

**HAWAII  
CONSTITUTIONAL  
CONVENTION STUDIES  
1978**

**Article VI:  
Taxation and Finance**

**Newton N. S. Sue**

**Legislative Auditor  
State Capitol  
Honolulu, Hawaii 96813  
June 1978**

## Chapter 6

### GOVERNMENTAL AUDITING

In the past decade, two trends have dominated the development of governmental auditing at the state and local levels. One trend is the continuing shift of post-audit responsibilities from the executive branch to the legislature. The second trend is the expansion of auditing beyond its traditional financial focus to encompass examinations of management performance, agency operations, and program effectiveness.

Hawaii's Constitution was an early leader in assigning the post-audit function to an official responsible to the legislature, or to a "Legislative Auditor," as the position has come to be called. When the constitutional convention met in 1950, there were only four states with auditors responsible to the legislature.<sup>1</sup> By the time the 1968 convention met, there were 29 states with legislative post-audits.<sup>2</sup> The latest count is that there are 39 states with post-audit responsibilities located in the legislative branch.<sup>3</sup>

As to the trend in the conduct of "performance audits," a generic term used to cover those audits which are not strictly financial but include tests for efficiency of operations and effectiveness of programs, a 1971 review found nine states with performance auditing programs and identified Michigan, New York, California, and Hawaii as being the "most advanced."<sup>4</sup> Since 1971, a number of other states have reported the establishment of performance auditing programs, usually at the initiative of the legislature, and the trend in that direction now appears to be pronounced.

This chapter reviews the generally accepted principles related to post-auditing, the considerations of the 1950 and 1968 constitutional conventions, and the issues raised by the emergence of charter government in all counties and the practice of the executive branch auditing its own agencies.

#### Some Principles of Governmental Auditing

There is a growing body of literature dealing with post-auditing, particularly as practiced by government. While practitioners of governmental auditing may differ as to the exact scope and content of the post-audit function, there is substantial agreement as to the desirable organizational arrangements for the post-audit and its applications.

*The pre-audit and post-audit. In auditing, the post-audit function should be separated from the pre-audit function.*

<sup>1</sup>Legislative Reference Bureau, *Manual on State Constitutional Provisions* (University of Hawaii, 1950), p. 275.

<sup>2</sup>Newton N.S. Sue and Thomas W. Wong, *Hawaii Constitutional Convention Studies, Article VI: Taxation and Finance* (University of Hawaii, 1968), p. 93.

<sup>3</sup>The Council of State Governments, *The Book of the States, 1976-1977*, Vol. XXI (Lexington, Kentucky, 1976) pp. 130-135.

<sup>4</sup>Massachusetts, Legislative Research Council, Report Relative to Legislative Post Audit, February 17, 1971, p. 36.

There are two basic categories of auditing, the pre-audit and the post-audit. Pre-audits are examinations made before financial transactions take place. The purpose of the pre-audit is to ensure that a proposed expenditure is not in violation of law or regulation and that sufficient funds are available to cover the proposed expenditure.

The function of the pre-audit is probably of greater importance in government than in private business because of the numerous, detailed and technical restrictions placed upon the use of government funds and upon the amounts that may be used for designated purposes. In practice, pre-auditing is usually conducted as a normal part of accounting routine. Pre-auditing is a control function designed to prevent funds appropriated for one purpose from being used for some other purpose, and it can have the force of forestalling expenditures of questionable propriety.

The pre-audit is considered a function of the executive branch. It is appropriately an executive function, because the pre-audit enables managers in the executive branch to exercise control over the use of funds by subordinate officials. If an external group, such as auditors responsible directly to the legislature, were responsible for pre-auditing, the external auditors would become the effective managers in the executive branch, and such a condition would be contrary to the system of separation of powers.

The post-audit is an after-the-fact examination. It is conducted to ensure that revenues are collected and expenditures are made in compliance with law, that public resources are being conserved through the efficient and effective administration of public programs, and that internal controls exist which safeguard public funds from loss, waste, extravagance, and fraud.

It is not within the purview of the post-audit to control, direct, or interfere with the operations of the government agency being audited. The accepted parameters of post-

auditing are to limit the function to examining, reporting, and recommending.

Since the post-audit is a check on the administrative branch, it should not be performed by persons or agents of that branch. As one public administration specialist puts it, "The objectivity of post-auditing could not be trusted if it were carried out by representatives of the same branch that authorized the expenditures in the first place." It follows that it is illogical to put the same agency or officials in charge of both pre-auditing and post-auditing, because an office approving an expenditure in the pre-audit is not likely to question it in the post-audit. Worse, "such a combination of functions is apt to put temptation in the way of any weak character who functions in both roles." Some years ago, Illinois separated the responsibilities of pre-auditing and post-auditing, but only after an official responsible for both functions was found to have embezzled millions of dollars from the state.<sup>5</sup>

**Legislative responsibility for the post-audit.**  
*The responsibility for the post-audit should be assigned to the legislative body or to an official responsible to that body.*

The objectivity of the post-audit rests on its conduct as an *independent* examination. Because it is designed as a check on the executive branch, the function should be located outside that branch. Its appropriate assignment is to the legislative branch.

The post-audit is implied in the powers of the legislature to appropriate money to administrative departments and agencies to carry on the programs of government. Where the form of government is characterized by separation of powers, authority commensurate with full responsibility for all administrative operations may be accorded the executive as long as the legislative body utilizes post-auditing to bring

<sup>5</sup>Felix A. Nigro, *Modern Public Administration* (Harper & Row, New York, 1970), pp. 397-398.

it to complete accountability for its performance.

Moreover, there is increased recognition that, in support of its policy-making responsibility, it is the legislature which needs impartial information concerning government operations and programs. The assignment of the post-audit function to the legislative body or to an official responsible to that body provides for independence from the executive branch and enables the function to be responsive to legislative needs.<sup>6</sup> Because self-auditing is generally condemned, there are precious few who would still propose that post-auditing responsibilities can be assumed by agencies or agents of the executive branch.<sup>7</sup>

*Objectivity and independence of the post-audit. The organizational arrangements for the post-audit function should protect its independence and promote its objectivity.*

Post-audits are worth very little if they are not objective. What is desired from post-auditing is the *truth* about a program or agency, or at least as much of the truth as can be humanly perceived. Objectivity will hardly come about if those who are in the business of auditing are subject to the pressures of either an agency's supporters or its detractors.

The prerequisite to objectivity is independence, the condition which allows auditors to report the facts as they see them. Without arrangements and relationships deliberately designed to protect its independence, the legislative auditing arm would be vulnerable to influence from powerful interests, both within and outside the legislature.

One leading theoretician of government auditing states the necessity for independence in this way:

"... The state auditor may serve the legislature or he may stand alone; what he absolutely cannot do is to be a servant of the executive, except in minor incidentals. To do so would be to become an internal auditor and thus to accept a drastic

lowering of his constitutional standing. No state auditor, or at any rate no chief state auditor, can afford to be without independence; he needs it as a judge needs it, in order to be impartial and fearless in criticism."<sup>8</sup>

The principle of independence of the post-audit function in a legislative setting does not mean that the audit agency should not be under the umbrella of responsibility to the legislature. Neither does it mean that the audit agency should not be responsive to legislative requests to audit certain programs or agencies. But beyond satisfying immediate legislative interests, the audit agency should have at least that measure of independence which permits it to select freely which programs or agencies are to be audited, and, in the conduct and reporting of audits, independence means at least being insulated from the retaliatory pressures which might originate from within the legislature, from the executive branch, or from forces outside of government.

*Newer dimension of the post-audit. The post-audit should review the financial activities of government as well as the efficiency of government operations and the effectiveness of public programs.*

The traditional type of governmental post-audit addressed itself primarily to the accuracy of the financial statements and the adequacy of financial records and internal control systems of agencies. The newer dimensions of the post-audit encompass: (1) the examination of operations to determine the extent of management efficiency in its utilization of public resources; and (2) the examina-

<sup>6</sup>Jesse Burkhead, *Government Budgeting* (John Wiley and Son, New York, 1961), pp. 362-363.

<sup>7</sup>The state auditor of Washington says that the independence of the post-audit can be secured by electing the auditor and developing the function as a "fourth power" of government: Robert V. Graham, "Is Auditing a Fourth Power? Yes, *State Government*, Autumn, 1970, pp. 258-259, 266-270.

<sup>8</sup>E. L. Normanton, *The Accountability and Audit of Governments* (Frederick A. Praeger, New York, 1966), p. 298.

tion of government programs to determine the extent to which the programs are accomplishing the results expected of them.

The more modern concept of the post-audit is that systematic examinations should be conducted not only to determine the propriety of expenditures but also to ascertain how efficiently and effectively government funds are spent. It recognizes that funds may be expended legally but unwisely, and that government must be held to greater accountability for the efficient management of its operations and the effectiveness of its programs.

The Congress of Supreme Audit Institutions, an international organization comprised of national auditors, has recommended that a full or complete concept for the auditing of government programs or agencies should include recognition of the following elements:

"Fiscal accountability, which should include fiscal integrity, full disclosure and compliance with applicable laws and regulations.

"Managerial accountability, which should be concerned with efficiency and economy in the use of public funds, property, personnel and other resources.

"Program accountability, which should be concerned with whether government programs and activities are achieving the objectives established for them with due regard to both costs and results."<sup>9</sup>

Similarly, the U.S. General Accounting Office, the auditing arm of Congress, has recommended as guidelines for state auditing acts and constitutional amendments that auditing be defined to recognize the following components:

"*Financial and compliance*—determines whether financial operations are properly conducted, whether the financial reports of an audited entity are presented fairly, and whether the entity has complied with applicable laws and regulations.

"*Economy and efficiency*—determines whether the entity is managing or utilizing its resources (personnel, property, space, and so forth) in an economical and efficient manner and the causes of any inefficiencies or uneconomical practices,

including inadequacies in management information systems, administrative procedures, or organizational structures.

"*Program results*—determines whether the desired results or benefits are being achieved, whether the objectives established by the Legislature or other authorizing body are being met, and whether the agency has considered alternatives which might yield desired results at lower costs."<sup>10</sup>

Formal post-audit reports. *Audit reports should be formal, written reports and a matter of public record.*

The result of post-audit examinations should be formalized in written reports which should be submitted to the legislative body and to the officials responsible for taking action on the audit recommendations. In addition, audit reports should be a matter of public record for the basic reason that the public has a right to know how well public officials are discharging their responsibility in the conduct of governmental operations. Against the general tendency that "no regime will permit its weaknesses to be publicized if they are the rule rather than the exception," public audit reports assure that no public agency will be shielded from public view and scrutiny.<sup>11</sup>

Formalized audit reports and public disclosure serve to safeguard the integrity of the post-audit itself. As previously stated, the accepted parameters of the post-audit limit the function to examining, recommending, and reporting. Policy-making and the exercise of management and control functions are beyond the scope of those engaged in the post-audit. Formal public reports serve to bring the post-

<sup>9</sup>VIIth International Congress of Supreme Audit Institutions, *Recommendations on Management or Operational Auditing Approved* (Montreal, September 1971).

<sup>10</sup>Comptroller General of the United States, *Suggested State Auditing Acts and Constitutional Amendments, 1974*, p. 7.

<sup>11</sup>Normanton, *The Accountability and Audit of Governments*, p. 158.

audit function under public accountability, just as the post-audit itself seeks to bring the programs and operations of government under accountability.

The value of publicity and formal reporting in connection with the conduct of post-audits has been summed up in this way:

"In a society in which *informed* criticism is increasingly rare, the few prime sources of impartial reporting and comment based upon inside information are therefore of especial value. The list is a short one, and high upon it must figure the published reports of state audit. These are checked and double-checked for accuracy and are issued by officials who enjoy statutory protection against the pressures to which the citizen is exposed through authority, hierarchy and association. State audit is not a participant in the decisions of power, and it examines their consequences without involvement."<sup>12</sup>

### Hawaii's Constitutional Provisions for Post-Auditing

In establishing the auditor as a constitutional office, the 1950 drafters evidently believed, as the National Municipal League's Model State Constitution was later to point out, that the post-audit function is of "such importance as to justify constitutional prescription for appointment."<sup>13</sup>

The 1950 convention believed that it was breaking new ground in establishing the office. The drafters observed that they were creating one of the more important positions in the field of financial management, and they expected that the auditor would serve as a force in eliminating waste and inefficiency in government operations, provide the legislature with an effective check against usurpation of powers by the executive, and ensure that public funds have been expended in accordance with legislative intent.<sup>14</sup>

Several considerations guided the constitutional formulation of the office:

First, the auditor should be responsible

to the legislature. The 1950 Committee on Taxation and Finance believed that "inasmuch as [the legislature] determines what moneys are to be spent . . . and is vested with the responsibility for determining state policy, it should be the [branch] to which accounting is made." In fixing legislative responsibility, the committee rejected the idea of popular election of the auditor, on the basis that "it throws the Auditor directly into politics and the usual result has been the selection of a strong politician rather than a qualified auditor." It also rejected the alternative of having the auditor appointed by the governor (as was the procedure in territorial government), because "it is never good practice to have the accounts audited by the agency responsible for the spending."

Second, the auditor "must maintain—to be effective—a degree of independence." The delegates believed that the auditor should be free from the "undue pressure" which might be exerted by any one legislature. It was felt that the auditor's position should be stabilized and that he should be in a reasonably secure position to offer suggestions and criticisms to the legislature.

Third, as part of the responsibility of conducting post-audits, the auditor should also serve "at all times as the 'watchdog' of public spending." Outside the regular audits, the auditor should provide the legislature with "such information as it may need. . . ." "It should also be the responsibility of an auditor to submit recommendations covering means and methods for improving financial management. His work can never be completely divorced from either

<sup>12</sup>*Ibid.*, p. 159.

<sup>13</sup>National Municipal League, *Model State Constitution*, 6th Ed. (New York, 1963), p. 12.

<sup>14</sup>State of Hawaii, *Proceedings of the Constitutional Convention of Hawaii, 1950*, Vol. I (Honolulu, 1960), pp. 463–464.

budget-making, expenditure controls, or financial planning."<sup>15</sup>

With the foregoing considerations, the 1950 drafters structured a constitutional office for the post-audit, of which the main elements are the following:

- . The auditor is appointed by the legislature for a term of eight years and thereafter until a successor is appointed.
- . The auditor can be removed by the legislature for cause, but only by a two-thirds vote of the members in joint session.
- . The post-audit function and jurisdiction in auditing the accounts of the State and political subdivisions are vested in the auditor.
- . Outside of the regular audits the auditor is empowered to conduct, the legislature may direct the conduct of other investigations and the making of additional reports.
- . The auditor is to report his findings and recommendations to the legislature and to the governor.

In retrospect, and in what now appears to have been a stroke of farsightedness, the drafters of 1950 had translated into constitutional provisions virtually all of the contemporary post-auditing principles: clear separation of the post-audit function from the executive branch; assignment of the function to an official of the legislative branch; safeguarding the independence of the auditor through tenure and the requirement for an extraordinary majority for removal; and formal public reports of audit findings and recommendations.

In only one respect did the 1950 provisions not completely translate the currently accepted principles of post-auditing. The constitutional language did not completely articulate the newer dimensions of post-auditing, although it is evident that the original drafters had fore-

seen that the post-audit function would encompass duties beyond those required by the traditional financial post-audit. It remained for the 1968 convention to recognize the newer dimensions of auditing.

### 1968 Constitutional Review

The Office of the Legislative Auditor was not activated until 1965, when the legislature appointed an auditor in accordance with the constitutional provisions. Between that time and the time the 1968 convention met, the legislative auditor had proceeded to develop and execute an audit program which included three kinds of audits: (1) *financial audits* which attest to the accuracy of the financial statements of the agencies, examine the adequacy of internal control systems, and determine the legality of expenditures; (2) *operations audits* which examine managerial efficiency, the manner in which agencies are organized and how well resources are acquired and utilized; and (3) *program audits* which assess whether the programs of government are attaining the results expected of them.<sup>16</sup>

The 1968 Taxation and Finance Committee took note of the newer dimensions of auditing, and, for a time, considered clarifying the provisions of the Constitution. However, it decided against making a change, believing that, in the changing environment of governmental auditing, it should not be necessary, from the standpoint of the Constitution, to identify the specific kinds of audits which the auditor is empowered to conduct.

In its report, the Committee on Taxation and Finance said:

<sup>15</sup>State of Hawaii, *Proceedings of the Constitutional Convention of Hawaii, 1950*, Vol. I, pp. 197-198.

<sup>16</sup>Legislative Auditor, *Manual of Guides of the Office of the Legislative Auditor*, September 27, 1967, p. A-1.

"Your Committee has heard and considered suggestions that clarifying language be included to define the post-audit function more clearly. It has determined that the current provisions are sufficient to encompass the on-going audit activities of the auditor, including financial, program and performance audits, and that it is not necessary to enumerate the specific sub-categories of audit which the auditor is empowered to conduct."<sup>17</sup>

With that expression of constitutional intent, the 1968 convention left intact the original provisions of the 1950 Constitution.

### Post-Auditing and the Emergence of Charter Government

The constitutional provisions for the post-audit assign to the legislative auditor audit jurisdiction over state agencies as well as political subdivisions. With charter government, the jurisdiction over the counties may need to be reviewed in the context of the charter provisions of the various counties.

With the emergence of charter government among the neighbor island counties, along with the charter of the City and County of Honolulu, all of the counties now have charter provisions which require the periodic conduct of post-audits under the responsibility of the respective legislative bodies of each county.

Rather than duplicate the audits conducted for the various county councils, the legislative auditor, at various times, has assisted the counties in reviewing audit specifications, proposals, workpapers, and preliminary reports. For example, under a long-standing agreement with the legislative auditor of the County of Hawaii, the state legislative auditor has "furnished technical assistance to the County's Legislative Auditor in the planning and preparation for the audit, in the administration of the audit contract and in the review of the preliminary and final drafts of the audit report. This arrangement prevents duplicating the post-audit functions of the two offices and allows [the state legislative auditor] to use the report

to inform the Governor and the State Legislature on the financial condition and general operations of the County of Hawaii."<sup>17</sup>

If there is a movement to provide the counties with greater "home rule," and other parts of the Constitution are amended to bring about greater home rule, it may be appropriate for the constitutional reviewers to examine the post-audit provisions in the context of whatever actions may be taken with respect to county powers. If greater home rule is given to the counties, one possible alternative consistent with such action would be to amend the provisions to delete the legislative auditor's automatic jurisdiction over the counties but to retain the legislature's prerogative of directing the auditor to conduct special investigations.

### Executive Auditing

While the Constitution assigns the post-audit function to the legislative auditor, audits are also conducted by the executive branch. This has led some to question whether audits, conducted by internal auditors in the executive branch or by certified public accountants under contract to agencies of the executive branch, are consistent with the intent of the Constitution or whether such audits are tantamount to self-auditing.

In the 1978 session of the legislature, the House of Representatives adopted a resolution directed to the 1978 constitutional convention and requesting a solution to the particular issue, among other issues, of "[t]he conduct of post-audits and whether all post-audits, including those conducted by executive agencies or by firms under contract to the executive branch should be covered or consolidated under constitutional provisions."<sup>18</sup>

<sup>17</sup>Legislative Auditor, An Overview by the Legislative Auditor of the Financial Audit of the County of Hawaii, 1976-77, January 1968, p. 1.

<sup>18</sup>House Resolution 595, H.D. 1, 1978 Regular Session.



The problem of executive auditing has apparently bothered the legislature for some time. It received earlier attention, particularly with respect to audits conducted, by or under contract to, the Department of Accounting and General Services. In 1975, a joint Senate-House report recommended that "the department of accounting and general services . . . refocus its attention from the conduct of routine audits to monitoring the internal control and accounting systems of agencies and to assist the agencies in correcting their systems, and, if necessary, to establish new systems. The appropriation made for AGS 104<sup>19</sup> is intended for the department of accounting and general services to monitor and improve the internal control and accounting systems of the various agencies, rather than the conduct of post audits, except in those specific situations where audits are required as a condition for receiving or maintaining federal grants or where a specific audit is required by statute."<sup>20</sup>

The practice of executive auditing, at least with respect to the Department of Accounting and General Services, has a statutory basis. The general provisions governing the department were part of the Reorganization Act of 1959, the basic act which reorganized territorial government and established state government. Among the duties assigned is one that "[t]he department shall preaudit and conduct after-the-fact audits of the financial accounts of all state departments to determine the legality of expenditures and the accuracy of accounts. . . ."<sup>21</sup>

There appears to be only one reasonable explanation as to why such an anomalous provision, which appears to fly in the face of the Constitution, should have been written into law. In 1959, no agreement could be reached with respect to the appointment of a legislative auditor and, indeed, it would be some years later—in 1965—that the position would be filled and the office established.

On its face, it would appear that the assignment of the pre-audit function, together with the conduct of "after-the-fact" audit to

one agency, and one which functions as the accounting agency for the State, would be contrary to the basic auditing principle that the pre-audit and the post-audit should never be exercised by the same agency. In this connection, the federal government, in requiring audits to be conducted of revenue sharing funds, has explicitly stated that such audits must be "independent," and that "no auditor shall be considered to be independent if such person . . . maintains the official accounting records being audited or reports to the person who does maintain such records."<sup>22</sup>

Some legislators have complained that executive audits are considered to be the preserve of the executive branch. Executive audit reports are not routinely distributed to the legislature or to the news media and public. And the question arises as to whether such audits can be completely objective, whether they are conducted by executive agency personnel or by certified public accountant firms. In the case of the latter, by the standards of the auditing profession, the firms are required to maintain "independence," but the scope of any examination and the particular areas to be covered are matters for the executive agency to decide.

### Issues and Alternatives

The issue of audit jurisdiction over the counties is contingent upon what changes might be made with respect to county powers.

<sup>19</sup>"AGS 104" is the appropriations program code for the internal post-audit program of the Department of Accounting and General Services.

<sup>20</sup>Conference Committee Report No. 28 on S.B. 535, 1975 Regular Session.

<sup>21</sup>Section 26-6, Hawaii Revised Statutes.

<sup>22</sup>Department of the Treasury, *Audit Guides and Standards for Revenue Sharing and Antirecession Fiscal Assistance Recipients* (Washington, D.C., December 1977), p. II-1.

However, the issue of executive auditing can stand by itself, and, as raised by the House of Representatives, it goes to the question whether such audits should be consolidated under the constitutional provisions which assign the post-audit function to the legislative auditor.

**Arguments.** Those who favor consolidating all post-audits under the existing constitutional provisions would contend that auditing by the executive branch of itself, regardless of whether the audits are conducted by executive agency personnel or by CPA firms under contract to the executive branch, is self-auditing and, by all principles of auditing, indefensible; that, if audits are to be contracted to CPA firms, they could just as well be contracted by the official charged by the Constitution with the post-audit function; and that hundreds of thousands of

dollars are expended on executive audits and reports each year, with little opportunity for legislative or news media review or public notice of their findings.

Those who oppose consolidating all post-audits under the existing constitutional provisions would argue that audits conducted by the executive branch are designed to assist the executive agencies in improving their various financial systems; that, when such audits originate from within the executive branch, they are likely to be more responsive to the specific needs of agencies than if they were to be conducted by external auditors; and that, in many cases, objectivity is safeguarded by contracting the audits to certified public accountants, who are required by their professional standards to remain independent.