

Danny Werfel

Danny Werfel is the Deputy Controller and currently serving as the Acting Controller of the Office of Federal Financial Management (OFFM) within the Office of Management and Budget (OMB). He is responsible for coordinating OMB's efforts to initiate government-wide improvements in all areas of financial management. Mr. Werfel plays a leadership role in coordinating OMB review of agency efforts under the Financial Performance, Real Property, and Improper Payments initiatives of the President's Management Agenda. Mr. Werfel is also responsible for coordinating the development of government-wide policy on financial accounting standards, grants management, and financial systems.

Prior to his current position, Mr. Werfel served as the Chief of the Financial Integrity and Analysis Branch within OMB, as a budget examiner in OMB's Education Branch, and as a policy analyst in OMB's Office of Information and Regulatory Affairs. Mr. Werfel also served as a Trial Attorney in the Department of Justice's Civil Rights Division.

Mr. Werfel is a recipient of both national and local awards from the Association of Government Accountants for his contributions to Federal financial management. Mr. Werfel also serves as a member of the Federal Accounting Standards Advisory Board.

Mr. Werfel holds a Masters Degree in Public Policy from Duke University, a Juris Doctor from the University of North Carolina at Chapel Hill, and a Bachelors Degree in Industrial and Labor Relations from Cornell University.

Testimony of Daniel I. Werfel

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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.

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 programs² 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.