

ASSOCIATION of GOVERNMENT ACCOUNTANTS

TO: National Executive Committee
c/o Virginia Brizendine

FROM: David R. Hancox *DH*
Chairman - Emerging Issues Committee

DATE: November 4, 1992

RE: TRUTH IN BUDGETING AND ACCOUNTING - An AGA Emerging Issues Report

Enclosed is a copy of the report of the Blue Ribbon Task Force on Truth in Budgeting and Accounting chaired by Mr. Joseph Dioguardi. We ask that you present it to the National Executive Committee.

The purpose of this report, as stated by the authors, is to voice the opinions of experienced government financial managers with the intention of generating additional thought, discussion and corrective action on budgeting and accounting issues. From this report, the National Executive Committee might identify other issues that could be addressed by other AGA task forces.

The United States government budgets, controls and directs cash resources in excess of \$1.4 trillion dollars each year. Yet at a time when Congress must make important decisions on future budget priorities and commitments, the information necessary to make those decisions is woefully defective. Weak government-wide budgeting and accounting systems produce insufficiently reliable information about how the government spends its funds and how decisions made today will affect tomorrow's taxpayers.

Further, the Congressional budgeting process commonly relies upon imaginary revenues, ignores unfunded obligations, and makes use of numerous other practices lacking economic and accounting reality.

The Federal government badly needs major budgeting reforms. Despite some recent steps in this direction by Congress and the Executive Branch, much remains to be done. This Task Force recommends these further steps:

1. ADOPT SOUND ACCOUNTING AND BUDGETING PRINCIPLES AND STRENGTHEN THE CFO POSITION

While the Budget and Accounting Act of 1950 required the Comptroller General to prescribe the principles and standards for accounting to be observed by each agency (i.e., generally accepted accounting principles (GAAP)), there were no specifically defined principles for the government to use.

(a) The Need for GAAP

The absence of meaningful accounting principles leaves the government using an accounting system which emphasizes cash flow, even though major new financial commitments are made and new liabilities incurred. Payroll checks and payments of accounts are moved from one fiscal year to another to manipulate deficit reduction targets. No acceptable accounting is made for government guarantees of private economic transactions, such as savings and loan deposit insurance, which may go bad and require government outlays. Nor is any acceptable accounting made for accrued leave and future pension payments to retirees, which are earned but not disbursed today.

In October 1990, a breakthrough agreement was reached on the creation of a Federal Accounting Standards Advisory Board (FASAB) to define GAAP for the federal government. The Board is composed of representatives from OMB, GAO, Treasury, CBO, Defense, domestic agencies, and the private sector. To date FASAB has agreed on a mission statement, interim financial standards, and its first exposure draft on financial resources.

FASAB must work expeditiously to agree on a set of Generally Accepted Accounting Principles for Federal government operations. Such principles will likely require the use of an accrual basis of accounting, including realistic treatment of all unrecorded and contingent liabilities.

The benefits in using GAAP for Federal financial reporting include:

- Stimulating awareness among program managers of the causes and consequences of financial management problems and focusing management attention in solutions.
- Comparing consistent-format reports over several years, thus revealing trends and performance comparisons, thus increasing understanding of program performance by Congress, the Executive Branch, the media and the public.
- Improving confidence in the financial management of agency programs.

(b) *Integrating Budget and Accounting Standards*

Under the CFO Act, audited financial statements are due nine months after the end of a fiscal year. Budget formulation usually begins as much as 18 months (if not more) before the beginning of a fiscal year. Thus the life span from budget initiation to final accounting is usually as long as four years. Because of this long time span, final accounting occurs far too late to have any impact on misleading budget practices which occurred many months earlier in the process. We encourage the FASAB (in conjunction with OMB and the CFO) to develop and administer budgeting standards consistent where possible with FASAB accounting standards and require audit oversight for compliance during the budget formulation and execution stages, so that unsupportable budget requests can be identified at a point in time when corrective action can most effectively be taken, and when misleading or manipulative budget practices can be eliminated.

FASAB principles should clearly prohibit such notorious budget gimmicks as off budget expenditures and "savings to be realized later". The Budget Enforcement Act should be amended to allow a point of order to be made in either the House or Senate whenever any such deceptive practices appear in budget resolutions.

(c) *Strengthening the Chief Financial Officer System*

The Chief Financial Officers appointed in each agency pursuant to PL 101-576 should be professionally competent in applying the budgeting and accounting standards established by the FASAB. The CFOs should be subject to the same high-level performance qualifications required of the Deputy CFOs. (The statute required high-level professional qualifications only for the Deputy CFOs). The CFOs must be given the full support of the President and Office of Management and Budget.

2. ADOPT SEPARATE BUDGETS FOR GENERAL FUNDS, TRUST FUNDS AND GOVERNMENT-SPONSORED ENTERPRISES (GSEs)

Under present budgeting practice, activities as diverse as the National Park System, Social Security, NASA, food stamps, weapons purchases, home mortgage insurance, and the Export-Import Bank are lumped together in one budget document, even though the activities are vastly different. Some expenditures are made every year from annual receipts; other activities are supposedly based on actuarial considerations; yet others are commercial operations similar to private business.

In October 1989, the Comptroller General proposed that the Federal government should account and report separately for general funds, trust funds and government-sponsored enterprises, instead of treating all three as economically equivalent. Under such a reporting plan, trust fund surpluses (notably those of Social Security) could no longer be used to reduce deficits in the General and GSE parts of the budget. These GSEs could be run more like business enterprises, without the constant threat of fiscal demands driven by a political need to show a smaller "budget" deficit. Overall, such tripartite reporting would give Congress and the public a far more accurate picture of the Federal government's spending activities.

3. ADOPT EFFECTIVE CAPITAL BUDGETING

Capital budgeting is a financial process used to plan and control long-term capital expenditures. It is not currently used by the federal government, although the federal government each year allocates tens of billions of dollars to acquire such assets as buildings, space satellites, weapons systems, and other capital items with a useful life longer than one year.

Private sector firms use capital expenditure planning and budgeting to provide for the assets needed to support corporate activities on an ongoing basis, not just for the current fiscal year, and for their replacement at the end of their useful life. While there are difficulties in the accounting treatment of certain government-owned capital assets (notably weapons), some acceptable, independently sanctioned form of capital budgeting should be put in place in every agency at the earliest possible time.

4. ADOPT BIENNIAL BUDGET CYCLES

A two-year budget cycle, corresponding to a Congressional term of office, would require Congress to authorize spending only once in two years. Since about 60 percent of votes in Congress are budget related, stretching the process over two years would leave a great deal of time for badly needed program oversight. In the second year of the cycle, Congress would only have to pass appropriations bills carrying out the terms of the previous year's budget resolution. The adoption of this reform must be accompanied by strict discipline so that supplemental budget amendments and appropriations bills are not used to augment the basic budget decisions in the first year of the cycle.

5. MAINTAIN THE BUDGET ENFORCEMENT ACT (BEA)

The Budget Enforcement Act of 1990 established new standards for disciplining the budget adoption and management process. If discretionary spending in any of three categories (defense, international, domestic) exceeds the Act's target as of October 15 (at the beginning of a fiscal year), an automatic sequester is applied to that category. Additional compliance reports, which could trigger sequestration orders, are required during the budget year. While not foolproof, the BEA requirements are a useful beginning toward greater discipline in budgeting procedures, and should be strictly observed. Efforts by Congress to override the BEA requirements to benefit favored programs constitute a backward step from necessary budgetary discipline.

6. PUBLICIZE THE TRUE FINANCIAL CONDITION OF THE FEDERAL GOVERNMENT

While the Treasury's Financial Management Service (FMS) has made important steps forward in recent years in presenting the state of the nation's finances, the absence of meaningful accounting principles and capital budgeting, the complexity of the often inconsistent information collected through the many different accounting systems used by the federal agencies, and the inaccessibility of reports, has made the FMS statement of interest only to financial specialists.

A concise, independently-audited GAAP-consistent report on the operation and financial condition of the U.S. government, including its revenues, expenditures, assets, and liabilities, ought to be made readily available to the public and news media. Consideration should be given to including more extensive information as part of the brief summary report included at the beginning of the annual 1040 individual income tax forms and instructions package distributed to all taxpayers each January.

AGA Truth in Budgeting and Accounting Task Force

Joseph J. DiGuardi, Chairman
Member of Congress, 1985-88

Roger B. Feldman
Former Comptroller, Department of State

John H. Hummel
Audit Partner, KPMG Peat Marwick

Clyde G. McShan, II, Director, National Finance Center
U.S. Department of Agriculture

Allen L. Reynolds, City Auditor
City of Baltimore, Maryland

Richard J. Schwartz, President
David Schwartz Foundation

W.T. Wrege, Associate Professor of Accounting
Ball State University