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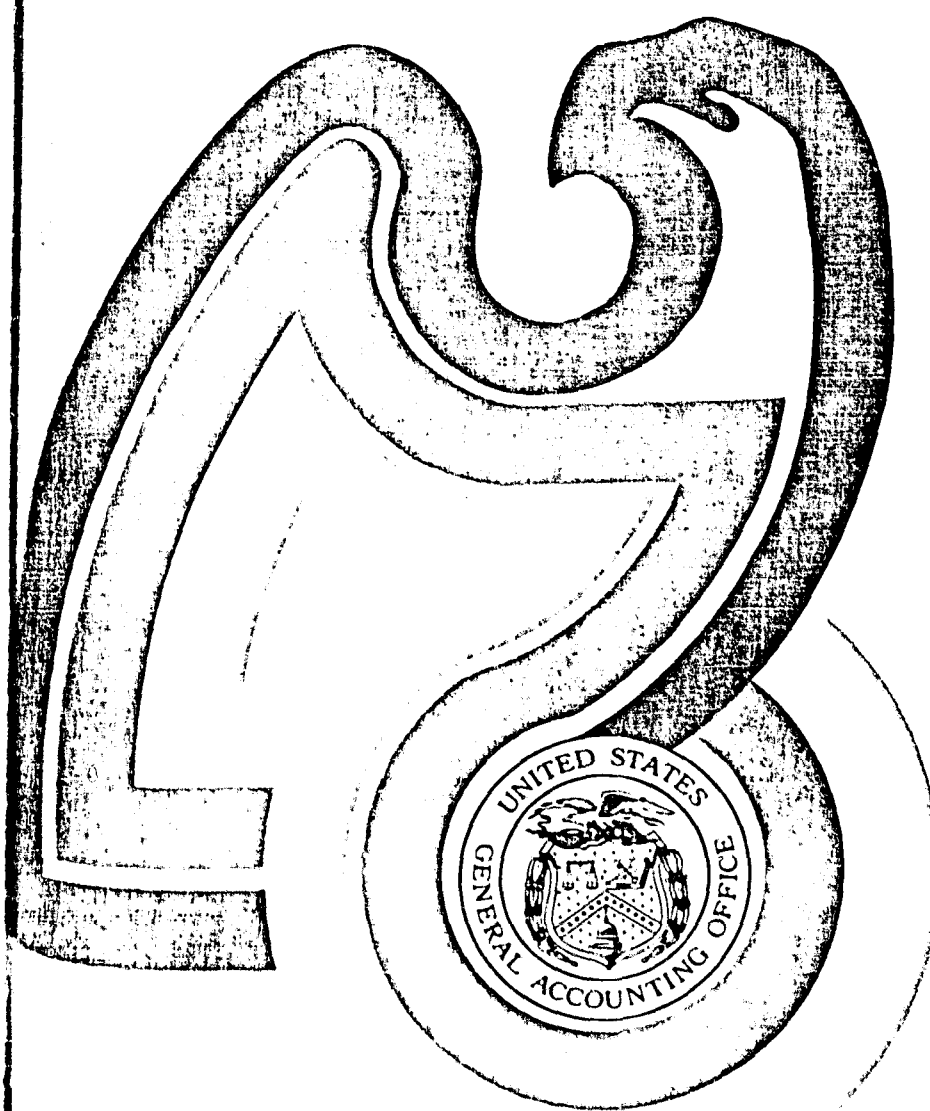
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*GAO Renewal, Vol 12, No 4, Fall 1977
P1-10*

ELMER B. STAATS
COMPTROLLER GENERAL OF THE UNITED STATES

The Increasing Importance of Internal Auditors in Today's World

On June 20, 1977, the Comptroller General addressed the 36th International Conference of the Institute of Internal Auditors at Hollywood, Florida, on this subject. The following remarks are adapted from his address.

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The General Accounting Office has taken a strong stand on the need for internal auditors in government. Federal agency heads were made responsible for creating and maintaining effective internal audit in their agencies by the Accounting and Auditing Act of 1950 which states that:

The head of each agency should establish and maintain systems of internal control, including appropriate internal audit, to provide effective control over the accountability for all funds, property, and other assets for which the agency is responsible

I was not at GAO in 1950, but I was in the Bureau of the Budget. These organizations were the principal architects of this legislation. Today there are about 11,600 persons in the Federal Government who call themselves internal auditors. Similar functions are performed by many others who identify themselves

by different titles, such as management analyst, internal review, etc.

In the Federal Government today, auditors are among the principal providers—if not the principal providers—of factual information to Government officials, legislators, and the public on economy of operations and financial integrity. The same audit goals that are in the 1950 act are being adopted almost uniformly by State and local government auditors.

Examples of GAO Audit Work

Before discussing the increasing importance of the role of internal auditors, let me provide some examples of the work government auditors do, drawn from the operations of the General Accounting Office, with which I am most familiar.

Financial Audits

GAO sends reports on audits of financial statements to the Congress on such Government corporations as the Federal Deposit Insurance Corporation, the Commodity Credit Corporation, and the Federal Prison Industries, Inc. We also make audits of many other aspects of the financial operations of Government agencies.

For instance, in the last few years, sales of U.S. arms to foreign governments have become sizable. Legislation requires that prices charged by the Defense Department for these arms be sufficient to recover the Government's cost. There is a similar requirement in providing foreign military students with technical training in piloting aircraft, helicopter repair, and many similar skills. We reviewed the Department of Defense's procedures for recovering the Government's costs incurred in training these students and found that millions of dollars have not been recovered due to faulty pricing, billing, and collecting systems. We reported this to the Congress in December of last year, pointing out that in the Army alone, such unrecovered costs totaled \$18 million during fiscal year 1975.

As one result of this report, the Department of Defense took action to improve its pricing system, but it subsequently made reductions in its tuition charges. We followed up with a report to the Congress in February which

pointed out that these reductions would cost the United States at least \$40 million in this fiscal year. In response to our report and congressional concern, the Department, on May 3, raised its tuition rates to the cost-recovery level as the law requires.

On the subject of cost recovery, we found also that, contrary to law, the rates charged to non-military medical personnel for the care they get in military facilities did not recover costs. In fact, about \$12 million in medical costs are not recovered annually. We reported this to the Congress in March. The Department of Defense responded favorably, raising its rates to U.S. civilians and foreign nationals in April. While these rates will increase the amount of reimbursements significantly, they will not recover all costs that should be recovered because all applicable costs are not included in the existing rate computation due to accounting system deficiencies. The Department has advised us that it is giving high priority to developing the accounting procedures needed to provide more complete information for determining reimbursement rates.

Economy and Efficiency Audits

GAO has a long history of reporting to the Congress on ways in which Federal executive agencies can do their job either as effectively or more effectively at a lower cost. Here are some recent examples:

Recently, we reviewed the effi-

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We are hopeful that Federal agencies that operate hydroelectric plants will recognize these opportunities and act accordingly.

Some of our economy and efficiency audit findings involve supplies, equipment, or facilities that are either excess to the needs of an agency or not used sufficiently. One example involves the Veterans Administration's cardiac catheterization laboratories, operated at a total cost of about \$20 million in some 67 VA hospitals. By way of explanation, in a cardiac catheterization, a thin, pliable tube—the catheter—is inserted into an incision in the patient's arm and passed through a vein or artery into the heart chambers. The procedure is used to diagnose heart ailments.

We reviewed the use of cardiac catheterization units in 12 VA hospitals and found that 11 of them were underused. The problem appears to be that the VA central office permitted cardiac catheterization laboratories to be established without adequately determining whether they were needed.

We found also that 8 of these 12 laboratories were not located at VA hospitals where cardiovascular surgery is regularly performed, even though the medical community and the Veterans Administration agree they should be. We pointed out this problem in our report to the Congress, issued in February, stating that the Veterans Administration may be exposing its patients

efficiency and effectiveness of federally operated hydroelectric power plants, such as those operated by the U.S. Army Corps of Engineers, the Department of Interior's Bureau of Reclamation, and the Tennessee Valley Authority. To put this review in proper perspective, I should mention that about 15 percent of our Nation's electric generating capacity is hydroelectric, and of that capacity, about 40 percent is federally owned.

Hydroelectric power is produced by channeling water from dams through turbines that drive generators that produce electric current. We found that the potential exists at some Federal hydroelectric plants to increase power production because of technological advances in turbine and generator designs and materials since the 1930s, when the Government first became substantially involved in hydroelectric power production.

In March we reported to the Congress that if Federal hydroelectric power plants would modernize their turbines and generators to increase efficiencies and capacities, power production at Federal dams could be increased. We pointed out that the additional hydroelectric power production not only will increase the Nation's energy supply but also will

- reduce pollution,
- increase Federal revenues, and
- displace or delay construction of alternate power sources.

to unnecessary risks by performing cardiac catheterizations in hospitals without facilities to handle emergencies. We are hopeful that the Veterans Administration will correct these deficiencies.

Program Results Audits

Much of our work in GAO involves audits designed to assess the effectiveness of Government programs in achieving the objectives for which they were created. An example is our study of the effect of regulation of the airlines industry by the Civil Aeronautics Board on passenger fares. The study was made at the request of the Chairman, Subcommittee on Administrative Practice and Procedure, Senate Committee on the Judiciary.

Our study estimated what fares would have been on a number of busy routes if the airlines were less regulated by the Board and compared those fares with fares charged by the regulated airlines. Our analysis offered reliable evidence that less regulated airlines probably would have charged lower first-class and coach fares, primarily due to increased competition. We estimate that if airlines had been less regulated during the period from 1969 through 1974, passengers would have saved on the order of \$1.4 billion to \$1.8 billion annually. I should point out that while passengers on the average would have paid lower fares, they would have been required to give up some conveniences regulated air-

lines now provide. For example, some flights would have been more crowded, and fewer flights might have been provided on some routes.

Our report states that the Civil Aeronautics Board itself has concluded that economic regulation of the kind that has been applied to the airline industry is no longer in the public interest, but has taken the position that such a fundamental change in the approach to regulating air transportation should be mandated by the Congress. This case is an excellent example of the expanding horizons of GAO's work, particularly in the evaluative area.

Another example is GAO's first audit of the supervision of State and national banks by the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Federal Reserve System. From time to time, there are incidences of bank failures in the United States notwithstanding Federal supervision of banks, including periodic bank examinations. We found that one reason failures occurred was that Federal bank examinations emphasized analyses of a bank's condition at the time of an examination but did not always provide sufficient attention to basic management policies and controls exercised by the banks themselves, which could lead to detection of situations causing deterioration of a bank's operations. Fortunately, the Comptroller of the Currency recently revised bank examination procedures, which should result in ear-

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...er detection of such situations. I am hopeful the Federal Deposit Insurance Corporation and the Federal Reserve System will join the Comptroller of the Currency in using the revised bank examination procedures.

We also found that Government surveillance of the Federal Reserve System's bank holding companies was not sufficient to disclose problems in the holding companies before these problems affected affiliated banks. We recommended more frequent, in-depth, onsite inspections of holding companies to improve the detection of such problems.

Computer Auditing

About a year ago we issued a report entitled "Improvements Needed in Managing Automated Decisionmaking by Computers Throughout the Federal Government." In our audit work at a naval installation, we observed that certain types of stocks in an automated inventory system were building up, though they should not have been. After some diligent digging, we discovered a quirk in the computer program which had the effect of double counting requests for issuance of parts and supplies. Naturally, the computer ordered replacements automatically to accommodate this apparent increase in the need for such parts and supplies. But the result was that unneeded stock was ordered.

No one had questioned the computer's output. Before we looked into the cases, the com-

puter's actions were assumed to be correct. Our auditors worked to get the situation remedied. Then one of our more thoughtful staff members began to wonder how frequently other situations of this type might exist, where a computer's input was resulting in actions being taken automatically—actions that could be wrong—with no review by human beings.

We reviewed the reports of a number of internal audit agencies within the Government to find out whether similar situations had been encountered elsewhere. These internal audit reports provided us the answer in a short time at a minimum cost. We were surprised to find that it was rather common for internal auditors to encounter automated systems turning out bad decisions—decisions not being detected by operators and users of the system. The internal auditors had unearthed the errors in automated systems, had run them down, and had corrective actions taken. But—and here is the point—each of these had been treated as an individual case when, in fact, there was a pattern of such bad decisions. Eventually, we were able to attribute these similar cases to bad programming, bad data, or a combination of the two. These factors, together with almost unquestioning acceptances of the outputs of computers as correct, had resulted in a loss of hundreds of millions of dollars through erroneous payments, ordering unneeded items, incorrect eligibility determinations, etc.

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By establishing that this pattern existed rather generally across the Government, and in disclosing the magnitude of the errors being made, we were able to convince the Office of Management and Budget of the paramount need to issue specific directives to all Federal departments and agencies directing them to take the broad corrective steps recommended in our report.

One of the most important of these steps is the provision for internal auditors to make periodic reviews of the output of automated systems to assure that the decisions being made are correct. Another is to encourage early auditor involvement in the development of such systems to make sure that appropriate controls and audit trails are built in. This report has made a vital contribution to improving the use of computers in the Federal Government and to demonstrating the need for continued, careful surveillance by internal auditors of computer systems.

Our report complements, in many respects, the recent contribution of the Institute of Internal Auditors to improvement of the entire area of computer systems development and operation in the Systems Auditability and Control Project. The institute is to be commended for its outstanding foresight in recognizing the need for such a comprehensive study of the area of computers and information systems.

Our office has already benefited from this study. We are using it in our computer training

courses because we feel it is a landmark effort in the struggle to show the contribution that auditors can make toward improved managerial efficiency in the electronic age.

Earlier this year we participated with the institute in a national Bureau of Standards workshop in considering whether supplementary audit standards for situations involving computers would be useful. We have concluded, as did those in the workshop, that such standards would be useful and we have a project underway to prepare a supplement to our GAO audit standards for application when computerized systems are under audit.

How Internal Auditors Can Be of Help to Federal, State and Local Government

Today, Government at all levels is beset with financial problems; one need only read the papers. Our larger cities have serious financial problems—New York, of course, being the prime example. The Federal Government and State governments too are feeling the pinch of steadily rising costs accompanied by widespread taxpayer opposition to tax increases.

In such a situation, the skills of internal auditors are often just what is needed. One answer to such a situation is to reduce costs, improve efficiency, and eliminate unproductive or ineffective programs. These are pre-

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... precisely the things that internal auditors are skilled in.

For internal auditors who are in government at one level or another, opportunity is at hand. They need to be sure they have a sound planning process so they can concentrate on matters of significance; do the best work they can so their findings will be understood and their recommendations implemented; and, when necessary, educate those in managerial positions who do not yet know how internal auditing can be used as a tool for improvements in efficiency and effectiveness.

For those of you not in government, I would urge you to take an interest in governmental affairs. Many levels of local government still have no internal audit staffs and little work is done in such organizations to cut costs or eliminate unproductive programs. Frequently, the lack of internal audit is directly related to lack of knowledge by local officials on how the audit function can help them. The same is true, to a lesser extent, in State government and even in some agencies of the Federal Government. If internal auditors would take the lead in helping government organizations that do not have internal audit staffs to understand the value of internal audit work and assist them in establishing effective internal audit organizations, they would help to eliminate some of the budget crunch that many government

organizations are experiencing. Another area in which internal auditors might help is to get those government organizations that are totally oriented toward financial work to broaden their scope into economy, efficiency, and effectiveness reviews.

Insofar as the Federal Government is concerned, there is a strong movement to make the periodic assessment of the usefulness of programs a requirement.

I refer here to what is called "sunset legislation." For those of you not familiar with this term, let me explain. Almost all Federal Government programs have been created without concern to whether they should ever end. This, of course, means that programs tend to perpetuate themselves even though they may have outlived their usefulness. The objective of sunset legislation is to specify termination points for such programs so that they cannot continue unless reauthorized specifically by the Congress.

In considering whether to do this, the Congress will want information. What is the program achieving? Is it reaching the desired target group? Has the problem been corrected? These and many other questions will and should be asked. As we see it, the Congress, in its search for factual and impartial answers, will rely to a considerable extent on auditors.

Where Is Auditing Going And What Must Auditors Do To Get There?

Periodically, all of us should take stock of the overall picture in our profession, but too often in the heat of battle, we see the task at hand but avoid looking at where we are going and how we are going to get there. In concluding these remarks, let us do a little crystalball gazing about the future of internal auditing.

There is a direct connection between the complexity of governmental and business operations, and the need for auditors. The more complex things are, the more difficult it is for management to get accurate information. In such circumstances, managers will rely on internal auditors to provide them with such information.

From what we understand about internal auditing in industry, the function now centers on testing financial controls and identifying areas in which operational efficiency and economy can be improved. Audits of the effectiveness of programs have not received as much attention. We have perhaps devoted more attention to effectiveness auditing in the Government because there the bottom line is how well a program achieves its intended purpose. I think industry will do more of this kind of work in the future.

Industry has programs too that can be advantageously evaluated. For instance, training programs might be evaluated to see if they

are cost effective and produce good results. The effect of pension plans might be evaluated to see whether they actually do attract and retain desired types of employees. Programs to protect the environment might be evaluated to see whether alternatives might do a job more effectively. Thus, as I see it, the frontier for internal auditors lies in evaluation of whether various types of programs are achieving the objectives for which they were created. This is not to say that internal auditors will give up their traditional roles in the financial and efficiency and economy areas. Rather, they will be called upon to add another function to their traditional skills.

Although I see increasing demand for evaluation of the results of programs, internal auditors are going to have to make some changes of their own if they are to do this work well. They will need to

- acquire new skills,
- learn to work on what is happening right now rather than what did happen, and
- learn more effective ways of reporting their findings.

Acquiring New Skills

The demands on auditors for greater skills in just the financial and efficiency and economy arenas are challenging enough, but as we have seen, even broader skills are necessary to do the kind of audit that produces information on effectiveness of programs. To do this work well

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requires a mixture of a variety of skills—mathematical, statistical, actuarial, engineering, and data-processing skills. Some of these skills are also useful in economy and efficiency audits.

Some of the basic auditing skills needed to perform audits of operational efficiency and economy and program effectiveness are not taught in schools. Accounting and auditing curriculums center almost entirely on financial auditing. Curriculums for other subjects—engineering, mathematics, and so forth—do not give them the point of view which the auditor follows in doing his work. So we all are faced with complex training jobs.

While I believe more training is necessary, training alone is not the answer. The days are too short for anyone to acquire *all* the skills needed to perform some audit tasks. Consequently, auditors must discard the idea that an individual auditor can possess every necessary skill. Audit staffs need to be teams of people with varying backgrounds and professional disciplines.

Learning to Audit
What Is Happening Now

Traditionally, auditors like to look at records of transactions that occurred weeks or months ago and check on the way they were handled, to reach a conclusion on whether such transactions were proper, economical, and so on. The days in which such auditing can be done are numbered. In the systems of the

future, we will have to audit transactions as they occur, before there is necessarily a record to look at. This will mean that much better audit planning will be needed so that many tasks now performed sequentially can be performed more or less simultaneously. Without far greater planning than is now given most audits, such audits cannot be done.

Auditors will also have to rely far more on systems functioning effectively, after they have been checked out, than they do now. This will require some better techniques for testing such systems than we now have. Both the Institute of Internal Auditors and GAO have done considerable work in this area, but I believe far more is needed before we can say that we have this well under control.

Learning More Effective
Ways Of Reporting

Reporting audit findings promptly and in an understandable manner is perhaps the most difficult problem auditors face. It certainly is a constant problem with us at GAO, and I am sure it is with many other audit organizations. Difficult as it is, auditors must learn to do it well, for audit findings and recommendations are of little value if not communicated effectively.

I think use of innovative reporting techniques—more briefings, video tapes, and greater use of photographs when appropriate—can help management

"get the message." However, we will also need a written report in most cases, and report writing for audits that go beyond a simple opinion on financial statements remains a common problem. Auditors must communicate with people who are unsophisticated in the technicalities of programs as well as auditing and accounting terminology. Writing reports that communicate requires talent and hard work—especially the latter—as in other challenges of life.

But difficult as this is, auditors are going to be pressed to do far better in the future. Things will

be happening so fast on the data processing systems that prompt action and clear communication will be demanded to stop inefficient or uneconomical procedures.

Concluding Remarks

In closing, I must tell you that we in GAO hold internal auditors in high esteem and, as you have already heard, we rely heavily on their work. Without internal audit staffs in the Federal agencies, GAO would have to be much larger than its present size to do its job.

Reporting Waste and Inefficiency

***We create this independent establishment, answerable to Congress, an establishment that has clerks and accountants, who will go through every department of the Government. When they find waste and inefficiency, when they find duplication in the service, they will come to the committee of Congress that has jurisdiction of appropriations and report that fact. That fact will also be communicated to the President of the United States. With that system of checks and balances it is believed that this great overlapping of activities, this duplication that exists in every department of the Government, will cease, and that the Government of the United States will be placed upon a business basis ***.

Congressman James W. Good of Iowa
Debates on budget and accounting legislation
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