



U.S. Department of Agriculture



Office of Inspector General
Southwest Region

Audit Report

Single Audit Management National Rural Water Association

**Audit Report 50022-9-Te
June 2005**



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL
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June 13, 2005

TO: Robert Johnson
Chief Executive Officer
National Rural Water Association
2915 South 13th Street
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ATTN: Claudette Atwood
Chief Financial Officer

SUBJECT: Audit Report 50022-9-Te, Single Audit Management – National Rural Water Association

We have completed our initial and quality control reviews of the single audit of the National Rural Water Association (NRWA) for the fiscal year (FY) ending February 28, 2002. The Certified Public Accountant (CPA) firm of Eldridge Gordon, Jr. P.C., performed the audit.

In our opinion, the audit of your FY 2002 financial statements and compliance with contracts and grant agreements did not meet the requirements for a Single Audit. Consequently, you should obtain an audit of your FY 2002 financial statements that meets the requirements of the Single Audit Act and Office of Management and Budget (OMB) Circular A-133.

Based on our review, we found several instances where the CPA firm did not meet the general requirements of the Single Audit Act of 1984 and the OMB Circular A-133. Specifically, the CPA firm did not test a major type-A program; did not audit 50 percent of the type-A major programs, as required; did not adequately document the working papers to support his completion of compliance requirements or his audit of indirect costs, and did not identify all findings. Our findings, in detail, and recommended corrective actions are presented under the Findings and Recommendations section of this report. Also under this section are excerpts from the auditee's response to the draft report and the Office of Inspector General's (OIG) position. The auditee's complete response, dated May 23, 2005, is included as exhibit A.

Based on this response, the auditee is working with its current CPA firm to provide a new audit of its FY 2002 financial statements that will comply with its contracts, grant agreements, the Single Audit Act and OMB Circular A-133. No further response is needed for this report.

BACKGROUND

The Inspector General Act of 1978, as amended (5 U.S.C. App. (1982)), requires Federal Inspectors General to ensure that non-Federal auditors comply with Generally Accepted Government Auditing Standards when they audit Federal programs, activities, and functions.

The Single Audit Act of 1984 (Public Act 98-502) and the Single Audit Act Amendments of 1996 (Public Law 104-156) initiated the issuance of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations (revised June 24, 1997). The circular set forth standards for obtaining consistency and uniformity among Federal agencies for the audit of States, local governments, and nonprofit organizations expending Federal awards.

The NRWA is a nonprofit federation of 45 State rural water associations from the 48 contiguous States. Incorporated in 1976, the affairs of NRWA are directed by a board of directors composed of members from each State association. NRWA provides training and onsite assistance to rural water and sewer systems throughout the United States through grants and contracts received from the Environmental Protection Agency (EPA) and the U.S. Department of Agriculture's, Rural Utilities Service (RUS).

OMB Circular A-133, dated June 24, 1997, required recipients of Federal funds, expending more than \$25 million a year in Federal awards, to have a cognizant agency for audit. The NRWA expended over \$27.8 million in its FY 2002. The U.S. Department of Agriculture had been its cognizant audit agency since FY 2000.¹ The Single Audit Act of 1984 and its amendments required A-133 audits of NRWA.

In performing the audit, the auditor should have used a risk-based approach to determine which Federal programs were major programs. This risk-based approach should have included consideration of current and prior audit experience, oversight by Federal agencies, and inherent risk of the Federal programs. The auditor should have identified the larger Federal programs (type-A programs) based upon the calculation threshold determined by OMB Circular A-133, subpart 520.² Under certain circumstances, a type-A program can be determined as low-risk. The auditor should identify type-A programs that are low-risk. For a type-A program to be considered low-risk, it should have been audited, as a major program in at least one of the two most recent audit periods, and should not have had any audit findings, or changes in personnel or its system. At a minimum, the auditor shall audit all type-A programs, except those identified as low-risk. The auditor shall audit Federal programs with Federal awards expended that, in the aggregate, encompass at least 50 percent of total Federal awards expended. If the auditee meets the criteria for a low-risk auditee, the auditor need only audit Federal awards expended that, in the aggregate, encompass at least 25 percent of the Federal awards expended.

¹ Designated as the Federal agency contributing the predominant amount of direct funding to the recipient, unless OMB designates another specific cognizant agency for audit assignment.

² Three percent of total Federal awards expended

OBJECTIVES

The objectives of the initial review and quality control reviews were to (1) ensure that the audit reports met applicable reporting standards and OMB Circular A-133 reporting requirements, (2) identify any followup audit work needed, (3) identify issues that may require management attention, and (4) ensure that the audits were conducted in accordance with Generally Accepted Government Auditing Standards and generally accepted auditing standards.

SCOPE AND METHODOLOGY

We reviewed NRWA's audit report for the year ending February 28, 2002, the CPA firm's working papers supporting its audit of those financial statements, and the NRWA's compliance with laws and regulations. We planned and performed our initial review and quality control review based upon the Uniform Guide, President's Council on Integrity and Efficiency, of OMB Circular A-133 Audits.³ The focus of our initial review was the audit report. We focused our quality control review on the auditors' qualifications, independence, due professional care, quality controls, planning, and supervision. We also assessed the CPA firm's documentation of its work on Federal receivables and payables, major program determinations, internal controls, and compliance testing for major programs. We reviewed the working papers supporting the (1) schedule of expenditures of Federal awards, (2) followup on prior years' findings, (3) schedule of findings and questioned costs, and (4) data collection forms. We reviewed the CPA firm's working papers supporting its tests of two of six major programs and interviewed the CPA official. We discussed, by telephone, aspects of NRWA, EPA, and RUS grant operations with NRWA's Chief Financial Officer, EPA, and RUS officials. We also discussed interest bearing accounts with EPA, Oklahoma banking and NRWA officials, obtaining applicable data as needed. In order to determine the validity of the CPA's scope of work for the FY 2002 audit, we reviewed the scope of work of the prior two NRWA audits.

We met with the CPA at his offices in Oklahoma City, Oklahoma, on July 7, 2004, and obtained the working papers supporting the audit of NRWA's FY 2002 financial statements. We reviewed the working papers in our offices in Temple, Texas. We returned the working papers to the CPA on August 2, 2004.

FINDINGS AND RECOMMENDATIONS

FINDING 1: The CPA Did Not Provide Required Audit Coverage

The CPA did not audit sufficient type-A major programs. This occurred because the auditor improperly determined the auditee to be a low-risk auditee, which would only have required the testing of 25 percent of Federal awards expended, not the 50 percent coverage actually required. As a result, NRWA did not receive an audit of its FY 2002 financial statements conducted in accordance with the Single Audit requirements of OMB Circular A-133.

³ 1999 edition

OMB Circular A-133, section .520(e), states that, at a minimum, the auditor shall audit all of the following as major programs: all type-A programs,⁴ except those that have been audited in one of the last 2 years and such additional programs as may be necessary to comply with the percentage of coverage rule discussed in paragraph (f). Section .520(b)(1)(i), defines a major program to be one whose expenditures exceed \$300,000 or 3 percent of total Federal awards⁵ expended. Section .520(c)(1) states that a type-A program should not be considered a low-risk program unless it had been audited as a major program in one of the two most recent audit periods as required by Federal guidelines.⁶

OMB Circular A-133, section .520(f), states that the auditor shall audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 50 percent of total Federal awards expended. If the auditee meets the criteria in section .530 for a low-risk auditee, the auditor need only audit as major programs Federal programs with Federal awards that, in the aggregate, encompass at least 25 percent of the total Federal awards expended.

OMB Circular A-133, section .530, states that an auditee which qualifies as a low-risk auditee and eligible for reduced audit coverage in accordance with section .520 is one for which single audits have been performed on an annual basis that meet with the provisions of OMB Circular A-133.

The auditee, NRWA, expended Federal awards totaling \$27,866,073 in FY 2002. To meet the 50 percent criteria, the auditor would have had to audit expenditures of Federal awards exceeding \$13,933,036. However, the auditor indicated on the schedule of expenditure of Federal awards only that he audited as major programs those Federal awards with expenditures totaling \$8,927,194 in FY 2002.

Though the auditor determined NRWA to be a low-risk auditee, the auditee did not meet the criteria established by OMB Circular A-133, section .530(a). **The FY 2001 audit had audited the same three type-A major programs as the prior FY 2000 audit – allowing two type-A major programs to be unaudited for two audit periods.** In order to have met the criteria of section .530(a) those two major programs would have had to meet the criteria of sections .520(c)(1) and .520(e)(1), i.e., to have been audited in either FYs 2000 or 2001.

In addition, another major type-A program, other than the two the auditor audited in FY 2002 was required to be audited in FY 2002, since it had not been audited in FY 2001. Board Support Training became a grant administered by NRWA in June 2000, NRWA's FY 2001. FY 2001 would have been the first opportunity it could have been audited; therefore, it was absolutely required to have been audited in FY 2002. **Because Board Support Training, and the other two major type-A programs audited in FY 2002, were not audited in FY 2001, NRWA did not qualify as a low-risk auditee – eligible for 25 percent audit coverage.** Consequently, the CPA auditor did not audit sufficient type-A major programs to provide an audit in accordance with OMB Circular A-133 guidelines in FY 2002. It should be noted, however, that had the auditor incorporated Board Support Training into the FY 2002 audit, the audit coverage would still not have met the 50 percent audit coverage required, as follows:

⁴ Type-B programs are those not identified as type-A major programs.

⁵ Total Federal awards expended by the NRWA in 2002 were less than \$100 million.

⁶ OMB Circular A-133, dated June 24, 1997

| | | |
|--|------------|------------------|
| <u>Total Grants Administered by NRWA in FY 2002:</u> | | \$ 27,866,073 |
| Grants Audited by CPA | 32 percent | 8,927,194 |
| Addition of Board Support Training | | <u>1,047,802</u> |
| Prospective FY 2002 Audit | 36 percent | \$ 10,046,840 |

Required FY 2002 audit coverage would include the programs audited in FY 2002, the addition of RUS' Board Support Training and EPA's Groundwater and Wellhead Protection contract (\$4,141,241) or both contracts associated with EPA's Training and Onsite Assistance (\$4,361,613).

RECOMMENDATION 1:

Provide a FY 2002 audit that meets the requirements of the Single Audit Act and OMB Circular A-133.

AUDITEE RESPONSE:

The auditee stated, "As discussed in the exit conference, NRWA will contract with its current auditor to have an OMB Circular A-133 audit of the fiscal year ending February 28, 2002. All the findings and recommendations that have been discussed in the report will be implemented in connection with the new audit."

OIG POSITION:

OIG agrees with the action taken. No further response is needed for this report.

FINDING 2: Schedule of Expenditures of Federal Awards Incomplete

The schedule of expenditures of FY 2002 Federal awards incorrectly reported (1) contract numbers, (2) type-A major programs, and (3) award years and amounts expended. This occurred because the auditor did not verify the expenditures and other information with supporting data. As a result, Federal-awarding agencies may experience difficulty tracking expenditures by program area from year-to-year.

OMB Circular A-133, section .320(b), requires that the data collection form include the name of each Federal program, identification of each major program, and the amount of expenditures of Federal awards associated with each Federal program. Section .300 requires the auditee to identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received. Federal awards identification shall include the Catalog of Federal Domestic Assistance title and number, award number and year, and the name of the Federal Agency. Section .300(d) states that the auditee shall prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with section .310. Section .310 requires notes on the schedule of expenditures of Federal awards that describe the significant accounting policies used in preparing the schedule. At a minimum, the schedule shall (1) list individual Federal programs by Federal agency, (2) include notes that describe the significant accounting policies used in preparing the schedule, and (3) pass-through entities should identify in the schedule the total amount provided to subrecipients from each Federal program.

RECOMMENDATION 2:

Provide a properly formatted FY 2002 Schedule of Expenditures of Federal Awards indicating all of the Federal awards, the years of the awards and/or the contract numbers, the contract amounts associated with the awards, the expenditures associated with those awards, and which of those awards were audited with the FY 2002 audit.

AUDITEE RESPONSE:

The auditee's response indicated that all recommendations in this report would be implemented with the conduct of the new audit of its FY 2002 financial statements. See response to Finding 1.

OIG POSITION:

OIG agrees with the action taken. No further response is needed for this report.

FINDING 3: Working Papers Did Not Support Opinion on Compliance Requirements

The CPA's working papers did not support that the CPA performed sufficient auditing procedures to test NRWA transaction data for compliance requirements, other than limited tests of charges to the grants audited. The CPA limited compliance testing because he believed the grantee Federal agencies to be inattentive to noncompliance with grant agreements. As a result, Federal agencies and other users of the NRWA's financial statements may improperly rely upon the CPA's opinion of the NRWA's compliance with laws, regulations, and covenants of grant and contract agreements.

OMB Circular A-133, section, 235(b)(3)(iii), states that the auditor shall perform an audit of the financial statements for the Federal program and perform procedures to determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements consistent with the requirements of section .500(d). Section .500(d) states that the principal compliance requirements applicable to most Federal programs are included in the compliance supplement and that an audit of these compliance requirements will meet the requirements of this part. The auditor should review the provisions of contracts and grant agreements and the laws and regulations referred to such contracts and agreements; compliance testing shall include tests of transactions and such other auditing procedures necessary to provide the auditor sufficient evidence to support an opinion on compliance.

Though more than 90 percent of the Federal grant funds awarded to NRWA in FY 2002 were passed through to the States, the auditor did not test NRWA's controls over monitoring the State's expenditures in accordance with grant covenants or OMB Circular A-133, part 3, Compliance Supplement, requirements. In addition, our review of the auditor's working papers revealed no evidence that the auditor had performed suggested or alternative tests of compliance in the following areas:

- A review of the indirect cost rate proposal, or the charges of indirect or other allocated costs, for allowability as required by the OMB Circular A-133, part 3, Compliance Supplement. NRWA is required to submit its indirect cost rate proposals each year to its cognizant

agency⁷ for approval of its indirect cost rate; however, since 2001, NRWA had been submitting its indirect cost proposals to EPA, rather than to the U.S. Department of Agriculture, as required.

- A review of cash management procedures, including the deposits of grant fund advances into interest bearing accounts and remission of interest earned on those advances to the awarding entities, as required by OMB Circular A-133, part 3, Compliance Supplement.
- A review of transactions that “earmarked” a percentage of Federal awards expenditures for prime contracts and subcontracts for supplies, construction, equipment, or services to be made available to organizations owned or controlled by socially and economically disadvantaged individuals, women, and historically black colleges and universities at NRWA and to its subrecipients, as required by OMB Circular A-133, part 3, Compliance Supplement.
- A review of NRWA’s procedures for monitoring to preclude its own, and States’, use of debarred and suspended persons and firms vendors to fulfill contracts for goods and services funded with Federal awarded funds, as required by OMB Circular A-133, part 3, Compliance Supplement.
- A review of the financial and performance reporting requirements for recipients of Federal awards to ascertain that reporting was accomplished as required and that reporting was accurate and supported by documents indicating the need for, or the use of, funds to be distributed as required by OMB Circular A-133, part 3, Compliance Supplement. The auditor stated that he had verified that there was documentation to support the requests for advance or reimbursement, form SF-270, but he had not traced the amounts reported to source documents, except for payroll amounts for the two type-A major programs he audited, but he had not checked the math of the documentation to the forms.

FINDING 4: NRWA Official Limited Scope of Audit

The CPA conducting the audit of NRWA’s FY 2002 financial statements did not contact NRWA’s attorneys to determine the status of any then current or pending litigation against NRWA. This occurred because an NRWA official prevented him from conducting that audit step required by Generally Accepted Government Auditing Standards according to his working papers. As a result, the FY 2002 audit of NRWA did not meet standards of a Single Audit, despite the unqualified opinion received on the audit.

AICPA Codification of Statements on Auditing Standards, section 337.08, states that a letter of audit inquiry to the client’s lawyer is the primary means of obtaining corroboration of the information furnished by management concerning litigation, claims, and assessments. Evidential matter obtained from a client’s inside counsel is not a substitute for information outside counsel refuses to furnish. AICPA Codification of Statements on Auditing Standards, section 337.13, states that a lawyer’s refusal to furnish the information requested in an inquiry letter either in writing or orally would be a limitation on the scope of the audit sufficient to preclude an unqualified opinion.

⁷ The Federal agency providing the majority of Federal funding

While the lawyer(s) did not refuse to answer a CPA's inquiry letter, the CPA's working papers noted that a NRWA official refused to permit the CPA to make inquiry of the NRWA attorneys, indicating that various attorneys were used by the organization only for lobbying activities, and that it would not be necessary for the auditor to perform that audit procedure. In our opinion, preventing independent corroboration of management disclosures of litigations, claims, and assessments is a scope limitation in and of itself and should have generated a qualified opinion at the very least.

RECOMMENDATION 3:

Provide the CPA performing the FY 2002 audit with the names and addresses of its attorneys under retainer in FY 2002 and afford them all the cooperation needed to perform the procedures necessary to obtain corroboration of management's statements.

AUDITEE RESPONSE:

The auditee response stated, “* * * This finding was a matter of what was found to be in the auditor's workpapers and not what was found to be actual fact. We would like for this to be clarified in the final report.” NRWA officials indicated that they were “* * * fully aware that this (inquiry) was part of the scope of an audit and would allow current auditors to question the attorneys whether they disclose lobbying activities or litigations, claims or assessments. * * *.” Further, the auditee's response indicated that all recommendations in this report would be implemented with the conduct of the new audit of its FY 2002 financial statements. See response to Finding 1.

OIG POSITION:

While we did not alter the title of the finding, we did indicate that the working papers indicated the scope limitation. We do not know the facts—we only reviewed the CPA's working papers and noted that he did not inquire of the attorneys, noting the reasons. The impact is a scope limitation still, not just a compliance issue. However, because the auditee has agreed to obtain a new audit of the FY 2002 financial statements, the scope limitation versus compliance deficiency is a moot point once that audit is accomplished. We agree with the action taken. No further response is needed for this report

We appreciate the courtesies and cooperation extended to our staff during this review. Please contact Regional Inspector General Timothy Milliken at (254) 743-6565, or Senior Auditor James Goodwin at (254) 743-6593, if you have further questions or need additional information.

/s/

TIMOTHY R. MILLIKEN
Regional Inspector General
for Audit



National Rural Water Association

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May 23, 2005

REPLY TO ATTN OF: 50022-9-Te

SUBJECT: Single Audit Management – National Rural Water Association

TO: Timothy Milliken
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FROM: Robert Johnson
Chief Executive Officer
National Rural Water Association
2915 South 13th Street
Duncan, OK 73533

This letter is in response to the quality control review of the single audit of National Rural Water Association (NRWA) for the fiscal year (FY) ending February 28, 2002.

We were under the assumption that the audit complied with all the applicable requirements of the Single Audit Act and Office of Management and Budget (OMB) Circular A-133. As a result of the assurances and certifications that were received from the outside auditor retained to perform the audit, we received an audit that gave us the impression we had received the type of audit we had paid for.

As discussed in the exit conference, NRWA will contract with its current auditor to have an OMB Circular A-133 audit of the fiscal year ending February 28, 2002. All the findings and recommendations that have been discussed in the report will be implemented in connection with the new audit.

One comment regarding the discussion during the exit conference regarding Finding 4: NRWA Official Improperly Limited Scope of Audit. This finding was a matter of what was found to be in the auditor's workpapers and not what was found to be actual fact. We would like for this to be clarified in the final report. Finding 3 stated that "Working Papers Did Not Support Opinion on



Informational copies of this report have been distributed to:

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|---|-----|
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| Leah Nikaidoh, Single Audit Coordinator, Environmental Protection Agency | (1) |
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