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ADDRESS BY
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BEFORE THE
5TH BIENNIAL SYMPOSIUM ON
AUDITING RESEARCH
SPONSORED BY THE
DEPARTMENT OF ACCOUNTANCY
AT THE UNIVERSITY OF ILLINOIS
NOVEMBER 4, 1982

"ACCOUNTING AND AUDITING ISSUES FACING THE
GOVERNMENT MANAGER TODAY"

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Chancellor Cribbet, Dean Zimmerman, Professor Neumann, distinguished faculty and members of the accounting profession, and ladies and gentlemen, I am honored to participate in your 5th biennial symposium on auditing research. And I am pleased to return to the University that gave me so much. I have always felt indebted to the University for the excellent preparation I received from my undergraduate work.

I heard through the grapevine that when Dean Zimmerman learned of my appointment as Comptroller General, he immediately pulled my records to see if I was worthy of being publicly claimed as an Illinois graduate.

The series of symposia that have been held on auditing research and the forums that those symposia have created for encouraging and exchanging ideas are commendable. This year's program appears to be equally impressive. And the University, specifically the Department of Accountancy, is to be commended for its national leadership role in accounting and for its recognition as one of the top accounting schools in the Nation.

I believe the report of the accounting accreditation visitation team of the American Assembly of Collegiate Schools of Business summed up the reputation and accomplishments of the accounting program at the University of Illinois when it said

"The accounting faculty at the University of Illinois has been a major force in both academic and professional accounting for over 50 years. A long list of highly successful accounting graduates could be compiled. The Ph.D. program is one of the oldest in the country. It has produced more graduates than any other accounting Ph.D. program in the country, and continues as one of the largest and most respected programs in the Nation."

And the Department of Accountancy is to be congratulated for receiving AACSB accreditation of its baccalaureate and masters of accounting programs--they are among the first to be accredited under the new accounting accreditation standards. I might point out that the University's College of Commerce and Business Administration received initial AACSB membership in 1924, and has been one of the leaders in the association since its founding. Other universities, many of whom are represented at this symposium, have established similar reputations for their accounting and business programs, and they have served as leaders in the academic field.

Tonight, I would like to direct my comments to accounting and auditing as it relates to government. I want to emphasize the importance of government financial management and my role and your role in improving it.

During the 1960s and 1970s, the number, complexity, and cost of governmental programs increased substantially. Coupled with this past growth are recent events of declining revenues, fiscal crises, and cutbacks in certain government programs. We have seen an increased demand by public officials, legislators, and private citizens to know not only whether government funds are handled properly and in compliance with laws and regulations, but also whether the objectives of programs are being achieved. This has brought an increased demand for full accountability by those responsible for administering government programs--accountability in which governmental auditing is playing an increasingly important role.

Tonight, I would like to look at governmental auditing and accounting from three perspectives--the General Accounting Office's

role, some current efforts underway in governmental auditing and accounting and the role that the universities and colleges might play in research and publishing.

GAO's Role

GAO's role in governmental accounting and auditing is a unique one. GAO, which I head as Comptroller General, is an independent, nonpartisan agency in the Federal legislative branch. The Office was established in 1921 to assist the Congress in its oversight of the executive branch.

GAO has a professional staff of approximately 4,000 and a support staff of approximately 1,000. The professional staff is interdisciplinary, including not only accountants and auditors, but also program analysts, attorneys, actuaries, engineers, computer specialists, psychologists, and mathematicians. Our staff is located in Washington, D.C., at 15 regional offices throughout the continental United States, and at branch offices in Honolulu, Frankfurt, and Panama City.

During fiscal 1981, GAO issued nearly 1,000 reports to Congress, congressional committees, individual members of Congress, and Federal agency officials. While we identified an estimated savings of \$8.4 billion attributable to our work during fiscal 1981, it is not possible to determine the full effect of GAO activities in terms of quantifiable financial savings because many savings resulting from management and program improvements frequently cannot be measured.

Auditing Role

Our audits and evaluations of ongoing Federal programs, activities, and financial operations have as their basic objective helping

the Congress and agency officials improve government operations. We examine Federal departments and agencies as well as their contractors and grantees to evaluate how they are carrying out their financial, management, and program responsibilities. From these evaluations we provide the Congress and Federal agency officials with objective information and recommendations to aid them in carrying out their responsibilities.

We seek answers to such questions as:

- (1) Where can waste and the inefficient use of public money be eliminated?
- (2) Are Federal programs achieving their objectives and doing so at the lowest cost possible?
- (3) Are funds being spent legally and accounted for adequately?

Many of our reports recommend congressional or agency actions that we consider necessary to correct problems or improve Federal programs and activities. However, we at GAO cannot compel the agencies or Congress to accept our recommendations. We must convince agency management and the Congress that it is in their interest to take the actions we recommend.

Given the size of the Federal Government and the scope of its operations, we must be selective in determining which programs and activities we will review. In deciding what to review, we emphasize those Federal programs and activities that Congress is or could be particularly interested in and that have opportunities for improvement.

Let's look at a few recent assignments GAO has completed.

--The Liquid Metal Fast Breeder Reactor--Options For Deciding
Future Pace and Direction

The Liquid Metal Fast Breeder Reactor offers the promise of a long term energy source for this country. Since the mid-1970s, however, the Breeder Reactor program in general and the Clinch River Breeder specifically--a plant designed to demonstrate breeder technology--have been controversial. The controversy relates both to longstanding concern about commercial nuclear power and nuclear proliferation, and concern stemming from the breeder's reliance on plutonium as a fuel.

In 1972 the Atomic Energy Commission projected that from 800 to 1,500 nuclear power plants would be on line by the year 2000. The Department of Energy has since lowered its projection to between 145 and 185 plants by that year, but a recent Nuclear Regulatory Commission staff memo estimated that the number will be even lower--only about 115 plants on line by 2000. The lower projection is due to the cancellation, deferral, or lack of orders for new plants. For example, of the 17 plants the Tennessee Valley Authority originally planned, 4 have been cancelled and 4 deferred. Similarly, of the 5 plants the Washington Public Power Supply System originally planned, 2 have been cancelled and 1 deferred.

This situation of reduced demand is the result of several factors. In addition to the basic controversy over nuclear power, low electric power demand growth rates, the utility industry's generally poor financial condition, the capital-intensive nature of nuclear power, and the lack of agreement on the best way to dispose of highly radioactive waste, have all contributed to this situation.

About \$6 billion has been spent on Breeder Reactor research from 1966 through fiscal 1981, including a little over \$1 billion

for the Clinch River Reactor. In addition, the Department of Energy spent another \$585 million during fiscal 1982, and is requesting \$523 million for fiscal 1983.

During the past 7 years, Congress asked GAO to report on numerous aspects of the nuclear power program and the Clinch River project. In those reports we generally supported the view that a Breeder Reactor program is needed if nuclear fission is to be a long term energy source. Most recently, GAO re-examined its earlier work in light of three questions: First, how long can domestic uranium supplies fuel conventional nuclear reactors? Based on the Department of Energy's latest projections, uranium supplies appear adequate to fuel conventional reactors well past the year 2020. Second, when will breeder reactors be economical? According to the Department's most recent study, a commercial reactor would most likely be economical between 2025 and 2035. And last, is the Clinch River project still an important and necessary step in developing the breeder option? GAO continues to believe that a demonstration project is a necessary step in developing the breeder option.

We also pointed out to Congress that decisions about the future pace and direction of the Liquid Metal Fast Breeder Reactor program and the Clinch River Breeder Reactor require policy judgments on many factors--the need for nuclear power to meet future energy requirements, budget priorities, and possible reliance on foreign technologies and energy sources. In the final analysis, Congress must make these judgments.

--Further Research Into Noncompliance is Needed to Reduce Growing Tax Losses

Another review we undertook dealt with the need to reduce growing tax losses.

The Federal Government is losing billions of dollars in tax revenues annually because individuals are not complying with tax laws. For example, in May 1982, the Internal Revenue Service released some preliminary estimates indicating that the total tax revenue loss for 1981 may be as much as \$97 billion, of which \$66.1 billion represents unreported individual income.

IRS has several programs for deterring noncompliance but has relied mainly on the process of examining tax returns--a process that requires more than one-half of IRS' enforcement staff. Its other programs might be more cost effective in obtaining maximum compliance, but IRS has not done enough compliance research of these programs to determine that. We recommended that IRS study how to best structure its various compliance activities and that, in the interim, IRS emphasize getting maximum tax revenue from its existing compliance programs. We also pointed out that while the reasons for deteriorating compliance are unclear, it is clear that IRS needs additional resources to respond effectively to the growing demands being placed on it.

I might point out that the new tax bill passed this year addresses some of the concerns discussed in our report. For example, the new law gives the Internal Revenue Service new compliance tools which should facilitate overall tax administration as well as help assure greater compliance with the tax laws. During its consideration of the new tax law, Congress emphasized the need for additional resources for IRS in carrying out its administrative role, including more timely collection of revenue and greater taxpayer compliance.

--Early Observations on Block Grant Implementation

As you know, the current administration is dedicated to minimizing Federal involvement at the State level. Under this "New Federalism," program responsibility and authority in administering federally funded programs will be shifted, as much as possible, to the States. As part of that shift in responsibility, Congress passed legislation in 1981 consolidating numerous categorical grant programs into 9 block grants.

Shortly after passage of this legislation, GAO initiated a study because the consolidation and shift in administrative responsibility significantly changed intergovernmental fiscal relations and policymaking concerning those federally assisted programs covered. We felt that this initial study was needed to provide Congress, Federal executive agencies, and others with information on what States were doing to accommodate their new responsibilities. The information would also be useful in deliberations on future block grant proposals.

We visited 13 States and found that they were making reasonable progress in the transition to block grant administration, especially considering the short time between the August 13 passage and October 1 implementation of the act, program funding reductions, and uncertainties about fiscal 1982 block grant appropriations.

One important factor easing the initial transition to most of the block grants was the States' considerable involvement in the predecessor programs. States already received the vast majority of funds from these programs and had various ties with program recipients. For instance, States were the exclusive recipients and were heavily involved in administering the programs

preceding the Social Services and Low Income Home Energy Assistance block grants. Where State experience was not as extensive, more adjustments were made, including deferring responsibility for some programs.

--Defense Budget Increases: How Well Are They Planned and Spent?

Between fiscal 1980 and 1982, the defense budget increased by approximately \$72 billion, or about a 50 percent increase. We initiated a study of this increase to ensure we would be able to provide Congress with the information it would need to analyze how the Department of Defense planned to spend its rapidly increasing budget.

Generally, we found that the Department followed through on its pledge to emphasize readiness and sustainability, and to invest heavily in force modernization. It also increased military pay to recruit and retain critical skills, and increased funding for real property maintenance to improve not only readiness but also the quality of life for military personnel. However, we found that the Department of Defense had only limited success in eliminating marginal weapons programs to make funds available for higher priority programs.

We also found that increases in operations and maintenance funds could have been spent more prudently, and that more needs to be done to define the objectives for using these funds. Also, top managers in the Department of Defense must increase their oversight of how the funds are used. We found that some of the readiness funds at one base we reviewed were used to buy and insert simulated redwood slats in a chain link fence, and at another location readiness funds paid for a new gate house, a visitors center, and a parking area.

--Major Financial Management Improvements Needed at Department of Energy

During another recent study, we reviewed several aspects of the Department of Energy's financial management. Our review focused on internal controls, cash management, property management, and contract administration; and disclosed significant weaknesses in each area. The extent of the identified weaknesses is so great that the Department is vulnerable to fraud, waste, and abuse and unable to assure that its financial systems are producing reliable data.

We found, for example, that the Department of Energy did not have an effective system for recording, managing, and disposing of Government-owned property held at contractors' facilities. While written procedures were available, they had not been properly implemented. And further, no controls were in place to ensure that property information was reported or recorded accurately. This resulted, in part, in discrepancies of at least \$187 million between accounting and procurement records. This lack of controls also led to considerable differences between agency and contractor records.

While we found that the Department of Energy had taken action to improve its financial management, it must make substantial improvements in several other areas. Proper implementation of its internal controls must be ensured, sound accounting systems must be developed, and its cash and property management must be improved. If these improvements are implemented now, the Department will be in a better position to comply with the internal control requirements of the new Federal Managers' Financial Integrity Act, which I will discuss later.

Accounting Role

Another one of GAO's major responsibilities is to set accounting principles and standards for Federal agencies and to review and approve accounting systems.

In setting accounting principles and standards, GAO attempts to fill the accounting disclosure needs of the Congress, Federal managers, and the public. Currently, GAO is developing a conceptual framework under which current accounting principles and standards can be examined and revised where necessary.

We are also restudying our approach to approving Federal accounting systems. I believe we have directed too much of our effort to reviewing a system's design documentation rather than reviewing the accounting system, itself, in operation. We want to determine what improvements can be made so that agencies will be motivated to seek approval of their systems and to make changes to those systems when necessary.

Current Efforts in Accounting and Auditing

Currently, several efforts are underway which I believe will significantly improve governmental accounting and auditing. I would like to take a few minutes now to discuss three of those efforts.

Governmental Accounting Standards Board (GASB)

In April 1980, after a year of discussions, an ad hoc Governmental Accounting Standards Board Organization Committee was formed to study the best approach for filling a need for accounting and reporting standards at the State and local levels.

In October 1981, the organization committee issued its final report which recommended that a Governmental Accounting Standards

Board, similar to the Financial Accounting Standards Board, be formed to establish accounting principles and standards for State and local governments. The organization committee recommended that the Financial Accounting Foundation be made responsible for setting all accounting standards, and that its membership be enlarged by three trustees who would represent the State and local government financial community.

The GASB is on the verge, I hope, of being formed after 3 years of work and dedication by many individuals and organizations in the accounting profession. As it is now envisioned, the GASB will be equal to the FASB under the Financial Accounting Foundation, have a full-time chairman and a part-time board, be located in Stamford, Connecticut, and have an annual operating budget of approximately \$1 to \$2 million. Once formed, it will be very important that all organizations concerned with governmental accounting support the GASB. Eventually, we hope to incorporate the applicable accounting principles and standards of both the GASB and FASB into the accounting principles and standards we set for the Government.

Internal Controls

A common denominator for all accounting and financial systems is internal control. Strong internal control systems are effective tools for improving financial management.

During the past few years, there has been a growing awareness at the Federal level of the need for a comprehensive system of internal controls. This awareness culminated in the passage of the Federal Managers' Financial Integrity Act of 1982, which was signed

by the President on September 8. This legislation requires ongoing evaluations of the adequacy of each executive agency's systems of internal accounting and administrative control. These evaluations will determine whether the agencies' systems comply with standards to be set by GAO. The legislation also calls for an annual statement, signed by the agency head, reporting on the effectiveness of the agency's internal controls.

Improving internal controls in the Federal Government is one of GAO's top priorities, and this legislation will help us achieve that goal.

State and local governments are also beginning to place a high priority on internal controls. With the New Federalism proposals, internal controls at these levels will become even more important. At least two States, California and New York, are following the Federal Government's example and are considering legislation similar to the Federal Managers' Financial Integrity Act.

Single Audit Approach

The third effort to improve governmental auditing and accounting that is receiving wide attention is the single entity-wide audit.

In the past, Federal grant funds received by the State and local governmental entities and nonprofit organizations were audited primarily on a grant-by-grant basis. Since 1979, however, Federal policy has changed, and all Federal grant funds received by State governmental entities are to be covered by a single audit.

I view the single audit approach on an entity-wide basis, including all funds, to be superior to the more common practice of

auditing grant by grant. The single audit approach results in improved audit coverage and more effective use of scarce audit resources, and will contribute to overall improvements in the quality of accounting, auditing, and internal control systems of governmental entities. Such audits may also provide the foundation for assessing whether systems of internal control are properly designed and functioning as management intends.

The goal of the single audit approach was to improve the effectiveness of the audit of Federal grants. However, a number of issues must be resolved before the single audit can be implemented.

In my testimony before the House Subcommittee on Intergovernmental Relations and Human Resources in March 1982, I stated that the single audit approach on an entity-wide basis was complex because it requires the cooperation and participation of many organizations. I also testified that we must avoid unrealistic expectations on the part of Congress and other officials at all levels of government as to what the single audit will do. I pointed out that some officials will look for the single audit approach to provide detailed testing of all compliance items, whether financial or not, for each grant in the entity. It will not do this, nor is it intended to. Other officials will insist that their individual grants be audited as before, on a grant-by-grant basis. This, also, is not an option of single audit approach.

Recently, we held discussions with several Federal, State, and local government officials as well as independent public accountants, all of whom have the primary responsibility for performing single audits. These discussions revealed strong support

for the single audit approach. They not only found the approach workable but highly desirable. And, generally, the officials agreed that the single audit should be performed on an entity-wide basis and that a more systematic implementation plan was needed.

I have directed my staff to draft an action plan to assure that annual financial audits (or biannual where appropriate) be conducted of State and local governmental entities in such a manner that the material financial audit needs of the participating governments will be satisfied. This plan will allow for phasing in single financial audits over a specified period for the States and local governmental entities.

Universities' Accounting and Auditing Role

The third perspective from which I would like to discuss governmental accounting and auditing is your perspective--the role of the academic community. Traditionally, universities and colleges have been the leaders in research and publishing in the accounting and auditing field, and our profession has thus looked to you for this leadership.

Progress has been made in improving accounting, financial reporting, and auditing in both the private and government sectors over the last 40 years. However, the catalyst has, too many times, been some fiscal crisis rather than a basic need for a systematic plan to improve these areas.

The 1929 stock market crash was the catalyst that forced improved accounting and financial reporting in the private sector. The 1975 New York City fiscal crisis did the same for the government sector and has prompted many State and local governments to

make notable progress in developing sound accounting and financial reporting systems. Several States now have accounting systems that, in whole or in part, produce reports that are in accordance with generally accepted accounting principles. And a number of other States, as well as local governments such as New York City and the Nation's Capital, have invested a great deal of time and money improving their accounting and financial reporting systems.

Most of the improvements made in governmental accounting, financial reporting, and auditing, have been made without adequate research and without developing theory or conceptual frameworks--all things that are vitally needed to establish strong accounting, financial reporting, and auditing systems. While experienced academic researchers such as you are beginning to become more involved in the governmental area, that research is limited when compared to the research you have done on private sector accounting and auditing.

Many potential research areas can be found in the governmental accounting and auditing field. A few of the areas include:

- (1) Pensions, particularly recognition and measurement of pension fund participants' liability.
- (2) Donated property and services.
- (3) Capitalization and depreciation of the cost of assets.
- (4) Performance in State and local governments, particularly measurement of service performance and goods provided.
- (5) Liability recognition and measurement under insurance and loan guarantee operations.
- (6) Accounting and reporting entities, specifically the definition and identification of the entities in the government sector.

- (7) Budgetary reporting, specifically the feasibility of reporting budgetary information on the financial statements for governmental entities.
- (8) Types and content of financial statements necessary to satisfy the number and diverse users of governmental financial statements.
- (9) Relationships between accounting and budgeting, especially the need to integrate the government budget processes and accounting systems.

Other sources of possible research issues can be obtained from organizations such as the Securities and Exchange Commission, the Municipal Finance Officers Association, various State and local accounting and auditing organizations, and public accounting firms that are now actively involved in providing accounting and auditing services to the government.

With the growth in government spending (currently the annual budgets for Federal, State, and local governments is \$1 trillion) and the complexity of the various programs, government managers and officials need your help, not only in seeking solutions to the many problems facing them but also to help better prepare the accounting student who may seek government employment after graduation.

CONCLUDING REMARKS

In conclusion, let me say that notable improvements have been made in governmental accounting and auditing over the past few years, but much remains to be done. Make no mistake, we in the accounting field--whether as government managers, public accountants, or academicians--are at a crossroads. We must all make significant

contributions to government auditing and accounting over the next 10 years if we are to achieve our goal of efficient, effective, and accountable management of the taxpayers' money. And I believe research is vitally important to our efforts.

We in government must help identify areas of research. We must make staff available to facilitate that research and provide access to the government and its information. Most importantly, we must provide internships for academicians, particularly to do research.

Those of you in public accounting must also help identify areas of research, as well as encourage the academic community through research support and internships. You can encourage more of your members to apply their skills in the government arena and you can continue to work with the government to solve its financial problems.

You in the academic community must expand your research, publication, and teaching in the area of governmental accounting and auditing. And, as I mentioned, it will be our responsibility as managers--both public and private sector--to help provide resources for you.

We must change how we've operated in the past. Improvements in governmental financial management, thus far, have been largely reactionary, and it's time we had systematic research leading to sound systems and policies which will allow us to head off crises--not just cope with them.

We must join forces and work closely together in our efforts to manage more efficiently and effectively and be more accountable to the public.

In closing, I would like to thank you again for inviting me to participate tonight, and I wish you a successful symposium and continued success in the future.