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Developments in Governmental Auditing: Their Impact On the Academic and Business Communities

Richard E. Brown

Legislative Post Auditor, State of Kansas

Thank you very much for inviting me here tonight. The opportunity for a state official to give advice to representatives of the private and university worlds was an invitation I could not pass up! As Mark Twain was supposed to have said: "To do good is noble; to instruct others in doing good is just as noble and much easier."

My comments this evening will be in two parts. First, I want to tell you about what I know best: auditing in Kansas and the developments that I have witnessed here during the past nearly eight years. I believe you will find, as I always tell the classes I teach in auditing, that Kansas is indeed in the mainstream of what is happening nationally in governmental auditing. Second, based on this experience, I want to suggest some areas of concern in governmental auditing for all of us, problems which I believe will need our attention in the years ahead.

The Evolutionary Changes in the Kansas Audit Operation

The audit operation in the State of Kansas gets its basic mandate from the Legislative Post Audit Act of 1971. This is a well-researched document that was developed and written with a great deal of care and only after considerable expert testimony was received. That care and attention to detail shows in the legislation.

Under the terms of the statute, the audit operation in Kansas has two key units. The first is the Legislative Post Audit Committee. The composition of that Committee is made up of the bipartisan leadership of the two houses of the Kansas Legislature and includes the Speaker of the House, the President of the Senate, the Majority Leader and Minority Leader of the two houses, the chairmen of the House and Senate Ways and Means Committees, and a minority member of each Ways and Means Committee appointed by the Minority Leader. The duties of the Legislative Post Audit Committee include appointing the Post Auditor to a four-year term of office, choosing performance audit topics, and receiving and acting on all audit reports. The second main component of the audit operation in Kansas is the Legislative Division of Post Audit, which is the administrative arm of the audit operation. The Division is headed by the Post Auditor, who has complete management responsibility over the 40-member staff and all audit activity.

The day-to-day functioning of both the committee and the Division are guided by the Legislative Post Audit Act and by a fairly elaborate set of Committee rules covering all major aspects of operations, including media contacts, the release and distribution of audit reports, the availability of working papers, etc. The Legislative Division of Post Audit in Kansas performs financial audits, sunset audits, and performance audits.

As is true in most states, there have been a number of changes in the operations of the Kansas Post Audit machinery throughout the last decade. Formerly an elected State Auditor headed the operation. Many of the staff members were hired without degrees or other professional certifications. Now the Division of Post Audit has a diversified staff of CPAs, MBAs, lawyers, MPAs, EDP experts, and other professionals. Formerly the Division really had no financial audit cycle, leading to audit coverage, at best, over an extended period of time. Now the State is basically on a two-year financial audit cycle. As recently as just a few years ago, the Division did no financial auditing to satisfy federal audit requirements. In the belief that federal revenue sharing audit requirements might go away, they were largely ignored. Today the State is among the leaders in implementing the new single audit concept. Using our own staff resources, we have just completed a single audit of our Department of Social and Rehabilitation Services. The Department is one of our largest State agencies, spending in the neighborhood of \$500 million annually. We have contracted out to private firms a number of other single audits and will continue to do so in the future.

As recently as 1975, the Legislative Division of Post Audit did little or no performance or sunset auditing. Now, I think it is fair to say, we are considered a leader in the field, having completed dozens of performance audits in recent years, including audits of social services, highway maintenance, university construction, off-campus courses, duplication of higher education courses, the transferability of courses from community colleges to four-year institutions, and school district performance audits. The latter are among the first in the nation to be completed. Kansas is also a leader in sunset auditing—auditing which in essence examines the need for regulation, the fairness of that regulation, and whether the regulation is being performed in the interest of the public or in the interest of the regulated activity. Sunset audits completed range from audits of small licensing groups like the cosmetologists and barbers, to the larger concerns of nursing home and utility rate regulation.

Indeed, legislative interest in more and more performance and sunset audit work, coupled with increased federal requirements for financial audits, has created such a strain on the audit resources in the State of Kansas that, with the approval of the Legislative Post Audit Committee and the Legislature, the Division has arrived at a solution of contracting more financial audits. In fiscal year 1980, our Division will contract roughly \$300,000 of financial audit work to help accomplish that work and to make available resources for more performance audit activity. And that figure is likely to increase in the future. It is important to mention in passing that in the State of Kansas a decision has been made, at least for the time being, to avoid a statewide financial audit and instead conduct financial audits on an agency-by-agency basis.

These developments and changes have been significant, and to a great extent parallel the changes in auditing in other states in the country. The time

has not been without its anxious and even humorous moments. Let me give you a couple of illustrations. Back in 1975, we completed our first performance audit dealing with the regulation and use of water in Kansas. It is important to remember, of course, that this is a topic of grave concern in what is still very much an agricultural state. The audit was quite critical of the manner in which the State program was being operated, generating the following letter from a Senator:

Dear Mr. Brown:

I understand that your staff worked hard trying to understand and evaluate the operations of the . . . Act. However, when I looked over the members of the committee and learned the background of your staff, I realized the problem . . .

Water is a highly emotional issue. I believe that I can best illustrate it thus: There are three ways to get shot: (1) fool with a neighbor's wife; (2) claim three feet of his worthless land; and (3) cut his water off.

Another elected official was equally sensitive about an audit we completed of her operation. Actually, the report was not that critical, but she certainly took it that way. She wrote:

Dr. Brown:

I have received a copy of your report . . . I hereby demand . . . an evaluation of . . . your office by an unbiased public accounting firm, free of political control and intervention. The report is grossly incorrect. It is malicious, prepared for purely political uses. It violates the code of ethics of your field. It is an attempt to discredit me personally.

I remind you that although you were hired by a controlled committee, you are paid by the citizens. I demand you account to them for your actions.

But the letter was not the worst part of the whole process. When our audit manager and I visited this official to discuss the draft report, we found that she had invited the TV cameras and other media representatives into the meeting. We immediately reminded her that our Committee rules prohibited discussing a draft audit report in a public setting. At this point she literally jumped out of her chair and shouted at us "to get out of the office and never return." As embarrassing as this was, I was pleased that she was a woman and that she was located on the ground floor of the building. In this business one learns to take his blessings where he can find them. I could not help but be thankful that the then Secretary of Transportation did not receive his audit report in the same manner since he was a former All-American football player and has his offices on the seventh floor of the State Office Building.

Other Changes in Government Auditing

As I have already indicated, these developments and experiences in Kansas are virtually identical to those taking place in many other state governments. There has been a considerable increase in the authority and visibility of audits and of auditors. There has been a tremendous increase in the expectations for good useful audit work. And there has been a great increase in the quality and

influence of state audit officials and their staffs. The state auditors now meet on a regular basis to discuss issues of professional interest including pending legislative changes, and even have their own representative in Washington.

Intertwined with these developments are a number of other important related changes. The U.S. General Accounting Office has recently revised its "Yellow Book," the Comptroller General's governmental audit standards followed by most auditors engaged in governmental audit work. The revised standards cover many changes and place a great deal more emphasis on EDP audit work and on fraud and abuse. While no final decisions have been made, various proposals relating to the creation of a governmental accounting standards board are circulating—an idea which is certainly long overdue. There is considerable pressure on governmental jurisdictions from bond-rating firms for government to get its accounting and auditing systems in order, including the threat of a negative impact on bond ratings if they do not. Just a couple of year ago, the American Institute of Certified Public Accountants sponsored, in cooperation with the U. S. General Accounting Office, a conference in Cherry Hill, New Jersey, to discuss a variety of problems including the government's general dissatisfaction with the work quality on governmental audits by CPA firms.

All of these developments are hopeful signs for the future. The only question one might have is why did it take so long for all this to occur, and why did we have to wait until financial problems in government became so pervasive and so critical? And there is a related concern, a fear that the progress we are now making may not be permanent and that the cycle may swing again the other way.

Problems and Opportunities Suggested by the Kansas Experience

One senses some important questions and concerns beneath this great record of change. With regard to the financial audit in the public sector, there are many questions which still need to be resolved. In a State like Kansas where there is no general obligation bonded indebtedness, what is the value of the financial audit in such a setting—to whom does it convey information, and what is that information? If it is for "the investor" (the taxpayer), does this somehow suggest that the taxpayer may decide whether, on the basis of the audited financial statements, additional "investment" (taxes) should be withheld? Are these audits in any sense cost-beneficial? In our little State we are paying about a million dollars annually for financial audit work. The question is, what are we accomplishing—what if anything does a financial audit tell policymakers and the taxpayers about governmental performance? To illustrate the dimensions of the problem, it is not lost on any of us in Kansas that despite the fact that financial audits of the State's retirement system's financial statements had been conducted for a period of years, it was not until we did a performance audit of the system that we really learned anything about its then dubious investment performance.

A related question has to do with the matter of what is the best—most economical and effective—way to conduct a financial audit of state government. What are the trade-offs of the efficiencies of a statewide financial audit such as that conducted in states like Maryland and Minnesota vis-a-vis the value of the

audit presence provided by Kansas' agency-based approach? What of any importance is lost if the auditors do not conduct test work in a number of small agencies, presumably based on materiality concerns? Indeed, the whole issue of materiality in a government setting may need careful re-examination, since it is a setting which places great emphasis on compliance with law and regulations. In so many of these areas one senses that we are simply following tradition, piling on audit requirements instead of thinking these traditional audit concepts through for their application in a governmental setting.

As we in our state and local jurisdictions move to contract more and more audit work, other questions must also be addressed:

—Should the legislative or executive branch of government, the city council or city manager, do the contracting?

—What, if any, difference does it make?

Our experience in Kansas thus far indicates that this is an important area of concern, clearly impacting on the quality and objectivity of the final audit report.

The old "Yellow Book," under "Organizational Impairments," had some interesting language in it on this issue:

When independent public accountants or other independent professionals are engaged to perform work that includes inquiries into compliance with applicable laws and regulations, efficiency and economy of operations, or achievement of program results, they should be engaged by someone other than the officials responsible for the direction of the effort being audited. This practice removes the pressures that may result if the auditor must criticize the performance of those who engaged him. To remove this obstacle to independence, governments should arrange to have such auditors engaged by officials not directly involved in operations to be audited.

Unfortunately, this language has been dropped from the revised standards. The issue as to who does the contracting with CPA firms is an important matter because it may have a great deal to do with the difficulties that have arisen over quality control of contracted audits in government. It is possible, for example, that those doing the contracting at this point in time do not have a great deal of knowledge about audit requirements or what they anticipate receiving from an audit.

Some Educational Concerns

This leads me to my final area of concern, at least for tonight. I detect a great lack of interest at our universities in addressing these kinds of issues in governmental accounting and auditing. I understand that we in government are not alone in our complaints in this regard. For example, those concerned with internal auditing have similar difficulties in getting universities to offer course work in their area. The business schools seem to have a preoccupation with public accounting and with financial auditing, and do little or nothing for the rest of us in accounting and auditing.

The problem takes many serious forms. The courses in governmental accounting and auditing, if they exist at all, are small portions of other already compressed courses. Courses in performance and operational auditing are

lacking. A little attention may be given to management or operational auditing, but there is almost no coverage of program results or effectiveness auditing. Courses are almost entirely lacking in discussions of the “environment” of government, with the understandable result that students, given their lack of exposure and understanding, too often end up being unreasonably biased against government. This, in turn, leads to a situation in which the chances of students being successful in public sector work are greatly diminished. Government loses the trained attention of countless good, young minds while students lose considerable opportunities.

This inattention to the nonprofit sector creates enormous problems for CPA firms which must assign such graduates to do work for them in the governmental sector. One must question the preparation of these graduates for such work. While some steps have been taken by accreditation bodies to improve the curriculum in the governmental area, a great deal more needs to be done.

In conducting the research for my book, *Auditing Performance in Government* (John Wiley and Sons, 1982), I found that little help or guidance has been given by the American Accounting Association or its committees on the questions I have raised above about accounting and auditing in the public sector. Again, this is very regrettable. There has been little attention given to the entire issue of the interplay of budgeting, accounting, and audit systems in government, or to the development of appropriate performance measures which then become the basis for financial reporting and auditing in government.

For good or ill, most of the research and writing on performance auditing in government has been done by practitioners—Felix Pomeranz of Coopers and Lybrand, Leo Herbert, now of VPI and formerly with the U.S. General Accounting Office, and my book on performance auditing. Indeed, the whole development of performance auditing and evaluation in government has been far more a spontaneous groundswell on the part of policy makers than it has been a result of academic attention. It is clear that the profession has been most reluctant to play a leadership role in these innovative areas, suggesting a costly professional conservatism.

Government accounting and auditing has to date clearly not been a good advancement path at most universities, causing many professors to avoid the field and recognize that their careers will not be enhanced by research, teaching, and attention to this area. Again, all of this is most costly and regrettable for government and government finance.

Closing Comments

I recall living in Tennessee in the 1960s and reading one of Ralph McGill's books on the South and southerners, a book about rapid changes in the racial scene in the South at that time. McGill made a comment about that situation which went something like this: “To be a southerner in these times is the most magnificent agony of all.”

I feel much the same way about governmental auditing and accounting in the 1980s. Those of us in the field have great power to do good. There is at the same time a great temptation to avoid the hard questions, questions like:

- How much auditing is enough?
- What are its costs and benefits?
- What forms should governmental auditing take?
- Is traditional auditing by itself enough in the public sector?
- Can we demonstrate to policymakers the value of public sector auditing?
- And, finally, who will lead us in thinking through some of the old notions about these issues?

In my judgment, while CPA firms may help find the answers to these questions, it is not their fundamental role to do so. And it is certainly not the role of the business community in general. But it is very much the role of the AICPA, the GAO, the FAF and FASB, the GASB and its predecessor, the National Council on Governmental Accounting. Most of all, the formal pronouncements of such groups must result from the research attention of our universities. And, frankly, the lack of attention to date to these issues by these groups is astounding.

If you will indulge me a moment, I will end on a light but I believe appropriate note coming out of a song. It strikes me as being most relevant to the fate of governmental accounting and auditing, and to the decisions that are before us in the 1980s and beyond:

Thank you . . . for the time that is past, for all the values and thoughts that will last. May we all stagnant tradition ignore, leaving behind things that matter no more . . .

. . . Make us afraid of the thoughts that delay, faithful in all the affairs of today; keep us . . . from playing it safe, thank you that now is the time of our life!