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BEFORE THE
NORDIC COUNCIL OF AUDITORS GENERAL
June 7, 1978

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DEVELOPMENT OF AUDITING STANDARDS
IN THE UNITED STATES

I view the work of the General Accounting Office in establishing standards for government audits of government operations and programs in the United States as one of our most progressive accomplishments in the years I have served as Comptroller General. They are published in a brochure called Standards for Audit of Governmental Organizations, Programs, Activities and Functions. That title is something of a tongue twister and understandably so. The brochure is almost universally referred to as the "yellow book" from the color of its cover. Over 100,000 copies are now in circulation. The standards have been accepted by virtually every Federal agency and State audit group as well as many local government audit groups in the United States. They are well known also in England, Australia, Canada, Latin America and, I am told, by members of this Council as well.

WHY SPECIAL STANDARDS FOR
GOVERNMENTAL
AUDITS WERE NECESSARY

As a prelude, I should describe the relationship of governmental audit organizations in the United States.



Most cities and other local governments have their own audit organizations or employ independent public accountants to make annual audits of their records. Each of our 50 States has a State auditor with State-wide responsibility as well as internal audit groups within various State agencies. The Federal Government has internal audit groups within each large department or agency, and the General Accounting Office has Government-wide responsibility.

The Federal Government has somewhat more than a thousand grant and revenue-sharing programs under which Federal funds are disbursed to State and local governments annually. The General Accounting Office is responsible for seeing that the programs on which Federal funds are spent are conducted economically, efficiently, and effectively. We have a direct interest in the work of Federal internal auditors, State auditors, local auditors, and any independent public accountants engaged to do audits for them.

Before GAO's standards for audit of governmental organizations, programs, activities and functions were published, there were no uniform standards for all agencies and levels of government. Each Federal agency tended to perform audits according to standards

tailored to its own needs. Similarly, cities, States, and other governmental bodies had their own audit methods, their own gauges of quality, and their own requirements for audit performance. Often standards were vague--audits were made not according to written standards but according to tradition. Consistency was needed.

With the widespread increase in the use of Federal grants to State and local governments in the late 1960s, the need for audit standards became critical. Two--sometimes three--levels of government shared responsibility for seeing that the programs were carried out efficiently, effectively, and economically. The audit, and its resulting report, was the primary tool used to evaluate grant programs. But with everyone using different standards, there was always a question as to whether a State or local audit could meet a Federal need or vice versa; each level of government tended to make its own audit; and duplications and even triplications of audit work sometimes occurred.

However, with a common body of standards, auditors would in a sense be speaking the same language; they would all be using the same ground rules; and audits would then be comparable and exchangeable. Use of common standards would promote mutual acceptance and reliance

on audit results regardless of which agency or level of government did the audit work.

In GAO we decided to issue standards for auditing government programs and activities to achieve these purposes. We had two objectives:

The first was to spell out the kind of auditing needed and to provide guidelines for use in auditing federally assisted programs. In this way audits conducted by or for States and local governments could be used in lieu of auditing by Federal agencies.

The second was to improve the audits conducted by or for States and local governments so that Federal assistance programs could be better managed, thereby increasing the benefits to society.

HOW WE WENT ABOUT DEVELOPING THE STANDARDS

We agreed that a team of auditors from a number of Federal agencies would be desirable to develop the standards. We believed that if these agencies had a part in developing the standards, they would be more likely to accept the finished product. Also, we wanted the standards to include not only the institutional experience GAO had accumulated but the wisdom of other agencies as well. We asked each of the Federal grantmaking agencies to nominate a skilled

auditor to work on a task force created to perform this job. The Federal agencies responded and a task force consisting of about 10 persons with a GAO leader was formed.

It considered the problem of the scope of audit effort needed in government as the primary concern. The scope of a governmental audit is now defined as having three parts:

- Financial and compliance.
- Economy and efficiency.
- Program results.

Each of these aspects of a governmental audit is defined on the following pages.

Financial operations and legal compliance

First, in audits of financial operations and legal compliance, GAO examines financial transactions, accounts, and reports and checks compliance with applicable laws and regulations. The audit includes enough work to determine whether the agency or grantee:

- Controls and accounts effectively for its funds, property, and other assets; its liabilities; and its revenues and expenditures.
- Keeps adequate accounting records.
- Prepares financial reports that fully and fairly show its financial condition, the results of its operations and changes in its financial

condition, and that provide adequate financial information for use by managers.

--Has an adequate accounting system.

--Complies with the laws and regulations governing the receipt, disbursement, and application of public funds.

Efficiency and economy of operations

The second aspect concerns finding ways to improve economy and efficiency of operations. This can be one of the most constructive types of work government auditors do and one in which their accomplishments are most readily measurable. In GAO we do a lot of this type of auditing.

Economy and efficiency audits--as the name implies--are aimed primarily at making government operations less costly. We examine, the agencies' policies, procedures, and transactions in order to identify opportunities to save money or otherwise cut down on unnecessary or wasteful use of resources and to develop recommendations for improvements. Specifically, we inquire into such matters as

--the need for goods or services provided or procured;

--the reasonableness of costs incurred or expenditures made;

- the adequacy of safeguards over, and care of, resources acquired;
- the proper use of resources; and
- the adequacy of revenues received for goods or services sold.

We pursue these matters primarily from the standpoint of improvements needed--usually by identifying avoidable costs or waste, possibilities for increased revenues, less costly procedures, and organizational improvements that can be made to attain the desired results.

Program results

Auditing program results or program effectiveness--the third of these aspects--is the newest and perhaps the most challenging type of work in government auditing. The purpose is to find out whether a program or activity is achieving objectives set for it and to analyze reasons for any shortfalls. These audits often include considerations as to whether

- weaknesses in management prevent or retard achievement of desired results;
- alternative ways to do the job might be more effective, or lower in cost, or both;
- benefits or detriments are resulting that were not contemplated when a program was established; or
- program objectives should be reconsidered in light of experience.

The task force deliberated for several months before releasing its draft of the standards. The next step was to obtain comments from people who would be subject to them.

A word of explanation is needed. Insofar as audit standards are concerned, the General Accounting Office does not have any direct authority over internal auditors in the various Federal agencies, State auditors, local government auditors, or the thousands of certified public accountants who audit for many of our cities and other local governments. Our views and pronouncements in the field of accounting and auditing are influential, but we cannot require other auditors to comply with them. This was why we wanted to obtain their views on a number of issues before we made a final decision on many detailed aspects of the standards.

We sent out over 200 copies of the draft for comments. They went to Federal audit agencies, State auditors and various other interested organizations, such as the American Institute of Certified Public Accountants, the Municipal Finance Officers Association, and the Association of Government Accountants. About 100 replies containing over 2,000 individual comments were received. Each comment was considered and changes, mostly clarifications, were made based on the basis of these responses. GAO staff also met with some of those who responded to get a better understanding of their views.

This is how the developmental work was completed and the final standards issued in the summer of 1972. The standards as finally written incorporate the generally accepted auditing standards for financial work promulgated by the American Institute of Certified Public Accountants. In addition, they provide for an expanded scope for governmental audits to include the additional aspects I mentioned before:

- A more extensive audit of compliance with applicable laws and regulations
- An audit of efficiency and economy in the use of resources.
- An audit of program results to determine whether desired objectives are being achieved.

The standards are divided into three principal parts: general standards, examination and evaluation standards, and reporting standards. General standards deal with scope of an audit, qualifications of auditors, and independence and use of due professional care in performing audit work. Examination and evaluation standards cover planning the work, supervising assistants, making a review of applicable legal and regulatory requirements, evaluating internal control, and accumulating adequate evidential matter. Reporting standards deal with various aspects of reports to be prepared on the completed audit work.

The change in scope of an audit to the broader scope called for by the GAO standards attracted by far the greatest attention. While on the matter of scope, I might add that our standards do not require that every audit include the complete scope specified in the standards. We recognize that in some situations it may not be practicable to perform an audit having such broad scope. Consequently, we provide for a determination by responsible officials of the needs of potential users for the results of the audit and for setting the scope accordingly.

GAINING ACCEPTANCE OF THE STANDARDS

We recognized that issuing standards alone would not be enough. Thousands of auditors needed to know about the standards, understand why they were necessary and learn how to apply them. We decided that we needed a program to acquaint auditors with the standards and impart information on the training and skills needed to apply them properly.

One of the first things we did was to hold a press conference so that issuance of the standards would receive news coverage. This alerted many interested audit organizations that the standards were available.

Shortly after their issuance, members of GAO's staff arranged briefings to be held throughout the United States.

Over 6,000 auditors attended these briefings. Those who did received a copy of the standards, participated in a discussion of the differences between our standards and those of the American Institute of Certified Public Accountants, and were able to ask questions.

Following these initial briefings, we continued to make speeches on and discuss the standards with audit groups throughout the United States. We still give occasional speeches on the standards although they have been issued for nearly 6 years.

Making speeches and holding discussions was not enough. Many government auditors had never done any type of audit other than financial. They simply did not know how to do some of the work the standards required. Consequently, we issued a series of supplements to the standards in booklet form to explain how to do the work and deal with problems that had come up in our discussions with audit groups. Some of these are as follows:

Questions and Answers on the Standards - This booklet provides answers to questions that have been asked by Federal, State, and local auditors and public accountants about the standards.

Auditors: Agents for Good Government - This booklet describes the value of the broad scope audit to the management process. It was prepared principally for legislators and public officials.

Illinois' Use of Public Accountants for Auditing State Activities - The Auditor General of the State of Illinois does not have a staff to do detailed audit work but engages public accountants to do so. This booklet contains a description of the use of independent public accountants for State audits. Pro forma documents are included for use in engaging public accountants and maintaining surveillance over their work.

Examples of Findings from Governmental Audits - This booklet consists of examples taken from Federal, State, and local audit reports illustrating the type of findings common to the broad scope audit.

Illustrative Report Prepared in Accordance with GAO "Audit Standards--Air Pollution Control Program, Sassafras County, State of Maryland" - This booklet described a sample audit in which a broad scope audit in accordance with GAO standards had been done and includes the audit program followed and the report issued on that work.

Case Study - How Auditors Develop Findings--Increasing the Productivity of City Water Meter Readers - This booklet is one of several publications designed to show how broad scope auditing could be applied at the municipal level. It also showed step by step how the auditor went about his work.

Using Auditing to Improve Economy and Efficiency -

This booklet is another of the publications aimed at the municipal auditor. It gives details of an audit of a city sewer cleaning project, showing how an audit led to thousands of dollars saved in performing this function.

We also conducted demonstration projects by participating with State and local governments to gain acceptance of the standards. One such project was done in cooperation with the International City Management Association. Twelve member cities or counties and their auditors participated with GAO in the audit of a city or county function, such as public safety, garbage collection, or water supply. The work was aimed at improving economy, efficiency, and effectiveness. When the work was completed, the results were published by the International City Management Association. This cooperative project acquainted local governments with the benefits of broad scope auditing as prescribed by the GAO standards.

Another major project, recently completed, involved an audit of a federally financed child care program in the city of Philadelphia. This audit was comprehensive in scope. The objective was to demonstrate how audits made in accordance with our standards can satisfy the interests of all levels of government concerned--Federal, State, and local. It was quite successful.

Another important step was the creation of the intergovernmental audit forums. The General Accounting Office took the initiative in the creation of a national intergovernmental audit forum and 10 regional intergovernmental audit forums and invited representatives from Federal, State, and local agencies to participate. The Council of State Governments and the Municipal Finance Officers Association assisted us in identifying appropriate State and local representatives for the national forum. Representatives from participating Federal agencies were nominated by the heads of their agencies.

The forums meet quarterly to consider audit problems advanced by any governmental unit and serve as a means of bringing together persons who can work out solutions through discussion of the problems. The cooperation fostered by the forums benefits the General Accounting Office, other Federal agencies, States, local governments, and others. The forums have no decisionmaking authority to bind the Federal agencies or State or local governments represented; however, all members support a policy of cooperation and coordination.

The forums provide an arena for exchange of views by audit executives, promote the use of the governmental audit standards and keep them current, encourage coordination of audits performed by various governmental

units, and develop satisfactory solutions to mutual audit problems and promote cooperative audit work.

To further these objectives, the forums hold periodic general meetings, work through committees and sponsor technical group discussions, and develop and publish position papers or take such other action as may be appropriate with respect to

- maintenance and interpretation of the audit standards;

- how to standardize audit guides and coordinate audit effort, including guides to facilitate maximum reliance on and use of audit work performed by others; and

- specific intergovernmental audit problems and how best to resolve them.

The forums also provide a means of communication among the forums and Federal, State, and local officials, professional organizations, public interest groups, and others who from time to time may become directly involved with the subjects under discussion.

Membership of the national forum included 16 Federal audit executives selected from nominees made by each Federal governmental organization that has responsibility for audits of governmental organizations, programs, activities, and functions; the heads of six State audit organizations; and the heads of six local audit organizations selected by the Municipal Finance Officers Association. State and local government members have since been increased to 10 each,

and they are now elected by the State and local representatives of the 10 regional audit forums.

DEVELOPING A MODEL AUDIT LAW FOR STATE GOVERNMENTS

As more State governments became interested in broad scope auditing, they began asking about the type of organizations they should have to do this work and what changes were needed in their laws to give them the necessary authority. So we began working on a State audit law. We researched the statutes of all States with State audit operations and drew upon the best elements of each, drafting a "model" statute describing the qualifications of the auditor, his term, his duties, and the organization he would direct. The statute describes the audit committee that would oversee the function. We defined the relationships with other State organizations and with higher and lower echelons of audit activity, including local auditors. We made the draft available to State governments interested in establishing auditing laws.

AUDITOR TRAINING

One matter which arises frequently is whether such broad-scope audit work can be done with accounting-trained auditors alone. The answer is no.

Until about 10 years ago, GAO's audit staff was comprised largely of people who had majored in accounting in college. Through training and development, many of them became highly proficient in conducting management and program audits. In fact, most of our top managers today rose through the ranks from that beginning.

However, not everyone can acquire all the skills needed to perform some of the audit tasks we face. Consequently, we discarded the idea that an individual auditor can possess all the skills necessary and expanded our college recruiting efforts to seek students with majors in economics, industrial management, engineering, public and business administration, and the like. Upper level hiring was expanded along similar lines. We were able to add staff members who had expertise and experience in systems analysis, computer science, actuarial science, and statistical methods.

In June of 1967, there were only 10 out of about 2,500 audit staff members with specialty skills other than accounting. A year later, 483 of 2,900 auditors had concentrated their college studies in subjects other than accounting. Today roughly 1,700 of GAO's 4,100 professional auditors have specialities in areas other than accounting. I expect that in time at least half of our professional staff will have backgrounds and skills outside accounting

CONCLUSION

Summarizing all this detail, I leave with you the following recommendations if any of you seek to develop audit standards along the lines we have discussed today:

1. Determine what kind of information is required by those who will use the information provided by the audits done under the standards and then structure your standards around these requirements.
2. Use a task force or other group approach so that the experience of a large number of auditors is brought to bear on the project. A strong leader should be put in charge of the group.
3. Seek comments from all who must use the standards--this will not only provide good input to the development process but will help to gain acceptance of them later.
4. Plan for a considerable effort after the standards are issued to acquaint those who must use them with the requirements.
5. Recognize the need for staff training and the acquisition of new disciplines for some types of audit work.

Our experience has shown that the audit standards have developed a unity between auditors at all levels of government that did not exist before. The standards are helping to eliminate duplicate auditing by enabling interested auditors to rely on work done by other auditors. And in this way the standards are leading to more efficient, less costly performance of this important governmental function.