did not make audits when required because they thought the audits were not needed if Federal agencies did not ask for them. Also, they did not always know that the audits were required, or they expected the Federal agencies to come in and audit their own grants.

## CHAPTER 4

### ACTIONS TO GET FEDERAL AGENCIES TO MAKE

#### COORDINATED AUDITS ARE NOT WORKING

Few of the problems we have discussed are new. Most of them have been identified by Federal officials and addressed in our previous reports. OMB has taken steps to try to solve them, including such things as cross-servicing, establishing cognizant agencies, and requiring grantees to obtain compliance as well as financial audits. Although the intent of these policies is clear and laudable, our review shows that agencies generally have not implemented them. Moreover, they do not provide the overall direction and stronger measures that are now needed to institute the single audit approach.

#### AGENCIES ARE NOT FOLLOWING OMB GUIDANCE

OMB has issued various circulars aimed at the single agency audit approach. The circulars have

- directed Federal agencies to work out cross-servicing arrangements where one agency audits for others,
- established cognizant Federal agencies for auditing universities as well as overhead costs for certain recipients,
- pressed Federal agencies to coordinate with and rely upon other Federal or non-Federal audits whenever possible, and
- encouraged Federal agencies to simplify grant requirements to include a single audit of multifunded grantees.

This guidance generally has not been followed. Moreover, the circulars do not provide the overall direction we now see as being needed to institute the single audit approach.

#### Cross-servicing is seldom used

OMB Circular A-73 requires the Federal agency with the principal financial interest in a multifunded grantee to study the feasibility of one agency conducting audits for the other grantor agencies. The purpose of this cooperative approach, known as cross-servicing, was to conserve staff resources, promote efficiency, and minimize the impact of audits on grantee organizations.

We found that cross-servicing has not been used extensively. An important reason for this is the voluntary nature of cross-servicing arrangements based on the "lead" agency's initiative. Cross-servicing has also been inhibited by other factors, such as inflexible audit requirements.

Agencies are primarily concerned with satisfying audit requirements for their own grants rather than auditing recipients to satisfy other requirements as well. For example, the Department of Labor had cross-servicing agreements with several agencies for Job Corps center audits. Labor audit officials said that these audits were either not performed or did not satisfy Labor requirements. Labor internal reports showed that only 1 of 60 Job Corps centers under the arrangement was audited during 1976-77. As of January 1978, Labor terminated the previous cross-servicing agreements and assumed cognizant responsibility for auditing Job Corps centers. Labor audit officials said they plan to hire certified public accounting firms to do all future Job Corps audits.

In another case, HUD and Interior officials discontinued an arrangement whereby Interior was responsible for auditing the low-rent housing program at Indian reservations. HUD officials said the audits were not made on time. In response, Interior officials claimed it was a HUD program and Interior lacked the staff to provide adequate audit coverage. HUD audit officials said they now require local area housing offices to have the audits made by certified public accountants.

#### Use of cognizant audits is limited

Assigning audit cognizance is an important step toward eliminating multiple Federal audits of recipients. However, OMB has designated lead agencies to conduct Federal audits of grant recipients in only two instances. OMB designated HEW as the cognizant agency for auditing all Federal funds made available to about 2,000 colleges and universities. It also assigned certain lead Federal agencies to audit overhead costs at specific grant recipients. However, numerous multi-funded grant recipients such as hospitals, municipalities, and nonprofit organizations are still subject to many piecemeal audits.

#### Audit plans are inadequately prepared and coordinated between Federal and non-Federal auditors

For planning audits, OMB Circular A-73 provides guidelines for more efficient use of staff resources through improved audit coordination. However, few audit planning

systems in use today are designed to adequately identify and provide for conducting audit work at grantees or insure effective coordination of audit work with other audit agencies.

OMB's guidelines require that audit plans show the programs and operations subject to audit. They also require that Federal agencies coordinate their audit requirements with other governmental units to determine whether their grantees have periodic audits from other agencies. However, the audit plans we reviewed generally did not specify which grantees would be audited, only that certain programs would be audited and a given number of grantees would be visited. Audit plans usually were developed within an agency and not discussed among Federal agencies or among Federal, State, and local officials. In some of those cases, audit planning could have been improved if Federal agencies were aware of other audits, but they were not.

Federal agencies generally did not request information from, or coordinate with, State auditors in formulating their annual audit plans. Of 15 State audit agencies we contacted, the only example of coordination was in Tennessee, where the State auditor met with HEW and Transportation officials to coordinate their annual audit planning. The other 14 State auditors said they did not provide any input to Federal audit agencies' annual work plans.

Federal agencies seldom know about audits made by other Federal or non-Federal auditors, and therefore, may be planning audits for grantees that have just recently been audited. Audit officials said they usually become aware of other audits when they audit a grantee. With proper coordination, however, such duplicative visits could be avoided or postponed, and the findings could help establish audit priorities.

In September 1977 President Carter issued a memorandum requiring Federal audit agencies to send copies of audit plans to State and local governments. The National Intergovernmental Audit Forum's State and Local Committee is studying this order to determine how to best carry out the requirement. However, we believe planning and coordination can and should start even before Federal audit plans are sent to State and local governments.

Single grant application  
and audit not working

OMB Circular A-111, dated July 6, 1976, encourages Federal agencies and Federal Regional Councils 1/ to work together to (1) direct multifund<sup>d</sup> grantees to submit a consolidated grant application and (2) appoint a lead agency to administer the grant and to be responsible for obtaining a single audit of the grantee.

The joint funding approach has not been effective in consolidating agency audit practices. For example, two grantees in our sample had integrated grant agreements but still received audits from several funding agencies. Some duplication occurred because some audit agencies felt they could not rely on an audit performed on the integrated grants. That lack of confidence is a major problem in getting agencies to agree to such joint grant fundings. As of May 1978, OMB officials said that only 14 joint agreements were in use nationwide. In addition, a Federal Regional Council official in region X said that in May 1978 only one grantee in the region had a joint agreement.

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1/Executive Order 11647, dated Feb. 12, 1972, formally established Federal Regional Councils to develop closer working relationships among major Federal grant-making agencies and State and local governments and to improve coordination of the grant system.

## CHAPTER 5

### CONCLUSIONS AND RECOMMENDATIONS

#### CONCLUSIONS

We believe that the continuing problems in grant auditing will only be solved by an overhaul of existing Federal laws, policies, and agency practices. The Congress needs to enact new legislation that would rescind existing laws on audit frequency and give Federal agencies more control over scheduling audits. Although OMB's policies are laudable, OMB needs to provide the overall direction and the stronger measures that are now needed to institute the comprehensive, single audit approach. Federal agencies should insure that comprehensive audits are made to satisfy Federal requirements. They also need to coordinate their audits with non-Federal auditors to make full use of these audits and then do whatever additional work is necessary.

#### RECOMMENDATIONS TO THE CONGRESS

GAO recommends that the Congress amend the Intergovernmental Corporation Act of 1968 to prescribe standard audit requirements applicable to all Federal grants. The amendment should rescind existing laws for regularly scheduled audits of individual grants by particular organizations and allow Federal agencies flexibility in judging audit need. The amendment should designate a reasonable time interval within which grant recipients must be audited.

#### RECOMMENDATIONS TO THE OFFICE OF MANAGEMENT AND BUDGET

GAO recommends that the Director, Office of Management and Budget

- designate cognizant Federal agencies for making single audits of multifunded recipients (responsibility for auditing specific types of recipients, such as hospitals and colleges, could be divided among several agencies),
- hold periodic meetings with grant administering agencies to insure complete and successful implementation of the cognizant approach,

- direct cognizant agencies to use a standard audit guide 1/ or a suitable replacement in auditing multi-funded recipients,
- develop a nationwide system to identify Federal funding that grant recipients may receive, and
- stipulate that, to be paid for with grant funds, non-Federal audits must follow Federal audit guidelines.

RECOMMENDATIONS TO THE HEADS  
OF DEPARTMENTS AND AGENCIES  
ADMINISTERING GRANTS

GAO recommends that the heads of Federal departments and agencies administering grants

- establish procedures to insure that grantees under their cognizance have required audits that include steps necessary to satisfy Federal as well as their own needs,
- assure that their auditors make maximum use of audits arranged by non-Federal agencies and only do whatever additional audit work may be necessary to see that grant funds are spent for the intended purpose and are otherwise safeguarded, and
- assure continuous liaison with non-Federal audit staffs with common interest to minimize the amount of audit effort required and to learn of problem areas.

AGENCY COMMENTS AND  
OUR EVALUATION

The Director of the Office of Management and Budget expressed great concern over the findings of this report and commented on recent actions to improve grant auditing. He pointed to the President's September 1977 memorandum; the passage of the Inspector General Act of 1978; and OMB's work with us, the National Intergovernmental Audit Forum, and State and local governments. He also strongly endorsed the recommendation to rescind existing laws requiring audits of individual grants. Further, he agreed that use of a single audit guide would be a major breakthrough in auditing federally assisted programs.

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1/A guide has been developed by GAO, OMB, and the Intergovernmental Audit Forum which could serve this purpose.

The Office of Management and Budget felt that it would be too severe at this time to stipulate that to be paid for with grant funds, non-Federal audits must follow Federal audit guidelines. The Office of Management and Budget may have misunderstood the point here since its comments seemed to suggest that we want reimbursement denied unless the entire audit follows Federal guidelines. On the contrary, we believe that when an audit follows Federal guidelines to a significant degree, but deviates in certain aspects, a part of such an audit could be useful and therefore should be recognized. The stipulation we are recommending should prevent payment for those parts of audits or entire audits that do not follow Federal guidelines. This action would be justified since our review showed that many non-Federal audits are of little use to Federal agencies. To help expand audit coverage with existing resources, audits that are paid for with grant funds must better satisfy Federal needs. To do otherwise would be uneconomical.

OMB did not comment on recommendations that it designate agencies for making single audits of multifunded recipients, hold periodic meetings for implementing single audits, and develop a nationwide system for identifying grant funding.

We received comments from the 11 agencies in this review. The agencies agreed, at least in principle, with our recommendations to the departments and agencies. The comments indicated that they have done or plan to do more work to respond to the problems. Several agencies felt that the Congress and OMB must provide more centralized direction and management if significant improvements are to be made. We considered each agency's comments and made revisions when appropriate. Although some agencies expressed concerns, only the Department of the Interior did not favor our recommendation that OMB require formal audit cognizance. The Department believed that the current policy of voluntary cooperation is working and felt that duplication would result if agencies perform additional audits to meet special needs. To achieve coordinated, comprehensive audits, we believe that the designation of cognizant agencies is essential. When special audits are necessary, they should be coordinated to avoid duplication of effort.

Although the agencies generally agreed with our recommendations, their replies included a great deal of explanatory material. In view of the volume of those comments, we have included only the comments of OMB in the appendix.



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

FEB 14 1979

Honorable Elmer B. Staats  
Comptroller General of the United States  
General Accounting Office  
Washington, D. C. 20548

Dear Mr. *Elmer* Staats,

This is in reply to the draft report, "Grant Auditing: A Maze of Inconsistency, Gaps and Duplication That Needs Overhaul," sent to us January 3, 1979.

The findings of the report are consistent with those of a draft report by the Joint Financial Management Improvement Program on the same subject. Both agree that the policies on grant auditing expressed in our Circular A-73, "Audits of Federal Operations and Programs," are clear and laudable. However, the reports indicate that agencies have not fully implemented these policies. This causes us great concern, and we intend to take aggressive action to assure full agency compliance. A number of recent developments will help in this regard.

First, the President, in a recent memorandum to the heads of departments and agencies, called for improved coordination of grant audits. He said, "All three levels of government have audit responsibilities, but it does not make sense for them all to audit the same transactions." He ordered agencies to make public their plans for audits of State and local governments, and added, "I expect Federal agencies to use their audit plans as a basis for making greater efforts to improve interagency cooperation on audits, to increase Federal coordination with State and local auditors, and to increase reliance on audits made by others."

Second, the Congress has moved to improve grant auditing by passage of the Inspector General Act of 1978. This bill establishes a high-level, independent Office of Inspector General in each of the major grantmaking departments and agencies. The President has ordered other departments and

agencies to apply the essential features of the legislation to their own operations. We expect the Inspectors General to work together, and with State and local auditors, to bring greater order to the grant audit process.

Third, as you know, we have been working with your staff, the National Intergovernmental Audit Forum, and State and local governments to simplify the way grant audits are made. Two major documents have resulted from this work. One is a standard audit guide published by the General Accounting Office. The other is a proposed addition to our Circular No. A-102, "Uniform requirements for grants to State and local governments." The proposed addition would incorporate the audit guide into our Circular, and explain how it should be used.

The use of a single audit guide would be a major breakthrough in auditing federally assisted programs. One guide would replace almost one hundred that are currently in use in various Federal programs. It would eliminate the confusion that has resulted when individual guides focus attention on individual grant programs, rather than on the financial status of the organization carrying out those programs. The new approach would call for a total audit of an organization, with appropriate sampling of individual grants to determine overall reliability of financial operations.

We strongly endorse your recommendation for rescinding existing laws requiring audits of individual grants by particular organizations. As the report points out, doing away with these requirements would facilitate the establishment of audit cognizance arrangements, improve planning and coordination, and allow needed flexibility in establishing audit priorities.

We cannot agree with the recommendation that the Office of Management and Budget should deny reimbursement for the cost of non-Federal audits that do not follow a Federal audit guideline. At this point in the development of State and local audit capability, we believe such a policy would be too severe. For example, an audit that followed Federal guidelines to a significant degree, but deviated in certain aspects, could still be very useful. We believe it would be unfair, therefore, to say

that at least part of the cost of such an audit should not be recognized.

We appreciate the opportunity to comment on the draft report.

Sincerely,

A handwritten signature in black ink, appearing to read "J. McIntyre, Jr.", written in a cursive style.

James T. McIntyre, Jr.  
Director

LIST OF PROGRAMS FROM WHICH GAO SELECTEDRECIPIENTS TO TEST AUDIT COVERAGE

<u>Federal Agency</u>	<u>Name of Program (note a)</u>	<u>OMB Catalog Number</u>	<u>Type of Program (note b)</u>
Department of Agriculture	National School Lunch Program	10.555	A
	Water & Waste Disposal Systems for Rural Communities	10.418	B
Department of Health, Education, and Welfare	Child Development--Headstart	13.600	B
	Educationally Deprived Children--Local Educational Agencies	13.428	A
	Followthrough	13.433	A,B
	Community Mental Health Centers--Staffing and Construction	13.240	B
	Mental Health--Hospital Improvement Grants	13.237	B
	Drug Abuse Prevention Formula Grants	13.269	A
	Drug Abuse Community Service Programs	13.235	B
	Cancer Treatment Research	13.395	B
	Migrant Health Grants	13.246	B
	Child Support Enforcement	13.679	A
	Special Program for Aging--State Agency Activities and Area Planning and Social Service Programs	13.633	A
Department of Housing and Urban Development	Public Assistance--Maintenance Assistance (State Aid)	13.761	
	Community Development Block Grant--Entitlement Grants	14.218	A
	Community Development Block Grants--Discretionary Grants	14.219	B
	Lower Income Housing Assistance Program	14.156	B
Department of Labor	Disaster Assistance	14.701	B
	Comprehensive Employment and Training Programs	17.232	A,B
Department of Transportation	Job Corps	17.211	B
	Highway Research, Planning, and Construction	20.205	A,B
	Urban Mass Transportation Capital Improvements Grants	20.500	B
	Urban Mass Transportation Capital And Operating Assistance Formula Grants	20.507	A
Community Services Administration	Community Action	49.002	B
	Summer Youth Program	49.015	B
Environmental Protection Agency	Construction Grants for Wastewater Treatment Works	66.418	B
	Water Pollution Control--State and Interstate Program Grants	66.419	A
	Water Pollution Control--State and Areawide Water Quality Management Planning Agency	66.426	B
ACTION	Foster Grandparent Program	72.001	B
	Retired Senior Volunteer Program	72.002	B

a/We were also able to evaluate coverage of other programs where (1) the same grants management branch administered other programs and (2) grant recipients obtained funding from other programs.

b/A--Formula grant program.  
B--Project grant program.

APPENDIX III

APPENDIX III

GRANT AUDIT RESPONSIBILITIES AND STAFFING

Department or agency	Total FY 1977 estimated budget outlays (millions)	Number of grant programs offered in FY 1978	Annual grant budget FY 1978 (est.) (millions)	Number of grantees (estimated)	Federal audit staffs (FY 1976)	
					Staff size	Audit budget (note a) (millions)
HEW	\$159,385	262	\$29,466	50,000	937	\$27.1
ACTION	168	8	69	1,000	9	.2
Community Services	450	7	417	1,450	38	1.0
Agriculture	12,761	41	3,475	35,000	510	14.1
Labor	19,619	14	5,430	1,100 (plus 50,000 CETA sub-sponsors)	188	5.3
Transportation:						
Federal Highway Administration	7,162	2	6,949	50 States and various subgrantees	214	4.9
Urban Mass Transit Administration	2,225	8	2,059	500	17	.6
HUD	8,722	9	6,465	1,000	350	7.9
EPA	6,006	27	5,352	13,900	98	4.5

a/Does not include funds obtained to hire non-Federal auditors.