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SINGLE AUDITS: ARE THEY HELPING TO SAFEGUARD FEDERAL FUNDS?

HEARING

BEFORE THE

FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY SUBCOMMITTEE

OF THE

COMMITTEE ON
HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

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CONTENTS

	Page
Opening statements:	
Senator Carper	1
Senator Coburn	3
Senator McCaskill	17

WITNESSES

THURSDAY, OCTOBER 25, 2007

Hugh M. Monaghan, Director, National Single Audit Sampling Project and Director, Non-Federal Audits, Office of Inspector General, U.S. Department of Education	6
Jeanette M. Franzel, Director, Financial Management and Assurance, U.S. Government Accountability Office	8
Daniel I. Werfel, Acting Controller, Office of Federal Financial Management, U.S. Office of Management and Budget	10
Mary Foelster, Director, Governmental Auditing and Accounting, American Institute of Certified Public Accountants	11

ALPHABETICAL LIST OF WITNESSES

Foelster, Mary:	
Testimony	11
Prepared statement	70
Franzel, Jeanette:	
Testimony	8
Prepared statements	45
Monaghan, Hugh:	
Testimony	6
Prepared statements	35
Werfel, Daniel I.:	
Testimony	10
Prepared statements	766

APPENDIX

David Costello, CPA, President and Chief Executive Officer, National Association of State Boards of Accountancy, prepared statement	77
New York State Society of Certified Public Accountants, prepared statement	82

SINGLE AUDITS: ARE THEY HELPING TO SAFEGUARD FEDERAL FUNDS?

THURSDAY, OCTOBER 25, 2007

U.S. SENATE,
SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT,
GOVERNMENT INFORMATION, FEDERAL SERVICES,
AND INTERNATIONAL SECURITY,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:34 p.m., in Room SD–342, Dirksen Senate Office Building, Hon. Thomas R. Carper, Chairman of the Subcommittee, presiding.

Present: Senators Carper, McCaskill, and Coburn.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. The Subcommittee will come to order. Welcome, one and all. We are delighted that you are here and it is nice to see our witnesses. We look forward to your testimony. We appreciate your preparation. It is nice to see some folks out in the audience, including some people who helped us on this Subcommittee on earlier versions when we were just planning this hearing and we thank you for joining us, as well.

We are going to have one member of our staff, who I think this is her last hearing. She is going to throw us under the bus and going where the grass is greener and I just want to say before we go any further how much we appreciate your help, Claudette David. It is great being a part of your team, so good luck and God bless.

I welcome everyone to our hearing today on single audits as they are designed to help us protect and safeguard Federal funds. I also want to thank my colleague just arriving, Dr. Tom Coburn from Oklahoma—welcome—for his continued support in ensuring that the Federal Government is accountable to the American taxpayers. I would also like to thank our other colleagues who are going to be joining us. I know Senator McCaskill, a former State auditor, has a keen interest in this issue and is going to be coming on board before long.

Today, we are going to be discussing a key accountability mechanism used by the Federal Government to monitor how States, local governments, our universities, and nonprofit organizations use Federal funds provided to them to help achieve some very important national goals. The Federal Government, as we know, sends these entities hundreds of billions of dollars each year for pro-

grams, a lot of them meritorious programs like Head Start, Foster Care, Food Stamps, and Pell Grants. Single audits are one of the primary mechanisms that the Federal Government uses to oversee those funds and how they are used.

I have been a proponent for a long time of single audits because I think the concept makes a whole lot of sense. In fact, I was one of the original cosponsors, my friend, back in 1984—I must be old—when I was serving in the House of Representatives. Before 1984, there were multiple Federal agencies and auditors stepping over each other to review how program funds with Federal dollars were being spent. It was a maze of inconsistency with both gaps in coverage and duplication of audit coverage.

The Single Audit Act really is about three things. One is encouraging sound financial management, including effective internal controls, by those who have received these Federal funds, those universities, State and local governments, nonprofit organizations.

The second thing we are trying to do with the Single Audit Act is to reduce some of the burden on State and local governments, hold them responsible, hold them accountable, but at the same time to reduce some of the undue burdens on those State and local governments and on nonprofits, including universities.

The third thing we tried to do with the Single Audit Act was to promote efficient and effective use of audit resources.

Well, a lot of progress has been made since the passage of the Act over 20 years ago. However, a recent study by the President's Council on Integrity and Efficiency contained some troubling findings. Notably of the 208 single audits reviewed in the statistical sample, more than half were problematic. Now, they looked at 208, as I understand it, but there are a whole lot—it was many times more audits that were conducted, but someone picked 208 of them to look at, to scrub closely.

Now, of those 208 that were reviewed in detail, more than a third were of such poor quality that the results could not be relied upon. In my view, this rate of quality is just flat out unacceptable.

The study also noted that the audits of entities that expended more than $50 million were of noticeably higher quality than those that spent less than $50 million. Nonetheless, there appear to be problems pretty much across the board and I am convinced that this key mechanism may not be meeting the goals that we are intending.

This hearing will focus on the results of the study and on the various roles oversight organizations have in monitoring single audits. The hearing will also explore the study's recommendations and the potential impact that implementing the recommendations could have to help ensure Federal funds are safeguarded.

I believe that it is important to keep in mind as we explore this area during this hearing that single audits are the key mechanism used to monitor hundreds of billions of Federal funds. If the auditors aren't doing their jobs, at least in a number of areas, then the risk of those funds being misspent increases.

I take a special interest in this because I was present at the creation of the legislation 23 years ago. We had State and local governments complaining to us that folks were literally stepping over each other auditing Federal funds and it didn't make a whole lot

of sense and why didn't we simply have a single audit that can get the job done. It made a whole lot of sense.

What we found out during the course of the last several months is that too many of these audits that are being done are poorly done. They are unreliable. They don't inform us as to how the money is being spent, how the programs are being run, if they are in compliance with the law. There is a huge concern that I have given the amount of dollars, hundreds of billions of dollars that are involved, that monies are being misspent, programs are being poorly run, and we can do better than that. And hopefully during the course of this hearing and what is going to flow from it, we will do a whole lot better than that.

Dr. Coburn.

OPENING STATEMENT OF SENATOR COBURN

Senator COBURN. Thank you, Senator Carper and also Senator McCaskill, because I think a lot of her emphasis led to us having this hearing, one that was discussed in one of our markups about the Single Audit Act.

This reminds me of the Latin quote, "quis custodiet ipsos custodes," who will guard the guards, and that is what this hearing is really about today.

As an accountant myself, my least favorite thing was auditing, I will have to admit that, but what we have seen in this IG report is not just troubling. What it says is there is incompetence. There is a lack of oversight. There is a lack of direction. And what we intended to accomplish with this is not being accomplished when half the audits are so poorly done that they are meaningless or they have tremendous flaws within them. And the whole goal for this hearing is to really hear the details of that, to ask for some explanations, and then I would hope that we would promise that we would be back to make sure there is improvement.

Senator Carper and I both are keen on making sure that every dollar we spend is spent in the way it was intended, and what we see from this sampling is that is not the case. So what we had hoped to achieve through your efforts in 1984—gosh, that was a long time ago—is not being accomplished. My hope is that we learn what we need to do better to be checking on it and what GAO and the IGs need to be doing better, and also that those that are out there that are receiving Federal funds understand this is going to get a lot tougher. You are going to have to meet the standards, and if you don't, there are going to be consequences.

We are going to borrow $330 billion from our kids this year—$330 billion. We have borrowed right now about $10 trillion, or close to $10 trillion, and they have got about $79 to $110 trillion worth of unfunded liabilities. There is no excuse for the Single Audit Act not to be working. I am committed, and I know Senator Carper is, to make sure that it is going to happen and you are going to have to help us make that happen. Thank you.

Senator CARPER. Dr. Coburn, thank you very much.

Before we introduce our witnesses, we have been joined by an interesting line-up there in the back of the hearing room, Dr. Coburn, as you can see.

Senator COBURN. I notice that we are protected well.

Senator CARPER. For folks who are following this on television, we have been joined by it looks like almost a dozen uniformed police officers. I don't know—— [Laughter.]

Senator COBURN. They are the guards who will guard the guards. [Laughter.]

Senator CARPER [continuing]. If they are here for us or what, but welcome. We know our police chiefs are here from the State of Delaware and we appreciate very much not only your presence here in our Capitol today—they are here for other meetings—but they are good enough to stop by to say hello.

Let me just say on behalf of all the folks in Delaware that Senator Biden and Congressman Castle and I are privileged to represent, thank you for all the good that you do for all of us. We are grateful for your service and we appreciate that you stopped by. I think they are going to try to get on a 3 o'clock train.

I used to be on the Amtrak Board of Directors and whenever there was a close call or we were just finishing up our work in the House or the Senate and I am on the run to catch the train, if we knew it was going to be close, we would call ahead and tell them I was on my way and they would leave without me. [Laughter.]

Senator COBURN. Good for them. [Laughter.]

Senator CARPER. They will leave without you guys, too, so you may want to hit the road pretty soon, but it is great to see you. Thanks so much for coming.

Our first witness today—actually, I have gotten more biographical details on these witnesses than I have ever seen or heard in any hearing I have ever conducted, so I am going to go through this, but we are going to do it fairly quickly.

Our first witness will be Hugh Monaghan. Mr. Monaghan serves as Project Director for the National Single Audit Sampling Project that is the focus of today's hearing. Welcome. Hugh Monaghan is Director of Non-Federal Audits for the U.S. Department of Education, Office of Inspector General, a position that he has held since January 2000. Based in Philadelphia, a suburb of Wilmington, Delaware, he manages all aspects of this Office of Inspector General's activities relating to audits required to be performed by independent auditors engaged by entities funded by the Department.

Mr. Monaghan began his Federal career in New York, New York, in 1971 with the U.S. Treasury Department, being in the Customs Service, as I recall, and also worked for the U.S. Department of Housing and Urban Development in Atlanta, Georgia, from 1976 to 1980. One last P.S. Mr. Monaghan is a Certified Government Financial Manager and a graduate of Lehman College of City University of New York. He also did graduate work in public administration at the CUNY branch of Baruch College. That is a mouthful about you, isn't it? That is more than I have ever thought we would learn.

Next we have Jeanette Franzel—welcome, Ms. Franzel is Director for Financial Management and Assurance at the U.S. Government Accountability Office (GAO). Among her responsibilities at GAO are areas such as internal control standards, grant accountability, government auditing standards, commonly called the Yellow Book—the other Yellow Book, I suppose.

Prior to joining GAO, Ms. Franzel worked in public accounting, providing auditing and accounting services to not-for-profit clients and clients that received government funding. Ms. Franzel is a Certified Public Accountant, a Certified Management Accountant, and a Certified Government Financial Manager. She is also Chair of the American Institute of Certified Public Accountants Government Performance and Accountability Committee.

Ms. Franzel has a Master's degree in business administration from George Mason University and a Bachelor's degree in accounting and Spanish from the College of St. Theresa. She has also completed the Senior Executive Fellows Program at Harvard University, and prior to her accounting career and auditing, she taught elementary school and high school in South America, and I am told that you are going to present your testimony today in Spanish. [Laughter.]

You probably could. I will let you interpret for me, my friend.

Next, Daniel Werfel. My testimony here says "Danny." Do you go by Danny?

Mr. WERFEL. I do go by "Danny."

Senator CARPER. All right. Danny Werfel is Deputy Controller and currently serving as Acting Controller of the Office of Federal Financial Management within the Office of Management and Budget. He is responsible for coordinating OMB's efforts to initiate Government-wide improvements in all areas of financial management. Mr. Werfel is responsible for coordinating the development of Government-wide policy on financial accounting standards, grants management, and financial systems.

Mr. Werfel holds a Master's degree in public policy from Duke University, a J.D. from the University of North Carolina—that is an interesting combination. We will let you explain that in your testimony—and a Bachelor's degree in industrial and labor relations from Cornell.

And finally, last but not least, Mary Foelster, Director of Governmental Auditing and Accounting (AICPA) at the American Institute of Certified Public Accountants, where her primary responsibility is to address government auditing and accounting matters. She oversees the activities of the AICPA Governmental Audit Quality Center and staffs both the AICPA Governmental Audit Quality Center Executive Committee and her State and local government expert panel. In addition to managing the activities of the Center and various technical projects, Ms. Foelster is also responsible for monitoring and analyzing Federal regulatory and legislative developments affecting auditing or accounting in the government environment.

Prior to joining the AICPA staff in 1993, she was in public accounting practice for 6 years. She is a graduate of the University of Maryland and a Certified Public Accountant.

I am told that in addition to the statements provided by our four witnesses here today, we have two additional statements. One, I think, is submitted by the National Association of State Boards of Accountancy and the New York State Society of Certified Public Accountants. With the concurrence of my friend, Dr. Coburn, those

statements will be made part of the record. Hearing no objection, all right.[1]

That is a lot of wind-up for a pitch for you all to make. Again, we are happy that you are here. We look forward to your testimony and we look forward to being able to ask some questions. Most of all, we look forward to figuring out what has gone wrong in what was, I think, a very good idea—single audits. What has gone wrong? How can we get it fixed? The American people expect nothing less.

Senator COBURN. Could I jump in here?

Senator CARPER. Yes, sir, please.

Senator COBURN. I am going to have to leave at 3:15. It is not because of anything you all have said, it is a commitment that I had. I had this hearing at 2. Most of them noticed I came at 2 and left. So I will be submitting a lot of questions for the record.

Senator CARPER. OK. Do you want to go right to your questions now?

Senator COBURN. I have them, but I will wait.

Senator CARPER. OK, fair enough. All right. Mr. Monaghan, you are on. Welcome.

STATEMENT OF HUGH MONAGHAN,[1] DIRECTOR, NON-FEDERAL AUDITS, OFFICE OF INSPECTOR GENERAL, U.S. DEPARTMENT OF EDUCATION

Mr. MONAGHAN. Thank you, Chairman Carper, Ranking Member Dr. Coburn, and Members of the Subcommittee. Thank you for the opportunity to testify about the National Single Audit Sampling Project that was conducted under the auspices of the President's Council on Integrity and Efficiency (PCIE).

I was Project Director and am here on behalf of Department of Education Inspector General John P. Higgins, Jr., who chairs the Audit Committee of the PCIE. This afternoon, I will summarize the project for you and try my best to keep it to 5 minutes. My written testimony provides more detailed information and I respectfully request that it be included in the record.

Senator CARPER. Without objection.

Mr. MONAGHAN. This afternoon—as you know, the Single Audit Act, as amended, requires an annual financial and compliance audit of most State and local government entities and not-for-profit entities that receive Federal assistance awards. It also gives the Director of the Office of Management and Budget the authority to prescribe implementing guidance. Under that authority, OMB issued Circular A–133, which describes how the audit must be conducted and reported on.

For many years, Federal agencies have conducted Quality Control Reviews (QCRs), of single audits to determine whether they were properly performed in accordance with the law and Circular A–133. However, selections of audits for these QCRs were not made based on statistical random sampling. Thus, it was not possible to accurately assess the quality of single audits overall from them.

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[1] The prepared statements of the National Association of State Boards of Accountancy and New York State Society of Certified Public Accountants appear in the Appendix on pages 77 and 82 respectively.

[1] The prepared statement of Mr. Monaghan appears in the Appendix on page 35.

The National Single Audit Sampling Project was conducted to fill that void. It had two goals: First, to determine the quality of single audits with statistically reliable estimates; and second, to make recommendations to address noted audit quality issues.

The project involved conducting and reporting on the results of QCRs of a statistical sample of 208 single audits randomly selected from over 38,000 single audits accepted by the Federal Government for the one-year period ending March 31, 2004. The project QCRs focused on the audit work and reporting relating to Federal awards. Audit work and reporting related to the general purpose financial statements was not reviewed.

For each of the 208 QCRs, we categorized the results in three groupings: Acceptable, limited reliability, and unacceptable. Acceptable included audits with minor deficiencies that did not require corrective action for the audit. Audits of limited reliability included those with significant deficiencies warranting corrective action to afford unquestioned reliance on the audit. Unacceptable audits were those with deficiencies so serious that the auditor's opinion on at least one major program could not be relied upon, or there was a material reporting error or omission.

Based on the results of the project QCRs performed on the 208 randomly-selected audits, we estimate that just short of half of the audits in the population from which the sample was drawn, 48.6 percent, were acceptable. Sixteen percent had significant deficiencies, and thus were of limited reliability. And 35.5 percent were unacceptable.

However, while we estimate that significant numbers of audits were not acceptable, audits reporting large dollar amounts of Federal awards were significantly more likely to be of acceptable quality than other single audits. The 208 audits we reviewed reported total Federal expenditures of $57.2 billion. Ninety-two-point-nine percent of this amount, $53.1 billion, were covered in acceptable audits.

Our report also describes the kinds of deficiencies we found and provides estimates of rates of occurrence. Based on our findings, we addressed our recommendations to OMB, recommending a three-pronged approach to improve audit quality to be implemented in consultation with other key stakeholders in the single audit process.

First, we recommend revisions and improvements in single audit criteria and guidance and pertinent auditing standards to address deficiencies we noted.

Second, we recommended that OMB establish minimum requirements for training on performing single audits as a prerequisite for conducting them and periodic update training.

And third, we suggested that OMB review and enhance processes to address unacceptable audits and not meeting established training requirements.

If these recommendations are adopted, we believe that the occurrence of deficiencies can be markedly reduced and significant improvement achieved in the quality of single audits.

This concludes my statement. I would be happy to answer any questions that you may have.

Senator CARPER. All right, Mr. Monaghan. Thank you very much.

Ms. Franzel, you are recognized for 5 minutes, more or less, and if you run a little bit over, that is all right.

Ms. FRANZEL. Thank you.

Senator CARPER. But don't go too far over because I want to make sure that Dr. Coburn has a chance to ask some questions before he has to leave.

STATEMENT OF JEANETTE FRANZEL,[1] DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Ms. FRANZEL. I will be very careful not to go too far over. Good afternoon, Chairman Carper and Dr. Coburn. I am pleased to be here today to discuss GAO's analysis of the PCIE's National Single Audit Sampling Project. GAO also has a written statement for the record, which I would ask to be submitted for the record.

Senator CARPER. Without objection.

Ms. FRANZEL. Thank you. I would like to commend the PCIE and OMB for conducting this important study. The single audit is a key accountability mechanism over the use of Federal grants. In fiscal year 2007, the Federal Government budgeted approximately $450 billion in Federal grants to State and local governments. Today, I will provide GAO's perspectives on the Single Audit Act, our preliminary analysis of the recommendations made by the PCIE, and additional factors that we believe need to be considered.

Congress passed the Single Audit Act in response to concerns that large amounts of Federal assistance were not subject to audit and at the same time agencies sometimes overlapped in their audit efforts. The Act adopted the single audit concept to meet both the needs of Federal agencies as well as grantees' needs for a single, uniformly structured audit.

The objectives of the Act also were to promote sound financial management and effective internal control over Federal awards, establish the Uniform Audit Requirements, promote efficient and effective use of audit resources, and reduce burdens on grant recipients. The 1996 Amendments added emphasis on establishing cost beneficial thresholds and focusing audit work on programs that present the greatest risk to the government.

As you know, Mr. Chairman, GAO supported the Single Audit Act and related amendments. We continue to support the concepts and principles behind the Act.

Regarding the PCIE study, we believe that the PCIE report presents compelling evidence that there continues to be a serious problem with single audit quality. Over the years, GAO and the IGs have identified concerns similar in nature to those in the recent PCIE report. As Mr. Monaghan described, the PCIE report recommends a three-pronged approach to correcting these problems: First, improved standards and guidance; second, establishing training requirements; and third, enhancing disciplinary processes for unacceptable audits.

While we support the recommendations made in the PCIE report, we believe that a number of issues regarding the proposed training requirements need to be resolved. For instance, what are the effi-

[1] The prepared statement of Ms. Franzel appears in the Appendix on page 45.

ciency and cost-benefit considerations for providing the proposed training? How can mechanisms already in place—for example, the AICPA's Government Audit Quality Center and others—be leveraged to implement the proposed training? And how will the training requirement affect the availability of audit firms that are qualified and willing to perform single audits going forward? Finally, how will compliance with the proposed requirements be monitored and enforced?

We also believe that two other critical factors that Mr. Monaghan mentioned also need to be considered in evaluating the proposed actions. The first factor is the rate of problem audits by size, with size referring to the dollar amounts of a grantee's Federal expenditures, and the second is the distribution of single audits by size within the entire universe of single audits.

The PCIE study found that the rate of problem audits was much higher for audits of entities expending less than $50 million in Federal awards than for the larger audits. The PCIE data also show that the vast majority of single audits, or almost 98 percent, were in the smaller stratum, which covered a relatively small dollar amount, 16 percent of the total. However, that was also the stratum with the higher error rate. So these are important considerations as we go forward and think about potential solutions.

To conclude, we believe that actions must be taken to improve single audit quality and the related accountability over Federal awards. We are concerned that problem audits may provide a false sense of assurance, and frankly, mislead users of those reports. We also believe there may be opportunities for considering these size characteristics when implementing actions to improve the quality of single audits. For instance, for a category of the smallest audits, there may be merit to considering whether a less complex but more effective audit approach could be used for achieving accountability through the single audit process.

Another consideration is strengthening the cognizant agency oversight for larger agencies, those that expend large amounts of Federal dollars, again, aimed at improving accountability over Federal dollars.

Considering the recommendations of the PCIE within this larger context is important in achieving the proper balance between risk and cost-effective accountability and good accountability. In addition, we believe a larger effort to review the overall framework for single audits may be warranted. This effort could include answering questions such as the following: Is the current Federal oversight structure for single audits adequate and consistent across Federal agencies? What role can the auditing profession play in increasing single audit quality? And do the specific requirements in OMB Circular A–133 and the compliance supplement, as well as the Single Audit Act, need modernizing?

Mr. Chairman and Dr. Carper, we will be pleased to work with the Subcommittee as it considers additional steps to improve the effectiveness of the single audit process and Federal oversight of grant funds.

Ms. FRANZEL. Dr. Coburn—I am sorry. I just promoted Mr. Carper to Doctor. [Laughter.]

Senator CARPER. He leaned over and he said, you just got promoted. I told him, I will take it.

Senator MCCASKILL. Dr. Carper, good to see you. [Laughter.]

Senator CARPER. General McCaskill, it is nice to have you on board today. [Laughter.]

You are just in time for Danny Werfel. Mr. Werfel, your entire statement will be made a part of the record. You are recognized. Try to hold it to about 5 minutes, please. Thanks.

STATEMENT OF DANIEL I. WERFEL,[1] ACTING CONTROLLER, OFFICE OF FEDERAL FINANCIAL MANAGEMENT, U.S. OFFICE OF MANAGEMENT AND BUDGET

Mr. WERFEL. First, let me begin by thanking Chairman Carper, Dr. Coburn, and Senator McCaskill and the rest of the panel for having this hearing today and inviting me to speak.

The single audit is the primary tool that Federal agencies use for overseeing the over $450 billion in grant awards going to non-Federal entities annually. Federal agencies rely on the single audit to verify that program requirements are being met, that strong internal controls for reducing waste, fraud, and error are in place, and that recipients are meeting their responsibility for reliable and timely financial reporting.

When these audits are done effectively, they surface important issues that result in improved management of Federal grant programs. When these audits are of substandard quality, Federal oversight efforts are weakened and there is greater risk that ongoing improprieties in Federal grant programs are not being detected or addressed.

The National Single Audit Sampling Project issued by the President's Council for Integrity and Efficiency and the Executive Council for Integrity and Efficiency brings into focus significant deficiencies with the manner in which these audits are conducted. OMB is committed and prepared to play an important role in ensuring that these deficiencies are addressed.

We have already begun to implement the report's identifications and identify further areas for improvement. We are beginning to draft amendments to OMB Circular A–133 that will provide additional guidance to auditors on how to identify major programs in their reports, to clarify the requirements for sample selections and when audit findings must be reported, and to emphasize the need to provide more specific documentation of audit activities and findings from major programs.

In addition to the amendments to the OMB Circular, we will help facilitate new audit training programs and requirements and will explore strategies for strengthening the accountability for those auditors who are failing to meet the minimum professional standards.

Beyond the recommendations from the report, we are pursuing additional measures to improve the quality and overall effectiveness of the single audit process. We want to evaluate approaches such as whether a more robust peer review process can be used to help ensure that minimum audit standards are being met.

[1] The prepared statement of Mr. Werfel appears in the Appendix on page 66.

We are also exploring the possibility of expanding and leveraging the single audit process to assess improper payments within grant programs. If we can leverage the single audit process, Federal agencies will have an important tool for obtaining cost effective improper payment error measurements.

We believe the single audit process can be instrumental in identifying and correcting noncompliance with laws and regulations, lack of internal controls, and other financial management deficiencies. We are committed to improving the quality of the single audit process, as I have testified today, and we will continue working collaboratively with Federal agencies, the Inspector General community, GAO, the AICPA, and State auditing agencies to accomplish this.

Thank you again for the opportunity to testify today and I look forward to answering your questions.

Senator CARPER. Mr. Werfel, thank you very much.

Ms. Foelster, you are recognized for 5 minutes. Your whole statement will be made part of the record, so please proceed.

STATEMENT OF MARY FOELSTER,[1] DIRECTOR, GOVERNMENTAL AUDITING AND ACCOUNTING, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Ms. FOELSTER. Thank you, Mr. Chairman, Dr. Coburn, and Senator McCaskill. I appreciate the opportunity to testify with the other representatives on this panel with whom we work regularly on improving the quality of single audits. With your permission, I would like to submit my written testimony and for now would like to summarize what that testimony says.

On behalf of the American Institute of Certified Public Accountants and its 340,000 members, thank you for the opportunity to testify here today. The AICPA shares the commitment of the Federal agencies involved in the study on the quality of single audits.

The PCIE report is based on audits that were performed primarily in 2002 and 2003, but after this time frame and long before the PCIE report was released, the AICPA on its own initiative has taken a number of very significant steps to improve the quality of these single audits. Indeed, the AICPA has been working at least as actively as anyone involved in this process to keep the quality of these audits as high as we can.

In recent years, the AICPA has further stepped up its commitment by adding new single audit-specific publications and single audit training. The AICPA also publicizes common deficiencies found by the Inspectors General and through the profession in various forums. We have established a semi-annual roundtable where we bring all the stakeholders together that are involved with these audits—the IGs, OMB, GAO, the AICPA, and members of the profession—where we can talk about the issues.

In September 2004, that is almost 3 years before the PCIE report was released, the AICPA took its most significant step by launching its Governmental Audit Quality Center. The Center's mission is to promote the highest-quality government audits, which include single audits, and to help CPAs meet the challenges of performing these unique and complex audits.

[1] The prepared statement of Ms. Foelster appears in the Appendix on page 70.

Center member firms are required to adhere to membership requirements that go beyond what they would have to do otherwise to perform these engagements. The Center is also a resource for best practices. It helps raise awareness about the importance of government audits and develops a community of CPA firms that demonstrate a commitment to the highest-quality government audits. Its website enables member firms to access information, guidance, and practical tools whenever they are needed. The Center also sends alerts to its members electronically with important news and developments. After this hearing today, we will be sending an alert to tell them what has happened at this hearing.

The Center's current membership of over 850 audit firms audits approximately 83 percent of the total Federal expenditures covered in single audits that are performed by CPA firms. The Center is also a resource for firms and government auditors who are not members. Anyone can access our website. A lot of the information is available to the public, and many Federal agencies are beginning to recognize this and actually give us information when important developments occur so that we can post it on our website. We also send electronic alerts at times to auditors that are not members of the Center.

The subject of this hearing is whether single audits help to safeguard taxpayer dollars. The answer is an unequivocal yes. The report indicates that more than 92 percent of the dollars of the Federal grants reviewed were in acceptable audits. Their value is undeniable.

The PCIE report indicates that there are some audit documentation and reporting issues, particularly in the smaller audits, that need to be addressed. The Subcommittee should be aware that those issues do not necessarily negate the benefits or outcomes of those audits. This is especially true for those audits where the primary issues were with documentation or reporting. However, all deficiencies need to be corrected regardless of whether they are technical or substantive.

For many small grantees, the audit is the primary, and in many cases the only review of Federal expenditures, and compliance with Federal regulations. In addition, audits have been shown to be an effective motivation for grantees to develop internal controls over their Federal expenditures to ensure compliance.

The PCIE report focuses recommendations almost entirely on the auditing profession, but meaningful improvements in single audit quality will only occur when all of the key stakeholder groups, that is the auditing profession, the procurers of the services, and the Federal agencies themselves, are involved in the solution.

The goal should be for all grantees to have robust governance structures that support the benefit of audits, consider the qualifications of a firm during the hiring process, and evaluate the reasonableness of the firm's anticipated hours and fees in relation to the work to be performed. Until the governance structure of these entities are addressed, the quality enhancements that we all seek will be much more difficult to attain.

The PCIE report shows a marked positive difference in the quality of the work performed in the larger audits. These audits are typically performed by larger firms, which tend to have greater in-

ternal resources to devote towards this complex and unique audit area. Another reason for the difference is the increased support by Federal agencies for large grantees and their auditors.

To make further strides in improving audit quality, more Federal agency support of the single audit process is needed. The AICPA is going to work cooperatively to explore how enhancements in the compliance supplement and other potential activities that might flow from additional Federal resources can improve audit quality.

We have reviewed the detailed recommendations in the report at a very high level regarding criteria and standards and other guidance. Seven task forces have been established to review the detailed recommendations in the reports and to make appropriate enhancements to guidance and standards.

With regard to continuing education, the AICPA has always been supportive of the existing requirements in government auditing standards and supports single audit-specific training. It is difficult to assess whether the recommendations to establish minimum education requirements as a prerequisite for conducting single audits and the proposed update training will help to resolve the quality issues cited in the PCIE report. We first need to better understand the extent to which the education of the auditors reviewed in the PCIE study contributed either to them being acceptable or not acceptable. The AICPA does appreciate that the PCIE recognizes us as a key organization to help in assisting development minimum content requirements for the training that might be required.

Finally, the report includes a recommendation to review and enhance processes to address unacceptable audits. We fully support a robust Federal enforcement process and the Federal Government's use of all tools already at their disposal for addressing unacceptable audits. This includes the current suspension and debarment process as well as the referral of auditors performing unacceptable audits to licensing agencies and professional bodies for appropriate discipline. Reviewing these tools to make them more efficient seems to be an appropriate course of action.

The AICPA is confident that our recent efforts, including the creation of our Governmental Audit Quality Center, are already beginning to address some of the issues raised in the PCIE report. We also looking forward to working with this Subcommittee as it continues to monitor these issues.

Thank you, and I am happy to answer any questions that you have.

Senator CARPER. Thank you very much.

I am going to recognize Dr. Coburn, for some questions to start off. He has to leave here in a couple of minutes. We may have a vote at 3:15, an amendment to the Amtrak reauthorization bill. We will see what the situation looks like. My intention, Senator McCaskill, would be to go to you next for questions or comments.

Senator COBURN. Thanks again for your testimony. Nobody there disagrees there is a problem. Does anybody disagree there is a problem?

[Witnesses shaking heads.]

Senator COBURN. OK. A couple of questions based on your testimony. There was a suggestion that maybe we ought to make the

requirements for tier two or smaller grants a different set of requirements. Does anybody disagree with that?

[No response.]

Senator COBURN. OK. Second question——

[Comment from audience.]

Senator COBURN. Well, I am asking them. Senator McCaskill has offered to educate us all on this. She knows it and I am anxious to learn that, but based on what their testimony was, I want to see what——

Mr. MONAGHAN. I just wanted to say, Senator Coburn and Senator McCaskill, I am testifying on behalf of the President's Council on Integrity and Efficiency. It is a group of very opinionated folks. They haven't had the opportunity yet to consider that specific idea, so I——

Senator COBURN. Well, how about you personally?

Mr. MONAGHAN. My personal opinion really shouldn't be said here. Do you want it?

Senator COBURN. Sure.

Mr. MONAGHAN. I think it is worthy of consideration, yes.

Senator COBURN. OK. Next question, should audit capability and demonstration of audit efficiency and demonstration of audit capability be a part of the request for any grant? In other words, we are doing it after the fact. Why shouldn't that be a requirement before the fact for grants?

Ms. FOELSTER. I personally think that any time the government is giving money to a grantee and asking them to have compliance surrounding what they are supposed to do with the money, that part of the process of the grantee hiring an auditor to audit those expenditures and how they have been spent should include some look at the qualifications of the firm and whether they have done one of these audits before.

Senator COBURN. Well, a lot of the grants, there is no requirement at all that you demonstrate that, so I am kind of going to the lower level. There is $450 billion worth of grants and a lot of them don't have—there is a requirement on the Audit Act, but there is no demonstration of proficiency before you apply for a grant, you have to demonstrate that you have either hired or have proficiency to complete the audit. Does OMB have any problem with that?

Mr. WERFEL. Well, I think, Senator, that you are correct that right now, we don't go to that level of specificity in terms of delineating that element of a grant award. Before we issue an award to a grantee, though, we do an assessment of the financial responsibility of that grantee. We look at their ability to carry out their duties as would be indicated in the grant——

Senator COBURN. Except for those that are not grants that are mandated through an earmark, right? You don't look at that capability when it is a mandate.

Mr. WERFEL. There are cases in which the agency that is issuing the earmark will go through a similar type of financial responsibility review. But generally, going back to the question of auditability, we do not go to that level, but that is something that could be worth exploring. As we review the issuing of the grant awards, we could focus deeper into this question of looking at their

capability, their willingness, their commitment to procure adequate audit services.

Senator COBURN. The whole point behind this, this idea of the guards guarding the guards, is if somebody knows up front that a requirement for receiving the grant is that you demonstrate that you have hired proficient auditors from a list. What that implies is they know what the requirements are and so therefore the grant is given conditioned that you know the auditing standard is in there from the start.

If you take up 92 percent of these as far as the money looked OK, that is just $36 billion on the $450 billion that may not look OK, and that is pretty worrisome. Thirty-six billion dollars would educate a lot of kids or take care of a lot of their health care. So I think it is a big problem.

On the CPA exam, when I said—I didn't pass it all the first time, I will admit that in front of this group—the auditing portion, but are there questions about government audits and the Single Audit Act in the CPA exam now?

Ms. FOELSTER. There are likely a few questions——

Senator COBURN. But not everybody is going to get one?

Ms. FOELSTER. Not necessarily. There is such a wide spectrum of topics that have to be tested, and these audits are very narrow, so that it would be a very limited number of questions.

Senator COBURN. OK. One other thing that you said, Ms. Foelster, was that many of them, just because they didn't pass the audit test, because there wasn't documentation there. The accounting that I was taught, if they didn't document it, it didn't happen. And everybody that goes through accounting knows that and that documentation is the number one thing to back up what the numbers are that you put there. So if they are not there, your testimony kind of lessened the impact. You may be right, but as far as an accounting standard, that number is meaningless unless there is the back-up data there for it, correct?

Ms. FOELSTER. One of the things that we have been doing through our Governmental Audit Quality Center is stressing this notion of having to make your documentation so specific that someone could come along and look over your shoulder after the fact and be able to understand what you have done——

Senator COBURN. They are supposed to be able to follow the trail.

Ms. FOELSTER. So the Governmental Audit Quality Center has been stressing this with our member firms and even non-member firms for the last 3 years.

Senator COBURN. So as you all have looked at this study, how much of it was incompetence of auditors versus negligence versus—let me rephrase it. In what was looked at, how much of it seemed to be incompetence versus negligence? Does anybody want to talk on that?

Mr. MONAGHAN. We attributed lack of due professional care as an overarching problem for most of the deficiencies and, as you know, Dr. Coburn, due professional care is a requirement of the auditing standards. I believe GAO in its written testimony has defined it rather extensively, and we believe that cross the board, it contributed to most of the deficiencies.

Senator COBURN. But if you are auditing a private firm and did that, a publicly-traded company, shareholders would have an action against you for that, is that not correct? Ms. Foelster.

Ms. FOELSTER. Yes.

Senator COBURN. That is an actionable failure of an auditing firm, correct?

Ms. FOELSTER. I don't know that it is necessarily relevant that it is a public company or not.

Senator COBURN. Well, OK. Public or private, the fact is, in the private sector, if you have an auditor that does not exhibit that standard, that is an actionable item.

Ms. FOELSTER. Yes, and we fully support a robust Federal enforcement process for these kinds of engagements that are found and look forward to working with the agencies to help improve that process if it is needed.

Senator COBURN. OK. Yes, ma'am.

Ms. FRANZEL. One of the dilemmas, I guess, that we saw when we analyzed the results of the PCIE study was this conclusion, which I believe is probably on track, that many of the problems were caused by lack of due professional care. What that means is the auditors did not take enough care and attention to following standards, and we questioned then to what extent would improved guidance and additional training cause auditors to care more and to do a better job.

Now, one element of the recommendations could help in that the additional training would be a prerequisite, so auditors could not do the audits unless they have gone through this training regimen, and in that manner you may limit the universe of auditors to those who do want to take the time necessary to become qualified.

Senator COBURN. Is there the attitude out there that this is not as important as the ones in the private sector?

Ms. FOELSTER. My experience in working in this area for 14 years is that many firms are trying to do this correctly. I did many of these audits when I was in practice and they are complex. So I think that in many cases, it is just a lack of understanding, potentially, of the detailed requirements of the OMB Circular and the compliance supplement and all the underlying laws and regulations.

Senator COBURN. So do you think the audit firms that do this really don't know the rules that they are——

Ms. FOELSTER. Yes, and we gave an example in our written testimony of a firm that might have a very wide, diverse practice and all of a sudden their local government client gets $550,000 and they are thrown into having to understand how to do these engagements. The recommendation from the PCIE is that you need 16 to 24 hours of training before you can even do that.

Senator COBURN. So why shouldn't we, going back to my original question, why shouldn't we say, if you are going to be engaged in this, then you have to be certified as having had training?

Ms. FOELSTER. I think the whole procurement process is something that needs to be looked at in terms of these engagements.

Senator COBURN. I will stop at that, and the rest of my questions, I will submit.

I want to thank each of you for being here. My son-in-law is going to be real happy that I had Danny Werfel, the quarterback, in front of me today—— [Laughter.]

And I can't wait to tell him.

Mr. WERFEL. I will sign a ball for him.

Senator COBURN. Thank you. [Laughter.]

Senator CARPER. Thanks, Dr. Coburn.

We are about 5 minutes into a vote, and I think my inclination, if we were to start, we wouldn't get very far and I would have to run and vote, as well. I asked Senator McCaskill to return once she has concluded that vote and to Chair the Subcommittee hearing until I return. I will be back about suppertime. [Laughter.]

No, I won't. I will be back shortly. I should be back in about 15 minutes. But I would ask that we stand in recess and I expect that Senator McCaskill will be back in 5 or 6 minutes. Thank you again very much. We will see you in a few minutes.

[Recess.]

Senator MCCASKILL [presiding.] Thank you for giving me enough time to dash over and vote.

Let me start with talking about peer review. Mr. Monaghan, what is your sense of the deficient audit firms—and first, before I say that, what I wasn't surprised about in the material I read for this hearing was what a great job the government auditors were doing. In my experience, I have found that government audit work is usually done very well by government auditors. It is what they do.

Whereas with Sarbanes-Oxley and a lot of other pressure out there in the marketplace, private CPA firms have either primarily had tax practices or they have migrated over into the world I call consulting, and frankly, those that had government audit shops in terms of contracting government audits, many of them have closed because there is not the profit margin there that there is in the other areas of the CPA practice.

So when I was trying to privatize, we were required in Missouri to do county audits in about 90 of Missouri's counties, the smallest Missouri counties, and I was trying to figure out a way to more efficiently and effectively do that in terms of travel costs. Of course, I was having to send an audit team down there to stay in a hotel to do the field work for as long as 2 to 3 weeks, and I thought, well, rather than do that, why don't we competitively bid those to private firms, and if we could find a firm that wanted to specialize in doing that in a smaller region of the State, it would be a win-win for the taxpayers.

And that worked, but there were struggles, and one of the things we had to do was we were doing quality control. My government auditors, the ones who had done county audits as their bread and butter for years and years, were looking at the audit work and the product and reassuring themselves—and the work papers—and reassuring themselves that the product that was being produced was, in fact, a good product.

Now, I know the kind of stress we had in our shop when it was time for peer review. I also know the kind of stress it caused me when I had to send my folks out on peer review, because inevitably, the auditors that were asked to go to do peer review in other juris-

dictions were some of my best auditors and I hated losing them for the period of time that they had to go peer review.

Tell me what the status is of peer review on the audit firms that have been doing this government audit work where you found the deficiencies.

Mr. MONAGHAN. Senator, we did not look at the peer review process other than to try to obtain a copy of peer review reports for the project selections that we made. I can tell you this. A last-minute change was made in the agenda of an annual AICPA conference on peer review that they hold, and on October 1, I spoke there. They actually changed the agenda for me to speak because this is a conference that brings together the key folks who are involved in peer review for the AICPA throughout the country, and they were very interested in hearing the results of this report.

So I do know they are interested, and that they set up a task force—Ms. Foelster can speak to that. I was reading in her testimony that they had set up a task force to look at enhancements to the peer review process to address the single audit area.

The other part of your question, Senator?

Senator MCCASKILL. Well, I guess what I am struggling with is I assume the majority of these firms, these private CPA firms where these audits were found to be unreliable, I am assuming the majority of these are smaller firms?

Mr. MONAGHAN. As we indicate in our report, we divided the sample into two strata, large and small firms, and there was a higher incidence of unacceptable audit work—excuse me, not by firms——

Senator MCCASKILL. Right.

Mr. MONAGHAN [continuing]. But by the size of the audits measured by the Federal dollars that are reported in the Schedule of Expenditures of Federal Awards. We did not stratify the sample in any way other than the dollars reported in the Schedule of Federal Awards. So, for example, we did not gather information about size of firm and report results by size of firm.

Senator MCCASKILL. Was there any data that you gathered or that we could look at as to the locations of these in terms of metro versus rural areas?

Mr. MONAGHAN. We did not stratify the sample by geography, Senator.

Senator MCCASKILL. I think those are a couple things that we need to look at. I think that AICPA, you guys need to look at it in terms of a professional trade group, in terms of your professional organization, and obviously OMB. It seems to me, I mean, if I had to just use my instincts, having done a whole lot of audits in very small places and a whole lot of audits in very big places, that where we struggle to find CPA firms that were ready on a dime to do an A–133 audit, it was in the metropolitan areas. It was the big firms that had an ongoing basis of government clients, whether they be large school districts or large universities.

But when you get into these $500,000 awards to a local road district or a local health care center—what about the cognizant agencies for these? What kind of responsibility at OMB are you instructing the cognizant agency for their oversight on the quality of

the audit work that is being done in the single audit for these smaller awards?

Mr. WERFEL. The cognizant agency has a clearly delineated responsibility to do the Quality Control Review, to play this role, as I think Senator Coburn said, audit the auditors, or police the police, and these Quality Control Reviews are carried out.

One of the things about the Quality Control Review process today, though, that we are looking at as a result of this study is that each agency approaches Quality Control Review differently. Some may in their deliberations and decisions say, you know what? Let us go after rural, small audit firms because we believe that they are going to lack some of the Federal expertise necessary to do a government audit, and an agency down the street might say, no, we are going to go look at the higher dollar, we are going to look at the big audit firm, and really, because it is higher volume, higher dollar, do a deeper dive with the bigger audit firm.

What we don't have is a consistent standard across Government, across these cognizant agencies and the Inspector Generals within these cognizant agencies, for how we think about Quality Control Reviews, and that is something that we have started as a result of this study, started discussions with the Inspector General Audit Committee to start thinking about what parameters might we put into Quality Control Reviews so there is more predictability and cohesion as the government moves forward, and we might decide that one of the parameters is to look at it by rural versus urban, small versus big, and therefore make sure we have sufficient coverage of Quality Control Reviews. But without those parameters right now, we really have each agency individually deciding and I think there is some benefit to exploring a more—to still maintain agency flexibility, but have some more parameters across government.

Senator MCCASKILL. Couldn't you fairly simply in a straightforward way just say, the cognizant agency must do a random sample of a variety, and maybe just a review read? I mean, a lot of these deficiencies would jump out at you if you did government auditing work. We are not talking about having to go into a complete peer review where you are reviewing every work paper and every review, but rather a read and—I don't know, how deep did you all go in terms of these studies? What was the scope of your survey as it related to the reliability of these audits?

Mr. MONAGHAN. Senator, for the 208 audits that we reviewed, we did a very thorough review of the portion of the audit relating to the major Federal programs that we selected. In small audits that were selected—most small audits only cover one or two or three major programs and——

Senator MCCASKILL. Right.

Mr. MONAGHAN [continuing]. We looked at every one of them. If it were a larger audit and we had more than three programs, we randomly selected three and our results are based on that.

There was an in-depth look at, for each of the selected major programs, whether the auditor did what the rules require them to do as documented in their working papers.

Senator MCCASKILL. So you basically made sure that they were following the Yellow Book. Did you actually look at their sampling methodology and all of those things?

Mr. MONAGHAN. Of the 208, we did look at 50 audits in terms of the depth of audit testing. We looked, though, very thoroughly for every one of the 208 at the work that was performed as documented pertaining to the compliance requirements that they are required to do for major Federal programs under the rules that OMB sets forth. OMB has a compliance supplement that addresses exactly what must be addressed in the single audits and we used that as the guide post, if you will, for evaluating what was performed by the auditor as documented.

Senator MCCASKILL. It seems to me that OMB could make a decision, and working with GAO and working with Mr. Monaghan's group, come up with a straightforward requirement that the cognizant agency must do the following in terms of quality control. And there are some efficiencies that could be gathered.

For example, in most States, I think, there is someone who is doing a single audit for the State Government. Our cognizant agency was HHS in Missouri. If we had been asked by the Federal Government to provide a review service for agencies in Missouri that were receiving Federal funding, there were some efficiencies we could gain.

For example, if we were going in to do a county audit and there was a school district there that had had difficulty finding competent government auditing services at a reasonable price, I think we could in a very straightforward way charge a very reasonable amount while the auditors were down there to do field work and provide that audit service as long as—we were compensated by local governments all the time for petition audits. When local governments would petition us, we would go in and do a government audit for them and we would charge them, and it was a very reasonable amount because, of course, we were just doing time and travel expenses. We weren't doing—there was obviously no profit involved.

It seems to me that there are all these government auditors out there that could either by helping do these audits on a contract basis, as long as they were getting compensated for them—you can't do an unfunded mandate—or in the alternative, assist with the quality control in terms of a peer review. Has any of that ever been discussed in terms of looking at the single audit, improving this reliability?

Mr. WERFEL. It has been discussed, both elements. It is just that it has been discussed more recently, Senator. The results of these studies got the dialogue going with OMB and the Inspector General community and the cognizant agencies on these issues.

But I think you are exactly right. If we can integrate subject matter expertise on government auditing into both the peer review process and the Quality Control Review process, you are going to see better results in terms of identifying smart things that can be done at the local level to improve these audits.

In my written testimony in particular, even though it was not a recommendation in the report, we specifically pointed to the peer review process as something that could be strengthened. Clearly, the results indicate, when you have in a small strata, the small audits, that high incidence of unacceptable audits, something is not going right. We feel pretty safe drawing the conclusion that some-

thing is not going right with the peer review process. Either the peer review process isn't uncovering problems and then helping to ensure that they are being addressed, or there is some kind of data communication not being understood, that the peer review process is uncovering problems and that is not getting back to the cognizant agency and they are not taking action to do something about it.

So we are very serious about looking at the peer review process, and your point about integrating government auditing expertise into that so that the peer review—I don't know if it helps that much if an audit firm that has limited government experience is being peer reviewed by another audit firm with limited government experience.

Senator MCCASKILL. Well, you can't do that.

Mr. WERFEL. Yes.

Senator MCCASKILL. You have got to send in people that know what they are doing.

Mr. WERFEL. Exactly.

Senator MCCASKILL. Well, what we found, and one of the ways we kept the cost down, which is another efficiency you could do here, is we said to the audit firms we hired to do these county audits, we will give you our scope. We will give you our plan. We will give you all of basically what a new auditor in our office was given in terms of what they needed to do in these county audits. So we almost provided the training for them.

And, of course, once these audit firms began doing these audits, and especially with our help at the beginning, they got pretty good at it. It is a little bit like if you audit somebody four or five times for control, by the time you do it the fourth or fifth time, they usually have segregated control. So they got it and they started doing these in a pretty efficient way at a very low cost to the taxpayers and we ended up saving a lot of money for the State of Missouri in terms of how those audits were done.

All those things could easily be done. Has anybody thought to call in a group of State audits so far to talk about perhaps involving them in solving this problem, because I think the capacity is there.

Mr. MONAGHAN. Senator, in making our recommendations in our report, they were addressed to OMB, but we also recommended that they be implemented in concert with other key stakeholders, and as I know you know from the report, we specifically mentioned——

Senator MCCASKILL. Right.

Mr. MONAGHAN [continuing]. The State auditors' National State Auditors Association.

Senator MCCASKILL. Right.

Mr. MONAGHAN. You mentioned training, Senator. That is a critical component and our recommendation, just to emphasize, recommends that there be comprehensive training required as a prerequisite, which is essentially what you said you did in Missouri, Senator, for any auditor doing a single audit, and there is another recommendation in there that I didn't address in the testimony that the procurement requirements in A–133 require that only

auditors who have completed the comprehensive training can be engaged to do the audit.

And finally, just one other point, and you mentioned the CPAs in the rural areas. Many of us are very sensitive to that, and you will note in our last recommendation in the second prong in mentioning the delivery of this training, we encourage that the training be delivered in ways that enable auditors throughout the United States to take the training at locations near or at their places of business, including technologies such a webcasts, and that was specifically made with in mind that you have CPAs that are far away from large cities where training might normally be given.

Senator MCCASKILL. Does AICPA have specific coordination with government auditors in the 50 States to provide CPEs particularly in this area?

Ms. FOELSTER. We often involve the State auditors in many of the activities that we carry out, including our training programs. They are often presenters at some of our AICPA conferences. I have a contact with the National State Auditors Association through their executive director, so we do have a lot of interaction with that organization.

And I would just like to follow back to the peer review comment that Hugh had made. I did just want to make clear that we do have a task force at the AICPA that has been established to look at our practice monitoring program and any enhancements that could be made to it as a result of the results of this study. So I didn't want that to get lost in the discussion.

Senator MCCASKILL. I guess, would it be possible to find out, and if so let me know, if, in fact, there are CPE hours offered in all 50 States on government auditing?

Ms. FOELSTER. Sure, and the State CPA societies offer CPE, too.

Senator MCCASKILL. Right.

Ms. FOELSTER. The AICPA is not the only one that offers CPE. Each State society offers CPE and I could certainly find out and give you a schedule, high level, of whether they do or do not. My guess is because government auditing standards has included a requirement for 24 hours of specific training and then 80 hours every 2 years that most States are offering some sort of training that would meet the requirements of government auditing standards.

Senator MCCASKILL. I would love to see what is the current state-of-the-art tapes that are available on government auditing. I will admit in this room that when I became State auditor, I had no idea about being an auditor. I was not as proficient as I then became after serving 8 years in that job. My background was as a prosecutor, not an auditor. And so when I found out that I had to have CPE, it was a very sad day for me—— [Laughter.]

Because, of course, I was signing the audits. Even though my deputy was a CPA and statutorily could sign the audits, in order for my name to appear on them, I had to have a CPE and so I had to watch a lot of tapes and they were terrible. These were really boring, awful things. It was like taking the worst medicine you could possibly imagine for somebody who can't sit still, and I have a hard time sitting still.

So who is producing the state-of-the-art audio-visual material for training for government auditors at this point?

Ms. FOELSTER. I can just say from the AICPA's perspective, I am actually involved in some of the training that we do. We do a lot of webcasts where CPAs can actually sign on live sitting at their desk at their computer and view an interactive discussion of the issues at hand. We do videos. We also have group study that is offered through the States. We have self-study programs that CPAs can get to obtain their CPE requirements. So there are all sorts of different venues and opportunities for CPAs to get their education.

Senator MCCASKILL. Well, I was so incredibly blessed to work with auditors who had been doing their work for literally decades under many different bosses of many different political parties and they stayed at that office because they were the consummate professionals. The man who was in charge of the single audit in Missouri, who is still there, he could easily help probably 99 percent of the audit firms that you found to be deficient because he could do this stuff in his sleep.

And he would probably want me to say that he doesn't think OMB is being proactive enough in terms of providing assistance. He doesn't believe that OMB has, and I hate to do this to him because now his cognizant agency is probably not going to give him the extension he needs, and isn't it about that time of year——[Laughter.]

That he needs for the single audit, and we usually needed an extension, minimum usually, but some extension every year. But I think he would say if he were here that in his experience, which is probably now 25 years of being responsible for the single audit—well, it is not 25 years, because we haven't had it that long, but since the beginning of the requirement, he has been in charge of it, and I think he would say that OMB has not been proactive, that they have not been available to proactively reach out and force the cognizant agencies to provide more oversight in terms of the quality of the audits that are being done, particularly those in the private sector.

Whatever paths you all take forward on trying to solve this problem, I hope you will continue to keep this Subcommittee informed, and I certainly, in my office, have a personal interest in trying to be as helpful as I can. I have an awful lot of respect for the people that are doing this work and I want to be as helpful as possible. Thank you very much.

Thank you, Mr. Chairman. I stretched to get you here, because it is hard for me to be mean to these guys. These are people—I can be mean to some witnesses, as you have probably noticed, but I want to be nice to these guys——

Senator CARPER [presiding.] And don't be fooled——

Senator MCCASKILL. I want to be nice to the auditors.

Senator CARPER [continuing]. There is not a mean bone in her body.

Senator McCaskill, thank you for presiding and for asking, I am sure, a lot of good questions.

I apologize to the Subcommittee. It is rude for the Chairman to leave even in the middle of a vote, but the bill that we are debating on the floor is a bill that I have helped co-author, the Amtrak reauthorization, and the amendment to the bill that is up before them right now is language in another bill that I wrote, so they needed

me to be there for a little while to try to help work things out and I think we made some progress. I am sure you made progress here, and with Senator McCaskill here, you probably didn't miss me at all.

Let me just come back, and one of the questions I want to ask, it seems to me when we talk about the amount of money involved in these single audits, I think I have heard the term $450 billion thrown around. I understand from your testimony that the larger dollar volume audits are generally done pretty well. They tend to be more acceptable. The smaller dollar items are less acceptable, as it turns out.

In reading between the lines, and maybe reading the lines, I gather that the lion's share of these Federal dollars, if it is $450 billion, that the lion's share of the dollars in the Federal funds are being audited in a single audit approach in ways that are acceptable. They are not degraded. They are not unacceptable. Could somebody talk to me about that?

Mr. MONAGHAN. Well, the numbers that are presented in our tables of the report would indicate a much higher incidence of acceptable audits in stratum one, which is the larger dollar amounts, and what we did for the 208 audits that we looked at, was present a correlation between the groupings and the dollars reported in those audits. But each audit is an individual audit and there were some in the large strata that were not acceptable and there were almost half in the lower strata that were. So that should be mentioned, as well.

Senator CARPER. Let me just ask you my question in a little different way. Listed in the amount of money involved here is $450 billion on an annual basis. Of that $450 billion, can you say, given the work that you did on the 208, looking at the 208 audits, what percentage of the dollars were audited in audits that were found acceptable?

Mr. MONAGHAN. For the 208 audits that we looked at, of all the reported dollars for both strata, it was 92.9 percent that were reported in audits that we characterized as acceptable.

Senator CARPER. All right.

Mr. MONAGHAN. So the total.

Senator CARPER. Now, out of that 208, the dollar value, it was basically that these audits said these programs were OK, the monies were being spent in appropriate ways. So in about roughly 7 percent, that was not the case.

Mr. MONAGHAN. The percentages that we indicate that were not in the acceptable category relate to the dollars reported in audits that we judged were not acceptable. It does not mean that those monies were misspent. It means that the auditing, the accountability of those monies was deficient in those audits, but not that the money was misspent.

Senator CARPER. Does anybody else want to amplify on this, because otherwise I will follow up with my questioning. Ms. Franzel, and then Mr. Werfel.

Ms. FRANZEL. I do want to caution about that 93 percent, and that is because we are talking about apples and oranges here, but it is the only thing we really have to go on to give us a general

feel for dollar coverage. The universe used by the PCIE consisted of $880 billion——

Senator CARPER. Help me reconcile the $450 billion and the $800-and-some-billion dollars. I don't understand.

Ms. FRANZEL. The $880 billion was the total dollar value of expenditures in single audits that were accepted during the one-year time. There is a lot of double-counting of money in that $880 billion, so that is why it is so much bigger than the $400 billion or so in grants, because——

Senator CARPER. I am sorry, just start that sentence over again. There was a lot of——

Ms. FRANZEL. A lot of, I am going to say, double-counting of Federal expenditures because in some cases, the money goes to the State and then the State gives it to a local government. Both the State and the local government are having audits of those dollars, and so that is why the universe that was used was $880 billion, because that is the total universe of audits. That is not the total universe of grant monies.

So to the extent that for the larger audits, with money going to the State and then large chunks going to large cities, that money might be getting double-counted. So I just wanted to offer a caution, and I know that the statistical methodology was not designed to do that sort of conclusion——

Mr. MONAGHAN. This gets into a very technical area of statistics, Senators. We do, in presenting this data in the report itself, and I would give attention to the chart at the bottom of page 40 of our report, we do disclose the—Ms. Franzel describes it as the double-counting. It is attributed to money passing through the State Government. For example, in my Department of Education, most of the money going to local school districts passes through the State Department of Education. It is audited there in the single audit at the State Department of Education.

But the auditing there is limited, for the most part, because that money is spent ultimately at the school district level, it is audited at the State education agency to see that the State education agency is discharging its responsibilities for those funds which are ultimately expended at the local school district. And it is audited again at the local school district level, which is on the second tier, the stratum two of these audits.

Senator CARPER. All right. Mr. Werfel, you were going to add something to this, weren't you?

Mr. WERFEL. What I was going to add, Senator, is that we are taking a look at this from, I think, both angles. Clearly, it is encouraging that 93 percent of the awards were covered by acceptable audits and that tells us that there are certain elements and ingredients of what we are doing in those situations that are working. The cognizant agency reviews, the quality assurances that we are doing, the peer review process is having an impact and assuring good quality audits.

On the other side of that, when we deal with these big dollars, and my office has testified on many cases in front of this Subcommittee that in the Federal Government, even a 1 percent or 2 percent error rate is billions of dollars, and in this case, if you look

at the $450 billion, just to keep it easier, and you look at 7 percent of that, you are over $30 billion.

So we are very concerned about that and what we want to do is see if we can start to bridge some of the good things that are going on in the 93 percent and make sure they are spreading into the 7 percent. The 93 percent tells us we can do this. We can sustain a single audit process with acceptable audits. The question that we have now is how do we start to close that gap, because a 7 percent error rate, if you will, is unacceptable to us and we want to try to minimize that as much as possible.

Mr. MONAGHAN. Senator, I also think it is important, since this testimony is going on the record, to emphasize that for those projections, there were no projections made to the universe for the dollars. Our report reported that for the 208 that we looked at, whereas for the numbers of audits, those were statistical projections. We used a technique called attribute sampling to assess the quality of the audits. We did not do estimation sampling to project to the entire universe the dollar effect. That would have required a much larger sample than we were able to perform.

Senator CARPER. All right. Thank you. Before we move on, I have another question I want—in fact, several questions. Before we move on, this is my understanding for this discussion. Out of this, we will say it is $450 billion, not $880 billion, but out of the $450 billion, in terms of dollar volume, a little more than 90 percent appears to have been audited in programs that the audits were found acceptable. Close to 10 percent were not, and as Mr. Werfel suggested, that is no small amount of money.

I am still confused on this. If you actually looked at the number of audits out of the 208 that were done, was it roughly half of those audits were just unacceptable for just one reason or another, or over a third?

Mr. MONAGHAN. There are significant differences between the large audits and the small.

Senator CARPER. The number 35 percent sticks in my mind from your testimony.

Mr. MONAGHAN. Yes, it is. Senator, you are absolutely correct. For both strata together, the number of unacceptable audits were 35.5 percent. For some of those in stratum one, they were unacceptable because of—this gets very technical—a material reporting error that was made where the auditor erroneously said that they audited a major program as such but had not, and we considered that unacceptable. It may have been a very simple mistake, but in the end, the only product that the user of an audit uses is the report itself. So they may have relied on that mistaken reporting. When you bore down into the data that we have, in stratum one, the audits that are purely substandard as opposed to just with the material reporting errors are 14.6 percent of that strata.

But to be simple, overall, for the entire sample, a little more than a third of the audits were unacceptable. There was an additional 16 percent that were of limited reliability, and 48.6 percent that we found to be acceptable.

Senator CARPER. Why is there this apparent incidence of larger volume audits, fewer problems, smaller dollar volume audits, bigger problems. Ms. Foelster.

Ms. FOELSTER. Well, I think, generally, the ones that have the higher-volume Federal expenditures running through them, the entities themselves probably have stronger governance structures, so when they are actually going through the hiring process with the firm, they have procedures in place to ensure that the firm has the appropriate qualifications. I think, as Mr. Werfel said, that there is more oversight of those entities by the Federal agencies themselves monitoring not just the grantee, but also the auditors through the QCR process. And finally, those firms that do those engagements are likely to be larger, have more staff and resources to have the ability to ensure that they do understand all the rules and requirements for doing these engagements.

Senator CARPER. Anybody else on this point?

Mr. WERFEL. The only thing I would add, Senator, is that from our experience, from OMB's vantage point, there is always a tradeoff when you do things on a risk management basis and you focus additional energy and effort into the higher dollar, higher volume areas. That is—we believe that is the right thing to do. It is a smart thing to do. You get a better return on investment for the taxpayer. But as you shift resources into that higher-risk environment, you are by definition shifting resources and attention away from the lower-risk areas and the lower-dollar areas.

What this study, I think helps us see and crystallizes for us is that tradeoff in action. We see a lot of the agencies really digging deeper and doing more due diligence with respect to the quality of audits in the higher dollar volume areas. What I think we need to think about going forward, and I think GAO and Ms. Franzel's testimony does a good job of teeing up the issue if there is a better framework out there so as we transfer resources and focus resources, as I think we should, into the higher-risk areas, is there a framework that we can establish better in the lower-risk areas that can ensure better results, and I think that is the challenge that we have coming out of this report.

Senator CARPER. OK. Thank you for those responses. Senator McCaskill, did you want to jump in here again?

Senator MCCASKILL. No. Basically, I think the testimony is pretty clear. We have got work to do and I think this has been a wake-up call. We have learned that just because there has been an audit doesn't mean that we should rest our heads on the pillow at night assuming that the audit has accomplished its goal. The helpful thing about this study is that we now know a lot more about where we need to be focusing and auditors are really good at determining where is high risk.

So nobody can have the excuse when we revisit this in 18 months or whenever we come back to it that all the stakeholders now don't understand that there is a risk that has been identified, and I know that there are mechanisms in place, particularly if you reach out to State and local government auditors to be helpful with this. I think that could really be the key for the Federal Government to do this effectively, and I will say that as bias, I am not sure that the Federal Government always does that reaching out to local and State officials as aggressively as they should. There is a tendency, I think, sometimes for all of us that hang out up here to think that we know best and there is a great pool of talent out there that is

waiting to be helpful on this, and I think if we harness it, we can do it more effectively and more efficiently.

So I just thank all of you for your testimony today. I think it has been very helpful.

Ms. FOELSTER. Senator, could I just quickly add, I wanted to say that we have established seven task forces at the AICPA to deal with all the specific recommendations and we are inviting someone from the State audit community to participate on every single one, including CPE. So if that contact that you mentioned that has experience with training is available as a resource, I would love to get that name from you.

Senator MCCASKILL. That is great. He will remind me that I can't tell him what to do anymore, but I will definitely call him.

Ms. FOELSTER. OK. Tell him that we are looking for volunteers——

Senator MCCASKILL. And frankly, there are a number of people there that I think could be very helpful. So I will reach out to them and make sure that they are participating. You will find, Mr. Chairman, that one thing that auditors do, they take audit recommendations more seriously than people who don't audit, because they are all very frustrated because they issue their audit findings and when they get ignored, it is very frustrating. So I have a feeling that this particular group will take this seriously and will make some progress, so thank you all.

Senator CARPER. Thank you, Senator.

A couple more questions. Let me just ask, and I think this would be for Mr. Werfel——

Mr. WERFEL. Senator, my staff has been teasing me. I think I misspoke at the beginning. I was a little nervous and my throat constricted. It is actually "WER-fell."

Senator CARPER. My staff has underlined "Wer," and you said "Wer-FELL," so—— [Laughter.]

Mr. WERFEL. I finally got the courage to correct you. It only took about—— [Laughter.]

It only took about 90 minutes, but——

Senator MCCASKILL. By the way, the other thing you need to know about auditors, they don't loosen up easily. [Laughter.]

It takes a little bit. They take this stuff really seriously.

Senator CARPER. You seem to have gotten over that.

Senator MCCASKILL. Well, I was not an auditor by trade, but they take it all very seriously, as they should.

Senator CARPER. All right. Well, let me just say to Ms. Franzel, while changing accents on the syllables, did you want to stay with "Fran-ZELL," or——

Ms. FRANZEL. "Fran-ZELL" is the correct pronunciation.

Senator CARPER. Good. All right, Mr. Werfel, are you concerned that the audit quality problems that were cited in the PCIE study might either be masking or leading to improper payments, something this Subcommittee is interested in, in some of these programs? And a second sort of follow-on to that would be, what have you all been doing at OMB to follow up on any findings by the cognizant agencies?

Ms. FRANZEL. The first question, I think, is a very important one, Senator. The Improper Payments Information Act, as you know, is

a very challenging law to implement and the single audit happens to be one of the tools that agencies use, and they use it in two key ways. The first is one of the first things the Improper Payments Act asks agencies to do is to designate high-risk programs versus low-risk programs, and the high-risk programs are the ones where agencies are going to invest time, energy, and resources into tracking and improving. For the low-risk ones, agencies going to divert energy away from those for improper payment purposes. And the single audit findings and what we learn through the single audit is critical to helping agencies decide what is high-risk versus what is low-risk. So to the extent the quality of the single audits are substandard, I think diminishes the agency's ability to distinguish between high- and low-risk programs.

Second, when agencies go out and measure improper payments for programs, and when they learn what these error measurements are, they want to understand what the root causes of those errors are. And so they use that measurement approach to do so. But it is not the only tool they have to figure out what are the root causes of error. The single audit in many cases provides a much deeper dive. You really get down to see in this case, for this locale and in this scenario, here is how the payments were paid out improperly. And while that individual case isn't a statistically national estimate, it does inform on whether or not the right corrective actions are in place to drive improper payments lower for the program as a whole.

So with this critical role that this Single Audit Act plays, if we are seeing deficiencies in the way it is being carried out, we are concerned that, as your question posits, that we are seeing—we will see weaknesses in the ability for agencies to implement the important law of the Improper Payments Act.

Senator CARPER. OK. Good enough.

Mr. WERFEL. And you had a second question.

Senator CARPER. The second question was I had asked what have you all been doing at OMB to follow up on any findings by the cognizant agencies.

Mr. WERFEL. Well, there are several things—the way I am going to start thinking about OMB's role with respect to the single audit might be our approach pre-this study and post-this study, because I think we need to transition into a different approach based on these results.

Before this study, what we did and what we continue to do is look at programs at a higher level through things like the Improper Payments Initiative. We are requiring agencies to measure their error rates, give us their corrective actions. We monitor those, we hold them accountable for those, and we see the results of those going down throughout the year.

The same thing with the financial statement audit. With the financial statement audit, we have taken a very direct role in holding these agencies accountable under the President's Management Agenda. We get every agency's corrective actions in, and in some cases, those relate directly to the issues that the single audit is bringing up—grantee oversight, in some cases, concerns with how agencies are overseeing grants, enter into financial statement audits. So OMB is there holding agencies accountable and pushing for

improvements, and we have seen improvements at agencies such as the Department of Transportation and the National Science Foundation. We have seen them over the last 3 or 4 years strengthening their oversight.

What we haven't done historically is take a more broad global view of audit quality that this study implicates is necessary, and I think Mr. Monaghan was telling earlier about all the different requirements that exist for the single audit. We have a 1,000-page compliance supplement. We have Circular A–133. We have a lot of detailed requirements telling auditors how to do audits. What we don't have today is a lot of guidance on telling cognizant agencies how to validate the quality of the audits being conducted. What we have is that we have—A–133 does require the cognizant agencies to do these quality assessments or Quality Control Reviews, but we don't have specific parameters for how they do it. There is a lot of flexibility that the agencies have.

And so we anticipate continuing that flexibility, but at the same time building in parameters for the Quality Control Review process and working more closely in the future with the Inspector General community. We have already started dialogue with the PCIE and with the Audit Committee about what we can do more globally with Quality Control Reviews. What role can OMB play to say, we have a concern with audit quality. We want the cognizant agencies to step up their game, so to speak, in terms of looking at audit quality. OMB has to play a role in establishing the parameters for how we do that going forward.

So looking ahead, I think that is really where you will see OMB insert itself and enhance its role in the single audit process, is in building a stronger and more cohesive approach to Quality Control Reviews.

Senator CARPER. Thank you, Mr. Werfel. I am going to stick with you for a moment, if I could. This may be the last question. I am supposed to be someplace else at 4:30 and they want me to come to the Cloakroom right now, so we will just ask you one more question. But if somebody else wants to chime in, you are welcome to.

As I recall, there were maybe three recommendations for follow-up in terms of what we have learned in this process from this PCIE study. The first was to improve the guidance related to single audits. The second is to establish specialized training requirements related to single audits. And let me just stop right there and say, on this panel, do you all agree on the first one? Is there any disagreement on the first one?

Mr. WERFEL. We agree with that.

Senator CARPER. OK. On the second, to establish specialized training requirements related to single audits, any disagreement or qualification of support for that one? Yes, ma'am.

Ms. FRANZEL. We did raise several questions that we think need to be resolved——

Senator CARPER. Do you want to mention those, please?

Ms. FRANZEL. Yes, I certainly can. First of all, are we going to assume status quo right now with the single audit procedures, and if so, then that does imply that all auditors, all current auditors need to be trained. And so questions such as which auditors in each firm need to be trained, etc., need to be worked out because

it is a very large task and we do want it to be effective, so we have some implementation questions like that that would need to be worked out—cost-benefit, practicality questions, etc., which we discussed here.

But the big issue is before we jump into the training—we do support the training recommendation and we do support the concept of using it as a prerequisite—but if there are going to be major changes in the process within the next couple of years, I think we need to sequence this so that it is effective and efficient and cost beneficial.

Senator CARPER. Any other qualifications of support?

Ms. FOELSTER. I would say that I would agree with what Ms. Franzel just said.

Senator CARPER. You do? Entirely?

Ms. FOELSTER. Yes.

Senator CARPER. All right.

Ms. FOELSTER. There are a lot of questions, and it is hard to say who is against training. Training is a wonderful thing. We know that there are over 5,000 CPA firms alone that do the work, so we would need to figure out how it would be implemented in a cost-beneficial manner.

Senator CARPER. OK. Now, the third recommendation—this is a question again for you, Mr. Werfel, but others are welcome to chime in. Regarding the third recommendation, the PCIE asked you work with the AICPA and NASBA. What is NASBA?

Mr. WERFEL. The National Association of State Boards of Accountancy.

Senator CARPER. I don't like acronyms too much, and some of these acronyms I have heard of. That is a new one to me, but thank you for telling us what it is.

But the PCIE asked you to work with the AICPA and NASBA to identify ways to further audit quality, and they also, I think, said they wanted you to review the suspension and debarment process. And they were to consider instituting sanctions to be applied to auditors for unacceptable work or not meeting training requirements. How do you react to those recommendations?

Mr. WERFEL. Well, we certainly support entering into a dialogue on how to improve accountability. Earlier, Senator Carper asked the question of whether we perceived the problem was a competency issue, a lack of clarity issue, and I will paraphrase him, an incentive issue. He indicated the question of because these auditors are receiving government funds, they feel they can do less of a due diligent job. Is that part of it?

And this last recommendation—I think the first two recommendations, improving the clarity of the guidance and training, get at his first two questions, the competency issue and the clarity. But the last question in terms of incentives, we think it is absolutely important to hold these auditors accountable. We are concerned, and have issued our written concerns to the Inspector General community, about jumping right to a sanctions program. Our experience tells us that sanctions programs are very expensive to get up and running. You need a lot of infrastructure. There is a tremendous amount of due process that you need to put in place be-

fore you can impose something like a civil penalty against a public entity like an independent auditor.

So what we would prefer to do and what we think should be explored first is looking at the suspension and debarment process, which basically is a list of, in this case, auditors that would not be able to engage in further Federal work because it has been found that they have been involved in substandard work product. That suspension and debarment process, we believe is not working as well as it can today. I think the evidence of this project certainly points to a problem with holding auditors accountable for quality work.

The key with fixing the suspension and debarment process is—and I think one of the concerns with it is it tends to be a bureaucratic process. Even that tends to be an expensive process that agencies will shy away from, seeing the mountain of paperwork they have to go through to use it. But that paperwork is important because it is due process and it is these elements that are needed.

So again, it is a balance that we have to strike, I think, in terms of streamlining and improving the bureaucratic nature of the suspension and debarment process while at the same time not compromising due process, and that is not an easy task to do, but I think that it is probably the most effective one that we can take right now from a cost-effective standpoint and to strengthen accountability, because I do think that is key.

I think the auditors in the field that are doing this work, whether in a rural area or urban, whether big dollars or small dollars, have to have that sense that substandard work is going to have a consequence, and the consequence of being put on this list is pretty severe. It means that they do not have access to further government work, which affects them in their pockets, which is important.

And right now, we would support looking at that process together with all the different acronymed agencies and entities that you mentioned and figuring out what might work. But it is not an easy question to answer because of the tradeoff between due process and all these—and streamlining.

Senator CARPER. Yes, ma'am. Ms. Franzel.

Ms. FRANZEL. We have heard through anecdotal evidence that the current process is not implemented consistently by the agencies, and so there is probably room for improvement in the current process. Some agencies have just said this is too hard, we won't do it, and others are out there pursuing it. So to the extent that current process can be improved, perhaps auditors can have the sense that their work will be looked at and it does matter to do a quality job.

Of course, we would prefer to see all of this preempted by a good quality assurance and quality review program rather than trying to catch it at the back end. So we think that is also very important, a consistent approach by the agencies in overseeing the quality of these audits, because that is also another area where we are hearing anecdotal evidence that the agencies are handling oversight of the audit process inconsistently and then the enforcement process inconsistently.

Senator CARPER. All right. Anybody else on this point?

[No response.]

OK. Let me just conclude with this. I want to thank the members of our staff who have put together the hearing today. You all have done a very nice job and I want to thank you on behalf of our Senators. We very much appreciate each of you being here, as well.

I thought I knew something about this, but I have learned, in preparation for the hearing today, I have learned some things here today. There is a fair amount of money at risk. Even though maybe it is only 7 percent of $450 billion—only 7 percent of $450 billion, it is a lot of money and it would be over $30 billion. We know it is not all at risk, but some of it may be.

As I like to say, if it isn't perfect, make it better, and clearly we have an opportunity to make these audits better and make sure the money is being well spent, and frankly, just making sure that the programs are being appropriately run by these various nonprofit agencies or whoever is getting the money to use.

As I mentioned during the hearing, this Subcommittee has asked GAO to do an in-depth examination of the PCIE report and related issues. We plan to continue to pursue these issues and we would like to continue to work with our witnesses, now that we know how to pronounce your names—— [Laughter.]

To get the reforms we discussed today moving in a forward direction.

The hearing record is going to be open for a couple of weeks, 2 weeks, in fact, for the submission of additional statements and questions. I just ask your help. When you get the questions that are going to be submitted in writing, try to provide prompt responses to questions, whether from the Chairman and Ranking Member or from other Members of our Subcommittee who were here or not.

With that having been said, I think we are going to call it a day and I am going to go back to work. This has been enjoyable and I think highly informative, and I think important, as well. Thank you all.

The hearing is adjourned.

[Whereupon, at 4:28 p.m., the Subcommittee was adjourned.]

APPENDIX

Statement of Hugh M. Monaghan
Director, National Single Audit Sampling Project
and Director, Non-Federal Audits
Office of the Inspector General
Department of Education

Before the
Senate Committee on Homeland Security and Government Affairs
Subcommittee on Federal Financial Management, Government Information, Federal Services and International Security

October 25, 2007

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to testify about the National Single Audit Sampling Project (the Project), a major project conducted under the auspices of the President's Council on Integrity and Efficiency (PCIE). The Project was a collaborative effort involving PCIE member organizations, a member of the Executive Council on Integrity and Efficiency (ECIE), and three State Auditors. The PCIE is primarily composed of the presidentially-appointed Inspectors General (IGs) and the ECIE is primarily composed of IGs appointed by agency heads. I am here on behalf of Department of Education Inspector General John P. Higgins, Jr., who chairs the Audit Committee of the PCIE. My involvement with the Project was as Project Director. In this testimony, I will describe the Project to you, including why and how it was conducted, and its results and recommendations.

I. Background on Single Audits

First, I would like to give you some background information about single audits – what they are and their importance.

The Single Audit Act (the Act), as amended, requires annual financial and compliance audits of most state and local governments and not-for profit entities (including colleges and universities and hospitals) that are recipients and subrecipients of federal assistance awards. Many kinds of entities receive such awards, including departments and agencies of state governments, counties, cities, townships, public housing agencies, water, sewer, airport and transit authorities, as well as many non-profit organizations. Public and non-profit colleges, universities, and hospitals are also covered. A wide variety of federal programs are included in the scope of single audits, including programs for grants and loans for college students, road construction, public housing and mortgage insurance, temporary assistance for needy families, public health services, food stamps, and many others.

The Act provides that each covered entity that expends $500,000 or more in federal financial assistance in its fiscal year must obtain an independent financial and compliance audit that includes coverage of its federal awards. Under the Act, single audits must be performed in accordance with generally accepted government auditing standards published by the Comptroller General of the United States. Entities procure their single audits from an auditor that is a public accountant or a governmental (e.g., state) auditor who meets the qualification requirements of such standards. Single Audits are submitted to the Federal Audit Clearinghouse (FAC), a unit of the Bureau of the Census, operated for the U.S. Office of Management and Budget (OMB) and funded by major grant making agencies.

The Act gives the Director of OMB authority to prescribe implementing guidance. Under that authority, OMB has issued Circular A-133, *Audits of State, Local Governments, and Non-Profit Organizations* (OMB Circular A-133).

OMB Circular A-133 describes how the audit must be conducted and reported on. For entities with multiple federal award programs, not all programs may be covered in the annual single audit. Circular A-133 includes guidance and requirements for selecting federal programs to be covered. Programs selected for coverage are called *major programs* and identified in the single audit report.

OMB also annually publishes a *Compliance Supplement* to OMB Circular A-133 that identifies specific compliance requirements that should be covered for federal programs frequently selected as major programs, and contains guidance about how compliance requirements should be audited for major programs. The American Institute of Certified Public Accountants (AICPA) also promulgates auditing standards, which are incorporated by reference into the *Government Auditing Standards* (GAS) and issues Audit Guides used to conduct single audits.

The single audit report itself includes:

- Financial statements, a supplementary Schedule of Expenditures of Federal Awards (SEFA), and the auditor's opinions on these;
- The auditor's report on Internal Control over Financial Reporting;
- The auditor's report on compliance with requirements applicable to each major federal financial assistance program and internal control over compliance for these programs; and
- Audit findings, if any.

Under the Act and OMB Circular A-133, for each entity required to have a single audit, there is a designated federal cognizant (or oversight) agency for audit. Pursuant to their authorities, for many years such federal agencies have conducted quality control reviews (QCRs) of single audits, which are essentially "audits of audits," and are performed to determine whether single audits were properly conducted. However, selections of single audits for these QCRs have not been made based on statistical random sampling. This QCR work disclosed that the quality of single audits varied, but without selecting QCRs

using a statistical methodology, it was not possible to accurately assess the quality of single audits overall.

In August 2002, representatives of OMB and federal cognizant and oversight agencies for audit met to discuss the feasibility of drawing a national statistical sample of single audits for QCRs. This resulted in further discussions, followed by comprehensive planning, and the conduct of the National Single Audit Sampling Project (the Project).

Single audits provide an important degree of accountability for the expenditure of federal assistance programs. Because staffing and resources of federal grantor and pass-through entities are finite, it is not possible for them to perform on-site monitoring of all grantees and sub-grantees. Therefore, for many grantees and sub-grantees, the annual single audit provides the only independent on-site scrutiny of how federal taxpayer dollars are spent. Consequently, it is important that these audits be properly conducted and reported on.

II. The Objectives, Scope and Methodology of the Project

Next, I will describe the objectives of the Project, and summarize its scope and methodology.

The objectives of the Project were to:

- Determine the quality of single audits, by providing a statistically reliable estimate of the extent that single audits conform to applicable requirements, standards, and procedures; and

- Make recommendations to address noted audit quality issues, including recommendations for any changes to applicable requirements, standards and procedures indicated by the results.

The Project involved conducting and reporting on the results of QCRs of a statistical sample of 208 audits randomly selected from the universe of over 38,000 audits submitted and accepted by the federal government for the period April 1, 2003 through March 31, 2004. The sample was split into two strata. Stratum I consisted of audits of entities that expended $50 million or more of federal awards. Stratum II included audits of entities that expended at least $500,000 of federal awards but less than $50 million. We excluded single audits covering $300,000-$499,999 of expenditures because, beginning in 2004, single audits are no longer required for entities expending this range of Federal expenditures.

The following table, included in the Project report, summarizes the stratified sample and the universe from which it was drawn:

Stratum	Total Federal Award Expenditures per Audit	Number of All Audits in Universe	Total Federal Awards Expended for All Audits in Universe	Number of Audits in Sample
I	$50,000,000 and higher (Large Audits)	852	$737,171,328,433	96
II	$500,000-$49,999,999 (Other Audits)	37,671	$143,077,774,976	112
TOTAL		38,523	$880,249,103,409	208

The $737,171,328,433 of expenditures for the universe of Stratum I included $42,888,498, 211 received through a pass-through entity. The $143,077,774,976 of expenditures for the universe of Stratum II included $63,319,321,829 received through a pass-through entity.

The scope of the Project QCRs focused on the audit work and reporting related to federal awards. Audit work and reporting related to the general-purpose financial statements was not reviewed. If the single audit report covered one, two, or three major federal programs, documented audit work related to each major program was reviewed. If more than three major programs were reported to have been covered, three were randomly selected for review. For this scope, the Project QCRs covered audit planning, conduct of the audit field work, and reporting.

Each Project QCR involved review of the audit documentation to determine if required work was documented as performed. The Project results are based on the audit documentation. Applicable standards for all audits reviewed in the Project, include the following requirement:

> "Working papers should contain…documentation of the work performed to support significant conclusions and judgments, including descriptions of transactions and records examined that would enable an experienced auditor to examine the same transactions and records…" GAS (1994 revision), ¶ 4.37.

Project QCRs were conducted based on this GAS requirement. Therefore, if the audit working papers did not contain documentary evidence that the work was performed, the project concluded that record did not support that it was performed.

The results of each individual QCR were communicated to each auditor. The auditors were given the opportunity to comment on the proposed deficiencies and provide information to refute deficiencies with which they did not agree. We fully considered those responses in reaching conclusions about deficiencies for each QCR and in assessing the quality of each audit.

III. The results of the Project

Now, I will summarize the results of the Project.

We compiled and reported the results in two ways: (I) an *Assessment of Audit Quality*, and (II) *Types of Deficiencies Noted.*

a. Assessment of Audit Quality

For each of the 208 Project QCRs, we categorized the results in three groupings, comprised of five corresponding categories:

Group:	**Category:**
Acceptable	Acceptable (AC) Accepted with Deficiencies (AD)
Limited Reliability	Significant Deficiencies (SD)
Unacceptable	Material Reporting Errors (MRE) Substandard (SU)

Let me explain briefly what these categories and groupings mean.

The term "acceptable" is readily understandable. We include audits with minor deficiencies in the Acceptable grouping of audits, categorizing them as *Accepted with Deficiencies*. For these audits, we noted one or more deficiencies with applicable auditing criteria that do not require corrective action for the audit, but which should be corrected in future audits.

Audits in the *Limited Reliability* grouping are comprised of audits categorized as having *significant deficiencies* with respect to applicable criteria and require corrective action to afford unquestioned reliance upon the audit.

Audits categorized as *substandard* were those audits found with deficiencies so serious that the auditor's opinion on at least one major program cannot be relied upon. These are in the *Unacceptable* grouping, together with a category of audits – *material reporting error* – for which the only significant deficiency noted was that an opinion was erroneously reported that a particular federal program was covered as a major program, or (in one case) a required opinion on the Schedule of Expenditures of Federal Awards was omitted.

Whether an audit was deemed acceptable, of limited reliability, or unacceptable, and in which category, was a judgment we made based on the severity of deficiencies noted.

The following two tables from the Project Report summarize the Project's analysis and estimates of audit quality by groupings and categories, and include point estimates of quality of all audits within the universes of two strata, and all audits reviewed:

Table I – Audit Quality by Groupings with Statistical Estimates of Audit Quality Based on Numbers of Audits

Stratum	ACCEPTABLE		LIMITED RELIABILITY		UNACCEPTABLE		In Sample	In Universe
	In Sample	Point Estimate	In Sample	Point Estimate	In Sample	Point Estimate		
I – Large	61	63.5%	12	12.5%	23	24.0%	96	852
II– All Other	54	48.2%	18	16.1%	40	35.7%	112	37,671
Total	115	48.6%	30	16.0%	63	35.5%	208	38,523

Table II – Audit Quality Within Groupings by Category with Statistical Estimates of Audit Quality Based on Numbers of Audits

	ACCEPTABLE				LIMITED RELIABILITY		UNACCEPTABLE				In Sample	In Universe
Category	Acceptable		Accepted With Deficiencies		Significant Deficiencies		Material Reporting Errors		Substandard			
Stratum	In Sample	Point Estimate	In Sample	Point Estimate	In Sample	Point Estimate	In Sample	Point Estimate	In Sample	Point Estimate		
I – Large	16	16.7%	45	46.9%	12	12.5%	9	9.4%	14	14.6%	96	852
II – All Other	23	20.5%	31	27.7%	18	16.1%	0	0.0%	40	35.7%	112	37,671
Total**	39	20.5%	76	28.1%	30	16.0%	9	0.2%	54	35.2%	208	38,5

Estimates in these tables are rendered at a 90% confidence level with margins of error ranging between ± 2.1 and 7.9 percentage points. Of the 38,523 audits in the total universe of audits reviewed, 37,671 were in Stratum II; consequently, percentage estimates for the entire universe are significantly weighted by the large number of audits in Stratum II.

To provide information to help assess the effect of these results, we also analyzed the results in relation to the dollar amounts of federal awards reported in the audits. This analysis, presented in our report, shows that for the 208 audits we reviewed, audits covering large dollar amounts of federal awards (Stratum I) were significantly more likely to be acceptable than other audits (Stratum II). The following table summarizes this analysis:

Table III – Distribution of Dollars of Federal Awards Reported in the Audits Reviewed in the Project by Audit Quality Groupings

Stratum	ACCEPTABLE	LIMITED RELIABILITY	UNACCEPTABLE	Total
I – Large	$52,911,305,271 (93.2%)	$1,270,684,096(2.2%)	$2,621,245,403(4.6%)	$56,803,234,770 (100%)
II – All Other	$232,047,485 (56.3%)	$39,690,326(9.6%)	$140,497,532(34.1%)	$412,235,343(100%)
Both Strata	$53,143,352,756 (92.9%)	$1,310,374,422(2.3%)	$2,761,742,935 (4.8%)	$57,215,470,113(100%)

b. Types of Deficiencies

I have just described the results of our assessment of the quality of single audits. An audit is the sum of many individual steps in planning, performance of audit field work, and reporting. Our audit quality categorization and groupings of audits were based on the severity (or absence of) deficiencies relating to the individual steps. In analyzing the results, we identified the types of deficiencies noted in single audits and determined their frequency. We identified and reported on all of the kinds of deficiencies we noted, with information about percentage rates and estimates (or numbers) of audits in which they occurred.

The most significant and/or prevalent deficiencies we noted with rates/estimates of their occurrence in an audit were:

a. At least some required testing of compliance requirements was not documented as performed or not documented as applicable for the audit (47.9% in Stratum I; 59.6% in Stratum II)
b. Testing of internal controls over compliance not documented (34.4% in Stratum I; 61.6% in Stratum II)
c. Obtaining understanding of internal controls over compliance not documented (27.1% in Stratum I; 57.1% in Stratum II)
d. Deficient risk assessments as part of major program determination (13.5% in Stratum I; 25% in Stratum II)
e. Written audit program missing or inadequate for part of single audit (16.7% in Stratum I; 38.4% in Stratum II)
f. Misreporting of coverage of major programs (9.4% in Stratum I; 6.3% in Stratum II)

We also noted the following deficiencies relating to audit findings for which we could not estimate a rate of occurrence, because audit findings do not necessarily exist for all audits:

g. Unreported audit findings (22 of 208 audits)
h. Information required to be included in audit findings was not included (49 of 208 audits)

These are rates/estimates of the percentage (or numbers) of audits in which these *kinds* of deficiencies occurred, without regard to the severity of individual occurrences. For example, not documenting required testing for a few compliance requirements is reflected in these rates/estimates (or numbers) the same as not documenting required testing for most or all compliance requirements. Capturing information about deficiencies this way enabled a determination of which aspects single audits most need improvement. The severity of deficiencies is reflected in the audit quality categorizations and groupings I discussed earlier.

Information about the frequency of deficiencies was especially useful in formulating some of our recommendations to improve the quality of single audits, which I will discuss next.

IV. Project Conclusions and Recommendations

I will now address the Project conclusions and recommendations.

Tables I and II succinctly summarized the results of the Project with respect to audit quality. They indicate that, by number of audits, a majority of the stratum of large audits, and almost half of those in the stratum of other audits reviewed were acceptable, and that acceptable single audits can be, and are being, performed. Also, our analysis of results in relation to the dollar amounts of federal awards reported in the audits we reviewed indicates that single audits covering large dollar amounts of federal awards were more likely to be of acceptable quality than other single audits.

However, the results also indicate significant numbers of audits of limited reliability with significant deficiencies and unacceptable audits with material reporting errors and that were substandard. We concluded lack of due professional care was a factor for most deficiencies, to some degree.

These results pose a challenge: *What can and should be done to reduce audit deficiencies and eliminate audits that are of limited reliability or unacceptable?*

This question is by far the most important one posed by the results of the Project. We gave much thought to answering it, and in response, in the Project report we recommend to OMB a three-pronged approach to improve the quality of single audits. We also recommend that OMB implement the approach in consultation with other key stakeholders in the single audit process: federal cognizant and oversight agencies for audit, the AICPA, State Auditors (through the National State Auditors Association), and State Boards of Accountancy (through the National Association of State Boards of Accountancy). The recommended three pronged approach consists of the following:

1. Revise and improve single audit criteria, standards, and guidance to address deficiencies identified by the project;
2. Establish minimum requirements for completing comprehensive training on performing single audits as a prerequisite for conducting single audits and require single audit update training for continued performance of single audits; and
3. Review and enhance processes to address unacceptable audits and not meeting established training and continuing professional education requirements.

The recommendations for the first prong are contained in the part of the report that describe audit deficiencies and involve specific recommendations to revise:

(i) OMB Circular A-133,
(ii) Statement on Auditing Standards No. 74, *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance,* and
(iii) the AICPA Audit Guide used for single audits, *Government Auditing Standards and Circular A-133 Audits.*

The recommended revisions are to add to or revise parts of these issuances to improve guidance so as to reduce the occurrence of certain specific deficiencies.

The key recommendations of the second prong are to establish:

(i) a requirement for comprehensive training of a minimum specified duration (e.g., 16-24 hours) for staff performing and supervising single audits, as a prerequisite to doing so, and
(ii) a requirement for continued professional education (CPE) related to single audits every 2 years afterwards.

Additional recommendations of the second prong include:

(iii) Developing minimum content requirements for both the prerequisite training and CPE;
(iv) Amending OMB Circular A-133 criteria related to auditor selection to provide that single audits may be procured only from auditors who meet the training requirements; and
(v) OMB encouraging professional organizations and qualified training providers to offer and deliver the training in ways that it is accessible to auditors throughout the United States.

The recommendations for the third prong are:

(i) Review the suspension and debarment process to identify whether (and if so, how) it can be more efficiently and effectively applied to address unacceptable audits, and based on that review, pursue appropriate changes to the process.

(ii) Enter into dialogue with the AICPA and State Boards of Accountancy to identify and implement ways to further the quality of single audits and address the due professional care issues noted in this Project.

(iii) Identify, review, and evaluate the potential effectiveness of other ways (existing or new) to address unacceptable audits. These other ways could include, but not be limited to, revising Circular A-133 to include sanctions to be applied to auditors (for unacceptable work and/or for not meeting training and continuing professional education requirements) and/or considering potential legislation that would provide for a fine to be available to federal cognizant and oversight agencies as an option to address unacceptable audit work.

If these recommendations are adopted, we believe that the occurrence of deficiencies can be markedly reduced and significant improvement achieved in the quality of single audits.

If implemented, the second prong recommendations for training as a prerequisite for performing single audits and continuing professional education for continued performance of single audits could be especially effective. This is because requiring such training would ensure that auditors who perform single audits obtain the specialized knowledge about single audits necessary for their proper planning, performance and reporting.

Implementation of our prong one and prong three recommendations would strengthen existing single audit standards, criteria and guidance and processes to address unacceptable audits.

This concludes my statement. I would be happy to answer any questions you have.

United States Government Accountability Office

GAO

Testimony

Before the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

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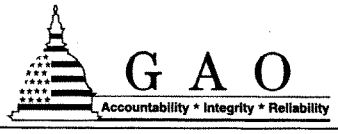
SINGLE AUDIT QUALITY

Actions Needed to Address Persistent Audit Quality Problems

Statement of Jeanette M. Franzel
Director, Financial Management and Assurance



GAO-08-213T

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss GAO's analysis of the results of the *Report on National Single Audit Sampling Project*[1] recently issued by the President's Council on Integrity and Efficiency (PCIE) under the direction of the Office of Management and Budget (OMB). First, I would like to commend the PCIE for conducting this comprehensive and important study dealing with the quality of single audits. The single audit is a key accountability mechanism over the use of federal grants and other awards. In fiscal year 2007, $449 billion in federal grants was budgeted to state and local governments. The PCIE report raises significant concerns about the quality of single audits, and makes recommendations aimed at improving the effectiveness and efficiency of those audits.

Today, I will provide (1) GAO's perspective on the history and importance of the Single Audit Act and the principles behind the act, (2) our preliminary analysis of the recommendations made by the PCIE for improving audit quality, and (3) additional factors for consideration for improving the quality of single audits. My statement today is based on our continuing work as the standards setter for generally accepted government auditing standards (GAGAS) and our related work in the area of single audits, including ongoing interaction with key stakeholders in the single audit process and members of the auditing profession providing single audit services to recipients of federal awards. In addition, this statement is based on our analysis of the PCIE report, and our discussions with the PCIE project team, the American Institute of Certified Public Accountants (AICPA), and OMB.

[1]President's Council on Integrity and Efficiency (PCIE)/Executive Council on Integrity and Efficiency (ECIE), *Report on National Single Audit Sampling Project* (June 2007). The project was conducted under the auspices of the Audit Committee of the PCIE, as a collaborative effort involving PCIE member organizations, as well as a member of the ECIE and three State Auditors. The project was performed to determine the quality of single audits using statistical methods and to make recommendations to address noted audit quality issues.

Evolution of the Single Audit Act and Its Underlying Principles

In the early 1980s, Congress had concerns about a lack of adequate oversight and accountability for federal assistance[2] provided to state and local governments. Before passage of the Single Audit Act in 1984 (the act), the federal government relied on audits of individual grants to help gain assurance that state and local governments were properly spending federal assistance. Those audits focused on whether the transactions of specific grants complied with program requirements. The audits usually did not address financial controls and were, therefore, unlikely to find systemic problems with an entity's fund management. Further, individual grant audits were conducted on a haphazard schedule, which resulted in large portions of federal funds being unaudited each year. In addition, the auditors conducting the individual grant audits did not coordinate their work with the auditors of other programs. As a result, some entities were subject to numerous grant audits each year, while others were not audited for long periods.

In response to concerns that large amounts of federal financial assistance were not subject to audit and that agencies sometimes overlapped on oversight activities, Congress passed the Single Audit Act of 1984.[3] The act stipulated that state and local governments that received at least $100,000 in federal financial assistance in a fiscal year have a single audit conducted for that year. The concept of a single audit was created to replace multiple grant audits with one audit of an entity as a whole. State and local governments which received between $25,000 and $100,000 in federal financial assistance had the option of complying with audit requirements of the act or the audit requirements of the federal program(s) that provided the assistance. The objectives of the Single Audit Act, as amended, are to

- promote sound financial management, including effective internal control, with respect to federal awards administered by nonfederal entities;
- establish uniform requirements for audits of federal awards administered by nonfederal entities;
- promote the efficient and effective use of audit resources;
- reduce burdens on state and local governments, Indian tribes, and nonprofit organizations; and

[2]Federal assistance, also known as federal awards, includes grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and federal cost reimbursement contracts.

[3]Pub. L. No. 98-502, 98 Stat. 2327 (Oct. 19, 1984) (codified, as amended, at 31 U.S.C. §§ 7501-7507).

October 25, 2007

GAO
Accountability· Integrity· Reliability

Highlights

Highlights of GAO-08-213T, a testimony before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

Federal government grants to state and local governments have risen substantially, from $7 billion in 1960 to almost $450 billion budgeted in 2007. The single audit is an important mechanism of accountability for the use of federal grants by nonprofit organizations as well as state and local governments. However, the quality of single audits conducted under the Single Audit Act, as amended, has been a longstanding area of concern since the passage of the act in 1984. The President's Council on Integrity and Efficiency (PCIE) recently issued its *Report on National Single Audit Sampling Project*, which raises concerns about the quality of single audits and makes recommendations aimed at improving the effectiveness and efficiency of those audits. This testimony provides (1) GAO's perspective on the history and importance of the Single Audit Act and the principles behind the act, (2) a preliminary analysis of the recommendations made by the PCIE for improving audit quality, and (3) additional considerations for improving the quality of single audits.

What GAO Recommends

GAO supports PCIE's recommendations and points out factors for consideration in determining actions, including (1) audit quality problems by size of audit and (2) the distribution of audits by size. GAO also suggests a separate effort to evaluate the framework for single audits.

To view the full product, including the scope and methodology, click on GAO-08-213T. For more information, contact Jeanette Franzel at (202) 512-9471 or franzelj@gao.gov.

SINGLE AUDIT QUALITY

Actions Needed to Address Persistent Audit Quality Problems

What GAO Found

In the early 1980s, Congress had concerns about a lack of adequate oversight and accountability for federal assistance provided to state and local governments. In response to concerns that large amounts of federal financial assistance were not subject to audit and that agencies sometimes overlapped on oversight activities, Congress passed the Single Audit Act of 1984. The act adopted the single audit concept to help meet the needs of federal agencies for grantee oversight as well as grantees' needs for single, uniformly structured audits. GAO supported the passage of the Single Audit Act, and continues to support the single audit concept and principles behind the act as a key accountability mechanism for federal grant awards. However, the quality of single audits has been a longstanding area of concern since the passage of the act in 1984.

In its June 2007 *Report on National Single Audit Sampling Project*, the PCIE found that, overall, approximately 49 percent of single audits fell into the acceptable group, with the remaining 51 percent having deficiencies severe enough to classify the audits as limited in reliability or unacceptable. PCIE found a significant difference in results by audit size. Specifically, 63.5 per of the large audits (with $50 million or more in federal award expenditures, were deemed acceptable compared with only 48.2 percent of the smaller audits (with at least $500,000 but less than $50 million in federal award expenditures). The PCIE report presents compelling evidence that a serious problem with single audit quality continues to exist. GAO is concerned that audits are not being conducted in accordance with professional standards and requirements. These audits may provide a false sense of assurance and could mislead users of the single audit reports.

The PCIE report recommended a three-pronged approach to reduce the types of deficiencies found and to improve the quality of single audits: (1) revise and improve single audit standards, criteria, and guidance; (2) establish minimum continuing professional education (CPE) as a prerequisite for auditors to be eligible to be able to conduct and continue to perform single audits; and (3) review and enhance the disciplinary processes to address unacceptable audits and for not meeting training and CPE requirements.

In this testimony, GAO supports PCIE's recommendations and points out issues that need to be resolved regarding the proposed training and other factors that merit consideration when determining actions to improve audit quality. GAO believes that there may be opportunities for considering size when implementing future actions to improve the effectiveness and quality of single audits. In addition, a separate effort considering the overall framework for single audits could answer such questions as whether simplified alternatives can achieve cost-effective accountability in the smallest audits; whether current federal oversight processes for single audits are adequate; and what role the auditing profession can play in increasing single audit quality.

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

The Single Audit Act adopted the single audit concept to help meet the needs of federal agencies for grantee oversight as well as grantees' needs for single, uniformly structured audits. Rather than being a detailed review of individual grants or programs, the single audit is an organizationwide financial statement audit that includes the audit of the Schedule of Expenditures of Federal Awards (SEFA)[4] and also focuses on internal control and the recipient's compliance with laws and regulations governing the federal financial assistance received. The act also required that grantees address material noncompliance and internal control weaknesses in a corrective action plan, which is to be submitted to appropriate federal officials. The act further required that single audits be performed in accordance with GAGAS issued by GAO. These standards provide a framework for conducting high-quality financial audits[5] with competence, integrity, objectivity, and independence.

The Single Audit Act Amendments of 1996[6] refined the Single Audit Act of 1984 and established uniform requirements for all federal grant recipients. The refinements cover a range of fundamental areas affecting the single audit process and single audit reporting, including provisions to

- extend the law to cover all recipients of federal financial assistance, including, in particular, nonprofit organizations, hospitals, and universities;
- ensure a more cost-beneficial threshold for requiring single audits;
- more broadly focus audit work on the programs that present the greatest financial risk to the federal government;
- provide for timely reporting of audit results;
- provide for summary reporting of audit results;
- promote better analyses of audit results through establishment of a federal clearinghouse and an automated database; and

[4]Grant recipients must prepare a SEFA for the period covered by their audited financial statements, which identifies all federal awards received and expended, and the federal programs under which they were received. Federal program and award identification shall include, as applicable, the Catalog of Federal Domestic Assistance (CFDA) title and number (assigned to a federal program), award number and year, name of the federal agency, and name of the pass-through entity.

[5]GAGAS also provide standards for attestation engagements and performance audits.

[6]Pub. L. No. 104-156, 110 Stat. 1396 (July 5, 1996).

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

The 1996 amendments required the Director of OMB to designate a Federal Audit Clearinghouse (FAC) as the single audit repository,[7] required the recipient entity to submit financial reports and related audit reports to the clearinghouse no later than 9 months after the recipient's year-end, and increased the audit threshold to $300,000. The criteria for determining which entities are required to have a single audit are based on the total amount of federal awards[8] expended by the entity. The initial dollar thresholds were designed to provide adequate audit coverage of federal funds without placing an undue administrative burden on entities receiving smaller amounts of federal assistance. When the act was passed, the dollar threshold criteria for the audit requirement were targeted toward achieving audit coverage for 95 percent of direct federal assistance to local governments. As part of OMB's biennial threshold review required by the 1996 amendments, OMB increased the dollar threshold for requirement of a single audit to $500,000 in 2003 for fiscal years ending after December 31, 2003.

Federal oversight responsibility for implementation of the Single Audit Act is currently shared among various entities—OMB, federal agencies, and their respective Offices of Inspector General (OIG). The Single Audit Act assigned OMB the responsibility of prescribing policies, procedures, and guidelines to implement the uniform audit requirements and required each federal agency to amend its regulations to conform to the requirements of the act and OMB's policies, procedures, and guidelines. OMB issued Circular No. A-133, Audits of States, Local Governments, and Non-Profit Organizations, which sets implementing guidelines for the audit requirements and defines roles and responsibilities related to the implementation of the Single Audit Act.[9] The federal agency that awards a grant to a recipient is responsible for ensuring recipient compliance with federal laws, regulations, and the provisions of the grant agreements. The awarding agency is also responsible for overseeing whether the single

[7]The Federal Audit Clearinghouse Single Audit Database is maintained by the Bureau of Census in the Department of Commerce. It contains summary information on the auditor, the recipient and its federal programs, and the audit results.

[8]The 1996 amendments changed the phrase "federal financial assistance" to "federal awards."

[9]See 68 Fed. Reg. 38401 (June 27, 2003).

audits are completed in a timely manner in accordance with OMB Circular No. A-133 and for providing annual updates of the Compliance Supplement[10] to OMB. Some federal agencies rely on the OIG to perform quality control reviews (QCR) to assess whether single audit work performed complies with OMB Circular No. A-133 and auditing standards.

The grant recipient (auditee) is responsible for ensuring that a single audit is performed and submitted when due, and for following up and taking corrective action on any audit findings. The auditor of the grant recipient is required to perform the audit in accordance with GAGAS. A single audit consists of (1) an audit and opinions on the fair presentation of the financial statements and the SEFA; (2) gaining an understanding of internal control over federal programs and testing internal control over major programs; and (3) an audit and an opinion on compliance with legal, regulatory, and contractual requirements for major programs. The audit also includes the auditor's schedule of findings and questioned costs, and the auditee's corrective action plans and a summary of prior audit findings that includes planned and completed corrective actions. Under GAGAS, auditors are required to report on significant deficiencies in internal control and on compliance associated with the audit of the financial statements.

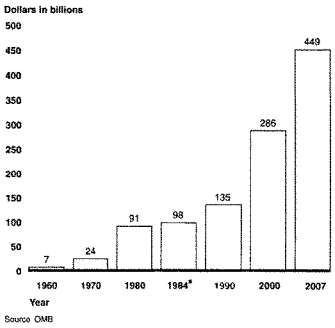
Recipients expending more than $50 million in federal funding ($25 million prior to December 31, 2003) are required to have a cognizant federal agency for audit in accordance with OMB Circular No. A-133. The cognizant agency for audit is the federal awarding agency that provides the predominant amount of direct funding to a recipient unless OMB otherwise makes a specific cognizant agency assignment. The cognizant agency for audit provides technical audit advice, considers requests for extensions to the submission due date for the recipient's reports, obtains or conducts QCRs, coordinates management decisions for audit findings, and conducts other activities required by OMB Circular No. A-133. According to OMB officials, the FAC single audit database generates a listing of those agencies that should be designated cognizant agencies for audit based on information on recipients expending more than $50 million.

[10]The Compliance Supplement is based on the requirements of the 1996 Amendments and 1997 revisions to OMB Circular No. A-133, which provide for the issuance of a compliance supplement to assist auditors in performing the required audits. It provides a source of information for auditors to understand the federal program's objectives, procedures, and compliance requirements relevant to the audit as well as audit objectives and suggested audit procedures for determining compliance with these requirements.

The officials also stated that OMB is responsible for notifying both the recipient and cognizant agency for audit of the assignment. Federal award recipients that do not have a cognizant agency for audit are assigned an oversight agency for audit, which provides technical advice and may assume some or all of the responsibilities normally performed by a cognizant agency for audit.

Federal grant awards to state and local governments have increased significantly since the Single Audit Act was passed in 1984. Because single audits represent the federal government's primary accountability tool over billions of dollars each year in federal funds provided to state and local governments and nonprofit organizations, it is important that these audits are carried out efficiently and effectively. As shown in figure 1, the federal government's use of grants to state and local governments has risen substantially, from $7 billion in 1960 to almost $450 billion budgeted in 2007.

Figure 1: Increase in Federal Grant Awards to State and Local Governments between 1960 and 2007



Notes: Data from the Budget for Fiscal Year 2008, Historical Tables. The above figures do not include grants made directly by federal agencies to nongovernmental organizations.

*The Single Audit Act was enacted in 1984

GAO supported the passage of the Single Audit Act, and we continue to support the single audit concept and principles behind the act as a key accountability mechanism over federal grant awards. However, the quality of single audits conducted under this legislation has been a longstanding area of concern since the passage of the Single Audit Act in 1984. During the 1980s, GAO issued reports[11] that identified concerns with single audit quality, including issues with insufficient evidence related to audit planning, internal control and compliance testing, and the auditors' adherence to GAGAS. The federal Inspectors General as well have found similar problems with single audit quality. The deficiencies we cited during the 1980s were similar in nature to those identified in the recent PCIE report.

Results of PCIE Report Identify Serious Single Audit Quality Issues

In June 2002, GAO and OMB testified at a House of Representatives hearing about the importance of single audits and their quality.[12] In its testimony,[13] OMB identified reviews of single audit quality performed by several federal agencies that disclosed deficiencies. However, OMB emphasized that an accurate statistically based measure of audit quality was needed, and should include both a baseline of the current status and the means to monitor quality in the future. We also recognized in our testimony the need for a solution or approach to evaluate the overall quality of single audits.

To gain a better understanding of the extent of single audit quality deficiencies, OMB and several federal OIGs decided to work together to develop a statistically based measure of audit quality, known as the National Single Audit Sampling Project. The work was conducted by a committee of representatives from the PCIE, the Executive Council on Integrity and Efficiency (ECIE), and three State Auditors, with the work

[11]GAO, *CPA Audit Quality: Inspectors General Find Significant Problems*, GAO/AFMD-86-20 (Dec. 5, 1985); *CPA Audit Quality: Many Governmental Audits Do Not Comply With Professional Standards*, GAO/AFMD-86-33 (March 19,1986); *Single Audit Act: Single Audit Quality Has Improved but Some Implementation Problems Remain*, GAO/AFMD-89-72 (July 27,1989).

[12]GAO, *Single Audit: Single Audit Act Effectiveness Issues*, GAO-02-877T (June 26, 2002).

[13]Office of Management and Budget, *Statement of the Honorable Mark W. Everson, Controller, Office of Federal Financial Management, Office of Management and Budget before the House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations* (June 26, 2002).

effort coordinated by the U.S. Department of Education OIG. The Project had two primary objectives:

- to determine the quality of single audits by performing QCRs of a statistical sample of single audits, and
- to make recommendations to address any audit quality issues noted.

The project conducted QCRs of a statistical sample of 208 audits randomly selected from a universe of over 38,000 audits submitted and accepted for the period April 1, 2003, through March 31, 2004. The sample was split into two strata:

- Stratum 1: entities with $50 million or more in federal award expenditures, and
- Stratum 2: entities with less than $50 million in federal award expenditures (with at least $500,000).

The above split in the sample strata corresponds with the current threshold for designating a cognizant agency, which is for entities that expend more than $50 million in a year in federal awards. Table 1 shows the universe and strata used in the analysis and the reviews completed in the National Single Audit Sampling Project.

Table 1: Sample Universe for National Single Audit Sampling Project

	Sample size	Universe	Total federal awards for audits in universe (dollars in billions)
Stratum 1[a]	96	852	737.2
Stratum 2[b]	112	37,671	143.1
Total	**208**	**38,523**	**880.2**

Source: President's Council on Integrity and Efficiency and Executive Council on Integrity and Efficiency

Notes: Data from *Report on National Single Audit Sampling Project* (June 21, 2007). The $880.2 billion differs from the federal grant funding for the audit period covered in the PCIE report due to the double counting associated with pass-through entities that provide federal awards to a subrecipient to carry out a federal program.

[a]Entities with ≥$50 million in federal award expenditures.

[b]Entities with <$50 million in federal award expenditures (with at least $500,000).

The project covered portions of the single audit relating to the planning, conducting, and reporting of audit work related to (1) the review and testing of internal control and (2) compliance testing pertaining to compliance requirements for selected major federal programs. The scope of the project included review of audit work related to the SEFA and the

content of all of the auditors' reports on the federal programs. The project did not review the audit work and reporting related to the general purpose financial statements.

The PCIE project team categorized the audits based on the results of the QCRs into the following three groups:

- Acceptable—No deficiencies were noted or one or two insignificant deficiencies were noted. This group also includes the subgroup, Accepted with Deficiencies, which is defined as one or more deficiencies with applicable auditing criteria noted that do not require corrective action for the engagement, but should be corrected on future engagements. Audits categorized into this subgroup have limited effect on reported results and do not call into question the auditor's report. Examples of deficiencies that fall into this subgroup are (1) not including all required information in the audit findings; (2) not documenting the auditor's understanding of internal control, but testing was documented for most applicable compliance requirements; and (3) not documenting internal control or compliance testing for a few applicable compliance requirements.
- Limited Reliability—Contains significant deficiencies related to applicable auditing criteria and requires corrective action to afford reliance upon the audit. Deficiencies for audits categorized into this group have a substantial effect on some of the reported results and raise questions about whether the auditors' reports are correct. Examples of deficiencies that fall into this category are (1) documentation did not contain adequate evidence of the auditors' understanding of internal control or testing of internal control for many or all compliance requirements; however, there was evidence that most compliance testing was performed; (2) lack of evidence that work related to the SEFA was adequately performed; and (3) lack of evidence that audit programs were used for auditing internal control, compliance, and/or the SEFA.
- Unacceptable—Substandard audits with deficiencies so serious that the auditors' opinion on at least one major program cannot be relied upon. Examples of deficiencies that fall into this group are (1) no evidence of internal control testing and compliance testing for all or most compliance requirements for one or more major programs, (2) unreported audit findings, and (3) at least one incorrectly identified major program.

As shown in table 2, the PCIE study estimated that, overall, approximately 49 percent of the universe of single audits fell into the acceptable group. This percentage also includes "accepted with deficiencies." The remaining 51 percent had deficiencies that were severe enough to cause the audits to be classified as having limited reliability or being unacceptable. Specifically, for the 208 audits drawn from the universe, the statistical

sample showed the following about the single audits reviewed in the PCIE study:[14]

- 115 were acceptable and thus could be relied upon. This includes the category of "accepted with deficiencies." Based on this result, the PCIE study estimated that 48.6 percent of the entire universe of single audits were acceptable.
- 30 had significant deficiencies and thus were of limited reliability. Based on this result, the PCIE study estimated that 16.0 percent of the entire universe of single audits was of limited reliability.
- 63 were unacceptable and could not be relied upon.[15] Based on this result, the PCIE study estimated that 35.5 percent of the entire universe of single audits was unacceptable.

Table 2: Audit Quality by Groupings with Statistical Estimates of Audit Quality Based on Numbers of Audits

	Acceptable	Limited reliability	Unacceptable	In sample	In universe
Stratum 1[a]	61 63.5%	12 12.5%	23 24.0%	96	85[illegible]
Stratum 2[b]	54 48.2%	18 16.1%	40 35.7%	112	37,671
Total	**115** **48.6%**	**30** **16.0%**	**63** **35.5%**	**208**	**38,523**

Source: President's Council on Integrity and Efficiency and Executive Council on Integrity and Efficiency

Notes: Data from Report on National Single Audit Sampling Project (June 21, 2007).

[a]Entities with ≥$50 million in federal award expenditures.

[b]Entities with <$50 million in federal award expenditures (with at least $500,000).

It is important to note the significant difference in results in the two strata. Specifically, 63.5 percent of the audits of entities in stratum 1 (those expending $50 million or more in federals awards) were deemed

[14]The percentages indicated as estimates in this paragraph are point estimates of the quality of single audits based on the stratified sample results for the universe of all 38,523 single audits from which the stratified sample was drawn. At the 90 percent confidence level, the margins of error range between ±5.3 and ±7.8 percentage points. Also, due to rounding, these percentages do not add to exactly 100 percent.

[15]Of these 63 audits, 9 had material reporting errors that resulted in the audits being considered unacceptable. The remaining 54 of the 63 unacceptable audits were substandard.

acceptable, while 48.2 percent of audits in stratum 2 (those expending at least $500,000 but less than $50 million) were deemed acceptable.

Because of these differences, it is also important to analyze the results in terms of federal dollars. For the 208 audits drawn from the entire universe, the statistical sample showed the following about the single audits reviewed in the PCIE study:

- The 115 acceptable audits represented 92.9 percent of the value of federal award amounts reported in all 208 audits the PCIE study reviewed.
- The 30 audits of limited reliability represented 2.3 percent of the value of federal award amounts reported in all 208 audits the PCIE study reviewed.
- The 63 unacceptable audits represented 4.8 percent of the value of federal award amounts reported in all 208 audits the PCIE study reviewed.

The dollar distributions for the 208 audits reviewed in the study are shown in table 3.

Table 3: Results—Distribution of Dollars of Federal Awards Reported in the 208 Audits

	Acceptable	Limited reliability	Unacceptable	Total
Stratum 1[a]	$52.9 billion 93.2%	$1.3 billion 2.2%	$2.6 billion 4.6%	**$56.8 billion 100%**
Stratum 2[b]	$232.0 million 56.3%	$39.7 million 9.6%	$140.5 million 34.1%	**$412.2 million 100%**
Total	**$53.1 billion 92.9%**	**$1.3 billion 2.3%**	**$2.7 billion 4.8%**	**$57.2 million 100%**

Source: President's Council on Integrity and Efficiency and Executive Council on Integrity and Efficiency

Notes: Data from Report on National Single Audit Sampling Project (June 21, 2007).

[a]Entities with ≥$50 million in federal award expenditures.

[b]Entities with <$50 million in federal award expenditures (with at least $500,000).

The most prevalent deficiencies related to the auditors' lack of documenting

- an understanding of internal control over compliance requirements,
- testing of internal control of at least some compliance requirements, and
- compliance testing of at least some compliance requirements.

The PCIE report states that for those audits not in the acceptable group, the project team believes that lack of due professional care was a factor

for most deficiencies to some degree. The term due professional care refers to the responsibility of independent auditors to observe professional standards of auditing. GAGAS further elaborate on this concept in the standard on Professional Judgment. Under this standard, auditors must use professional judgment in planning and performing audits and in reporting the results, which includes exercising reasonable care and professional skepticism. Reasonable care concerns acting diligently in accordance with applicable professional standards and ethical principles. Using professional judgment in all aspects of carrying out their professional responsibilities—including following the independence standards, maintaining objectivity and credibility, assigning competent audit staff to the assignment, defining the scope of work, evaluating and reporting the results of the work, and maintaining appropriate quality control over the assignment process—is essential to performing a high quality audit.

We previously noted similar audit quality problems in prior reports. In December 1985, we reported[16] that problems found by OIGs in the course of QCRs mostly related to lack of documentation showing whether and to what extent auditors performed testing of compliance with laws and regulations. In March 1986, we reported[17] that our own review of single audits showed that auditors performing single audits frequently did not satisfactorily comply with professional auditing standards. The predominant issues that we found in our previous reviews were insufficient audit work in testing compliance with governmental laws and regulations and evaluating internal controls. We also observed, through discussions with the auditors and reviews of their work, that many did not understand the nature and importance of testing and reporting on compliance with laws and regulations, or the importance of reporting on internal control and the relationship between reporting and the extent to which auditors evaluated controls. As a result, in 1986, we reported that the public accounting profession needed to (1) improve its education efforts to ensure that auditors performing single audits better understand the auditing procedures required, and (2) strengthen its enforcement efforts in the area of governmental auditing to help ensure that auditors perform those audits in a quality manner.

[16]GAO/AFMD-86-20.

[17]GAO/AFMD-86-33.

Similar to our prior work, the PCIE report presents compelling evidence that a serious problem with single audit quality continues to exist. The PCIE study also reveals that the rate of acceptable audits for organizations with $50 million or more in federal expenditures was significantly higher than for audits for organizations with smaller amounts of federal expenditures. The results also showed that overall, a significant number of audits fell into the groups of limited reliability with significant deficiencies and unacceptable.

In our view, the current status of single audit quality is unacceptable. We are concerned that audits are not being conducted in accordance with professional standards and requirements. These audits may provide a false sense of assurance and could mislead users of audit reports regarding issues of compliance and internal control over federal programs.

PCIE Recommendations to Improve Single Audit Quality Are Based on Three-Pronged Approach

The PCIE report recommended a three-pronged approach to reduce the types of deficiencies noted and improve the quality of single audits:

1. revise and improve single audit standards, criteria, and guidance;
2. establish minimum continuing professional education (CPE) as a prerequisite for auditors to be eligible to conduct and continue to perform single audits; and
3. review and enhance the disciplinary processes to address unacceptable audits and for not meeting training and CPE requirements.

Revise and Improve Standards, Criteria and Guidance

More specifically, to improve standards, criteria, and guidance, the PCIE report recommended revisions to (1) OMB Circular No. A-133, (2) the AICPA Statement on Auditing Standards (SAS) No. 74, Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance, and (3) the AICPA Audit Guide, Current AICPA Audit Guide, collectively to

- emphasize correctly identifying major programs for which opinions are compliance are rendered;
- make it clear when audit findings should be reported;
- include more detailed requirements and guidance for compliance testing;

- emphasize the minimal amount of documentation needed to document the auditor's understanding of, and testing of, internal control related to compliance;
- provide specific examples of the kind of documentation needed for risk assessment of individual federal programs;
- present illustrative examples of properly presented findings;
- specify content and examples of SEFA and any effect on financial reporting;
- emphasize requirements for management representations related to federal awards, similar to those for financial statement audits;
- provide additional guidance about documenting materiality; and
- require compliance testing to be performed using sampling in a manner prescribed by the AICPA SAS No. 39, Audit Sampling, as amended, to provide for some consistency in sample sizes.

Minimum CPE Requirements for Conducting Single Audits

The PCIE report recommendation called on OMB to amend its Circular No. A-133 to require that (1) as a prerequisite to performing a single audit, staff performing and supervising the single audit must have completed a comprehensive training program of a minimum specified duration (e.g., at least 16–24 hours); (2) every 2 years after completing the comprehensive training, auditors performing single audits complete a minimum specified amount of CPE; and (3) single audits may only be procured from auditors who meet the above training requirements. The PCIE report also recommends that OMB develop, or arrange for the development of, minimum content requirements for the required training, in consultation with the National State Auditors Association (NSAA), the AICPA and its Governmental Audit Quality Center (GAQC), and the cognizant and oversight agencies for audit. The report states that the minimum content should cover the essential components of single audits and emphasize aspects of single audits for which deficiencies were noted in this project. In addition, the report recommends that OMB develop, or arrange for the development of, minimum content requirements for the ongoing CPE and develop a process for modifying future content.

The report further recommends that OMB encourage professional organizations, including the AICPA, the NSAA, and qualified training providers, to offer training that covers the required content. It also recommends that OMB encourage these groups to deliver the training in ways that enable auditors throughout the United States to take the training at locations near or at their places of business, including via technologies such as Webcasts, and that the training should be available at an affordable cost. The PCIE project report emphasizes that the training

should be "hands on" and should cover areas where the project team specifically found weaknesses in the work or documentation in its statistical study of single audits. The report specifically stated that the training should cover requirements for properly documenting audit work in accordance with GAGAS and other topics related to the many deficiencies disclosed by the project, including critical and unique parts of a single audit, such as

- the auditors' determination of major programs for testing,
- review and testing of internal controls over compliance,
- compliance testing,
- auditing procedures applicable to the SEFA,
- how to use the OMB Compliance Supplement, and
- how to audit major programs not included in the Compliance Supplement.

The PCIE report concludes that such training would require a minimum of 16 to 24 hours, and that a few hours or an "overview" session will not suffice. We believe that the proposed training requirements would likely satisfy the criteria for meeting a portion of the CPE hours already required by GAGAS.

Enhance Disciplinary Processes

This recommendation focuses on developing processes to address unacceptable audits and auditors not meeting the required training requirements. OMB Circular No. A-133 currently has sanctions that apply to an auditee (i.e., the entity being audited) for not having a properly conducted audit and requires cognizant agencies to refer auditors to licensing agencies and professional bodies in the case of major inadequacies and repetitive substandard work. The report noted that other federal laws and regulations do currently provide for suspension and debarment processes that can be applied to auditors of single audits. Some cognizant and oversight agency participants in the project team indicated that these processes are rarely initiated due to the perception that it is a large and costly effort. As a result, the report specifically recommends that OMB, with federal cognizant and oversight agencies, should (1) review the process of suspension and debarment to identify whether (and if so, how) it can be more efficiently and effectively applied to address unacceptable audits, and based on that review, pursue appropriate changes to the process; and (2) enter into a dialogue with the AICPA and State Boards of Accountancy to identify ways the AICPA and State Boards can further the quality of single audits and address the due professional care issues noted in the PCIE report. The report further recommends that OMB, with federal cognizant agencies, should also identify, review, and evaluate the potential

effectiveness of other ways (both existing and new) to address unacceptable audits, including (but not limited to) (1) revising Circular No. A-133 to include sanctions to be applied to auditors for unacceptable work or for not meeting training and CPE requirements, and (2) considering potential legislation that would provide to federal cognizant and oversight agencies the authority to issue a fine as an option to address unacceptable audit work.

GAO Analysis of PCIE Recommendations

While we support the recommendations made in the PCIE report, it will be important to resolve a number of issues regarding the proposed training requirement. Some of the unresolved questions involve the following:

- What are the efficiency and cost-benefit considerations for providing the required training to the universe of auditors performing the approximately 38,500 single audits?
- How can current mechanisms already in place, such as the AICPA's Government Audit Quality Center (GAQC), be leveraged for efficiency and effectiveness purposes in implementing new training?
- Which levels of staff from each firm would be required to take training?
- What mechanisms will be put in place to ensure compliance with the training requirement?
- How will the training requirement impact the availability of sufficient, qualified audit firms to perform single audits?

The effective implementation of the third prong, developing processes to address unacceptable audits and for auditors who do not meet professional requirements, is essential as the quality issues have been long-standing. We support the PCIE recommended actions to make the process more effective and efficient and to help ensure a consistent approach among federal agencies and their respective OIGs overseeing the single audit process.

Additional Factors for Consideration When Determining Actions to Improve Audit Quality

In addition to the findings and recommendations of the PCIE report, we believe there are two other critical factors that need to be considered in determining actions that should be taken to improving audit quality: (1) the distribution of unacceptable audits and audits of limited reliability across the different dollar amounts of federal expenditures by grantee, as found in the PCIE study; and (2) the distribution of single audits by size in the universe of single audits. These factors are critical in effectively evaluating the potential dollar implications and efficiency and effectiveness of proposed actions. The PCIE study found that rates of

unacceptable audits and audits of limited reliability were much higher for audits of entities in stratum 2 (those expending less than $50 million in federal awards) than those in stratum 1 (those expending $50 million or more).

Table 1 presented earlier in this testimony shows the data from the sample universe of single audits used by the PCIE. Analysis of the data shows that 97.8 percent of the total number of audits (37,671 of the 38,523 total) covered approximately 16 percent ($143.1 billion of the $880.2 billion) of the total reported value of federal award expenditures, indicating significant differences in distributions of audits by dollar amount of federal expenditures. At the same time, the rates of unacceptable audits and audits of limited reliability were relatively higher in these smaller audits.

We believe that there may be opportunities for considering size characteristics when implementing future actions to improve the effectiveness and quality of single audits. For instance, there may be merit to conducting a more refined analysis of the distribution of audits to determine whether less-complex approaches could be used for achieving accountability through the single audit process for a category of the smallest single audits. Such an approach may provide sufficient accountability for these smaller programs.

An example of a less-complex approach consists of requirements for a financial audit in accordance with GAGAS, that includes the higher level reports on internal control and compliance along with an opinion on the SEFA and additional, limited or specified testing of compliance. Currently, the compliance testing in a single audit is driven by compliance requirements under OMB Circular No. A-133 as well as program-specific requirements detailed in the compliance supplement. A less-complicated approach could be used for a category of the smallest audits to replace the current approach to compliance testing, while still providing a level of assurance on the total amount of federal grant awards provided to the recipient.

Another consideration for future actions is strengthening the oversight of the cognizant agency for audit with respect to auditees expending $50 million or more in federal awards. As shown in the data from the sample universe of single audits used by the PCIE, 852 audits (or 2.2 percent) of the total 38,523 audits covered $737.2 billion (or 84 percent) of the reported federal award expenditures. This distribution suggests that targeted and effective efforts on the part of cognizant agencies aimed at

improving audit quality for those auditees that expend greater than $50 million could achieve a significant effect in terms of dollars of federal expenditures.

Conclusions

We continue to support the single audit concept and principles behind the act as a key accountability mechanism over federal awards. It is essential that the audits are done properly in accordance with GAGAS and OMB requirements. The PCIE report presents compelling evidence that a serious shortfall in the quality of single audits continues to exist. Many of these quality issues are similar in nature to those reported by GAO and the Inspectors General since the 1980s. We believe that actions must be taken to improve audit quality and the overall accountability provided through single audits for federal awards. Without such action, we believe that substandard audits may provide a false sense of assurance and could mislead users of audit reports. While we support the recommendations made in the PCIE report, we believe that a number of issues regarding the proposed training requirements need to be resolved.

The PCIE report results also showed a higher rate of acceptable audits fo. organizations with larger amounts of federal expenditures and showed that the vast majority of federal dollars are being covered by a small percentage of total audits. We believe that there may be opportunities for considering size characteristics when implementing future actions to improve the effectiveness and quality of single audits as an accountability mechanism. Considering the recommendations of the PCIE within this larger context will also be important to achieve the proper balance between risk and cost-effective accountability.

In addition to the considerations surrounding the specific recommendations for improving audit quality, a separate effort taking into account the overall framework for single audits may be warranted. This effort could include answering questions such as the following:

- What types of simplified alternatives exist for meeting the accountability objectives of the Single Audit Act for the smallest audits and what would the appropriate cutoff be for a less-complex audit requirement?
- Is the current federal oversight structure for single audits adequate and consistent across federal agencies?
- What alternative federal oversight structures could improve overall accountability and oversight in the single audit process?
- Are federal oversight processes adequate and are sufficient resources being dedicated to oversight of single audits?

- What role can the auditing profession play in increasing single audit quality?
- Do the specific requirements in OMB Circular No. A-133 and the Single Audit Act need updating?

Mr. Chairman, we would be pleased to work with the subcommittee as it considers additional steps to improve the single audit process and federal oversight and accountability over federal grant funds. Mr. Chairman and members of this subcommittee, this concludes my statement. I would be happy to answer any questions that you or members may have at this time.

Contacts and Acknowledgments

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Testimony of Daniel I. Werfel

Acting Controller, Office of Federal Financial Management, Office of Management and Budget

before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security

October 25, 2007

The Federal Government has a fundamental responsibility to be effective stewards of the taxpayers' money. This requires Federal agencies to implement rigorous financial management disciplines to ensure that Federal funds are appropriately accounted for and wisely spent. The "Single Audit" is critical to these efforts and I am happy to be here today to discuss the steps we must take to improve its effectiveness.

The Single Audit is the primary tool that Federal agencies use for overseeing the over $450 billion in grant awards going to non-Federal entities annually. The Single Audit requires Federal fund recipients to undergo an annual audit of their activities to ensure that relevant program requirements are being met; strong internal controls for reducing waste, fraud, and error are in place; and that recipients are meeting their responsibility for reliable and timely financial reporting. Each year, these audits surface important issues that result in improved management of Federal grant programs.

It is important however to continuously assess whether Single Audits are meeting objectives and are sufficiently rigorous and comprehensive. In 2002, the Office of Management and Budget (OMB) reported to Congress our concern that Single Audits were not being implemented effectively. At the time, we based this concern on specific cases of poor audit quality identified by Federal agencies and the Government Accountability Office (GAO). To understand the full extent of the problem, we initiated – through the President's Council on Integrity and Efficiency (PCIE) and the Executive Council on Integrity and Efficiency (ECIE) – a statistically-based study to assess the overall effectiveness of Single Audits. This study is now complete and the results confirm significant gaps and deficiencies in the quality of the audits being implemented.

The PCIE/ECIE study contains several recommendations for improving audit quality (e.g., clarifications to guidance, improved training programs) that OMB concurs with and has begun implementing. In addition, we are exploring additional solutions for improving Single Audits that we believe will result in better audits, but, more importantly, better management of Federal grant programs.

BACKGROUND ON THE SINGLE AUDIT

The Federal Government annually awards grants totaling more than $450 billion, one-sixth of the Federal budget. Prior to the Single Audit, recipients (States, local and tribal governments; colleges and universities; and other non-profit organizations) of multiple awards, were often subject to separate audits of each award. Audits overlapped or several audits were scheduled for

the same grantee throughout the year. This raised audit costs and added undue administrative burden on both the grantee and the grantor. Additionally, some grantees were not audited at all.

The Single Audit Act of 1984 (further amended in 1996, 31 U.S.C. 7501) provided a cost-effective audit in lieu of multiple audits and combined the annual financial statement audit with the review and testing of the grantee's internal controls and compliance with requirements of major programs. OMB implements the Act through OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Under this Circular, all grantees receiving more than $500,000 in Federal funds in a given year (95% of all Federal grant funds) must be subject to an annual audit of its activities.

Single audits are conducted by independent auditors (e.g., State auditors or Certified Public Accounting firms) in accordance with Generally Accepted Government Auditing Standards (GAGAS). The auditor must use a risk-based approach to select Federal programs to be reviewed, gain an understanding of the internal controls, test internal controls and major program compliance requirements, determine if the grantee has complied with requirements that have a direct and material effect on major programs, and follow up on prior audit findings. The auditor is required to present conclusions in a schedule of findings and costs. This information is made publicly available by the Federal Audit Clearinghouse.[1]

When Single Audits are conducted effectively, they are instrumental in identifying and correcting non-compliance with laws and regulations, lack of internal controls, and other financial management deficiencies (including improper payments). A good example of this is in the Medicaid and SCHIP programs, where approximately one billion dollars in disallowed costs have been identified for recovery over the past several years as a result of Single Audit activities.

In June 2002, Mark Everson, former OMB Controller, reported to Congress that Quality Control Reviews (QCRs) performed by Federal agencies and related findings from GAO identified significant audit quality problems in certain cases. These findings identified auditors who: (a) lacked professional care when selecting Federal programs to be tested; (b) failed to adequately gather and document evidence; and (c) did not sufficiently test compliance requirements. Such deficiencies weaken Federal oversight efforts and dramatically increase the risk that ongoing improprieties in Federal grant programs are not being detected or addressed.

In order to understand the extent of audit deficiencies and to define a comprehensive approach for addressing them, OMB worked with the PCIE, the ECIE, the National State Auditors Association (NSAA), and several Federal agencies to complete a statistically-based study of Single Audit quality.

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[1] The Federal Audit Clearinghouse (FAC), operated by the Bureau of the Census, serves as the central collection point, repository, and distribution center for Single Audit reports. See http://harvester.census.gov/fac/. Single Audit results are entered into this national database so that audit findings can be tracked by program, State, or grantee. The FAC database is on-line, fully automated, accessible by the public for information from Single Audit reports and findings nationwide, and provides a cost-effective way for grantees to submit reports to the Federal government as required by law.

THE NATIONAL SINGLE AUDIT SAMPLING PROJECT

In June 2007, the PCIE and ECIE issued the final report on the National Single Audit Sampling Project to OMB, with copies concurrently provided to key stakeholders in the single audit process [the American Institute of Certified Public Accountants (AICPA), the National Association of State Boards of Accountancy (NASBA), and NSAA]. The project had two goals: to determine the quality of audits using statistical methods, and to make recommendations to improve the quality of single audits.

In the report, samples were drawn from two strata – one consisting of larger entities that expended more than $50 million and one consisting of entities that expended less than $50 million, but more than $500,000. Audits that were reviewed were generally characterized as either "acceptable," "limited reliability," or "unacceptable." Audits found to be acceptable covered 93% of all Federal grant dollars reviewed in the study. Of concern, however, for the smaller dollar stratum, approximately two-thirds of audits sampled were deemed to be unacceptable or to have limited reliability. For the larger dollar stratum, approximately one-third of audits sampled were deemed to be unacceptable or to have limited reliability.

Although it is encouraging that auditor performance is significantly better in high-dollar activities, the overall results of the study are troubling and confirm OMB's belief that improvements must be made to the Single Audit process. Each of the study's recommendations for OMB action is underway. Specifically, OMB has taken initial steps to:

- Draft amendments to Circular A-133 (to be completed by June 30, 2008) that will:
    - provide additional guidance to auditors on how to identify major programs [2] in the auditors' reports;
    - clarify when audit findings must be reported;
    - emphasize auditors provide more specific documentation of audit activities and findings for major programs; and
    - clarify requirements for sample selections.
- Ensure new audit training programs and requirements are developed; and
- Discuss with key stakeholders measures that can be taken to strengthen accountability for auditors who fail to meet minimum standards in implementing the Single Audit.[3]

NEXT STEPS

In addition to the recommendations in the PCIE/ECIE report and the initial steps discussed above, OMB is evaluating other measures to improve the quality and overall effectiveness of Single Audits, including approaches to address the lack of due professional care by the auditor, which the PCIE/ECIE report cited as the largest cause of unacceptable audits. This will include working with Single Audit constituents (e.g., PCIE, ECIE, GAO, State auditors, the AICPA,

[2] The programs auditors test and provide an opinion on compliance are identified as major programs. Major programs are defined in section .520 of OMB Circular A-133.

[3] In written comments to the PCIE/ECIE on the report recommendations, OMB expressed concern with the report's suggestion of imposing monetary penalties on auditors. We believe that other alternatives, such as strengthening current suspension and debarment procedures, should be explored before pursuing monetary sanction programs which historically are expensive to implement.

NASBA, and NSAA) to evaluate approaches such as whether a more robust peer review process can be employed to assist Federal agencies in ensuring that audit standards are followed.

OMB is also exploring longer-term reforms to the Single Audit that will help achieve successful results in the implementation of the Improper Payment Information Act (IPIA). Specifically, we are evaluating how the Single Audit can be expanded beyond Federal program compliance to also assess the risk of improper payments and the extent to which improper payments are systemic throughout the program. If the Single Audit can be leveraged in this manner, Federal agencies will have an important tool for obtaining cost-effective IPIA error measurements. Additionally, because Single Audit tests internal controls, this change would provide greater insight on corrective actions that will have a broader impact on program integrity and thus have a higher return on investment.

For each of these areas, OMB will work closely with Federal agencies, the PCIE, the ECIE, GAO, the AICPA, NASBA, and NSAA to ensure extensive input and consensus on improvement efforts.

CONCLUSION

If conducted properly, Single Audits can be an effective tool to improve Federal program integrity and provide the Federal government reliable information that can be used in the administration of Federal programs. Unfortunately, the percentage of substandard audits illustrated in the National Single Audit Sampling Project report is unacceptable and creates an uncertainty with respect to reliability of a grantees' financial performance. The report identifies key problem areas with corresponding recommendations that OMB will pursue with the audit and grant communities to implement improvements to the single audit process.

Thank you again for the opportunity to testify today. I look forward to answering your questions.

TESTIMONY OF MARY FOELSTER
ON BEHALF OF THE
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

BEFORE THE

SENATE SUBCOMMITTEE ON FEDERAL FINANICAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY

OCTOBER 25, 2007

On behalf of the American Institute of Certified Public Accountants and its 340,000 members, thank you for the opportunity to testify today on the President's Council on Integrity and Efficiency study, "Report on National Single Audit Sampling Project."

The AICPA has been representing CPAs in public accounting, corporate accounting, government and education for almost 120 years. It develops standards for audits and other services provided by CPAs, providing educational guidance materials to members, administering the uniform CPA examination, assisting its members in complying with the profession's technical standards, and enforcing compliance with ethical standards for the purpose of assessing continued AICPA membership.

The AICPA shares the commitment of the federal agencies involved in the study to the quality of single audits. Indeed, long before this report was released, and on its own initiative, the AICPA took a number of very significant steps to improve the quality of single audits.

I want to assure the subcommittee that the AICPA and its members take the results of this study very seriously. We are dedicated to working with the Office of Management and Budget, the Government Accountability Office, and other federal agencies on how to resolve the issues raised in the PCIE report.

In fact, the AICPA has already established several task forces to specifically address issues raised in the PCIE report and to consider other ways to improve audit quality. Each task force will carefully study the issues raised in the PCIE report. The task forces are:

1. Sampling/Materiality Issues In A Single Audit Environment
2. Internal Control And Compliance Responsibilities In A Single Audit Environment

3. Schedule Of Expenditures Federal Awards Reporting Issues
4. Reporting Audit Findings In A Single Audit
5. Single Audit Training Needs And Continuing Professional Education Evaluation
6. Practice Monitoring In A Single Audit Environment
7. Compliance Auditing Considerations In Audits Of Governmental Entities And Recipients Of Governmental Financial Assistance.

The AICPA executive committee that oversees the activities of the Governmental Audit Quality Center, which I will describe in detail later in my testimony, will also be evaluating the PCIE report from several perspectives. The first will be to determine what new activities and tools the center can offer its members and others in light of the study results. The second will be to consider whether there are any other actions that the AICPA should be taking either from the perspective of the recommendations in the report or other actions not contemplated in the PCIE report.

The AICPA's Role in Enhancing Single Audit Quality

The PCIE report is based on audits that were performed in 2002 and 2003 and in some cases earlier. Since these audits were conducted and long before the PCIE report was completed, the AICPA has taken a number of very significant steps to enhance single audit quality. Indeed, the AICPA has been working at least as actively as any one involved in the single audit process to keep the quality of these audits as high as possible.

For more than twenty years, the AICPA has been devoting significant resources to assist its members perform quality single audits. The AICPA's focus has been to develop government-specific publications, including auditing and accounting guides, checklists and risk alerts; continuing professional education programs; and conferences that include numerous detailed sessions on performing single audits. The publications and programs are updated annually for new issues, standards, and practices that are generated by the government and the profession.

In more recent years, the AICPA has stepped up its commitment by adding new single audit-specific publications and single audit training. The publications now include a separate audit guide, related audit risk alert, and a practice manual. The AICPA publicizes federal IG and profession-determined deficiencies in various publications, continuing professional education (CPE) programs, and various public forums. We also facilitate a semiannual roundtable that brings together the key stakeholders in the single audit process including the OMB, the GAO, federal inspector general representatives, and members of the profession.

In September 2004, that is, almost three years before the PCIE report was released, the AICPA launched its Governmental Audit Quality Center. GAQC's mission is to promote the highest quality governmental audits and to help CPAs meet the challenges of this unique and complex area. GAQC is a resource for best practices. It also helps raise awareness about the importance of governmental audits and develops a community of

CPA firms that demonstrate a commitment to the highest quality governmental audit practices. Its web site -- http://www.aicpa.org/GAQC -- enables member firms to access information, guidance, and practical tools whenever they are needed. GAQC also sends electronic alerts to members with important news and developments.

GAQC member firms are required to adhere to membership requirements that go beyond what they would otherwise have to do to perform this work. For example, any firm joining GAQC must:

- Designate an audit partner to have firm-wide responsibility for the quality of the firm's governmental audit practice.

- Require the audit partner designated with firm-wide responsibility for the quality of the firm's governmental audit practice to meet the CPE requirements of Government Auditing Standards even if that partner is not otherwise subject to those CPE requirements. The firm must also require the audit partner to participate in an annual GAQC-sponsored program on recent developments in governmental auditing.

- Establish policies and procedures specific to the firm's governmental audit practice to comply with the applicable professional standards and GAQC membership requirements. These policies and procedures must be documented and appropriately communicated.

- Establish annual internal inspection procedures that include a review of the firm's governmental audit practice by individuals possessing current experience and knowledge of the accounting and auditing practices specific to governmental audits.

- Make publicly available information about its most recently accepted peer review as determined by the GAQC executive committee, and have its governmental audits selected as part of the firm's peer review by a team member employed by a GAQC member firm.

- Periodically file with the center information about the firm and its governmental audit practice and agree to make such information public.

GAQC's current membership of over 850 firms audits approximately 83 percent of the total federal expenditures covered in single audits performed by CPA firms.

GAQC is also resource for firms and government auditors who are not members. Many federal agencies are beginning to recognize this and are informing the center staff when matters of importance occur so that they may be communicated on the center site and in some cases through a GAQC alert.

GAQC also periodically communicates matters that are of importance to every auditor of record in the Federal Audit Clearinghouse database regardless of AICPA or GAQC membership.

GAQC continues to emphasize helping all firms better understand the importance and complexities of single audits and will play a key role in helping to address some of the PCIE report findings and educate firms that perform this work about the common deficiencies and how to avoid them.

The PCIE Report

The subject of this hearing is whether single audits help to safeguard taxpayer dollars. The answer is an unequivocal "yes." The report indicates that more than 92 percent of the dollars in the federal grants reviewed were in acceptable audits.

The PCIE report indicates that there are audit, documentation, and reporting issues, particularly in the smaller audits, that need to be addressed. The subcommittee should be aware, however, especially for those audits where the primary issues were with documentation and/or reporting, that those issues do not necessarily mean that the audit findings are incorrect and do not necessarily negate their benefits or outcomes.

For example, consider the material reporting errors (MRE) identified by the PCIE report in the unacceptable audit category. In many cases, the audits in the MRE category noted no other serious deficiencies. In these instances, the auditor did not correctly complete a required summary of the auditor's results, but did audit the appropriate major programs in an acceptable manner.

But regardless of whether the deficiencies are technical or substantive, they need to be corrected. For many small grantees, the single audit is the primary, and in many cases the only, review of federal expenditures and compliance with federal regulations. In addition, audits have been shown to be an effective motivation for grantees to develop internal controls over their federal program expenditures to ensure compliance.

Auditors, of course, are responsible for carrying out a single audit in accordance with professional standards. Those standards or audit requirements for single audits are complex, particularly for audit firms that might only perform one or two smaller engagements each year.

Consider, for example, an audit firm in a rural part of the country. It audits several local commercial businesses and performs corporate and individual tax services. The small town in which it is located needs a single audit because it receives $550,000 in federal money from three federal agencies. The audit firm is requested to perform the audit because it is the only audit firm within reasonable proximity.

The fact that the single audit is required means that the auditor must learn a multitude of rules and regulations from many different federal agencies, GAO, and AICPA. Many of these rules and regulations relate to compliance auditing, a service the firm does not regularly perform. For the firm to do the highest quality single audit, it must learn all of the rules and regulations and commit significant resources to fully understand the scope, complexity, and depth of audit procedures and documentation requirements for these audits. To accept the audit engagement, the firm must have the competency to do the work. But, the firm's commitment to dedicate such resources results in additional audit costs and higher audit fees that are at odds with the typical audit purchasing philosophy of smaller governmental entities.

While this is no excuse, it is time for federal agencies to take another look at the underlying single audit requirements to determine if they can be streamlined, particularly for grantees that receive relatively small amounts of federal dollars.

The PCIE report focuses its recommendations almost entirely on the auditing profession. But meaningful improvements in single audit quality will only occur when all of the key single audit stakeholder groups -- the auditing profession, procurers of single audit services, and the federal agencies -- are involved in the solution.

Procurers of single audit services, or grantees, are required to have a single audit when they expend $500,000 or more in federal awards and have the responsibility to engage qualified independent auditors to determine that they have complied with the laws and regulations that relate to those awards. Some grantees take the auditor-hiring process very seriously and engage in a rigorous procurement process that focuses on the firm's qualifications, the experience of their staff, the extent of the firm's practice with similar organizations, the results of external quality control reviews, and the firm's participation in quality improvement programs, like the AICPA's Governmental Audit Quality Center.

Others, however, do not have a robust procurement process because of poor governance, lack of real involvement by audit committees, and management weaknesses. These entities are more likely to have poor audit quality issues.

The goal should be for all grantees to have robust governance structures that support the benefit of audits, consider the qualifications of a firm during the hiring process, and evaluate the reasonableness of the firm's anticipated hours in relation to the proposed fee based on the work to be performed. Until the governance structures of these entities are addressed, the quality enhancement we all seek will be much more difficult to attain.

The AICPA has heard that some federal agencies, particularly on the program side, question grantees in situations where they believe too much money has been spent on the audit fee. While the AICPA certainly understands the budget pressures on all levels of government, the PCIE report indicates that quality rather than least costly audits are what best protects taxpayers. Federal agencies need to educate their program offices accordingly.

The PCIE report shows a marked positive difference in the quality of the work performed in the larger audits, which are typically performed by the larger firms who tend to have greater internal resources to devote toward this complex and unique audit area. Another reason for the difference is the increased support by federal agencies for large grantees and their auditors. To make further strides in improving audit quality, more federal agency support of the single audit process is needed. The AICPA will work cooperatively to explore how enhancements to the OMB *Compliance Supplement* and other potential activities that might flow from additional federal resources in this area will improve audit quality.

PCIE Report Recommendations

The first recommendation in the PCIE report is to revise and improve single audit criteria, standards, and guidance to address the identified deficiencies.

At a high level, the AICPA has reviewed the detailed findings and recommendations contained throughout the PCIE report regarding single audit criteria, standards, and other guidance. In response, we established the task forces described earlier in this testimony to review the detailed recommendations in the report to make appropriate enhancements to related AICPA standards or other guidance, including materials developed by OMB or the federal agencies.

The second recommendation is to establish minimum requirements for completing comprehensive training as a prerequisite for conducting single audits, and to require single audit update training for continued performance of single audits.

The AICPA has always been supportive of the existing CPE requirements contained in *Government Auditing Standards* and supports single audit-specific training. The PCIE report proposal recommends 16-24 hours of single audit-specific CPE as a prerequisite to performing single audits, as well as periodic update training thereafter.

It is difficult to assess whether this recommendation will help to resolve the quality issues cited in the PCIE report without better understanding the extent to which a lack of appropriate CPE contributed to the deficiencies found or, alternatively, that the CPE obtained by auditors associated with the acceptable audits contributed to that classification. The AICPA appreciates that the PCIE report identifies it as a key organization to assist in developing minimum content requirements for the comprehensive training that might be required and it stands ready to work with OMB as it studies this issue further and determines whether and how a CPE requirement should be applied.

Finally, the report includes a recommendation to review and enhance processes to address (1) unacceptable audits and (2) not meeting established training and continuing professional education requirements.

The AICPA fully supports a robust federal enforcement process and the federal government's use of all of the tools already at its disposal for addressing unacceptable audits. That includes the current suspension and debarment process, as well as the referral of auditors performing unacceptable audits to licensing agencies and professional bodies for appropriate discipline. Reviewing and potentially changing the current suspension and debarment process to make it more efficient and effective in addressing unacceptable audits seems like an appropriate course of action.

With regard to the recommendation to consider the establishment of fines to address unacceptable audits, The AICPA is not certain that this will improve audit quality any more than the tools already at the disposal of the federal agencies. For this reason, OMB should first improve the processes already in place before adopting this recommendation. If fines are ultimately sought, defined parameters should be established so that they are not abused or unfairly applied.

The AICPA, which is one professional body where federal inspectors generally refer unacceptable audits, takes seriously any allegation of poor audit quality by its members and investigates and takes appropriate action on all matters referred to it by the federal agencies. If a violation is found, our potential actions range from additional and specific CPE, to required concurring reviews, to work product follow-up, to suspension of AICPA membership and expulsion. The AICPA's Professional Ethics division is ready to investigate any referrals that federal agencies make, including any referrals that result from this federal study. Appropriate action will be taken for situations where the AICPA finds members who are not performing these audits in a manner that violates of our Code of Professional Conduct.

The AICPA will be pleased to work with OMB to explore improvements and to strengthen its referral and resulting investigative process. However, the AICPA does not license CPAs to practice public accounting; its mission is on the quality and accountability of our members. State boards of accountancy are responsible for licensing CPAs who practice public accounting and disciplining CPAs where appropriate and we encourage OMB to work with the state boards of accountancy to review the current referral processes and to suggest improvements.

Conclusion

The results of this study raise important issues the profession has been and will continue to address. However, the results also indicate that the vast majority of federal dollars subject to single audit are reviewed in acceptable audits. The AICPA's efforts to help our members perform quality single audits are longstanding and have been recently enhanced.

We are confident that our more recent efforts, including our Governmental Audit Quality Center which was launched after the years reviewed in the study, are already beginning to address some of the issues raised in the PCIE report. With that said, we have established task forces to address most of the specific recommendations in the report and stand willing to work with the OMB, the GAO, and the other federal agencies involved in the oversight of single audits to further address potential solutions to the problems identified in the study.

Statement of

David Costello, CPA
President and Chief Executive Officer
National Association of State Boards of Accountancy

Before

The United States Senate Committee on Homeland Security Government Affairs (Subcommittee on Federal Financial Management, Government Information, Federal Services and International Security)

October 25, 2007

Chairman Carper, Senator Coburn, and Members of the Subcommittee, the National Association of State Boards of Accountancy (NASBA) appreciates the opportunity to offer comments relating to the President's Council on Integrity and Efficiency (PCIE) report titled *National Single Audit Sampling Project* (Report).

Our testimony today will focus on the role of NASBA and State Boards of Accountancy (State Boards) as integral parties of the regulatory process, provide comments on the Report, and set forth NASBA's suggestions relating to certain recommendations contained in the report, such as NASBA's commitment to developing and maintaining an effective referral program for governmental agencies and State Boards. I will describe this program in detail later.

It is encouraging to note that the Report indicates that 92.9% of the Federal awards reported were acceptable and could be relied upon. This percentage reveals substantial success and should provide comfort that there is only a need to refine the Single Audit process, not initiate a complete overhaul.

Background

First, we would like to provide some background information that will help the Committee understand the roles of State Boards and NASBA.

Mission of State Boards and NASBA

The primary mission of each State Board is to protect the public through regulation, as well as work with governmental entities, both federal and state, which also represent and serve the public. The State Board, as well as each U.S. territory or commonwealth that has a board of accountancy, is responsible for administering the CPA examination, determining whether an applicant has met the education, examination, and experience qualifications to be licensed as a Certified Public Accountant (CPA), and enforcing the state's accountancy laws and regulations.

NASBA's mission is to enhance the effectiveness of State Boards. This mission is achieved by

- serving as a forum for the 55 State Boards;
- providing high quality, effective programs and services;
- identifying, researching, and analyzing major current and emerging issues affecting State Boards and developing solutions;
- maintaining effective communications with State Boards to facilitate the exchange of ideas and opinions; and
- developing and enhancing relationships with organizations that impact the regulation of public accounting.

NASBA is guided by a board of directors consisting of current and former State Board members from throughout the country. Many of the board members are CPAs who provide a rich, extensive background in public accounting, industry and government. The Board is supported by a staff of

approximately 200 professional and administrative individuals who operate out of the Nashville and New York City offices. In addition, there are approximately 30 NASBA Committees comprised of current and former State Board members working to help achieve NASBA's mission.

Through an extensive volunteer network, NASBA has been able to work as a partner in the development of the Uniform Accountancy Act, model legislation which has been adopted by a majority of the 55 State Boards. Currently, the volunteer community of NASBA is working to evaluate the feasibility of the convergence of international and U.S. accounting standards; researching improvements to increase the effectiveness of peer reviews, a process mandated by many states as a requirement for firms engaged in the attest (assurance) function; and revisiting the interaction between State Boards and Federal regulatory bodies through the recently developed Government Agency Referral Task Force. In summary, NASBA is attuned to the needs of State Boards as they fulfill their charge of protecting the public and it is those needs that drive the activities of NASBA.

NASBA's Comments on the Report Recommendations

Report Recommendation Relating to Regulatory Referrals

A recommendation in the Report that is very relevant to the missions of NASBA and State Boards is: "Review the suspension and debarment process to identify whether (and if so, how) it can be more efficiently and effectively applied to address unacceptable audits, and based on that review, pursue appropriate changes to the process."

State Boards take seriously their responsibility to protect the public and, therefore, carefully investigate and adjudicate the complaints they receive. For many years, State Boards have expressed frustration and concern about:

- the lack of timely communications between governmental agencies and State Boards;
- the difficulty of obtaining information when a State Board becomes aware of a matter that should be investigated; and
- the long lapse of time between the alleged violation and the referral, which can span several years thereby placing the State Boards at a severe disadvantage in pursuing the matter; whereas, expedited referrals would allow boards to begin the complaint process while the information is most relevant and accelerate the process so the public is protected sooner rather than later.

NASBA holds semi-annual conferences to address issues affecting State Boards and the aforementioned issues have been discussed at these conferences numerous times. We have also engaged in dialogue with various governmental agencies, some of whom regularly attend our conferences. Thus, NASBA wholeheartedly agrees with the need to develop a better process to address unacceptable audits.

In an attempt to facilitate referrals from governmental agencies, NASBA has recently employed Linda Biek, a CPA who will work with NASBA's Government Agency Referral Task Force to establish a process

and basis of assuring that appropriate referrals are made, that the appropriate State Boards are not only in receipt of the referrals, but that they are processing them, that there is a process of monitoring progress on the disciplinary process and that there is effective communication of the entire process between the State Boards, Federal and State Regulators and NASBA on a continuing basis. Ms. Biek's background includes public accounting experience in the audit department of a Big Four accounting firm. She formerly served as the Executive Director for the Tennessee State Board of Accountancy and began her career with the Board as the technical investigator charged with overseeing the complaint process. Ms. Biek will draw on this experience as she assumes the role of NASBA's Director of Governmental, International and Professional Relationships.

Oftentimes, it has been noted by State Board executives that they have properly processed a complaint but failed to notify the referring agency. As a result, the referring agency is left to assume that the State Board took no action on the referral. By closing the loop in the process with good communication, the referring agency will be made aware of the status and ultimate disposition of the case.

Appropriate response by State Boards to complaints is critical to their mission of protecting the public. Most State Boards accomplish this goal exceedingly well. However, the enforcement efforts of some State Boards are impeded by limited staff. NASBA will assist those boards that do not have adequate enforcement staff and, when applicable, assist these boards in seeking adequate funding to fulfill their enforcement responsibilities.

Furthermore, NASBA is developing plans to host a conference which will include relevant Federal agencies, NASBA, and other interested groups. The purpose of the conference is to exchange ideas on best practices, identify the needs of the Federal agencies, provide updates on emerging issues, and expose the proposed referral process. Ms. Biek will coordinate the conference to ensure that it is held on a continuous basis and that it serves the needs and interests of Federal agencies and other entities committed to protecting the public.

Report Recommendation Relating to Sanctions for Unacceptable Work

This recommendation states: "Identify, review, and evaluate sanctions to be applied to auditors (for unacceptable work and/or for not meeting training and CPE requirements) and/or considering potential legislation that would provide for a fine to be available to Federal cognizant and oversight agencies as an option to address unacceptable audit work."

We believe that it is extremely important for the Committee to recognize that once State Boards have been provided with information pertaining to audit deficiencies, they possess the legislative authority to investigate the complaint, to adjudicate the complaint, and to impose a large range of disciplinary actions. These actions include assessing substantial fines, requiring continuing professional education, and suspending or even revoking the CPA's license to practice. Only State Boards can revoke a CPA's license to practice. Thus, Federal legislation to provide for other suspension and debarment measures is not necessary. Instead, governmental agencies should work with State Boards and NASBA to ensure that there is a process in place for communication of substandard practice to State Boards so they can take appropriate action.

Report Recommendation Relating to Continuing Professional Education

The Report recommends consideration of additional continuing professional education (CPE). Currently, the GAO requires individuals who participate in audits performed in accordance with *Government Auditing Standards* (Yellow Book) to obtain 24 hours of CPE relating to such audits within each 2 year period. NASBA suggests the careful evaluation of the content of this CPE.

Vendors who wish to supply this CPE should be evaluated to determine that the courses meet appropriate standards. Many State Boards utilize the NASBA CPE Registry to assist them in the vendor evaluation process. The value of the Registry results from the quality control procedures that are in place to ensure that CPE vendors are offering courses that will enhance the proficiency of the CPA. Vendors who do not comply are removed from the Registry and run the risk of their courses not being accepted in the states that require listing on the Registry. Certain organizations (e.g. colleges & universities, the AICPA and certain other organizations) are exempt from the registration requirement. We suggest the GAO consider requiring non-exempt vendors offering governmental CPE be listed on the Registry.

Conclusion

To summarize:

- State Boards take seriously their responsibility to protect the public and, therefore, carefully investigate and adjudicate complaints they receive.
- State Boards can and do effectively protect the public.
- The process for referral of complaints from governmental agencies to State Boards can be improved and NASBA is committed to developing and maintaining that process, however we will need the assistance of the federal community in order to be successful.
- Where needed, NASBA will provide assistance to State Boards that need assistance with their enforcement responsibilities.
- State Boards possess a complete arsenal of disciplinary actions and, thus, there is no need for additional legislation. Instead, the emphasis should be on making the referral process effective.
- NASBA can provide assistance in strengthening any additional continuing professional education that might be needed.

In closing, NASBA appreciates the opportunity to address the Subcommittee and embraces the beginning of collaboration that will not only benefit the general public but also the Federal agencies charged with the responsibility of providing funding to governmental and non-profit entities throughout the country.

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Statement of the New York State Society of Certified Public Accountants

Submitted for the Record of October 25, 2007 Hearing Entitled "Single Audits: Are They Helping to Safeguard Federal Funds", By the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security of the United States Senate Committee on Homeland Security and Governmental Operations

Statement of the New York State Society of Certified Public Accountants (NYSSCPA) submitted for the record of October 25, 2007 hearing, entitled "Single Audits: Are They Helping to Safeguard Federal Funds", by the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security of the United States Senate Committee on Homeland Security and Governmental Operations

Chairman Carper, Ranking Member Coburn, and distinguished Members of the Subcommittee. Thank you for the opportunity to submit a written statement on the question of whether Single Audits are helping to safeguard federal funds. In an effort to address the many concerns raised in the "Report on National Single Audit Sampling Project" (the Report) by the President's Council on Integrity and Efficiency and the Executive Committee on Integrity and Efficiency, NYSSCPA President David Lifson created a task force: the "Committee on Governmental Audit Quality" (the Committee) to study the Report and develop recommendations. Committee members were chosen from four of the Society's most active and technically relevant committees—Government Accounting and Auditing, Public Schools, Not for Profit Organizations, and Health Care—and are some of the most knowledgeable people in the state regarding governmental and not-for-profit accounting and auditing.

Findings and Recommendations

To improve Single Audit standards, the Committee endorses the strategy outlined in the Report, which calls for the following three-pronged approach to improve Single Audit quality:

1. **Revise and improve Single Audit criteria, standards and guidance to address deficiencies identified by the Report;**

2. **Establish minimum requirements for completing comprehensive training on performing Single Audits as a prerequisite for conducting Single Audits and require Single Audit update training for continued performance of Single Audits; and**

3. **Review and enhance processes to address unacceptable audits and not meeting established training and continuing education requirements.**

The Committee notes the following, pertaining to the first recommendation:

Revise and improve Single Audit criteria, standards and guidance to address deficiencies identified by the Report.

- Office of Management and Budget (OMB) Circular A-133 sets out the requirements for Single Audits. The related Compliance Supplement and the AICPA's Audit Guide "Government Auditing Standards and Circular A-133 Audits" provide specific circumstances in which a Single Audit is required and the suggested audit procedures to be followed in a comprehensive manner. However, there is no single depository for all of this information and guidance. The lack of a sole source for this needed knowledge contributes to the struggle of audit organizations as well as auditees to identify the programs, which should be audited, and the extent to which the programs should be tested. Federal agencies providing funds for governments and not-for-profit organizations (directly or indirectly) need to work together with OMB and the AICPA to produce a single source to benefit the auditee agencies and their auditors.

- Federal funders and pass-through agencies must improve the information provided to recipients and subrecipients. OMB In cooperation with the federal funders must make a stronger effort to identify all programs and their requirements in the Compliance Supplement. The pass-through agencies at the state or local government level must comply with the requirement to identify which portion of the funds are being federally provided and which portion is coming from the state and local government's own resources.

The Committee recommends that a comprehensive database be established to provide the information needed for management to effectively administer direct federal awards and pass-through federal awards, and for auditors to be able to perform an effective and efficient audit.

Further, the Report concluded, in part, that the results indicate that Single Audits reporting large dollars of federal awards are more likely to be of acceptable quality than other Single Audits.

The Committee believes certain organizations may only occasionally expend federal awards in excess of the threshold for which a Single Audit is required in accordance with OMB Circular A-133. It further recommends that OMB Circular A-133 be amended to require a Single Audit only after the dollar threshold is reached for a consecutive period of two years. The funding agencies providing the funding in the initial year have the ability to request that a program audit be performed, thereby achieving the required assurance that its funds are being expended in accordance with the grant or contract terms.

The Committee notes the following, pertaining to the second recommendation:

Establish minimum requirements for completing comprehensive training on performing Single Audits as a prerequisite for conducting Single Audits and require Single Audit update training for continued performance of Single Audits.

- Government Auditing Standards issued by the Comptroller General of the United States (the "Yellow Book") together with the AICPA currently provide the standards for continuing professional education requirements for independent auditors who conduct the Single Audits of governments and not-for-profit organizations in accordance with OMB Circular A-133. The Yellow Book standards for continuing professional education require a minimum number of credits in subjects that are related to the government or not-for-profit environments or in subjects that relate to the industries in which recipient auditees conduct operations. (Generally, tax related courses are not counted towards that minimum). NYSSCPA is further expanding its complement of courses in the area of A-133 audits to address this recommendation.

- The requirements, with which to comply, are difficult to understand and for many smaller audit firms, expensive, requiring either the hiring of an outside instructor or attendance at seminars and conferences sponsored by professional associations. Self-study programs available from a variety of sources can be expensive as well.

- An audit firm requested by its clients to conduct Single Audits must exhibit the training and professional capacity to perform such audits.

The Committee believes that there is one significant element missing from the Report's recommendations. The Committee recommends that responsible members of recipient management of the agency also undergo mandatory education in the Single Audit process and the OMB Circulars that spell out the recipient's administrative requirements, including but not limited to procurement of audit services and the components of the costs/expenditures that can be charged against the grant or contract. As auditors we find that client management is often a bystander rather than a significant "partner" to the Single Audit process.

In accordance with the newly effective Statements on Auditing Standards (SAS), independent auditors will be required to report as a deficiency to those charged with oversight of clients, the inability of financial management to prepare the Schedule of Expenditures of Federal Awards and the inability to comply with the requirements of the OMB Circulars.

These new SAS's provide auditors with the ability to educate Boards of Directors and Trustees. These deficiencies will likely be findings that will be included in the A-133 audit reports because they deal with the matters covered by the audits. Management will be required to respond to the deficiencies noted and to provide an action plan to correct them. Having mandatory continuing education for auditee management as well as that already required for the independent auditor will create an atmosphere in which more effective and efficient Single Audits will be conducted.

The Committee recommends that OMB and/or Government Accountability Office (GAO) publish minimum continuing education requirements for appropriate levels of government and not-for-profit recipient management.

The Committee notes the following, pertaining to the third recommendation:

Review and enhance processes to address unacceptable audits and not meeting established training and continuing professional education requirements.

- The current environment provides for remedies and/or potential "punishment" for the auditor when an Inspector General finds deficiencies. These include re-audits or expanded audits as well as referral of the matter to the auditor's licensing or professional association.
- In a situation that arises from errors or fraud at the recipient level, there could be loss of funds or penalties for those responsible for the errors or fraud.

The Committee recommends that OMB/GAO establish remedies for responsible members of management who do not fulfill mandatory continuing education requirements in a manner similar to that provided for independent auditors.

Thank for your consideration of our recommendations.