Single Audit Concept Quality vs Convenience
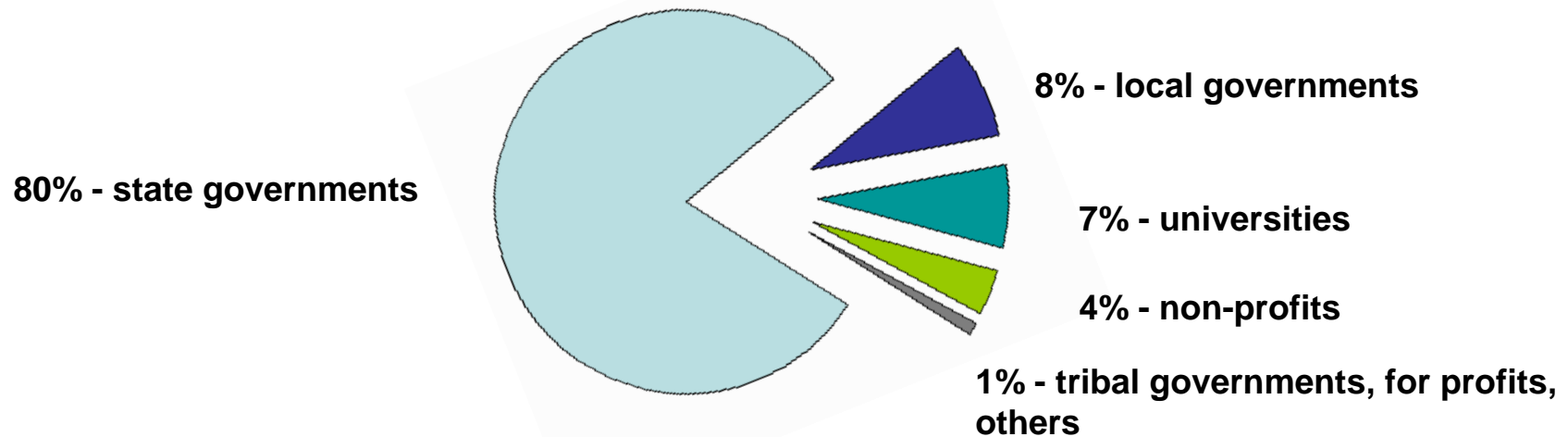
International Workshop on
Accountability in Science Funding
Strasbourg, France
June 6-7, 2007

Agenda

- Importance of Single Audits in U.S.

- Audit Requirements

- Past Problems With Audit Quality

- Results of Single Audit Quality Project
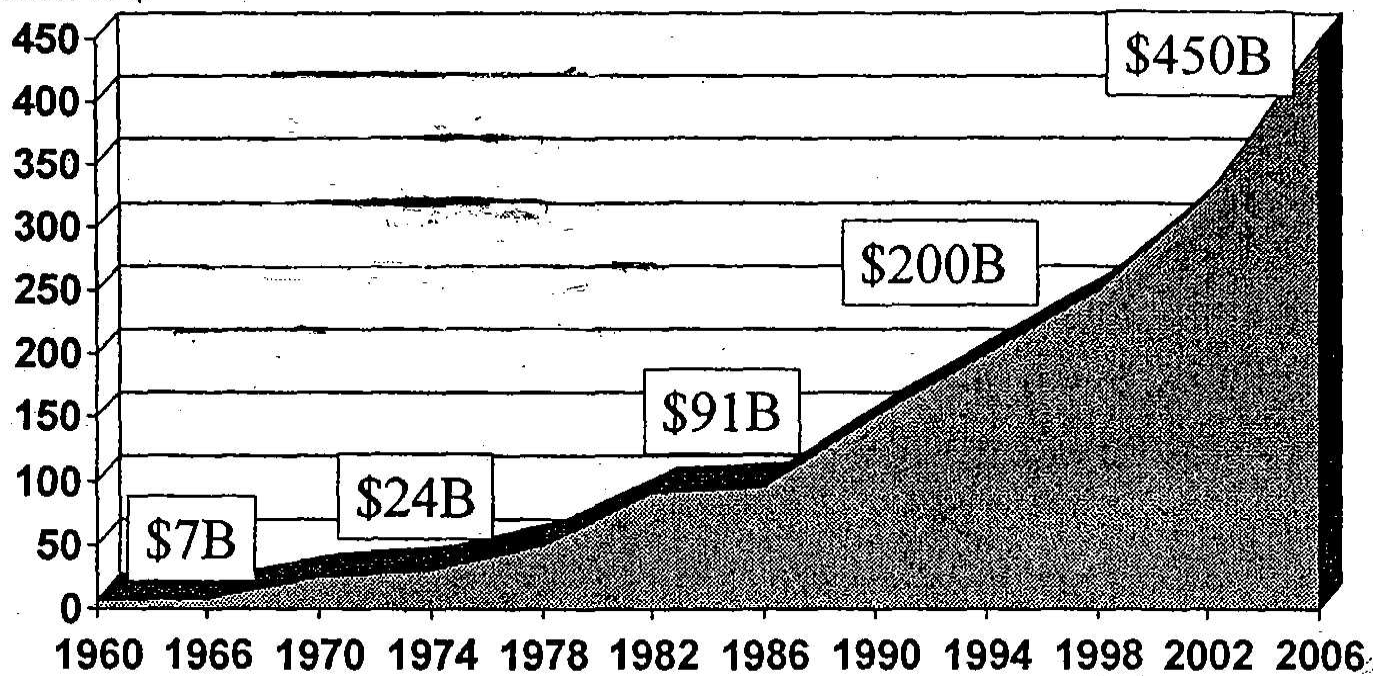
Distribution of Federal Grants

80% - state governments

8% - local governments

7% - universities

4% - non-profits

1% - tribal governments, for profits, others

2006 US Budget - $2.6 Trillion   Grants - $450 Billion

Steep Rise in Federal Grants Since 1960

In Billion of $

In Billion of $

450
400
350
300
250
200
150
100
50
0

1960 1966 1970 1974 1978 1982 1986 1990 1994 1998 2002 2006

$450B

$200B

$91B

$24B

$7B

CFDA lists more than 1000 Federal grant programs

Why Single Audits Are Important

- More $ require more accountability
- Single Audit Act (1996 Amendments) require institutions spending>$500,000 in a year on federal awards to obtain an annual audit
- Audit covers all federal awards received by the institution (known as Single Audits)

Why Single Audits Are Important

- Approximately 30,000 state and local governments and not for profit institutions submit single audit reports annually
- For most of these entities, the single audits are the ONLY on-site reviews of how federal dollars are expended

Why Single Audits Are Important

Therefore, single audits are heavily relied upon by many users, including:

- Federal agencies who award the grants
- Primary grantees who pass funds through to other institutions
- Congress who enacted the Single Audit Act requiring audits
- Public taxpayers who fund the federal grant programs

Audit Requirements

- Audit reports must be submitted to central audit clearinghouse (over 30,000 annual audits)

- Audits must be performed in accordance with federal audit standards and Circular A-133 requirements

A-133 Compliance Supplement

- Contains grant program requirements for specific federal programs
- Contains 14 common types of compliance requirements
- Provides mandatory instructions for auditors (audit objectives and suggested audit procedures to test compliance and internal controls over major programs)
- Covers currently 160+ federal programs, including the federal research and development cluster of programs
- Updated annually for new programs and requirements
- Content of Compliance Supplement affects quality of audit

What is Audited

- The financial statements
- Schedule of expenditures by federal award
- Major program compliance with laws, regulations and grant agreement
- Internal controls over major program compliance

Problems With Audit Quality

- Given the scope and coverage of the audits and the extent that stake holders rely on them, audit quality is critical
- But there have been questions about the quality of the audits for a number of years

Problems With Audit Quality

The Controller, OMB testified on June 26, 2002 that reviews performed by the Federal agencies identified "significant audit quality problems."

He also stated since the OIG selection of audits for review is not statistically based, "we do not know whether the problems noted significantly diminish ...agencies' abilities to rely on single audits to ensure accountability of Federal grants."

"We need an accurate measure of audit quality and it needs to be statistically based."

Single Audit Quality Project

- In 2003, seven Offices of Inspector General agreed to participate in a project to statistically assess the quality of Single Audits government-wide and provide a baseline for monitoring future Single Audit quality

Project Objectives

The objectives of the project were to:

- Determine the quality of Single Audits by providing a statistically reliable estimate of the extent that these audits meet applicable requirements, standards, and procedures, and

- Make recommendations for addressing audit quality issues, including recommendations for any changes to related audit standards and requirements

Review Scope

- Selected a statistical random sample of 208 Single Audits from a universe of 38,000 audits submitted for the period April 1, 2003 through March 31, 2004
- Provided for assessing quality of single audits in two strata:
  - large single audits which cover entities expending $50 million or more in a year
  - other single audits which cover entities expending between $500,000 and $49.99 million in a year

Review Methodology

- Assessed how well auditors planned, conducted and reported results of their audit related to:
  - testing of entity's internal controls for compliance with grant rules and requirements
  - testing of entity's actual compliance with specific major program requirements
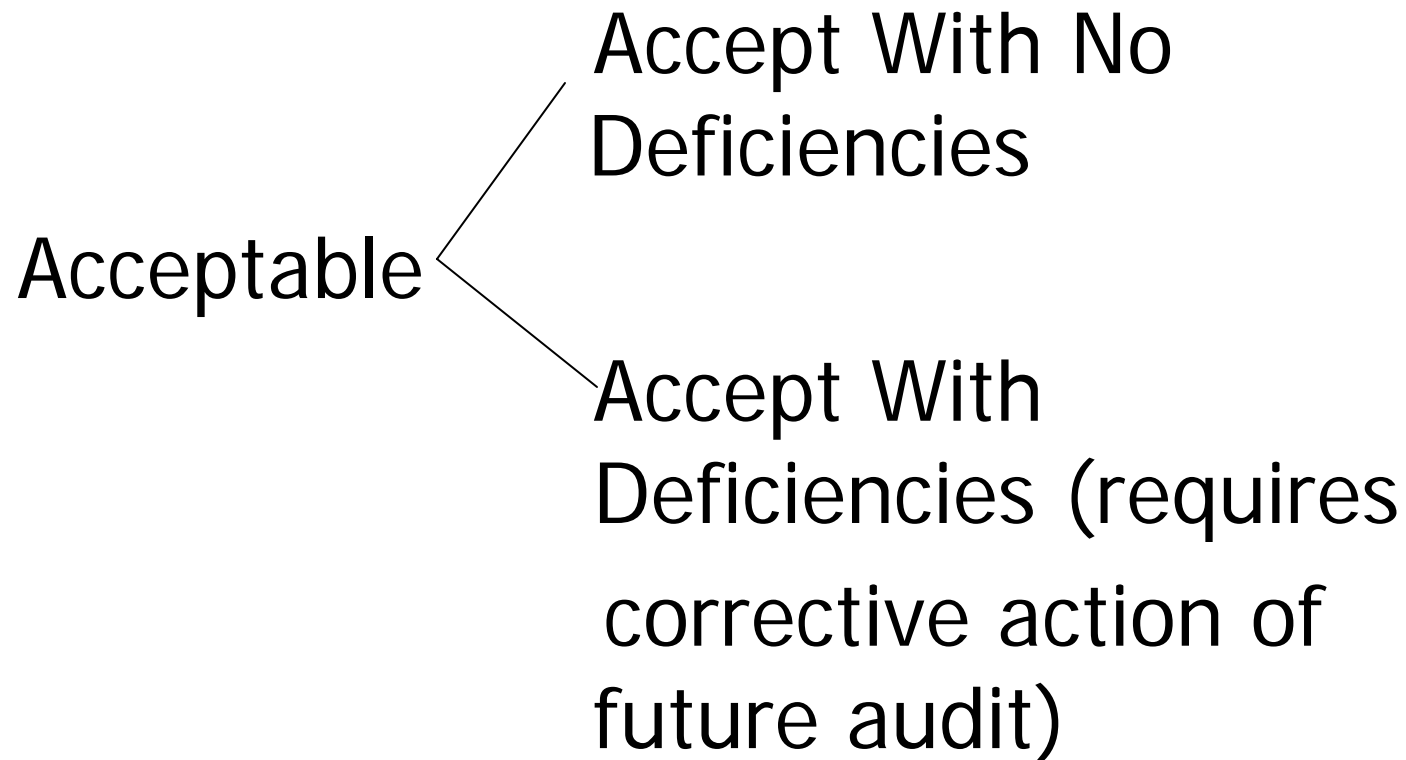 - content of report

Review Methodology

- Assessed quality of each single audit based on:
  - evidence contained in audit workpaper documentation
  - prevalence and severity of deficiencies
  - consensus of all members of project management team

Quality Assessment Categories

Accept With No Deficiencies

Acceptable

Accept With Deficiencies (requires corrective action of future audit)

Quality Assessment Categories

Limited Reliability —Significant
Deficiencies
(requires corrective
action of audit)

Quality Assessment Categories

Unacceptable — Material Reporting Errors (requires report to be reissued)

Substandard (requires audit to be redone)

Assessment Results -Total Audits

Acceptable	115	48.5%	18,683
Limited Reliability	30	16%	6,164
Unacceptable	63	35.5%	13,676
	208	100%	38,523

Assessment Results – Audits of Large Institutions

Acceptable	61	63.5%	541
Limited Reliability	12	12.5%	107
Unacceptable	23	24.0%	204
	96	100%	852

These 96 audits reported federal expenditures of $737 billion.

Assessment Results- Audits of All Other Institutions

Acceptable	54	48.2%	18,157
Limited Reliability	18	16.1%	6,065
Unacceptable	40	35.7%	13,449
	112	100 %	37,671

These 112 audits reported federal expenditures of $143 Billion

Assessment Results – Audits of NSF Institutions

Acceptable	27	80%
Limited Reliability	1	3%
Unacceptable	6	17%
	34	100%

➢ Note: These results are not statistically reliable

Major Types of Deficiencies

- Missing documentation to evidence audit work performed and/or basis for audit findings and opinion
- Inadequate review and testing of grantee internal controls over compliance with grant requirements
- Inadequate testing of grantee compliance with major programs grant requirements
- Incomplete and/or incorrect reporting of audit findings

Documentation Problems

Federal audit standards state that "audit documentation...should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditor's significant judgments and conclusions. ..."should contain support for findings, conclusions, and recommendations..."

Documentation Problems

Inadequate or

Missing Documentation = Audit work not performed or not sufficient

to support conclusions and judgments

Missing or poor documentation was consistent problem in the audits that were of limited reliability or unacceptable quality

Internal Control Review Problems

- Testing of grantee controls to ensure compliance with requirements governing major programs is an integral part of a Single Audit

- Circular A-133 requires auditor to perform work to obtain an understanding of internal controls over compliance and to test the controls

  - are controls properly designed?
  - are controls properly implemented?

Internal Control Review Problems

- 114 (54.7 percent) of single audits did not evidence that auditors obtained understanding of controls over compliance and 121 (58.4 percent) did not document testing of controls over compliance

- Auditors did review grantee controls related to the financial statements, but did not review controls specific to major program compliance

Internal Control Review Problems

- Without adequate review of compliance controls, the federal agency cannot be sure the grantee institution is meeting the program requirements or spending funds on allowable costs

Compliance Testing Problems

- Circular A-133 requires auditors to test grantee compliance with the major program requirements contained in a supplement to the Circular

Compliance Testing Problems

- For 113 (54.3 percent) of Single Audits, it was unclear what testing of grantee compliance with major program requirements was performed, or that all compliance requirements were tested

- This problem was primary cause for single audits judged as substandard

- This problem also existed to a lesser degree for the Single Audits categorized as having limited reliability

Reporting Problems

- Circular A-133 requires auditors to identify the major programs audited for compliance with program requirements
- But 18 (7 percent) of Single Audits incorrectly reported major programs that were not audited
- Misreporting the programs that were audited results in auditor expressing an opinion on a program that was not audited and federal agency making incorrect decisions on the level of oversight/monitoring it provides

Reporting Problems

- Circular A-133 requires auditors to report audit findings that identify certain things:
    - the affected federal awards and federal agency
    - the criteria or specific requirement on which the finding is based

Reporting Problems

- the condition found, including facts to support the deficiency and the amount of questioned costs

- the prevalence of the finding (isolated or systemic problem)

- the possible effect on the grantee or federal agency

- the recommendations to prevent further occurrences

Reporting Problems

- This information is needed for grantee to prepare a corrective action plan
- Without it, the problem may not get corrected
- But 49 (24 percent) of audit reports did not contain one or more required elements of the finding

Reporting Problems

- Also, 24 (12 percent) of audits identified matters that should have been reported as audit findings, but were not

Reporting Problems

- Because of reliance placed on Single Audits to provide accountability of taxpayer funds, noncompliance with major program requirements and other similar matters should be reported in the audit report

- If not reported, then auditor's workpapers should explain reasons/basis for not reporting

- Federal audit standards require auditors to document significant conclusions and judgments

Recommendations to Improve Audit Quality

- Revise and improve Single Audit criteria, standards, and guidance
- Develop training and establish minimal prerequisite requirements for performing Single Audits
- Impose monetary penalties for unacceptable audits and not meeting minimal training requirements

Revise and Improve Guidance

- Revise current federal requirements and professional audit standards and guide for conducting Single Audits to:

  - Include illustrative examples of minimal audit documentation to evidence auditor understanding and testing of internal controls over major program compliance

Revise and Improve Guidance

- Clarify the extent that auditor can rely on its internal control work related to financial statements to satisfy compliance control work

- Require the auditor to specifically document reasons for not testing any one of the major program requirements included in the Circular A-133 supplement

- Provide illustrative examples of properly presented audit findings

Revise and Improve Guidance

- Provide unambiguous language for when audit findings must be reported and resolve any uncertainty in favor of disclosure

- Require major programs that were audited to be identified by name in the report on compliance to emphasize the importance of correct identification of major programs

Improve Training and Requirements

- **Establish single audit training program that requires**
  - Development of a training program having minimal content and duration requirements and that are specific to Single Audits
  - All staff performing and supervising Single Audits to complete the training program as a prerequisite to initial audit and then every two years

Impose Monetary and Other Penalties

- Take action to address unacceptable audits
  - Impose civil penalties equal to 3 times cost of audit
  - Study and advise if and how current laws for suspension and debarment can be amended and/or implemented as another option

Next Steps

- Issue project report to Office of Management and Budget by 6/30/07

- Await action by OMB on report recommendations

Questions?

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