

17459

ADDRESS BY ELMER B. STAATS

COMPTROLLER GENERAL OF THE UNITED STATES

AT THE  
HUD CONFERENCE  
ON  
LOCAL FINANCIAL MANAGEMENT

BALTIMORE, MARYLAND  
SEPTEMBER 8, 1980

[IMPROVING FINANCIAL MANAGEMENT AT THE  
STATE AND LOCAL GOVERNMENT LEVELS--  
HOW THE FEDERAL GOVERNMENT CAN HELP]

I am pleased to be here with you today and I want to thank the Department of Housing and Urban Development for the invitation. Because efficient and effective operations are what the public expects from us, I especially welcome this opportunity to address you who are in a position to improve governmental operations. I am doubly pleased because this visit gives me an occasion to [share with you some of my concerns about financial management at the State and local levels and to share ways in which I believe the Federal Government can help you achieve the better financial management] toward which I know you are striving.

The reason for my concern for financial management below the Federal level is that [one of the General Accounting Office's many responsibilities is to report to the Congress on how effectively State and local governments are handling Federal funds.] Considering that State and local governments

016093

receive about \$90 billion annually to operate Federal or federally-assisted programs, our work in this area is very important. Unfortunately, we have had great difficulty in getting information that shows us how effectively these funds are handled and spent, so we share your concern for better financial management and reporting.

(Over the years, many improvements have been made in State and local governments' financial management.) Improvements have been spurred by financial crises experienced by city governments as well as by inflation and by the "proposition 13" and "balanced budget" syndromes with which we all are very familiar.

(But despite these improvements, financial management is still far from what it ought to be. Financial statements do not reflect a number of important assets and liabilities because their disclosure currently is not required. And some of the information that now appears on financial statements does not answer taxpayers' questions simply because it is not in a form that the layperson can understand. As a result, taxpayers still have trouble trying to evaluate and understand government operations.)

(The Federal Government is supporting several efforts to help improve financial management and reporting at the State and local government levels.) I would like to take a few moments to tell you about three of these efforts.

- The revision and improvement of State and local government accounting and reporting standards.
- Efforts to establish a single audit implementation task group.
- Efforts to encourage better internal controls over Federal funds spent by State and local governments.

REVISION OF ACCOUNTING AND  
REPORTING STANDARDS FOR  
STATE AND LOCAL GOVERNMENTS

The financial crises to which I just alluded resulted at least in part from inadequate accounting and reporting standards. Understandably, the efforts underway to improve those standards have taken on a new sense of urgency.

Before delving into the revision efforts, I would like to discuss in greater detail some of the problems encountered with the existing standards.

As you may know, accounting and reporting standards for State and local governments were largely devised before revenue sharing and special purpose Federal grants became a significant part of State and local budgets. These standards were developed by the National Council on Governmental Accounting--an organization that is primarily volunteer and sponsored by the Municipal Finance Officers Association. The standards are set forth in a 1968 publication entitled "Governmental Accounting, Auditing, and Financial Reporting." In March 1979, the National Council published Statement 1, entitled "Governmental Accounting and Financial Reporting

Principles," which provided immediate and much needed authoritative guidance for short term improvements in governmental accounting and reporting standards. Statement 1 updated, clarified, and amplified the principles published in 1968 and also incorporated pertinent aspects of the American Institute of Certified Public Accountants' Industry Audit Guide.

Although certain revisions to the standards have been made since 1968, additional modifications are necessary. Under the current standards, a number of assets, liabilities, commitments, and other contingencies and expenses are not required to be disclosed in financial statements. A prime example of omitted information is the treatment of pensions and other employee benefits. [Many governments have large liabilities for pension benefits due their employees in future years, for accrued vacation pay, and for other employee benefits not shown on financial statements. Without identifying these sizable liabilities, it is impossible to get a true picture of a government's financial status.] Similarly, it is difficult to determine what Federal funds an organization has, how it got these funds, or how it uses them. Moreover, financial statements prepared under these standards often are difficult for even the most sophisticated financial analyst to understand.]

[Because of the need to improve the current standards, HUD has provided a grant of more than \$1 million] to the National

Council on Governmental Accounting to undertake the research necessary to make revisions. This is certainly a step in the right direction; however, after this research is completed, much more work will be necessary to complete the development of acceptable standards. Furthermore, the Council has acknowledged that State and local accounting standards need rebuilding from the ground up and that this task is too much for a volunteer organization to perform quickly.

For these reasons, action is underway to establish the Governmental Accounting Standards Board which will be responsible for completing the development of these standards for State and local governments and for keeping them current. As it is currently envisioned, this Board would assume the Council's responsibilities. Its structure would be similar to that of the Financial Accounting Standards Board, the standard-setting body for the private sector. The new Board would have 12 trustees and 5 members. The trustees would be responsible for raising funds and for selecting the board members, who in turn would be responsible for setting standards. Attempts would be made to obtain sufficient funds from non-Federal sources to obviate the need for direct funding from the Federal Government. The annual budget required for the Board is currently estimated at about \$2.5 million.

I believe that, as structured, the Governmental Accounting Standards Board would be a great benefit to State and local governments. It would be able to devote all its effort toward revising accounting and reporting standards and

toward serving State and local governments by answering questions or interpreting standards. We in the Federal Government have a great interest in this effort because we rely on State and local governments' accounting systems to give government managers at all levels--Federal, State, and local--information on how Federal grant and revenue sharing funds are spent. For all of these reasons I favor the concept of the Board.

For more information on this subject, you may wish to attend a session tomorrow morning at which Ron Points of our Office will discuss this subject in more detail.

ESTABLISHING A SINGLE AUDIT  
IMPLEMENTATION TASK GROUP

The second major effort undertaken by the Federal Government to improve financial management is the implementation of the single audit concept. Audits, as I believe we all would agree, contribute to better financial management and provide assurance to management that their system is working as intended. The single audit approach is simply a refinement of prior audit approaches. Only one group of auditors is responsible for auditing all Federal funds received by an organization, rather than several groups with each responsible for auditing only the funds provided by one agency. Therefore, single audits are more comprehensive and mean fewer disruptions to organizations audited.

As many of you are aware, the change to the single audit concept was recommended in two recently issued reports--one

by the General Accounting Office and the other by the Joint Financial Management Improvement Program. Both organizations believe that since the frequency of audit visits would be reduced under the single audit concept, auditing resources would be used more effectively and the productivity of the organizations audited would be increased. It is further believed that recipients of Federal funds should be assigned to one Federal agency for audit oversight. These cognizant Federal audit organizations would share their audit findings with any other Federal agencies who had also provided funds to the organization audited.

[Federal agencies have taken several steps to make the single audit concept a reality.] For example, in February 1980 our Office issued a revised single audit guide which was completed with the strong support and assistance of the Intergovernmental Audit Forums and the Office of Management and Budget. OMB has also taken steps to implement the concept by publishing, for comment, the assignment of Federal audit organizations to act as cognizant audit agencies for the more than 800 State agencies now receiving major Federal assistance. Similar assignments are being considered for local governments. The Office of Management and Budget also issued, on August 18, 1980, a "compliance supplement" that summarizes the major audit compliance features for 60 Federal assistance programs which use 90 percent of the Federal aid

dollars. This supplement was developed cooperatively by Federal agencies with advice from State and local auditors.

As one must expect with such a major change as a new audit approach, several problems and concerns have surfaced during implementation of the single audit concept. These range from the relatively simple to the very complex--from misinterpreting regulations or guidelines to funding single audits.

[ To solve these problems, an organization is needed to identify and analyze each difficulty so it can be systematically discussed with the Federal agencies and other organizations involved. After all, the most expeditious and effective way to resolve problems is through open discussion with those who must deal with the situation daily.

Discussions are currently underway on the structure of this task group and its charter. You will be interested in knowing that there is unanimous agreement that the group should be comprised of representatives from Federal, State, and local government levels. The intent is to have each representative identify the problems experienced by those he or she represents so that all problems can be addressed and solved by the group. Every effort is being made to form the group quickly so that the single audit concept can be implemented as soon as possible.



ENCOURAGING BETTER INTERNAL CONTROLS  
OVER FEDERAL FUNDS SPENT BY STATE  
AND LOCAL GOVERNMENTS

The final major Federal Government effort to help improve financial management at the State and local government levels that I want to tell you about is the effort to encourage better internal controls over Federal funds. Because of their increased concern for better internal controls over Federal funds and assets for which they are responsible, Federal managers undoubtedly will be placing greater emphasis on the internal control systems of Federal fund recipients.

( Good internal control systems are an important, integral part of financial management. They help ensure that transactions are executed according to top management's authorization, that transactions are properly recorded, that access to assets is controlled, and that assets and records will be compared and reconciled at reasonable intervals. ) In short, good internal controls can help assure management that the organization is operating the way they want it to and that assets and authority are not being abused or misused.

Federal managers are becoming more concerned with internal control systems for several reasons. First, the General Accounting Office has issued several audit reports and has testified several times recently before committees of the Congress on the inadequacy of internal controls over Federal assets at both Federal government and recipient levels. Our most recently issued Government-wide report on internal

controls, dated August 28, 1980, was entitled "Continuing and Widespread Weaknesses in Internal Controls Result in Losses Through Fraud, Waste, and Abuse." That report pointed out that control weaknesses existed in virtually all aspects of accounting operations at 11 Federal agencies--civilian and military, domestic and overseas. At congressional hearings we testified that over 100,000 cases of alleged fraud and related illegal acts had been found in 21 major departments and agencies over a 30-month period. Individual losses, which could have been minimized if not prevented through better systems of internal controls, ranged from \$100 to over \$1 million. In total, it is estimated that these losses are in the hundreds of millions of dollars. Surfacing these problems has created substantial concern in the legislative and executive branches about the adequacy of the internal control of Federal assets.

Another effort contributing to this increased concern over internal controls is OMB's Internal Control Task Force, which was recently established as part of the President's Financial Priorities Program. The mission of the Task Force is to improve internal controls in Federal departments and agencies and to reduce the risk of fraud, abuse, and inefficiency. Task Force members are working in several subgroups to

- provide assistance to OMB in drafting a new circular on internal controls,
- develop administration policy on the draft of the

- Financial Integrity Act which is being considered by the Congress and which I will discuss in detail later,
- update special guidelines on administrative control of funds,
  - develop special guidelines on internal controls for cash management and debt collection,
  - develop special guidelines for ADP security, and
  - consider special guidelines in such areas as procurement and assistance programs.

In addition, the Office of Management and Budget is working with the new Offices of Inspector General in 15 departments and agencies to increase top management's awareness of internal control issues.

The final reason for Federal managers' increased concern about internal controls is the draft of the Financial Integrity Act which, as I mentioned earlier, the Congress is currently considering. [This proposed legislation would require agency heads to give more attention to the adequacy of the system used in their organization to control the use of Federal funds and assets.] It would parallel the internal control principles of the much publicized Foreign Corrupt Practices Act of 1977, which applies to the private sector. Essentially, [it would require agencies to report periodically on the adequacy of their internal control systems.] Having seen the efforts by the private sector to improve corporate accountability, we believe this legislation would have similar positive effects on Federal agencies.

When you consider the numerous scandals involving Federal funds and other assets, you can easily understand why the concern over controls is so great. And when you consider that State and local governments receive about \$90 billion annually in Federal assistance, Federal managers are quite naturally going to be interested in the control maintained over such an amount.

We believe that you at the State and local government levels, for your own reasons, are becoming just as concerned as we are about the adequacy of internal controls. Our concern, therefore, parallels yours and should help your efforts to improve internal control systems. Although we certainly do not know how good the internal control systems are at the State and local government levels, we believe it is essential that every organization have a good system to insure that it operates the way its management wants it to operate.

[ We frequently find during our audits that important internal controls have been deleted or were never considered in computer programs because they are believed to lengthen the the processing time with no visible benefit.) Computers, as we are all well aware, are playing an ever increasing role in the processing of transactions affecting organizational operations. Therefore, it is becoming just that much more important that the controls over the data being processed are adequate to prevent intentional or accidental misuse of funds or other assets. If you believe it necessary to encourage

management at your organizations to increase the attention they pay to internal controls over tasks performed, perhaps you too may want to consider internal control legislation.

#### CONCLUSION

While there have been many advances in financial management, much improvement is still needed at all levels of government. At the Federal level, we are working arduously to better our systems--just as I know you are. And I believe that the Federal government, through the efforts I have mentioned, can help you in your efforts to improve your systems.

I know we share the same concerns for better financial management. Armed with a good foundation of principles and standards, a good auditing approach, and a good system of internal controls, better financial management can be realized.

Each of our governments is sustained by the taxpayers' confidence and trust. For their taxes they rightly expect the most efficient, economical, and effective governmental operations--free from bias, scandals, fraud, and theft. Furthermore, taxpayers need to be assured that the government programs for which they are paying are achieving what they expect.

Good financial management systems can help retain this confidence and trust. Good systems can provide information for better management decisions and for preventing intentional or accidental wrongdoing. By working together, as we have in the past, we can improve our financial management systems for better government.