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REPORT TO THE CONGRESS

UNITED STATES
GENERAL ACCOUNTING OFFICE

JUN 26 1975

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Problems In Reimbursing State Auditors For Audits Of Federally Assisted Programs

General Services Administration

**BY THE COMPTROLLER GENERAL
OF THE UNITED STATES**

FGMSD-75-22

JUNE 25, 1975

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

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To the President of the Senate and the
Speaker of the House of Representatives

This is our report on the problems State auditors have in obtaining reimbursement for audits of federally assisted programs. These problems are related to the indirect reimbursement procedures directed by the General Services Administration.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Director, Office of Management and Budget, and to the Administrator of General Services.

A handwritten signature in black ink, reading "Luther B. Starks".

Comptroller General
of the United States

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C o n t e n t s

		<u>Page</u>
DIGEST		i
CHAPTER		
1	INTRODUCTION	1
	Federal policy requires coordination with and reliance on State and local audit groups	2
2	FINANCING AUDIT COSTS OF FEDERALLY ASSISTED PROGRAMS	5
3	FEDERAL REIMBURSEMENT PRACTICES--THE INDIRECT APPROACH	7
	Payment of audit costs is subject to acceptance by program administrators	7
	Federal program administrators resist paying audit costs	8
	State program administrators resist paying audit costs	9
	Reimbursing through program administra- tors compromises audit independence and reduces opportunities to use State auditors	12
4	NEED FOR ALTERNATIVE APPROACHES TO REIMBURS- ING STATE AUDITORS	14
	The direct approach	14
	Advantages of direct approach	15
	Problems related to direct approach	15
5	CONCLUSIONS, RECOMMENDATION, AND AGENCY COMMENTS	16
	Conclusions	16
	Recommendation	16
	Agency comments	17
APPENDIX		
I	Letter dated March 25, 1975, from the Deputy Administrator, General Services Administration	18
II	Principal officials responsible for the activities discussed in this report	20

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

PROBLEMS IN REIMBURSING
STATE AUDITORS FOR AUDITS
OF FEDERALLY ASSISTED
PROGRAMS

D I G E S T

Many State auditors are unable to obtain reimbursements for audits of federally assisted programs because of the methods used to reimburse them for such work. GAO is recommending that the General Services Administration work with other Federal agencies to improve reimbursement procedures. (See pp. 5 and 16.)

When States accept funds under federally assisted programs, they are responsible for carrying out those programs efficiently, economically, and effectively, including auditing them with the same thoroughness with which State programs are audited. (See p. 1.)

To avoid duplication by Federal and State government auditors, the General Services Administration established a policy requiring Federal agencies to make maximum use of State audits by generally providing guidelines to State auditors on specifics they think should be covered in the audit.

Federal policy allows State audit costs to be charged against federally assisted programs, but State auditors are having difficulty in obtaining reimbursements because Federal and State program officials must approve State audit costs before they can be paid from program funds. GAO found that Federal and State program administrators resist using program funds to pay for State audits. (See pp. 1, 8, and 10.)

Forcing State auditors to rely on program administrators for audit resources has an important disadvantage. Because administrators are in charge of operations audited, they can resist making payments and thereby inhibit the auditor from maintaining the independence required for effective auditing. (See p. 12 and 13.)

When funds for audits are provided by or through program administrators, they can have a strong influence on the reporting, timing, and scope of the audits. (See pp. 12 and 13.)

General Services Administration and the other Federal agencies need to give more attention to making the existing procedures more effective and to consider more effective alternative approaches.

One alternative approach is direct contracting by the Federal agency audit organization with the State auditors.

--The Environmental Protection Agency has contracts with State auditors in California and New York describing the work desired and providing for direct reimbursement from the Agency audit organization. (See p. 14.)

--The Department of Labor's audit organization has a similar arrangement with the Legislative Auditor of Maryland. (See p. 14.)

GSA is willing to work with Federal agencies along the lines GAO proposed. (See p. 18.)

GSA said the same type of problems experienced by State auditors in obtaining reimbursement under indirect procedures would apply equally to local auditors who attempt to obtain reimbursement for audits of federally assisted programs. (See p. 18.)

CHAPTER 1

INTRODUCTION

Federal agencies, to satisfy their stewardship responsibilities, need to make internal audits and audits of organizations with which the Government has contractual relationships. State and local governments and private concerns having contractual relationships with Federal agencies engage in a variety of activities supporting Federal or federally assisted programs.

Section 113 of the Budget and Accounting Procedures Act of 1950 made top management within each agency responsible for the agency's own internal auditing by providing that:

" * * *The head of each executive agency shall establish and maintain systems of accounting and internal control designed to provide * * * effective control over and accountability for all funds, property, and other assets for which the agency is responsible, including appropriate internal audit * * *."

In discharging these responsibilities, most Federal agencies have established internal audit staffs that are responsible for auditing grants and contracts with other organizations and with State and local governments. Funds for these audit staffs are normally provided as part of administrative or management appropriations.

Responsibility for audit oversight of the various political subdivisions' program administrations varies widely among the States. States have audit staffs that are responsible for auditing many of the same programs that the Federal agencies audit. When States accept funds under federally assisted programs, they are responsible for carrying out those programs efficiently, economically, and effectively and for auditing those programs with the same thoroughness with which State programs are audited. Many municipalities have their own auditors who are responsible for auditing these same programs, and many have public accountants audit such programs.

Because various levels of government are responsible for auditing federally assisted programs, audit effort can be duplicated, time and money can be wasted, and the work of program personnel can be interrupted if auditors do not coordinate their work.

FEDERAL POLICY REQUIRES COORDINATION WITH
AND RELIANCE ON STATE AND LOCAL AUDIT GROUPS

Office of Management and Budget (OMB) Circular A-73 required Federal agencies to rely, as much as possible, on audits made at State and local levels. A primary objective was more efficient use of auditors through better coordination of Federal, State, and local auditing.

To provide for maximum use of State or local audits, Federal agencies generally provide guidelines to State and local auditors on specifics that should be covered in the audit.

OMB Circular A-73 was superseded by Federal Management Circular (FMC) 73-2 issued by the General Services Administration (GSA) 1/ in September 1973.

Agency top management remains responsible for the agency's auditing. FMC 73-2, however, strengthens the requirement that Federal agencies rely on non-Federal audits to the maximum extent possible, as follows:

"Reliance on non-Federal audits.

"In developing audit plans, Federal agencies administering programs in partnership with organizations outside of the Federal Government will consider whether these organizations require periodic audits and whether the organizations have made or arranged for these audits. * * * Federal agencies will coordinate their audit requirements and approaches with these organizations to the maximum extent possible. The scope of individual Federal audits will give full recognition to the non-Federal audit effort. Reports prepared by non-Federal auditors will be used in lieu of Federal audits if the reports and supporting workpapers are available for review by the Federal agencies, if testing by Federal agencies indicates the audits are performed in accordance with generally accepted auditing

1/In May 1973 the President, by Executive Order 11717, re-assigned a number of Government-wide management functions from OMB to GSA. To carry out these new responsibilities, GSA established the Office of Federal Management Policy, which issued FMC 73-2.

standards (including the audit standards issued by the Comptroller General), and if the audits otherwise meet the requirements of the Federal agencies."

* * * * *

"Coordination of audit work

"Federal agencies will coordinate and cooperate with each other in developing and carrying out their individual audit plans. Such actions will include continuous liaison; the exchange of audit techniques, objectives, and plans; and the development of audit schedules to minimize the amount of audit effort required. Federal agencies will encourage similar coordination and cooperation among Federal and non-Federal audit staffs where there is a common interest in the program subject to audit."

Coordination of Federal, State, and local auditing falls short of what is attainable. Our report to the Administrator of General Services (B-176544, Apr. 8, 1974), entitled "Increased Intergovernmental Cooperation Needed for More Effective, Less Costly Auditing of Government Programs," discussed the reasons Federal auditors had not relied more on State auditors' work and the actions needed and being taken to increase this reliance.

According to Federal audit officials:

- Formal procedures for coordinating audit plans of State and Federal auditors were lacking.
- The scope of many non-Federal audits were too limited to meet Federal needs.

According to State audit officials:

- Federal audit requirements should be standardized so that State audits could respond to Federal needs.
- Federal reimbursement practices should be improved so that additional audit resources could be obtained to satisfy Federal audit needs.

Requirements for State and local audit assistance have increased tremendously because of the proliferation and size of federally assisted programs. State auditors believe that

Federal agencies should recognize the varying effort and audit time spent on these programs and the need of some method to compensate the auditing agency. Several State auditors asked us to study Federal practices for reimbursing States for audits of federally assisted programs.

We held discussions with State auditors, legislative committee staff members, and agency program administrators and/or budget and finance officials in the following 16 States.

Alabama	Minnesota
California	Nevada
Colorado	New Hampshire
Connecticut	New Mexico
Florida	South Dakota
Georgia	Tennessee
Illinois	Utah
Massachusetts	Wisconsin

We also interviewed audit and other officials of the nine member agencies of the Federal Regional Councils established by Executive order in 1972 to improve coordination of the categorical grant system. These agencies are:

- Department of Agriculture
- Department of Health, Education, and Welfare (HEW)
- Department of Housing and Urban Development (HUD)
- Department of the Interior
- Department of Labor
- Department of Transportation
- Environmental Protection Agency (EPA)
- Law Enforcement Assistance Administration (LEAA)
- Office of Economic Opportunity (OEO)1/

1/On January 4, 1975, the Economic Opportunity Act of 1964 was amended by Public Law 93-644, and a new agency known as the Community Services Administration was established as the successor authority to OEO.

CHAPTER 2

FINANCING AUDIT COSTS OF FEDERALLY ASSISTED PROGRAMS

Representatives of the National Legislative Conference and the National Association of State Auditors, Comptrollers and Treasurers discussed with the Comptroller General the problem of obtaining reimbursement for audits of federally assisted programs. Although total audit costs are less when a State audit team satisfies all audit requirements, State audit costs are increased because of Federal requirements.

We discussed this matter with State audit officials in Alabama, Colorado, Connecticut, Florida, Georgia, Massachusetts, Nevada, New Mexico, Tennessee, and Utah. They said that more effective reimbursement procedures were necessary if they were to audit federally assisted programs.

The States' need for effective reimbursement procedures is further illustrated by the experience of the Department of Agriculture. Agriculture held a series of seminars in 1971 to persuade State audit representatives to increase the scope of their audits to satisfy Agriculture's audit requirements. In summarizing the results of these efforts, an Agriculture audit official wrote that one of the most persistent roadblocks to more State audit assistance was the lack of adequate funding. He reported that most of the audit groups contacted were willing to assist Agriculture but were unable to do so without more effective reimbursement procedures.

In only 1 of the 16 States we visited were effective audit reimbursement procedures employed on federally assisted programs. Colorado provided State assistance to Department of Health, Education, and Welfare (HEW) auditors relying on the State Auditor's audit of the Colorado Department of Social Services. The Colorado State Auditor expanded the scope of his work to include the work required by HEW guidelines. He was willing to do the additional Federal work because the welfare program administrators reimbursed him for it.

OMB Circular A-87, 1/ issued in 1968, prescribed principles and standards for determining costs applicable to Federal grants and contracts with State and local governments.

1/ On July 18, 1974, GSA replaced OMB Circular A-87 with FMC 74-4. GSA made no substantive changes, and comments in this report about OMB Circular A-87 apply also to FMC 74-4.

These principles and standards provided a uniform approach to determining allowable grant costs. That circular stated that, "The cost of audits necessary for the administration and management of functions related to grant programs is allowable."

State audit costs may be charged against federally assisted programs directly or indirectly. Audit costs may be charged directly when they are related to a specific project or program. Audit costs are generally treated as indirect costs, however, because they usually benefit more than one specific project or program.

Most Federal agencies allow State audit costs as indirect charges to grant programs. State auditors often have difficulty in having indirect costs approved and accepted by both Federal and State program administrators. The indirect approach to reimbursement and its related difficulties are discussed in chapter 3. We also found that the auditors of two Federal agencies had had good experiences by contracting with State auditors and making direct payments. The direct reimbursement approach and its advantages and disadvantages are discussed in chapter 4.

CHAPTER 3

FEDERAL REIMBURSEMENT PRACTICES--

THE INDIRECT APPROACH

Indirect costs are distributed to each program they benefit through a cost allocation process provided by FMC 74-4. Under this process State audit and other central agency costs (e.g., central motor pool, data processing, and purchasing) are included in a State-wide cost allocation plan usually prepared by a central agency, such as a finance department. HEW has been designated to approve these State-wide plans for the Federal Government. HEW's approval authorizes each State operating agency to add audit costs and other central agency costs to its own indirect costs. Thus a composite, indirect cost rate applicable to each State operating agency is created. This composite rate is submitted for approval to the Federal agency providing the largest amount of Federal support to the particular State operating agency.

Of the 16 States in our study, 11 had State-wide cost allocation plans that included audit costs, 3 had plans that did not include State audit costs, and 2 had no cost allocation plans. We attempted to get information on the total amount of audit costs reimbursed to each State by the Federal Government under FMC 74-4. This data, however, was not available on a reliable, centralized basis from the States included in our study.

PAYMENT OF AUDIT COSTS IS SUBJECT TO ACCEPTANCE BY PROGRAM ADMINISTRATORS

FMC 74-4 recognizes State audit costs as allowable charges against federally assisted programs and provides a process to allocate audit and other costs to benefited programs. It does not, however, dictate the extent to which the Federal Government will provide funds for audit costs or any other allowable costs. It also does not provide additional Federal money for paying allowable costs. Thus States with approved cost allocation plans are not automatically provided with Federal funds for the Federal share of allowable costs chargeable to federally assisted programs. Each Federal program administrator can decide whether to make funds available and each State program administrator can decide whether to charge allowable costs against the program.

Audit officials of Agriculture, HEW, HUD, Interior, LEAA, and OEO confirmed that reimbursements for State auditor assistance are subject to acceptance and approval by the

program administrator of the State agency administering the program. An Agriculture memorandum describes this approach as follows:

"The Department's Instructions covering the type of costs allowable in use of the grant incorporate provisions of Bureau of Budget Circular A-87. These Instructions specifically provide that State-conducted audits are an allowable cost item against the grant whether charged as a direct or indirect cost. The State agency responsible for the administration of the food distribution program and the grant should determine the portion of the funds that may be used for the audit program."
(Underscoring supplied.)

FEDERAL PROGRAM ADMINISTRATORS
RESIST PAYING AUDIT COSTS

Federal program administrators resist using program funds to pay for audit costs. In a memorandum to us, HEW's Assistant Secretary, Comptroller, identified the following problems with paying for indirect costs, including audit costs, under FMC 74-4.

"At least one * * * DHEW program, Head Start, is experiencing funding problems and is unable to pay full indirect costs. Some of the grantees under these programs are State and local units of Government but we cannot estimate the budgetary consequences upon them.

"The DHEW administers awards of the Appalachian Regional Commission, issued under Title II of the Appalachian Regional Development Act of 1965, as amended (PL 89-4). The Commission has advised us that it is opposed to paying indirect costs on its awards, virtually all of which are to State and local units of Government. Program awards totaled approximately \$28.5 million last year.

"There are two fundamental problems that we are encountering in paying Circular A-87 costs:

- "1. a lack of resources with which to review proposals submitted by States and localities in depth, and
- "2. a lack of funds to reimburse States and localities for progressively greater indirect

cost claims being made against our programs as the States and localities become more familiar with the Circular.

"These are problems confronting all the Federal programs subject to Circular A-87." (Under-scoring supplied.)

Agriculture and Labor have encountered similar problems.

In a December 1972 letter, the Assistant Secretary for Administration, Department of Agriculture, said:

"It is difficult to pay a State audit organization for performing audit service when the audit organization is not a part of the State agency administering the Federally assisted program. Where the State program agency does not contain the audit group, it is reluctant, as is the Federal program agency, to divert funds away from accomplishing the program.

"There is no provision for direct reimbursement to other agencies of the State for services (central services such as accounting, auditing, etc.) that they provide and that benefits the State program agency. Therefore, it is possible that the recognized cost of services performed will not be reimbursed to the performing organization."

The Department of Labor, region VIII, Manpower Administration, told its State agencies that FMC 74-4 costs would be financed only to the extent that funds were available and that such financing would not diminish program efforts.

STATE PROGRAM ADMINISTRATORS RESIST PAYING AUDIT COSTS

Agriculture held a series of seminars in 1971 to encourage State auditing of its programs. The seminars were held in 4 cities and were attended by State agency and audit officials from 25 States. Representatives of 14 States said they agreed with the concept of sharing audit responsibility if financing and other problems could be resolved but indicated that the primary barrier to more State help was the lack of Federal funds needed to increase State audit staffs. Most administrators at the seminar doubted that program money could be made available for audit costs because it was needed to operate the programs.

State officials we contacted were generally opposed to using program funds to pay for State central agency costs, such as audit cost. For example:

- The Director of the Legislative Finance Committee in New Mexico told us that most New Mexico operating agencies felt that Federal auditors, not State auditors, should audit federally assisted programs at no cost to the program.
- Administrative officials of the Connecticut Departments of Welfare, Labor, and Health; the Connecticut Board of Education; and the Massachusetts Department of Public Welfare told us that State auditor reviews of federally assisted programs were acceptable only if payments for such reviews would not reduce the amount of Federal funds available to operate the programs.

The statements of State education and health officials contacted typified the program administrators' attitude toward conserving program funds. They cited several examples where federally assisted programs had not been charged for all indirect costs because such charges would have reduced the amount of funds available for operating purposes.

- The Chief Administrative Officer, Connecticut Department of Health, told us that the department had not submitted an FMC 74-4 indirect cost allocation proposal to HEW for approval and had not tried to obtain Federal reimbursements for indirect service costs because such reimbursements would reduce the funds available to operate the program.
- The Massachusetts Mental Health Department had not charged its programs for indirect costs approved by HEW under the FMC 74-4 cost allocation plan. The Department's Assistant Administrator for Administration said one reason for this was to avoid using program funds for FMC 74-4 reimbursements.
- The Director, Division of Administration, Connecticut Department of Education, said the department had charged its program for only a minor part of the indirect costs approved in its FMC 74-4 plan. He expected a barrage of complaints from program administrators when the division tried to charge for all approved indirect costs.

--The Colorado State Health Department did not charge its programs for all indirect costs approved under FMC 74-4. The department's accounting branch chief told us its grants were not charged for all indirect costs because the charges reduced the funds available to operate the programs. State officials estimated that the department would recover \$650,000 in fiscal year 1975, if all approved charges were paid. Recovery of only \$350,000 was anticipated, however, because the department's policy was not to charge the programs for all indirect costs.

--The Comptroller, Colorado Department of Education, told us that his department had not charged its programs for indirect service costs because it would have reduced the funds available to operate the programs.

Colorado was the only State in our study in which the total amount of indirect central service costs was reimbursed under the FMC 74-4 allocation process. In fiscal year 1974, the State was reimbursed \$401,000 for indirect central service costs, of which \$321,000 was from State welfare programs. These reimbursements, however, confirm, rather than contradict, the point that program administrators resist charging federally assisted programs for indirect service costs. The welfare program administrators pointed out that welfare was an open-end Federal program and therefore the charges for indirect costs did not reduce funds available to operate the programs. HEW audit officials and various State fiscal officials told us the only major open-end federally assisted program was the welfare program.

Federally assisted programs administered by OEO and LEAA were the only ones we found being audited by State auditors with some regularity. OEO required its grantees to obtain annual audits made according to OEO guidelines. The costs of these audits were allowed to be charged to the grants. Money saved on audit costs, by getting a free audit from a State auditor in lieu of an audit by a public accountant, could, however, be used for other purposes.

LEAA requires annual audits of State grantees. LEAA audit officials plan eventually to rely entirely on State-level audits. Governors were advised that each State would be required to assume the major responsibility for thorough and complete audits of LEAA-funded programs. LEAA issued a guide containing its audit requirements.

LEAA audit officials said they did not have a formal policy of paying State auditors for the work necessary to

meet their audit requirements. State auditors were informally told that grant funds were available through State program administrators.

In the 16 States we visited, 7 State auditors had responded to LEAA's audit needs during their audits of LEAA programs. Of these seven State auditors, four had been reimbursed through the State agency administrator; one had not charged the State agency for his audit costs; one had not been paid, because the State had not decided whether to reimburse the State auditor, and one had not been paid because the program administrator believed funds in the LEAA grant were to be used only for audits of State agency subgrantees.

The program administrator in one of the reimbursed States had an opposing view. This State auditor had also audited LEAA subgrantees, but the program administrator did not believe that he was required to pay for them. At the time of our visit, the State auditor had been unable to persuade the program administrator to pay for over 1,300 hours of audit work. The State auditor said that billings for this work had not been honored although LEAA officials had told him that the audit costs were reasonable and that the grant funds could be used to reimburse him.

REIMBURSING THROUGH PROGRAM ADMINISTRATORS
COMPROMISES AUDIT INDEPENDENCE AND
REDUCES OPPORTUNITIES TO USE STATE AUDITORS

The need for reimbursing State auditors for their help is not the only reason for improving Federal reimbursement practices. Even if program administrators were willing to pay for State audit costs, forcing State auditors to rely on them for such payment would not be compatible with the auditors' requirement for independence. Furthermore, when payments for State or other audit services require approval by program administrators, Federal agency audit organizations have more difficulty in carrying out their responsibility to effectively coordinate audit coverage.

"Standards for Audit of Governmental Organizations, Programs, Activities & Functions," issued by the Comptroller General in 1972, was adopted for Federal executive agency audits by FMC 73-2. The standards state that professionals engaged in auditing government activities should be engaged by someone other than the officials responsible for these activities. This practice removes pressures that may exist if the auditor must criticize the performance of those who have engaged him and will be expected to pay him.

Audit independence requires the responsibilities of auditors to be separate from the responsibilities of program administrators. Payment by program administrators to State auditors for audits of federally assisted programs does not adequately separate the responsibilities of these two parties. When program administrators must be relied on to pay audit costs, the auditors' independence may be compromised. Also it is more difficult for Federal auditors to coordinate audit coverage and obtain maximum use of audits by State auditors under their circumstances.

LEAA's experience illustrates this problem. State audits of LEAA programs often do not include adequate coverage of LEAA audit requirements. The Director, Policy and Coordination, LEAA's Office of Audit, has said getting State auditors to include LEAA Federal audit requirements in their audit is a major problem. He believes that the ability to contract directly with State auditors would provide better coordination of the scope of audit work and would help bridge the gap between what the Office of Audit needs and what it gets.

A different reimbursement problem is illustrated by the experience of the Department of Transportation. A Transportation official told us Transportation was not involved with reimbursing State auditors. He said the only departmental program involving State-level administration was its Federal-Aid Highway Program and that this program was prohibited by law from accepting State costs that did not directly relate to Federal highway projects.

FMC 74-4 does not apply where the payment of costs is prohibited by law. Some Federal programs prohibit or limit the payment of indirect service costs. For example, Transportation's airport development programs prohibit payment of indirect costs. Also, title I of the Elementary and Secondary Education Act limits the payment of State indirect costs to either \$150,000 or 1 percent of the grant funds in any fiscal year. Some other HEW programs and a few grants administered by HUD, Interior, and Agriculture limit or prohibit the payment of indirect costs. Generally, however, audit costs are allowable. HEW believes the effect of legal limits on paying audit costs on its programs is negligible.

CHAPTER 4

NEED FOR ALTERNATIVE APPROACHES

TO REIMBURSING STATE AUDITORS

Because of the reimbursement problem under existing procedures, GSA and the other Federal agencies need to make the existing policy more effective and to consider effective alternative approaches.

THE DIRECT APPROACH

One approach which has been successful for EPA and Labor is the direct contracting approach.

EPA's Office of Audit has negotiated contracts with State auditors in California and New York for the audits of construction grants for waste treatment facilities. These audits determine whether the costs incurred agree with grant provisions. The audits are made as single efforts designed to serve both State and Federal needs.

The contracts require EPA's Office of Audit to reimburse State auditors. The audits are made according to EPA's "Audit Guide for the Construction Grant Program." The Director, Office of Audit, told us that direct financing of State audits provided better coordination of audit coverage of Federal audit needs than would be possible if program administrators paid audit costs out of grant funds.

The Office of Audit's budget is justified independently in EPA's budgeting process. These funds are used to pay State auditors and other contractors.

The Directorate of Audit and Investigations, Department of Labor, relies heavily on direct contracting with public accountants for audit assistance. In fiscal year 1974 it contracted with accounting firms for audits costing over \$4.4 million of various programs administered by Labor's Manpower Administration. The office also had a contract with the Legislative Auditor of Maryland for auditing all Federal funds and related activities of the Maryland unemployment insurance program. This agreement identified Labor's audit requirements and provided for direct reimbursement.

Labor's Associate Assistant Secretary for Administration said Labor's audit organization planned to contract directly with State auditors, as it now does with public accountants. He felt that audits coordinated through State auditors provided better coverage of Federal audit needs and were more consistent with the lines of audit responsibility. He pointed

out that audit funds should flow through the audit organization because it was responsible for auditing departmental programs.

The Directorate of Audit and Investigations must obtain money from program administrators to pay its auditing contracts. (These funds are not independently budgeted or appropriated.) Labor's appropriation for departmental management includes the total budget for the audit office except for contracting. The audit office gets its contracting money through fund transfers negotiated with top program administrators.

ADVANTAGES OF DIRECT APPROACH

The advantages in using the direct approach are:

1. Federal auditors are assured that their needs will be satisfied which, in turn, allows them to rely on State audit work as required by GSA. EPA and Labor said that coordination of audit coverage was improved.
2. Labor pointed out that direct relations with State auditors were consistent with the lines of audit responsibility as assigned in Federal agencies. This helps to insure that audit independence is maintained.
3. Legal prohibitions against using programs funds to pay audit and other indirect costs would not apply if audit costs were reimbursed directly by Federal auditors using funds appropriated to them for that purpose.

PROBLEMS RELATED TO DIRECT APPROACH

The primary deterrent to more widespread use of the direct approach is that most federally assisted programs rely on the indirect approach under FMC 74-4 and therefore are funded in a manner that does not provide adequate sums for contracting for audits. Funds included in grant programs for paying audit costs under FMC 74-4 would have to be transferred or directly appropriated to the budget of the Federal audit group for subsequent direct payment to State auditors or other audit groups.

Funds for EPA audit activities are justified independently in the budgeting process. These funds cover all types of audit services. EPA has followed the practice of directly contracting for audits with public accountants and State auditors. On the other hand, Labor's auditors receive an appropriation for personnel costs and negotiate with top program administration for transfers of contracting funds to the audit budget.

It is clear from our study that top management support, as well as vigorous GSA leadership, will be required to assist each agency in determining the best approach to reimbursement.

CHAPTER 5

CONCLUSIONS, RECOMMENDATION, AND AGENCY COMMENTS

CONCLUSIONS

Experience has shown that relying on program administrators to reimburse State auditors for audit costs is not effective. On the other hand, direct payment from the Federal auditor works well and promotes the kind of audit cooperation that is a more effective, less costly way of auditing programs in which both Federal and State governments are involved.

We cannot reliably estimate what savings in audit effort and cost can be realized by the cooperative auditing approach, but we believe they would be large. Moreover, fewer auditors visiting an organization means less disruption of the duties of program personnel.

We do not take the position that direct contracting is the only acceptable method of reimbursing State auditors. We believe, however, that improving Federal reimbursement practices is a prerequisite for expanding Federal use of the work of non-Federal auditors.

More direct contracting between Federal and State auditors will require modifying the budget procedures now used for most Federal audit groups. Funds included in programs for payment of audit costs under FMC 74-4 will have to be transferred or appropriated to the budget of the Federal audit group. This change will require support by agency top management and vigorous leadership by GSA's Office of Financial Management Policy.

Although we directed our review toward the problems State auditors had experienced in obtaining reimbursement under FMC 74-4, we feel that these problems would apply equally to local auditors who attempt to obtain reimbursement for audits of federally assisted programs.

RECOMMENDATION

We recommend that the Administrator of General Services work with OMB and other Federal agencies to develop effective procedures for reimbursing State and local auditors for audits of federally assisted programs.

AGENCY COMMENTS

GSA told us on March 25, 1975, that it enthusiastically endorsed any steps to further maximum use by Federal agencies of the work of non-Federal auditors. (See app. I.)

GSA agreed that attention needs to be given to the Federal Government's reimbursement procedures. GSA pointed out that present policy made audit costs eligible for reimbursement and that the principal problems were carrying out that policy.

GSA believes that a concerted effort should be made to obtain full compliance with FMC 74-4 and is willing to work with us and with OMB and other agencies to improve the reimbursement procedures.

UNITED STATES OF AMERICA
GENERAL SERVICES ADMINISTRATION
WASHINGTON, DC 20405



MAR 25 1975

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

Dear Mr. Staats:

Thank you for the opportunity to review and comment on the draft report, "Problems in Reimbursing State Auditors for Their Audits of Federally Assisted Programs," submitted to this office on March 7, 1975.

The report is a very useful document in pointing up some of the problems which deter State auditors from participating more extensively in the audit of Federal assistance programs. As the report points out, the General Services Administration has established a Government-wide policy requiring Federal agencies to use audits made by non-Federal auditors to the maximum extent practicable. We enthusiastically endorse any appropriate steps which further this objective.

The report concludes with the recommendation "that the Administrator of General Services work with OMB and other Federal agencies to develop effective procedures for reimbursing State auditors for audits of federally assisted programs." We note that the report, including the recommendation, is confined to the reimbursement practices of State auditors. We suspect that the same type of problem would apply to the auditors of local government and the auditors of other recipients of Federal grants. We believe it would be desirable to deal with the total problem rather than confining attention entirely to State auditors.

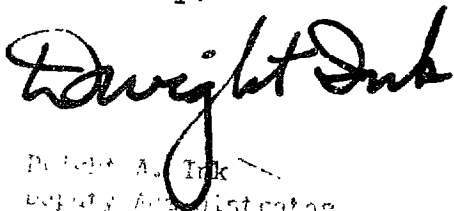
We also think it is important to recognize, as the report points out, that in accepting funds under federally assisted programs, States assume the responsibility for managing the programs. This includes the responsibility for auditing the

programs with the same thoroughness that State programs are audited. Such audits are to be made regularly, with reasonable frequency, usually annually, but not less frequently than once every two years as provided in Federal Management Circular 74-7. More emphasis needs to be placed on this responsibility as far as grant recipients are concerned. In this connection the Treasury Department has had excellent cooperation from State auditors in its Revenue Sharing program. We understand that, at the present time, Treasury has signed agreements with 39 States to audit all Revenue Sharing funds spent by the State and by local governments within the State. No reimbursement is involved.

We agree, however, that additional attention needs to be given to reimbursement procedures. Audit costs, along with other administrative costs, are now eligible for reimbursement under FMC 74-4 as the report points out. The principal problems lie in the implementation of that policy. We believe that a concerted effort should be made to obtain full compliance with the Circular. In this connection, I have asked our staff to see whether existing legal obstacles warrant the submission of clarifying legislation. Towards this end, we would be glad to work with your staff and other agencies concerned in seeking a resolution of the problems. In addition, we agree that alternative approaches should be explored such as the direct contracting by Federal auditors with State auditors. It may be that different approaches in different circumstances would provide the most practical solution to the problem.

In any case, we will be glad to work with OMB, other Federal agencies, and your staff, in order to improve reimbursement procedures as the report recommends.

Sincerely,



Dwight A. Ink
Deputy Administrator

PRINCIPAL OFFICIALS
RESPONSIBLE FOR THE ACTIVITIES
DISCUSSED IN THIS REPORT

Tenure of office
From To

OFFICE OF MANAGEMENT AND BUDGET

DIRECTOR, OFFICE OF
MANAGEMENT AND BUDGET:

James T. Lynn	Feb. 1975	Present
Roy L. Ash	Feb. 1973	Feb. 1975
Caspar W. Weinberger	June 1972	Feb. 1973
George P. Shultz	July 1970	June 1972

DIRECTOR, BUREAU OF THE BUDGET:

Robert P. Mayo	Jan. 1969	June 1970
Charles J. Zwick	Jan. 1968	Jan. 1969
Charles L. Schultze	June 1965	Jan. 1968

ASSISTANT DIRECTOR, OFFICE OF
MANAGEMENT AND BUDGET:

Dwight A. Ink	Feb. 1969	May 1973
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GENERAL SERVICES ADMINISTRATION

ADMINISTRATOR OF GENERAL SERVICES:

Arthur F. Sampson	June 1973	Present
Arthur F. Sampson (acting)	June 1972	June 1973

DEPUTY ADMINISTRATOR:

Dwight A. Ink	May 1973	Present
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