SINGLE AUDIT ACT AMENDMENTS OF 1996

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

MAY 13, 1999

Serial No. 106–81

Printed for the use of the Committee on Government Reform

Available via the World Wide Web: http://www.gpo.gov/congress/house
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62–468 CC WASHINGTON : 2000

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CONTENTS

	Page
Hearing held on May 13, 1999	1
Statement of:	
Lee, Diedre A., Acting Deputy Director for Management, Office of Management and Budget; David L. Clark, Director, Audit Oversight and Liaison, General Accounting Office; and Auston G. Johnson, State auditor of Utah and chairman, single audit committee, National State Auditors Association	3
Letters, statements, et cetera, submitted for the record by:	
Clark, David L., Director, Audit Oversight and Liaison, General Accounting Office, prepared statement of	16
Horn, Hon. Stephen, a Representative in Congress from the State of California, prepared statement of	2
Johnson, Auston G., State auditor of Utah and chairman, single audit committee, National State Auditors Association:	
Advirosy circular of FAA	61
Prepared statement of	34
Lee, Diedre A., Acting Deputy Director for Management, Office of Management and Budget, prepared statement of	6
Sonntag, Brian, Washington State auditor, prepared statement of	41
Turner, Hon. Jim, a Representative in Congress from the State of Texas, prepared statement of	12

SINGLE AUDIT ACT AMENDMENTS OF 1996

THURSDAY, MAY 13, 1999

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION, AND TECHNOLOGY,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2247, Rayburn House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Horn and Turner.

Staff present: J. Russell George, staff director and chief counsel; Randy Kaplan, counsel; Matthew Ebert, policy advisor; Bonnie Heald, director of communications; Mason Alinger, clerk; Faith Weiss, minority counsel; Mark Stephenson, minority professional staff member; Ellen Rayner, minority chief clerk; and Earley Green, minority staff assistant.

Mr. HORN. The Subcommittee on Government Management, Information, and Technology will come to order. Today we will discuss the status of the implementation of the Single Audit Act Amendments of 1996.

The Single Audit Act of 1984 replaced a desperate and unmanageable approach to audits of State and local programs that receive Federal funding. Prior to its passage, there existed a system of multiple grant-by-grant audits. This created a scenario in which an organization that received Federal funds from more than one Federal agency could find itself spending vast amounts of time and resources managing several different Federal audits.

In the early 1990's, three separate studies were conducted to determine the effectiveness of the act. These studies conducted by the General Accounting Office, and the President's Council on Integrity and Efficiency, and the National State Auditors Association prompted legislation to amend the Single Audit Act. Early in 1996, that legislation was moved by this subcommittee. In June 1996, Congress passed the Single Audit Act Amendments of 1996, which was subsequently signed into law on July 5, 1996.

Today, we will explore how well the Federal, State, and local governments and their auditors are doing in implementing those amendments, and whether Congress needs to consider any further changes in the Single Audit Act.

I welcome our distinguished panel, and I look forward to your testimony.

[The prepared statement of Hon. Stephen Horn follows:]

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"Implementation of the Single Audit Act Amendments of 1996"

Opening Statement of Chairman Stephen Horn (R-CA)
Subcommittee on Government Management, Information, and Technology
May 13, 1999

A quorum being present, the Subcommittee on Government Management, Information, and Technology will come to order. Today, we will discuss the status of the implementation of the Single Audit Act Amendments of 1996.

The Single Audit Act of 1984 replaced a disparate and unmanageable approach to audits of State and local programs that received Federal funding. Prior to its passage, there existed a system of multiple grant-by-grant audits. This created a scenario in which an organization that received Federal funds from more than one Federal agency could find itself spending vast amounts of time and resources, managing several different Federal audits.

In the early 1990s, three separate studies were conducted to determine the effectiveness of the Act. These studies, conducted by the General Accounting Office, President's Council on Integrity and Efficiency, and the National State Auditors Association, prompted legislation to amend the Single Audit Act.

Early in 1996, that legislation was moved by this subcommittee. In June 1996, Congress passed the Single Audit Act Amendments of 1996, which was subsequently signed into law on July 5, 1996.

Today, we will explore how well the Federal, state and local governments, and their auditors, are doing in implementing those amendments, and whether Congress needs to consider any further changes to the Single Audit Act.

I welcome our distinguished panel, and I look forward to their testimony.

Mr. HORN. Our witnesses today will be Ms. Deidre A. Lee, Acting Deputy Director for Management, Office of Management and Budget; Mr. David L. Clark, Director, Audit Oversight and Liaison, General Accounting Office; Mr. Auston G. Johnson, State Auditor of Utah, and chairman of the Single Audit Committee of the National State Auditors Association.

Some of you know the routine here. Let me just repeat it for some of the newcomers. We are a subcommittee of the full Committee on Government Reform. All our witnesses are sworn witnesses in terms of their testimony. When we call on you, it will be generally in line with what the agenda states there. Your full statement will be in the record. We would like you to summarize the statement. With three witnesses, we don't have to rush ourselves today. So, if you want to go through more than a summary, that's fine.

What we like to do, however, is have a dialog between the members of the subcommittee once all three witnesses have spoken. And, you are certainly welcome when another witness has said something you don't agree with or you do agree with, feel free to comment on that. This isn't strictly one-way dialog, not just a train where cars pop off into the siding and we never see them again.

So, if you will all three stand, raise your right hands.

[Witnesses sworn.]

Mr. HORN. We will start with Ms. Deidre Lee, the Acting Deputy Director for Management of the Office of Management and Budget, known to all as OMB.

STATEMENTS OF DIEDRE A. LEE, ACTING DEPUTY DIRECTOR FOR MANAGEMENT, OFFICE OF MANAGEMENT AND BUDGET; DAVID L. CLARK, DIRECTOR, AUDIT OVERSIGHT AND LIAISON, GENERAL ACCOUNTING OFFICE; AND AUSTON G. JOHNSON, STATE AUDITOR OF UTAH AND CHAIRMAN, SINGLE AUDIT COMMITTEE, NATIONAL STATE AUDITORS ASSOCIATION

Ms. LEE. Good morning, Chairman Horn. I appear before you today to discuss the Single Audit Act Amendments of 1996, and I would like to thank you, Mr. Chairman and members of the subcommittee, for your continued efforts to improve financial management throughout the Federal Government.

The Single Audit Act of 1996 is one of several laws this subcommittee has used to promote financial accountability in government. The key financial management legislation of recent years, the Chief Financial Officers Act of 1990, the CFO Act, and the Government Management and Reform Act of 1994, which we refer to as GMRA, together require the Federal Government to prepare and have audited agency and governmentwide financial statements. These have received important support from the subcommittee.

The interrelationship of these legislative initiatives becomes more apparent as the government gains experience in preparing audited financial statements. To make the CFO Act and the GMRA financial statement process work, the government relies on a single audit process to provide assurance over more than $300 billion in Federal funds which are expended annually by States, local governments, and nonprofit organizations.

You very clearly outlined the background of this act and, of course, the history of the single audit amendment process. As you mentioned, one of the reasons behind this was to have some uniform audit requirements to reduce the burden on the governments and those that participated in the audits and also to have a more effective use of audit resources.

Key features of the 1996 amendment included extending the coverage to all nonprofits as well as State and local governments which administer Federal programs; raising the threshold for the audit to $300,000; and authorizing a risk-based approach in selecting programs for testing. We also accelerated the time period through which a single audit was due after the close of the entity's fiscal year and increased some administrative flexibility, primarily through use of pilot projects, and an increase in the threshold when it was appropriate.

So what has been done so far in the last 3 years? Certainly we have now—and I have it here—another update of A–133. We have the A–133 compliance document, which is a very collaborative process that we worked on to provide guidance for single audit processes. It identifies compliance requirements as well as specific program guidance, and there are some 120 programs that it addresses, which are about 90 percent of the dollars expended by these entities. Additionally, we've developed a governmentwide single audit data base, and we have the clearinghouse so we can look across and get, in fact, more consistent information on single audits. That is a work in process. I'll mention later some things that we are still working on.

And additionally, one of the very fine things about this act has been the professional approach. We have worked with the American Institute of CPAs, the GAO, the grantmaking agencies themselves, the PCIE, the President's Council involving the IGs, and they are providing training for the State auditors and the entities that are involved in this as well as preparing guidelines which will be ready in July 1999. So a lot has been done.

Additional future work including compliance updates: One of the things that the amendments mentioned is that the compliance supplements need to be kept current to provide people the guidance they need. As new programs or changes to the grants occur, we need to ensure they're picked up in the compliance supplement so the auditors can use them appropriately, and we are doing that.

Also, we're trying to improve the clearinghouse with on-line forms that will aid in self-editing so we can assure that people can easily respond to the requirements of the act. Additionally, we're coordinating with GAO in ensuring that additional audit requirements don't burden the single audit process, and I know that Mr. Clark will talk about that a little bit further. And we're working with the IGs, the PCIE, to ensure that we have some quality assurance procedures for these audits.

We also just last week, with concurrence of the Congress, authorized a pilot program for the State of Washington where they're going to look across the State at statewide education programs at approximately 200 local education entities. They think that this pilot program is going to help the State to be able to look at the effectiveness of their programs and find out what the single audit

tells us about the actual results of that education program. And we're working with the Department of Education on that.

So certainly significant progress has been made. Implementation continues, and we look forward to furthering this process. And I thank the members of the subcommittee for their interest in financial management.

Mr. HORN. Well, we thank you.

[The prepared statement of Ms. Lee follows:]

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

Statement of Deidre A. Lee
Acting Deputy Director for Management
Office of Management and Budget
on the Single Audit Act Amendments of 1996
Before the Subcommittee on Government Management, Information, and Technology
Committee on Government Reform
U.S. House of Representatives
May 13, 1999

Mr. Chairman and members of the Subcommittee, I am pleased to be here today to discuss the Single Audit Act Amendments of 1996. First, I would like to thank this Subcommittee for its continued efforts to improve financial management throughout the Federal Government. Indeed, the Single Audit Act Amendments of 1996 is only one of several laws this Subcommittee has used to promote financial accountability in Government. The key financial management legislation of recent years -- the Chief Financial Officers Act of 1990 (CFOs Act) and the Government Management and Reform Act of 1994 (GMRA), which together require the Federal Government to prepare and have audited agency and Government-wide financial statements -- received important support from this Subcommittee.

The interrelationship of these legislative initiatives becomes more apparent as the Government gains experience in preparing audited financial statements. To make the CFOs Act and GMRA financial statement process work, the Government needs to rely on the single audit process to provide assurance over the more than $300 billion in Federal funds expended annually by States, local governments, and non-profit organizations.

BACKGROUND

In short, the single audit process became widely accepted with the Single Audit Act of 1984. Under this act, State and local governments were generally required to have one audit performed that encompassed the financial activities of the entire entity, including all of the Federal programs administered by the entity -- rather than performing individual audits on a grant-by-grant basis. Under the single audit process, grantees are responsible for having audits performed -- usually by a certified public accounting (CPA) firm or State auditor -- and then must share the results of the audit with the Federal Government. Federal grant-making agencies are responsible for using the results of these audits in their grants-monitoring processes.

In the early 1990s, studies conducted by the National State Auditors Association (NSAA), the Inspectors General (IG) Council (called the President's Council on Integrity and Efficiency, or the PCIE), and the General Accounting Office (GAO) concluded that the Single Audit Act of 1984 had promoted accountability in Federal grant programs and improved financial management practices at States and local governments. The studies found, however, that though

the 1984 Act was working, there were areas that needed to be strengthened. The specific recommendations in these studies served as the foundation for the Single Audit Act Amendments of 1996 (1996 Amendments or Act).

1996 AMENDMENTS

The 1996 Amendments received bipartisan support and were endorsed by the GAO, NSAA, and OMB. On July 5, 1996, the President signed the amendments into law.

The key provisions of the 1996 Amendments:

1) extend coverage to audits of non-profit organizations that administer Federal programs;

2) raise the amount of Federal funds an entity can administer before they are required to perform a single audit from $25,000 to $300,000;

3) authorize a risk-based approach to selecting programs for testing;

4) accelerate the audit report due date from 13 months after an entity's year end to 9 months; and

5) increase administrative flexibility in implementing the Act by authorizing OMB, in certain circumstances, to use pilot projects and increase the $300,000 audit threshold.

OMB ACTIONS TO IMPLEMENT THE 1996 AMENDMENTS

The 1996 Amendments charge the Director of OMB with overall responsibility for implementing the Act. To fulfil this responsibility, OMB has completed several major initiatives -- ranging from issuing Government-wide single audit policies in OMB Circular A-133 to developing implementation tools for grantees and auditors. The following paragraphs detail OMB's implementation of the 1996 Amendments. These accomplishments would not have been possible without the sustained support of single audit stakeholders -- particularly, the GAO, Federal grant-making agencies, NSAA, and the American Institute of Certified Public Accountants (AICPA).

Circular A-133: On June 30, 1997, OMB published a revised Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," which establishes uniform single audit requirements for States, local governments, and non-profit organizations that administer Federal programs. As a result, Circular A-128, issued in 1985, which established separate audit requirements for States and local governments, was rescinded that same day. Because the single audit studies noted Federal agency inability to implement OMB guidance in a timely manner, OMB coordinated Federal agency efforts to incorporate Circular A-133 in agency regulations within two months of its issuance.

Compliance Supplement: In June 1997, OMB published the Circular A-133 Compliance Supplement. This document identifies key compliance requirements the Federal Government expects auditors to address in performing single audits. The last previous update of the compliance supplement was in 1991. In the single audit studies, State auditors and independent public accountants said that their single audit work was hampered by the lack of updated compliance supplement information. In 1996, OMB led an interagency team to update the compliance supplement so that it would be available as auditors conducted the first cycle of single audits performed under the 1996 Amendments. In addition, OMB established a process for using interagency teams to issue annual updates to the compliance supplement. As a result, the first annual update of the June 1997 compliance supplement was published in May 1998. I am pleased to announce that the second annual compliance supplement update was recently finalized. It will be available soon on OMB's home page and in hard copy. This April 1999 compliance supplement provides specific guidance for auditing approximately 120 Federal programs, which account for over 90 percent of Federal funds expended annually by States, local governments, and non-profit organizations.

Government-wide Single Audit Database: Another key recommendation identified by the single audit studies was to make better use of single audit results. In September 1996, OMB led an interagency task force, working with the Federal Audit Clearinghouse, to establish a government-wide database for single audit results. In August 1997, OMB finalized a standard "data collection form," used to collect information about grantees, the Federal programs they administer, and the related single audit results. This information is then entered into the Clearinghouse's database. By 1998, the database was fully operational and publicly accessible on the Internet.

As with any new system, the Clearinghouse experienced initial implementation problems. However, working with OMB and an interagency users group, the Federal Audit Clearinghouse has addressed, or is in the process of addressing, their most significant challenges. The Federal Audit Clearinghouse is also developing a "web-based data collection form" that should be available for use by Fall 1999. The web-based form provides built-in, on-line edit functions and user-friendly, interactive capabilities, which should significantly improve the data collection process.

Professional Outreach: Since passage of the 1996 Amendments, OMB has been providing training in single audit requirements and helping develop single audit implementation tools. OMB staff have given extensive training to grantees and single audit professionals at AICPA national conferences, State CPA societies, and national and regional Intergovernmental Audit Fora. OMB has also provided single audit training to Federal agencies – both to program officials and the IG community.

On March 17, 1998, the AICPA published Statement of Position 98-3, "Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards," which provides detailed guidance and tools for auditors conducting single audits. OMB worked closely with the

AICPA and State audit community in developing this guidance. In addition, OMB assisted the PCIE in updating the quality control review guides used by Federal agencies to ensure that the single audit work performed by independent auditors adheres to professional standards. These guides are expected to be finalized in July, 1999.

FUTURE INITIATIVES

Although significant accomplishments have been made, additional work is required to successfully implement the 1996 Amendments. I would like to discuss several areas that require continued work.

Compliance Supplement Updates: Single audit stakeholders continue to emphasize the need for annual updates to the compliance supplement. Experience shows that this is a resource-intensive exercise. The continued commitment of OMB, Federal agencies, and GAO is necessary to ensure that the compliance supplement is updated on an annual basis.

Federal Audit Clearinghouse: OMB will continue working with the Federal Audit Clearinghouse to streamline the report and data submission process. The continued involvement of Federal agencies is needed to assure that the Government's informational needs are met by the Clearinghouse. OMB will work closely with single audit stakeholders to assess the completeness and accuracy of the Clearinghouse's single audit database.

GAO's Legislative Monitoring: Under the 1996 Amendments, GAO is responsible for monitoring proposed legislation for provisions inconsistent with the Act. Legislatively-mandated audit requirements inconsistent with 1996 Amendments would erode the single audit concept and reduce the effectiveness of the Act. OMB will continue to support GAO's work in this area.

Quality Assurance: The second year of single audit reports prepared under the 1996 Amendments are being submitted to the Federal Government, yet little has been done to assess the quality of single audit work performed by independent auditors. This is an important component of the Federal Government's effort to improve single audits. Without evidence demonstrating that single audits are being conducted by independent auditors in accordance with professional standards and the 1996 Amendments, Federal agencies could be placing inappropriate reliance on the single audit process. To prepare audited financial statements under the CFOs Act and GMRA, the Government needs to be able to rely on the single audit process to provide audit coverage of the more than $300 billion in Federal funds expended annually by States, local governments, and non-profit organizations. The single audit process is the only practicable way to provide audit coverage for these funds. The PCIE recently began developing new government-wide quality assurance policies and procedures. OMB will work closely with the PCIE and single audit stakeholders to ensure single audit quality.

Pilot Projects: The 1996 Amendments permit OMB to authorize pilot projects to test alternative

methods of achieving the objectives of the Act, after consulting with Congress. The Subcommittee should be commended for its insight in providing administrative flexibility in the Act through this provision. After recent consultation with Congress, OMB approved this week the first pilot project under the 1996 Amendments. This pilot authorizes the State of Washington to audit as one entity the State education system and approximately 200 local education agencies throughout the State. Currently, separate single audits are conducted for these 200 entities. This pilot is expected to result in audit efficiencies and greater opportunities to identify systemic problems in the State's administration of Federal programs. OMB and the U.S. Department of Education will monitor this pilot project and consider the impact of its results on future single audit initiatives. OMB will also continue working with single audit stakeholders to consider future pilot projects.

CONCLUSION

OMB believes that significant progress has been made towards achieving the underlying objectives of the Act: improving accountability over Federal programs; establishing uniform single audit requirements; promoting efficient and effective use of audit resources; reducing burden on grantees; and maximizing reliance on single audits by Federal agencies. However, the sustained support and commitment of single audit stakeholders is required to ensure that future implementation initiatives are completed.

Thank you again Mr. Chairman and members of the Subcommittee for your continued interest in improving the single audit process and Federal financial management as a whole. This concludes my remarks. I would be pleased to answer any questions.

Mr. HORN. Mr. Turner, the ranking minority member, has joined us. Mr. Turner, would you like to submit your statement or read your statement? We have plenty of time this morning.

Mr. TURNER. I'll submit it for the record. Thank you, Mr. Chairman.

Mr. HORN. Without objection, please submit Mr. Turner's prepared statement and put it in as if read. Thank you.

[The prepared statement of Hon. Jim Turner follows:]

OPENING STATEMENT OF THE HONORABLE JIM TURNER
GMIT: "SINGLE AUDIT ACT AMENDMENTS OF 1996"

May 13, 1999

I am pleased to be here to consider the progress made by the inclusion of the 1996 amendments to the Single Audit Act. Established in 1984, the Single Audit Act represents a valuable reform, in that it replaced with a single audit requirement the numerous federal audits of different state and local government programs that receive federal dollars. Additionally, the Act mandates a financial statement audit. All audits required under the Single Audit Act are conducted in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States and the Office of Management and Budget's Circular A-133. As a result of this Act, the burden on recipients of federal funds has been greatly reduced, and the quality of the financial information reported to the federal government improved.

In 1996, amendments to this Act extended the single audit requirement to non-profit organizations receiving federal financial assistance, increased the audit threshold, focused audits on riskier programs, improved audit reporting, and provided more administrative flexibility.

The 1996 amendments also allow state and local governments and non-profit organizations that are subject the Single Audit Act to devise pilot programs to better achieve the aims of this law. The State of Washington just received approval for the first pilot project and will be auditing its federal funding for state

and local school districts as a separate single audit entity. I am pleased to see a State step forward and use the flexibility provided in this statute for the benefit of the state, local, and federal government.

I look forward to the testimony of our witnesses and would like to thank the Chairman for holding this hearing.

Mr. HORN. We now go to Mr. Clark, the Director of Audit Oversight and Liaison for the General Accounting Office. Mr. Clark.

Mr. CLARK. Thank you, Mr. Chairman. I'm pleased to be here this morning to discuss the refinements to the single audit process called for in the Single Audit Act Amendments of 1996. The refinements along with OMB's implementing guidance, such as the compliance supplement, provide the underpinnings to improve the auditing for the more than $300 billion annually of Federal financial assistance provided to non-Federal entities. The refinements were developed through the collaborative efforts of the many stakeholders in the single audit process, including, for example, OMB and State auditors, the AICPA, and us.

This subcommittee has played an important role in supporting the refinements. This hearing should help to keep attention on the refinements and ensure that the momentum achieved thus far in implementing them continues.

This morning I would like to briefly highlight seven of the refinements and some of the actions taken to date to implement them. First, the refinements expand the act to cover all recipients of Federal financial assistance. Previously the act covered State and local governments, but not colleges, universities, hospitals, or other nonprofit organizations. OMB has helped implement this refinement by issuing one circular. Before we had two. That now provides consistent audit requirements for all recipients.

Second, the refinements raise the threshold for which recipients must obtain a single audit. Previously, many small recipients were required to obtain single audits, even though collectively they accounted for a very small percentage of overall Federal financial assistance. The new threshold eliminates single audit requirements for many small recipients while still maintaining audit coverage for at least 95 percent of all Federal financial assistance. In Pennsylvania, for example, the new threshold eliminates single audit requirements for approximately 1,200 smaller entities.

Third, the refinements allow auditors to use a broader risk-based approach for determining which programs to test in detail in their audits. Previously, dollar size drove the determination of programs to be tested. That resulted in the same programs being tested every year and other programs never being tested. Today, other factors, such as a program's inherent risk or vulnerability to fraud or other problems, also help to drive the determination of what programs are selected for detailed testing. This results in a better mix of testing.

Fourth, the refinements reduce the timeframes for single audits to be completed and submitted to the Federal Government. Program managers and others had identified this refinement as critical to being able to use single audit reports effectively. The timeframe is now 9 months, or will be 9 months when it is phased in, and it is our hope that single audits in the future can be completed even faster than that.

Fifth, and my personal favorite, the refinements call for auditors to provide a summary of their single audit results, thereby allowing readers to focus on the message and critical information resulting from the audits. Both OMB and the public accounting profession

have now issued guidance to auditors on how to better summarize the reports. Today, I believe, the reports are much easier to follow.

Six, the refinements spurred the creation of a Federal automated data base of all single audit results. The Bureau of Census, which was designated by OMB as the Federal clearinghouse for all single audit reports, has made great progress in developing an automated data base. When fully up and running, the data base will greatly enhance users' ability to quickly and accurately analyze single audit results and should help to better focus other Federal monitoring and oversight efforts.

And seventh, the refinements provide the opportunity for pilot projects to test ways to further streamline the single audit process and to make single audit reports more useful. The Washington State auditor, in his written comments provided for this hearing, discusses a pilot project which we believe has great potential to improve the single audit process and lead to greater accountability.

Mr. Chairman, because of the phased-in effective dates in the law and OMB's implementing guidance, it's too early to fully assess the effectiveness of all the refinements. Nevertheless it's important to underscore the significant steps that have already been taken and, as I mentioned, the importance of ensuring that the momentum achieved thus far continues.

I want to note that GAO is committed to overseeing the continued successful implementation of refinements, including assurances that there are no future conflicts with the Single Audit Act. We intend to work closely with all stakeholders as we have over the last few years in the single audit process to identify any implementation issues that may arise, to help develop and propose solutions, and to keep this subcommittee and the Congress fully informed on those actions and the progress being made. This concludes my summary.

Mr. HORN. We thank you for that very helpful testimony.

[The prepared statement of Mr. Clark follows:]

Statement of Mr. David L. Clark
Director, Audit Oversight and Liaison
General Accounting Office
on the Single Audit Act Amendments of 1996
Before the Subcommittee on Government Management,
Information, and Technology
Committee on Government Reform
May 13, 1999

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the status of efforts to implement the Single Audit Act Amendments of 1996. These amendments refined the single audit requirements enacted 12 years earlier, in 1984. The 1996 refinements and the Office of Management and Budget's (OMB) implementing guidance provide the underpinnings to improve the auditing for the more than $300 billion annually of federal assistance provided to nonfederal entities.

As a result of the 1996 amendments, uniform requirements are now in place for all federal grant recipients--state and local governments, colleges and universities, hospitals, and nonprofit entities. Many of the audit burdens previously facing these governments and nonprofit organizations have been reduced and the audits will be more

effective because they will focus on the programs that present the greatest financial risk to the federal government.

The changes embodied in the 1996 refinements were developed through the collaborative efforts of the many stakeholders in the single audit process, including OMB, the federal inspectors general, federal and state program managers, the state auditors, the public accounting profession and us. This Subcommittee played an important role by supporting the legislation needed to enact those changes.

Today, I would like to provide a perspective on the importance of the 1996 amendments, describe some of the actions taken to implement them, and discuss ways in which the refinements will continue to evolve and benefit future single audit efforts. Because of phased-in effective dates in the law and in the OMB implementing guidance, it is too early to fully assess the effectiveness of refinements. However, this hearing should help to keep attention on the refinements and ensure that the momentum achieved thus far in implementing the 1996 amendments continues.

EVOLUTION OF THE 1996 REFINEMENTS

The concept of the single audit was created to replace multiple grant audits with one audit of an entity as a whole. The single audit is an organizationwide audit that focuses on internal control and the recipient's compliance with laws and regulations governing the federal financial assistance received. The objectives of the Single Audit Act, as amended, are to

- promote sound financial management, including effective internal controls, with respect to federal awards administered by non-federal entities;

- establish uniform requirements for audits of federal awards administered by non-federal entities;

- promote the efficient and effective use of audit resources;

- reduce burdens on state and local governments, Indian tribes, and nonprofit organizations; and

- ensure that federal departments and agencies, to the maximum extent practicable, rely upon and use audit work done pursuant to the act.

We studied the single audit process, and in June 1994, we reported[1] on financial management improvements resulting from single audits, areas in which the single audit process could be improved, and ways to maximize the usefulness of single audit reports. We recommended refinements to improve the usefulness of single audits through more effective use of single audit resources and enhanced single audit reporting, and in March 1996, we testified[2] before this Subcommittee on the proposed refinements.

Subsequently, in July 1996, the refinements to the 1984 act were enacted. The 1996 amendments were effective for audits of recipients' fiscal years ending June 30, 1997, and after. The refinements cover a range of fundamental areas affecting the single audit process and single audit reporting, including provisions to

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[1] Single Audit: Refinements Can Improve Usefulness (GAO/AIMD-94-133, June 21, 1994).
[2] Single Audit: Refinements Can Improve Usefulness (GAO/T-AIMD-96-77, March 29, 1996).

- extend the law to cover all recipients of federal financial assistance;

- ensure a more cost-beneficial threshold for requiring single audits;

- more broadly focus audit work on the programs that present the greatest financial risk to the federal government;

- provide for timely reporting of audit results;

- provide for summary reporting of audit results;

- promote better analyses of audit results through establishment of a federal clearinghouse and an automatec database; and

- authorize pilot projects to further streamline the audit process and make it more useful.

OMB's Role

In June 1997, OMB issued Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. The Circular establishes policies to guide implementation of the Single Audit Act 1996 amendments and provides an administrative foundation for uniform audit requirements for nonfederal entities that administer federal awards. OMB also issued a revised OMB Circular A-133 Compliance Supplement.

The Compliance Supplement identifies for single auditors the key program requirements that Federal agencies believe should be tested in a single audit and provides the audit objective and suggested audit procedures for testing those requirements. We reported in our 1994 report that the Compliance Supplement had not kept pace with changes to program requirements, and had only been updated once since it was issued in 1985. We recommended that the Compliance Supplement be updated at least every 2 years. OMB is now updating this supplement on a more regular basis. The initial Compliance Supplement for audits under the 1996 amendments was issued in June 1997. A revision was issued for June 1998 audits in May 1998, and a revision for June 1999 audits was just recently finalized.

We commend OMB for its leadership in developing and issuing the guidance and the collaborative efforts of the federal inspectors general, federal and state program managers, the state auditors, and the public accounting profession in working with OMB proactively to ensure that the guidance effectively implements the 1996 refinements.

KEY REFINEMENTS AND ACTIONS TO IMPLEMENT THEM

Highlighted below are several of the key refinements and some of the actions taken to implement them.

Law Extended to All Recipients

The 1984 act did not cover colleges, universities, hospitals or other nonprofit recipients of federal assistance. Instead, audit requirements for these entities were established administratively in a separate OMB audit circular, which in some ways was inconsistent with the audit circular that covered state and local governments. For example, the criteria for determining which programs received detailed audit coverage were different between the circulars.

The 1996 amendments expanded the scope of the act to include nonprofit organizations. To implement the 1996 amendments, OMB combined the two audit circulars into one that provided consistent audit requirements for all recipients.

More Cost-Beneficial Thresholds

The 1996 refinements and OMB Circular A-133 require a single audit for entities that spend $300,000 or more in federal awards, and exempt any entity that spends less than that amount in federal awards.[3] Also, the threshold is based on expenditures rather than receipts.

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. To achieve this, a $100,000 single audit threshold was included in the 1984 act.[4] The fixed threshold, however,

[3]If a recipient receives funds under only one program, the Single Audit Act amendments allows the option of a program-specific audit instead of a single audit.

[4]The 1984 act included a $25,000 threshold but gave entities that received between $25,000 and $100,000 in federal

did not take into account future increases in amounts of federal financial assistance. As a result, over time, audit resources were being expended on entities receiving comparatively small amounts of federal financial assistance.

In 1984, we reported 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. In 1994, we reported that coverage at the same 95 percent level could be achieved with a $300,000 threshold.

Also, the refinements require the Director of OMB to biennially review the threshold dollar amount for requiring single audits. The Director may adjust upward the dollar limitation consistent with the Single Audit Act's purpose. We supported such a provision when the amendments were being considered by the Congress. Exercising this authority in the future will allow the flexibility for the OMB Director to administratively maintain the single audit

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assistance an option to have separate audits of each of its federal assistance programs or a single audit. The 1996 amendments eliminated the dual thresholds.

threshold at a reasonable level without the need for further periodic congressional intervention.

As a result of these changes, audit attention is focussed more on entities receiving the largest amounts of federal financial assistance, while the audit burden is eliminated for many entities receiving relatively small amounts of assistance. For example, Pennsylvania reported that this change will still provide audit coverage for 94 percent of the federal funds spent at the local level in the state, while eliminating audit coverage for approximately 1,200 relatively smaller entities in the state.

Broader Risk-Based Focus

The 1996 amendments require auditors to use a risk-based approach to determine which programs to audit during a single audit. The 1984 act's criteria for selecting entities' programs for testing were based only on dollar amounts.

The 1996 amendments require OMB to prescribe the risk-based criteria. OMB Circular A-133 prescribes a process to guide

62-468 2000 - 3

auditors based not only on dollar limitations but also on risk factors associated with programs, including

- entities' current and prior audit experience with federal programs;
- the results of recent oversight visits by federal, state or local agencies; and
- inherent risk of the program.

For practical reasons related to the audit procurement process, OMB Circular A-133 allowed auditors to forgo using the risk criteria in the first year audits under the 1996 amendments. Therefore, the risk-based approach will be fully implemented in the second cycle of audits under the 1996 amendments, which started with audits for fiscal years ending June 30, 1998 and is currently in progress. When fully and effectively implemented, this refinement is intended to give auditors greater freedom in targeting risky programs by allowing auditors to use their professional judgment in weighing risk factors to decide whether a higher risk program should be covered by the single audit.

Timely Reporting

Under the 1984 act, OMB guidance provided entity management with a maximum of 13 months from the close of the period audited to submit the audit report to the federal government. The 1996 refinements reduce this maximum time frame to 9 months after the end of the period audited. The amendments provide for a 2-year transition period for meeting the 9-month submission requirement.

OMB's guidelines call for the first audits subject to the revised reporting time frame to be those covering entities' fiscal years beginning on or after July 1, 1998 and ending June 30, 1999, or after. This means that March 31, 2000 will be the first due date under the new time frame.

When fully implemented, this change will improve the timeliness of single audit report information available to federal program mangers who are accountable for administering federal assistance programs. The Congress and federal oversight officials will receive more current information on the recipients' stewardship of federal assistance funds they receive.

Summary Reporting

The 1996 amendments require that the auditor include in a single audit report a summary of the auditor's results regarding the nonfederal entity's financial statements, internal controls, and compliance with laws and regulations. This should allow recipients of single audit reports to focus on the message and critical information resulting from the audit. OMB Circular A-133 requires that a summary of the audit results be included in a schedule of findings and questioned costs.

In 1994, we reported that neither the Single Audit Act nor OMB's implementing guidance then in effect prescribed the format for conveying the results of the auditors' tests and evaluations. At that time, we found that single audit reports contained a series of as many as eight or more separate reports, including five specifically focussed on federal financial assistance, and that significant information was scattered throughout the separate reports.

OMB Circular A-133 provides greater flexibility on the organization of the auditor's reporting than was previously

provided. Taking advantage of this flexibility, the American Institute of CPAs has issued guidance for practitioners conducting single audits that allows all auditor reporting on federal assistance programs to be included in one report and a schedule of findings and questioned costs.

Better Basis for Analyses

The 1996 refinements call for single audit reports to be provided to a federal clearinghouse designated by the Director of OMB to receive the reports and to assist OMB in carrying out its responsibilities through analysis of the reports. The Bureau of the Census was identified as the Federal Audit Clearinghouse in OMB Circular A-133.

In our 1994 report, we noted that data on the results of single audits was not readily accessible and discussed the benefits of compiling the results in an automated database. The Clearinghouse has developed a database and is now entering data from the single audit reports it has received. As this initiative progresses, it is expected to become a valuable source of information for OMB, federal

oversight officials, and others regarding the expenditure of federal assistance.

Pilot Projects

The 1996 amendments allow the Director of OMB to authorize pilot projects to test ways of further streamlining and improving the usefulness of single audits. We understand that OMB has recently approved the first pilot project under this authority. This first pilot, which was proposed by and will be carried out by the State of Washington, provides for auditing the state education agency and all school districts in the state as one combined entity, rather than having about 200 separate single audits. The Washington State Auditor's office has submitted a statement for the record that describes in more detail the pilot project.

Our preliminary view is that the pilot has the potential to both streamline the audit process and to provide a single report that is more useful to users than the approximately 200 reports it will replace. We fully support testing options for streamlining and increasing the effectiveness

of single audits and will monitor this and any other pilot projects that are approved in the future.

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We are committed to overseeing the successful implementation of the 1996 amendments, working closely with all stakeholders in the single audit process and periodically providing information to the Congress on the progress being made on all of the refinements. Mr. Chairman, this concludes my statement. I will be glad to answer any questions you or other Members may have at this time.

(911943)

Mr. HORN. Our last witness will be Mr. Auston G. Johnson, the State Auditor of Utah. He is also the chairman of the Single Audit Committee of the National State Auditors Association. Besides his remarks going into the record at this point, we will also attach with them the statement from Brian Sonntag, the Washington State auditor. It's roughly 12 or 13 pages, and that will go following Mr. Johnson's testimony.

Mr. Johnson.

Mr. JOHNSON. Thank you, Mr. Chairman. I appreciate the opportunity to be here today and to address this subcommittee. The State audit community is basically where all of the theories and philosophies of the Single Audit Act come together. It's where the rubber hits the road, I guess you'd say. We are the ones who try to implement all of the provisions that have been delineated in the different documents, and try to make the Single Audit Act work.

In the broadest terms, the Single Audit Act has been a tremendous success. The act of 1984 was great in moving forward the overall auditing of Federal programs, and the refinements that came about in the 1996 amendments went a long way to taking care of some of the problems. Mainly the problem with auditing of the major programs is that we were auditing the same programs over and over every year because we were only auditing the largest programs. With the risk-based approach, we were able to look at problems that we were able to identify from a lot of work we had done at States that had a greater risk than some of the larger programs that had been audited for 10 years at that time.

We have had some concerns with the Single Audit Act, the implementation, but those concerns are in the written statement that I've submitted, and in actuality they seem a lot worse in writing than they really are. Whenever you have a new program in its implementation process, you're going to have problems, and this one has created problems. I think there's been some Federal departments that have jumped the gun a little bit and have put some pressure on us to do things that would have been better left a couple of years until we could get a better handle on this, but those things are being worked out through cooperative efforts with the State auditors, the GAO, OMB, mainly through the intergovernmental audit forums where we can meet with the Inspectors General of the various departments and work through these issues, and we have solved a lot of the issues that have come up, and I think we will continue to solve the issues.

There is one situation that I think is beyond what we can do through the forums, and that is going to take a legal or a legislative action, and that would be access to records. And quite frankly, some of this is outside the realm of a single audit, but I think as State auditors we see the expenditure of all tax dollars, whether they be State or Federal, as our responsibility. And in doing single audits, we have access to a lot of records that we would like to check against other records, and with computers available to us, we can do that, but there are different privacy acts that are in place, confidentiality acts, department by department, that don't allow us to cross-match records from one Federal department to another. And we think that there could be some benefit gained by being able to do that, but like I say, in some cases it is outside the realm of

the Single Audit Act, but we would like to pursue that, and it might take some clarifications in the law that would allow us access to those records. Actually, we do have access to the records. We just don't have the ability to use them in auditing other programs.

Mr. HORN. You make an excellent point, and I think when we discuss the privacy bill a few months from now, maybe that's where we could tuck it in, because you're absolutely correct. You ought to have that cross-reference.

Mr. JOHNSON. I think we could do some great things. It may make some people nervous, but I think we could do some great things in being able to do that.

Some of the things that need to take place are, first of all, we need to have continued support of the intergovernmental audit forums, the ability to sit down and openly and clearly, honestly discuss issues and bring them to a conclusion that's mutually beneficial to everyone.

The compliance supplement needs to continue to be updated annually. When the compliance supplement was first put together—I think we got it in August, June, or August—it was way too late for us to use. We're up to the point now where it's dated May 1. The efforts of OMB, I think, have been tremendous in being able to get that document out in the timeframe that's beneficial to State audits. Most States have a fiscal year end of June 30, and in order for us to really make use of that document, we need it in March in order to assist in our planning, and I think it's getting closer. That will continue to improve. I think there's over 100 programs, 118 programs, I think, now in the current supplement. There can't be that many more programs that are significant, so I think we've hit the point where it will be easier to update that thing each year, and the problem of timeliness will go away.

And we need GAO to continue to review legislation so that individual audit requirements don't creep into legislation for specific departments that would conflict with the Single Audit Act without a real open public debate between State auditors, GAO, OMB, and the department on why that has to be. And that, Mr. Chairman, would conclude my remarks.

Mr. HORN. Well, thank you very much.

[The prepared statements of Mr. Johnson and Mr. Sonntag follow:]

Single Audits

A State Auditors Perspective Of the 1996 Amendments To the Single Audit Act

Auston Johnson
Utah State Auditor

May 13, 1999

Brief History of Single Audits

During the 1960's, there was a tremendous growth in federal assistance to state and local governments. This growth in assistance and the corresponding desire to have appropriate oversight by federal agencies caused changes in the way federal funds have been audited.

Throughout the 60's and much of the 70's the federal government supported a concept of grant-by-grant auditing. Each federal agency had a cadre of auditors who were trained to audit their programs. By the mid-1970's, there were more than 100 individual audit guides, each designed to audit an individual program. The diversity in materiality and audit procedures between the various audit guides was tremendous.

Since each federal agency had their own audit group, recipients of federal assistance were often inundated with auditors. This process did not provide for sharing information or audit results between federal agencies.

In an attempt to standardize audit requirements, the U.S. General Accounting Office (GAO) issued *Government Auditing Standards*, referred to as the Yellow Book in 1972. The Yellow Book has gone through several revisions, and there is currently a standing committee, whose purpose is to revise the Yellow Book and make sure it is up-to-date.

Also in 1972, The U.S. Office of Management and Budget (OMB) issued Circular A-102, *Uniform Requirements for Grants and Cooperative Agreements with State and Local Governments*, which provided administrative regulations for grants and contracts with state and local governments.

Although the Yellow Book and A-102 went a long way in standardizing administrative procedures, and audit requirements, the burden of grant-by-grant auditing was still too much for both federal agencies, and recipient governments. Attachment P to Circular A-102 was issued in 1979, it required an organization wide audit to be performed. The, attachment P, audit could be performed by non-federal auditors and the subsequent report had to be accepted by all federal agencies.

The concept of a single audit that would meet the needs of all federal agencies was not quickly embraced, and in fact is not fully embraced today. Many federal agencies continued to perform grant-by grant audits, and since these agencies continued to send auditors, recipient governments were reluctant to pay for a single audit. Also, since the requirement was in regulation form, many governments did not take it seriously.

The Single Audit Act of 1984 codified many of the audit requirements established in Attachment P, and put the force of law behind organization wide audits. Following the Single Audit Act, OMB issued Circular A-128, *Audits of State and Local Governments*. A-128 was the implementation guide for the Act. In 1985 a compliance supplement was issued in cooperation with many federal agencies. The supplement contained legal and

regulatory requirements, along with suggested audit procedures. It included the 60 most significant federal assistance programs, which represented about 95% of the total assistance received by state and local governments.

OMB issued Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Insitittions,* in 1990. A-133 paralleled A-128 in many ways and was applicable to Audits of Institutions of Higher Education and Other Nonprofit Institutions. A compliance supplement applicable to A-133 was also issued.

Studies performed by the National State Auditor's Association (NSAA), the President's Council on Integrity and Efficiency (PCIE), and GAO indicated that there were problems with the basic approach taken by the Single Audit Act in selecting what were called "Major Programs." Many federal program administrators were not relying on the single audit because it did not meet their needs, and there were other technical problems identified in the Act that needed to be fixed.

The Single Audit Act Amendments were passed into law in 1996. The Amendments applied to both state and local governments, and to higher education and nonprofits. Circular A-128 was superceded by a new Circular A-133, which applied to all recipients of federal assistance.

Changes to the Single Audit Act as a result of the Amendments of 1996 and the revised A-133

There were several significant changes to the Single Audit Act as a result of the 1996 amendments. First of all, the new act applied to nonprofits and institutions of Higher Education. The act of 1984 only applied to state and local governments.

The amendments raised the threshold for a single audit from $25,000 to $300,000, and changed the focus of the audit from strictly the highest dollar programs to a risk based approach. The change to a risk based approach gave the auditor greater opportunity to audit programs that posed a potential risk regardless of the size of the program. It also provided federal agencies an opportunity to designate programs as high risk. (i.e., a high likelihood of noncompliance with applicable laws and regulations).

The reporting deadline for submission of single audits changed from 13 months to 9 months. There was however, a two-year implementation period written into the circular to allow for this change.

Monitoring of subrecipients would have to change if subrecipient received less that $300,000 in federal assistance. Many governments had relied on single audits of subrecipients as a monitoring tool. Recipient governments could make use of "limited scope audits" to monitor. However, the recipient government would have to pay for the

audit. The cost could not be transferred to the subrecipient, but would be eligible for federal reimbursement by the recipient government.

Performance audits are allowed upon authorization by OMB under the amendments.

A data collection form is now required. It provides information to be accumulated by OMB through the single audit clearinghouse, to evaluate the need for future changes in single audits. The data collection form also provides for centralized reporting of single audit results.

Revised Circular A-133 also provides for the "clustering of programs". Federal programs with similar compliance requirements could be considered as one program for testing.

Problems noted in implementing the provisions of the Single Audit Act Amendments and the revised Circular A-133.

As with the implementation of any new program, there are bound to be some problems, and the Single Audit Act Amendments and Circular A-133 were no different. One of the complaints about single audits, going back to 1984, is that questioned costs generated by non-federal auditors are not as large as those generated by federal auditors when they were performing grant-by-grant audits. This complaint is probably true, but can be easily explained. Federal auditors would spend a significant amount of time looking at a single program, or a group of programs administered by a single federal agency. As was mentioned earlier, this type of auditing caused problems with recipients, and did not provide coverage of the number of programs that the federal agencies wanted.

Under the Single Audit Act, the number of programs audited was much greater. However, the depth of the audit was significantly less. It has been said that federal auditors audited a foot wide and a mile deep, while non-federal auditors audited a foot deep and a mile wide. This difference is not seen as a problem by state auditors, and in fact is seen as an efficient and cost effective way to audit federal programs. This process allows federal agencies the opportunity to build on the single audit, or to concentrate their efforts on problems identified by the non-federal auditors.

There were initial problems with submission of the Data Collection Form. Some reports indicated more than 90% of the forms were rejected. This was caused in large part because of the rush to "get something on the street." OMB did a great job of having the form available in a very short period of time. As of May 6, 1999, of the approximately 37,000 reports submitted, 27,000 have been accepted for an acceptance rate of about 73%. However, many of these "accepted" forms have been submitted more than once. This indicates that although many of the problems have been solved, there is still work to do in training submitting governments and CPA's in properly completing the form.

Subparagraph 7503 of the amendments states: "An audit conducted in accordance with this chapter shall be in lieu of any financial audit of Federal awards which a non-Federal entity is required to undergo under any other Federal law or Federal regulation." It also states that if the audit doesn't meet its needs, the federal agency can arrange for additional audits to be performed. To date, the Environmental Protection Agency (EPA) and the Federal Aviation Administration (FAA) are the only agencies that we are aware of who have required additional audits.

The Clean Water Act State Revolving Fund (SRF) administered by EPA requires a separate audit. Although EPA expressed reasons for requiring separate audits, the state audit community, in a letter dated April 1, 1997, stated this requirement "...contradicts and undermines Congress's expressed intent" in adopting the Single Audit Act. Currently, EPA is sending audit teams to audit states that have not arranged for separate audits. We consider this to duplicate the work performed as a result of the Single Audit Act and an unnecessary use of federal funds.

In an advisory circular dated August 3, 1998, the FAA required a review and opinion of the review on the agency's funding activities with respect to its airport or local airport system each time a single audit is required. This requirement is a result of section 805 of the FAA Reauthorization Act of 1996.

In this case, requirements were added to single audit reporting before the first reports required by the Single Audit Act were even submitted. The FAA, following intervention by OMB, is now reviewing airport audits on a case by case basis, and will require the additional reporting only in situations where it is determined there is sufficient risk. This compromise is in keeping with the intent of the Single Audit Act, in which federal agencies build on the work completed as part of a single audit.

Every time a situation like the two illustrated occurs, the single audit and the idea of risk based auditing is undermined and the single audit loses its value in being consistently and evenly applied. GAO needs to be vigilant in identifying individual agency audit requirements that would undermine the effectiveness of the Single Audit Act.

Problems or situations that need to be addressed in the future.

Since reports required under the risk-based approach are just now being received by the clearinghouse, it is difficult to assess the success of the Amendments to the Single Audit Act. There are several situations that need to be addressed.

With the incredible power available to state auditors through the use of computers, there are opportunities to provide testing of federal programs that may be outside of the requirements of the single audit. We have the ability to cross check

records gathered by one federal agency against those of other federal agencies. However, when this has been attempted, the results have been less than favorable.

In one situation that was required by the Single Audit Act, the state auditors of Connecticut and Louisiana were testing the Temporary Assistance to Needy Families (TANF) program. Audit work requires testing of the Income Eligibility Verification System (IEVS). One element of the IEVS is Internal Revenue Service (IRS) 1099 data. The IRS has refused to provide this information stating that in their opinion neither the single audit act nor IRS regulations would allow access to state auditors. Although, the Compliance Supplement has been revised to eliminate the need to review 1099 data, the need for state auditors to have access to records has not been settled.

In another case, the State of Texas wanted to match HHS program recipients with USDA recipients but were denied ability to do this by USDA. They cited privacy issues as the reason.

The State of New York has been denied access to Medicare Part B claims. HCFA has steadfastly refused to give information citing confidentiality issues. Only after considerable delays were they granted access to Medicare Part A information. The information was needed to run matches between Medicare and Medicaid.

In Utah we wanted to match student records with Unemployment Records and various other records to identify individuals that might be wrongfully receiving federal assistance. The Department of Education denied access citing privacy issues. We were told we could have the records only to test programs within higher education.

State Auditors need a clear statement in Federal Statute providing access to all records necessary for us to perform audits. Obviously state auditors would be under the same confidentiality requirements as anyone else handling the same records. However, The benefits to the federal government as a whole could be greatly enhanced if state auditors were allowed to develop innovative audit tests using existing federal records.

The Amendments to the Single Audit Act were designed to reduce audit burden and reduce cost of the single audit. In raising the threshold to $300,000 this was certainly accomplished for many smaller entities. However, some early comments by state auditors and independent auditors of larger entities, indicate that this may not be true in all cases. Information needs to be gathered to determine the effect of the amendments. If there are increases in costs or time is it the result of start-up, i.e., adjusting to the risk based approach, or some other cause.

One other cause could be federal agencies meeting the requirements of the Chief Financial Officers (CFO) Act. As federal agencies are required to comply with the CFO act, they are relying on information that can be obtained and tested under the umbrella of the single audit. One example of this is the Department of Education (DOE) requirement that the Federal Family Education Loan (FFEL) program be audited as a major program. One of the reasons for requiring an audit of this program was so that the DOE could

receive certain assurances because this program has a direct and material effect on DOE's agency wide financial statements. Although we agree that this work is necessary to DOE, it should not be confused with the requirements of the single audit act, as it would inflate the costs of the single audit and mask the costs of compiling a financial statement for DOE.

The 1996 amendments require OMB to review certain provisions of the circular on a periodic basis. One in particular is the audit threshold, now set at $300,000. The question to be answered is, should the threshold be changed. Information gathered on the data collection forms should provide a basis for future decisions.

The current circular requires Type A programs (large programs) to be audited at least every three years. A determination that a Type A program is low risk, will allow it to be skipped in the audit cycle for two years, but then it must be audited in the third year. Experience with the new act should be used to determine if this cycle makes sense. It may be that low risk Type A programs can go longer between audits without any adverse effects.

Communication must be open and honest. The National Intergovernmental Audit Forum is essential in providing an environment where state, local, and federal auditors can meet and discuss common issues and concerns. The forum needs a continued level of support and funding in order for it to assist all levels of auditing.

The Compliance Supplement must be updated annually. The supplement provides information on the nature and objectives of federal programs. It identifies the significant compliance features of each program and suggested audit procedures. The Compliance Supplement is arguably the most important document used by auditors in performing single audits. OMB has done an admirable job in producing the supplement on an annual basis. We continue to stress the importance of timely updates to this critical document for use by the audit community.

GAO should continue to review legislation so that audit requirements for individual federal programs that would conflict with the single audit act is not introduced. The reasons for any specific audit requirements should be reviewed and approved by OMB and GAO prior to passage. In this way only the truly extraordinary situation will receive special attention. With a little understanding and compromise, all perceived special circumstances could probably be covered by the Single Audit Act.

In conclusion, even with all the comments made in this document, the Amendments to the Single Audit Act have been beneficial to the auditing of federal programs. We need an ongoing review of the Single Audit Act in order to maximize the benefit to federal, state, and local users.

Legislative Building
PO Box 40021
Olympia, Washington 98504-0021

Washington State Auditor
Brian Sonntag

(360) 902-0370
FAX (360) 753-0646
TDD Relay 1-800-833-6388
http://www.wa.gov/sao/

May 12, 1999

The Honorable Stephen Horn
United States Representative
Chair, Committee on Government Reform
Sub-Committee on Government Management, Information and Technology
B-373 Rayburn House Office Building
Washington, DC 20515

Dear Representative Horn:

Thank you for the invitation to provide comments for your hearing tomorrow on the status of implementation of the Single audit Act Amendment of 1996. The provisions of this Act are critically important in promoting and demonstrating public accountability.

Should you have any questions, please do not hesitate to call me a (360) 902-0360 or Deputy State Auditor Linda Long at (360) 902-0367.

Sincerely,

BRIAN SONNTAG, CGFM
STATE AUDITOR

BS:LL:pvh

STATE OF WASHINGTON
OFFICE OF THE STATE AUDITOR

WRITTEN COMMENTS

For

THE UNITED STATES
HOUSE SUBCOMMITTEE ON GOVERNMENT
MANAGEMENT, INFORMATION AND TECHNOLOGY

Of The

COMMITTEE ON GOVERNMENT REFORM

"Status of Implementation of the Single Audit Act Amendments of 1996"

May 13, 1999

BRIAN SONNTAG, CGFM
STATE AUDITOR
(360) 902-0360

Mr. Chair, Members of the Subcommittee. Thank you for the opportunity to provide comments regarding the implementation of the Single Audit Act Amendments of 1996.

By way of background, the Washington State Auditor is both a constitutional and statutory officer. The Constitution specifies that the State Auditor is the auditor of public accounts and by statute is the auditor of all Washington State agencies and local governments. There are approximately 160 state agencies and 2,300 units of local government.

The Washington State Auditor's Office has a long history of auditing federal grants and performing single audits. Since the enactment of the Single Audit Act, we have performed in excess of 5,000 single audits. Under a fairly recent state Legislative mandate, we have also performed agreed-upon procedures engagements involving publicly funded not-for-profit organizations delivering services on behalf of the state of Washington.

Our purpose in providing these comments is to share:

- General observations about the implementation of the 1996 amendments,

- Specific observations relative to aspects of the Act and its implementing guidance, and

- Recommendations.

General observations.

The Single Audit Act amendments of 1996 were long overdue. Notable among the changes were the dollar threshold for federal audit requirements; more clearly defined roles for the Office of Management and Budget (OMB), grantor agencies, recipients and subrecipients; and the risked-based approach for single audit coverage.

The OMB should be commended for its leadership in implementing the 1996 amendments and in carrying out its obligations under the Act. We appreciate their thoughtful and inclusive deliberations. Overall, OMB has been very responsive to the audit community within the powers that have been granted to it.

We also can report that we have seen increased understanding of single audit requirements and reports by grantor agencies. This is a move in the right direction.

Specific observations.

Our specific observations are intended to address aspects of the Act that we feel could be further refined. We make these recommendations with the goal of ensuring that the citizens of the United States receive maximum value for each dollar allocated for audit purposes.

1. ***Granting of pilot projects.***

   The Act calls for OMB to authorize pilot projects to test alternative methods of achieving the purposes of the chapter. We advocated this provision and value the fact that it was authorized.

   We made this request because in 1995 we had proposed to OMB that we take a more global approach to the audit of K-12 education dollars in our state. This proposal could not be granted due to OMB's lack of authority

In a nutshell, our proposal was to audit K-12 as a single system of government rather than auditing the 190 school districts that require a single audit. In addition to saving the taxpayers in excess of $400,000 annually in audit costs, we would also be positioned to provide more relevant systemic information on this area of government to managers and policy makers.

Recognizing that we have all been in a learning curve relative to our pilot project, we do feel there is still tremendous room for improving the process for granting pilot project authority.

We are just now getting final authority to proceed with this project, four years after it was proposed. In the meantime, the taxpayers have funded less-than-optimum audit coverage.

2. ***Risk-based program selection criteria.***

Introducing the risk-based approach to single audit represented a significant shift. It was a move in the right direction. However, we feel the model needs to be studied to determine whether it is ensuring maximum value for the audit dollar.

Currently, the risk-based model focuses on programs and still uses formulas, percentages and dollar thresholds to determine audit coverage.

We feel the model needs to be reevaluated to give greater flexibility to the auditor in determining audit coverage. For example, the risk assessment needs to be performed on the organization as a whole prior to performing the risk assessment on any individual program.

Too often we have found that institutional problems have been missed because the audit focused too heavily on individual programs and funding streams.

3. ***Blended resources movement.***

We are finding that federal and state grantor agencies are encouraging recipients and subrecipients to blend resources in the delivery of public services. No one disputes the merits of this strategy.

However, we have found that the Single Audit Act and implementing guidance do not address administrative and accountability expectations for this method of funding public services.

Effective blending of resources from more than one grantor agency or program within an agency also requires a significant commitment to coordination and collaboration.

It is important to note, however, that the state of Washington may be unique among the states in not having established an institutional arrangement to support the blending of resources.

4. ***Subrecipient and vendor determinations.***

OMB Circular A-133 outlines criteria to be considered in determining whether an auditee is a subrecipient or a vendor. While the criteria seems reasonable and fairly straight forward, in practice it is very difficult to interpret and, we believe, creates incentives to go the vendor route.

Quite frankly, we find that pure economics are driving the propensity to classify service providers as vendors rather than subrecipients. The bottom line is the fact that the administrative burden is less in a vendor relationship. There is a significant loss of accountability when a contract specifies a vendor relationship rather than a subrecipient relationship.

We find that all too frequently that various officials within the same federal and state agencies cannot agree on who is a vendor and who is a subrecipient.

As this determination is critical to the delivery of many federal programs, we feel that more research and guidance is necessary in how to draw distinctions between subrecipients and vendors.

5. ***Oversight agency for audit responsibilities.***

While the guidance for oversight agencies outlined in OMB Circular A-133 make sense, in practice agencies are not routinely assuming these responsibilities. From our perspective, this is primarily due to resource constraints at the federal and state level.

There are significant responsibilities associated with being an oversight agency. Carrying out these duties does not come without cost. For many federal and state agencies, it appears to not be a priority in terms of funding.

Many of the reportable conditions that we have identified during our audits could have been precluded had there been an effective oversight agency.

The role of the oversight agency is particularly critical to the effective administration of funds that are *blended* in delivering public services.

6. ***Harmony between the Single Audit Act and the Government Performance and Results Act.***

The Single Audit Act is focused on compliance and *red tape* rather than performance or *results*.

We feel we are at a crossroads in terms of implementing the Government Performance and Results Act as well as similar acts at the state and local

level. Serious consideration needs to be given to how *audit* can support its implementation.

Recommendation.

Our comments are based on our experience in performing in excess of 5,000 single audits since enactment of the original Single Audit Act and are intended to be constructive.

We feel that as we approach the millennium, it is timely to study the fundamental tenants of the Single Audit approach and requirements. The overall goal of revisiting the Act would be to ensure that the citizens of the United States are receiving maximum value for each audit dollar expended in delivering public services.

In carrying out this study, it is critical to involve those charged with authorizing and delivering public programs and services. We also need to ensure that single audits produce valuable information that can be used by citizens in assessing whether governments are accountable for the tax dollars they spend.

Thank you for holding the hearing on this important topic and inviting our written comments.

Mr. HORN. Mr. Turner, do you wish to start the questioning?

Mr. TURNER. No, you can go ahead, Mr. Chairman.

Mr. HORN. Mr. Johnson, in your written testimony, you stated there were initial problems with the submission of the data collection form. You stated that some reports indicated that more than 90 percent were rejected, and that this was caused in large part because of the rush to get something on the street even though we appreciate what OMB did when we're talking about the guidelines. So, would you first describe for us the purpose of the data collection form?

Mr. JOHNSON. Yes. The data collection form, in all the time we've been doing single audits, we've never actually accumulated data on what was happening, what programs were being audited, what was the extent of coverage of Federal dollars out there. And the data collection form allowed—will allow the collection of data that will be beneficial in setting parameters for future single audits or amendments to single audits again.

The form is just a way for the auditee and the auditor to put down information, findings that were issued, question costs that were a result of the audit, the programs that were audited, the type of opinion that was given, that type of information.

I think the reason we had problems with submission is that the form was being formulated and put together at the same time that the compliance supplement was being put together, and we were running up against deadlines to submit reports, and something had to be put out, and it came out. And I think it was very confusing because it asked questions that auditors and auditees never had to answer before. It showed that there was some gaps in knowledge out there about oversight agencies and cognizant agencies and different fine points of the Single Audit Act, and because of that—and I think also it was because of the way the clearinghouse was tasked in entering the data. They were not doing desk reviews. They weren't correcting anything. If there was the slightest error at all, it was rejected and sent back for resubmission. I think that's why it added to the large number of problems there, the rejections in the first go-around, but I understand it's getting better, and I think it will continue to get better as people become aware of how that form is supposed to work.

Mr. HORN. So you're optimistic about it.

Mr. JOHNSON. Oh, yes.

Mr. HORN. Ms. Lee, do you have any comments on that? Do you agree with that?

Ms. LEE. The group is working together. This is a very collegial group. One of the things they're trying to do is make the form electronic, which in itself will have some self-edit. The person trying to enter it, if they try to enter it incomplete—or with wrong data, they will immediately know that they need to make some changes. There won't be this frustration of, "I sent in and I get it back." So I think that's an improvement that's going to work.

Mr. HORN. Mr. Clark, do you have any comment on that?

Mr. CLARK. I want to underscore the importance of it, and I think what we're seeing is a product of the recognition that the data collection form and the creation of the data base really has a lot of potential, and I'm glad that we're dealing with the problems

now. I think it's worth the investment, and the progress, I think, is fine. The first year there were problems, but again, going back to the audit forum process, those problems were identified immediately. The right stakeholders got together and worked on it. I think it's been solved fairly fast.

Mr. HORN. Just as a general question, is there anything now that you've had some experience with the single audit that you feel we should add to the law, or can it all be done by regulation, and if so, what are the things—now that you've experienced this, we missed?

Mr. JOHNSON. I think the one that I brought up about access.

Mr. HORN. That's a good point.

Mr. JOHNSON. Information, the ability to cross-test would be nice. If it was in the Single Audit Act, I think it would clarify the issue if that was able to supersede some of the privacy acts. And we understand as State auditors that we would be subject to the same confidentiality, but we handle confidential records all the time, so it's not an issue, I don't believe. Otherwise I think the Single Audit Act pretty well covers everything we need. I think everything else can be handled through regulation working with GAO and OMB on this.

Mr. HORN. Mr. Clark, do you have any suggestions on this after you sort of lived reviewing this?

Mr. CLARK. I have lived most of my life doing this. If we go back to the 1996 amendments, that was a product of a 6-year effort. Every stakeholder was involved. The State auditors had done a study of the single audit. The Inspectors General had done a study of the single audit. We took our time, and we did it right. I think when the amendments passed, we had more than consensus. I think we almost had unanimity on what needed to be done.

We have this phase-in approach, as I mentioned. We're going to be beginning some studies. We're going to be looking to see how this is working; whether, in fact, everything everybody wanted is being achieved.

The act provides a lot more flexibility—the amendments provide a lot more flexibility to the act than it did before, things like the pilot program. OMB has some authority to raise the threshold. I would like to keep that current.

There may be a point a few years down the road where, based on reviews that we may have done or issues identified by the people, that a consensus will begin to emerge, or maybe something will need to be done. But at this point I'm not aware of anybody coming to the table and saying there's something about the act, or about the amendments or, about OMB's role that needs to be addressed.

Mr. HORN. Ms. Lee, do you have anything after you have gone through this comma by comma or semicolon?

Ms. LEE. Just again, on the threshold, I anticipate we need a couple of years, 2 years, before we will look at that threshold and say is that still the appropriate threshold. I think, again, the collection of data and the clearinghouse is going to give us a lot of information to show us what programs were looked at to what level, to what degree, and from there then we probably will get back congenially and say, OK, are we about right on the threshold? Is there

more time? Where should we be? But we've got that flexibility in the act.

Mr. HORN. Well, let's get back a minute to the sensitive bit and the crosstabs and all the rest.

To what degree do State auditors generally transfer their responsibility on an audit of an agency or a Federal grant program to that agency with a public accounting firm rather than with their own State personnel, and would that be a problem? I will ask all three of you in terms of, say, a contract for an audit with a private firm as opposed to government auditors of State, Federal Government, local, regional, special district, whatever. How do you feel about that? Is there a problem there?

Mr. JOHNSON. I don't believe there would be, the reason being in the early stages of the single audit, we almost had to fight with some CPA firms to get them to release records to the Federal Government. I think that there is that client/auditor relationship that requires confidentiality on their part the same as it would on anyone handling those records. If there was, it would be a matter of putting it in contract and making sure that they understood their responsibilities.

We have never had a problem in access to, as I said, State records of any kind and Federal records as long as we used them in testing that Federal program. The issue we had specifically was that we wanted to look at unemployment records and student records at the universities. We wanted to run a test to see how many students were full-time students and collecting unemployment. As long as we used student records to test student programs, there was no problem with access. We had everything we needed. As soon as we wanted to take it outside of higher ed programs, that was where the problem came up.

Mr. HORN. The clientele, let's say, of a social service agency, is that what we're thinking of?

Mr. JOHNSON. Right. For instance, you have USDA that runs commodity programs and food stamp programs and those types of things, and HHS runs several other social assistance programs. It would be nice to be able to cross-match some of those records to see if eligibility income limits for people receiving different programs were reported the same. It would be nice to run Social Security Administration records against welfare records to see if we're paying dead people, those types of things.

Mr. HORN. You're not even near Chicago. I think you make a very good point. When L.A. County welfare went to pictures, photographs, an identification card, 1,000 people dropped off the welfare rolls voluntarily. But I think you're right on that.

The gentleman from Texas, Mr. Turner. Please proceed.

Mr. TURNER. In terms of questions, let me followup, Mr. Chairman, on this privacy issue. Perhaps Ms. Lee is the right one to ask to kind of get an administration perspective.

It seems to me in terms of the privacy issue, maybe where it ought to be dealt with is on the front end. If someone applies for a government benefit, I assume that under existing law, they don't sign any form or any waiver of any privacy rights, but perhaps they should. That is to say when a person receives a benefit from the Federal Government, whether it's a student loan or welfare

benefit, perhaps it should be incumbent upon them at the same time to waive access to certain other records so that it can be verified that they're eligible.

Do we do that now, and if not, do you think we should be doing it? Would that be a more appropriate way to deal with the privacy issue than simply on the back end to give auditors the authority to look into it when the recipient hadn't had any role in that process at all?

Ms. LEE. Mr. Turner, as you're so familiar, the whole issue of privacy—confidentiality of records and access to records, who has access to them and what their uses are is a large issue that we're working together on. We want to try to figure out what the best solutions are. I believe you're correct in saying that currently there's an issue now if an individual says, "You're going to use my data for this and only this." We cannot use it for other purposes, so we need to get all those issues straightened out and determine whether or not it's appropriate to tell the recipient up front what the uses are or whether we can make a determination that that's appropriate. It's privacy, confidentiality, and it's a pretty sticky wicket right now, but I know you're working on issues.

Mr. TURNER. Do you think it makes sense to try to catalog the types of information that an auditor would need to verify that an individual is, in fact, eligible for certain government programs and then to put in the statute a provision that says when a person applies for that particular benefit, they sign a waiver allowing certain auditors to have access to that information for that specific purpose?

Ms. LEE. I think that's a possible solution. The data issue goes beyond just auditing. I think it goes into eligibility for some programs. It cross-cuts many of the programs. Right now we're discussing what records you can access to determine if a person is eligible for particular programs, in particular your tax records.

Mr. TURNER. I guess the thing that concerns me about it if we simply say in law that auditors, State auditors, can have access to certain information, once you get the information and you determine there's some perhaps fraud involved, it seems like then you're obligated to do something with that information, and that's when it seems to me to become a more significant problem for the recipient, and it just might be better if we required recipients of government loans and benefits up front acknowledge that certain people will have access to certain records of theirs relating to their receipt of that benefit and really kind of pin it down so everybody knows up front what they're getting into, and it might have a deterring effect to ensure that there's not fraud on the front end by an applicant for a government benefit. Are there any problems with that?

Ms. LEE. I think there's certainly an option. Right off the top of my head, I can't tell you how many programs that would mean and whether or not we want to do that only for the States; or whether there are other programs that we need to look at beyond just the State auditing, Federal programs, or other local programs. I think we need to look at the whole package.

Mr. TURNER. Mr. Johnson, do you have any comment on that?

Mr. JOHNSON. Just on your initial question are there releases on the forms now. From personal experience I have a son that just

qualified for SSI and Medicaid, and there's a statement on that form that says, don't worry, this will be kept confidential and not released to anybody else for any reason. So it's just the opposite, at least on those programs.

Mr. TURNER. There may be legitimate reasons for that person to not want that information to be released. It just seems to me addressing it on the front end—and I didn't realize we are doing exactly the opposite now, advising people that this is confidential.

Mr. JOHNSON. And I don't know if that's true in all programs, but it was on those.

Mr. TURNER. That statement that you just referred to appears to be sort of a blanket assurance that nobody is going to get ahold of it for any reason, and it seems to me that perhaps there are some legitimate reasons for making certain information available that may be—if it were specifically set forth, then the recipient signs, acknowledges they understand up front that particular entity will be able to get that information about them.

Mr. JOHNSON. I think it's certainly something to look at to see if that would work.

Mr. TURNER. Mr. Clark, is my idea off base here?

Mr. CLARK. This is an issue that I personally have not looked at. I don't know whether GAO has a position on it.

I would like to make a comment, though, with respect to the single audit process and whether you all want to look at this issue as part of the Single Audit Act or in another vehicle. Single audit is not designed to be an absolute thorough determination of the actual extent of compliance with any particular program. That's not its purpose. We like to say there's not enough audit resources to go around. We need to allocate those resources.

The single audit sets up a foundation or a starting point. I'll try to use a simple example here one that I always use. If I'm a program person, and I have $100, and I send $1 to each of 100 recipients, I, of course, would like to know the absolute extent to which each of those recipients spent my dollar and all the bells and whistles and requirements that come with it, but that's very costly. So I would like to be a little smarter and maybe a little more rational.

So single audit comes back and says to me as a program person, if done right through an automated data base, we're going to tell you, Mr. Clark, as a program person which of your recipients appear to have good financial management, which one of them appear to have good controls, which ones appear to be struggling, which ones can't put statements together, which ones have system problems. We're going to give you a sense of which recipients are experiencing compliance problems. And I may get the single audit reports back, and I may say, OK, looks like I have a success story with 80, but with 20 there's a problem.

Single audit becomes the foundation for me as a program person to begin targeting all the tools that I may have, including this very sensitive, powerful issue of computers and matching and the like. I think then we might have a better determination of the extent to which we want to give these powers to the Federal Government, State auditors, the public accounting profession, and put in the necessary safeguards.

Mr. TURNER. Thank you, Mr. Chairman.

Mr. HORN. OK. Let me, Mr. Johnson, pursue in just a little more detail—for the record. It's in your statement, but you noted there's a couple of examples of additional audit requirements, and one was the Environmental Protection Agency. Another was the Federal Aviation Administration. Could you sort of spell out now what was your concern on those?

Mr. JOHNSON. With the Environmental Protection Agency, they came out with a statement that basically said, we will not accept the single audit. It doesn't meet our needs. We want separate audits done of the clean water funds and now the drinking water funds in States, and that will be separate financial statements for those programs with an auditor's opinion on them done on an annual basis.

Mr. HORN. So separate statements are for the water program?

Mr. JOHNSON. Yes. The clean water——

Mr. HORN. Clean Water Act.

Mr. JOHNSON. And also the Drinking Water Act. So there are actually two programs now that require separate audits.

In the act itself and also in the circular it says that if the single audit doesn't meet the needs of an agency, they can request additional auditing that they would have to pay for the add-on auditing. That is the loophole that EPA has gone through, although I don't know why at this point they need separate financial statements on their programs with separate opinions.

When this came out, that position—where they said you must do that, they modified that slightly and said that where States won't do it, we will come in and do it, and I'm not sure of the numbers though, but I think there are roughly 12 to 14 States who do not audit the programs where EPA sends their own auditors in to audit that program on an annual basis.

Even though—an example, our State, the State revolving fund is a major program, and it has been audited on an annual basis. We do look at compliance. They come in and do a separate audit, issue separate financial statements with a separate opinion on them. It seems like a real duplication of effort in that.

We need to sit down, put a work group together with State auditors, OMB, GAO, EPA, find out why they can't accept the single audit and what type of adjustments need to be in the regulations so that they can accept it.

Mr. HORN. How can we deal with that, Ms. Lee? Do you get them all in around your desk?

Ms. LEE. Well, I agree we need to put a group together and find out what the issues are. We have authority in the act to make changes as appropriate, or even use a pilot program if there's a need.

Also, from an OMB standpoint, we have a way of encouraging the agencies through the President's Management Council. So as we identify these kinds of issues, we can take it to that group and say, here are some issues.

Part of what Mr. Clark mentioned for this act, we had a fairly good consensus and the agencies agreed that the Single Audit Act would work for them. We have to find out why it is and then take appropriate action.

Mr. HORN. You'll followup on this?

Ms. LEE. Yes, sir.

Mr. HORN. Then we'll know that it is in good hands.

Mr. Johnson, that State revolving fund is also related to the Clean Water Act, is it?

Mr. JOHNSON. There are two separate programs, but I think they address basically the same——

Mr. HORN. It will get bigger and bigger, and I sit on that subcommittee also. I will be watching for it when it comes through to see what, if anything, can be put in that language.

Mr. JOHNSON. Mr. Chairman, it may very well be that they do need a separate audit, but given the fact that the amendments just passed in 1996, and immediately this requirement came out, the concern is that the act wasn't given a chance. One of the major ideas behind the amendments in 1996 were that we would go to risk-based auditing and that we would look at programs that have demonstrated a risk, whether that be designated by Federal Government or through audit experience. When any department comes through and automatically declares a separate audit, or designates a major program under any circumstances, it takes away from that very basic idea of what we're trying to accomplish, and I think from the State audit community, we would have liked to have gone through some of these situations before they were mandated to us.

Mr. HORN. Do we know if EPA had their own staff of auditors? And, this would sort of put them out of business if the State audited it and they didn't?

Mr. JOHNSON. I don't think any department's auditors would be out of business. One of the ideas behind the single audit is that, as Mr. Clark pointed out, the single audit identifies broad problems, or it can question costs, findings that are there, weaknesses in internal controls where the Federal departments can then come in and find out the extent of the problem and deal with it specifically and resolve the problem with the auditee.

There's no way that the single audit will ferret out all the problems or get to the root cause of all the problems. I don't think there's a danger of losing auditors in any departments.

Mr. HORN. Ms. Lee is going to solve that one.

How about the Federal Aviation Administration? What's that situation?

Mr. JOHNSON. Federal Aviation Administration—and this was or may have been just a timing issue here because their advisory came out in 1996, but it says that they had concerns about diversion of funds within airports, and that whenever their program was audited as a major program as part of the Single Audit Act, there had to be a separate review of the diversion of funds and an opinion given on that review.

Mr. HORN. Could this be under the trust fund, the Aviation Improvement Act? Is the adding of a runway or improving the infrastructure at a particular airport the type of thing we're thinking of from them, or is there a separate pot of money somewhere for something else?

Mr. JOHNSON. Mr. Chairman, I have never audited an airport. We don't have those. This came to me as a——

Mr. HORN. You simply ski in Utah?

Mr. JOHNSON. That's right.

Mr. HORN. I watched those planes going into Salt Lake City. You've got a great skiing——

Mr. JOHNSON. That's Salt Lake City, and Salt Lake City audits that, so I've never dealt with this problem. It came to me as a request to add it into the testimony from another State, so I really can't comment on exactly what the program is or exactly what the problem is. I hope somebody else here could specify on it, but it was an add-on problem.

Mr. HORN. Apparently some of your colleagues have had that problem. Could we sort of get a document we can put in the record at this point if you can phone up a few of your State counterparts and say, hey, what were the questions, what was the problem?

Mr. JOHNSON. I will do that.

Mr. HORN. We'd just sort of like to round it out here if you wouldn't mind.

Mr. JOHNSON. Yes, I will do that.

[The information referred to follows:]

U.S. Department of Transportation

Federal Aviation Administration

Advisory Circular

Subject: GUIDE FOR AUDIT CERTIFICATION BY AIRPORT SPONSORS

Date: 8/31/98
Initiated by: AAS-100

AC No: 150/5100-18
Change:

1. **INTRODUCTION.** Section 805 of the Federal Aviation Administration (FAA) Reauthorization Act of 1996 requires non-Federal entities to submit as part of their "Single Audit" required by 31 U.S.C. §§ 7501 through 7505 (the Single Audit Act, as amended), a review and opinion concerning their funding activities with respect to an airport that is the subject of the project grant (or other Federal financial assistance) and the sponsors, owners, and operators (or other recipients) involved. [49 U.S.C. § 47107(m)]

The congressional intent of Section 805, in part, was to impose a financial reporting requirement designed to identify instances of illegal diversion of certain revenues generated by a public airport. Title 49 U.S.C. §§ 47107(b) and 47133 (the revenue use requirements), together, require airports that are the subject of Federal assistance (including, but not limited to Airport Improvement Program (AIP) grant funding) to use the revenues generated from a public airport for the capital or operating costs of the airport, the local airport system, or other local facilities owned or operated by the airport owner or operator and directly and substantially related to the air transportation of passengers or property.

2. **PURPOSE.** This advisory circular (AC) provides airport sponsors with guidance for complying with the audit certification requirement of 49 U.S.C § 47107(m) and discusses FAA's responsibilities for the certification program.

3. **APPLICABILITY.** This AC contains information that applies to AIP Sponsors. However, this AC is not applicable to the following:

a. Privately owned airports.

b. Non-Federal entities that are not subject to the requirements of the Single Audit Act of 1984, as amended.

4. **SOURCES.** Federal guidance on single audits is contained in the following legislation, regulations, policies, procedures, grant assurances, circulars, and guidance.

a. **Title 31 U.S.C. §§ 7501 through 7505.** These titles establish the requirement for certain non-Federal entities expending Federal grant awards to have an annual audit of their financial statements and Federal grant awards.

b. **Title 49 U.S.C. § 47107(b) and 47133.** These titles establish the airport "revenue use requirement."

c. **Title 49 USC § 47107(m).** This title establishes the audit certification requirement as part of a public agency's single audit.

d. **Title 49 USC § 47121.** This title establishes audit and record keeping requirements.

e. **Title 49 USC § 47131.** This title establishes annual reports from airport Sponsors.

f. **OMB Circular A-133 - Audits of States, Local Governments, and Non-Profit Organizations.** This AC superseded OMB A-128. Circular A-133 implements the Single Audit Amendments of 1996. The Amended Act raised the audit threshold from $100,000 to $300,000.

g. **DOT Single Audit Compliance Supplement.** This DOT supplement to OMB guidance provides additional guidance for complying with the Single Audit Act of 1984, as amended.

h. **Grant Assurance 13.** This assurance requires that certain provisions relating to an airport's accounting system and audit and record-keeping requirements be incorporated in AIP grant agreements.

i. **Grant Assurance 25.** This grant assurance implements the revenue use requirements of 49 U.S.C. § 47107(b) and requires an airport sponsor to furnish annual audit certifications in accordance 49 U.S.C. § 47107(m).

j. **Grant Assurance 26.** This assurance provides for reports and inspections.

k. **Federal Register notice on Policy and Procedures Concerning the Use of Airport Revenue dated February 26, 1996.** This document discusses in detail the requirement, applicable to public airports that have received Federal grants, that revenue generated by the airport generally be used only for airport purposes.

l. **Federal Register Supplement dated December 18, 1996.** Notice on Policy and Procedures Concerning the Use of Airport Revenue. This document provides additional information and clarification to the policy issued on February 26, 1996.

m. **FAA Order 5190.6A.** *Airport Compliance Requirements.* This order provides policies and procedures for FAA functions related to airport compliance.

n. **FAA AC 150/5100-10A.** *Accounting Records Guide for Airport Improvement Program Sponsors.* This AC provides record-keeping, reporting, and auditing requirements imposed on Sponsors of AIP projects under the Airport and Airway Improvement Act.

5. **SINGLE AUDIT REQUIREMENT.** The Single Audit Act, as amended by Pub. L. 104-156, requires non-Federal entities that expend $300,000 or more in Federal grant awards annually to have an annual audit that includes both the agency's financial statements and Federal grant awards.

6. **AUDIT CERTIFICATION REQUIREMENT.** A public agency required to have an annual audit conducted under the Single Audit Act requirements, as amended, must include as part of its single audit, a review and opinion of the review on the agency's funding activities with respect to its airport or local airport system.

a. **Non-Federal entities affected by requirement.** Non-Federal entities affected by this requirement are those agencies that have a single audit requirement and own or operate an airport which has received any of the following:

(1) Interest in surplus property for the purpose of developing, improving, operating, or maintaining a public airport on or after October 1, 1996.

(2) An airport development grant and the airport sponsor is subject to the assurances of that grant on or after October 1, 1996, either directly or through a state block grant program.

(3) An airport-specific AIP planning grant on or after October 1, 1996.

b. **Content of Review.** The review will provide an audit of the airport's financial transactions, and a specific review and opinion as to whether funds paid or transferred from the airport to the sponsor were paid or transferred in a manner consistent with 49 U.S.C. 47107(b) and related policies and procedures, including FAA's Policy and Procedures Concerning the Use of Airport Revenues.

c. **Duration of Audit Certification Requirement.** Obligations relating to the use of airport revenue in effect on or after October 1, 1996, remain in effect so long as the airport is used as an airport. The duration of the audit certification requirement is the same.

d. **Frequency of Certification.** Audit certifications required by 49 U.S.C. § 47107(m) shall be performed each time an applicable public agency is required to conduct a Single Audit in accordance with the Single Audit Act and OMB Circular A-133.

e. **AUDIT CERTIFICATION RESPONSIBILITIES - GENERAL.** There are four parties involved in the audit certification process: the airport sponsor, the auditor, the Office of Inspector General (OIG), and the FAA.

f. **Audit Certification Responsibilities - Airport Sponsor.** To assure compliance, the airport sponsor:

(1) Selects an auditor. This can be a public accountant or a Federal, State, or local government audit organization, which meets the

general standards specified in generally accepted government auditing standards (GAGAS). The term auditor does not include internal auditors of non-profit organizations.

(2) Ensures that the engagement letter, agreed upon audit procedures, and/or other statements of work contain a specific requirement for the auditor, in conducting the single audit, to complete the required audit and provide the required opinion on the use of airport revenues;

(3) Ensures the engagement letter, agreed upon audit procedures, and/or other statements of work provides that the auditor will (a) audit and express an opinion on the airport's financial statements, and (b) determine whether funds paid, and property or services transferred from the airport were paid or transferred in a manner consistent with 49 U.S.C. § 47107(b) and related policies and procedures, including the FAA's Policy and Procedures Concerning the Use of Airport Revenues;

(4) Ensures that the auditor fully understands the audit certification requirement and the steps the auditor must take to meet the audit certification requirement. It is critical that this is accomplished at the start of the single audit process to avoid the need to reopen a completed audit to correct any errors or omissions.

(5) Ensures that the audit certification review is conducted in accordance with OMB Circular A-133 and GAGAS;

(6) Responds to audit findings and cooperates with the FAA in resolving any problems;

(7) Keeps the audit certifications on file for at least three years from the date of their issuance;

(8) Submits copies of the Single Audit report and audit certification report to the single audit central clearinghouse and submits a copy of the audit certification to the FAA, Airports Compliance Division (AAS-400), 800 Independence Avenue, S.W., Washington, D.C., 20591. FAA regional offices may continue to request separate copies of the Single Audit Report to support their administration of AIP grants.

(9) Submits written notification to FAA Airports Compliance Division of any filing extension granted by the cognizant agency as described in Paragraph 10.

7. **Audit Certification Responsibilities - The Auditor.** To assure compliance, in accordance with the engagement letter, agreed upon audit procedures, and/or other agreements which reflect the auditor's scope of work, the auditor:

a. Performs a major program audit or alternative procedure which will satisfy the requirement of 49 U.S.C. 47107(m) and grant assurance No. 25(b).

b. Obtains an understanding of the airport's internal control systems and perform tests as they relate to the FAA's Policy Regarding the Use of Airport Revenues.

c. Performs tests of transactions sufficient to determine whether funds paid and property or services transferred to sponsors were, or were not paid or transferred in a manner consistent with 49 U.S.C. § 47107(b) and related policies and procedures, including the FAA's Policy and Procedures Concerning the Use of Airport Revenues.

d. Carries out the audit in a professional and responsible manner and in accordance with the provisions of OMB Circular A-133 and FAA's compliance supplement for the AIP.

e. Prepares a certification report in accordance with GAGAS, OMB Circular A-133.

f. Keeps working papers and reports for three years from the date of the audit report.

8. **Audit Certification Responsibilities - OIG.** As part of the single audit process, the OIG may do the following:

a. Obtain or make quality control reviews of selected audits made by non-Federal audit organizations and advise the cognizant Federal agency of audits that have been found not to have met the requirements of the Single Audit Act and/or OMB Circular A-133.

b. Inform other affected Federal organizations and appropriate Federal law enforcement officials of any reported illegal acts or irregularities.

c. Perform or arrange for special or supplemental audits to the single audit at the request of the FAA.

9. *Audit Certification Responsibilities - FAA.*

The FAA:

a. Determines that audits are made and distributed in accordance with OMB Circular A-133, this AC, and 49 U.S.C. § 47107(m).

b. Investigates potential instances of unlawful airport revenue diversions identified in the single audit reports, and ensure sponsors take the appropriate corrective actions.

c. Requires sponsors to take the appropriate corrective actions when single audit reports are found by the OIG not to be in compliance with OMB Circular A-133 and/or 49 U.S.C. § 47107(m).

10. **AUDIT CERTIFICATION REPORT.** The auditor's (audit certification) report will be a separate report, combined as a separate section within the single audit report. The report will also state that the audit was conducted in accordance with OMB Circular A-133 and GAGAS.

a. **Audit Certification Contents.** At a minimum, the audit certification report includes the following:

(1) An opinion (or disclaimer of opinion) as to whether the financial statements of the airport present fairly, in all material respects, the financial position of the airport.

(2) A report on the airport's internal control structure as it relates to use of airport revenue. This report shall describe the scope and results of the internal control testing performed.

(3) A specific opinion on compliance with the revenue use requirement. The opinion (or disclaimer of opinion) shall specify whether funds paid and property or services transferred to sponsors were paid or transferred in a manner consistent with 49 U.S.C. § 47107(b) and FAA's Policy and Procedures Regarding the Use of Airport Revenues.

(4) A schedule of findings and questioned costs for the airport that includes a summary of the auditor's results relative to the FAA's Policy and Procedures Regarding the Use of Airport Revenues.

b. **Audit Report Submission.** In accordance with OMB A-133, the certification is completed and submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to, in advance, by the cognizant or oversight agency for audit. (However, for fiscal years beginning on or before June 30, 1998, the audit must be completed and the certification shall be submitted within the earlier of 30 days after receipt of the auditor's report, or 13 months after the end of the audit period.)

11. **MONITORING AND COMPLIANCE.** The FAA will monitor airport sponsor submissions of annual audit certifications and review the audit certifications upon their receipt. Failure to comply with 49 U.S.C. § 47107(m) and the grant assurance implementing the single audit review and opinion will result in the withholding of future AIP grant awards and existing grant payments.

DAVID L. BENNETT
Director, Office of Airport
Safety and Standards

Mr. HORN. Now, Mr. Clark, the General Accounting Office has the responsibility to review provisions requiring financial audits of non-Federal entities; is that correct?

Mr. CLARK. That is correct.

Mr. HORN. Do you agree that the EPA requirements contradicted the intent of the Single Audit Act?

Mr. CLARK. If I could back up and then answer that question. First, to be fair here, I do want to say that the EPA issue and the FAA issue were a problem. And I think the timing was horrible, close to when the amendments were passed. We had two Federal agencies who, by the way, were not evil. They honestly wanted accountability over their funds. They're in a hurry. They were getting a lot of pressure, and they wanted to get going, and sometimes they want everything audited, and so they went ahead.

And I think from the State auditors perspective—and again, if I were a State auditor, I'd have the same concern—State auditors, I think, may, if I can speak for you, Auston, look at the Federal Government as one and count on OMB, GAO and the IGs working together to communicate. When an agency on its own, like EPA or FAA, goes out with an action like this without it being announced, without it being floated through the audit forums, and all the other mechanisms we had to do that, there's perhaps a sense of distrust.

It is important to look at the EPA and the FAA issues. I would like to say, though, these are exceptions. I think the norm is that we do a very good job. We monitor. We are required under the law to monitor all legislation. Technically the amendments tell us to identify legislation as reported out of a committee, and then we have some requirements to notify. We actually get involved now much earlier in the process. We try to identify any bill that's introduced, and with 5,000, 10,000 bills being introduced every Congress, this is an enormous effort. We're trying to involve everybody in the process here, and, before we get to the point where we have legislation and we have a conflict, we can look at what everybody's purpose is, what they're tying to accomplish.

We've had a lot of success stories here of sitting down with program people, with IGs, with the State auditors, listening to what is needed and fashioning a solution that is less than the legislative issue. Once the FAA issue was put on the table, I think we struck a compromise from that point forward, struck an excellent compromise, and still stayed within the constraints of the Single Audit Act.

Again, as I said in my statement, we're going to continue to do this monitoring effort. It is taxing, it is tedious, but it is rewarding, because I think in the end we have everybody on the same page.

Mr. HORN. Let me go back a minute to the attachment I put in the record that Mr. Johnson had from his colleague in the State of Washington, Mr. Brian Sonntag, the State auditor, the State of Washington. Unfortunately, he couldn't be here. He was able to submit a statement, and I think as Ms. Lee pointed out in her testimony, the State of Washington has submitted a proposal for a pilot project under the act, and the amendments of 1996 give OMB that authority to authorize pilot projects.

Have you received any other proposals besides Mr. Sonntag's?

Ms. LEE. Not that I'm aware of.

Mr. HORN. Is there anything that OMB or Federal agencies could be doing to promote more interest in pilot projects?

Ms. LEE. I think that we should continue to work in the groups and as people identify potential pilots, to encourage them. There's also a lot of people looking to this pilot program in Washington and saying, "OK, what happens here." I think we'll have some further requests or further ideas from this very pilot program.

Mr. HORN. Mr. Johnson, do you have any thoughts on why there have not been more pilot projects from the State auditor community in particular?

Mr. JOHNSON. I think the newness of the program. We've been busy just getting our arms around what we have to do, not looking at ways to improve. I do think the State of Georgia was looking at a very similar project to what Washington was, and I think they're just waiting to see what happens with the one in Washington. But they had the same issue on auditing school districts on a statewide basis.

Mr. HORN. What's the sort of feeling, Ms. Lee, that you have in OMB on what type of projects we are looking for?

Ms. LEE. I think we're just looking for anything that will meet the needs of the act: the reduced burden, more accountability, good insight. One of the pieces of the act that hasn't really been exercised yet, but I think is going to come into fruition, is the program accountability. You know, right now we're doing the consistency audits and the financial background, but now there's still another piece of the act which is going to evolve, which is actual programmability. This is going to tell us something about the programs themselves.

Mr. HORN. Is there any movement to have, say, simplification of what might have been a very complex approach to something?

Ms. LEE. Just as it evolves from these groups from their ideas on that, and from working with the circular, and from this particular test program. But as far as a big rush to further simplify, it's not there yet.

Mr. HORN. You're very good with that demonstrative pile.

Ms. LEE. I'd love to leave this with you, sir.

Mr. HORN. No, I want you to stay awake at night and use it for curing insomnia, but, that looks frightening to say the least.

Mr. JOHNSON. Mr. Chairman, if I might, there have been big advances in that document from when it started. There's been some matrixes added, some clarifications. OMB has done a great job in getting rid of—I hesitate to use the word ridiculous, but unnecessary audit requirements that some departments wanted. It has been simplified and has been streamlined a great deal, and it's a much more useful document than when we first started.

Ms. LEE. And we're putting it on the Internet now so everybody can access it easily.

Mr. HORN. Given that proposal in front of you, is OMB committed to reviewing proposals in a timely way?

Ms. LEE. Yes, sir. In fact, I'm interested in trying to move it up a month so it is more useful.

Mr. HORN. Mr. Turner doesn't have any more questions. I don't have any more questions. And I must say this is about the most civilized group I've ever had in a hearing. One, we're getting out

of here in 51 minutes; and No. 2, everybody is so nice to everybody else. Nobody is shouting and saying, that's the craziest idea I've ever heard.

So, we thank you all three for coming, and obviously you have all the knowledge in your brains. We don't. But we welcome you to work together as you have been and keep this thing moving, because I think it's in all of our interest to do that as long as we can catch fraud, waste, and abuse in the process. So no more questions. We adjourn this hearing, and we thank you all for coming.

I want to thank the staff in particular that put this together. Mr. George is over there with the phone in his ear. That's because he's from New York, and everybody has a phone in their ear in New York. He's staff director and general counsel.

Bonnie Heald is in the back of the room probably, the director of communications.

And I regret to say that the gentleman to my left and your right, Larry Malenich, is from the General Accounting Office, and he will be leaving us after this assignment. And we thank him for all that he's done. He and other GAO people have just done a terrific job for the Congress.

And I thank Mason Alinger, our faithful clerk here; and Faith Weiss, the minority counsel; and Earley Green, the minority staff assistant. And the court reporters this morning are Julia Thomas and Laurie Harris, and we thank you all.

With that we are adjourned.

[Whereupon, at 10:53 p.m., the subcommittee was adjourned.]

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