

7-1979

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Richard A. Scott

Rita K. Scott

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Recommended Citation

Scott, Richard A. and Scott, Rita K. (1979) "Audits of Federally Assisted Programs: Difficulties, Differences – and Opportunities," *Woman C.P.A.*: Vol. 41 : Iss. 3 , Article 5.

Available at: <https://egrove.olemiss.edu/wcpa/vol41/iss3/5>

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Audits of Federally Assisted Programs

Difficulties, Differences — and Opportunities

By Richard A. Scott and Rita K. Scott

There is a practice area of considerable size and importance that offers growing opportunities for Certified Public Accountants — audits of federally assisted programs. By the same token it can also be a quagmire that lies in wait to ensnare the unsuspecting who would enter without proper regard for its unique requirements and the risks¹ involved. This article is intended to point out some of the characteristic difficulties which attend these audits and to highlight certain basic differences from commercial engagements.

Identifying the Practice Area

The federal government distributes money and properties and provides technical and other assistance to a variety of units at the state and local level in the form of grants-in-aid, contracts, loans, loan guarantees, and insurance. Collectively they are referred to as "Federally assisted programs" and have been instituted by various pieces of legislation (Public Laws or "PLs"). More than one thousand programs are listed by the Office of Management and Budget (OMB) in the *Catalog of Federal Domestic Assistance*.² An estimated \$72 billion will be provided this year to 50 states, 3,000 counties and nearly 90,000 cities and towns, as well as innumera-

ble organizations closely associated with the federal government.³

Certainly the magnitude of these statistics is impressive. Perhaps even more impressive is the prospect for rendering professional service. By fiscal 1980 as many as 20,000 audits per year could result from the Comprehensive Employment and Training Act of 1973 (CETA) alone.⁴ Many of the 39,000 General Revenue Sharing Trust Funds which participating governments have established to receive Federal monies will be audited by CPAs. Neither the federal, state, nor local governments are equipped to handle tasks of these proportions.⁵ The opportunities for audit and MAS work are manifold.

The Federal Overseer

In 1973 President Nixon, by executive order, transferred administrative responsibility for Federal grants to the General Services Administration (GSA). In carrying out their responsibilities GSA issued a number of Federal Management Policy Circulars (FMCs) among which FMC 74-7 was particularly important; it contained standards for administering grants-in-aid. On December 31, 1975 the same administrative functions were transferred back to the office of OMB. They in turn revised FMC 74-7 and reissued

it on August 24, 1977 as Circular No. A-102 (Revised).⁶ A summary of significant changes contained in that document included a specification that grantee audits should be made in accordance with generally accepted auditing standards (GAAS) including the Government Accounting Office's (GAO's) *Standards for Audit of Governmental Organizations, Programs, Activities and Functions* (the "yellow Book"). The various Federal agencies charged with administering to the Government's assistance programs will apply these standards.

The Yellow Book Standards

How do audit standards contained in the Statements on Auditing Standards (SAS's) of the accounting profession differ from those of the yellow book? The GAO explicitly acknowledged the AICPA (American Institute of Certified Public Accountants) standards and subsumed them into their own. Insofar as standards for financial accounting and auditing are concerned there is substantial agreement between the two except where federal agency audit guides prescribe special principles at odds with those that are generally accepted. At one extreme a comprehensive basis of accounting other than GAAP may be encountered, in which case a special form of auditor's report is required.⁷ In between that extreme and GAAP one may encounter departures from GAAP which call for an "except for" qualification of the standard auditor's report.

But there is a more important difference in audit standards; one that stems from the broad duties and responsibilities of GAO. Because GAO is a "watchdog" agency of the Congress it concerns itself with matters of legal compliance, optimal use of government resources, and the outcomes of legislative programs. These objectives are reflected in the yellow book's statement of audit scope. The scope of an audit includes three elements (hereafter referred to as a "comprehensive audit").

1. Financial examinations and evaluations of compliance.
2. Evaluation of economy and efficiency.
3. Evaluation of program results.

A financial examination is within the traditional realm of CPAs and was touched upon above. To date audits of federally assisted programs have been largely directed toward this facet.

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However, government administrators and legislators are becoming increasingly concerned with management and program accountability. It seems reasonably safe to predict that the latter two elements which have heretofore been downplayed will grow in importance. Independent accountants will be impelled into a role that is less familiar than auditing in its traditional form.

Not all three elements are considered necessary in every instance, nor are they present in an unchanging degree of importance. It is critical at the outset, therefore, to clarify the audit scope with the contracting agency and to have it explicitly described in the engagement letter if it is not already specified in the audit guide.

Financial Examinations and Evaluation of Compliance

We mentioned earlier that CPAs are on familiar ground with respect to financial examinations. Fortunately, compliance reviews are also familiar to the independent accountant. The auditor is usually asked to ascertain whether a grantee has complied with laws, statutes and regulations which stipulate how funds are to be used. For example, procurement regulations requiring solicitation of bids and proper approval of contract change-orders are matters that are customarily reviewed in Environmental Protection Agency (EPA) construction grant audits.

The contracting agency has a responsibility to give the independent accountant sufficient guidance in these matters. Even so, it may come in a form that is difficult to work with or that is vaguely defined. The reader is urged to examine, as a case in point,

the *Code of Federal Regulations*, Title 40, "Protection of Environment" which applies to EPA and the grants which it makes.⁸ Or, an auditor may be asked to make a compliance review where the criteria are not defined in audit guides or other sources. Inadequate guidance with respect to the appropriate laws, rules, or regulations may compel the auditor to disclaim an opinion.⁹

Evaluation of Economy and Efficiency

The second element of a comprehensive audit involves determining whether government-furnished resources are being managed in an optimum manner. An independent auditor is not expected to render an opinion with respect to the economical and efficient use of resources entrusted to a grantee. Nor is a judgment expected concerning the performance of local management. The CPA is being asked to report upon specific procedures, methods, or activities that can be made more efficient or economical, and to make recommendations for bringing about changes. This entails issues such as the following:

1. Were expenditures really necessary?
2. Does duplication of efforts exist?
3. Are procurements made in economic order quantities, and are inventories at "lean" levels?
4. Is equipment operated at a high level of capacity?

Efficiency and economy should be viewed as relative terms, and thus their proximity to a maximum practicable level can be a subject of considerable disagreement. Clearly, the functions to be reviewed must be identified in the engagement letter and at no time should any assurances be given or implied concerning the overall operation of the entity.

Evaluation of Program Results

The federal legislation that gives birth to a program should set out the results and benefits that are anticipated. An appraisal of program results will evaluate the degree to which goals are reached, with proper regard given to the program costs involved. The strategies chosen, the directions taken, and how resources have been employed become important considerations. However, judgments concerning the wisdom of these actions will be extremely difficult to make. For them to be fairly made, criteria should

be articulated by legislators or implementing agencies and promulgated to decision-makers. The criteria ought to be measurable, and a system of data gathering instituted to provide a basis for managing the program toward its intended goals, as well as for evaluating the extent to which goals are achieved. "Success measurements" should be audited, but as the reader probably suspects, the state of the art is as yet embryonic. To illustrate, consider a case in point.

A local government receiving an EPA grant for its air pollution control programs would be expected to enact ordinances to effect changes that will meet EPA's air quality specifications. It would also be expected to monitor and control air quality and to bring pollution levels within quality standards. There are several facets of this program that could be audited. Was appropriate monitoring equipment acquired, installed and put to work? Have policies been established for taking timely abatement action in the event that violations are observed? Are data gathering systems in effect for recording open burning permits, fuel conversions, and registration of major industrial and institutional sources of emissions? An inventory of emissions¹⁰ taken periodically is an auditable set of measurements and is a significant determinant of program success, particularly when trends are considered. Another set of auditable measurements is the air quality monitoring data of pollutant concentrations such as sulfur oxides, carbon monoxide, and particulates in the atmosphere. National primary ambient air quality standards exist for defining unacceptable levels of these pollutants. Their monitoring entails taking readings of concentration levels at prescribe time intervals. The frequency and degree by which the standards are exceeded are objectively determinable facts that are subject to audit.¹¹ From this illustration the CPA's role emerges as potentially including activities such as:

1. Assisting in the design of control and information systems.
2. Assisting in the development of standards for measuring program results.
3. Audits of data on program activity which reflect the extent to which program goals are being attained.

GAO does not yet expect auditors to express an opinion on the success of programs, and CPAs should avoid giv-

ing wide-ranging assurances. At the same time it is well to remember that this is virgin territory and pioneering efforts could yield considerable rewards.

Other Considerations

The quality of accounting for federal funds is as varied as the governmental units themselves, and a correlation does not necessarily exist between unit size and excellence. On the whole, accounting information does not approach a quality level ordinarily found in business. Incomplete documentation and insufficient records often frustrate the auditor. A representative of one CPA firm arrived at a rural court house to find that all of the checks written during a period against a grant about to be audited had been inadvertently emptied into the incinerator by a porter. The entity employed a cash basis system to boot!

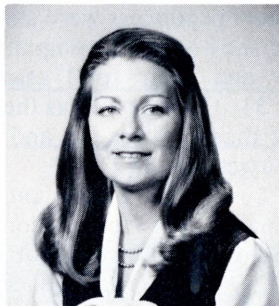
Audits may be conducted as much as several years after a grant is made, thereby making the situation more difficult to deal with. Compounding the problem, local personnel are often unfamiliar with the facts and circumstances surrounding the program because of high employee turnover. Furthermore, local personnel at times exhibit a lack of understanding of Federal grants and their compliance requirements. Record-keeping as a consequence often suffers. Auditors, too, can experience difficulties trying to cope with the myriad of audit requirements spelled out in dozens-upon-dozens of audit guides that have been issued by a plethora of federal agencies.¹²

In some cases independent auditors will be engaged by a local government unit, and in others by a federal agency. In the latter situation local government personnel tend to be guarded and mistrustful, and enlisting their assistance is difficult. The CPA is looked upon as an intruder sent there by Washington. On the other hand, auditors hired by local government authorities may be asked to make evaluations of economy and efficiency, and program results which could cast a critical light on the very persons engaging their services. Complicating matters even further, federal authorities expect CPAs to inform them of grantee deficiencies that are discovered, no matter who has engaged the auditors. It is like being caught between Scylla and Charybdis;

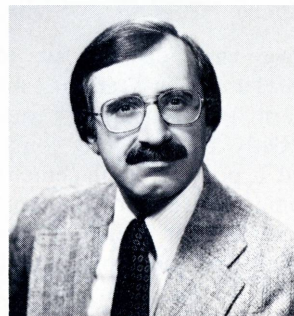
whichever turn is taken can have troublesome consequences.

Conclusion

Federal assistance programs have created an excellent opportunity for practice development. Because the vast majority have June 30th year-ends, these programs can be serviced by the CPA during the traditionally slower months. Prospects for financial and compliance audits are very good, and the possibilities created by expansion of economy and efficiency audits and evaluations of program results make this practice area both attractive and interesting. Although the complications and pitfalls accompanying an engagement of this sort are very real and should be held in proper regard, they ought not to impede the accounting profession's response to a call for service. □



Rita K. Scott, CPA, MS, is a senior accountant in the Richmond, Virginia office of Peat, Marwick, Mitchell & Co. She is an adjunct faculty member at Virginia Commonwealth University, is a member of AIC-PA and NAA, and serves on the Education Committee of the Richmond Chapter — VSCPA. She has collaborated with Richard A. Scott in previous publications.



Richard A. Scott, CPA, Ph.D., is Associate Professor of Accounting at the University of Virginia. He has been published in numerous accounting and business journals, is a member of the Journal of Accountancy's Editorial Advisory Committee, Chairman of the Virginia Society of CPAs Continuing Education Committee, and a consultant to the Va., State Board of Accountancy.

The quality of accounting for federal funds is as varied as the government units that use the funds.

FOOTNOTES

¹For a discussion of some of these risks see: Robert H. Werner, "CPA Opportunities in Federally Assisted Programs," *The CPA Journal* (July, 1976), p. 12.

²A partial listing of the more significant programs may be found in: "Audits of Federal Government Programs: Annual Roundups," *Journal of Accountancy* (May, 1974), pp. 34, 36, 38.

³Elmer B. Staats, "Shortcomings With Grant Auditing and Suggestions on What Needs to be Done," Remarks made before the AICPA National Conference on Federally Assisted Programs, Washington, D.C., November 8, 1977.

⁴*Ibid.*

⁵See for example: "Case Study — Illinois' Use of Public Accountants for Auditing State Activities," GAO Audit Standards Supplement No. 3. The appendix contains useful illustrations of written proposals, audit scope instructions, audit report content and form, and descriptions of auditor qualifications.

⁶"Uniform Administrative Requirements for Grants-in-Aid to State and Local Governments," *Federal Register*, vol. 42, no. 176, September 12, 1977.

⁷"Special Reports," *Statement on Auditing Standards No. 14* (AICPA, December, 1976), par. 4-6.

⁸See particularly: "Subchapter B — Grants and Other Federal Assistance."

⁹"Reports on Internal Control Based on Criteria Established by Governmental Agencies," *Statement on Auditing Standards No. 1*, (AICPA, November, 1972), Sec. 641.

¹⁰Emissions are registered as tons of pollutants entering into the atmosphere for a time period for a geographic area.

¹¹For further detail see: "Illustrative Report, Air Pollution Control Program, Sassafras County, Maryland," GAO Audit Standards Supplement No. 6.

¹²See: Thomas R. Hanley, "Expanding Practice to Include Federally Assisted Programs Requires an Added Library Shelf," *Journal of Accountancy* (July, 1975), pp. 37-41.