

**THE JOINT FINANCIAL MANAGEMENT  
IMPROVEMENT PROGRAM  
AUDIT IMPROVEMENT PROJECT**

**REPORT ON AUDIT OF  
FEDERALLY ASSISTED PROGRAMS:  
A NEW EMPHASIS**

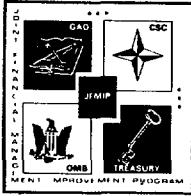
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Prepared  
By The Staff Of The 090 893  
Audit Improvement Project  
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CONTENTS

|   | Page |
|---|------|
| EXECUTIVE SUMMARY   | 1    |
| CHAPTER   |      |
| 1 INTRODUCTION . . . . .  | 4    |
| 2 VARIED FEDERAL AUDIT APPROACHES,<br>AUDIT GUIDELINES, AND REPORTING AND<br>ACCOUNTING REQUIREMENTS . . . . .                  | 8    |
| 3 AUDIT DUPLICATION AND OVERLAP . . . . .   | 16   |
| 4 AUDIT COVERAGE . . . . .  | 19   |
| 5 COORDINATION OF AUDITS . . . . .  | 21   |
| 6 RELIANCE BY FEDERAL AUDITORS ON OTHER<br>FEDERAL AUDIT ORGANIZATIONS FOR AUDIT . . . . .                                      | 25   |
| 7 RELIANCE BY FEDERAL AUDITORS ON STATE AND<br>LOCAL AUDIT ORGANIZATIONS FOR AUDIT . . . . .                                    | 27   |
| 8 MECHANISMS FOR REIMBURSING STATE AND LOCAL<br>AUDITORS FOR AUDITS OF FEDERALLY ASSISTED<br>PROGRAMS . . . . .                 | 29   |
| 9 CONCLUSIONS AND RECOMMENDATIONS . . . . .   | 33   |
| APPENDIX  |      |
| I Letter dated September 7, 1976, from<br>the Secretary of the Treasury . . . . .   | 52   |
| II Letter dated September 20, 1976, from<br>the Comptroller General . . . . .   | 53   |
| III Memorandum for the Heads of Executive<br>Departments and Agencies dated<br>September 9, 1977, from the President . . . . .  | 54   |
| IV Memorandum for the Heads of Executive<br>Departments and Agencies dated<br>December 6, 1978, from the Director, OMB. . . . . | 55   |

| APPENDIX |   | Page |
|----------|---|------|
| V        | Action Plan--Suggested Sequential Steps . . . . | 57   |
| VI       | Current Audit Approach. . . . .                 | 58   |
| VII      | Single Audit Approach . . . . .                 | 59   |
| VIII     | Gaps in Audit Coverage. . . . .                 | 60   |



## JOINT FINANCIAL MANAGEMENT IMPROVEMENT PROGRAM

666 ELEVENTH STREET, N.W.  
SUITE 705  
WASHINGTON, D.C. 20001  
TELEPHONE (202) 376-5415

May 3, 1979

The Honorable Elmer B. Staats  
Comptroller General of  
the United States

Dear Mr. Staats:

The JFMIP Audit Improvement Project has completed its work and has made a number of recommendations in its final report. The report is the result of a comprehensive study of the complex problems associated with auditing of Federal assistance to State and local governments.

The recommendations are aimed at overcoming the problems of audit overlap and duplication, audit gaps, and financing of audit activities. The nine recommendations of the report are set forth in Enclosure No. 1. Most of them are directed to the Office of Management and Budget. Some have already been implemented or are in process of being implemented by OMB.

One of the recommendations has to do with the adoption of a "single audit approach." Under this approach audits will be conducted on an organization-wide basis, rather than on a grant-by-grant basis, to determine whether financial operations had been properly conducted and whether the recipients had complied with grant requirements. Federal agencies will be expected to rely on these audits and only do additional audits when warranted.

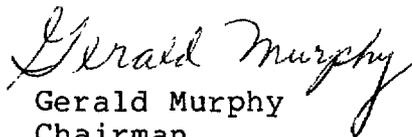
The Steering Committee generally endorses the major thrust of the recommendations with two minor qualifications. In Recommendation No. 1, rather than creating a new inter-agency group to help OMB implement the "single audit approach," the Steering Committee would prefer to rely on an existing group such as the National Intergovernmental Audit Forum. Recommendation No. 9 provides for the Presidential appointment of an independent group to review and monitor the implementation of the recommendations. The Steering

Committee believes that a separate group for this purpose is not necessary, and that the function should be assigned to an existing council, committee, or group that has a general interest in improving financial management. The newly created Presidential Management Improvement Council might be an appropriate group.

The Steering Committee commends the Audit Improvement Project for the thorough study and thoughtful report, "Audit of Federally Assisted Programs: A New Emphasis" (Enclosure No. 2). We recommend that the JFMIP Principals accept the recommendations of the report and take action to implement them through their own organization.

The Steering Committee can provide any additional information you may desire.

Sincerely yours,



Gerald Murphy  
Chairman  
JFMIP Steering Committee

Enclosures - 2

1. Extract of the nine recommendations from the report
2. The Audit Improvement Project Report

Identical letters sent to all JFMIP Principals

"We have an obligation to manage with excellence..."

President Carter

Steering Committee  
Joint Financial Management Improvement Program

Gentlemen:

In January 1977, at the request of the Principals, a Joint Audit Improvement Project was initiated to study Federal grant auditing. This report presents the study results, along with recommendations for resolving problems surrounding the audit of federally assisted programs. The report does not cast blame for existing problems, but rather encourages cooperation to solve them.

A draft of this report dated August 14, 1978, was sent to selected Federal, State, and local audit and program officials and other interested parties to obtain advance comment from those directly or indirectly affected by our recommendations. We considered the comments in formulating our final conclusions and recommendations. Where appropriate, we incorporated the major concerns in our discussion of each recommendation.

The study from the beginning involved many officials from all levels of government. To those many Federal, State, and local audit and administrative officials who cooperated with us, thank you. Also a special thanks to the the inter-governmental audit forums for their support and assistance. Lastly, without the direct aid of over 50 Federal, State, and local audit organizations, the study's completion would not have been possible.

February 1979

*W. A. Broadus*

W. A. Broadus  
Project Director

## EXECUTIVE SUMMARY

Our study corroborates the findings of previous studies by other organizations that considerable duplication and overlap of effort exist in auditing federally assisted programs and that there are substantial gaps in audit coverage. Also there is limited coordination of audits between Federal auditors or with State and local auditors and public accountants hired by recipients.

Duplication and overlap of audit effort are most prevalent at the local government level. Duplication and overlap occur when different audit organizations audit an entity within the same period and review the same accounting records, internal controls, and policies; contact the same personnel; and audit the same organizational segments of an entity. They also occur when an audit of a grant is made and the audit is subsequently determined as inadequate, causing the auditors to reaudit the same grant covering essentially the same areas.

Gaps in audit coverage exist at all levels. Gaps occur primarily from the failure of auditors to assess compliance with grant requirements, but also from infrequent audits of certain Federal programs.

Most studies, including this one, indicate substantial improvement in the audit of federally assisted programs over the past few years. These improvements can be attributed mainly to the issuance of policy circulars by the Office of Management and Budget; the work of the General Accounting Office and the intergovernmental audit forums; and individual efforts by Federal, State, and local audit organizations. But additional changes are needed. Continuation of the practice whereby each auditor audits primarily to satisfy his own organization's needs would confound audit coordination and perpetuate duplication and overlap and gaps in coverage. Further, it would effectively preclude the optimum use of audit resources.

We believe the answer lies in Federal agencies adopting the single audit approach to auditing federally assisted programs. This would provide for a single financial and compliance audit of a recipient covering all the recipient's funds. The audit would be regularly conducted on an organizationwide basis to assess the fiscal integrity of financial transactions and to assess compliance with grant requirements. The latter would involve, for example, checking whether eligibility requirements had been met, grant funds

had been spent for the intended service or product, cost allocations had been proper, direct charges had been reasonable, and any matching requirements had been met.

The single audit approach would not substitute for other reviews, such as economy and efficiency audits, program results reviews, investigative audits, program monitoring, and other special audits directed toward a specific overall Federal program rather than toward individual grants and individual recipients. A substantial portion of Federal audit effort is directed toward individual grant audits. With the adoption of the single audit approach, more emphasis could be placed on performing these above audits.

However, obstacles must be removed before the single audit approach could be fully implemented. Two of the most formidable would be getting Federal auditors to rely on audits by others and getting non-Federal auditors to perform audits to satisfy Federal needs. The single audit approach would require that those currently responsible for arranging for and auditing recipients perform (or have first option to perform) the audits. For someone else to perform the audits would either necessitate changes in State and local legislation, which might not be feasible, or require a separate audit to satisfy Federal needs, which we are trying to avoid. However, a separate audit might be necessary when a single audit could not be arranged for or when an audit by non-Federal auditors was found deficient and the recipient of the audit did not take corrective action. Such a separate audit would be made for the benefit of all Federal agencies by the cognizant Federal agency or by an auditor it had designated.

Other obstacles would also have to be removed before the single audit approach could be fully implemented. These would include adopting a single audit guide, identifying the audit requirements, devising mechanisms for resolving audit findings and recommendations, and establishing a system to identify who was receiving grant funds. Each of these is addressed by our recommendations. (See chapter 9.)

Actions should begin immediately to implement the single audit approach. However, because of the number of complex issues that must be resolved, gradual implementation, starting with selected States, would permit a smoother adoption nationwide. Single audits could be made of all recipients within the State or could be limited to those receiving above a stated amount of Federal funds. Those receiving less would be exempt from the requirement.

Full implementation of the single audit approach would be a complex undertaking and would not be accomplished overnight. Implementation would depend on concurrent implementation of many of our other recommendations.

## CHAPTER 1

### INTRODUCTION

With the "grant explosion" of the mid-1960s, Federal, State, and local governments have joined to provide services and programs which have grown from about \$11 billion in 1965 to an estimated \$85 billion in 1979. Currently there are more than 1,000 federally assisted programs, administered by 55 Federal agencies and distributed to about 90,000 State and local governments.

The proliferation of federally assisted programs 1/ has presented serious problems in intergovernmental relations. During the mid-1960s recipients of Federal grants increasingly objected to Federal administrative requirements because, as the programs expanded, State and local governments had become more entangled in a web of differing requirements and procedures.

In response to these intergovernmental relations problems, the Federal legislative and executive branches tried to simplify and standardize grant administrative procedures and requirements. The Congress passed the Intergovernmental Cooperation Act of 1968, which urged an increase of grant information to the States, simplified the grantees' maintenance of funds, and began broader coordination of grant planning. The Office of Management and Budget (OMB) directing the overall effort for the executive branch, standardized the grant administrative process with three policy circulars:

--A-73:        Audit of Federal Operations and Programs by  
                 Executive Branch Agencies. 2/

1/Federally assisted programs are defined in OMB Circular A-102.

2/Designated "Federal Management Circular 73-2" from 1973 through 1978.

- A-102: Uniform Administrative Requirements for Grants-in-Aid to State and Local Governments. 1/
- FMC 74-4: Cost Principles Applicable to Grants and Contracts with State and Local Governments. 2/

These circulars, covering many areas affecting the administration of federally assisted programs, each contained guidelines to facilitate the audit of such programs. Circular A-73, first issued in 1965, encouraged intergovernmental audit coordination and the sharing of audit findings. In 1973 the circular was amended, requiring Federal agencies to coordinate their audit requirements and approaches with State and local governments, and use reports prepared by non-Federal auditors in lieu of Federal audits, provided they met the agencies' requirements.

In 1978 the circular was amended again in response to a Presidential memorandum to agency heads which ordered that the agencies' plans for auditing State and local governments be available to all interested parties. The revision was intended to provide the basis and stimulus for increased intergovernmental audit cooperation.

Circular A-102 was originally issued in 1971 and amended in 1974 and 1977. 3/ The circular provides uniform requirements to be followed by Federal agencies in awarding grants and contracts to State and local governments. Attachment G of the circular, in part, requires grantees to provide for financial and compliance audits with reasonable frequency, usually annually, but not less than once every 2 years.

The third circular, FMC 74-4, establishes principles and standards for determining costs applicable to grants and contracts with State and local governments. The circular defines the cost of a grant program as the allowable direct cost incident to its performance, plus its designated portion of allowable indirect costs. Costs of grant audits are specifically identified as allowable.

1/ Designated "Federal Management Circular 74-7" from 1974 through 1977.

2/ First issued as OMB Circular A-87.

3/ A counterpart Circular A-110 provides the same standards for nonprofit organizations.

There is a consensus among Federal, State, and local program and audit officials that grant administration has been improved and standardized as a result of these circulars. However, the auditing of federally assisted programs continues to pose problems, largely because the audit policies discussed above have not been fully implemented.

#### STUDY PURPOSE

Several barriers to solving these problems had been identified before 1977, and several studies and reports had focused on these problems. The Department of the Treasury issued a report in early 1976 which discussed many of these problems. The report had resulted from problems brought to the Secretary's attention by a number of Governors.

After the Treasury report, the Joint Financial Management Improvement Program (JFMIP) Principals asked the JFMIP staff to study the audit of federally assisted programs. In requesting the study, they stated that numerous areas needed prompt remedial action and that possible improvements included clarifying Federal reimbursement policy toward State and local governments for audit costs, broadening audit coverage, and eliminating unnecessary audit duplication. They stated further that to ensure implementation of appropriate audit reforms, JFMIP should be entrusted with the project. The Principals pledged their support to JFMIP in carrying out the reform project and directed the JFMIP staff to work closely with and through the intergovernmental audit forums.

We identified and analyzed several problems in auditing federally assisted programs and then made detailed studies of the following seven of those problems:

1. Varied Federal audit approaches, audit guidelines, and reporting requirements.
2. Possible audit duplication and overlap.
3. Possible lack of audit coverage.
4. Coordination of audits.
5. Reliance on other Federal organizations for audits.
6. Reliance on State and local organizations for audits.
7. Mechanisms for reimbursing State and local auditors for audits.

Each problem is discussed in the following chapters, and recommendations are presented to help eliminate or minimize these problems.

STUDY APPROACH

We obtained the opinions of audit and administrative officials at all levels of government and reviewed the audit coverage being provided federally assisted programs. The following types of organizations were included:

| <u>Levels</u>        | <u>Audit organizations</u> | <u>Administrative/program organizations</u> |
|----------------------|----------------------------|---|
| Federal headquarters | 10                         | 10  |
| Federal regions      | 42                         | 41  |
| State governments    | 50                         | 65  |
| Local governments    | 25                         | 131   |

Although we concentrated on audits of State and local government recipients, we did review audit coverage of a number of nonprofit agencies who were subgrantees of State and local governments and who had also received funds directly from Federal agencies. Many of the conditions and problems discussed in the report also apply to audits of nonprofit agencies. Therefore, our recommendations in chapter 9 can apply to them.

## CHAPTER 2

### VARIED FEDERAL AUDIT APPROACHES, AUDIT GUIDELINES, AND REPORTING AND ACCOUNTING REQUIREMENTS

Federally assisted programs vary widely in their funding and administration. The approaches used by Federal agencies in auditing these programs, including audit requirements and guidelines, also vary. These variations contribute to the problems in auditing grant programs and to the duplication of audit effort and gaps in audit coverage discussed in the following chapters.

#### PROGRAM FUNDING AND ADMINISTRATION

Federal grants awarded to State and local governments are funded and administered in essentially these three ways.

1. Funds are given directly to States, and the programs are administered largely by State departments. Highway trust funds are an example.
2. Funds are given to States for distribution to other governmental and nongovernmental organizations, often in accordance with Federal formulas. These are sometimes referred to as State pass-through grants. Examples are formula grant programs.
3. Funds are awarded directly to and administered by local governments. Block grant programs are a prime example.

To complicate things, some organizations that receive money from the States, as well as some local governments, redistribute the money to other organizations, some of which are direct recipients or subgrantees.

#### AUDIT APPROACHES

All levels of government need a sound financial management system as a prerequisite to good management. Such a system should provide for accurate and current disclosure of results of operations, effective control and accountability over all funds and assets, and built-in controls to assure that all terms and conditions attached to the funds are met. Audit is a necessary part of a sound and viable financial management system.

OMB Circular A-102 establishes the need for recipients of federally assisted programs to have a sound financial management system, including audit. The circular, in establishing the need for recipients (both primary grantees and subgrantees) to secure audits of their Federal funds, states:

\*\*\*These examinations are intended to ascertain the effectiveness of the financial management systems and internal procedures that have been established to meet the terms and conditions of the grant. They should be made in accordance with generally accepted auditing standards including the standards published by the General Accounting Office, 'Standards for Audit of Governmental Organizations, Programs, Activities & Functions.' It is not intended that each grant awarded to the recipient be examined. Generally examinations should be conducted on an organization-wide basis to test the fiscal integrity of financial transactions, as well as compliance with the terms and conditions of the Federal grants."

The circular further states:

\*\*\*These examinations do not relieve Federal agencies of their audit responsibilities, but may affect the frequency and scope of such audits."

Federal agencies' approaches to auditing federally assisted programs are governed by FMC 73-2, paragraph 6(d), which states:

"In developing audit plans, Federal agencies administering programs in partnership with organizations outside of the Federal Government will consider whether these organizations require periodic audits and whether the organizations have made or arranged for these audits. This consideration is especially necessary for those agencies that administer Federal grant-in-aid programs through State and local governments and which are subject to OMB Circular A-102, Attachment G. Attachment G provides standards for financial management systems of grant-supported activities of State and local governments and requires that such systems provide, at a minimum, for financial/compliance audits at least once every 2 years. Federal agencies will coordinate their audit requirements and approaches with these organizations to the maximum extent possible. The scope of individual Federal audits will give full recognition to the non-Federal audit effort. Reports prepared by non-Federal auditors will be used in lieu of Federal

audits if the reports and supporting workpapers are available for review by the Federal agencies, if testing by Federal agencies indicates the audits are performed in accordance with generally accepted auditing standards (including the audit standards issued by the Comptroller General), and if the audits otherwise meet the requirements of the Federal agencies." 1/

### Federal agency audits

Our study showed that Federal audit agencies generally did not follow the above policies in auditing federally assisted programs and that their audit approaches varied from agency to agency. For example, four agencies awarding project-type grants had four methods for determining what to audit. One agency audited every project over \$50,000, the second audited every project over \$200,000, the third hoped to audit every project over \$250,000, and the fourth had no criteria but selectively audited projects. The first and fourth were programs funded through State agencies, which in turn subgranted the funds. The second and third agencies awarded grants directly to local recipients.

Organizations performing the audits also varied among these four agencies. The first agency's projects were audited by its own Federal auditors or State auditors. The second relied exclusively on audits secured by recipients. The third used public accountants and State auditors under contract to the Federal agency along with its own Federal auditors. The fourth agency's projects were audited by its own Federal auditors, but the agency was attempting to contract with State auditors to make the audits.

An example of inconsistent Federal audit approaches was two major block grant programs administered by two agencies. The grants were generally awarded directly to local governments.

One agency, rather than have its Federal auditors audit its grants, instructed its grantees to arrange for individual grant audits at least once every 2 years. These audit reports were sent to and reviewed by the Federal auditors. The Federal auditors then performed audits on a certain percentage of the grantees each year. These audits generally

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1/FMC 73-2 was revised and redesignated as "OMB Circular No. A-73" (revised on Mar. 15, 1978).

included a review of the grantee's audit, and, where necessary, additional tests were performed and the scope of the audit was expanded.

The other agency initially decided that only Federal auditors should audit the primary grantees and that since the program involved thousands of subgrantees, the primary grantees would contract for audits of a certain percentage of their subgrantees. The agency has since contracted with several State and local auditors to audit primary grantees. <sup>1/</sup> The Federal auditor then reviews the reports. The primary grantee generally continues to arrange for audits of funds distributed to subgrantees. We found little evidence that previous audits of subgrantees had been considered before the above audits were arranged by the primary grantees.

Another example of inconsistent audit approaches was found in formula grant programs administered by State agencies. Such programs normally involve pass-through funds to lower levels of government or nonprofit organizations.

One Federal agency required the State agencies to have their internal audit staffs audit annually a certain percentage of grant funds distributed to local recipients. The State agency, in turn, was to be audited by State auditors or by Federal auditors if agreement could not be reached with a State auditor. Federal auditors in this agency worked extensively with State auditors and departmental internal auditors to implement this concept.

Federal auditors in another agency audited the State agencies receiving their funds. These audits generally consisted of reviewing the agency's overall operations and controls and testing the use of selected grant funds distributed to local recipients. However, the auditors had no established review cycle for these audits and did not know when they would review all the State agencies receiving the Federal agency's funds. Before these audits the Federal auditors did not know the extent of audit coverage for their funds at the local level.

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<sup>1/</sup>In some instances the contracts also provide for auditing at the subgrantee.

## Grant recipient audits

Federal agencies' implementation and adherence to the requirement for a single recipient audit in Circular A-102 vary greatly.

Federal agencies had, for most of the federally assisted programs in our study, included in their grant regulations the audit requirement in Circular A-102 (formerly FMC 74-7). However, the interpretation of the scope of the audit that was necessary and the degree of implementation varied considerably.

Many of these agencies required the recipient to have individual audits of the grant made in accordance with Federal audit guides. Other agencies called for audits of the recipient's operations to be made in accordance with generally accepted auditing standards, with due consideration for Federal policies governing the use of Federal grant funds, as well as State and local policies and procedures.

The degree of implementation of the audit requirement also varied among the agencies. For example, some of the Federal audit organizations assured themselves that the recipient audits had been made by receiving, reviewing, and approving the audit results. These agencies generally relied on the individual grant audits. Other Federal auditors had no formal followup system for assuring the audits had been made. However, the regulations did indicate that in these cases audit reports and workpapers should be available for review by Federal auditors if requested. Under this system the Federal auditors do not know the extent of audit coverage until contacts are made with the recipients.

Those Federal agencies requiring individual grant audits generally exercised the greatest control over the recipients to assure that the audits had been made and that they had been performed in accordance with Federal audit guidelines.

Also some Federal agencies did not include the Circular A-102 audit requirement in their grant regulations, or they substantially deviated from it. For example, one Federal agency either had its own auditors review the grant administered by the recipient or it contracted with an outside auditor to audit the grant. However, it did require the primary recipient to arrange for audits of the funds distributed to local recipients.

Another large Federal agency just recently started to implement the A-102 audit requirement. However, its approach does not appear consistent with the intent of A-102 in that it is asking for individual grant audits of its programs rather than relying on single audits of the grantee.

Although the lack of the single audit approach was generally the case in our study, we did find several instances, especially at the local level, when this approach had been successfully implemented. For example, a number of councils of governments have had single audits of their organizations for a number of years. Some of these resulted from the Integrated Grant Administration program discussed in chapter 6, while others were initiated by the councils of governments or auditors of governmental agencies having funds administered by the councils of governments.

We found almost complete agreement among auditors that single audits of multifunded recipients was the preferred approach if certain obstacles could be removed. Although most of the local recipient officials felt that the single audit approach was feasible, there was not complete agreement among them that this was the desired approach.

#### Audit guidelines

The growth of Federal programs and the emphasis on individual grant audits has resulted in numerous individual Federal audit guidelines being issued to cover the audit of these programs. Because of the divergence of audit approaches in the guidelines, State and local auditors, as well as public accounting firms, have experienced difficulty in responding to the audit requirements of the Federal agencies. Furthermore, most grantees receive Federal grant funds from several Federal agencies. If a single recipient audit is attempted, the auditor is confronted with reviewing several Federal grants and being required to use a different audit guide for each program. If this is not done, the recipient may find several audit organizations auditing individual programs, thus resulting in the duplication and overlap of effort discussed in chapter 3.

At least 14 Federal agencies have issued about 80 Federal audit guides relating to auditing federally assisted programs. Review of 43 of these guides disclosed the following:

- Some agencies have prepared audit guides for more of their programs than other agencies.

- Most guides are oriented toward individual grant programs.
- Few are directed toward entitywide audits.
- The majority call for both a financial and a compliance audit.
- The guides' reporting formats differ significantly, not only in presentation but in the amount of information required.

Also, the guides contained several common audit requirements and procedures.

The lack of a uniform or standard audit guide was the obstacle mentioned most by auditors attempting to perform single audits of multifunded recipients.

The intergovernmental audit forums and GAO took the lead in developing a single audit guide for use in auditing multifunded recipients. OMB in December 1978 sent it to Federal agencies for comment.

#### CONFLICTING AUDIT AND ADMINISTRATIVE REQUIREMENTS

The Congress has legislated audit and accounting requirements for some grant programs that differ from OMB's requirements. Federal agencies also impose administrative requirements that are not consistent with OMB's requirements. Such differences require different treatment in auditing the grantee and further complicate the audit of federally assisted programs, especially the single audit approach.

We noted a few instances where grant-legislated requirements differed from those in the circulars. However, we limited our study in this area because at least four studies were being conducted involving this matter.

These studies reported several inconsistencies between the cost principles imposed by OMB, some Federal agencies, and statutory requirements. One study recommended that the OMB review of proposed legislation concerning Federal assistance programs cover administrative requirements which conflicted with A-102. These differences would then be highlighted and possibly eliminated before becoming statutory provisions which would override the circular.

Another study, in its draft report, made the following tentative recommendation to the Congress:

\*\*\*To promote financial accountability and better relationships between grantees and their Federal

counterparts, we recommend that the Congress amend the Intergovernmental Cooperation Act of 1968 to establish that the Federal policy of recognizing total allowable costs incurred by grantees to administer and operate Federal programs has Congress's support. Because statutory limitations on the payment of certain types of costs, generally overhead or administrative costs, tend to discourage grantees from systematically identifying total program costs, we recommend that the Congress reexamine the need for such limitations in existing legislation and, as a general policy, refrain from imposing such limitations in future legislation."

## CHAPTER 3

### AUDIT DUPLICATION AND OVERLAP

Substantial duplication and overlap in auditing federally assisted programs is taking place at the State and local levels. These conditions are more prevalent at the local level.

Duplication and overlap occur when a grant is audited and the audit is subsequently determined by Federal auditors as inadequate, causing the Federal auditors to reaudit the same grant covering essentially the same areas. Duplication and overlap also occur when different audit organizations audit an entity within the same period. The same accounting records, internal controls, and policies are reviewed; the same personnel are contacted; and the same organizational segments of the entity are audited.

Almost half the Federal regional audit and program officials contacted felt that there was little duplication and overlap at the State level but that it did occur at the local level. For example, one multifunded planning agency had 10 different audits during 1 year. The majority of these covered individual grants and were performed by Federal and State auditors as well as public accountants. One reason reported for little duplication and overlap at the State level is that many State departments receive funds from only a few Federal agencies. Another is that the States, in some cases, serve mostly as agents dispersing the money to local governments.

State department officials reported some duplication and overlap at the State level between the State auditors and the Federal auditors. Most of it occurred in departments administering social service programs. The main reasons they cited were that audits were not coordinated and were done for different purposes.

#### DUPLICATION AND OVERLAP AT THE LOCAL GOVERNMENT LEVEL

The amount of duplication and overlap at this level varies among the types of recipients--cities, counties, and planning agencies. Generally there is a substantial duplication and overlap in large cities. (See appendix VI and VII). It normally involves programs of only a few Federal agencies and related State departments. For example, in a 3-year period 1 large city had at least 47 separate audits covering its operations and programs. These audits included:

- Fifteen audits of city operations.
- Sixteen grant audits of one Federal agency's programs.
- Eight grant audits of programs of a second Federal agency.
- Three grant audits involving a third Federal agency's programs.
- Five grant audits of programs of two additional Federal agencies.

These audits were conducted by either public accountants or Federal, State, and local auditors.

The above conditions occasionally appear in medium-sized cities. For example, 1 city in a 3-year period had 14 audits of 9 grant programs by public accountants or Federal, State, or State departmental auditors. In addition, there were three annual audits of the city. Generally, however, the medium-sized and small-sized cities tend to have only an annual financial audit by a public accountant and an occasional grant audit.

Considerable duplication and overlap occur at the county level. For example, about 400 audits were made during a 3-year period at the 36 counties we studied. The majority were individual grant audits. Large counties were audited the most. One large county, for example, in a 3-year period had over 30 grant audits by Federal, State, or State departmental auditors, in addition to annual audits of its operations.

Also, substantial duplication and overlap occur at the planning agency level. According to our review of 28 planning agencies, about 170 audits were made during a 3-year period. The number of audits ranged from 1 to 26 per agency. About 30 percent of the 170 audits involved programs of 4 Federal agencies.

Before our study, a regional intergovernmental audit forum surveyed 24 multifunded planning agencies. The survey showed that many had been audited several times by different audit organizations during a 1-year period. Some had as many as 10 different audits during the period.

Duplication and overlap have been widely discussed and reported by GAO and the intergovernmental audit forums. These problems have also been cited by the various State auditors as some of the major issues in auditing federally

assisted programs. The President, in his memorandum of September 9, 1977, to executive agency heads, stated that it does not make sense for all levels of government with audit responsibilities to audit the same grants.

#### CAUSES OF DUPLICATION AND OVERLAP

The following were cited as the primary causes for duplication and overlap by Federal, State, and local auditing and program officials and by recipients we questioned.

- Audits by State and local auditors and certified public accountants do not satisfy Federal needs, either because they do not follow the audit guides or the audit scope is too limited in the Federal auditor's judgment.
- Federal and State auditors audit for different purposes; e.g., the State auditor is concerned with auditing the total expenditures of the entity, while the Federal auditor is concerned with seeing whether the recipient has complied with the grant requirements.
- Each Federal agency audits its own grants with little or no concern for the grant funds of other Federal agencies, requiring separate audits by each.
- Federal audit and Federal program officials review the same grants.

Duplication and overlap may be justified on limited occasions. However, to make the maximum use of audit resources and reduce the disruption of recipient's operations, Federal agencies, along with State and local auditors and grant recipients, need to work together to have one financial and compliance audit that will satisfy all their needs. The problems involved and recommendations for achieving this objective are discussed in chapters 5 through 9.

## CHAPTER 4

### AUDIT COVERAGE

Most federally assisted programs are receiving periodic financial audit coverage at both the State and local levels. Generally State audit organizations provide this coverage at the State level, while public accounting firms provide most coverage at the local levels. However, these audits usually do not address whether the grant requirements are being met; therefore, a wide gap exists in the compliance audit coverage. <sup>1/</sup> This gap is narrowed somewhat by audits of individual grants of some federally assisted programs. However, some programs are not audited for long periods. The lack of coverage has also been recognized by the GAO, the intergovernmental audit forums, Federal and State audit and program officials, and grantee officials.

Many of the Federal headquarters audit officials interviewed believed that audit coverage on their programs was inadequate. Either audits are not made or they do not address compliance with grant requirements. One agency official that arranged its audits pointed out that the agency's federally assisted programs were audited every 3 to 4 years. Another agency official that relied on grantees to secure audits acknowledged that a substantial amount of its grant funds were not being audited for compliance with grant requirements.

Most Federal regional audit and program respondents felt audit coverage was inadequate. Some stated that their regional audit staffs were too small to provide proper coverage of recipients. Others expressed concern with the scope of coverage by non-federal auditors. They said there was a lack of compliance auditing and that in some States, their programs had received little coverage over the last 3 years.

Many State department officials also felt that coverage was not adequate and expressed many of the same concerns as Federal audit and program officials. They indicated that the scope of Federal audits of their departments is occasionally too narrow; some Federal organizations emphasize auditing some of their agency programs to the exclusion of others; and smaller recipients seldom receive grant audits.

1/See appendix VIII.

Analysis of State audit reports, State statutes and laws, and interviews with selected State auditors indicates that all States require their audit organizations to perform at least financial or financial and compliance audits of State departments' operations. For the most part the frequency of these audits is spelled out in the State constitution or in State statutes, e.g., each department is to be audited every 2 years. However, in some instances such audits may be scheduled to satisfy the requirements of a legislative calendar. Although State auditors include federally assisted program funds as part of their normal financial or financial and compliance audits, they generally do not perform the audits in accordance with Federal audit guidelines unless there have been specific agreements to do so.

Although Federal agencies may not accept audits that are not performed in accordance with their guidelines, many do not elect to make separate audits. Our analysis of Federal audit coverage of 11 federally assisted programs administered by State agencies in 8 States indicated that nearly two-thirds of them had not been audited by Federal auditors during a 3-year period in at least 5 States. About half were not audited by Federal auditors during this period in at least half the States.

Gaps in audit coverage also exist at the city, county, and planning agency level. Most of these recipients had annual audits. The majority were traditional financial audits and in most instances did not indicate whether the Federal grant requirements had been met. As pointed out in chapter 3, individual grant audits were also performed on the federally assisted programs, but many of these were concentrated on a few Federal programs, leaving a gap in the coverage of other programs. Worse, individual grant audit reports disclosed that many of these had also been limited to financial matters and had not indicated whether significant grant requirements had been met.

Our recommendations do not deal explicitly with the problem of gaps in audit coverage. However, our recommendations for full implementation of the single audit approach, plus the establishment of cognizant Federal agencies to oversee the proper audit of federally assisted programs, are intended to resolve this problem.

## CHAPTER 5

### COORDINATION OF AUDITS

There is no formal system for coordinating intergovernmental audits of federally assisted programs. <sup>1/</sup> Coordination generally is informal and occurs at the initiative of the auditors.

Current Federal policy is found in OMB Circular A-73, which encourages coordinated audits of federally assisted programs. Many examples of coordination can be found. However, much of this takes place in audits of State departments; less coordination occurs locally. The intergovernmental audit forums were instrumental in increasing audit coordination between individual Federal, State, and local auditors. However, this coordination is basically confined to individual situations as opposed to an ongoing concept followed by all agencies.

Many Federal regional audit and program officials indicated that there was little coordination. Audits of multifunded local entities, such as planning agencies, were cited as the most difficult to coordinate. When coordination did occur between Federal regional auditors, it usually consisted of exchanging audit schedules and reports with other Federal auditors, performing limited audits for other Federal agencies, and determining when particular grantees had been audited.

The majority of State agency officials contacted also felt coordination was limited, and many local agency officials indicated that they saw little evidence of coordination. When coordination did occur locally, it was most prevalent in the planning agencies.

In addition, a number of groups, such as GAO, State audit organizations, and audit forums, have indicated that intergovernmental audit coordination falls far short of what is attainable.

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<sup>1/</sup>Formal systems do exist for colleges and universities (FMC 73-8) and for negotiation and audit of indirect cost rates at State and local governments (FMC 74-4). Also the Defense Contract Audit Agency normally audits contracts awarded by Federal agencies to DOD contractors.

Although our study showed little evidence of widespread coordination, substantive efforts to achieve this are underway. For example, one major objective in establishing the intergovernmental audit forums was to encourage coordination of audits and standardization of guidelines. The forums have completed several projects involving coordination.

- The Western Forum is testing procedures intended to expedite coordination between Federal, State, and local audit agencies.
- The Mid-America, Midwestern, and Southwest Forums conducted tests to determine whether a single audit of a multifunded recipient could satisfy all funding agencies.
- The General Accounting Office and the National Forum sponsored the development of a standard audit guide, which auditors at all levels of government can use in audits of grantees.
- The Mid-Atlantic Forum sponsored a joint audit of a major program. This audit was performed by Federal, State, and local auditors.

In addition, some State and local audit organizations have attempted to coordinate the audit of federally assisted programs within their jurisdictions. Some Federal audit groups have also made extensive efforts to improve coordination.

We noted examples when recipients had arranged for single audits of their organizations and gained acceptance of this practice from all funding sources.

#### OBSTACLES TO COORDINATION

It was evident from our contacts with the various audit officials that the present approach in auditing federally assisted programs was an obstacle in coordinating audits of multifunded recipients. Currently most audits of federally assisted programs are directed toward individual grants rather than toward single audits of the recipient's operations and administration of all grant funds. This approach was discussed in chapter 2.

Another major obstacle to coordination is that there is no central location within the Federal Government where auditors can identify the Federal funds being awarded and related audit requirements in sufficient detail to facilitate audit planning. Information in publications such as "Federal Outlays to States," "Federal Aid to States," and "Catalog of Federal Domestic Assistance" was not designed with the auditor in mind.

Individual Federal agencies studied could identify their primary recipients of federally assisted program funds; however, their systems did not normally identify subgrantees.

The central information systems at the State level varied in their capacity to provide sufficient information on grant awards and audit requirements to be of use to the State auditor. However, one large State was developing a central system that would identify all Federal funds awarded to State departments and also identify subgrantees. But even in this case, Federal funds received directly by local levels are not identified at the State level.

A number of State auditors informed us that the basic information needs of the State auditor were quite simple:

- Identification of the grant.
- The Federal agency awarding the grant.
- The State agency receiving the grant.
- The audit requirements for the grant.

They reported that to obtain this information, inquiries must be made of individual State departments or local recipients to ascertain which Federal grants they were receiving, then of each Federal agency to determine where the responsibility for audit lay and the audit requirements for each grant.

Most of the local recipients visited could readily identify grant funds received directly from the Federal and State Governments. However, the amount of information in the systems varied among the recipients, and sometimes it was difficult to identify whether those funds received from the State level included federally assisted program funds.

Auditors from all levels of government complained about their inability to identify where and by whom federally assisted programs were being administered. They felt this was an obstacle in coordinating audits of multifunded recipients.

Several different Federal and State audit organizations have cited the need for more adequate information concerning the award and receipt of Federal grant funds. There was consensus among them that a system must be established for identifying recipients if audit resources were to be used more effectively.

Although caution has been suggested by Federal agencies concerning the cost of developing an extensive central data base, it is generally recognized that there is a valid need for the information.

## CHAPTER 6

### RELIANCE BY FEDERAL AUDITORS ON OTHER FEDERAL AUDIT ORGANIZATIONS

The concept of Federal reliance on other Federal auditors' work is not new. OMB Circular A-73 encourages Federal agencies to use this approach when possible. Federal agencies' implementation of this policy for the audit of federally assisted programs has not been substantial and should be increased.

Circular 73-6 established a system for coordinating indirect cost rates and audit at educational institutions. Circular 74-4 established a cognizant agency system for the audit and negotiation of State and local government indirect cost allocation plans and indirect cost proposals. However, there is no established cognizant agency designation covering the audit of direct costs of federally assisted programs administered by State and local governments. <sup>1/</sup> But several cross-servicing arrangements have been initiated by individual Federal agencies for specific programs or types of grantees.

Over half the Federal audit officials contacted indicated that they had used or currently did use some cross-servicing arrangements where one Federal agency audited federally assisted programs for others. We found several examples of this approach. However, the examples represented a very small percentage of the programs. Much of the cross-servicing involved programs with small and scattered grants or multifunded recipients with known problem areas.

Of over 160 State and local grant recipients, most received funds from more than 1 Federal agency. Further, we found few arrangements between Federal auditors to rely on one another's audits involving these recipients. However, several of the Federal auditors, at the time of our study, were exploring the feasibility of cross-servicing.

1/The only exception is the audit of recipients administering Joint Funding Simplification Program funds (formerly the Integrated Grant Administration Program).

Many Federal audit officials were sometimes less than enthusiastic about cross-servicing. Particular complaints included:

- Audit reports did not specifically identify their grants.
- In many instances their grants were not adequately covered.
- Audit reports did not provide sufficient information to resolve exceptions involving their grants.
- Audits were not made in a timely manner.
- Audit staff lacked program knowledge necessary to audit their programs.
- No standard audit guide existed for multifunded recipients.
- Reimbursement procedures were not adequate.

A 1977 GAO report stated that Federal agencies had worked out many cross-service auditing arrangements over the last few years. However, GAO identified several barriers which inhibited additional cross-servicing, including the (1) lack of Federal-wide funding information on grantees, (2) limited Federal audit staffs, (3) lack of reimbursement procedures, and (4) lack of a standard audit guide which would cover multifunded recipients.

Apparently some of these problems were reasons for not expanding Circular 74-4 to provide for a cognizant agency system for the audit of federally assisted programs. Many audit officials felt that without a standard audit guide and uniform approach to audit, such a system could not work.

Even though problems with cross-servicing were expressed, it did work under the Joint Funding Simplification Act program because there was a concerted effort by Federal audit and program officials. This program required that one Federal agency audit all funds administered by program grantees, of which there are now 15. The audits are made by one audit organization using a single audit program. The audits of this program reviewed during our study generally were acceptable to all funding agencies.

## CHAPTER 7

### RELIANCE BY FEDERAL AUDITORS ON STATE AND LOCAL AUDIT ORGANIZATIONS

Since the publication of OMB Circular A-73, urging greater Federal reliance on audits by State and local auditors of recipients of federally assisted programs, there has been a trend toward this objective. However, substantial implementation of this policy by Federal agencies has not been achieved.

Many federally assisted program recipients are routinely audited by State and local auditors. Federal agencies' reliance on these audits is generally limited because:

- Some Federal agencies plan their audits or arrange for them without considering audits by anyone else.
- Many Federal agencies do not know whether State or local auditors are auditing organizations administering their programs until they go to the grantee's location to conduct an audit.

When Federal auditors reviewed audits prepared by State and local auditors, those that placed limited reliance on them did so because:

- The reports did not identify their particular grant programs.
- The reports did not indicate whether grant terms and conditions had been met.
- The reports did not indicate their audit guides had been used.
- They felt the audits had been too limited in scope.

Federal auditors in more than half the agencies we studied did rely on some State and local audits to some degree. These audits were done by State or local auditors under agreements with the Federal agencies or the grantees. For the most part, the audits of individual grants were conducted using a Federal audit guide and served in lieu of Federal audits.

Some Federal agencies have recently made concerted efforts to have State and local auditors audit their grants using Federal audit guides. However, many State and local

auditors have shown little interest in making agreements to do these audits. They are reluctant to follow the numerous audit guides. They feel it is too time consuming, expensive, and unwarranted to audit individual grants in this manner. Other State and local auditors are not interested because of reimbursement problems (discussed in chapter 8), lack of sufficient advance notice of audit requirements, and lack of long-term audit commitment.

Obstacles encountered by State and local auditors in auditing federally assisted programs both in the course of their normal audits and as special audits are discussed in previous chapters. Federal, State, and local auditors believe that resolution of these problems would lead to increased reliance.

## CHAPTER 8

### MECHANISMS FOR REIMBURSING STATE AND LOCAL AUDITORS FOR AUDITS OF FEDERALLY ASSISTED PROGRAMS

Previous studies have concluded that State and local auditors are reluctant to audit Federal assistance programs because of problems in obtaining and accepting reimbursement. While some changes have been made, our study substantiates that Federal agencies have difficulty in obtaining the funds to pay for the audits and that State and local auditors have restrictions in accepting payment. If our recommendations are implemented, most of these problems will be resolved.

Generally, recipients of federally assisted program funds also receive State or local funds. As a result, Federal, State, and local auditors share an interest in auditing them. Because auditing is an important part of a sound financial management system and serves as a management tool to both the grantee and the grantor, both should share the costs.

Current Federal policy on reimbursement for audits of grant recipients is contained in FMC 74-4, which both recognizes audit as an allowable cost and provides a mechanism for reimbursement. A State may obtain reimbursement for audits first by including the costs of the State auditor's operations in the State-wide cost allocation plan and then recovering an allocable portion of those costs chargeable to Federal programs through the individual State department's indirect cost plan. If this mechanism is not used, a State auditor may charge the recipient directly for the cost of the audit. A local auditor may use similar procedures.

Audits by State and local auditors that are arranged by Federal audit agencies are reimbursed by the arranging Federal agencies. The reimbursement may go directly to the States or local audit organizations or to a central fund.

Although these procedures have worked in some States, they generally have not induced State and local auditors to participate in the audit of federally assisted programs to the extent that many Federal, State, and local officials would like. Four problems have contributed to this condition.

First, many recipients control the audit funds and select their own auditors to audit their programs. Those

selected sometimes are not the State or local auditors having audit responsibility for the grantees' operations.

Second, most Federal audit organizations do not have funds to contract for audits of federally assisted programs.

Third, many State and local laws require that all audit organizations' expenditures be authorized in advance through the appropriation process, thus precluding receipt and use of additional Federal audit funds without approval.

Fourth, even when funds can be received and used, State and local audit organizations have difficulties staffing and planning for audits of federally assisted programs. The main reason for this is the lack of a long-term Federal audit commitment.

### RECIPIENT CONTROL

Recipient control over both Federal audit funds and auditor selection have been problems with State organizations having audit responsibility for the recipients. Although not widespread, in some instances State auditors had audit responsibility for the recipients, but the recipients were unwilling to arrange with the State auditors to audit the grant funds to satisfy Federal requirements. We did find instances when Federal audit agencies had interceded to have the recipients rely on the State auditors for audit of the programs.

According to many Federal and State audit officials, recipients are sometimes reluctant to spend grant funds for what they consider nonprogram purposes, such as audits. In two States some State department officials claimed no indirect cost reimbursement in connection with Federal grants, because these charges reduced the amount available for direct program costs. 1/

Also, in isolated cases, recipients arranged for audits with State auditors and then did not have funds to pay for them. Several State auditors said they had been told by State administrators that while their grants allowed payment of audit costs, they had no money for such audits.

1/This could result in funds not being available for audits.

## FEDERAL CONTRACT FUNDS

Funds are necessary if Federal auditors wish to contract with State and local auditors or public accountants but these funds are limited. <sup>1/</sup> However, where such funds were available, they were sometimes used to contract for individual grant audits without first determining whether recipient-arranged audits had been made. In one agency, the auditor was arranging for audits of individual grants while at the same time the grant requirements called for the recipient to have an audit made at least once every 2 years.

Most Federal audit agencies requesting funds for contracted audits have been unsuccessful in getting funds directly appropriated for this purpose. They are thus required to obtain these funds by transfers from program appropriations. However, one large Federal audit agency has recently been successful in obtaining funds for contracted audits.

## STATE AND LOCAL LIMITATIONS

Many State and local audit organizations must have their expenditures authorized in advance through an appropriation process, thus precluding the receipt and use of additional Federal audit funds without approval. However, the auditors generally feel that this problem can be overcome.

Over 95 percent of State and local auditors responding to our inquiry said they could audit federally assisted program funds in accordance with Federal audit guidelines.

About half these State and local audit organizations did audit some federally assisted programs and were reimbursed for the work. Most of the audits involved individual grants and were made in accordance with Federal audit guides. However, those organizations not performing these audits indicated that the reimbursement issue was one major factor in not making the audits.

About 50 percent of the State and local auditors responding to our inquiry indicated they reviewed all recipient funds, including federally assisted funds, in their normal

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<sup>1/</sup>We are not referring to funds for financing the audits of grant recipients required under Circular A-102.

recurring audits and did not receive or request reimbursement for a portion of the audit costs from the recipients. 1/ However, these audits normally do not follow the individual Federal audit guides.

Also some States did recently amend or pass statutes removing barriers relating to the audit of federally assisted programs. One State passed legislation authorizing the State auditor to contract with Federal agencies for audits. Another State amended its statutes to authorize a shorter State audit cycle to coincide with Federal audit requirements. Still another State passed a statute requiring State departments to budget for audits of their federally assisted programs.

#### LONG-TERM AUDIT COMMITMENTS

Many State and local auditors informed us that even though they could receive and use Federal grant funds for auditing federally assisted programs, in accordance with Federal audit guidelines, they were unable or unwilling to because there was a lack of long-term Federal audit and reimbursement commitment. They felt that there must be a system to give them sufficient advance notice of audit requirements to provide leadtime necessary for staffing, budgeting and audit planning. They felt that long-term commitment would prevent undesirable fluctuations in audit staff from year to year and would permit development of a strong staff. They also expressed a need for advance funding for audits rather than reimbursement.

1/Over 50 percent of these State auditors told us that their operating costs were included in their State's cost allocation plan.

## CHAPTER 9

### CONCLUSIONS AND RECOMMENDATIONS

#### CONCLUSIONS

The problems in auditing federally assisted programs are very complex; therefore, it is impractical to say one easy solution can be found without extensive changes in the delivery system. Many concerns have been expressed, and numerous recommendations made. Most recently, the Federal executive and legislative branches have shown increased interest. Other organizations, such as GAO; OMB; intergovernmental audit forums; and Federal, State, and local audit organizations, are also seeking solutions to these problems.

The present piecemeal practice of auditing federally assisted programs, in our opinion, contributes to the duplication and overlap of audit efforts, gaps in audit coverage, and audit coordination problems. This approach must be changed if these problems are to be alleviated. Other obstacles, including varied audit guidelines and requirements, different audit philosophies, and audit reimbursement problems, must be removed before this can occur.

The Federal agencies must adopt a single audit approach to auditing recipients of federally assisted programs. These audits would be conducted on an organizationwide basis by one group to determine whether financial operations had been properly conducted and whether the recipient had complied with the grant requirements. 1/ A recipient generally is:

- A state department.
- A municipality, e.g., a city or a town having its own incorporated government for local affairs.
- A county, an independent school district, or a special district or an authority.
- A nonprofit agency.
- A regional planning agency or commission.

1/When the recipient is a large entity, such as Chicago, Los Angeles County, or the California Department of Transportation, a series of audits covering major segments may be substituted in lieu of one audit.

Much has been done to alleviate these problems and will continue as a result of the efforts underway. However, more specific and immediate actions are needed to improve audit coverage and more effectively use audit resources. We recommend, as a minimum, that the following actions be taken. These recommendations and suggestions center mainly around current practices. We have analyzed all comments received on our draft report, and, where appropriate, comments have been incorporated into the following recommendations and suggestions.

#### RECOMMENDATION 1

We recommend that:

- The Office of Management and Budget require Federal agencies to adopt an approach in which Federal agencies would rely on and require single audits of grant recipients (both primary recipients and sub-grantees).
- An interagency group be established to help OMB implement this approach.

#### Discussion

As discussed previously, the single audit approach is not new. It has been the intent of OMB circulars since at least 1974 to have such audits of recipients administering federally assisted programs. When OMB Circular A-102 was reissued in early 1978, this intent was emphasized.

After our draft report was issued in August 1978, the Director of OMB, on December 6, 1978, issued a memorandum to executive agency heads on audit of federally assistance programs for comment. The memorandum states in part:

"\*\*\*Last year President Carter wrote to you urging your participation in a program of streamlining Federal aid. One area the President highlighted as having a substantial need for improvement was audit of federally assisted programs. He directed Federal departments and agencies to improve audit coordination, and to increase their reliance on audits made by State or local governments."

"Following up on the President's initiative, our staff has been working with yours, and with the General

Accounting Office, the National Intergovernmental Audit Forum, and State and local government groups to simplify the way audits of federally assisted programs are made. Two major documents have resulted from this work. One is a standard audit guide published by the General Accounting Office."

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

As mentioned above, OMB Circular A-102 established the need for recipients of federally assisted programs to have sound financial management systems, including audit. The circular, in requiring grant recipients to make or secure audits, states in part:

"\*\*\*These examinations are intended to ascertain the effectiveness of the financial management systems and internal procedures that have been established to meet the terms and conditions of the grant. They should be made in accordance with generally accepted auditing standards including the standards published by the General Accounting Office, 'Standards for Audit of Governmental Organizations, Programs, Activities & Functions.' It is not intended that each grant awarded to the recipient be examined. Generally, examinations should be conducted on an organization-wide basis to test the fiscal integrity of financial transactions, as well as compliance with the terms and conditions of the Federal grants\*\*\*."

Officials commenting on the draft report expressed concern with four aspects of A-102, involving the audit of grant funds.

The first concern was whether the single audit recommended in this report was the same as that called for in A-102. They are.

The second concern dealt with whether the single audit must be made by an independent auditor. Yes, the auditor must be independent, both in attitude and in fact. A-102 states that the audit should be made in accordance with generally accepted auditing standards, including the GAO audit standards. The standards, in describing independence, state:

\*\*\*The third general standard for governmental auditing is:

"In all matters relating to the audit work, the audit organization and the individual auditors shall maintain an independent attitude."

"This standard places upon the auditor and the audit organization the responsibility for maintaining sufficient independence so that their opinions, conclusion, judgements, and recommendations will be impartial\*\*\*."

"The auditor should consider not only whether his own attitudes and beliefs permit him to be independent but also whether there is anything about his situation which would lead others to question his independence. Both situations deserve consideration since it is important not only that the auditor be, in fact, independent and impartial but also that other persons will consider him so\*\*\*."

OMB needs to revise A-102 to clarify the single audit requirement and to state succinctly that the audit must be made by an independent auditor. We suggest it refer to the current definition of "independence" in the Office of Revenue Sharing audit regulations.

The third concern about A-102 involved the grantee arranging for the audit of its operations. Several officials felt that the audit should be arranged for by or at least approved by someone independent of the grantee, such as the State or Federal auditor. We do not believe this is necessary. 1/ We believe that the oversight review by the cognizant agency discussed in recommendation 4 will assure that the auditor having made the audit is qualified and independent.

1/We do suggest that OMB revise A-102 to indicate when State or local laws or ordinances require the independent government auditor (State or local) to audit the recipient, the recipient not arrange with any other audit organization.

The fourth concern involved whether Federal agencies should make their own audits or rely on audits made by non-Federal auditors. To implement the single audit approach, those currently responsible by law for arranging for and auditing grant recipients must be relied on. Most State and local recipients have statutes or ordinances setting audit requirements and stating who is responsible for arranging for and performing the audit. Thus, where State auditors are responsible for auditing grant recipients, such as State departments, they should be relied on to perform the basic financial and compliance audits. When local auditors are responsible for auditing grant recipients and the auditors are independent, then they should be relied on. When recipients are required to secure audits by public accountants, such audits should be relied on. To follow some other approach would necessitate changes in State and local legislation, which may not be feasible.

### Concerns

Other interrelated concerns were expressed by officials who commented on the draft report concerning the single audit approach. The following concerns warrant discussion:

- The single audit approach will be difficult to implement because of the many complexities surrounding federally assisted programs.
- Federal officials must retain the authority to conduct additional financial and compliance audits, as well as other audits, when conditions or need exist.
- Single audits may not satisfy management's needs.
- Shift of the single audit responsibility to the State and local auditors may restrict the scope of the State and local auditor's work.
- The success of the single audit is contingent on a number of other decisions and actions.
- The role of the internal auditor must be clarified.

### Complexities

Some officials felt that the single audit approach would be a time-consuming and an enormously complex undertaking. They felt that resolving such issues as developing an acceptable single audit guide, obtaining agreement between Federal officials to minimize the number of grant audit requirements, and devising mechanisms for resolving audit findings and recommendations would be major tasks.

We agree that resolving these issues as well as many others would be major tasks. However, we believe that with top management support, they can be resolved. The inter-agency group, representing all levels of government, would be in a position to do this.

#### Retention of audit authority

Some Federal officials expressed concern whether the single audit approach would result in relinquishing their right to do audit work they deemed necessary to provide stewardship over Federal funds.

We believe that the Federal agencies should rely on the single financial and compliance audit unless quality review by the cognizant agency indicates the audit was deficient in some aspects. If the audit is unacceptable, the cognizant Federal agency should take the necessary actions, including its own audit, to assure proper audit coverage.

The single audit approach would not be a substitute for other reviews, such as economy and efficiency audits, program results reviews, investigative audits, program monitoring, and other special audits directed toward the specific overall Federal program rather than toward individual grants and individual recipients.

A substantial portion of Federal audit efforts are directed toward individual grant audits. With adoption of the single audit approach, more emphasis can be placed on performing these other audits.

#### Satisfy management

A concern was expressed that the single audit would not give management sufficient information to manage specific grants. Specifically, officials felt that their grant funds might not be included in the audit tests; that enough data might not be included in the report to permit resolution of findings or closeout of the grants; and that the single audit would result in a tradeoff among Federal agencies of the amount of basic audit coverage, e.g., certain agencies would receive greater coverage while others might receive less coverage than previously received.

These are reasonable concerns. However, from a total Federal viewpoint, the audit coverage should be greater than it is now. Also these concerns would be reduced by the interagency group in that those expressing the concerns would be part of the group implementing the single audit approach.

Limit audit scope for  
State and local auditor

A number of officials felt that the shift of the single audit responsibility to the State and local auditor might restrict the scope of the State and local auditor's work.

We did not intend that State and local auditors would be precluded from making other audits, such as economy and efficiency and program results. In fact, many are required by statute to make these audits.

While State and local independent auditors might increase the amount of financial and compliance audit effort under the single audit approach, they would be able to better staff for this increase because audit requirements would be known in advance; e.g., as long as there were Federal grant funds, a single audit would be required.

In addition, when State and local auditors are available and interested in broader scoped audits, the Federal agencies should, to the maximum extent possible, arrange with the State and local auditors to assist them with these audits when the audits involve a State or local recipient of Federal program funds.

Single audit contingent on other factors

Those commenting agreed almost unanimously that for the single audit to work, issues such as those mentioned above and the subsequent recommendations, such as numbers 2, 3 and 4, must be addressed by the interagency group. We agree.

Role of internal auditor

Several officials commenting on the draft report questioned what the role of the State departmental and local internal audit organization would be under the single audit approach.

These internal audit organizations would normally not meet the independence requirements for making the single audit. However, the work of internal auditors should be used to the maximum extent by the external audit organization performing the single audit.

Several officials also felt that State departmental internal auditors must reduce the number of audits currently being performed at the local level and also accept the single recipient audit to satisfy their audit needs. Otherwise a considerable amount of duplication and overlap of audit effort would continue at the local level.

## Approach for implementing recommendation

### Group appointment and composition

Implementation of the single audit approach would require the support of top governmental officials at all levels. Therefore, an interagency group must be established to help OMB implement the approach. This would provide uniform implementation. The members of the group should be appointed by the President. They should include top Federal, State, and local audit and program officials because each level has a significant interest in the accountability of federally assisted program funds. For the single audit to satisfy management needs, they must have a say in what is to be included in the audit.

An individual should be hired or detailed to the interagency group and OMB for at least the initial phase of implementation. This person should know about the problems surrounding the audit of federally assisted programs. This person would help in the overall management of implementing the approach and would add continuity and permanence to the group.

### Implementation

Actions should begin immediately to implement the single audit approach. However, because of the complex issues that must be resolved, gradual implementation, starting with selected States, would permit a smoother adoption nationwide. Single audits could be made of all recipients within the State or could be limited to those recipients receiving above a stated amount of Federal program funds. Those receiving less would be exempt from the audit requirement. This amount should be determined and agreed to by the interagency group. 1/

Full implementation of the approach would be complex and would not be accomplished overnight. Implementation would depend on concurrent implementation of many of the following recommendations. 2/

1/The "State and Local Fiscal Assistance Amendments of 1976" exempt small units of government from audit requirements in the act.

2/See appendix V for suggested sequential steps.

## RECOMMENDATION 2

For federally assisted programs, we recommend that the interagency group and OMB identify the material program and administrative requirements that need to be reviewed in a single audit and include these requirements in a uniform audit guide.

### Discussion

The major drawback to single audits of grant recipients is the numerous and varied grant requirements which many Federal agencies have included in audit guidelines that must be reviewed to satisfy the Federal agencies. Certainly many of these requirements are material and must be reviewed during the audit to assure grant compliance. Program requirements, such as recipient eligibility, coverage of services, and nature of in-kind matching funds, may be important to program accomplishments. However, certain administrative requirements, such as verifying that a given report was filed on time, do not have a material effect on whether grant terms are met.

For the single audit to be effective and feasible, the number of requirements to be audited must be made as uniform as practicable and must be reduced to include only those material to determining whether the terms of the grant have been substantially met. Once this has been done, they can be incorporated into a single audit guide or added to an existing guide, such as the GAO guide discussed in recommendation 1.

Most who commented on this recommendation generally felt either that the task could not be achieved fully or that the audit guide would be too general and would result in audit reports which would not meet program managers' needs. We believe that the task can be achieved and is indispensable to implementing the single audit approach. Our review of Federal audit guides and audit reports indicates that a financial and compliance audit guide can be developed.

The concern of whether the guide would result in audit reports too general to satisfy the needs of program managers is, we believe, a problem of definition. The single audit we are recommending is a financial and compliance audit and is only part of a full-scope audit. To the extent an expanded audit scope of individual Federal programs is required, it can be provided as discussed in recommendation 1. We also believe this concern stems from the role and function audit reports currently serve in the individual programs' grant management systems. In some cases they are properly

integrated with other program evaluation systems and provide an independent assessment of the accuracy of grantees' financial and management reports to grantor agencies. In other cases audit coverage is used to perform functions that are more properly the responsibility of program management, such as onsite grantee visits.

Other comments centered on the problem of defining "materiality" in terms of requirements and clarifying how this recommendation would reduce or make requirements more uniform. We believe the question of materiality must be addressed by the interagency group and negotiated with individual agencies. Also many current variations in programs, such as prior approval levels for purchases and subcontracting, would be eliminated or made uniform on a governmentwide basis while individual grant requirements were being identified.

#### Approach for implementing recommendation

We recommend that the interagency group work with OMB and the various Federal agencies to identify and agree to the material grant requirements to be reviewed during the financial and compliance audit of recipients. To the maximum extent possible, efforts underway by GAO and others should be used.

#### RECOMMENDATION 3

We recommend that OMB and other Federal agencies work toward removing unnecessarily conflicting audit and administrative requirements in current grant legislation and work toward standardizing grant audit and administrative language.

#### Discussion

Some grants have legislated audit and accounting requirements that differ from OMB uniform administrative requirements. Such differences require different treatment in auditing the grant recipient, thus complicating performance of single audits.

Most who commented on this recommendation stressed the importance of eliminating legislation which conflicted with administrative requirements. They also felt that implementing this recommendation was indispensable to implementing the single audit approach.

## Approach for implementing recommendation

We recommend that OMB, GAO, and other Federal agencies work with appropriate congressional committees to remove unnecessarily conflicting audit and administrative requirements from current grant legislation and to work toward standardizing grant audit and administrative language for inclusion in future legislation.

## RECOMMENDATION 4

We recommend that OMB extend cognizant Federal audit agency arrangements to provide oversight of the single audits of grant recipients required by OMB Circular A-102.

### Discussion

The cognizant agency arrangement must be extended if greater reliance is to be placed on other auditors' work, audit coordination is to be improved, and greater reliance on single audits of grant recipients is to be achieved. For the single audit approach to work, Federal agencies must be assigned to review these basic audits on behalf of all Federal agencies having an interest in the grant recipients. Otherwise, each Federal agency might review the single audit results to determine whether the audit was adequate.

### Concerns

Some officials commenting on this recommendation, although endorsing it, raised a number of concerns about its implementation. The following were their major concerns:

- Duties (oversight) of cognizant agency.
- Resource considerations.
- Unsatisfactory experience with the present cognizant agency system.
- Criteria governing cognizant agency assignments.

### Duties (oversight) of cognizant agency

From the comments on the recommendation, it is obvious that the duties to be performed by a cognizant agency must be explicitly defined by the interagency group and agreed to by the Federal agencies. At a minimum, these would include:

- The technical assistance to be provided grantee auditors and grantees.
- The scope of review offered during preaudit and post-audit reviews of grantee audits including audit contract and pricing reviews, report analysis, work-paper reviews, and reaudit tests.
- An agreed-upon evaluation criteria or peer review system for evaluating the quality and acceptability of auditors' work. <sup>1/</sup>
- An established system for reporting audit deficiencies and audit results to grantor agencies.

We also believe the interagency group must develop a system for grantor agencies to uniformly act on audit recommendations and questioned costs.

#### Resource considerations

We are not now sure whether additional resources would be needed to expand the cognizant agency system. Only experience could tell. On the positive side, Federal audit resources presently spent on auditing individual grants should become available; thus additional resources might not be required. On the negative side, additional resources might be needed if a considerable amount of Federal funds were not receiving audit coverage or if individual agency audit coverage was inadequate.

#### Unsatisfactory experience

A number of officials compared their experience with the current cognizant agency assignments with our proposed system. Their principal complaint centered on the lack of information that audit reports generated, under the present system, concerning their agencies' grants and contracts. Generally they felt their programs were not receiving adequate audit coverage. Some officials speculated that our proposed system might result in similar inadequacies and fail to gain acceptance as a result.

<sup>1/</sup>The National Intergovernmental Audit Forum and the State Auditor Coordinating Council are conducting a joint quality review project. The main objective of the project is to design an audit quality review system for audit organizations.

We believe the proposed system would overcome many of the problems of the current system. First, the single audit guide adopted by the interagency group would address the problem of information and coverage to be provided. Second, the duties of the cognizant agency would be clearly defined by the interagency group and agreed to by all agencies. We believe that if the above were achieved, the principal concern of the agencies in relying on each other would be resolved.

#### Criteria governing cognizant agency assignments

Officials commenting on this aspect of the recommendation agreed with one or more of the suggested alternative methods of implementation. However, a number of comments stressed the need for the cognizant agency to have the predominant financial interest in the particular grantee. We believe this is desirable and should be used as a factor in assigning cognizant agencies. But it should not necessarily be the predominant factor.

#### Alternative approaches for implementing recommendation

We recommend that the Director of OMB assign Federal audit agencies to oversee single audits of grant recipients. As confirmed by those commenting on the draft report, cognizant agency responsibilities could be assigned on the basis of the following:

##### 1. Area cognizance:

- All States within a given geographic region could be assigned to one Federal agency.
- One Federal audit agency could have cognizance over all grant recipients within the State.
- Different Federal audit agencies could be assigned to State departments, cities, counties, and planning agencies.

##### 2. Federal agency selection criteria:

- By agency program funding.
- By location of Federal auditors.
- By "fair share" of audit cognizance.
- By type of client.

When the above arrangements are being made, existing audit responsibilities should be considered. For example, if the State auditor had the responsibility to audit all recipients within a State, one (perhaps more than one for a large State) Federal audit agency would review the State auditor's audits. However, if responsibility rested with each recipient of the State, then a cognizant Federal audit agency would review each recipient's audit or arrange with the State auditor to review the audits.

#### RECOMMENDATION 5

We recommend that OMB and the interagency group establish a system for reimbursing the Federal Government's share of single recipient audits.

#### Discussion

Auditing serves as a management tool for both the grantee and the grantor; therefore, it is the grantor's responsibility to share the audit costs. Currently, FMC 74-4 permits audit cost as an allowable cost under the grant.

However, under the present approach to auditing federally assisted programs, some problems concerning reimbursement of audit cost have been encountered. Adoption and implementation of the single audit approach would eliminate some of these. However, at least two major problems must still be resolved:

- First, a fair and workable mechanism for paying the Federal grantor's fair share of the cost of the single audit must be found.
- Second, the obstacles facing some State and local auditors which prevent them from using and accepting reimbursement of costs for audits of federally assisted programs must be removed.

The latter problem is one that must be solved by the individual State and local auditor. Our recommendation addresses the former.

Those commenting on this recommendation agreed almost unanimously that a reimbursement system was a must. There was also a general consensus that the system must be kept as simple as possible for it to be feasible. However, there was no overall agreement of what system was needed or was best.

### Approach for implementing recommendation

We recommend that OMB and the interagency group consider the following approach for reimbursing the audit:

- The current practice of allowing part of grant funds to be used for audit purposes would be continued. However, the recipient (primary and subgrantee) would be required to certify that funds had been budgeted and would be reserved for financing part of the required single audit.
- The cost of the audit would be shared on the basis of funding received; e.g., if the total Federal funds received were 40 percent of the total, 40 percent of the audit cost would be shared by the various Federal grantors. The Federal share would be allocated among the various Federal agencies on the basis of value of grants; e.g., if the Department of Health, Education and Welfare's grant funds were 10 percent of total Federal funds, it would absorb 10 percent of the audit cost.
- The cognizant agency during its oversight review would ascertain whether the audit coverage had been proper. The review would assure that the Federal grantors were paying their fair share.

### RECOMMENDATION 6

We recommend that OMB determine the feasibility of establishing a single Federal agency to be responsible for monitoring, overseeing, and auditing federally assisted programs.

#### Discussion

A single Federal audit agency would eliminate many of the current problems surrounding the audit of these programs. However, it might create new problems.

Officials who commented on the draft report raised these concerns.

1. Such an agency is not feasible.
2. A feasibility study should be initiated by OMB immediately.

3. Any feasibility study should be delayed until the other recommendations in this report have had a chance to be tested.

Those officials stating that such an agency was not feasible gave reasons ranging from such an agency would create a huge and unwieldy organization, to such an agency would possibly conflict with the Inspector General Act of 1978. While not all these officials ruled out the need for such an agency, most did raise problems that might arise if such an organization were established.

A number of officials recommended that a feasibility study begin immediately. One major group of officials firmly supported simplification of the management of federally assisted programs and audit through establishing a single federal audit agency.

The last group of officials felt that OMB should wait to see how the single audit approach works before deciding to make a feasibility study.

The majority of those commenting on the feasibility study felt either that it should begin immediately or that the decision should be delayed until the other recommendations were implemented.

#### Approach for implementing recommendation

On the basis of the comments, we recommend that OMB give the Federal agencies time to test our recommendations before studying the feasibility of establishing a single Federal audit agency.

#### RECOMMENDATION 7

We recommend that OMB establish a system for identifying where and by whom grant funds are being administered.

#### Discussion

There is no location within the Federal Government where program managers or auditors can identify the Federal funds being awarded to grant recipients. Thus, auditors have no objective source to determine whether they have accounted for

all Federal funds awarded to any given grant recipient. Efficient implementation of recommendations 1 and 4 would require development of such a system.

Most audit officials commenting on this recommendation expressed a need for such a system and felt that it should include all recipients of federally assisted program funds. Many felt that the system was needed if the single audit concept was to work effectively; however, they indicated that developing such a system might take a substantial commitment of resources. Most felt that implementation of the other recommendations should not depend on design of such a data system.

While there is no firm estimate of time and cost to design and implement a grant data system, the effort may not be as massive and costly as some would conclude.

OMB, in a report to the Congress issued in December 1978 entitled, "Improving the Distribution of Information on Federal Assistance Programs," reported that a substantial data base already existed within many of the major Federal grantor agencies. The report stated that nearly all Federal awards to primary recipients could be obtained from Federal agencies' existing information systems and that the information was about 85 percent uniform across all agencies.

The report also indicated, and our study supported, that many State departments had rather complete information on federally assisted program funds they distributed to subgrantees. Some States are also designing systems to accumulate data on federally assisted program funds received by governmental organizations within their States. Also our study showed that local governments could generally, without too much difficulty, furnish information on grant funds received directly from the State and the Federal agencies and subsequently redistributed to other recipients.

While the information system envisioned by OMB may not have included all the information felt needed by those we questioned, it did contain much of the same basic data concerning awards to primary recipients.

The OMB report concluded that many of the necessary improvements in the existing Federal primary recipient data bases could be made without more resources. They felt the matter was partly one of commitment and partly one of using available resources more effectively.

The report concluded that OMB, consistent with the intent of the "Federal Program Information Act," would continue to seek ways to improve information on Federal assistance programs.

The above studies indicate that departments and agencies within the various levels of government have some type of data base showing awards or pass through of Federal funds. Thus, a partial data base exists at all levels of government which could be used as a start in establishing one central data base for federally assisted programs. The major obstacles would appear to be the lack of compatibility of the data base systems and data base information.

#### Approach for implementing recommendation

We recommend that OMB expand the efforts underway to establish a centralized system within the executive branch that would identify by primary recipient and subgrantee all grant funds awarded. The following factors should be considered:

- Compatibility of the system with State and local systems.
- Cost benefits.
- Other informational needs.

#### RECOMMENDATION 8

We recommend that OMB and the interagency group develop a plan to implement the above recommendations.

#### Discussion

Such a plan would be a must for those responsible for carrying out the recommendations and would show interested parties the progress being made.

Those commenting on the draft report agreed almost unanimously that an action plan would be necessary. Some felt that the JFMIP report should include a specific action plan, including milestones and time frames. Others felt that including meaningful time frames and milestones in the report would not be possible or feasible. These officials recommend the preparation of a specific action plan be one of the first tasks of the interagency group.

We are not in a position to recommend a specific action plan, including time frames and milestones. However, we have included, as appendix V, a schedule that shows the sequence in which recommendations should be considered and implemented.

#### Approach for implementing recommendation

We recommend that OMB and the interagency group, as one of their first tasks, establish a specific action plan which would include critical decision points, estimated time frames, and target dates. The group should keep interested parties informed of progress made.

#### RECOMMENDATION 9

We recommend that the President, in consultation with the Director of OMB, appoint an independent group to review and monitor implementation of the recommendations.

#### Discussion

Those commenting on this recommendation agreed unanimously that the President should appoint this group. Strong support was expressed for the group to include, in addition to Federal representatives, persons from State and local governments.

#### Approach for implementing recommendation

We recommend a group be appointed by the President once a specific action plan has been prepared by the interagency group and OMB. We also suggest that the group have representatives from all three levels of government but that, where possible, representatives of an organization such as the National Association of State Auditors, Comptrollers, and Treasurers or the National Intergovernmental Audit Forum be included.



## THE SECRETARY OF THE TREASURY

WASHINGTON 20220

SEP 7 1976

Dear Elmer:

Several months ago I brought to the attention of the Economic Policy Board a Treasury staff paper concerning the need for developing and implementing various reforms in the audit of Federal grants of funds to States. As a result, the Board agreed that a Task Force should be established to define the problems and objectives of audit reform and to develop options on the issue.

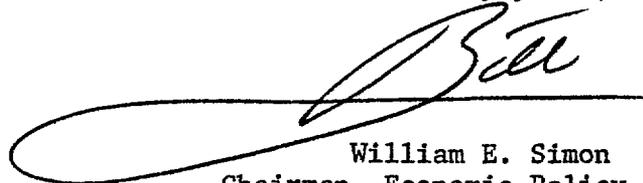
In studying the subject, the Task Force identified a number of audit areas in need of prompt remedial action. Possible improvements involve such significant matters as the clarification of Federal policy on reimbursing State and local governments for audit costs, the broadening of audit coverage through increased use of State and local auditors, the promotion of full compliance with audit regulations, the elimination of unnecessary duplication of audit work, and related items. These proposals are designed to improve the audit of Federal grants to States and strengthen the overall accountability for such funds -- a major management goal of the character suggested in the President's memorandum of July 24 to various agencies on the subject of management initiatives.

To ensure proper implementation of appropriate audit reforms, I have concluded that the matter should be referred to the Joint Financial Management Improvement Program for resolution. This approach would provide a forum for achieving necessary cooperative action, in line with the JFMIP's primary mission of improving financial management activities throughout the Government. Accordingly, I would like to suggest that a JFMIP audit reform project be initiated as soon as possible. A similar letter is being sent to the other JFMIP principals.

Your views on this matter would be appreciated.

With best regards,

Sincerely yours,



William E. Simon  
Chairman, Economic Policy Board

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



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

SEP 20 1976

The Honorable  
The Secretary of the Treasury

Dear Bill:

This is in response to your letter of September 7, 1976. As you know it has been my goal to strengthen the overall accountability for Federal funds through the improvement of governmental auditing. I am pleased to see this as one of the major management goals of the Administration.

I agree that the Joint Financial Management Improvement Program is the appropriate organization to help find solutions to problems involving the audit of federally assisted programs. I recommend that the JFMIP staff work closely with and through the intergovernmental audit forums since they are already working to solve these and related problems.

The JFMIP staff will have the complete support of the General Accounting Office in this undertaking.

Sincerely yours,

(signed) Elmer B. Staats

Comptroller General  
of the United States

THE WHITE HOUSE  
WASHINGTON

September 9, 1977

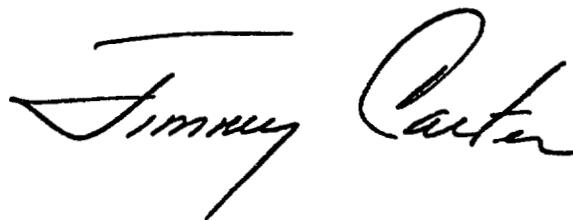
MEMORANDUM FOR THE HEADS OF EXECUTIVE  
DEPARTMENTS AND AGENCIES

SUBJECT: Sharing Federal Audit Plans

The Administration is committed to forging new ties of cooperation among all levels of government. We want to eliminate the duplication and wasteful effort that too often has accompanied the management of Federal grants to State and local governments.

One area where improvements can be made is in coordinating the audit of these grants. All three levels of government have audit responsibilities, but it does not make sense for them all to audit the same transactions. Therefore, in order to improve coordination, I am ordering all Federal executive agencies to make public the State and local portion of the annual audit plans required by Federal Management Circular 73-2. The plans will be available to State and local governments, to the National and Regional Intergovernmental Audit Forums, and to other interested parties. The plans would also be available to the general public, and would be submitted to OMB prior to the beginning of the fiscal year in which they are to be implemented. They should be updated periodically throughout the year as significant changes are made.

I expect Federal agencies to use their audit plans as a basis for making greater efforts to improve interagency cooperation on audits, to increase Federal coordination with State and local auditors, and to increase reliance on audits made by others.



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

DEC 6 1978

MEMORANDUM FOR HEADS OF DEPARTMENTS AND AGENCIES

SUBJECT: Audit of Federal Assistance Programs

Last year President Carter wrote to you urging your participation in a program of streamlining Federal aid. One area the President highlighted as having a substantial need for improvement was audit of federally assisted programs. He directed Federal departments and agencies to improve audit coordination, and to increase their reliance on audits made by State or local governments.

Following up on the President's initiative, our staff has been working with yours, and with the General Accounting Office, the National Intergovernmental Audit Forum, and State and local government groups to simplify the way audits of federally assisted programs are made. Two major documents have resulted from this work (See attachments). One is a standard audit guide published by the General Accounting Office. The other is a proposed addition to our Circular No. A-102, "Uniform requirements for grants to State and local governments." The proposed addition would incorporate the audit guide into our Circular, and explain how it should be used.

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

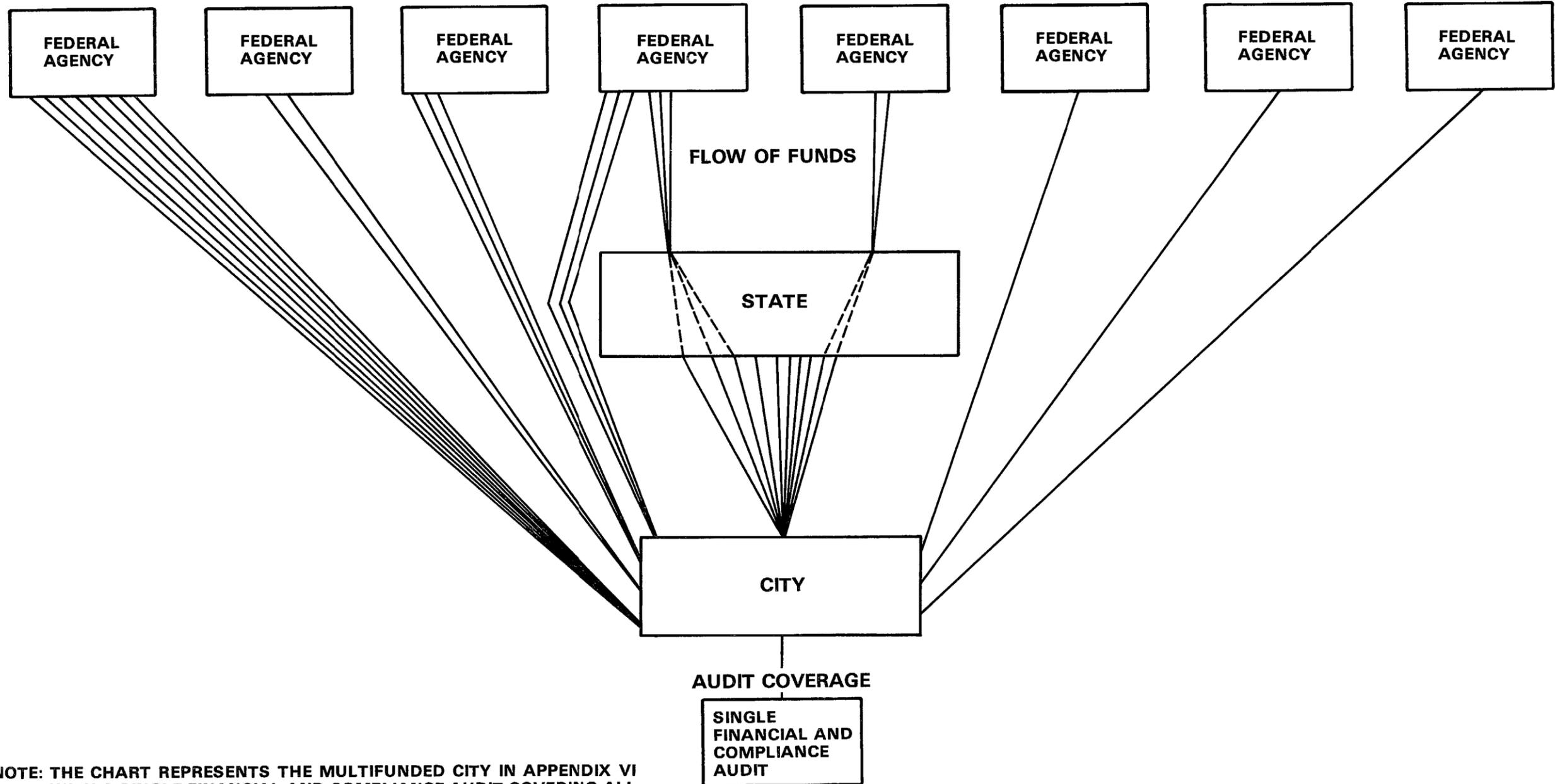
We believe the new audit guide and the proposed addition to Circular No. A-102 can substantially improve the audit of federally assisted programs. We would appreciate your comments on both documents by January 31, 1979. If your staff has questions, they may contact John Lordan at 395-6823.

  
James T. McIntyre, Jr.  
Director

Attachments - 2

**SINGLE AUDIT APPROACH**

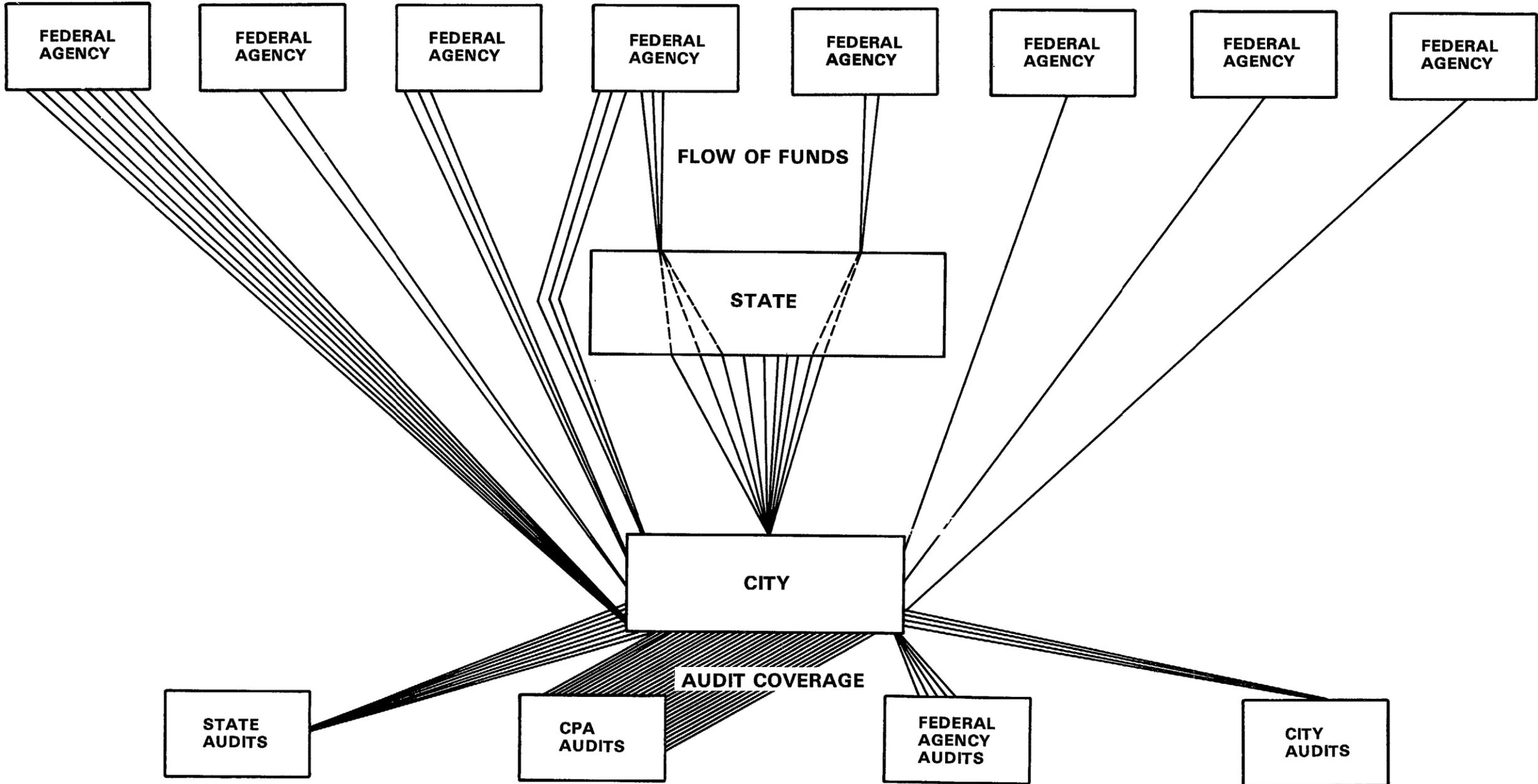
**APPENDIX VII**



**NOTE: THE CHART REPRESENTS THE MULTIFUNDED CITY IN APPENDIX VI WITH A SINGLE FINANCIAL AND COMPLIANCE AUDIT COVERING ALL FUNDS ON A CYCLICAL BASIS, CONDUCTED BY AN INDEPENDENT AUDITOR. AUDITS BY THE INTERNAL CITY AUDITORS WOULD BE USED TO MAXIMUM EXTENT POSSIBLE BY THE EXTERNAL AUDITOR.**

**CURRENT AUDIT APPROACH**

APPENDIX VI



**NOTE: THE CHART REPRESENTS THE FLOW OF GRANT FUNDS AND THE AUDIT COVERAGE OF A CITY OVER A THREE YEAR PERIOD. THIS EXAMPLE IS NOT INTENDED TO BE REPRESENTATIVE OF ALL CITIES, BUT TO DEMONSTRATE THE PIECEMEAL AUDIT APPROACH CURRENTLY BEING FOLLOWED AT THE LOCAL LEVEL.**