

REMARKS OF ELMER B. STAATS  
COMPTROLLER GENERAL OF THE UNITED STATES

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addresser



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[ OBJECTIVES OF GOVERNMENTAL ACCOUNTING ]

Good afternoon ladies and gentlemen, it is a pleasure to be here with you today to discuss governmental accounting-- a subject that is much on my mind these days as I am sure it is on yours.

There has perhaps never been a time in our history in which so many people have been concerned about how our various levels of Government keep their books, do their financial reporting, and set their budget priorities. These concerns have been spawned by a number of events that I am sure you are all familiar with. The crisis in New York City's financial situation in recent years has been directly related to the accounting and budgeting practices it followed. When the District of Columbia wanted to borrow its own money--instead of borrowing from the U.S. Treasury as it had historically done--we in the General Accounting Office (GAO) and a major accounting firm agreed that its accounting system was so poor that the city's financial statements could not be audited. A major redesign of that system is now in progress. There have been problems in other cities as well. Problems .

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which at least in part have been attributed to poor accounting.

Inflation has had its effect upon governmental accounting too. The rise in taxes that has resulted from the inflation we have been experiencing is of concern to all responsible Government officials. Moreover, the spectre of "Proposition 13" and "balance budget amendments" hangs over the whole country and is of concern to legislators and Government officials everywhere. From our vantage point, this concern seems to have heightened the interest of most everyone about how governments set priorities for spending the money they collect and this inevitably means a concern with accounting and financial reporting as well as budgeting.

#### CRITICISMS FREQUENTLY JUSTIFIED

We, in Government, must acknowledge that many of the criticisms of governmental financial reporting are justified. Although there have been some notable improvements in recent years, the financial reports issued by many governmental organizations are almost impossible to decipher by even the most financially sophisticated reader. The pages and pages of statements of individuals funds are hard to understand. Certainly, one could not get a feel for the financial condition of the whole entity by reading such statements.

Lack of clarity is not the only problem with governmental financial statements. Many of them do not show true financial condition because important assets and liabilities are not included. For example, many such governments have large

liabilities for pension benefits due their employees in future years and for accrued vacation pay and other employee benefits that are not shown on their financial statements. Without these sizable liabilities it is virtually impossible to get a good picture of the real financial status of the government involved.

We, in the Federal Government, did not until recently go as far as many State and local governments in meeting this need. While we adopted a unified budget in 1967 and published considerable consolidated information as a supplement to the budget, it was not until 1976 that we prepared any consolidated financial statements at all. Anyone who wanted such data for the Federal Government as an entity had to obtain the information from the 100 or so Federal agencies and consolidate it himself.

As I reflect on the kind of financial information that was available for most governmental organizations, it seems to me it was mostly useful to those intimately involved in the business of government on a day to day basis. The needs of investors and citizens who were less involved were scarcely served at all. In the Federal Budget we have gone to great lengths to provide easily readable summaries for the public, but we have not done this as well for our accounting reports.

#### MUCH IMPROVEMENT HAS TAKEN PLACE

Having painted a bleak picture about the status of

governmental accounting, let me now proceed to recent changes that hold great promise for improvement. They are considerable.

Let me start by congratulating the National Council on Governmental Accounting (NCGA) on the recent issuance of the restatement of its long-honored publication, "Governmental Accounting, Auditing and Financial Reporting." There are major improvements in this document that should be helpful in bringing the kind of accounting and financial reporting changes that are needed.

As you may know, we have long been supportive of the NCGA efforts. A GAO representative served on the committee that produced the GAAFR in 1968 and more currently, one of our division directors has served on the NCGA since its inception in 1972.

Improvements in financial reporting are not only contained in the restated GAAFR. A large number of cities, counties, and states send us informational copies of their financial statements and we have noted that many of them are seriously experimenting with ways of making their financial information more understandable.

#### FEDERAL EFFORTS TO IMPROVE FINANCIAL REPORTING

We have been making similar experiments in the Federal Government. In 1975 Arthur Andersen & Co. prepared illustrative consolidated financial statements for the Federal Government for fiscal year 1974. In its published booklet Arthur Andersen stated that the Federal Government "produces

an enormous amount of financial data and a wide variety of financial reports. However, such information is often duplicative and is not accumulated in one place or consolidated into reports or statements which permit an assessment of the overall financial condition or operating results of the entire Government." Arthur Andersen concluded that "Financial management systems and functions of the Federal Government should be strengthened and integrated to achieve financial accountability at all levels."

We have taken steps at the Federal level to respond to the challenge which Arthur Andersen gave us. As you may be aware, the Department of Treasury has an ongoing project to publish consolidated financial statements for the Federal Government on an accrual basis. Three prototype issues have been prepared for fiscal years 1975, 1976 and 1977. I was a member of the advisory committee established in 1976 by then Secretary of the Treasury, William E. Simon, to oversee development of the first prototype consolidated statements published by Treasury in 1976. I am now chairman of the Federal Interagency Advisory Committee set up by Treasury to continue the assessment of major conceptual issues that must be resolved before a fully reliable set of consolidated financial statements can be prepared. Task forces established by this Committee are currently studying seven subjects:

- Accruing personal and corporate income taxes with acceptable accuracy,

- Establishing appropriate allowances for losses on accounts and loans receivable,
- Computing accurate liabilities for Federal employee retirement plans and social security,
- Establishing reasonable values for Federally-owned assets,
- Determining appropriate ways of showing liabilities for Federal loan guarantee and insurance programs, and
- Reflecting the effects of inflation properly on Federal financial information.

We expect to make major improvements in the consolidated Federal financial statements with the information these Task forces provided to us.

I should add that continued reforms of Federal budgeting and congressional oversight and evaluation also include improvements in the reporting on policy and program costs and performance, which need the support of sound financial management systems.

COMMENTS ON OBJECTIVES OF GOVERNMENTAL FINANCIAL STATEMENTS

Although much is being done as I have already stated, it is only a start. Much more is required before we can say that governmental accounting effectively serves all those interested in it. A major starting point for making improvements in this area is establishment of objectives for governmental financial statements. The Trueblood Committee

established objectives for financial statements of profit-making entities but these objectives do not fit governmental units.

The difference in governmental and commercial goals is the basic reason why accounting information needs differ. Industry's objective is basically to make profits. True, it has a host of other lesser objectives but its basic one is to make profits. Without that objective, a firm would be a rare bird indeed and its ability to stay in business would be limited.

Government, on the other hand, is not in the business of making a profit. Its objectives are to protect and serve its citizens and promote their general welfare. It operates mainly through programs established by legislative bodies, and its managers are charged with responsibility for assuring that the programs accomplish their objectives. They are also concerned with keeping their costs low and not spending more money than they have been authorized to spend, but this too is not the same thing as making profits.

This point was illustrated and reinforced recently in Harvard University President Bok's 1978 annual report in which he outlined his view with respect to the role of the Business School. In that report, he stated "Although business may have much to teach the health care administrator or the government bureaucrat, nonprofit institutions and public agencies are still very different from the private corporation. \*\*\* Their managers must function in a more political environment

where decisions are subject to the checks and balances of other public agencies. Above all, whether they devote their efforts to health, education, or public service, they have goals that are less tangible, less precise, and quite different in nature from the profit margins and market shares that preoccupy the businessman. These differences may only be matters of degree, but they are substantial nonetheless."

Of course, there are some government organizations that are reimbursed for the services or products they provide and thus operate much like private companies. For these organizations, financial information will disclose numerous facts about whether established goals are being achieved (the goal often being to break even) and to some extent whether resources are being efficiently and economically managed. However, because such organizations often lack competition, financial information is frequently less useful for such purposes than it is for private concerns. Examples of such Federal organizations are the Bureau of Engraving and Printing, Bureau of the Mint, and the Tennessee Valley Authority. Many of these already follow commercial accounting practices and it is not primarily this segment of government--the business-type functions--that I am addressing. The part of government that would not be served well by commercial accounting, in our judgment, is the nonbusiness area designed to regulate, protect, and promote the general welfare of its citizens.



These programs make up the major part of the Federal budget.

Profits obviously do not enter into the managerial challenge of a manager involved in these aspects of Government. To such a manager, the concerns are whether his mission has been effectively accomplished and whether he used the resources he was given economically and efficiently. True, the Government manager needs to know what his costs are and whether he is staying within his budget. But when he knows this, he still will not have a significant part of the information he needs if he does not know whether his program or activity is achieving the nonmonetary goals it is responsible for. If he is charged with housing the poor, financial information telling him how much he spent and that his costs are low will be of only limited usefulness unless he also knows what impact his efforts have made in providing the needed housing.

I do not pretend to speak for all citizens because there are such a diverse group but I believe that they too are interested in more than just budgetary compliance. They see how much is spent--and often wonder where it goes--but do not really know how effectively their elected and appointed officials have accomplished the work they are responsible for or whether they have set budget priorities and spent the money with the kind of care they would give if the money were their own.

I am not going to try to provide detail on what such objectives should be. That is being studied by the NCGA

and the Financial Accounting Standards Board (FASB) for State and local governments and by the Joint Financial Management Improvement Program for the Federal Government.

This is important work because it provides the foundation for conceptual frameworks which will ultimately provide the unity in decisions on State and local governmental accounting principles which we all seek. Such unity may extend to both government and commercial accounting in many cases but in a significant number of other cases I suspect it will not be similar because of the different motivations I mentioned above. Thus I believe we will in all likelihood have considerable differences between the accounting principles applicable to State and local governments and those applicable to industry.

At this point I would like to comment on a question that is often posed to me: should Federal accounting principles be the same as those for State and local government? My answer is--I hope so but I am not sure. There are certainly similarities. The qualification is that there are considerable differences in function between the Federal and State and local governments that may require differences in accounting. We, in GAO, are developing our own conceptual framework for the Federal Government which is to be followed by a revision of the accounting principles we have established for Federal agencies. We hope to follow closely what is done in State and local conceptual frameworks and the setting of accounting

principles and it is our hope that if we have differences they will be based on identified need for such differences. However, we recognize that the Federal Government is in many respects a unique entity and we are prepared to prescribe differences when they are clearly called for. Congress has given us the responsibility for setting the accounting principles that Federal agencies shall follow and we intend to set principles that will serve the Congress, managers, and citizens as effectively as possible.

WHO SHOULD SET THE STANDARDS FOR STATE AND LOCAL GOVERNMENTS?

The question of who should set standards for the State and local governments is one that has received a great deal of concern in recent months. The traditional source was Government Accounting, Auditing and Financial Reporting or GAAFR, for short. This book, originally written by the MFOA-sponsored NCGA and recently restated by a reconstituted NCGA was accepted by the American Institute of CPA's, with minor modifications, as the generally accepted accounting principles for State and local governments.

Some of the problems in certain cities that I mentioned earlier created a concern about the accounting principles used by State and local governments--particularly large cities--in their accounting financial reporting practices. This concern has led to pressures being put on the Financial Accounting Standards Board to take on the project of setting

accounting principles and financial reporting standards for state and local governments.

As many of you know, I have been a strong supporter of the FASB since its inception. I serve on the Financial Accounting Standards Advisory Council and have consistently encouraged reliance on the FASB instead of the alternative generally proposed--Federally prescribed accounting principles for commercial businesses. I believe that unless proven otherwise an independent board like the FASB is an appropriate vehicle for setting such standards. However, it has been my view that it would not be in the best interests of the FASB, State and local governments, the accounting profession or the citizens of the United States to have the FASB alone also set the standards for State and local accounting. There are several reasons for my views.

First, the FASB is a private organization not part of Government. To have it set the standards for Government would be a reversal of roles--a non-elected private organization regulating a part of elected Government through the medium of accounting principles.

Second, the FASB has its hands full with private accounting. It has recently taken on the task of reviewing and accepting or rejecting accounting principles in statements of procedures and audit guides issued by the American Institute of CPA's. Also, it has the issue of non-profit organizations in the private sector to deal with. I think taking on State and local

accounting too could well be the straw that breaks the camels back.

Third, there is the question of acceptance. State governments have the sovereign right to set their own accounting standards just as the Federal government does, and there is doubt that they would accept the FASB's work in this area. All but a few State governments, I am told, have assigned specific responsibility for this task to a particular state official.

Finally, there is the considerable work already done by the NCGA on this matter. The NCGA has taken a two-pronged approach to the problem of standards. The first was the short-range effort called the GAAFR restatement which is to update and clarify the GAAFR. As I mentioned earlier this restatement has been completed and issued this Spring. The second is a longer-range and more ambitious project--to establish a conceptual framework for the accounting of State and local governments and to rethink the accounting and reporting principles in light of the conceptual framework.

With respect to State governments, the Council of State Governments committee on State government accounting principles and practices, together with a project committee jointly representing the state accounting task force of the NCGA and several national organizations of State governmental officials and public accounting firms, has undertaken a project to develop an inventory of current state accounting principles

and preferred practices. This data is being accumulated in cooperation with the NCGA and will be used by it.

As mentioned above, the NCGA has initiated a project to develop the conceptual framework for municipalities and has developed plans for subsequent reconsideration of existing accounting and reporting principles for local governments. The result of this work would be a new version of the GAAFR. The NCGA has applied to the Department of Housing and Urban Development for a grant to help it secure appropriate staff for its work and has engaged William Holder, associate professor, Texas Tech University, to start the research necessary to develop the conceptual framework. It has been estimated that the project will take 36 months to complete. Professor Holder started work on the project about November 1, 1978. I am advised that approval of the HUD grant will be announced very soon.

While we do not believe the FASB should take over standard setting for State and local governments, we strongly believe in close cooperation between the NCGA and the FASB. A start has been made in a joint effort to develop objectives for State and local governmental financial statements. We believe such joint efforts is not only desirable but necessary because there are some organizations in each of the three sectors (business, government and nonprofit) that perform the same functions. For instance, there are profit-making hospitals, government-operated hospitals and nonprofit

hospitals. A similar situation exists for some educational institutions and libraries. Cooperation between the two groups would seem to lead to the maximum similarity in the principles applicable to each sector while taking advantage of the experience and research capabilities of both the NCGA and the FASB. Maximum similarity in the principles applicable to such organizations would have many advantages--an important one being that comparisons would be facilitated.

#### THE WILLIAMS BILL

A further development in this area has taken place quite recently. On May 23, 1979, Senator Harrison Williams introduced S. 1236, a bill called the State and Local Government Accounting Act of 1979. This Act provides for an eleven person institute, funded from Federal funds that would take over the task of setting accounting and financial reporting principles for State and local governments. The eleven members of the institute would be:

- One member from the Federal Government,
- Three members from the State government,
- Two members from the local government,
- Two members from the public accounting profession,
- One member from the financial analyst community, and
- Two members representing the public.

The members would be appointed by the Secretary of the Treasury, the Chairman of the Securities and Exchange Commission (SEC) and the Comptroller General. These officials would have the

authority to approve by-laws but the principles and reporting standards adopted by the institute could not be changed by them.

I recognize that to many of you Federal involvement in such standard setting will be repugnant but I suggest that you look at the bill with unprejudiced eyes. The NCGA has consistently had problems with funding and even though it now appears that the HUD grant may provide the NCGA with the support it needs currently, this grant only covers a three year period. If the experience of the FASB is any guide-- and I think it is--the need for a standard setting body for State and local government could extend considerably beyond that period. This institute with its representative board might prove the long term answer to this problem.

#### ENFORCEMENT A MATTER OF CONCERN

Of course, setting standards for State and local accounting is only part of the problem. Getting people to comply with them is equally important. Judging by the MFOA Certificate of Conformance Program, compliance with the standards in GAAFR has not been good.

As you know, any State or local governmental unit can participate in the MFOA Certificate of Conformance Program. In order to receive a certificate of conformance, an entity must submit a comprehensive annual report in conformance with the accounting principles established by NCGA in the GAAFR. A careful review is made of such statements to see



that they do actually follow the GAAFR principles. Presently, Alaska is the only State that has obtained a certificate of conformance. Approximately 230, or less than 1 percent of the 40,000 local governments, have obtained this certificate. We recognize that some local governments probably comply or are close to complying but do not attempt to obtain a certificate of conformance. Nonetheless, these statistics indicate that the record of compliance with the GAAFR standards could be greatly improved.

This concern with enforcement of the standards once they are set should be a concern of everyone. Whether you support the FASB, the NCGA, or the Institute specified in the Williams bill as the standard setting body, you should give this matter consideration for no standards will be effective if they are not enforced.

At the present, we have no solution to this problem of compliance but we think it is one that should be considered as a necessary part of the improvement of State and local accounting and financial reporting.

#### CONCLUSION

We in the Federal Government are increasingly concerned with the financial reporting of State and local governments because we rely on their accounting systems to provide us with information on how they spend Federal grant and revenue-sharing funds. Such funds now total about \$85 billion annually--constituting approximately 25 percent of all State and local

outlays--and are quite naturally of a great deal of concern to Federal agencies responsible for seeing that such funds are used effectively and for properly authorized purposes. Our principal goal in this matter is that jurisdictional disputes will not cause irreconcilable problems and that all interested parties will work together toward the end we all hope to attain--more meaningful financial reporting.