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INTERNAL AUDITING AND GAO's AUDIT STANDARDS

By

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The expenditure budget of the Federal Government is now running at a clip of around \$300 billion a year.

We in the General Accounting Office, as independent Federal auditors in the legislative branch, are constantly concerned with that budget -- but not with its size so much as with what is accomplished as a result of the expenditures and with the avoidance of unnecessary expenditures to achieve desired results. Along the way, we are also concerned with whether all public funds are properly handled, whether they are spent and applied in accordance with the laws and regulations governing them, whether they are adequately accounted for, and whether clear and understandable reports are prepared to disclose what the expenditures were for.

These few words summarize the essence of the most important standard included in the code of auditing standards published over two years ago by the Comptroller General of the U. S. This standard relates to the scope of the audit of government operations and makes it clear that, to be most useful and effective, the government auditor must concern himself with more than the integrity and legality of with which public funds are managed and the fairness of financial reports on custody and use of such funds. The

traditional scope of work of the government auditor involves important work and work of the kind that should be done.

But he must also get into the efficiency and economy with which public funds are used and -- most important -- he must evaluate what, if anything, is being accomplished and whether and to what extent such accomplishments square with what was intended.

All of these factors relate to the overall management standard of accountability. Accountability for satisfactory performance--whether in government, private business, or other forms of enterprise--is a primary duty of those directly responsible for carrying on operations. They must not only perform well but they must account to those concerned as to how well they are performing. The auditor becomes involved secondarily in that his role is to review and evaluate independently that performance, including the adequacy of what is reported.

In simplest terms, auditing of the kind I am referring to involves examining into the operating, managerial, or administrative performance of selected aspects of an activity or organization beyond that required for the audit of accounts, financial transactions, and reports.

The primary purpose of such extended auditing is to evaluate the quality of management or operational performance and to identify opportunities for greater efficiency and economy, or for increased effectiveness in carrying out procedures or operations. The basic objective is improvement in relation to the goals of the organization.

A good, brief but simple and down-to-earth statement of the essence of this kind of auditing comes from William H. Allen, who used to head the Institute for Public Service in New York. He put it this way many years ago:

"That each man on a payroll actually received the pay charged for him doesn't prove that he worked the hours for which he was paid; that his work was worth his pay; that he did any work but collect his pay; or that there was any work for him to do."

Auditors are making progress in expanding the important part they can play in accountability systems. But their role and the art of auditing are still evolving. Much remains to be done in perfecting not only audit concepts and techniques but in demonstrating to policymakers, managers, and operating officials just how useful the auditor's work is in improving management and operation performance.

Our audit operations in the General Accounting Office are classified into three broad categories.

- Audits of financial operations and legal compliance.
- Audits of efficiency and economy of operations.
- Audits of program results.

Each audit category is described in terms of objectives; in other words, general specifications for each category are developed to describe what the audit seeks to accomplish.

Financial operations and legal compliance

An audit of financial operations and legal compliance, for example, embraces the audit of financial transactions, accounting records, and financial reports as well as compliance with applicable laws and regulations. The audit includes enough work to determine whether:

- The agency controls and accounts effectively for its funds, property, and other assets; its liabilities; and its revenues and expenditures.
- The agency has an adequate accounting system.
- The agency's financial reports show fully and fairly its financial condition and the results of its operations and provide adequate financial information for use by managers.
- The agency is complying with the laws and regulations governing the receipt, disbursement, and application of public funds.

Efficiency and economy

Many GAO audits are concerned with efficiency and economy in the use of public resources. Policies, procedures, and transactions are examined (1) to evaluate the efficiency, economy, and legality with which an agency carries out its

4

programs and activities and uses financial, property, and personnel resources and (2) to develop recommendations for improvements.

Specifically, these audits inquire into such matters as the:

- Need for goods or services provided or procured.
- Reasonableness of costs incurred or expenditures made.
- Adequacy of safeguards over and care of resources acquired.
- Proper utilization of resources.
- Adequacy of revenues received for goods or services sold.

Such matters are pursued primarily from the standpoint of improvements needed--usually by identifying avoidable costs or waste, possibilities for increased revenues, and alternative procedures for producing similar results at lower costs or better results at the same or lower costs. This kind of work is done on a selective basis. We do not try to perform audit work on a scale that would support overall opinions on efficiency and economy.

PROGRAM RESULTS

The third broad category of GAO auditing is concerned with the results of government programs or activities. Also referred to as program evaluation, an audit of program results involves evaluating whether desired results or benefits are being achieved and whether the objectives established by the Congress are being met.

Including program evaluation as a part of auditing is sometimes debated as a questionable extension of the auditor's job. However, we consider it to be an integral part of auditing and the Congress itself endorsed this concept by law when it included in the Legislative Reorganization Act of 1970 the specific requirement that the Comptroller General review and analyze the results of on-going Federal programs. More recently, this requirement was repeated in the Congressional Budget and Impoundment Control Act of 1974 which became law last July.

Traditionally, auditors have devoted almost all of their attention to inputs into management processes and operations-- that is, they have mainly audited and evaluated transactions, resources, policies and procedures, internal controls, and financial reports. Yet those concerned with an organization's success or usefulness are much more interested in, and concerned with, results achieved with its resources. They need and want answers to such questions as:

- What is being accomplished?
- Is the activity really successful--that is, are the accomplishments or results what was intended?
- Is as much being accomplished as was intended?
- Are the results worth the cost?
- Could the management do better?
- If so, what should be changed?

These are good questions and they are tough ones for most public programs. Auditors with their skills of analysis should try to help out by providing information on such questions.

Although program evaluation and audit staffs in some Federal agencies, GAO auditors, and auditors in some State and local governments have done some good work, the art of government program evaluation is still in a somewhat primitive state. This is particularly true for the massive social action programs such as those aimed at reducing poverty; improving education, health, welfare, and housing; and job creation and placement.

One journalist not long ago colorfully likened the program evaluation process in some areas to "nailing Jello to a wall."

Despite the difficulties, the auditor can be more helpful to the cause of better government if he does what he can rather than turning away.

Almost all Federal agencies have internal audit organizations of varying degrees of effectiveness. Internal auditing is recognized in Federal operations as an important component of a management control system and the Congress itself has endorsed and encouraged the application of this principle.

The GAO code of auditing standards is also applicable-- at least in our judgment--to internal auditing in the Federal agencies. We prepared a statement of basic principles, standards, and concepts for such audit operations many years ago. Just recently we revised it to incorporate our general code of audit standards. Copies of the revised booklet are available to those interested in examining it.

Because of the sheer size and complexity of the Federal Government's operations, we in the GAO are greatly interested in the management control systems of the Federal agencies. We are especially interested in the quality of the internal auditing in those agencies. Our interest and concern with the quality and usefulness of internal auditing in all Federal agencies has to be unflagging, if we in GAO are to do our job properly. Our audit policy is to keep in close touch with internal audit organizations to keep abreast

of their plans and programs, their findings and recommendations, and their problems. We use the results of their work when appropriate and by referring to it in published reports we add visibility not only to the existence of internal auditors (whose reports are seldom made public) but to the concept that they are an important part of a management control system.

I have probably said more on the conceptual plane of auditing than you are comfortable with but the subject is a large one and one in which we have a continuing, abiding interest. However, a few examples drawn from actual GAO audit operations can do a much better job of conveying to you some of our ideas on what the work of the auditor should embrace and what his impact can be.

Air Conditioning of Military
Family Housing in Hawaii

About three years ago the Department of Defense specified that all existing and future family housing in Hawaii be air-conditioned. This was to be an across-the-board requirement. We examined into this program because of the high cost of installation and later maintenance and operation and because of the increased use of energy that would result.

We estimated that the costs of installing such facilities would run as high as \$100 million and annual operating and

maintenance costs would increase by millions of dollars.

We concluded that the blanket policy of centrally air-conditioning all military family housing units in Hawaii was unnecessary for several reasons:

- The requirement for air-conditioning did not consider the cooling effect of trade winds and the consistently moderate temperature and humidity conditions which gives Hawaii one of the most pleasant climates in the world and makes it one of the most sought-after States to live in and visit.
- Central air conditioning is not common in Hawaiian townhouses and private homes, including those in the luxury category, and, generally, it is not essential to the health, welfare, or morale of persons living in Hawaii.
- The military services in Hawaii themselves do not believe that air conditioning is needed, except at some locations with unusual weather or noise problems.
- Other Federal agencies, such as the Federal Housing Administration and the U. S. Coast Guard, do not believe that air-conditioning is needed throughout Hawaii, although it might be desirable in certain locations.
- Across-the-board installation of central air-conditioning would aggravate Hawaii's existing energy problems.

The latter point is of especial interest in these days of growing shortages of energy sources. Hawaii has been one of the States most affected by the supply and cost problems related to oil consumption. Almost all of Hawaii's electric power is produced from imported oil.

Our report went to the Congress in May 1974.¹ If prompted some newspaper headline writers to say things like:

"Air-Conditioning Proposal Given Cool Reception" or

"Cooling Hawaii Homes Leaves Probers Cold"

The air-conditioning proposal did generate some interest on the congressional front. Senator William Roth of Delaware was especially concerned and on September 11 he introduced on the floor of the Senate an amendment to the military construction authorization bill to prohibit using any appropriated funds for air-conditioning military family housing units in Hawaii. His amendment was adopted. In discussing the amendment, the

Senator noted:

"When we are seeking ways to cut the Federal budget to help control inflation, there can be no justification for spending \$100 million on air-conditioning homes where climatic conditions are close to ideal."²

In mid-December when the final bill was being discussed in the Senate, Senator Roth commented further as follows:

" It seems hard to convince some people that tax dollars do not grow on trees. Central air-conditioning in Hawaii is the kind of luxury--both in terms of the budget and in terms of energy consumption--that the Nation simply cannot afford. Although this amendment effects but a small reduction

in our overall Federal budget and defense budget, I hope that it will have a larger impact by indicating to our bureaucracy that Congress is serious about limiting Government spending to necessities.³

This example shows how the auditor can have an impact if he presents a clear case and the issues are current. In this case, the combination of budgetary and energy aspects generated fairly prompt attention. This example also illustrates that reviewing of policies--before they are put into effect and expenditures made--can be more productive of impact than postreview of expenditures.

Protecting Consumers from Defective Pesticides

Concern is and has been widespread about the effects of pesticides on man and on his environment. Rachel Carson's well-known work of a few years ago highlighted this concern far better than learned reports, commentary by scientists, or opinions of auditors. The field is not one that many people expect auditors to operate in or to contribute to.

However, GAO has examined the effectiveness of Federal programs which have as one objective the protection of the public from dangerous or defective pesticides. The most recent of these audits was completed in May 1974. Its objective was to evaluate the policies and practices of the Environ-

mental Protection Agency for determining whether pesticides
are marketed in compliance with the basic pesticide consumer
protection law. This law bears the somewhat overpowering name--
the Federal Insecticide, Fungicide, and Rodenticide Act.
This law requires, simply, that all pesticides shipped inter-
state be safe and effective and be registered with EPA before
being sold to the public.

Our auditors found that consumers have not been adequately
protected from defective pesticides. The agency's efforts to
determine whether registered pesticides were marketed in
accordance with the law were just not adequate.

Sampling by EPA inspectors was deficient in that they
repeatedly sampled some pesticides but never sampled others.
About 32,000 different pesticides were registered at the time
of the audit but only about 7,000 had been sampled during the
preceding 4½ years. Nearly two-thirds of the manufacturers in
the 3 regions of the agency included in the audit did not have
any of their pesticides sampled by EPA during this period.

Lack of personnel, space, and equipment were reasons
cited by the agency for its inability to test most samples
taken for safety and effectiveness. Since the tests that
were made showed alarming degrees of defectiveness, the
failure or inability to conduct more complete tests of samples
drawn meant that the agency was not providing the public the
protection contemplated in the law.

13

Even when defective pesticides were found, the manufacturers were not always notified and as a rule the agency never notified the consuming public. In some cases, other Federal agencies purchased pesticides which EPA found to be defective or chemically deficient and they in turn recommended their use to consumers--a kind of undesirable domino defect.

The findings led to a long string of audit recommendations for tightening up the agency's procedures. EPA agreed generally with the auditors' findings and recommendations. Before the audit report was completed, the agency started proceedings to cancel the registration of 32 ineffective pesticides and took steps to provide for the prompt public release of information on its enforcement activities.⁴

"A Few Good Men"

A common sight on many street corners in the United States these days is the recruiting sign which reads:

"The Marine Corps needs a few good men."

In our study of Marine Corps plans for the work forces at its Finance and Automated Services Centers in Kansas City, our auditors found a good source to help meet this need. They noted that the Corps planned to continue to employ at the Centers 272 Marines, whereas their analysis showed that those Marines could be replaced by 249 civilians at an annual savings of almost \$1 million

a year. Besides the savings and the release of Marines for military duties, the Centers' overall efficiency would be increased by the greater stability of a civilian workforce.

These observations, which the auditors of course considered very reasonable, were conveyed to the Secretary of Defense in a short report completed in June 1974.⁵ with the recommendation to "civilianize" the workforce at the Centers and to make similar studies at similar activities of the Army, Navy and Air Force.

Three months later, we received a letter from the Department of Defense expressing reservations about some of our observations but noting that "Notwithstanding these points, the conclusion that the Centers should be staffed essentially with civilians remains valid." It then went on to state that the Marine Corps was reviewing the manning of the Centers in the light of our report and we are confident they will find some of their "good men."

Shortages of Doctors and Dentists

What can auditors do about shortages of doctors, dentists, and other health professionals? The answer to this question is that they can perform the same kind of service here as for any other problem in which the Government injects itself for the purpose of helping out. Auditors can review programs of action, analyze procedures and accomplishments, identify better ways of doing things, and propose recommendations for improvement.

Over 10 years ago the Congress authorized programs of financial assistance to students with exceptional needs as part of an overall program to meet anticipated national shortages of doctors, dentists, and other health professionals. The program was given the name of Health Professions Student Assistance Program and it wasn't long--in this day and age of the acronym--before it became known more familiarly as HPSAP.

The apparent objectives of the program were threefold:

- to increase the number of qualified applicants to health professions schools.
- to attract more health professions students from low-income families; and
- to encourage physicians and dentists to practice in shortage areas.

Several hundred million dollars of Federal funds have been spent to assist students under this program. For the 1971-72 school year, over 35,000 students received assistance and they represented over a third of the total number of students enrolled in participating health professions schools.

GAO's audit of this program led to the overall observations that the program had not had a significant impact on:

- Increasing the output of the Nation's medical and dental schools.
- Improving the quality of medical and dental students, and
- Influencing medical and dental school graduates to locate their practices in shortage areas, such as inner city and rural areas.

The auditors did observe that the program had helped persons from low-income families to get into the health professions but they also felt that much more could have been done in this respect.

The Department of Health, Education, and Welfare was the Federal agency responsible for the program but it didn't provide any too much guidance to medical schools as to what constituted acceptable financial need on the part of the students. One result was the allowance of some quite questionable expenses for individual students.

For example, we found allowances

- Up to \$300 a month just for transportation.
- Up to \$300 a month for housing.
- Expenses for books, equipment, and supplies that exceeded the actual cost of such items anywhere from \$300 to \$1500.
- For questionable items such as feed for a spouse's horses, a summer European tour, and even an abortion

for a student's girl friend (the latter loan was later cancelled after GAO auditors inquired about it).

Tightening up on these kinds of looseness with public funds was one result of the audit. Another was the information produced that should be helpful to the Congress in considering the future of the program.

For example, a major part of the audit was to find out whether the program had much influence on where doctors and dentists practiced after graduation. Portions of loans received could be cancelled if a/recipient practiced in a designated shortage area for a specified period of time. The auditors found, however, that this arrangement had little impact on individual decisions on where to practice. Many students were not even aware of the provision and others didn't find the financial incentive enough to overcome their problems with what they considered to be undesirable aspects of practice in the shortage areas. They also found that a large number who did set up practice in such areas said they would have done so irrespective of the loan cancellation provisions of the assistance program.

The GAO audit produced a flock of recommendations for improving the management of the program (which I won't detail here) and the Department agreed with them.

The audit report⁶ was released on May 24, 1974, which was timely in light of the fact that the existing law was expiring on June 30. On May 29, GAO representatives testified on the findings of the audit before the House Committee on Interstate and Foreign Commerce. Not long after, Senator Javits placed in the Congressional Record the entire chapter from the audit report summarizing the conclusions and recommendations along with the departmental comments and GAO's evaluations of those comments.⁷ This action made the essence of the audit report widely available to those in the Congress--and to many on the outside--interested in the subject.

I won't go into all the details relating to health manpower legislation, in the recently adjourned Congress but I should note that the GAO audit report was referred to from time to time during the floor debates on new legislation.

Other Audit Work

The Comptroller General sends to the Congress each year several hundred audit reports on diverse aspects of the Federal Government's wide-ranging activities. For this reason, I can only provide a sampling of the nature of the audit work performed and an indication of impact.

We do not find it necessary to keep records on all of the constructive impact that our audit work produces. However, do have a system of internal accomplishment reports that

communicates upward in our management channels information on significant achievements.

Some recent examples:

- An annual saving of over \$1 million is resulting from requiring Mexicans who are illegally in this country to pay the costs of transporting them back to Mexico.
- More efficient use of money to buy coffee for the military services is resulting from adopting a more flexible blending formula in lieu of the rigid 70 percent Brazilian and 30 percent Columbian coffee that had been followed. (The services buy 25½ million pounds of coffee a year.)
- A review of equipment usage at an air materiel area led to the agency's identifying nearly \$1 million in equipment as excess to its needs and available for use elsewhere.
- The safety of military hospital patients was increased as a result of better guidance from the Department of Defense and the Veterans Administration on the use of disposable catheters and guidewires in vascular studies. A GAO survey found that some hospitals were reusing them despite warnings of possible infections, allergenic reactions, and breakage.

To generalize somewhat, there are many ways that auditors can contribute to better management of government operations. The extent to which they are successful is the best indicator of the importance of their function. They can bring about such things as:

- Monetary savings through cost reductions
- Increased revenues
- Useful information for managers, policy-makers, and legislators to use in making decisions or evaluating performance.
- More understandable information for public use
- Prevention of waste of resources
- Prevention or discouragement of employee irregularities
- Improving the quality of services or products
- Correcting or strengthening weaknesses in management systems
- Improved day-to-day performance of employees
- Prevention of unsafe practices or improvements in safety procedures
- Better administration of laws, including improved compliance with legal requirements.

GAO Position.

In discussing the work of the GAO, I must emphasize that we recognize very clearly the unique position we occupy in the Federal Government's scheme of organization and checks and balances. Our independence as auditors of Federal operations is enhanced by being located in the legislative branch, by being given a very broad charter of authority and responsibility, and by being headed by two officials who are appointed for 15-year terms.

We recognize that, although comparable arrangements exist in some State and local governments, they are seldom found elsewhere--in industry or other non-governmental organizations, or in public accounting.

GAO's relative independence of operation and its performance has helped lead to a considerable broadening of the audit function in other levels of government and outside government. In short, the scope of GAO audit work and our published code of auditing standards are helping to serve as beacons for other governmental audit organizations. We think that State and local governments can definitely benefit from an advancement in the nature and quality of the audit work performed by them or on their behalf. We think, too, that auditors working on commercial or industrial operations can do more to expand the scope of their work. However, in saying this, we recognize that each internal audit group has to function in accordance with the policies of the organization he serves.

GAO has sponsored a national audit forum and regional forums around the country made up of Federal, State, and local government auditors as a means of exchanging ideas and promoting a better and more useful brand of auditing at all levels.

In closing, I would not wish to leave the impression that GAO is the only progressive and effective audit organization. We know there are others and we know that much innovative and constructive audit work is being done elsewhere. We try to keep informed of all important advances in techniques in the field.

One way to not only adapt but progress toward the general goal of more effective auditing and more useful and constructive impact is to observe and evaluate what others in the field are doing. The work of the GAO is in the public domain and its reports--most of which are publicly available--are a valuable source of information and ideas on how the audit function can be useful and have some desirable impact.

¹ DOD's Requirement For Air-Conditioning Military Family Housing
Hawaii Is Unnecessary--B-172376--5-20-74.

² Congressional Record, Sept. 11, 1974, p. S16395

³ Congressional Record, Dec. 14, 1974, p. S21514

⁴ Pesticides: Actions Needed to Protect The Consumer From
Defective Products--B-133192--5-23-74

⁵ Opportunity To Reduce Costs And Improve Efficiency By Employing
Civilians Instead of Marines--B-146890--6-19-74.

⁶ Congressional Objectives of Federal Loans and Scholarships To
Health Professions Students Not Being Met--B-164031(2)--5-24-74

⁷ Congressional Record, June 5, 1974, p. S9672