



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

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The Honorable David A. Stockman
Director, Office of
Management and Budget

Dear Mr. Stockman:

I have decided, following extensive coordination with government agencies, public accounting firms and others, to issue the revised title 2 of GAO's Policy and Procedures Manual for Guidance of Federal Agencies, "Accounting Principles and Standards for Federal Agencies." A copy, along with my transmittal letter to all federal agencies, is enclosed.

The need for better accountability and sound financial reporting extends to all forms of government--federal, state, and local. I believe title 2 contains some important requirements agencies are to follow if we are to achieve significant advancement in federal government financial management and if we are to set the groundwork for the long-range government-wide improvements we both seek.

The revised title 2 calls for agency accounting systems to produce financial statements on the totality of the agency's operations. It also requires that these systems be an integral part of the agency's total financial management system and contain sufficient discipline, effective internal controls, and reliable and useful information. This type of reporting has proven a noteworthy success in materially upgrading the level of financial management and control wherever it has been used in both the public and the private sectors.

By calling for such financial statements, title 2 is reinforcing the requirement for a basic year-end accounting by management to disclose the stewardship of resources entrusted to them and their performance for the period. Such annual accounting is not new in government. A number of state and local governments have been publishing annual audited financial statements for several years. These statements are not only supported and encouraged by the federal government but also required of state governments and large local governments. Recently enacted legislation--the Single Audit Act of 1984--further requires that these financial statements now be audited periodically. We believe that eventually the federal government should also have a financial audit; the requirements of

title 2 are a necessary first step in this process. In fact, we have discussed the possibility of doing this audit with your people, hopefully by fiscal year 1987 or 1988.

I would hasten to add that the reporting under title 2 is not meant to compete with the budget of the United States Government as the primary tool for planning and controlling the allocation of economic resources. Rather, it is an attempt to improve the financial reporting of the Federal Government by applying the principles of governmental and, where relevant, business accounting to the Government. It is intended to enhance Congress and the public's understanding of the relationship between the federal government's resources and the claims against those resources.

In addition to pointing out these major advantages of title 2, I would like to respond to each of the issues you raised in your October 17 comment letter.

o One of your primary concerns is that title 2 requires agencies to prepare annual financial statements modeled after business accounting practices. The financial statements required in title 2 are not those traditionally prepared by businesses in the private sector. Rather, they are year-end statements that specifically reflect a government environment. Title 2 incorporates and builds upon the relevant standards of the Government Accounting Standards Board (GASB) and its predecessor, the National Council on Governmental Accounting, both of which establish accounting standards for state and local governments. In addition, Financial Accounting Standards Board standards have been incorporated to the extent applicable. We realize there are areas of difference between the federal and the state and local sectors; however, most of the guidance issued by the GASB would also apply to the federal sector. As we refine our accounting requirements in the future, we fully intend to work closely with the GASB to eventually bring the federal, state, and local reporting even further into agreement.

o You expressed concern that such financial statements prepared in accordance with title 2 would be costly. We believe the additional costs to prepare such statements will be minimal mainly because agencies have been preparing similar annual financial statements for a number of years. The focus of agency efforts, however, will be on improving their accounting and financial management systems so that they capture, maintain, and report comparable, reliable, timely, and usable information necessary for effective management.

of government operations. To the extent that agencies do not currently have adequate systems, then, indeed, some cost is involved. This is not, however, a cost of the reporting, it is a cost to improve systems to a level needed to run our government. We believe the benefits derived from enhancing the financial information available to the executive branch, Congress and the public will be well worth the costs involved. Moreover, many of the needed improvements are already being made as a result of the work done to comply with the Federal Managers' Financial Integrity Act.

- o You stated that you have been advised that there are serious legal questions concerning GAO's authority to prescribe such financial reports. We have concluded that GAO has authority to prescribe the financial reporting in the manner called for in the revised title 2 requirements. GAO's authority to prescribe financial reporting requirements for executive agencies without OMB approval (although not without consultation) is clearly supported by law, legislative history, and continuous and consistent practice:

--The Budget and Accounting Act of 1921 gave GAO authority to prescribe "the forms, systems, and procedures for administrative appropriation and fund accounting" Under that law, we required financial reports by executive agencies as early as 1926.

--The Budget and Accounting Procedures Act of 1950 added authority to prescribe "the principles, standards, and related requirements for accounting to be observed by each executive agency." In writing the 1950 Act, the Congress, with the agreement of the Budget Bureau and the Treasury Department, rejected a recommendation that accounting requirements be the responsibility of an executive branch official. GAO's first issuance under the 1950 Act, published in 1952, required financial reports by executive agencies, including balance sheets and budgetary reports (comparable to the present-day statement of operations), and we have required such reports, as well as others, since then.

--The 1950 Act clearly is intended to provide full disclosure of executive branch financial operations, not just for the executive branch's use but for the Congress and the public as well. The requirement to consider needs of executive agencies is not intended to limit the issuance of accounting

principles to what those agencies need, but rather to assure that their needs, as well as those of the legislature and the public, are met by the accounting principles which we promulgate.

- o Another concern you expressed was doubt that the financial reports required by title 2 would be useful or used by the government, the public, or the Congress. This doubt apparently stems principally from the fact that the reports emphasize accrual accounting and thus present a different approach and a different bottom line than budgetary statements. We believe the financial statements required by title 2 will be very helpful in providing information not included or disclosed in budgetary statements, information that is necessary for greater control and oversight over agency activities. We also believe that the executive branch, Congress and the public will find these statements both informative and useful.
- o Finally, you expressed concern that title 2 fails to recognize meaningful disclosures made in the budget and existing Treasury reports and does not attempt to integrate these disclosures with those required by title 2. Title 2 contains the requirement for budgetary data to be captured, maintained, and reported to assist in budget preparation and to facilitate control over budget execution. Also, appendix III of title 2, which is currently under development, will highlight additional requirements at the systems level concerning integration of all financial information needs, including budget data for effective management.

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Over the past year and a half, GAO has consulted extensively with OMB and Treasury on their needs for financial information and has considered the needs of the other executive agencies. As you know our exposure draft was commented upon by substantially all major federal agencies, including every agency except one, represented on the President's Council on Management Improvement (PCMI); we have also met with many of them to discuss ways to handle specific issues raised by them. As a result, I do not believe continued delay in issuing title 2 for further review by the PCMI is warranted.

I fully support, and believe we have achieved, the law's goal of cooperation with the executive branch in development of title 2. At the same time, I believe I would be remiss in

carrying out my duty under the law to the Congress and the public if I permitted any remaining differences of opinion with OMB to further delay the issuance of title 2. I believe that GAO's positions, for the reasons given, are sound in terms of financial accounting, administration, and law.

I would be happy to discuss these or other title 2 issues at any time. Certainly our responsibility to consult with you concerning your needs does not end with issuance of this version of title 2; title 2 can and will continue to be revised in light of experience or as circumstances indicate.

Sincerely yours,

Signed Charles A. Bowsher

Comptroller General
of the United States

Enclosure

cc: The Honorable Donald T. Regan
The Secretary of the Treasury

bc: Mr. Socolar, OGC
Mr. Pierson, OGC ✓
Mr. Bedrick, OGC
Mr. Hagenstad, OCR
Mr. Horan, OP
Mr. Wolf, AFMD
Mr. Abel, AFMD
Mr. Schoenhaut, AFMD
Mr. Michelson, AFMD
Ms. Flo, AFMD
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