

TRUTH IN GOVERNMENT

THE NATIONAL ORGANIZATION FOR FISCAL INTEGRITY AND HONEST ACCOUNTING

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To: Members of the AGA Truth in Budgeting Task Force

From: Joseph J. DioGuardi, Chair

Enclosed is the "final" report of our Task Force, for submission to the AGA Emerging Issues Committee. I have tried not to be exhaustive, but to present the analysis and constructive recommendations as concisely as possible.

I would like each task force Member and unofficial advisor to read over this draft, and call me by March 25 to give me the benefit of any further thoughts you may have.

If you find this draft acceptable, please sign it, make a copy for your own purposes, and return the signed one to me at this address.

I really appreciate the excellent suggestions and incisive critiques supplied by members and by our unofficial advisors.

I will be making a presentation based on this report at the forthcoming AGA meeting in Dallas on June 22-24.

Unofficial advisors:

Mort Egol, Arthur Andersen & Co.
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TRUTH IN BUDGETING AND ACCOUNTING: AN AGA EMERGING ISSUES REPORT

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 on 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 PRINCIPLES TO PROMOTE FINANCIAL AND NON-FINANCIAL REPORTING BENEFITS

Since 1950 the U.S. government has legally been governed by Generally Accepted Accounting Principles (GAAP). Notwithstanding this legal requirement, the U.S. government is not in fact using GAAP.

a) The Need for GAAP

The absence of meaningful accounting principles leaves the government on the same bookkeeping system as a Mom-and-Pop grocery. Each year's accounts are kept on a cash basis, 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, some or many of which will go bad and require government outlays (as in the S&L bailout), or for future pension payments to retirees.

In October 1990 a breakthrough agreement was reached on the creation of a Federal Accounting Standards Advisory Board (FASAB), composed of representatives from OMB, GAO, Treasury, CBO, Defense, domestic agencies, and the private sector. To date the FASAB has agreed on a mission statement, interim financial standards, and ten draft proposals to the Treasury, OMB, and GAO to amend the GAO-adopted Title II financial accounting standards.

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

b) Benefits of Using GAAP

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 on solutions

* Comparing consistent formula reports with actual results to identify trends and performance comparisons

* Increasing understanding of program performance by Congress, the executive, the media and the public

* Improving confidence in the management of agency programs

c) Preventing Deceptive Budget Practices

FASAB principles should clearly prohibit such notorious budget gimmicks as "savings to be realized later" and "magic asterisks". Although it may be difficult to anticipate the ingenious artifices contrived by Congressional budget writers, the Budget Reduction Act should be amended to allow a point of order to be made in either House or Senate whenever any of a defined list of such deceptive practices appears in budget resolutions. All efforts to reestablish off-budget spending, as by the Resolution Trust Corporation, should be firmly opposed as inconsistent with sound budgeting practice.

d) Integrating budgeting and accounting standards

When implemented, audited financial statements would normally be due nine months after the end of a fiscal year. Budget formulation begins as much as 18 months before the beginning of a fiscal year. Thus the life span from budget initiation to final accounting can be as long as 39 months. 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. By adopting budgeting standards consistent with FASAB accounting standards and applying audit oversight for compliance during the budget formulation and execution stages, unsupportable budget requests can be identified at a point in time where corrective action can most effectively be taken, and misleading or manipulative budget practices minimized if not eliminated.

In addition, the Treasury should require accrual basis accounting reports from each reporting agency as soon as possible after the FASAB principles are agreed upon.

e) 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 statute requires 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.

f) Maintaining the Budget Enforcement Act

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 have been 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.

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

Under present budgeting practice, activities as diverse as the National Park System, Social Security, NASA, food stamps, weapons purchase, 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 revenues; others are supposedly run on an actuarial basis; yet others are commercial operations similar to private business.

In October 1989 the Comptroller General, in a landmark report, 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. The 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. It should be promptly implemented.

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. This is done through accounting recognition of actual use, wear and tear, and obsolescence and by making contributions to replacement funds, or otherwise providing for needed reinvestment. While there are difficulties in the accounting treatment of certain government-owned capital assets (notably weapons), some acceptable form of FASAB-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% 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. PUBLICIZE THE TRUE FINANCIAL CONDITION OF THE FEDERAL GOVERNMENT.

While the Treasury's Financial Management Service 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 agencies, and the inaccessibility of the report, 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. Until such information becomes available for all agencies on a consistent basis, making possible a government-wide report, there should be reports on as many individual agencies as possible. Consideration should be given to including more extensive information as part of the brief summary report included at the beginning of the annual 1040-5 individual income tax forms and instructions package distributed to all taxpayers each January.

AGA Truth in Budgeting
Task Force

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