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ADDRESS BY  
ELMER B. STAATS  
COMPTROLLER GENERAL OF THE UNITED STATES  
BEFORE THE  
COUNCIL OF THE AMERICAN INSTITUTE  
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THE VIEW FROM THE GAO

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I am very appreciative of the opportunity to meet with you today. When John Lawlor invited me to attend your meeting, he suggested that you would be interested in the view from GAO. We seem to be involved in so many aspects of Government operations these days, not the least of which is the vigorous discussion of executive-legislative branch power relationships, that it is necessary to be a bit selective on what to discuss with you. I will attempt, however, to touch on subjects in which I am sure that we have a community of interest.

We in the General Accounting Office have enjoyed a long and constructive relationship with your organization and I know that we have benefitted many times for the counsel of your officers, committees, and many of your members.

The recent formation of your new committee on the General Accounting Office, chaired by Walter Oliphant, is a welcome development. We believe that it will provide an even more

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systematic means of exchanging ideas on matters of mutual concern. We look forward to meeting with this committee from time to time.

Since we are both directly concerned with accounting and auditing functions in our society, we have many points of common and mutual interest. Our professional staff of 3,250 includes 2,450 members whose major field of study was accounting. We have over 500 certified public accountants on our staff and 335 of these are members of your Institute. I am glad to note that several members of our top staff are active members of Institute committees.

Our relationship with your Washington office under Lyman Bryan over a long period of years has been, I believe, mutually beneficial. More recently, we have followed with great interest your efforts, led by Lee Layton and Wallace Olson, to strengthen and expand the activities of your Washington office, now headed by Gilbert Simonetti.

The vast and wide-ranging activities of our Federal Government require the best of management talents if they are to be conducted effectively as well as efficiently and economically. The advice and counsel of professional accountants, represented so effectively in your organization, can be of tremendous value to this end. It is in the

national interest that this advice and counsel be readily available to Government officials in both the executive and legislative branches.

The General Accounting Office is directly involved in many efforts these days to help strengthen and improve the quality of performance of Government programs. The Congress appears determined this year to find the ways and means to improve its control over our growing national budget and continuing heavy deficits.

Its concern with the President's impoundment of funds has stirred up several proposals for strengthening the hand of the Congress in this complex area of executive-legislative branch relationships. Of direct interest to us is the fact that almost every proposal made to strengthen congressional operations looks to the GAO for assistance and calls for assigning more responsibility to our office to provide it.

Just last week I testified before the Senate Government Operations Committee on legislation designed to enable the Congress to exercise better control over the Federal budget, including ways in which the GAO could be of greater help.

#### AUDITING RESULTS OF GOVERNMENT PROGRAMS

In recent years, the General Accounting Office, which has had an extremely broad charter of audit authority and

responsibility since its creation over 50 years ago, has devoted more and more of its efforts to evaluating the results--the costs and benefits--of Government programs. This expansion of the art of auditing has been based in large part on the direct interest of the Congress--and to some degree the public--in what is being accomplished through Federal programs.

The Legislative Reorganization Act of 1970 included specific provision for performing these kinds of audits. Although that law did not add to our authority, it did emphasize the wishes and needs of the Congress for such expanded auditing of program-effectiveness.

Today about 30 percent of our professional staff effort goes into this kind of work.

Evaluation of Government program results is an art about which all of us have much to learn. There are many difficulties in making such assessments particularly in the social action areas. However, we are making progress and in the process we are learning more and more how to make these evaluations more useful. Several factors are involved in improving our performance and capability.

1. We are learning much by doing--through experience.
2. We have been building an interdisciplinary staff of engineers, economists, mathematicians, and other disciplines, as well as accountants.
3. We are making extensive use of expert consultants in various fields and by contracting work out to a limited degree.
4. We are conducting advanced training programs and holding special seminars on program evaluation in specific areas.
5. Increasingly, we are taking advantage of analytical and evaluation work of other Government agencies and non-government organizations such as the Urban Institute and the Brookings Institution.

## AUDITING STANDARDS

This leads me to the subject of auditing standards. As many of you know, last summer, we published a new code of audit standards under the rather imposing title "Standards for Audit of Governmental Organizations, Programs, Activities & Functions."

Many members of the public accounting profession have asked why we considered it necessary to publish auditing standards when the American Institute of CPAs has had widely accepted auditing standards for many years and has a committee continually at work on this subject.

Let me assure you that we in GAO are well aware of your standards and your Audit Standards Executive Committee and its work. In fact, Donald Scantlebury, director of the division which has responsibility for development of these standards, is a member of that committee. However, for a number of reasons we have found that the Institute's standards do not provide for auditing of the scope we find necessary today for government operations.

Insofar as audits of financial statements are concerned, the Institute standards are quite satisfactory and we intend that our own standards for such audits be consistent with

them. However, this is only one of several objectives of auditing that need to be considered in performing governmental audits.

In business, profit is the commonly recognized standard of accomplishment. Hence, financial results of operation are often considered reasonable demonstrations of effectiveness. Governments, on the other hand, have almost no concern with profit-making. Their objectives are varied, but generally they deal with promoting the safety, health, and welfare of their citizens. Accordingly, measures of the effectiveness of government activities must focus on what the programs are intended to achieve and what they actually achieve.

Moreover, since such programs are financed with taxpayer's funds, there is an accompanying need to know whether funds are properly safeguarded from loss, whether laws and regulations to govern the funds are followed, and whether those who spend the funds duly consider efficiency and economy in carrying out their work. Responsible government officials must be held accountable in all of these areas.

Our auditing standards therefore provide for audits of a broad scope. For convenience, we describe the desired scope of audit work in three categories: (1) audits of

financial operations and compliance with laws and regulations, (2) reviews of efficiency and economy, and (3) evaluations of program results.

Let me describe each of these categories briefly.

Audits of financial operations and compliance with laws and regulations

This category includes an examination of financial transactions and of administrative procedures to see whether appropriate checks and balances exist to safeguard resources. It requires the auditor to determine whether funds were collected or spent in accordance with the laws and regulations governing their collection and expenditure. It also includes all the work, with which you are most familiar, necessary to support an auditor's opinion on financial statements of the audited organization.

As an example of checking compliance with statutory requirements, I can cite our experience in auditing grantee performance under Title I of the Elementary and Secondary Education Act of 1965, which authorizes financial assistance to meet educational needs of educationally deprived children from low-income families. One of our findings was that local education agencies were not adequately controlling the use of millions of dollars worth of equipment purchased with

Title I funds. As a result, equipment was not being used to carry out the purposes of the Federal grants but instead was being made available for general educational use rather than for educating deprived children.

With such substantial amounts of Federal funds going into local activities, I believe it reasonable to expect that public accounting firms will become increasingly involved in audits of the financial activities of Federal grantees.

#### Efficiency and economy

The second category involves the auditor in considering the efficiency and economy with which operations are conducted. Basically, it involves inquiring into whether the organization being audited is effectively conserving its resources and keeping expenditures to a minimum while carrying out its operations.

Types of uneconomical practices the auditor needs to consider include such things as: (1) procedures that are more costly than necessary, (2) duplication of effort, (3) work that serves little or no purpose, (4) overstaffing, (5) faulty procurement, personnel, and inventory controls, (6) inefficient or uneconomical use of equipment, and (7) wasteful use of resources.

An example of this type of audit inquiry involves the question of whether computer equipment should be leased or purchased. GAO has reported many times on this subject. We have stressed the need for Government agencies to consider the financial advantages of Government ownership of computer equipment as contrasted with paying rental charged over long periods of continued use of this costly equipment. The executive branch and the Congress supported our findings and individual Federal agencies began purchasing significant amounts of their computer equipment requirements. At the time we issued our first report on this matter, the Government owned about 16 percent of its installed computer equipment, but as a result of the actions taken by the Congress and the executive branch, the Government now owns over 70 percent of its installed computers. Congressman Jack Brooks, Chairman of the House Government Operations Subcommittee on Government Activities, has estimated that the Government has saved over \$1 billion by purchasing rather than leasing computer equipment.

## Audits of program results

The third--and most challenging--audit area is the audit of program results. In simple terms, such audits inquire into whether programs or activities meet established objectives.

When evaluations of program effectiveness have been made by a government agency, the auditor should consider the relevance and validity of the criteria used, the appropriateness of the methods followed, the accuracy of the data accumulated, and the reliability of the results obtained.

When such evaluations have not been made, the auditor must be prepared to make his own and: (1) identify the objectives and performance criteria on the basis of available authoritative support, (2) accumulate appropriate data on resources used and accomplishments, (3) analyze and evaluate such data, in relation to objectives, (4) reach conclusions, and (5) recommend improvement actions, where appropriate.

I can cite almost countless examples of audits of this type that we in the GAO have made and reported on in recent years. A few examples should be sufficient here to illustrate the nature and variety of such work.

1. Last year we provided reports to the Congress on our evaluations of the housing and education programs for the American Indian.
2. Three months ago we reported to the Congress on the impact of programs of the Departments of Agriculture; Health, Education, and Welfare; Labor; and the Office of Economic Opportunity to improve the living conditions of migrant and other seasonal farmworkers.
3. In March of this year, we reported on our review of the operations of the Food and Drug Administration in carrying out its responsibilities to insure that potentially harmful shellfish do not reach the American consumer and that imported shellfish meet U.S. domestic standards.
4. Within the past month, we reported to the Congress on such subjects as:
  - Environmental Protection Agency requirements to remove hazardous pesticides from the channels of trade.
  - The program of the National Highway Traffic Safety Administration to insure compliance with Federal safety standards for motor vehicles.

--Continuing losses incurred by the Federal Government on the peanut price support program.

The Congress itself sometimes directs us to make specific studies. A good recent example is our comprehensive study of health facilities construction costs. This study was directed by the Comprehensive Health Manpower Training Act of 1971. The completed report of over 800 pages was submitted to the Congress in November 1972. It is concerned in great depth with the objective of reducing the high cost of constructing health facilities and also identifying and evaluating ways for reducing the demand for such facilities.

#### Follow-on Work

We believe that our statement of auditing standards will do much to help improve the quality of auditing of governmental activities. But publishing such a statement is only a part of the job--gaining acceptance of these standards and obtaining experience in audits of the scope contemplated is a much more difficult job and one that will require vigorous and concentrated attention for a long time to come.

Many members of your organization have expressed interest in our statement, as have many other organizations

and individuals. So far about 55,000 copies have been printed and distributed.

I would like to point out, too, that in developing our statement, we were assisted by Federal, State, and local auditors as well as many academic faculty members and professional associations including your Institute, which created a special ad hoc committee for this purpose. The standards as published reflect many worthwhile recommendations made by your committee.

We are doing a great deal to publicize our audit standards and make it easier to understand them. For example:

- We have held conferences at which we explained the standards to Federal, State, and local officials and CPAs in all of the 10 Federal regions. Over 6,000 people attended these meetings.
- We are publishing a book of questions and answers on the standards and we are considering publishing a sample audit report prepared in accordance with the standards.
- We have just about completed a model State audit statute and a model audit ordinance for use by governmental units that want to establish audit

organizations to carry out the kind of advanced auditing that we recommend.

--We are conducting surveys into problem areas involving cooperation on auditing matters between the Federal Government and State and local governments.

#### National Intergovernmental Audit Forum

Another course of action that we are working on is the establishment of a National Intergovernmental Audit Forum. In recent years, the amount of Federal financial aid to State and local governments has increased almost astronomically. This increase--and the related management and accountability problems--was a major factor in our decision to develop an expanded code of auditing standards.

Coordination of auditing efforts, however, between Federal, State, and local governments has been difficult to achieve. With the greatly improved communications, particularly with State auditors, that grew out of the process of developing our auditing standards statement, we have agreed to organize new machinery to improve coordination, avoid unnecessary duplication of auditing, promote intergovernmental reliance on auditing at different levels of government, promote training in auditing concepts and techniques in accordance with our auditing standards, and generally improve communications.

The National Intergovernmental Audit Forum is now being organized. Its members will consist of Federal, State, and local governmental auditors. We are hopeful it will be a productive mechanism in the future.

We are also experimenting with the idea of establishing regional intergovernmental forums which would be located outside of Washington. The first one has been organized in the southeastern states.

#### Audit Opinions

One aspect of expanded auditing of governmental operations that I would like to specifically comment on is the stating of audit opinions. I understand that stating overall audit opinions on other than accounts and financial statements gives concern to a great many practicing public accountants. Perhaps this concern is justified but let me point out that we do not expect the conventional type of auditor's opinion to be rendered on the other aspects of an audit.

Providing an overall opinion on whether the organization audited is efficient and economical, for instance, is neither necessary nor economical. But an auditor can still do much constructive work and provide useful information without expressing such an opinion. We look to the auditor

to include in his report the factual information he finds with respect to the activity he has examined, the conclusions he reaches, and any recommendations he may have for improvement.

The type of reporting we look for is not greatly different from what public accountants have long provided to their clients for years in what are generally referred to as management letters. The subject matter is extended and a report on a governmental activity will usually receive much wider distribution than is customary with public accountant's letters to the management. The difference is much more a matter of coverage and emphasis.

I have dwelt on this subject of our auditing standards at some length because I know you are interested in it. I know, too, that you recognize the potential for increased public service that your profession can render by performing audits of governmental activities of the scope embraced by these standards.

## ACCOUNTING SYSTEMS IN THE FEDERAL GOVERNMENT

Turning from auditing to accounting for Federal agency operations, as many of you know, the General Accounting Office has the responsibility under the law to approve Federal agency accounting systems when they are judged as conforming to prescribed principles and standards and related requirements.

By the end of last year, we had approved about 61 percent of the accounting systems in the civil agencies but less than 9 percent of those in the defense agencies. In comparison, in 1965, about 30 percent of the civilian agencies and about 1 percent of the defense systems had been approved. With a total of 320 systems in the Federal Government, you can see that we have a long way to go, particularly in the defense agencies, before all systems are approved. Also, because of changes in the law, reorganizations, and other reasons, agencies are continually redesigning their systems which again subjects them to approval.

This is an area where CPA firms can provide the Government with a valuable service, and some have done so in the past. Professional accounting manpower resources are scarce in the Government. Many agencies do not have on their rolls

the personnel needed to undertake accounting systems design projects. They must, therefore, look to a contractor such as a CPA firm to provide this service for them.

Although Government agencies have in the past often used CPA firms for help in designing their systems, the results have varied from very good to very poor. In all fairness, however, I must say that in most cases where the results have been poor, the blame must be shared by both the agency and the contractor..

There have been several instances where the contracting agency was left high and dry after the design contractor completed his work and, in some cases, the systems had to be completely redesigned in-house. Usually the agency personnel relied too much on the outside contractor and failed to gain the knowledge necessary to operate the system. In some cases, the systems designed were much too sophisticated for the agency personnel and the basic knowledge and comprehension of the system complexities almost completely disappeared when the contractor left. The primary cause, of course, was the lack of effective cooperation and communication between the agency and the contractor in the design project.

On the other hand, we know of numerous systems that were designed by CPA firms where agency personnel were either on the design team or worked closely with them. This arrangement provided the necessary continuity and trained care of personnel to carry on effectively when the contractor completed his work. If there is a lesson to be learned here, it is that CPA firms should insist upon agency participation when accepting contracts to design systems.

In helping to design systems for Government agencies, CPAs can provide assistance because of their objectivity and experience. An accounting system should be designed with the primary objective of providing useful information for management but within the broad framework of principles and standards which our Office is required by law to prescribe. However, the goal of GAO approval should be only a secondary consideration. Too often this fundamental purpose of accounting is overshadowed by the desire of the agency to obtain approval of the system design. Usually, systems designed with the basic objective of improving financial management operations in the agency will satisfy GAO's requirements.

## SOCIAL MEASUREMENT

This brief mention of the accounting function in Government leads to another subject of great current interest for which you in the Institute and we in the GAO have a community of concern and responsibility. I refer here to accounting for and measuring the consequences of social action.

Our nation's investment in social programs is vast. Each year many billions of dollars are spent on urgent needs of society. Remembering that accounting and the concept of accountability derive from the same roots, and remembering that auditors are especially able, because of their independence and objectivity, to support or improve the credibility of management's reports, including those related to social actions, it is clear that we cannot and should not avoid a major involvement.

I am pleased to report to you that senior members of my staff are active on the social measurement committees of two national accounting associations. Gregory Ahart, Director of our Manpower and Welfare Division, serves on the committee set up by the National Association of Accountants and Stewart McElyea, Deputy Director of our Field Operations Division, is a member of your Institute's committee.

Both committees have met with us in Washington during the past year. The development of more effective methods for measuring and reporting social impacts of government as well as business operations is an urgent need of our nation. I am glad to affirm the assurances I have earlier expressed to your officers that we in GAO are committed to doing all that we can to work with you and other groups to find solutions to these extremely difficult problems of social measurement.

#### COST ACCOUNTING STANDARDS

Let me turn to another kind of accounting measurement and take a few moments to discuss the work of the Cost Accounting Standards Board, which as Comptroller General I am designated by law as chairman.

As you may recall, the Board was created in 1970 and the Board members were appointed in January 1971.

From the very start, the Board has vigorously urged representatives of all those who are concerned with its work including Government agencies, the accounting profession, defense contractors, industry associations and the academic community to assist in the extensive research which is basic to developing cost accounting standards and the Board's rules and regulations.

Before we promulgate standards, rules, or regulations, we publish our proposals in the FEDERAL REGISTER and invite comments from all interested parties. We take these comments very seriously. Each Board member receives a copy of all comments received for study and analysis.

The Board and its staff devotes very considerable attention to the research necessary to develop standards. The Board insists upon careful, exhaustive research by its staff to satisfy it on the need, scope, and content of a proposed standard.

When we finally publish a standard, a rule, or a regulation, we discuss in a prefatory section the major comments received and how we disposed of them. Comments received often persuade the Board to make extensive modifications in the preliminary proposals we promulgate.

When I speak of research, I am not referring to the library type. We send our staff out to meet with contractors and we mail issue papers, questionnaires and draft material to hundreds of interested organizations seeking their views. We are well aware of the burden which this places on the recipients but their participation in this way and their contributions are essential to the development of sound and acceptable standards.

To further improve the understanding of the Board's fundamental objectives and concepts, we have published a Statement of Operating Policies, Procedures, and Objectives. In this way, the Board hopes to provide the basis for a productive dialogue with those concerned with the Board's work. This statement will enable those concerned persons to focus on the complex and difficult issues which the Board faces in promulgating cost accounting standards.

I emphasize at this time that while our enabling legislation provides for coverage of standards in defense procurements only, the Federal Procurement Regulations have extended the required adherence to standards with slight modification to non-defense procurements. What this means is that just about every contractor doing business with any

department or agency of the Federal Government through a negotiated contract not otherwise exempt will be required to comply with Board standards, rules, and regulations.

Also, representatives of State and local government finance offices have indicated an interest in adopting our standards for their procurements. What this suggests to me is not surprising and is highly gratifying. I conclude that the pioneer efforts of the Cost Accounting Standards Board are being recognized and that the quality of its work to date is creating considerable interest well beyond our particular legal jurisdiction.

What has the Cost Accounting Standards Board accomplished since its establishment?

1. We have promulgated a disclosure statement in which contractors are to describe their accounting practices. These statements must be completed by contractors meeting certain criteria established by the Board. The procuring agency must be satisfied that the contractor adequately describe his practices before a contract may be awarded.

2. We have promulgated four cost accounting standards.

These deal with:

- (a) consistency between estimating, accumulating, and reporting of costs;
- (b) consistency in the allocation of direct and indirect costs;
- (c) allocation of corporate home office expenses to segments of the corporation such as subsidiaries, divisions, and plants; and
- (d) capitalization of tangible assets.

3. Extensive research is under way in other areas for possible development of cost accounting standards, including:

- Depreciation of tangible capital assets
- Accounting for unallowable costs
- Selection of cost accounting period
- Allocation of overhead expenses to contracts
- Classification of costs as direct or indirect
- Labor and labor related costs
- Material costs
- Standard costs
- Contract terminations.

I expect that the Board will authorize exposure for public comment one or more proposed standards in many of these areas within the next year.

I should say that it is not our purpose to issue procedural rules nor do we attempt to prescribe accounting systems. However, we do have to look at the question of specificity versus generality from the standpoint of the Government as well as that of contractors. If we simply write broad generalities, we really do not provide guidance for either Government agencies or the contractors. Hence, we will not have achieved the objective of the legislation. We will be back where we were before the law was enacted.

The Board does consider any difficulties contractors state they will face in implementing proposed standards. We realize that if we cause contractors to incur additional costs these costs will most likely be passed on to the Government in the form of higher costs of procurement. Certainly, there will be increased costs to some contractors in conforming to some standards. This is probably inevitable but we want to keep such additional costs to a minimum. We take this possibility into account as best we can as we develop each standard. This is an area where you can be particularly helpful by letting us know specifically, when you can, about the impact of the application of a proposed standard.

The American Institute of CPAs has established a liaison committee chaired by George Catlett to work with our staff in the particular areas being researched. We find this to be a very effective means for getting the views of the accounting profession. Members of this committee are brought into our deliberations at a very early stage and they are making valuable contributions to our research efforts on the basis of their experience and by describing the possible effect on contractors' operations of a proposed standard on a given subject.

I believe that the Cost Accounting Standards Board is off to a good start and making good progress. We expect to work cooperatively with other authoritative bodies which have been established to issue pronouncements on accounting and financial reporting.

One reason is that there are many accounting areas of interest to our Board which are also of interest to others for financial and tax accounting purposes. These include

- the measurement of costs in general
- determination of the amount assigned to a resource to be consumed in operations
- allocation of the cost of resources consumed to time periods

--allocation of direct and indirect costs to the goods and services produced in a period.

Contract cost accounting often deals with precisely the same expenditures and problems of allocation to time periods as are of interest in financial and income tax accounting. Thus, promulgations by the Cost Accounting Standards Board may impinge on the areas of interest of other authoritative bodies.

The Cost Accounting Standards Board seeks to avoid conflict or disagreement with other bodies having similar responsibilities and, through continuous liaison, will make every reasonable effort to do so. The Board will give careful consideration to the pronouncements affecting financial and tax accounting and, in formulating cost accounting standards, will take those pronouncements into account to the extent it can do so. The nature of the Board's authority and mission, however, is such that it must retain and exercise full responsibility for meeting its objectives.

We welcome the creation of the Financial Accounting Standards Board, which was launched a few weeks ago to issue standards on financial accounting matters. I have met with the Chairman of the Financial Accounting Foundation, Ralph Kent, and the Chairman of the Financial Accounting Standards

Board, Marshall Armstrong, and arrangements have been made to coordinate the work of the two boards on subjects which are of mutual interest. Only last week, the two boards met in Washington to exchange views and discuss working relationships.

Another avenue of liaison is through the Advisory Council which has been set up as an adjunct of the Financial Accounting Standards Board. One of the Council members, Robert Mautz, is one of the five members of the Cost Accounting Standards Board. Another Council member is Ellsworth Morse, Assistant Comptroller General.

The recent announcement that the Financial Accounting Standards Board has selected seven problem areas for initial study was of interest to all of us. Several of these problems will probably overlap work of the Cost Accounting Standards Board and thus our ability to cooperate effectively with each other and avoid undesirable and unnecessary duplication of effort will be tested almost immediately.

Our mutual objective is to identify problem areas in which we may have parallel or overlapping interests. We do want to avoid different or conflicting standards if it is possible to do so and we will lend every effort in that direction. It is conceivable that some research and staff work can be shared by the two Boards.

## CONCLUDING REMARKS

I have touched on a few subjects where your interests and those of the GAO in better government operations tend to coincide. There are, of course, many other subjects in our vast system of government in this country in which we both have a deep concern. For example:

The recommendations of the Commission on Government Procurement, which only a few months ago completed its exhaustive study.

The reliability of cost and pricing data submitted by prospective contractors in the negotiation of Government contracts.

The troublesome cost growth in major weapons systems.

The measurement and extent of profits realized by industrial companies on government contracts as compared with profits on their commercial business--a recurring concern of not only contracting Government agencies but of the Congress itself.

The sharing of Federal revenues with State and local governments and obtaining suitable accountability for the management of the funds.

I need not compound examples like these further to illustrate that there are many problems in government operations, the solution to which require the best brains we can command. We in the GAO are working in all of these areas at one time or another.

I believe your profession also has much to contribute to improving on the way things are done in government as well as in industry. In working on these problems, the underlying objective--for both of us--is improvement for the benefit of the public.