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Roland L. Madison

Daniel L. Cohrs

Sidny K. Zink

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# Nonbusiness Organizations

## Federal Grants

### The Single Audit Concept — With Multiple Problems

Editor:  
Roland L. Madison, CPA, Ph.D.  
John Carroll University  
Cleveland, OH

By Daniel L. Cohrs and  
Sidny K. Zink

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Since the inception of government grants there has been a need for monitoring. This has typically been accomplished through a process of grant financial and compliance auditing. Over the years, this process has undergone gradual change. Indeed, the substantial increase in governmental programs and grants over the years has been the impetus of most of these changes. For example, federal assistance to state and local governments increased from about \$3 billion in 1955 to \$90 billion for fiscal year 1980. The nation has seen myriad shifts in federal fiscal policy, including FDR's New Deal, the concept of revenue sharing, Lyndon Johnson's Great Society and, of course, "Reaganomics." Currently, the catalogue of federal assistance lists over 1,100 different programs which are administered by more than 50 agencies.<sup>1</sup>

#### Separate Grant Auditing

Inherent in most federal assistance programs were audit requirements which became a rallying call for many

CPA firms and practitioners. For years CPAs were engaged to perform a multitude of specific grant audits that followed the respective granting agency's audit guide and entailed primarily financial and compliance aspects.

As the amount of federal assistance proliferated over the years, the complexity and sheer magnitude of audit guides also grew at an overwhelming rate. A local government which previously had one federal grant to audit was being subjected to many different audits. Because of different year-ends, different compliance features, and different auditors these events often occurred simultaneously. As many governmental agencies will affirm, the audit function became an arduous, time-consuming and very expensive task.

These gradual increases also had ramifications for the auditors. On one hand, an area of service was growing, seemingly without limits, to the extent that entire firms engaged solely in

grant auditing. This growth was especially encouraging to many small and minority firms that could do the work expediently, yet with a respectable profit margin due to their volume of business. For example, CETA grant audits with their proliferation of tedious compliance requirements became the expertise of many firms, while remaining the bane of many others due to their complexity. It came to the point where a firm needed to do many separate grant audits to justify the expensive time required merely to understand the grantor's audit guide.

On the other hand, the audit guides were becoming so numerous and burdensome that even the audit firms specializing in governmental work were becoming confused, not to mention the confusion suffered by the grantees. By 1979, this gradual growth and adaptation had reached nearly unmanageable proportions. The U.S. General Accounting Office made a very important report to Congress on June 15, 1979. The very title of the report suggests that the situation was out of control: *Grant Auditing: A Maze of Inconsistency, Gaps and Duplication that Needs Overhauling*. In the same year, the *Joint Financial Management Improvement Program (JFMIP)* issued its report on a study of federal grant auditing. This report left no doubt that a change was mandatory. It stated that congressional intent was not being met, tax dollars were being wasted, and audits were not serving their designated purpose.

Simply stated, it was time for a substantive change in government audit procedures that could match the magnitude of the problem that had developed.

#### Attachment P Transition

On October 22, 1979, the Office of Management and Budget (OMB) boldly challenged the dinosaur at hand by issuing to all heads of executive departments a revised policy directive: *Circular A-102 Uniform Administrative Requirements for Grants-in-Aid to State and Local Governments*. This revised circular also included a new Attachment P, named *Audit Requirements*, which has served to change the entire direction of grant auditing. Although it was only six pages long, Attachment

P caused the mountain of previously issued grant audit guides to become obsolete.

Attachment P was the federal government's first recognition of the advantages of what has come to be known as the "single audit concept." This commendable display of efficiency requires audits of federally assisted programs of a reporting entity to be made on an organization-wide basis rather than on a grant-by-grant basis. It also established the concept of a "cognizant agency," whereby one federal agency is appointed by the OMB to serve a respective governmental entity as a clearinghouse for all the other grantors to that entity. Under this concept, City X no longer has to contract for several audits each year, e.g., an April 30 HUD CDBG audit, a June 30 CETA audit and a September 30 EPA audit, in addition to its December 31 general purpose financial statement audit. Rather, all of these audits are to be accomplished at once, at least biennially, through the use of a single audit guide and coordinated by City X's OMB appointed cognizant agency. Grant compliance is to be performed through a random selection of transactions from the total universe of all grant transactions, applying only a few but extremely important compliance criteria.

Since October 22, 1979, the accounting profession has been adjusting to this sudden change. Although few people argue with the necessity of the change, there have been a number of obstacles to overcome before full implementation is achieved. At this time, nearly four years after the development of Circular A-102, comparatively few single audits have been performed and many entities receiving federal grants-in-aid are still using the old grant-by-grant auditing techniques even though doing so is a violation of the law.

This transition period had to be expected. The single audit concept represents a distinct and extreme move toward efficiency away from years of a thoroughly ingrained inefficient practice. Personnel functioning in the federal government had to learn to accept these single audits. Many major departments had to accept cognizant agency roles and such acceptance was no easy process. Many of the

departments, such as the Department of Labor (DOL) had become accustomed to the extremely detailed compliance procedures required by the CETA guide, and acceptance of the single audit guide required a realignment of expectations.

To complicate the adjustments required on the part of federal government employees, Attachment P also affected a huge number of state and local governments and quasi-governmental organizations. Virtually every federal grant-in-aid "recipient organization" had to comply. Attachment P defines a recipient organization as "a state department, a local government, an Indian tribal government, or a subdivision of such entities, that receives Federal assistance."<sup>2</sup> Since few entities, as defined above, do not receive

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### Attachment P has changed the entire direction of grant auditing.

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some form of federal assistance, the six pages of Attachment P had an overwhelming impact across the country.

The OMB appeared to be so anxious to get this sweeping change initiated that it was passed into law without first issuing some of the required implementation tools. Item 5 of Attachment P indicates that single audits are to be made in accordance with the compliance supplement which was not issued until almost a full year later in August 1980. Subsequent to issuance, it was revised and the draft revision dated July 1982 has been finalized, but is not yet sufficiently available for general usage.

Cognizant agency assignments and guidelines were also delayed. The country's 300 largest local governments were not given their cognizant agency assignments as required under *Cognizant Audit Agency Guidelines* under OMB Circular A-102, Attachment P until March, 1982. In fact, as recently as September 1982, the OMB issued Circular A-50 Revised, *Audit Follow-Up*, as an additional aid to the recently named cognizant agencies.

Meanwhile, in this period of transition, auditors were not reacting passively. Recognizing the importance of the project and its success, auditors were engaged in several pilot single audits throughout the country in an attempt to work out the details of implementation. Among the topics addressed were the definitions of the grant universe, compliance testing selection procedures, the scope of the audit and the types and format of audit reports to be issued.

Rather surprisingly, during the period of implementation and adjustment, there appears to have been little said about noncompliance penalties. Perhaps this is largely due to the fact that Federal departments such as the DOL, HUD, EPA and Education ultimately receive all their funding through the OMB and the adage "money talks" would seem to apply. Question 28 in the OMB's *Questions and Answers on the Single Audit Provisions of OMB Circular A-102 "Uniform Requirements for Grants to State and Local Governments"* addresses this issue and indicates, in part, that if noncompliance with Circular A-102 exists, repayment of federal funds:

*is an option open to Federal agencies and is usually used only as a last resort. However, there are other remedies that federal agencies may impose depending on the circumstances. These might include a reduced indirect cost rate for future grants or withholding funds until the audit is completed.<sup>3</sup>*

As discussed previously many CPA firms and practitioners made a living almost exclusively through separate grant auditing. These firms, including many minority firms, were built over a long period of time and grew concomitant with the gradual increase of federal grants-in-aid. Suddenly, with

the advent of Attachment P, it would seem that these firms were immediately obsolete with those units needing single audits possessing a penchant for larger firms. This particular ramification of the sudden change was also addressed within Paragraph 16(a) of Attachment P which:

states that grantees shall assure that small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals as defined in P.L. 95-507 are used to the fullest extent practicable (OMB, October, 1979).

This provision effectively provides an alternative so the fears of entire firms being placed out of business overnight appeared to have been allayed. Another relevant observation which has not been considered formally is the fact that it has taken and will yet take a long time before all grantees are in full compliance. Therefore, these separate grant audits are still being performed by many firms and it will undoubtedly be several more years before they are displaced by single audits.

## Current Implementation

This brief history of grant auditing brings us to the present time which is nearly four years after the rapid audit change mandated by "Attachment P." Auditors are now on the threshold of implementation throughout the country and single audits are no longer just a good idea, but are actually being done. Many of the initial "bugs" have been worked out and the necessary education of grantors, grantees and auditors has been, to a large degree, accomplished. In short, the concept is working and, once in place, many state and local governments have been pleased with the results.

It may be surprising to many practitioners to discover just how similar single audits are to commercial audits. In many respects this is refreshing, in that, for so many years grant auditing became a singular and unique category unto itself — bearing little similarity to "the real world." The accountant is no longer required to pour over the proliferation of audit guides, regulations and amendments required for separate audits. These manuals were

often contradictory, confusing and, at times, even humorous as anyone who has performed separate grant audits can attest. The HUD's lead-based paint compliance requirement is an example of humor and confusion.

When embarking upon a single audit there is no replacement for advance preparation. The first standard of field-work states in part that the "work is to be adequately planned,"<sup>4</sup> and this is especially critical whenever a new area is broached. To attempt a single audit without a thorough study of the appropriate literature will quickly lead to trouble.

Once the auditor has become familiar with the publications, subsequent actions depend, to a large extent, on the individual situation at hand. The

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Separate grant audits are being replaced by single audits.

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engagement letter should be explicit regarding Attachment P procedures to be performed in conjunction with the examination of the general purpose financial statements (GPFS). Attachment P does not require the preparation of GPFS (see Question 17 in OMB's *Questions and Answers*, December, 1981), but this is the most desirable and efficient situation.

Unfortunately, it seems that no matter how diligently advance reading is performed, the individual situation will generate an anomaly not anticipated. This should not prove insurmountable for an experienced auditor, in that all pronouncements require professional judgment to implement. Accountants should remember that for the first time in history, Attachment P has made grant auditing very similar to other audit engagements. Just like the commercial world, all state and local

governments are unique with their own peculiar accounting systems, issues and personnel. A compliance testing plan suited for a county may not be appropriate for a city, and the auditor must be flexible.

Also entailed in the planning stages are meetings, and no single audit is complete without them. Initially, meetings should be held by the auditors internally to ensure that all personnel assigned to the engagement have a thorough understanding of Attachment P and the related literature. Next, preliminary meetings should be held with the grantee entity (client) to gain an early understanding of the grant universe and the status of cognizant agency assignment. Key personnel within the client's management should also be encouraged to review the professional literature to establish better lines of communication. This will make the client aware of the work to be done and the special client assistance the auditor will require.

If the client has not yet been assigned a cognizant agency, it is to the auditor's benefit to assist the client in obtaining one before significant progress is made in the audit process. The OMB's *Local Government Audit Assignments* (March 1982) indicates that:

cities, counties and towns not among the 300 largest local governments are assigned to the department or agency that is responsible for negotiating their indirect cost rates under Circular A-87.... Smaller cities, counties and towns that are not among either the 300 largest nor among those assigned under Circular A-87, are assigned to the Federal Agency that provides them the greatest amount of grant funds.<sup>6</sup>

Once this assignment has been agreed upon by the client and the auditor, it should, of course, be communicated and agreed upon in writing by the affected federal agency and the OMB. There should be no resistance on the part of either the federal agency or the OMB, in light of the latter's desire to accomplish total implementation.

Before the first meeting with the cognizant agency, the auditor should complete the identification of the grant universe and develop a preliminary audit approach, audit plan, testing plan and working paper format. This advance preparation will expedite the

actual performance and will prove invaluable when meeting initially with the cognizant agency. Because of the chaotic nature of grants-in-aid before Attachment P, the actual identification of all grants-in-aid may be difficult. The cognizant agency will probably have no knowledge of the total universe and even the client may not be sure that all grants have been identified. The federal government is currently developing and testing a central collection system of selected uniform information on federal financial assistance transactions known as the Federal Assistance Awards Data System (FAADS), but, until totally completed and operative, only the client with the auditor's assistance can define this universe (OMB, December, 1981).

The first meeting with the cognizant agency should result in approval of all the items indicated above. Although not mandatory, this approval is certainly prudent to avoid any misunderstandings after the audit is concluded. This approval should preferably be in writing to insure that all parties involved understand the audit approach, timing, scope and other pertinent issues. When dealing with the cognizant agency one should use a "reasonable man" approach. In its cognizant role, the agency must justify the audit and related issues to the other funding agencies, making the development of a good working relationship expeditious.

During the preliminary stages previously discussed, the auditor is also engaged in an identification of the major systems of internal control, the amount of audit reliance to be placed on each and the nature, extent and timing of compliance testing. These procedures are parallel to any commercial audit and differ only to the extent that state and local governments in general are more regulated than their commercial counterparts.

The auditor is responsible for determining whether the organization, program, function or activity under audit has complied with laws and regulations which may have a *material effect on the grantee's financial position* (OMB, February, 1980).

The exact meaning of what is material has been debated since the issuance of Attachment P and has yet to be resolved. Auditors have had a long-standing opinion of its definition and

grantors have had another viewpoint, which has been generally more restrictive. A letter dated December 1, 1982 from Associate Director of Management, Office of Management and Budget, to the Director of the Federal Government Division of the AICPA, offers some insight into the OMB's perspective of materiality, which is more restrictive than in the commercial arena. This should be clarified upon final issuance of the Audit Guide.

It is pointless to generalize on specific techniques for evaluation of systems of internal control and the related compliance since systems differ from one entity to another. This is one area for which there exists no substitute for professional judgement.

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### The entity must consider the cost/benefit relationship of the single audit.

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There exists no requirement for one testing technique versus another, but the "red book" does recognize the value of statistical methods if it makes sense in the circumstances. During the testing of compliance, the auditor will make reference to the *Compliance Supplement* which has incorporated specific requirements of 60 programs and provides over 90 per cent of the total federal aid to state and local governments. If the auditor has identified a material grant that is not included in the *Compliance Supplement*, they should identify and utilize the equivalent significant compliance requirements from the respective award agreement or the individual agency's regulations. The cognizant agency should be notified immediately of the intended procedures.

It should be kept in mind that the single audit currently encompasses

only federal grants-in-aid. An individual local government may have material state grants which should be considered in terms of audit compliance tests. Many states are accepting the single audit concept, but the auditor and client should be aware that unless they are federal pass throughs, states are not required to accept the single audit. This is an aspect that should be decided early in the engagement and an appropriate disposition made, dependent on the jurisdiction involved.

## Reporting

Assuming the audit progresses as planned, the next major delineation between Attachment P audits and commercial audits is the area of reporting. Chapter 5 of the Industry Audit Guide *Audits of State and Local Governments and Indian Tribal Governments Conducted under the Audit Requirements of OMB Circular A-102, Attachment P* (Working Draft August 1982) clearly describes the required three separate but interrelated reports as follows:

1. A report on the financial statements of the recipient of federal awards, including the supplementary schedule of grant awards;
2. A report on the internal accounting controls of the recipient organization; and
3. Comments on compliance of the recipient organization with the terms and conditions of federal awards and regulations.

*These reports may be bound together and issued as a blanket report for the organization or they may be issued separately.<sup>5</sup>*

In contrast to the separate grant audit reports, which only went to the individual grantors, it should be kept in mind by the auditor that the single audit report will be disseminated to others by the cognizant agency and read by several different agencies. Therefore, care should be exercised to provide for maximum clarity, particularly in the second and third reports previously mentioned, so that all readers can comprehend their intended meaning.

Chapter 5 of the Industry Audit Guide provides specific guidance regarding the types and nature of reports to be issued. It should be noted, however, that the schedule of grant awards or schedule of grant activity is an addition to the statements and schedules normally found in an entity's GPFS. This schedule should be a natural result from the other grant award compliance testing and substantive procedures performed during the audit and, if properly executed, should not require elaborate additional procedures. The actual format of this schedule can and does vary on a situational basis and should already have been agreed upon by the entity's cognizant agency during the planning stages of the audit.

### Cost of the Single Audit

A major aspect of the single audit in the minds of the governmental officials is the cost. Once again, it is difficult to estimate a uniform audit cost due to varying circumstances. A single audit, however, can generally be expected to cost more than an audit of the GPFS. This incremental cost may be projected to be as much as 20 per cent to 25 per cent, particularly in the year of implementation. Of course, many factors can precipitate this increase, such as the treatment of stub periods, the cooperation between the client and the cognizant agency, the adequacy of the accounting records, the quality of internal controls and grant documentation plus the number of grants administered by the unit.

From a cost viewpoint the single audit, once in place, will replace the various separate audits. Thus, total auditing fees for the year may not increase by as great a percentage when compared only to the examination of the GPFS, and it is possible they may even decrease in some cases. The entity must also consider the cost/benefit relationship, whereby under the single audit, the organization as a whole is

receiving a better and certainly more uniform quality of service for each dollar expended — which ultimately is to the benefit of all parties involved, inclusive of the taxpayers.

### Conclusion

Grant auditing has experienced many changes over the years. Some changes have been quite slow while others, like Attachment P, have been very revolutionary. Some changes may be labeled bureaucratic red tape while others, like Attachment P, are significant improvements. With the advent of Attachment P and its resultant efficient operating style, it appears that this aspect of the federal government is headed toward a desirable destination. It is in the best interest of all concerned — the government, the auditors and the taxpayers — that the course of change remain headed in this direction and the accountant must strive to see that the implementation and smooth operation of the single audit concept is successful. Ω

### NOTES

<sup>1</sup>Office Of Management and Budget, *Guidelines for Financial and Compliance Audits of Federally Assisted Programs*, February 1980.

<sup>2</sup>Office of Management and Budget, Attachment P to Circular A-102, *Uniform Administrative Requirements for Grants-in-Aid to State and Local Governments*, October 1979.

<sup>3</sup>Office of Management and Budget, *Questions and Answers on the Single Audit Provisions of OMB Circular A-102 "Uniform Requirements for Grants to State and Local Governments,"* December 1981.

<sup>4</sup>American Institute of Certified Public Accountants, *Statement on Auditing Standards No. 1*, 1973.

<sup>5</sup>Task Force on Guidelines for Financial and Compliance Audits of Federally Assisted Programs Industry Audit Guide, *Audits of State and Local Governments and Indian Tribal Governments Conducted under the Audit Requirements of OMB Circular A-102, Attachment P* (working draft), August 1982.

<sup>6</sup>Office of Management and Budget, *Local Government Audit Assignments*, March 1982.

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**Daniel L. Cohrs, CPA**, is an audit manager in the Denver Office of Fox and Company, CPAs. He holds a B.S. in Accounting from Oklahoma Christian College and is a member of the AICPA, the Municipal Finance Officers Association, and the Colorado Society of CPAs.

**Sidny K. Zink, CPA**, is an audit supervisor for Fox and Company, CPAs in Denver. She holds a B.S. in Business Administration from the University of Nebraska-Lincoln. She is a member of AWSCPA, the Nebraska and Colorado State Societies of CPAs, and the AICPA.