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STATEMENT OF
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BEFORE THE
LEGISLATION AND NATIONAL SECURITY SUBCOMMITTEE
OF THE
HOUSE COMMITTEE ON GOVERNMENT OPERATIONS
ON GAO'S
REVIEW OF AUDIT QUALITY OF
CERTIFIED PUBLIC ACCOUNTANTS

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our review, performed at your request, of the quality of audits by certified public accountants (CPAs) of entities receiving federal funds. As you know, the Single Audit Act is now being implemented. This act, which your subcommittee was instrumental in passing, places greater reliance on governmental audits performed by CPAs. Thus, it is essential that these audits be of the highest quality to assure report users that public and federal funds were properly spent.



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The report that we are issuing today, our most extensive study of the quality of CPA audits, clearly shows that problems with audit quality exist. These problems require significant reforms within the accounting profession. Our report contains the following findings:

- CPAs did not satisfactorily comply with standards on 34 percent of the governmental audits they performed, making the audit reports less useful in ensuring that federal funds are used for authorized purposes.
- More than half of the unsatisfactory audits had severe standards violations.
- CPAs' two predominant problems in performing governmental audits were insufficient audit work in (1) testing compliance with governmental laws and regulations and (2) evaluating internal accounting controls, including controls over federal expenditures.
- Smaller CPA firms had a greater problem than larger firms in satisfactorily complying with standards.

These findings are consistent with those the inspectors general (IGs) identified as reported in our December report on IG reviews of CPA audit quality:

- IGs identified reporting problems needing correction in one out of four audits receiving a desk review.
- Generally, these problems related to professional standards on reporting since a desk review is a review of an audit report for conformity with professional

standards - usually reporting standards - and for identification of items needing clarification.

--IGs identified problems in 45% of the audits they reviewed for quality control. Furthermore, IGs did not accept half of these audits because the required audit work was not performed or the audit documentation was inadequate or unclear. A quality control review includes a review of the auditors' working papers to ensure that the audit conforms with all applicable professional standards.

These findings are consistent with five GAO reports issued between 1971 and 1984. Also, the accounting profession has examined governmental audit quality problems on two occasions, once in 1980 at a conference with representatives from the inspectors general and GAO, and again in a 1984 report that identified problems with about half of 200 audit reports submitted by the inspectors general.

MAJOR PROBLEM AREAS

The two predominant problem areas, namely testing for compliance and reviewing internal controls, are two areas of greatest importance to the government and the taxpayer in providing reasonable assurance that government funds are not misspent. We observed, through discussions with the CPAs and reviews of their work, that many CPAs did not understand the nature and importance of testing and reporting on compliance with laws and regulations, nor did they understand the importance of properly

reporting on internal control evaluations. A contributing factor is that CPAs do not normally include a statement on internal control in their audit reports when performing a commercial audit. Further, such problems may exist because CPAs do not receive sufficient training or do not have sufficient experience in these areas and because governmental audits may not always be perceived to be as high a risk or receive the same level of attention as commercial audits.

SUGGESTIONS TO THE ACCOUNTING PROFESSION

As we move toward full implementation of the Single Audit Act, it is essential that the accounting profession institute reforms to avoid the types of problems we have identified. Toward this end, we have made a number of recommendations and suggestions to improve the quality of audits by CPAs.

The report we are issuing today suggests that the accounting profession:

- strengthen enforcement efforts through positive enforcement programs and referral of substandard audits to disciplinary bodies which should act promptly and decisively to address professional standards violations referred to them;
- broaden requirements for continuing professional education to include a specified level of governmental accounting and auditing for CPAs performing governmental audits;
- require governmental audits to be included in peer reviews;

- place greater emphasis on governmental accounting and auditing in the uniform CPA examination;
- include governmental audits in CPA firms' internal reviews of their audit quality; and
- seek an expansion of college curricula to include greater attention to the nature and performance of governmental accounting and auditing.

RECOMMENDATIONS TO OMB AND INSPECTORS GENERAL

Also, in light of the discussion at your November hearing on audit quality and of the provisions in the Single Audit Act prohibiting the cost of a substandard audit from being charged to federally assisted programs, we asked the inspectors general for their views on how to best implement these provisions. Their responses included a number of diverse suggestions on the role of the entities, OMB, and the federal awarding agencies. This indicated to us the need for a clearly defined and uniform process for the actions to be taken when a substandard audit is first identified. We are, therefore, recommending that the Director of the Office of Management and Budget (OMB) revise OMB circular A-128 to provide more definitive criteria for the disallowance process, including appropriate review procedures.

Our December report also made a series of recommendations to the statutory inspectors general to examine systemic problems rather than just correcting individual audits. We recommended that inspectors general:

- compile, analyze, and use the results of desk and quality control reviews to identify and correct the underlying causes of audit quality problems,
- revise policies for taking actions against CPAs on unacceptable audits, and
- work with the AICPA and state boards of accountancy to expedite referrals to these bodies.

As requested in your letter of February 28 and consistent with our practice, we have referred the firms with severe standards violations to their respective boards of accountancy, and we are currently processing other referrals to the inspectors general and the AICPA.

Since issuing our December report, we have had a number of meetings with the IGs and the AICPA to provide our advice and assist them in implementing our recommendations. In addition, we intend to share the results of the report issued today and to continue to work with the accounting profession.

I might add that, in regard to our suggestion on including governmental audits in peer reviews, I sent a letter to the AICPA last December suggesting that their policies on peer reviews be changed accordingly. Just a few weeks ago the AICPA's board of directors adopted the proposal.

Over the years, we have received a number of suggestions for expansion and clarification of governmental auditing standards, and we are currently revising the "yellow book."

ONGOING GAO WORK ON AUDIT QUALITY

Our work on audit quality is continuing. We are currently studying the process of how agencies or federal recipients contract for CPA audits to see if improvements are needed in this process. Further, we are reviewing the federal agencies' processes for determining the quality of CPA audits which federal program managers receive directly and which, therefore, bypass inspectors' general review. We hope to have the results of these two studies by the end of the year.

As we can clearly see, no single solution exists for these problems. Rather, each organization has a role--the AICPA, the state societies, the state boards, the IGs, the General Accounting Office, and the practitioners. At the same time, because of the magnitude of the taxpayers' funds and trust involved, expectations of public accountability have risen. The public accountant, through the Single Audit Act, has a key role in meeting these expectations. Consequently, existing problems must be corrected if that role is to be effectively carried out.

This concludes my statement, Mr. Chairman. I will be pleased to answer any questions you or any other members of the subcommittee may have.