

**TESTIMONY OF MARY FOELSTER  
ON BEHALF OF THE  
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**

**BEFORE THE**

**SENATE SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT,  
GOVERNMENT INFORMATION, FEDERAL SERVICES, AND  
INTERNATIONAL SECURITY**

**OCTOBER 25, 2007**

On behalf of the American Institute of Certified Public Accountants and its 340,000 members, thank you for the opportunity to testify today on the President's Council on Integrity and Efficiency study, "Report on National Single Audit Sampling Project."

The AICPA has been representing CPAs in public accounting, corporate accounting, government and education for almost 120 years. It develops standards for audits and other services provided by CPAs, providing educational guidance materials to members, administering the uniform CPA examination, assisting its members in complying with the profession's technical standards, and enforcing compliance with ethical standards for the purpose of assessing continued AICPA membership.

The AICPA shares the commitment of the federal agencies involved in the study to the quality of single audits. Indeed, long before this report was released, and on its own initiative, the AICPA took a number of very significant steps to improve the quality of single audits.

I want to assure the subcommittee that the AICPA and its members take the results of this study very seriously. We are dedicated to working with the Office of Management and Budget, the Government Accountability Office, and other federal agencies on how to resolve the issues raised in the PCIE report.

In fact, the AICPA has already established several task forces to specifically address issues raised in the PCIE report and to consider other ways to improve audit quality. Each task force will carefully study the issues raised in the PCIE report. The task forces are:

1. Sampling/Materiality Issues In A Single Audit Environment
2. Internal Control And Compliance Responsibilities In A Single Audit Environment

3. Schedule Of Expenditures Federal Awards Reporting Issues
4. Reporting Audit Findings In A Single Audit
5. Single Audit Training Needs And Continuing Professional Education Evaluation
6. Practice Monitoring In A Single Audit Environment
7. Compliance Auditing Considerations In Audits Of Governmental Entities And Recipients Of Governmental Financial Assistance.

The AICPA executive committee that oversees the activities of the Governmental Audit Quality Center, which I will describe in detail later in my testimony, will also be evaluating the PCIE report from several perspectives. The first will be to determine what new activities and tools the center can offer its members and others in light of the study results. The second will be to consider whether there are any other actions that the AICPA should be taking either from the perspective of the recommendations in the report or other actions not contemplated in the PCIE report.

### **The AICPA's Role in Enhancing Single Audit Quality**

The PCIE report is based on audits that were performed in 2002 and 2003 and in some cases earlier. Since these audits were conducted and long before the PCIE report was completed, the AICPA has taken a number of very significant steps to enhance single audit quality. Indeed, the AICPA has been working at least as actively as any one involved in the single audit process to keep the quality of these audits as high as possible.

For more than twenty years, the AICPA has been devoting significant resources to assist its members perform quality single audits. The AICPA's focus has been to develop government-specific publications, including auditing and accounting guides, checklists and risk alerts; continuing professional education programs; and conferences that include numerous detailed sessions on performing single audits. The publications and programs are updated annually for new issues, standards, and practices that are generated by the government and the profession.

In more recent years, the AICPA has stepped up its commitment by adding new single audit-specific publications and single audit training. The publications now include a separate audit guide, related audit risk alert, and a practice manual. The AICPA publicizes federal IG and profession-determined deficiencies in various publications, continuing professional education (CPE) programs, and various public forums. We also facilitate a semiannual roundtable that brings together the key stakeholders in the single audit process including the OMB, the GAO, federal inspector general representatives, and members of the profession.

In September 2004, that is, almost three years before the PCIE report was released, the AICPA launched its Governmental Audit Quality Center. GAQC's mission is to promote the highest quality governmental audits and to help CPAs meet the challenges of this unique and complex area. GAQC is a resource for best practices. It also helps raise awareness about the importance of governmental audits and develops a community of

CPA firms that demonstrate a commitment to the highest quality governmental audit practices. Its web site -- <http://www.aicpa.org/GAQC> -- enables member firms to access information, guidance, and practical tools whenever they are needed. GAQC also sends electronic alerts to members with important news and developments.

GAQC member firms are required to adhere to membership requirements that go beyond what they would otherwise have to do to perform this work. For example, any firm joining GAQC must:

- Designate an audit partner to have firm-wide responsibility for the quality of the firm's governmental audit practice.
- Require the audit partner designated with firm-wide responsibility for the quality of the firm's governmental audit practice to meet the CPE requirements of Government Auditing Standards even if that partner is not otherwise subject to those CPE requirements. The firm must also require the audit partner to participate in an annual GAQC-sponsored program on recent developments in governmental auditing.
- Establish policies and procedures specific to the firm's governmental audit practice to comply with the applicable professional standards and GAQC membership requirements. These policies and procedures must be documented and appropriately communicated.
- Establish annual internal inspection procedures that include a review of the firm's governmental audit practice by individuals possessing current experience and knowledge of the accounting and auditing practices specific to governmental audits.
- Make publicly available information about its most recently accepted peer review as determined by the GAQC executive committee, and have its governmental audits selected as part of the firm's peer review by a team member employed by a GAQC member firm.
- Periodically file with the center information about the firm and its governmental audit practice and agree to make such information public.

GAQC's current membership of over 850 firms audits approximately 83 percent of the total federal expenditures covered in single audits performed by CPA firms.

GAQC is also resource for firms and government auditors who are not members. Many federal agencies are beginning to recognize this and are informing the center staff when matters of importance occur so that they may be communicated on the center site and in some cases through a GAQC alert.

GAQC also periodically communicates matters that are of importance to every auditor of record in the Federal Audit Clearinghouse database regardless of AICPA or GAQC membership.

GAQC continues to emphasize helping all firms better understand the importance and complexities of single audits and will play a key role in helping to address some of the PCIE report findings and educate firms that perform this work about the common deficiencies and how to avoid them.

### **The PCIE Report**

The subject of this hearing is whether single audits help to safeguard taxpayer dollars. The answer is an unequivocal “yes.” The report indicates that more than 92 percent of the dollars in the federal grants reviewed were in acceptable audits.

The PCIE report indicates that there are audit, documentation, and reporting issues, particularly in the smaller audits, that need to be addressed. The subcommittee should be aware, however, especially for those audits where the primary issues were with documentation and/or reporting, that those issues do not necessarily mean that the audit findings are incorrect and do not necessarily negate their benefits or outcomes.

For example, consider the material reporting errors (MRE) identified by the PCIE report in the unacceptable audit category. In many cases, the audits in the MRE category noted no other serious deficiencies. In these instances, the auditor did not correctly complete a required summary of the auditor’s results, but did audit the appropriate major programs in an acceptable manner.

But regardless of whether the deficiencies are technical or substantive, they need to be corrected. For many small grantees, the single audit is the primary, and in many cases the only, review of federal expenditures and compliance with federal regulations. In addition, audits have been shown to be an effective motivation for grantees to develop internal controls over their federal program expenditures to ensure compliance.

Auditors, of course, are responsible for carrying out a single audit in accordance with professional standards. Those standards or audit requirements for single audits are complex, particularly for audit firms that might only perform one or two smaller engagements each year.

Consider, for example, an audit firm in a rural part of the country. It audits several local commercial businesses and performs corporate and individual tax services. The small town in which it is located needs a single audit because it receives \$550,000 in federal money from three federal agencies. The audit firm is requested to perform the audit because it is the only audit firm within reasonable proximity.

The fact that the single audit is required means that the auditor must learn a multitude of rules and regulations from many different federal agencies, GAO, and AICPA. Many of these rules and regulations relate to compliance auditing, a service the firm does not regularly perform. For the firm to do the highest quality single audit, it must learn all of the rules and regulations and commit significant resources to fully understand the scope, complexity, and depth of audit procedures and documentation requirements for these audits. To accept the audit engagement, the firm must have the competency to do the work. But, the firm's commitment to dedicate such resources results in additional audit costs and higher audit fees that are at odds with the typical audit purchasing philosophy of smaller governmental entities.

While this is no excuse, it is time for federal agencies to take another look at the underlying single audit requirements to determine if they can be streamlined, particularly for grantees that receive relatively small amounts of federal dollars.

The PCIE report focuses its recommendations almost entirely on the auditing profession. But meaningful improvements in single audit quality will only occur when all of the key single audit stakeholder groups -- the auditing profession, procurers of single audit services, and the federal agencies -- are involved in the solution.

Procurers of single audit services, or grantees, are required to have a single audit when they expend \$500,000 or more in federal awards and have the responsibility to engage qualified independent auditors to determine that they have complied with the laws and regulations that relate to those awards. Some grantees take the auditor-hiring process very seriously and engage in a rigorous procurement process that focuses on the firm's qualifications, the experience of their staff, the extent of the firm's practice with similar organizations, the results of external quality control reviews, and the firm's participation in quality improvement programs, like the AICPA's Governmental Audit Quality Center.

Others, however, do not have a robust procurement process because of poor governance, lack of real involvement by audit committees, and management weaknesses. These entities are more likely to have poor audit quality issues.

The goal should be for all grantees to have robust governance structures that support the benefit of audits, consider the qualifications of a firm during the hiring process, and evaluate the reasonableness of the firm's anticipated hours in relation to the proposed fee based on the work to be performed. Until the governance structures of these entities are addressed, the quality enhancement we all seek will be much more difficult to attain.

The AICPA has heard that some federal agencies, particularly on the program side, question grantees in situations where they believe too much money has been spent on the audit fee. While the AICPA certainly understands the budget pressures on all levels of government, the PCIE report indicates that quality rather than least costly audits are what best protects taxpayers. Federal agencies need to educate their program offices accordingly.

The PCIE report shows a marked positive difference in the quality of the work performed in the larger audits, which are typically performed by the larger firms who tend to have greater internal resources to devote toward this complex and unique audit area. Another reason for the difference is the increased support by federal agencies for large grantees and their auditors. To make further strides in improving audit quality, more federal agency support of the single audit process is needed. The AICPA will work cooperatively to explore how enhancements to the OMB *Compliance Supplement* and other potential activities that might flow from additional federal resources in this area will improve audit quality.

### **PCIE Report Recommendations**

The first recommendation in the PCIE report is to revise and improve single audit criteria, standards, and guidance to address the identified deficiencies.

At a high level, the AICPA has reviewed the detailed findings and recommendations contained throughout the PCIE report regarding single audit criteria, standards, and other guidance. In response, we established the task forces described earlier in this testimony to review the detailed recommendations in the report to make appropriate enhancements to related AICPA standards or other guidance, including materials developed by OMB or the federal agencies.

The second recommendation is to establish minimum requirements for completing comprehensive training as a prerequisite for conducting single audits, and to require single audit update training for continued performance of single audits.

The AICPA has always been supportive of the existing CPE requirements contained in *Government Auditing Standards* and supports single audit-specific training. The PCIE report proposal recommends 16-24 hours of single audit-specific CPE as a prerequisite to performing single audits, as well as periodic update training thereafter.

It is difficult to assess whether this recommendation will help to resolve the quality issues cited in the PCIE report without better understanding the extent to which a lack of appropriate CPE contributed to the deficiencies found or, alternatively, that the CPE obtained by auditors associated with the acceptable audits contributed to that classification. The AICPA appreciates that the PCIE report identifies it as a key organization to assist in developing minimum content requirements for the comprehensive training that might be required and it stands ready to work with OMB as it studies this issue further and determines whether and how a CPE requirement should be applied.

Finally, the report includes a recommendation to review and enhance processes to address (1) unacceptable audits and (2) not meeting established training and continuing professional education requirements.

The AICPA fully supports a robust federal enforcement process and the federal government's use of all of the tools already at its disposal for addressing unacceptable audits. That includes the current suspension and debarment process, as well as the referral of auditors performing unacceptable audits to licensing agencies and professional bodies for appropriate discipline. Reviewing and potentially changing the current suspension and debarment process to make it more efficient and effective in addressing unacceptable audits seems like an appropriate course of action.

With regard to the recommendation to consider the establishment of fines to address unacceptable audits, The AICPA is not certain that this will improve audit quality any more than the tools already at the disposal of the federal agencies. For this reason, OMB should first improve the processes already in place before adopting this recommendation. If fines are ultimately sought, defined parameters should be established so that they are not abused or unfairly applied.

The AICPA, which is one professional body where federal inspectors generally refer unacceptable audits, takes seriously any allegation of poor audit quality by its members and investigates and takes appropriate action on all matters referred to it by the federal agencies. If a violation is found, our potential actions range from additional and specific CPE, to required concurring reviews, to work product follow-up, to suspension of AICPA membership and expulsion. The AICPA's Professional Ethics division is ready to investigate any referrals that federal agencies make, including any referrals that result from this federal study. Appropriate action will be taken for situations where the AICPA finds members who are not performing these audits in a manner that violates of our Code of Professional Conduct.

The AICPA will be pleased to work with OMB to explore improvements and to strengthen its referral and resulting investigative process. However, the AICPA does not license CPAs to practice public accounting; its mission is on the quality and accountability of our members. State boards of accountancy are responsible for licensing CPAs who practice public accounting and disciplining CPAs where appropriate and we encourage OMB to work with the state boards of accountancy to review the current referral processes and to suggest improvements.

## **Conclusion**

The results of this study raise important issues the profession has been and will continue to address. However, the results also indicate that the vast majority of federal dollars subject to single audit are reviewed in acceptable audits. The AICPA's efforts to help our members perform quality single audits are longstanding and have been recently enhanced.

We are confident that our more recent efforts, including our Governmental Audit Quality Center which was launched after the years PCIE reviewed in the study, are already beginning to address some of the issues raised in the PCIE report. With that said, we have established

task forces to address most of the specific recommendations in the report and stand willing to work with the OMB, the GAO, and the other federal agencies involved in the oversight of single audits to further address potential solutions to the problems identified in the study.

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