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STATEMENT OF  
CHARLES A. BOWSER, COMPTROLLER GENERAL  
BEFORE THE  
SUBCOMMITTEE ON LEGISLATION AND NATIONAL SECURITY  
HOUSE COMMITTEE ON GOVERNMENT OPERATIONS  
ON  
HOUSE BILL H.R. 4821 THE SINGLE AUDIT  
ACT OF 1984

Mr. Chairman, we welcome this opportunity to appear before you to comment on House Bill H.R. 4821, the Single Audit Act of 1984, introduced by you on February 9, 1984. I commend you and the other sponsoring representatives for your leadership and initiative in addressing this very important and timely issue.

I view the establishment of uniform audit requirements for state and local governments receiving federal financial assistance to be one of the most important financial accountability issues facing us today. Our recent study of progress made in implementing the single audit concept through OMB Circular A-102, Attachment P, showed that major problems still impede the process. I believe that legislation such as H.R. 4821 is essential to correct these problems and provide the permanency needed for successful implementation of this important reform.

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When enacted, this legislation will improve the financial management and accountability of state and local governments for federal financial assistance programs, and will promote the efficient and effective use of scarce audit resources.

As you know Mr. Chairman, in March 1982 I testified before the House Subcommittee on Intergovernmental Relations and Human Resources that I viewed the concept of a single audit on an entity basis to be superior to the more common past practice of auditing on a grant-by-grant basis. However, I pointed out that the concept as it was being administered by the Office of Management and Budget (OMB) through Attachment P to OMB Circular A-102 posed a number of problems that needed to be addressed.

As a result of those hearings, in April 1982 we initiated a study of the status of federal efforts to implement the single audit concept. The objective of this study was to identify concerns and problems impeding implementation and to develop suggestions for the Congress to remove obstacles to progress.

Our study disclosed that transition to the single audit has been slow and difficult, partially due to the evolution of policies and procedures that have resulted in varying interpretations of Attachment P over a 4-year period. We found that four major problems still impede progress in implementing the concept. There is a need for:

--A clear definition as to what is to be achieved by this type of audit. The definition should emphasize the study and evaluation of internal control systems over federal assistance, the extent and purpose of transaction testing,

and the concept of building on the financial statement audit in any additional audits and evaluations of federal programs.

- Reduction of the burden on local governments by exempting from single audit requirements those receiving relatively small amounts of federal assistance.
- Consolidation of existing multiple federal financial audit requirements for state and local governments through legislatively mandated uniform financial audit requirements applicable to all federal financial assistance programs.
- Implementation of the cognizant agency system in order to minimize existing diffusion of responsibility.

Legislation, which addresses these four issues, is needed to resolve the conflicting demands of federal, state, and local officials as well as existing federal statutes. Also, as noted in a recent GAO study, government-wide management improvement initiatives generally achieve more lasting results if carried out through a legislative mandate.

Since the March 1982 testimony, we have also had numerous discussions with federal, state, and local government officials as well as with independent public accountants. These discussions revealed strong support for the single audit approach, and these officials pointed out the same concerns and problems with the approach currently in practice as disclosed in our study.

I support your efforts to enact this legislation. I believe enactment of single audit legislation will go a long way toward resolving the problems and concerns discussed previously in my

comments and will ultimately lead to successful implementation of the single audit concept.

Mr. Chairman, with your permission, I would now like to comment on certain provisions of the bill.

Single Financial and Compliance Audit

The bill provides that each state and local government which receives a total of \$100,000 or more in federal financial assistance in any fiscal year shall have an annual financial and compliance audit made for such fiscal year. The bill also provides that a financial and compliance audit conducted in accordance with this bill shall be in lieu of any other financial and compliance audit which a state or local government is required to conduct under any other federal law or regulation.

The bill provides that each financial and compliance audit shall encompass the entirety of the financial operations of such government or such department, agency, or establishment, whichever is applicable, and shall determine and report whether:

A. the financial statements of the government, department, agency, or establishment present fairly its financial position and the results of its financial operations in accordance with generally accepted accounting principles;

B. the government, department, agency, or establishment has internal control systems to provide reasonable assurance that it (and any subgrantee or subcontractor) is managing federal financial assistance programs in compliance with applicable laws and regulations; and

C. the government, department, agency, or establishment (and any subgrantee or subcontractor) has complied with laws and regulations that could have a material effect upon each federal financial assistance program from which transactions are selected and tested.

The bill defines internal controls as:

\*\*\* the plan of organization and methods and procedures adopted by management to ensure (A) that resource use is consistent with laws, regulations, and policies; (B) that resources are safeguarded against waste, loss, and misuse; and (C) that reliable data are obtained, maintained, and fairly disclosed in reports.

The bill further provides that each financial and compliance audit shall include the selection and testing for compliance of a representative number of transactions for any program for which total expenditures of federal financial assistance by the state or local government during the applicable fiscal year--

A. is greater than \$3,000,000; or

B. is greater than the larger of \$100,000 or 3 per centum of the total federal financial assistance expended by such government.

#### Annual Audit Requirement

I fully support the provision to have an annual financial and compliance audit conducted of those state and local governments receiving federal financial assistance. This provision is consistent with the current audit trend at the state and local levels of government. Annual financial audits of their financial statements and operations are now being conducted by several state and local governments, while others have plans to do so. In a recent survey of accounting and auditing practices at the local government level,

the Municipal Finance Officers Association (MFOA) reported that the majority of local governments require financial audits and that they be conducted annually. Further, the members of MFOA adopted a policy statement at their 1983 annual meeting recommending that governmental entities obtain annual financial audits of their financial statements.

I view annual audits to be preferable to some other cycle, such as biennially. Annual audits result in a timely study and evaluation of internal controls, and timely identification of material weaknesses and noncompliance. Also, if proper controls are not in place or are not being complied with, annual audits will help prompt timely corrective action.

#### Audit Exemption Threshold

I fully support the provision to exempt those governments which receive less than \$100,000 in federal financial assistance from the requirements of this bill. Setting the audit threshold at \$100,000 will provide for substantial coverage of the total federal financial assistance while significantly reducing the number of small local government recipients required to have an annual audit.

#### Emphasis on Internal Controls

I favor the emphasis the bill places on internal controls. As you are well aware, Mr. Chairman, from your role in passing the Federal Managers' Financial Integrity Act of 1982, there is a need to strengthen internal controls to help restore confidence in governments and to improve their operations.

The traditional federal approach has been one of after-the-fact detection of noncompliance through the testing of numerous transactions for an individual grant, rather than concentrating on preventing noncompliance by ascertaining whether internal controls are in place and functioning to help ensure compliance with federal laws and regulations.

The bill provides that each audit shall determine and report whether the government's internal control systems provide reasonable assurance that it is managing federal financial assistance programs in compliance with applicable laws and regulations. This provision emphasizes a preventive approach and will help ensure improvements by treating the causes of noncompliance as well as serving as a more efficient and effective basis for further audits. Also, this approach will assist federal managers in fulfilling their managerial and programmatic responsibilities by helping them determine whether an entity's internal control systems can provide proper accountability over federal financial assistance programs.

#### Compliance Testing Requirements

In our recent study of progress made in implementing the single audit concept, we found that one of the problems was the extent of transaction testing necessary for compliance with laws and regulations.

I fully support the provision that clearly establishes the criteria for identifying those federal financial assistance programs that must be selected and tested for compliance with laws and regulations.

The bill also provides guidance on how to report instances of any noncompliance found during the audit. This provision will assist the auditor in ascertaining and reporting instances of material noncompliance with laws and regulations.

Relative to the \$3 million ceiling for testing federal financial assistance programs for compliance, the results of our recent survey of federal financial assistance received by state and local governments shows that the \$3 million ceiling is a reasonable amount at this time. Based upon the results of the survey, I support the inclusion of the \$3 million ceiling in the bill. However, Mr. Chairman, no adequate system presently exists for routinely identifying the programs and dollar volume of federal financial assistance to state and local government recipients. When legislation is enacted, I will monitor this provision and report thereafter, to each House of Congress if we conclude that the compliance testing provision should be modified by changing the \$3 million ceiling. During our monitoring, Mr. Chairman, I would like to assure the subcommittee that we will pay particular attention as to whether the ceiling imposes undue hardship on those large entities receiving federal financial assistance.

#### Uniform Crosscutting Audit Requirements

In addition to the financial audit requirements in OMB Circular A-102, Attachment P, about 30 federal statutory financial audit requirements exist which require financial audits of recipients of federal financial assistance. These audit requirements often differ in the frequency and scope of the audits, the organization

responsible for conducting the audit, and the standards to be followed, and make it difficult to combine audit efforts.

I support the provision that a financial and compliance audit conducted in accordance with this bill shall be in lieu of any other financial and compliance audit which a state or local government is required to conduct under any other federal law or regulation. I believe this provision will facilitate the accomplishment of the single financial and compliance audit.

#### Cognizant Agency Role

In our study of progress made in implementing the single audit concept through OMB Circular A-102, Attachment P, we found federal responsibility for management of the single audit process to be diffused.

Our study found that the cognizant agency system did not, in most states

- designate a lead or single federal agency to be responsible for coordination of the single audit within a state,
- facilitate the development of a plan for implementing the single audit at federal, state, and local levels of government,
- provide uniformity within a state on the technical aspects of the audit, or
- facilitate the development of a plan to monitor audits performed.

I believe that the provision in the bill for the establishment of procedures to identify, for each state or local government, a

cognizant federal agency for the administration of this bill will help eliminate the problems found in our study.

Also, I am pleased to see a provision in the bill that establishes the minimum responsibilities--rather than the maximum responsibilities for a cognizant federal agency--for administration of the audit requirements of the bill. This will allow the inspectors general more flexibility in administering the audit requirements of this bill as well as fulfilling their other statutory responsibilities.

#### Audit Resolution and Follow-Up

The bill also contains another important provision. If an audit identifies any failure or shortcoming in internal controls, compliance with laws and regulations, or presentation of financial statements, the state or local government is required to submit to the cognizant federal agency a plan for corrective action to eliminate the problem. The plan shall also be consistent with the audit resolution standard promulgated by the Comptroller General.

I support this audit resolution and follow-up provision and believe that it will facilitate more prompt evaluation of findings and recommendations and will help determine proper corrective actions to be taken.

#### Audit of Total Entity

The bill provides that the state or local government, at its option, may cover each of its individual departments, agencies, or establishments which received, expended, or otherwise administered federal financial assistance during such fiscal year in lieu of the entire state or local governmental entity.

I support a governmental entity concept, and would prefer that single financial and compliance audits be conducted on an entity-wide basis, rather than on a department by department basis or some other basis.

The National Council on Governmental Accounting (NCGA) provides authoritative guidance on state and local governmental accounting and financial reporting principles. In a recent statement, the council provided authoritative guidance on defining the state and local governmental reporting entity to include all governmental activities, organizations, and functions within its responsibility and control.

I suggest that the subcommittee encourage state and local governments to follow the guidance of NCGA in selecting the government unit for audit in meeting the provisions of the bill.

Mr. Chairman, I believe this is a sound bill and addresses the major concerns and problems currently involving the audit of state and local governments receiving federal financial assistance.

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

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