

Rejuvenating Single Audits for Greater Accountability

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December 23, 2022

In fiscal year 2023, the Biden administration expects to spend \$1.0 trillion – the equivalent of 4.1 percent of estimated GDP – on grants to state, local, territorial, and tribal governments. With so much money being distributed, there is a risk of significant waste, fraud, and abuse. To root out grant mismanagement, Congress should build on existing laws to improve oversight.

The most notorious recent case of federal grant misappropriation occurred during the pandemic, when states paid an estimated \$163 billion of federal funds to unqualified beneficiaries, mostly due to fraud. Another high-profile case of grant abuse occurred in 2019 when Puerto Rico’s former Education Secretary and former Health Insurance Administrator were arrested for mishandling \$15.5 million of federal funds. But, in most cases, finding problems with grant management is like looking for needles in a haystack.

Fiscally distressed state and local governments and those with poor financial controls are more likely to misappropriate or waste federal grant dollars. Fiscal distress can often be identified by reviewing an entity’s audited financial statements. Governments whose financial statements show very low or negative general fund balances and those that have very high liabilities relative to revenue are more likely to declare bankruptcy, default on municipal bonds, fail to pay vendor invoices or face a state takeover. When governments find themselves in a crisis, managers have a greater temptation to redirect grant funds from their intended purpose to other spending priorities.

The Single Audit Act of 1984 requires larger grantees to submit audited financial statements to federal oversight agencies each year. But this legislation has not achieved its full potential to protect taxpayers due to insufficient enforcement and lackluster rulemaking by the Office of Management and Budget (OMB), which controls Single Audit Act implementation. A package of three reforms could rejuvenate the single audit process to that it promotes grantee accountability and reduces the waste of taxpayer funds.

First, the government could enforce filing deadlines. Although single audit filers have far more time to file their audited financial statements than public companies (nine months vs. as little as sixty days), many auditees produce their reports months or years late, or not at all.

California, the nation’s largest sub-sovereign, is tardy for the fourth year in a row. The Commonwealth of Puerto Rico, the largest sub-sovereign entity to file for bankruptcy, has also been perennially late. The City of Compton, California has skipped filing multiple reports since 2014.

Although the original Single Audit Act required the executive branch to produce a list of non-compliant entities, such lists are no longer available. Further it is not clear that “naming and

shaming” is sufficient: Compton continues to be derelict despite being called out by the California State Auditor.

A more promising reform would involve withholding additional grant monies from tardy filers. For example, the federal government could withhold 10 percent of new grant funds to any government for the first three months after the filing deadline, and then 25 percent for further delays. Penalties should also be applied to governments whose financial statements are found to be unreliable by an independent auditing firm.

Next, OMB could require accrual accounting, which involves reporting financial obligations like pension liabilities as they are incurred. Accrual accounting has been part of Governmental Accounting Standards Board (GASB) standards since 2002, when the board required governmentwide financial statements using the full accrual basis of accounting.

Unfortunately, some categories of local governments, such as those in Arkansas and New Jersey, as well as school districts in Washington State, do not use GASB standards. Other governments scattered around the country present governmentwide statements using modified accrual accounting and are thus not fully compliant with GASB guidelines.

Federal law should require all single audit filers to follow government accounting standards just as all public companies are required to comply with standards set by the Financial Accounting Standards Board (FASB).

Finally, we should require standards-based machine-readable reporting. Financial statements provided in Portable Document Format are difficult to analyze, needlessly impeding comparative analysis of large groups of auditees. Although the Securities and Exchange Commission began requiring the use of eXtensible Business Reporting Language (XBRL) by public companies in 2009, state and local governments have not been subject to similar standardization, despite passage of the Grant Reporting Efficiency and Agreements Transparency (GREAT) Act of 2019, which mandated the application of machine-readable reporting standards to single audits.

Unfortunately, OMB has not implemented this mandate. New legislation should reprogram \$10 million of American Rescue Plan Act funds to support GREAT Act implementation. Congress should pair this funding with strict oversight to ensure no further delays in GREAT Act implementation.

By having access to more timely, consistent, and usable state and local government financial statements, federal oversight agencies, journalists, and citizen watchdogs can more readily identify grantees meriting further investigation.

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