

March 2, 2009

Members of the Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Joe Straus III, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas “Tommy” Williams, Member, Texas Senate
The Honorable Jim Pitts, House Appropriations Committee
The Honorable Rene Oliveira, House Ways and Means Committee

The following is a summary of information regarding audit and accountability issues for the State of Texas related to the American Recovery and Reinvestment Act (ARRA).

Recent Activities

The State Auditor’s Office (SAO) has been reviewing possible audit and other related implications of the ARRA. Recent SAO activities in this area include the following:

- Review of preliminary implementation guidance issued by the Office of Management and Budget to understand audit implications (see http://www.whitehouse.gov/omb/assets/memoranda_fy2009/m09-10.pdf).
- Conference call between the Government Accountability Office (GAO); the National Association of State Auditors, Comptrollers, and Treasurers (NASACT); and state auditors to discuss the GAO’s proposed approach to meeting requirements (for GAO) of ARRA. Some of the information included below comes from this conference call.
- Ongoing communication with the SAO’s contractor, KPMG, regarding audit implications. KPMG is a recognized national leader on federal Single Audit issues.
- Monitoring testimony by agencies at House and Senate committee meeting regarding stimulus funds and any needed statutory changes and related issues.
- Testimony by the State Auditor at the House Select Committee on Federal Economic Stabilization Funding on February 23, 2009, regarding possible accounting and audit issues related to ARRA.

Summary of Issues

There are two primary areas outlined in this document: (1) the need for changes to existing accounting and audit process to accommodate the new funds and (2) the requirement for additional reporting and related issues required under the ARRA.

Existing Processes Will Need Modifications to Address New Funds

- Currently, federal law requires entities expending more than \$500,000 in federal funds in a given fiscal year to receive an audit of their federal awards under

Office of Management and Budget Circular A-133 (this audit is referred to as the Single Audit). The SAO has statutory responsibility for auditing expenditures of federal funds in accordance with federal law. Currently, the SAO performs a portion of the audit work primarily related to federal funds at institutions of higher education, transportation, water, and public safety programs. KPMG, under contract with SAO, performs work related to health and human services, workforce, public education, and other programs. The receipt of the ARRA funds has the following implications for this audit:

- The federal government will likely require separate reporting on ARRA funds. Guidance will be provided on Catalog of Federal Domestic Assistance (CFDA) numbers in the near future.
- Federal representatives participating in the recent GAO conference call indicated that there would be separate “lines of credit” set up for the ARRA funds.
- The infusion of large amounts of federal funds will likely lead to more programs being subject to audit within the Single Audit, possibly up to a 30 percent increase in programs audited. This work will be divided between the SAO and KPMG.
- The Office of Management and Budget issues guidance for auditors on performing the Single Audit through documents entitled “Compliance Supplements.” A separate addendum to that guidance related to ARRA funds is projected to be published at the end of June 2009.
- The SAO has statutory responsibility for auditing the State’s financial statements. There will be increased audit work in association with the increase in federal funds, in some cases possibly requiring audit work in agencies and programs that may not have previously received significant federal funds or whose revenues and expenditures may not have previously been audited.
- Overall, state agency accounting and reporting systems will require modifications to support the flow of new funds. One change relates to the separate tracking of the new federal funds. Other changes relate to the timelines and reporting requirements for further subgranting of funds to local governments, nonprofits, and other subrecipients. Other issues include compliance with the federal Cash Management Improvement Act (CMIA), including whether or not ARRA funds will be subject to the CMIA.

There Will Be New Reporting and Accountability Issues

- Recipients, including states, will be required to submit quarterly recipient reports to the federal government under ARRA. As recipients of ARRA funds, states will be required to report on funds received, program activity, and certain performance measures. These reports will be filed beginning in July 2009, most likely through the recovery Web site (<http://www.recovery.gov>). How much additional state audit work would be advisable related to these quarterly reports is unclear at this time.
- There will be additional federal audits of these funds conducted by various federal audit groups.
 - The GAO has statutory responsibility under Section 901 of the ARRA to conduct reviews every two months of funds used by states and local governments. GAO will select 15 or 16 states at which to conduct audit work related to this responsibility, and it hopes to cover two-thirds of the total funds with those states.

These states will be notified by next week of their selection, and the GAO believes the first review must be filed in April 2009. The GAO will conduct the audit work but will seek assistance from state auditors in terms of risk assessment (awareness of issues at state agencies) and coordination with work that state auditor offices are already conducting.

- The GAO has responsibility under Section 1512 of ARRA to comment on the quarterly recipient reports noted above.
- The GAO will be coordinating work outlined above with state auditors.
- Both the GAO and other federal auditors will receive additional funding for the new audit work to be performed.
- For fiscal years ending September 30, 2009 and later, all Single Audit reports submitted to the federal government will be made available to the public on the Internet. A link will be provided on the recovery.gov Web site.

Testimony Summary

At the request of the House Select Committee on Federal Economic Stabilization Funding, the State Auditor testified on February 23, 2009. The testimony focused on state accounting and audit considerations related to the stimulus funds. The following are highlights from the presentation:

1) We recognize that the top priority is the distribution and utilization of funds for the purpose they are intended. The requirements for accounting and auditing should neither inhibit nor prevent the timely distribution or utilization of these stimulus funds.

2) State agencies should have resources to ensure the following:

- Accurate and timely accounting and sufficient documentation. The federal government has issued some preliminary guidance and is committed to issuing further guidance through a Web site (recovery.gov). The State may wish to issue specific accounting guidance related to the recovery funds as soon as that guidance becomes available.
- Internal Controls and Protection of Assets and Investments. Internal auditors at state agencies should have sufficient resources to review internal controls and assess the protection of assets and investments. Internal auditors should consider incorporating internal control and compliance issues related to the new federal funds into their audit plans.
- Adequate Waste, Fraud, and Abuse Prevention Programs. State agencies should maintain adequate waste, fraud, and abuse prevention programs. Agencies that have internal processes should continue to use those processes. In addition, agencies should refer complaints to the SAO through any of the mechanisms currently in place, including the SAO fraud hotline.

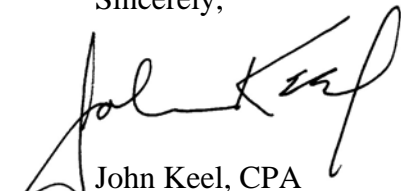
3) Issues Related to State Accounting for ARRA Funds

- Reporting on Federal Expenditures. The federal government will likely require reporting on ARRA funding expenditures by contract or grant award, specific to the ARRA funding. In addition, the ARRA will require recipients of the funds, including states, to provide quarterly reporting on funds received, funds expended, and various programmatic matters such as program description, number of jobs created, or other relevant data.

- State Reporting Requirements.
 - Currently, the Legislature appropriates federal funds to state agencies through the General Appropriations Act. Some General Appropriations Act riders also contain reporting requirements for state agencies relating to expenditure of federal funds.
 - There will be federal reporting requirements for the states. The Legislature may wish to request that all reports related to the ARRA be submitted to relevant committees and to the Legislative Budget Board and the Governor at the same time they are submitted to the federal government.
 - The Legislature may wish to require quarterly reports with financial and programmatic reporting on matters of particular interest to the state. These reports should go to the House Appropriations Committee, the House Select Committee on Federal Economic Stabilization Funding, the Senate Finance Committee, and substantive committees. Any agency that receives ARRA funds should provide a timeline to those parties regarding the anticipated expenditure of the funds and attainment of goals and performance targets.
- Audit Requirements.
 - Preliminary federal guidance indicates that expenditures of ARRA funds will be audited under existing federal Single Audit requirements. Agencies should continue to coordinate with their federal funding partners to ensure that they are aware of specific program or grant requirements, including documentation and other matters that will be subject to audit.
 - There are also provisions in the ARRA requiring additional audits related to the expenditure of these funds. The ARRA creates the Recovery Accountability and Transparency Board, which is authorized to conduct audits and investigations. This is in addition to a specific role envisioned for federal auditors related to oversight of audit of the ARRA funds.

If you have any questions, please contact Dan Wattles, Manager, Audit Research and Legislative Coordination; Kelly Linder, Audit Manager; or me at (512) 936-9500.

Sincerely,



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State Auditor