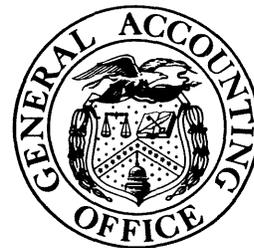


OFFICE OF THE COMPTROLLER GENERAL OF THE UNITED STATES

STATEMENT OF ACCOUNTING
PRINCIPLES AND STANDARDS
FOR GUIDANCE OF EXECUTIVE
AGENCIES IN THE FEDERAL
GOVERNMENT . . .



Washington, D. C.
November 26, 1952

UNITED STATES GENERAL ACCOUNTING OFFICE

FOREWORD

This statement is intended to be a working tool for use in our cooperative efforts with the agencies and represents our present views on general questions of accounting policy. These guides have evolved from experience gained under the joint accounting improvement program and give expression to concepts set forth in the Budget and Accounting Procedures Act of 1950.

This material is designed to be of specific assistance to agency personnel engaged in the development of accounting policy and systems. It is hoped that it will be of similar value to all levels of management by bringing about a greater understanding of the uses to which accounting can be put as an aid to effective administration.

A handwritten signature in black ink, appearing to read "Richard C. Warren". The signature is fluid and cursive, with a large initial "R" and a long, sweeping underline.

Comptroller General
of the United States

November 26, 1952

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STATEMENT OF ACCOUNTING PRINCIPLES AND
STANDARDS FOR GUIDANCE OF EXECUTIVE AGENCIES IN
THE FEDERAL GOVERNMENT

A. INTRODUCTION

I. RESPONSIBILITY FOR ACCOUNTING SYSTEMS

The Budget and Accounting Procedures Act of 1950, Public Law 784, approved September 12, 1950, 64 Stat. 832, places upon the head of each executive agency^{1/} of the Government the specific responsibility for establishing and maintaining adequate systems of accounting and internal control which conform to principles, standards and related requirements for accounting prescribed by the Comptroller General of the United States. The law provides that the Comptroller General shall act after consulting the Secretary of the Treasury and the Director of the Bureau of the Budget, concerning their accounting, financial reporting and budgetary needs and after considering the needs of other executive agencies.

The law declares its objective to be the modernization and simplification of the accounting of the Government to provide for the needs of both the Legislative and the Executive branches. It provides a carefully conceived basic framework for the continued improvement of financial management through the mutual efforts of all concerned.

II. STATUS OF THIS STATEMENT

In keeping with the policy of the Comptroller General to encourage maximum exercise of initiative by executive agencies, this statement is intended to (1) provide a framework sufficiently flexible that accounting can be fitted to the needs of each group to be served, (2) stimulate the development of the highest standards of accounting and financial reporting, and (3) encourage the continued orderly improvement of all phases of financial management.

^{1/} This law applies to Government corporations and agencies subject to the Government Corporation Control Act, Public Law 248, approved December 6, 1945, 59 Stat. 597, to the extent of sections 114, 116 and 119 and to the Post Office Department to the extent of sections 111, 114 and 116. Accounting principles and standards to be prescribed for the Post Office Department are separately provided for in the Post Office Department Financial Control Act of 1950, Public Law 712, approved August 17, 1950, 64 Stat. 460.

Accounting systems submitted by executive agencies for the approval of the Comptroller General, or otherwise reviewed by the General Accounting Office, will be tested against the principles, standards and related requirements set forth in this statement. However, the need for departures will be recognized if warranted by special circumstances.

B. REQUISITES FOR DEVELOPMENT AND APPLICATION OF ACCOUNTING PRINCIPLES AND STANDARDS

Before discussing principles and standards it seems appropriate to review the related factors which are important to their successful development and application.

I. ORGANIZATION AND PERSONNEL

1. Accounting and its place in the organizational structure.

Management depends on accounting for current factual information on financial operations for purposes of planning and control, as well as for an historical record of financial transactions. The accounting framework within an agency^{1/} should be consistent with assignments of responsibility to organizational units. It should constitute a major factor in establishing and maintaining controls over current operations and in providing financial data needed for planning and reporting. To serve these purposes, it is essential that the results of accounting, budgeting and related progress and statistical reporting, as well as internal audit, be integrated and coordinated to the end that these functions are developed with full cognizance of their complementary character. To be effective, the integration and coordination of these related functions of financial management must be accomplished at the top-management level.

2. Importance of qualified personnel. There are no substitutes for judgment and the ability to work with others but experience has demonstrated that an adequate staff possessing technical training and skill also must be present to accomplish effective results in accounting endeavors as is true in other technical fields. Administrators who must necessarily depend on accounting results for aid and guidance are entitled to and should demand a full measure of each of these basic elements in selecting or retaining their top accounting personnel. Moreover, technical competence is of prime importance in attaining the orderly continuing improvements in accounting set forth as the policy of the Congress in the Budget and Accounting Procedures Act of 1950.

II. DETERMINATION OF NEEDS OF THOSE TO BE SERVED

In the development of accounting systems, the agency should necessarily give first consideration to its own needs. It should, however, also give consideration to the requirements of other groups in the Executive

^{1/} The term "agency" is used throughout this statement in a general sense to refer to a department, establishment, commission, board or an organizational entity thereof, such as a bureau.

branch, with particular reference to the Bureau of the Budget and other staff agencies directly assisting the President in the discharge of his budgetary and management responsibilities and to the financial management and reporting responsibilities of the Secretary of the Treasury.

Further, in the declaration of policy and in the specific provisions contained in the Budget and Accounting Procedures Act of 1950, the Congress has clearly set forth its intention that the Comptroller General prescribe principles and standards which will provide for full disclosure to the public of the results of financial operations of each executive agency and the Government as a whole, as well as financial information necessary to enable the Congress and the President to discharge their responsibilities.

Requirements of other groups will ordinarily be consistent with but represent less detailed requirements than those of agency management. Accordingly, the basic framework of the accounting system should be developed by (1) beginning with the needs of the initial level of administrative responsibility, and (2) providing for the summarizing of the basic data so derived to meet subsequent requirements for internal and external reports.

III. PROVISION FOR COMPLIANCE WITH LAW

Compliance with general and specific laws applicable to the funds and appropriations for which an agency is responsible is an important factor in the development of agency accounting systems. The accounting system should be designed to demonstrate that the resources of each separate fund and appropriation, or other authorizations thereunder, are applied only to the purposes designated in the law. Similarly, the accounting system should provide for development of information to aid in securing compliance with the anti-deficiency provisions of the statutes, including the regulations issued thereunder, and furnish objective evidence of such compliance.

IV. PROVISION FOR INTERNAL CONTROL IN THE DEVELOPMENT OF AGENCY ACCOUNTING SYSTEMS

In the development of agency accounting systems, provision should be made for internal control by giving particular cognizance to those accounting features which can effectively contribute to such control. These features should be complementary to other forms of internal control less directly related to the accounting system.

Basic elements required for adequate internal control in an agency include a carefully planned organizational structure, well defined operating policies and procedures, clear delegations of duties to subordinates, competent personnel and a strong internal audit program. A broadly constituted internal audit program effectively carried out will provide the administrator and his subordinates not only with the auditor's findings regarding financial transactions but also with an objective appraisal of the manner in which policies and procedures have been carried out, along with recommendations for improvements.

The application of internal control principles is developed more fully in Part C. DISCUSSION OF ACCOUNTING PRINCIPLES AND STANDARDS.

V. INDEPENDENT AUDIT BY GENERAL ACCOUNTING OFFICE

An independent post audit by the Comptroller General as an agent of the Congress is provided for by law and contributes to continuing improvements in the development and application of the accounting principles and standards incorporated in properly designed accounting systems which are a vital factor to the effectiveness of such an audit. This is done through the review and evaluation of the accounting and related processes in actual operation.

C. DISCUSSION OF ACCOUNTING PRINCIPLES AND STANDARDS

I. ACCOUNTING SYSTEM OF THE FEDERAL GOVERNMENT

The accounting system of the Federal Government consists of the accounting systems of each agency and the accounting of the Treasury Department, including provision for suitable integration between the accounting processes of each agency and the accounting of the Treasury Department.

1. Agency accounting systems. Responsibility for establishing and maintaining the accounting systems of each executive agency rests with the head of the agency. Each accounting system should provide a complete and reliable record, stated in monetary terms, of the operations covered by it and accounting control over revenues or income, expenditures, assets (including property), and liabilities, as well as appropriations.

The accounts of each agency should ordinarily be kept on a decentralized basis. Decentralization may be accomplished on an organizational or geographic basis or a combination of the two, with due consideration being given to economy and the ready availability of financial data at the respective levels of organization to which management responsibilities have been assigned. The accounts should be kept in such detail as is necessary to meet agency needs and should be so designed as to be capable of furnishing information needed by other agencies in the Executive branch and by the Congress. The transactions reflected on these books should not be recopied even in summary form on the books of the agency at higher organization levels. Instead, the financial reports submitted by subordinate levels should be utilized in preparing summary reports. Adequate provision should, however, be made for technical supervision and interlocking accounting relationships between offices to assure the validity of consolidated agency reports.

Transactions should be adequately documented and should be so recorded that they can be readily traced from the original documents to records and from the latter to the financial statements.

Inter-agency and inter-fund transactions should be separately identified in agency records and statements so that they may be properly treated in preparing financial statements of the Government as a whole.

2. Treasury Department central accounting. In its capacity of a central fiscal agency the Treasury Department is by law authorized to establish and maintain a system of central accounting designed to discharge its responsibilities for central accounting and reporting as contemplated by the Budget and Accounting Procedures Act of 1950 which includes provision for suitable integration between the accounting processes of each agency and the accounting of the Treasury Department. The system of central accounting referred to is in addition to the agency accounting systems of the Treasury Department utilized in carrying out its operating responsibilities, e. g., the accounting system of the Bureau of Customs.

II. FINANCIAL REPORTING OF THE FEDERAL GOVERNMENT

Financial reports of the Federal Government fall into three groups: (1) agency reports for internal management purposes, (2) agency reports made available by an agency for the use of others, and (3) reports prepared by the Treasury Department as a central fiscal agency.

1. General principles of financial reporting. The following principles and standards apply to all types of financial reports and any important deviations therefrom should be explained in the report:

a. Reports should disclose all essential financial facts for the period covered and such other data as have an immediate and direct bearing on financial operations and financial condition, with appropriate consideration being accorded classified information where that factor is involved. In addition to tabular presentations, textual and graphic presentations should be utilized where advantageous.

b. Reports should be issued promptly.

c. Provision should be made for complying with legal requirements relating to preparation and issuance of reports.

d. All financial transactions of the period should be included; data applicable to a prior period should be so identified if material.

e. Data should be reported on a consistent basis from one period to another. If deviations become necessary, they should be adequately explained and their effect on financial condition and financial operations should be pointed out.

f. Common terminology should be employed for terms having Government-wide application.

g. Common classifications of accounts should be employed in reporting like transactions.

h. Data in each report should be based on adequate accounting support.

i. Evidence of compliance with general or special statutory requirements should be shown in financial statements and supporting schedules to the maximum extent practicable.

j. Significance and materiality must be kept in mind, that is, the cost and effort required to make refinements must be evaluated in the light of the usefulness of the data thus developed. Refinements which delay the timely issuance of data must be similarly evaluated.

2. Agency financial reporting. Because accounting results are conveyed to management through reports, the pattern followed in the preparation and submission of reports should be in conformity with assignments of management responsibility to organizational units. This is a major reason for the decentralization of accounting, i. e., to make financial data readily available to management. Only by such an arrangement can management effectively discharge its responsibility for reviewing reports to make certain that financial operations, including the effect of decisions made by management, have been fully reflected.

More specifically, reports should be prepared directly from the accounts in an organizational unit which keeps the books covering its own activities. Reports covering more than one such organizational unit should be prepared by consolidating the data carried in the individual reports of the units involved. To illustrate, assume that an agency is divided into regions which have project locations and that accounting has been decentralized to the projects. In that case, the reports covering the financial transactions at each office should be based on the accounts maintained in that office. Data for the region as a whole should be obtained by combining the data carried in the reports of the projects with the data for financial transactions at the regional level reflected in the accounts of the regional office. In turn, the report for the agency as a whole should be based on regional office reports plus the data taken from the books maintained at the central office for financial transactions consummated at that office.

3. Treasury Department central financial reporting. In carrying out its responsibilities for central financial reporting the Treasury Department will obtain from each agency such reports and information relating to financial condition and operations as the Treasury Department may require for the effective performance of its responsibilities. Reports prepared by the Treasury Department for the information of the President, the Congress and the public will be such as to present the results of the financial operations of the Government and will include such financial data as the Director of the Bureau of the Budget may require of the Treasury in connection with the preparation of the Budget or for other purposes of the Bureau.

4. Type and content of financial reports. Reports required of and prepared by each agency will necessarily vary with the purpose to be served. Needs on the part of others will ordinarily call for less detailed information than the data needed by the agency for its own purposes, and should be met by a summarization of the detailed data made available for internal management. The following will illustrate the more general principles involved:

a. All agencies operated wholly or in part from appropriations or other authorizations should prepare budgetary reports showing the amounts authorized, total obligations incurred, subdivided between expenditures and unliquidated obligations, and the unobligated balance of each appropriation or other authorization. Expenditure data should be in terms of accrued expenditures (as used in this document, the term accrued expenditures means the charges incurred for goods and services received and other assets acquired, whether or not payment has been made and whether or not invoices have been received) unless this refinement is not significant and would serve no useful purpose.

b. All agencies should prepare balance sheets. Agencies carrying on business-type activities should prepare income and expense statements on an accrual basis as well as a statement of sources and application of funds. Other agencies should prepare statements showing actual and estimated receipts, classified by source, as well as statements of accrued expenditure classified so as to be most useful for management purposes.

c. If several funds are involved, separate statements should be prepared for each fund if a significant purpose will be served. Otherwise, a combined statement for several funds may be prepared but the equity of each fund must be identified in the net-worth section.

d. In addition to the statements for individual funds, combined or consolidated statements covering two or more funds should be prepared if such statements will throw further light on the financial condition or financial operations of the agency.

III. FINANCIAL AND RELATED CONTROLS

It is the responsibility of management to provide a system of financial control which will assure (a) compliance with legal requirements, and (b) prudent financial management. The broader aspects of internal control were referred to in Part B. REQUISITES FOR DEVELOPMENT AND APPLICATION OF ACCOUNTING PRINCIPLES AND STANDARDS. The discussion which follows is directed at those phases of internal control which relate more specifically to the accounting and financial functions.

1. Compliance with legal requirements. Controls, formal or informal, should be designed with a view of (a) preventing any financial transaction which is not in conformity with legal requirements, and (b) providing the information necessary to show that legal requirements have been complied with. To cite one example, the system of control must assure that no obligation will be incurred in excess of appropriations made by the Congress and it must provide for records which will show the status of appropriations. Similarly, control over the certification of vouchers must provide for strict adherence to the provisions of Public Law 389, approved December 29, 1941, 55 Stat. 875, commonly referred to as the Certifying Officers Act.

2. General practices contributing to control. Controls must necessarily be woven into day-to-day activities. Some illustrations of simple every day practices which materially contribute to financial control are as follows:

a. Control over revenues or income, expenditures, assets and liabilities is strengthened by arranging the duties of employees in such a way that no one employee is solely responsible for all elements of any transaction. The following are some examples:

(1) Employees collecting revenues do not have access to the receivable accounts.

(2) Accounts receivable are established independently of those rendering the services or supplying the materials giving rise to the receivables.

(3) Employees handling cash or the accounts receivable records do not have authority to write off accounts receivable.

(4) Employees charged with the duty of purchasing materials do not have the responsibility for receiving or storing them.

(5) Employees having the duty of receiving inventory or property do not also keep the accounting records relating thereto or have authority to approve the transfer, use, sale or other disposition of materials or property.

(6) Both vendors' invoices and receiving reports flow directly to the accounting office rather than through the group responsible for purchases.

(7) Employees handling materials or supplies are not relied upon exclusively to take physical inventories for the purpose of ascertaining whether the physical quantities are in agreement with the amounts reflected in the accounting records.

b. The system of financial control should provide for the pre-numbering of financial stationery (receipt forms, checks, bonds, etc.) and for keeping such stationery under continuous control of a person not using it.

3. Revenue control. Adequate control over revenues involves not only seeing to it that the revenues are properly recorded as soon as earned but, more important, making sure that the Government collects all the revenues to which it is entitled. The use of the accrual basis will materially aid in achieving this end because accounting control is established as soon as the revenues are earned.

4. Expenditure control. Adequate control over expenditures, in addition to the legal aspects previously discussed, includes other factors such as:

a. Assurance that the materials were actually received or that the services were actually rendered and that quality, quantity and price are in accordance with the provisions of purchase orders, contracts, or other authorizations, and that the authorizations are consistent with applicable statutes, regulations and policies. Such assurance can be achieved by

providing, in addition to the measures previously described, that each expenditure must be supported by signed documents^{1/} which furnish the information necessary to substantiate each of these requirements.

b. Assurance that the most effective use is made of the purchased materials and that services whether they be contractual in nature or performed by the Government's own employees are rendered at the lowest possible cost. The achievement of these objectives is aided by (in addition to non-fiscal factors such, for example, as hiring qualified employees, training them properly, and exercising proper supervision over them) such fiscal measures as the adoption of the accrual basis of accounting. The accrual basis makes it possible to relate accrued expenditures to the amount of work performed and thereby provides data for comparisons with standards of other agencies or of the same agency for prior periods.

5. Asset control. The control over assets should assure that the best possible use is made of the assets, that they do not leave the possession of the Government except under proper authorization and follow-up where appropriate, that adequate measures are taken for their care and preservation, and that no assets are written off or disposed of otherwise without proper authorization. In addition to the measures described earlier, certain types of assets require special types of control. The following are a few examples:

a. Control over cash in the physical custody of employees is strengthened by providing for (1) the prompt recording of cash receipts, (2) their prompt deposit in an official depository, and (3) an independent comparison of the evidence of deposit with the original record of receipts; by prohibiting payments directly out of receipts; by limiting imprest cash funds to reasonable needs; and by providing for the review and reimbursement of imprest cash funds at frequent intervals.

b. Control over expendable materials and supplies requires the establishment of a system whereby the materials and supplies (1) are inspected and checked in as soon as they are received, (2) are stored in such a way that responsibility for custody can be definitely placed with some individual or group of individuals, and (3) cannot be withdrawn without

^{1/} Certain exceptions are provided under regulations governing small purchases.

proper authorization. If they are sufficiently important; they may also be further controlled by means of perpetual inventory records. Regardless of whether or not perpetual inventory records are kept, proper control calls for the taking of physical inventories at periodic intervals. If perpetual inventory records are kept, the causes of the variations between the amounts shown by the records and the amounts obtained through physical counts should be ascertained and reported to a responsible official. Moreover, the books should be brought into agreement with the results obtained from the physical counts and, wherever required, the entries should be based on properly approved survey reports.

6. Use of costs as a means of control. Financial management reaches its maximum potential through the use of cost data as a means of control. Costs of approved programs can best be kept within legal as well as administratively imposed limits if the individual in charge of each activity is made responsible (within limits fixed by higher authority) for the costs to be incurred because of the activity. Under this plan a cost is in every instance the result of an individual decision. Such an approach requires as a first step the development and approval of a carefully devised financial plan based on the estimated cost of the objectives to be accomplished. Based on such a financial plan appropriate control devices fitted to the particular undertaking (approved rates of accrued expenditures, control over size of staff, etc.) can be developed. Such flexibility and latitude as is consistent with the situation can be provided. Similarly, current adjustments based upon frequent reviews of operating plans can be made and performance can be evaluated in terms of accomplishments from period to period.

This approach also presumes the use of accrual accounting whereby recorded expenditures will include all appropriate costs and thereby supply an accurate basis for evaluating past accomplishments as well as for estimating current and future financial requirements. Among the advantages is the positive emphasis that is placed on the receipt of value for resources used which, in turn, gives greater prominence to cost in the planning of operations as opposed to placing exclusive emphasis on not exceeding budgetary authorizations with a resulting lack of emphasis on value received. Further, by directly relating costs to assignments of administrative responsibility it is possible to develop cost consciousness to a greater degree as well as a keener appreciation of all aspects of financial management.

IV. FUND AND ACCOUNT STRUCTURE

A fund is (a) a sum of money^{1/} or other resources^{2/} set aside for general or specific purposes in accordance with law or regulations, and (b) an accounting entity.

The fact that a fund is an entity for accounting purposes does not necessarily call for a complete set of separate accounts or a separate general ledger and financial statements. In many instances, it is sufficient if the equity of the fund is identified in the accounts and statements of a related fund. For example, deposit funds incidental to a project require only a separate liability account properly identified to reflect the nature of the liability and need not require a segregation of cash from other deposit funds or separate financial statements. In other cases, the nature of the assets may require their separate identification in the subsidiary records, in order to account properly for the equity of each fund, but not in the financial statements where it may be sufficient to show merely the equity of each fund separately.

1. Classification of accounts by type of fund. The fund accounts of the Federal Government fall within two general types: (a) those used to account for resources derived from the general taxing and revenue powers or from business operations of the Government, and (b) those used to account for resources held and managed by the Government in the capacity of custodian or trustee.

a. Funds derived from general taxing and revenue powers and from business operations. These accounts are further classified as follows:

(1) General Fund Accounts. These consist of receipt accounts, used to account for collections which are not dedicated to specific purposes and expenditure accounts, which are used to record transactions arising under Congressional authorizations to use for public purposes any resources of the Government not otherwise appropriated.

(2) Revolving and Management Fund Accounts. These are combined receipt and expenditure accounts established by law either: (a) to finance a continuing cycle of operations with receipts derived from such operations available in

^{1/} This includes an authorization to withdraw funds from the Treasury, e. g., an appropriation or other account with the Treasury and, accordingly, need not be cash in the usual sense of a funded account.

^{2/} Estimated revenues, inventories, equipment, accounts receivable, etc.

their entirety for use by the fund without further action by Congress; or (b) to facilitate accounting for and administration of intra-governmental operations which are financed by two or more appropriations of an agency.

(3) Special Fund Accounts. These consist of separate receipt and expenditure accounts established to account for receipts of the Government which are earmarked by law for a specific purpose, but are not generated from a cycle of operations for which there is continuing authority to reuse such receipts.

Working funds may be established in connection with each of the foregoing, advances from general fund and revolving fund accounts being grouped in a general fund classification and advances from special fund accounts being classified according to the parent fund.

b. Funds held by the Government in the capacity of custodian or trustee. These fund accounts are further classified as follows:

(1) Trust Fund Accounts. These are accounts established to account for receipts which are held in trust for use in carrying out specific purposes and programs in accordance with an agreement or statute. The assets of trust funds are frequently held over a period of time and may involve such transactions as investments in revenue producing assets and the collection of revenue therefrom. Generally, trust fund accounts consist of separate receipt and expenditure accounts but when the trust corpus is dedicated to a business-type operation, the fund entity is called a "trust revolving fund" and a combined receipt and expenditure account is used. Working funds may be established under trust fund accounts and are classified according to the parent fund.

(2) Deposit Fund Accounts. These are combined receipt and expenditure accounts established to account for receipts (a) held in suspense temporarily and later refunded or paid into some other fund of the Government, or (b) held by the Government as banker or agent for others and paid out at the direction of the owner. Such funds are not available for paying salaries, expenses, grants, or other expenditures of the Government.

2. Account structure. Since a fund is a separate accounting entity, a self-balancing group of accounts (double entry system) should be provided for each in accordance with the general categories illustrated below, except where the character of the fund does not warrant a separate group of accounts, as discussed more fully in the second paragraph of the introduction (page 14) to this section. All of the accounts illustrated will not necessarily be maintained for each fund; only those appropriate to the particular type of undertaking will be used in each instance. The accounts should also be identified with the organizational units to whose activities they apply where more than one such unit is involved in the administration of a particular fund.

a. "Balance sheet" accounts. The asset, liability and net worth accounts constitute this group. In the business-type operations, the net worth accounts include appropriations, donated capital and retained income, as well as the accounts which show the reduction in net worth by reason of funds returned to the Treasury. In other operations, the net worth accounts include unexpended appropriations and invested and donated capital.

b. "Income and expense statement" accounts. These accounts are applicable to business-type operations. Income accounts are used to record such items as fees and proceeds from the sale of products or services. Expense accounts are used to record such items as the cost of goods sold, operation and maintenance expense, administrative expense and interest expense.

c. "Statement of receipts" accounts. These accounts are applicable to non-business type operations. Examples are accounts used to record fees, rents, fines and penalties, and interest.

d. "Statement of accrued expenditures" accounts. These accounts are applicable to non-business type operations. Examples are accounts used to record accrued expenditures by activity, by organization unit or object, or by an integration thereof.

The general ledger accounts maintained for net worth should provide additional detail as may be required, such as unallotted appropriations or apportionments, unobligated allotments, unliquidated obligations, etc.

In appropriate cases, accounts should be maintained for estimated receipts and estimated reimbursements.

In any event, the accounts used to record the transactions applicable to a particular undertaking should be integrated in a single accounting system which should, where appropriate, include cost accounts.

3. Expansion of expenditure classifications by use of cost accounts.

Cost accounts may be used to provide a detailed classification of expenditures made (1) for the acquisition of assets, or (2) for current expenses.

The analysis by objects and the analysis by activities required for budget presentation purposes may also be provided for (when the budget is presented on an accrued expenditure basis) by the use of cost accounts if such accounts are in sufficient detail so that they can be grouped together to arrive at the total expenditures for a given object or activity.

4. Treatment of accounts in preparation of financial reports.

The relationship between the accounts of a unified accounting system is illustrated by their use in the preparation of financial reports. The type and content of financial reports has been previously described in Part C-II. FINANCIAL REPORTING OF THE FEDERAL GOVERNMENT. The accounts illustrated in the preceding discussion provide the data for each of the statements outlined. For example, statements showing the status of appropriations, balance sheets, income and expense statements, or statements of receipts and statements of accrued expenditures can be prepared from these accounts. The supplementary information provided by the cost accounts may form the basis for presenting the additional detail required for the supporting statements.

5. Accounting support for budget presentations. Coincident with other considerations referred to above, accounting support for activity schedules included in budget presentations should be provided for in the development of accounting systems. Because of the wide variation in activities and the many organizational patterns followed, no single approach can be suggested. As an objective, activities and organizational patterns should be made consistent to the extent feasible in each case, and accounts should be established to coincide with that pattern (within such activity pattern performance yardsticks should be developed to the extent feasible). One approach worthy of careful consideration is the use of cost classifications based on accrued expenditures, supplemented by an analysis of undelivered orders at the end of the period. In any event, however, a unified approach is urged, providing a single set of integrated accounts to adequately meet budgetary needs.

V. BUDGETARY CONTROL AND ACCOUNTING

Every agency is required by law to have a system of administrative control which will restrict obligations or expenditures from exceeding the amounts appropriated therefor, the balances in the funds involved and the amounts of the apportionments or reapportionments made for the current fiscal period. Reserves established by the Director of the Bureau of the Budget or other authorized officials are of equal import. In addition, the system of administrative control must be such as to fix responsibility for the creation of any obligation or the making of any expenditure in excess of an apportionment, reapportionment or other subdivision thereof determined administratively.

Several types of accounts provide data for budgetary purposes and various accounting techniques contribute to budgetary control. Used in a more limited sense, budgetary accounting provides the means for reflecting estimated receipts and the status of appropriations and apportionments. This is accomplished through summary accounts in the general ledger supported by subsidiary records which commonly include an allotment ledger or other allotment control device.

1. Accounting for apportionments and allotments. Because of the need for factual evidence of compliance with legal requirements it is necessary to provide in the accounting system and related budgetary control processes for the recognition of apportionments and established reserves. Allotment processes are the usual means of providing for such recognition and the basis for developing evidence of compliance with regulations issued pursuant to section 3679, Revised Statutes, as amended, 31 U. S. C. 665, which requires an administrative system of control of the character discussed in the opening paragraph of this section.

2. Number of allotments required. Allotments should parallel assignments of responsibility and ordinarily fewer allotments are required for purposes of budgetary control than the number of classifications needed for providing financial data to management. For example, a single allotment for a field office may suffice for purposes of budgetary control; while an activity breakdown, an object breakdown, and unit costs might be needed from a management standpoint. Under such circumstances, the object and activity data should not be made allotment categories, but should be obtained through accounting processes.

Specific limitations required by law within the scope of an appropriation must be provided for, either in the formal accounts or by some other acceptable means. In some cases, limitations may require

separate allotments. In other cases, they can be handled through the use of memorandum records. Where a limitation is stated in numbers of units instead of dollars (e. g., number of automobiles which may be purchased), the method of obtaining compliance and showing compliance can best be handled in terms of units, not dollars, outside the formal accounts.

3. Significance of obligations. Appropriation actions by the Congress, with limited exceptions, provide that obligations may not be incurred unless there is an appropriation or fund balance available therefor at the time the obligation is created. Obligations generally serve as the basis for requesting appropriations, as the basis for Congressional action, and as the basis for most apportionments and allotments. For these reasons the accounting system should provide for identifying obligations with the applicable appropriation or fund at the time they are incurred. Similarly, all reports reflecting obligations should be supported by evidence provided by the accounting system in terms of expenditures and unliquidated obligations.

4. Correlation of obligation, accrued expenditure and cost data. For many services, these data are vitually identical. This is generally true of the major elements provided for in salary and expense appropriations and many other types of charges, such as subsidies, annuities, awards, indemnities and interest. The differences become important in construction projects and other operations where substantial inventories and other elements of cost are not consumed or applied in the period in which the obligation is created. Thus, obligations cover goods and services ordered; accrued expenditures recognize goods and services received; and costs show goods and services consumed or applied. The use of somewhat different accrual techniques is necessary in each case and the accounting system should provide for each type of data to the extent warranted by the useful purposes which the data will serve. Depending upon the circumstances involved in individual situations, the accounting system can be based primarily on the development of accrued expenditures and costs, with obligation data being developed as a supplementary feature by correlating information as to unliquidated obligations with such accounting results. In other cases, the accounting system may be designed primarily to develop expenditure and obligation data with accrual features built in as refinements. Care should be exercised to correlate the means provided to obtain these data so that duplication of effort will be avoided.

5. Use of accounting in obligation control. Various accounting techniques may be employed in implementing the system of administrative control provided for in section 3679, Revised Statutes, as amended, 31

U.S.C. 665. The evaluation and use of accounting data is a primary tool for use under any plan of obligation control. One method of seeing that obligations are incurred only when there is a balance available for the purpose is to require validation of obligating documents prior to release. Many variations of this method can be developed with respect to particular types of transactions of varying importance. Other approaches place greater reliance upon administrative instructions and limitations with accounting devices being used less directly as a means of control.

The relationship and coordinate use of the different types of data described above can be illustrated as follows: The starting point is program costs, which represent the resources actually consumed or applied during a period and are the primary means of focusing attention on value received in relationship to accomplishments, whether the amount involved is used for current expenses or capital additions. To arrive at accrued expenditures, unapplied costs representing the variation (between the beginning and end of the period) in the value of resources available for use in future periods (inventories, etc.) must be taken into consideration. Such accrued expenditure data represents goods or services received during the period regardless of when ordered, paid for or used and, of course, makes available information on the resources carried over into the next period. When the figure for accrued expenditures is increased or decreased, depending upon whether undelivered orders for goods or services are greater or less at the end of the period than at the beginning, it will agree with obligations incurred during current period which are the measure of administrative performance in terms of compliance with law and regulations regarding limits on obligation incurred. Obligations incurred plus the unobligated balance, of course, reflect the total amount of the appropriation which completes the picture. It is the balanced use of these several types of data which contributes to effective administration.

VI. ACCRUAL BASIS OF ACCOUNTING

Historically the proprietary accounts of the Federal Government were developed, as was the case in commercial enterprises, on a cash basis, i. e., transactions were entered in the accounts on the basis of the receipt and disbursement of cash. The accrual basis has long been accepted as the standard in the commercial world and, although much progress has been made in this respect in Federal Government accounting, further emphasis on accrual accounting is needed for continued progress in increasing the contribution which accounting can make to financial management.

1. Contrast of the cash versus the accrual basis. The accrual basis can be briefly characterized as an effort to reflect in the accounting records and financial reports events as they transpire from a time or period standpoint. For example, unlike the cash basis which does not recognize revenues until the money is collected, the accrual basis recognizes them when they are earned. Under the cash basis, expenditures are recorded when payment is made whereas the accrual basis provides for recording the expenditure and a liability therefor when materials or services are received. Further, under the accrual basis the cost of materials is charged to expense in the period consumed (by the use of an intervening inventory account) rather than at the time payment is made. Similarly, in the case of fixed assets (plant, equipment, etc.) which ordinarily have a useful life beyond the current period, the cost is spread over the periods benefited under the accrual basis.

2. Purposes and advantages of the accrual basis. As demonstrated by its acceptance in the commercial world, the accrual basis when properly applied reflects a more accurate picture of financial condition and makes the income and expense or receipt and expenditure figures more meaningful and, thereby, more useful to management, the Congress and the public. For example, the data reflecting the purchase of a substantial supply of materials for a construction project could be most misleading, if viewed as an expense of the current period rather than as an asset to be capitalized as inventory and to be later included in the investment in a particular facility based upon the amount of such materials consumed. Similarly, the non-payment of an operating expense such as rent owed should not be permitted to obscure the fact that a liability has been incurred for an expense properly chargeable to the current period.

In other instances, as previously brought out in Part C-III. FINANCIAL AND RELATED CONTROLS, the use of the accrual basis materially strengthens financial control.

Finally, the use of the accrual basis is essential, as to major elements at least, in the development of adequate cost accounting. For example, if accurate unit costs are to be developed, it is essential that expenditures be reflected in the period in which the work was performed. Again, only under the accrual basis is it possible to arrive at the cost of goods sold or services rendered to be matched against the revenues earned therefrom during a given period.

3. Factors to be evaluated in application of the accrual basis. This refinement of the accounting process should be applied by weighing the advantages to be gained against the possible added record keeping

involved, if significant, in each instance. Both the items selected for accrual and the methods employed require the exercise of judgment. The following examples illustrate the types of factors to be considered:

a. The accrual of annual leave in a business-type enterprise financed from a revolving fund is both feasible and essential for adequate cost accounting and for the preparation of adequate financial statements. Since more than one leave system may be involved and since other factors may vary, the specific practices employed should be tailored to each particular situation. On the other hand, in an agency engaged primarily in administrative-type activities financed under present provisions of most annual appropriations there is little, if any, advantage to be gained by maintaining accounting control over accrued leave. In the latter instance, reasonably precise statistical data for management purposes can likely be provided at less expense in another manner.

b. An agency engaged in a manufacturing process should account for materials on a consumption basis in order to arrive at an accurate cost of both the materials used and the product manufactured. This basis is particularly important if the price at which the product is sold is based primarily on cost of production.

c. An agency carrying on a business-type activity should capitalize plant and equipment and should include in expense the charge for depreciation in arriving at its profit or loss for a given fiscal period. There is not as great a justification for this treatment of depreciation charges in an agency primarily engaged in an administrative-type activity financed from annual appropriations.

d. An administrative-type agency carrying on a program which involves substantial stores inventories should use the accrual basis for this phase of its activities if accounting is to make its maximum contribution to financial management from the standpoint of (1) financial control over inventory, (2) adequate operating costs for comparative purposes, and (3) effective budgeting for all resources available.

To summarize, the accrual basis of accounting should be used in each instance to the extent that accounting results will be significantly improved and thereby increase the value of accounting to management and others by (1) contributing to full disclosure, (2) improving financial

control over assets and liabilities, (3) aiding in the development of cost accounting, (4) providing more informative budget data, and (5) furnishing more significant accounting data which is related to specific assignments of managerial responsibility.

VII. COST ACCOUNTING

Cost accounting is that method of accounting which brings together all appropriate elements of cost incurred to accomplish a purpose, to carry on an activity or operation, or to complete a unit of work or a specific job.

The advantages to be gained from cost accounting are measured by the contribution which it can make to better management in the sense of providing more specific data for use in setting standards of performance and evaluating actual performance in terms of these standards, planning current and future operations and other like endeavors. To serve best these purposes, the practices adopted should be tailored to the type of operation involved and the specific objectives sought. The data produced should be consistent with assignments of responsibility for management within the organization.

1. Relationship between cost accounting and expenditure accounting. Cost accounting is an extension and refinement of expenditure accounting to improve its usefulness. Many of the factors considered in connection with the accrual basis of accounting have equal application in the development of cost accounting. Cost accounting may also involve other factors: (a) it may (and should, where feasible) provide for the cumulation of units of measurement in order that unit costs may be obtained; (b) it may provide for distinguishing between direct materials, direct labor and overhead; and (c) it may provide for a further distinction between controllable and non-controllable costs in the overhead category (although all costs are controllable by someone, the term "non-controllable costs" is used here in sense of not being subject to the control of the administrator of the activity being costed, e. g., cost of a service unit which does not administratively report to him).

2. Factors to be evaluated in application of cost accounting. The underlying elements to be evaluated in the application of cost accounting are generally the same as for other efforts designed to increase the value of accounting to management. Cost accounting should be developed and used to the extent that the value of the additional information made available outweighs the expense of the added record keeping involved. The following examples illustrate the type of factors to be considered:

a. Cost accounting is essential where reimbursement for services is to be at cost or where the sale price of a product is primarily based on cost. A substantially complete and precise use of cost accounting would be necessary in such instances. This is particularly applicable where a statute requires full recovery of cost.

b. Use of cost data as a basis for evaluating performance and consequently as a basis for the exercise of management responsibilities is rapidly gaining acceptance in the Government as the best means by which financial management can reach its greatest effectiveness. To serve this purpose, cost data must be accumulated in a manner consistent with assignments of management responsibility. This application of cost accounting can be adapted to many types of administrative activities, e. g., unit cost per loan approved, application processed, inspection made, investigation completed, claim approved, etc. Somewhat less precise costing than that referred to in the preceding paragraph will frequently serve this purpose.

c. Another use of cost accounting in administrative-type activities as a basis for evaluation of performance can frequently be developed where a number of offices are doing a similar job and the work lends itself to a reasonably accurate count of units. Under these circumstances performance between offices can be compared, standards can be set for management purposes and the results can be used as a basis for the support of budget presentations. Activities involving insurance, benefit payments and loans are illustrations of programs for which cost accounting can be developed to provide management with useful comparative financial data.

3. Cost accounting versus cost finding by analysis. A cost accounting system presumes that the cost accounts will be tied in with the related control accounts in the general ledger. The validity of the total amounts involved is assured by this process and it is this factor which distinguishes a cost accounting system from a cost finding system.

Under a cost finding system, unit costs (sometimes referred to as statistical costs), are obtained by analyzing certain expenditure accounts and making test counts of units at regular or irregular intervals without providing accounts in which cost data will be currently accumulated and tied in with the general ledger.

This method can be used successfully in some cases, particularly where such information is only needed occasionally for a special purpose.

The data ordinarily lack as great a degree of preciseness as is expected of the results produced by a cost accounting system, where the integrity of the data is enhanced by the tie-in with the general ledger accounts. While this method serves a useful purpose under given circumstances, it should not be confused with cost accounting.

VIII. PROPERTY ACCOUNTING

The development of property accounting in each executive agency must go hand-in-hand with the development of other aspects of the total efforts directed at improvements in property management of the character contemplated by the Federal Property and Administrative Services Act of 1949, Public Law 152, approved June 30, 1949, 63 Stat. 377, as amended. This Act also provides that the Comptroller General shall cooperate with the Administrator of the General Services Administration and with the executive agencies in the development of property accounting.

It is recognized that there is a wide diversity in the types of real and personal property used by the Federal Government as well as differences in the degree of importance which the utilization of property plays in individual agencies. Moreover, in some situations specific statutes must be considered.^{1/} In view of these factors the approach to property accounting will necessarily vary in individual situations. In general, improvements in property accounting create possibilities for enhancing the usefulness of accounting to management similar to advantages gained from other specialized phases of accounting and should be pursued with equal vigor.

For purposes of this discussion, property is treated in two general classes of items: (1) expendable materials and supplies, and (2) fixed assets (land, buildings, other structures, machinery, equipment, and furniture and fixtures).

1. Expendable materials and supplies.

a. Advantages of accounting control through use of perpetual inventory records. Perpetual inventory records which tie in with the general ledger accounts for materials and supplies and which reflect acquisitions, dispositions and stocks on hand include the following advantages:

^{1/} For example, section 410 - Title IV of the National Security Act of 1947, as added by section 11 of the National Security Act Amendments of 1949, Public Law 216, approved Aug. 10, 1949, 63 Stat. 578, includes specific provisions relating to property accounting in the Department of Defense.

(1) They provide better control because they are in turn controlled by the accounts in the general ledger, which ordinarily brings into play such additional control factors as division of duties, documentary support for entries, etc.

(2) They make it possible to determine readily the investment in inventory at any particular time.

(3) They make it possible to determine more readily and with a greater degree of accuracy the cost of materials used.

(4) They provide a valid basis for the comparison of results of physical inventories with the records.

(5) They furnish a better basis for custodial accountability.

(6) They provide data essential to maximum effectiveness in planning purchasing activities and utilization.

Stated in another way, financial accounting contributes to supply management by reducing a multitude of individual items to a common denominator in monetary terms (by such intermediate groups as desired and in total). Dollar amounts can then be used (a) in evaluating utilization, (b) in comparing actual inventory losses with established standards for such losses, (c) in measuring the rate at which property becomes unservicable, (d) in developing a keener appreciation on the part of the custodian of his responsibility through an awareness of the dollar amount involved, and (e) in simplifying advance financial planning through the use of experience factors and ratios.

b. Factors to be evaluated in selecting type of records maintained. Although perpetual inventory records and the financial control which they provide are advantageous, this improvement should be weighed against the expense of the added record keeping involved in each instance. The following examples illustrate the types of factors to be considered:

(1) An industrial-type or manufacturing activity using important amounts of materials would derive the greatest benefit from the use of perpetual inventory records because

they carry significant inventories and need to compute the cost of materials used. Because of the importance of inventories, similar advantages would generally be present in agencies carrying on activities of a public utility character. However, the advantages to be gained may not be sufficiently great to warrant such a method for the administrative supplies of such agencies.

(2) In an agency carrying on an activity which requires substantial stores inventories and particularly where central depots are used to supply materials to several separate activities, perpetual inventory records are warranted because they provide the accounting control necessary for cost, budget, and custodian accountability purposes.

(3) Consideration should be given to special situations where the need for accounting control over all or a portion of the materials and supplies used may warrant keeping these records. Examples are those cases where reimbursements are of major importance, where significant supplies of precious metals are used in research activities, where use of supplies is largely seasonal, and where supplies significant in amount are carried in a central or common inventory and are later charged to specific projects or activities when issued for consumption.

(4) The greatest variation in the need for financial control over inventories is found in agencies engaged primarily in administrative-type activities and because of the variation in the importance of the inventory of administrative materials and supplies. Factors such as the extent of central purchasing and storage of supplies may create different situations in agencies of equal size. In those instances where perpetual inventory records under accounting control would not ordinarily be justified, even relatively small stores of administrative supplies should be reflected in the accounts on an accrual basis where it can be accomplished with little effort. A simple method is to adjust the financial inventory account by a periodic charge or credit to expense based upon a pricing of the stocks on hand (in stockroom, i. e., exclusive of cupboard stocks) as determined by a physical inventory.

2. Fixed assets. Control over fixed assets (land, buildings, other structures, machinery, equipment and furniture and fixtures) can be obtained in two ways: (a) through keeping records of fixed assets in monetary values as part of the accounting system with a single set of records serving as support for the accounts as well as constituting the property record, and (b) through keeping only quantitative or other descriptive records.

a. Advantages of accounting control. The advantages of financial or accounting control include:

(1) It makes possible better control because the assets are controlled through accounts in the general ledger, which ordinarily brings into play such additional control factors as division of duties, documentary support for entries, etc.

(2) The investment of the Government in such fixed assets at any particular time can be readily determined.

(3) Not only can depreciation be charged to the proper activities where that is appropriate, but the accumulated depreciation charges can also be reflected as a reduction of the investment of the Government in the property in the preparation of financial statements and for other purposes.

(4) A valid basis is provided for the comparison of the results of physical inventories with the records.

(5) A more effective basis is provided for custodial accountability.

(6) Data are made available for financial planning with regard to acquisition, maintenance, replacement or retirement of such assets.

Approached from the viewpoint of its contribution to management, financial accounting for fixed assets, in addition to supplying more adequate control, furnishes data concerning the resources in use in terms of investment and, where appropriate, concerning the cost of the resources consumed, the latter in terms of depreciation. The importance of these data to that phase of financial planning which deals with effectiveness of utilization of such assets, present and future requirements, and other similar factors obviously is determined by the prominence of the role played by property in the discharge of the responsibilities of the agency.

b. Factors to be evaluated in selecting type of records maintained. The advantages to be gained by financial control over fixed assets should in each instance be weighed against the expense of the added record keeping involved. The following examples illustrate the types of factors to be considered:

(1) Agencies which carry on public utility activities (e.g., power and irrigation projects) and those engaged in industrial activities, including but not limited to those which manufacture products primarily for Government use (e.g., arsenals, shipyards, and printing plants), should control all fixed assets through their accounts with appropriate provisions for depreciation. This should be done irrespective of the method employed in financing such activities. In addition to the necessary control over such fixed assets thus provided, these practices are essential because of the importance of depreciation as an element of cost and the need to reflect accumulated depreciation as well as the cost of such assets in agency financial statements.

(2) In other situations, where the development of accurate costs is of particular importance because of their use in determining the amount of reimbursements, accounting control with provision for depreciation is called for if the investment in fixed assets is significant. However, under such circumstances, accounting control over only certain types of fixed assets may be appropriate. For example, in case of a research activity financed largely out of working funds, it would be necessary to capitalize machinery, equipment (including such scientific equipment as may be appropriate) and furniture and fixtures but if it is carried on in facilities which are occupied without cost to the activity, land and buildings would not be taken into account.

(3) Accounting control is ordinarily deemed essential as a basis for adequate control over the disposition of property held for sale. For example, land acquired upon default of a borrower should be accounted for as an asset by the lending agency which acquired it. Similarly, Government-built facilities, such as a manufacturing plant leased to a commercial concern, should continue under accounting control when it becomes surplus to the needs of the Government and is

offered for sale. However, where, under accepted practices of the agency, property had not been under accounting control, the determination that it is surplus to the needs of the agency does not call for a change in accounting methods as long as the property remains in the custody of the agency.

(4) In those situations where the activity of the agency involves program use (as opposed to administrative use in the sense of office staff) of fixed assets which comprise a substantial investment (land, structures, heavy machinery, fleet of trucks, etc.), accounting control should be established in the interests of adequate property control and in order to permit the preparation of meaningful financial statements for management, budget and other purposes in terms of resources in use. The extent to which depreciation accounting should be employed would depend on the usefulness of the resulting data.

(5) Land and public buildings, e. g., office buildings, public domain, national forests and national parks, used in carrying out Federal Government activities, other than those of the character referred to in previous illustrations, need be recorded as fixed assets in the accounting records of the agency having jurisdiction over operation and maintenance thereof only if the resulting data will significantly contribute to control over such assets and to disclosure in financial statements of the agency. Where fixed assets of the character under discussion are recorded in the accounts, provision need not be made for depreciation or amortization of structures but memorandum presentations may be utilized for purposes of disclosure or cost estimates where appropriate.

(6) In agencies whose activities are primarily administrative in character, accounting control ordinarily should be established over furniture and fixtures in the interests of adequate property control, with a single set of records serving as support for the accounts as well as constituting the property record. This can ordinarily be accomplished with a minimum of effort by utilizing composite class records to the maximum extent appropriate in lieu of individual item records.

3. Property to be accounted for on basis of cost.

a. Expendable materials and supplies. The cost of materials and supplies should include not only the amount paid for them but also freight, handling and storage charges. Departure from this practice is justified when the expense of allocating these additional charges outweighs the benefits.

Charges to the using activity for materials and supplies consumed and the pricing of inventories on hand should be determined on the basis of cost using a generally accepted method appropriate for the undertaking consistently applied.

b. Fixed assets. These assets should be accounted for at cost, or appraised value (preferably at date of acquisition) if cost is not reasonably ascertainable. Cost should include installation and transportation charges in addition to purchase price.

4. Physical inventories. Periodic inventories of both expendable and non-expendable property should be taken at regular intervals, on a cycle basis if desirable, but not less often than once each year. Discrepancies between the quantities reflected in the records and the quantities revealed by the physical count should be investigated. Adjustments should be made in the books to bring them into agreement with the results of a physical inventory.