Governmental Accounting: Bridging the Gap in GAAP

Martin Ives CPA
GOVERNMENTAL ACCOUNTING: BRIDGING THE GAP IN GAAP

by

Martin Ives, CPA
Vice Chairman and Director of Research
Governmental Accounting Standards Board
February 19, 1985

It is indeed an honor and a privilege to have been invited to present an Emanuel Saxe Distinguished Lecture at Baruch College. As an alumnus of Baruch (class of 1948), I am honored that you feel I can contribute to the development of our profession through this series of lectures. And as a former (and continuing) student of Dr. Saxe, it is a great privilege to speak at the series of lectures established in his name. I still remember Dr. Saxe as an awesome figure: a giant on the lecture platform and a marvelous human being. And perhaps the nicest thing about Manny Saxe is that he is no different today from what he was in the 1940s: he is still awesome and he still tells me what to do.

When I went to Baruch College I took a course called Accounting 245 Municipal Accounting. I will confess now that, at the time I took it, it didn't make much sense to me. The theories underlying municipal accounting haven't changed very much since the 1940s, and while I think I understand them better now than I did then, some of the concepts still don't make much sense. My objective tonight is to talk about Accounting 245, to discuss the underlying theories of governmental accounting and their resulting implications, and to suggest the need for some fundamental changes.

I believe the issues are important to you not only as accounting professionals, but also as citizens and taxpayers. State and local government purchases of goods and services in 1983 were approximately 12.5% of the gross national product; some 82,000 state and local government units employ more than 13 million people. The way state and local government finances are reported has a bearing upon economic policies and spending priorities at all levels of government. When the City of New York was required to balance its budget in accordance with generally accepted accounting principles to help restore its fiscal credibility in the mid-1970s, then municipal GAAP became your business both as accountants and as citizens. And now, ten years later, when the Governor of New York State talks about balancing the State's budget in accordance with GAAP, the issues loom even larger.

All of the issues that I will be discussing with you are on the current project agenda of the Governmental Accounting Standards Board. Although I'm a member of that Board, please bear in mind that my views do not necessarily represent those of my colleagues. And while I don't intend to talk about the GASB itself, I'll be glad to do so during the question period.

The Governmental Environment

For those of you who never took Accounting 245, it is first necessary to understand why state and local government accounting took a different road from commercial accounting. Governmental accounting is very much a product of the governmental environment. Carl Chatters and Irving Tenner summed it up in a few words in the textbook we used in the late 1940s. The differences between governmental and
commercial accounting, they said "are due to (1) the lack of the profit motive and (2) the necessity of complying with legal provisions...The two most important legal provisions affecting governmental accounting are those relating to (1) budgeting and (2) funds."

To see how these environmental differences affect accounting and financial reporting (the latter being more important from the perspective of financial statement users), we need to examine these points in greater detail.

**The necessity of complying with legal provisions**

**A. Budgeting**

The driving force behind all government activity -- whether it be at state, local, or federal level -- is the budget. In terms of public administration, the budget and the related appropriation acts represent an important expression of the separation of powers as between the executive and the legislative branches. Prepared by the executive branch, the budget is at once an economic, social, and political document; a statement of spending priorities; a plan of action; and a legal instrument. Since the amounts appropriated by the legislature represent legal limitations on spending for particular programs, activities, or objects, the budget is perhaps the most fundamental internal control in government.

**B. Funds**

There is a tendency in government toward the compartmentalization of activity, even beyond that which is reflected in the appropriation acts. This further compartmentalization takes two forms, separate funds and separate organizations. Funds represent another form of internal control, intended to make certain that moneys obtained for a specific purpose are used for that purpose and none other. They are separate fiscal and accounting entities, often established by law. Thus, a special revenue fund may be created by a state legislature to finance highway repairs by earmarking a specific revenue source, such as gasoline taxes. A turnpike authority (an enterprise fund) may be created as a separate legal entity to issue bonds to finance construction of a road, the tolls from which are used to operate and maintain the road and redeem the debt.

From the accountant's perspective, systems must be developed to assure compliance with the finance-related legal limitations caused by the appropriation acts and the creation of funds. Further, financial reports need to be prepared to demonstrate compliance with these limitations. So pervasive is the budgetary influence that the budgeted revenue estimates and appropriation limitations are actually incorporated into the general and subsidiary books of account. And so deeply ingrained is the principle of demonstrating compliance with legal limitations that, as late as 1968 (when the National Council on Governmental Accounting restated the principles originally developed in 1934), a prime financial reporting principle was that: where conflicts arise between legal provisions and GAAP, legal provisions must take precedence. It was not until 1974 that the principle was changed to require reporting in accordance with GAAP, with separate schedules prepared to demonstrate compliance with the law when the two are not in accord. Even then, as we shall soon see, budgetary concepts and fund orientation continue to dominate the scene.

**The lack of the profit motive**

An economic system based upon the profit motive has logically fed to the development of a commercial accounting and financial reporting model that measures net profit. Commercial accounting theory is based upon a matching relationship between revenues and expenses, wherein the sale of a product or service gives rise to the recognition of costs related to the sale. Accrual accounting, using accrual, deferral, and amortization techniques, facilitates the determination of cost.
But state and local governments are not in business to make profit. Their fiscal objective is to break even; to marshal! and balance the resources derived from taxes and other sources against the costs of providing a particular level of services. Governmental managers, whether they be mayors or department heads, do not get high marks for achieving "large" surpluses, because "large" surpluses imply "excessive" taxation, "unneeded" federal support, or the failure to provide the level of services that might have been provided if all the available appropriations had been spent. The foregoing comment should not be construed to mean a lack of concern for operating efficiently; it simply means that, when state constitutions and city charters require balanced budgets, when taxes are assessed at a level related to the estimated expenditures, when the political outlook is to the short run, when numerous institutions compete for scarce government funds, a year-end result that shows anything other than a "small" surplus is likely to be greeted in a negative manner by the citizenry and the politicians alike.

Furthermore, the revenue-expense matching relationship that plays such an important role in commercial accounting theory does not exist in general purpose governments like states and cities. In the first place, general-purpose governments marshal! resources from a variety of sources to provide services unrelated to the specific revenues used to pay for the services. Secondly, it is highly unlikely that those who provide governmental resources (i.e., individual taxpayers) provide them in the same proportion as the value of the services they consume. In short, there are no sales to drive the recognition of related costs in general-purpose governments. (Such a relationship does exist, however, in many special-purpose governmental units, such as those which provide electric and water.)

These environmental factors have attributed to the development of a governmental accounting and financial reporting model concerned not with the determination of net profit, but rather with the determination of financial resources currently available for spending. The amortization of fixed asset costs has no place in the model, since fixed assets represent sunk costs that are not available for spending. The effects of previous transactions and events are not recognized as revenues or expenditures unless they increase or decrease currently available spendable resources. It is, as we shall see, a model that asks for trouble.

**Summation of the Problem**

It is rather ironic that poor accounting and financial reporting practices should have played a role in the fiscal problems that beset New York City nearly a decade ago. It is ironic because, some 60 years earlier, a book financed by a former Comptroller of the City of New York, the Metz Fund *Handbook of Municipal Accounting*, represented the most advanced thinking in the country at that time concerning governmental accounting and financial reporting. In fact, there are many who argue that it is even more advanced than the current set of governmental accounting principles.

It is also ironic that, to help restore its fiscal credibility, New York City was required to adopt a set of accounting and financial reporting principles that, ten years later, should itself suffer from severe credibility problems. (As the person responsible for installing those accounting principles and preparing the City's financial reports in the aftermath of the fiscal crisis, I like to think that at least some of what we did represented an improvement over what we were required to do at the time.)

In any event, it is perhaps unfortunate that many of the principles enunciated in the Metz Fund *Handbook* did not become GAAP. At the same time, it is fortunate indeed that New York City has regained its fiscal credibility partly because it adopted the very principles that the Governmental Accounting Standards Board was created to change.

By way of illustrating the problems and exploring the potential solutions, I will discuss three of the issues currently on the agenda of the GASB. Before talking about the specifics, let me summarize briefly what I believe to be the basic causes of the problem.
1. The principles that are in place today are not materially different from what they were in 1934, when they were first adopted. Those who wrote the principles in 1934 were learned people and I have no doubt that they reflected the governmental environment and the conditions of the times.

2. Commercial accounting has benefited: from the oversight of an external organization (the Securities and Exchange Commission) and from the heavy input of standard-setting bodies (such as the Accounting Principles Board and the Financial Accounting Standards Board). Governmental accounting, on the other hand, has lacked the benefit of external oversight and, until the creation of the GASB, has received only sporadic or part-time standard-setting attention.

3. Traditionally, governmental external financial reporting has been based primarily upon the internal needs of governmental managers for demonstrating compliance with finance-related legal provisions. It has as not adequately reflected the needs of external users of governmental financial statements; nor have the internal systems adequately met the managerial needs of the governmental managers. Only in recent years, when investors in municipal bonds were chilled by the fiscal crises experienced in New York City and elsewhere, have the needs of external users become of concern.

Let us look now at three specific issues currently on the agenda of the GASB: (1) measurement focus and basis of accounting for governmental type funds; (2) fixed asset and infrastructure accounting and reporting; and (3) the financial reporting model. The opinions I express are my own. I trust you will understand that they are preliminary views based upon my observation as a former preparer of governmental financial statements and the early GASB research. A standard-setting organization functions by due process, whereby those affected by the standards have an opportunity to express their views, and I have no doubt that some of my opinions will be modified both by due process and by debate with my colleagues before standards concerning these issues are adopted by the GASB.

**Measurement Focus and Basis of Accounting -- Governmental Funds**

There are two basic categories of funds in the government accounting model, the governmental funds and the proprietary funds. The proprietary funds, which account for governmental business-type activities such as utilities, toll roads, and hospitals, derive most of their revenues from user charges, tend to be concerned with measuring net income, and follow the commercial accounting model. They are distinguished from the governmental funds, which include the general fund, the special revenue funds, the debt service funds, and the capital projects funds. The governmental funds are essentially segregation of financial resources (note the emphasis on the term financial), operate generally through legally-adopted budgets, and are often thought of as "expendable" type funds.

For background on the theory underlying the measurement focus/basis of accounting of the governmental funds, it is useful to turn to the 1951 Morey and Hackett text, *Fundamentals of Governmental Accounting*. Morey was a prolific writer of the 1920s and 1930s on governmental accounting and one of the fathers of governmental accounting as we know it today. Morey cites the accrual principle adopted by the National Committee on Municipal Accounting, whose name was subsequently changed to the National Council on Governmental Accounting (NCGA): "The use of the accrual basis in accounting for revenues and expenditures is recommended so far as practical. Revenues partially offset by provisions for estimated losses, should be taken into consideration when earned, even though not received in cash. Expenditures should be recorded as soon as liabilities are incurred."

The principle certainly sounds reasonable enough. It is when Morey explains the term "so far as practical" and ties it into some of the other principles, that our troubles begin. Morey cites the accrual principle adopted by the National Committee on Municipal Accounting, whose name was subsequently changed to the National Council on Governmental Accounting (NCGA): "The use of the accrual basis in accounting for revenues and expenditures is recommended so far as practical. Revenues partially offset by provisions for estimated losses, should be taken into consideration when earned, even though not received in cash. Expenditures should be recorded as soon as liabilities are incurred."
Earlier, Morey had indicated that for expendable funds, such as those arising from taxes and other revenues, the accounts should be set up to indicate the amount available for further appropriation and expenditure. Fixed assets have no impact on the amount available for spending since they represent expenditures already made, and long-term liabilities have no impact because they are payable out of revenues to be raised in the future. In discussing accrual accounting, Morey adds that only those amounts should be considered revenue that are reasonably certain of realization within the fiscal period under consideration or soon thereafter. On the expenditure side, he says that accrued items, not yet payable, need not be set up except where profit and loss determination is necessary. Accrued interest, not yet due, on obligations owed is treated as an expenditure of the succeeding period.

These little deviations from accrual accounting may not have mattered when life was simple in the 1920s, 1930s, and even in the early 1950s. But the leaky theory could not cope with the changes experienced by our society in the past 20 years. Pensions and other post employment benefits took on an increasing proportion of the labor dollar. Judgments and claim settlements became one of the fastest rising governmental expenditures during the late 1970s as we developed into an increasingly litigious society. And new financing forms, such as the zero-coupon bond, hit the public credit markets. All had one thing in common: they represented events and transactions of a particular accounting period whose cash effect either did not occur until many periods later or whose cash effect could be postponed by management decision. Zero-coupon bonds and personal and property damage claims are examples of the former; pension funding is an example of the latter.

Subsequent restatements and elaboration by the NCGA on the principles developed in the 1930s did not fundamentally change the principles. They changed the words, but the thoughts remained the same. The term "modified accrual" was used to describe the wanderings away from accrual accounting cited by Morey. It was said that the primary purpose of governmental fund accounting was to measure the "net financial resources available for expenditure."

- Property taxes applicable to a particular tax year are accrued to that year only if collected in that year or within 60 days thereafter; and most other revenues are recognized on the cash basis.
- Pensions related to the salaries of a particular accounting period are not charged to that period, unless the government has made an appropriation for that purpose.
- Interest on zero-coupon bonds is not recognized as an expenditure until the bonds are paid off.

In short, accrual accounting for governmental type funds has taken on an Alice in Wonderland quality. Under the "modified accrual" theory, a revenue is not a revenue unless it is "available for expenditure." And an expenditure is not an expenditure unless it is "payable out of available expendable resources." I doubt whether even Manny Saxe could justify the circularity of the theory. And surely Max Zimering would have had a field day with it.

And so, the Governmental Accounting Standards Board has begun the long procedure known as due process in an attempt to develop a rational standard. A discussion memorandum (DM) has been issued, which seeks comment on the threshold issue: the measurement focus of governmental type funds. It also seeks comment on the basis of accounting for specific items of revenue and expenditure. The DM suggests that there are at least three potential measurement focuses, each of which carry specific basis of accounting implications:

- Flow of economic resources, which is essentially the commercial accounting model, applying accrual accounting through the techniques of accrual, deferral and amortization.
- Flow of total financial resources, which carries with it the accrual technique of accrual accounting, but does not provide for the amortization of fixed assets, since fixed assets are not financial resources.
- Flow of current financial resources, which is basically the current model, except that the term
"current" would be applied consistently; e.g., one year.

I lean toward the model which measures the flow of total financial resources. I do so because I think it is vital that governmental financial statements present a meaningful bottom line. While we do not need to measure net profit, users of governmental financial statements need to know whether the obligations incurred during the year exceed or do not exceed the financial resources acquired during the year. Although the nature of governmental operations does not enable the matching of governmental "sales" with "costs of sales," we can match all the revenues earned in a time period with all the expenditures incurred during a time period. We cannot have a bottom line that causes governments to appear better off simply because it hasn't made an appropriation for pensions or hasn't recorded as an expenditure the increment in the liability related to zero-coupon bonds. As accountants, we cannot feel content to have recorded the increment in expenditures for the year in a column called "long-term debt group of accounts" without having run the causes of those increments through the operating statements. In short, it is time for governmental accounting to embrace fully the accrual technique of accrual accounting.

At the same time, I'm not ready to suggest the need for recording depreciation on fixed assets in the accounts of the governmental funds, partly because I do not think it is appropriate to the governmental environment and partly because I have very serious doubts concerning the present state of the art of depreciation and maintenance accounting. I have not yet figured out, for example, what purpose would be served by amortizing the historical cost of East River crossings. This leads me to a discussion of another subject on the GASB agenda, fixed asset and infrastructure accounting.

Fixed Asset Accounting and Reporting

Fixed asset accounting and reporting is probably the most neglected aspect of governmental accounting and reporting. Not only in theory, but in practice as well. The theory is lacking in that the most important element of fixed assets, the infrastructure, is not required to be reported at all. The weakness in practice is demonstrated by recent analyses of governmental financial reporting, which show that the major reason for auditor qualification to governmental financial reports relates to fixed asset reporting. An understanding of the causes of the problem is useful to the development of solutions.

- As I indicated previously, the amortization of fixed asset costs has no role in the governmental fund accounting model, since fixed assets are not financial assets available for spending. Since the fathers of governmental accounting were concerned with the stewardship aspect of fixed assets, they did provide for record-keeping concerning fixed assets, but the record-keeping was tucked away in a memorandum set of accounts, referred to as the fixed asset group of accounts. Because fixed asset accounting was placed outside of the mainstream of governmental accounting, the potential for neglect was clearly present.
- I think there is a direct relationship between the perceived value of fixed asset accounting records, the cost of maintaining the records, and the desire to maintain them. In government, there is no need to maintain fixed asset records to facilitate depreciation calculations for tax write off purposes. And until the advent of computers, fixed asset record keeping was difficult and expensive. In such an atmosphere, practice was likely to deteriorate.
- And deteriorate it did. As early as 1956, the Mikesell text noted that: "Notwithstanding untold billions of dollars of public money already invested in permanent property, with hundreds of millions added annually, accounting for fixed assets is a seriously neglected aspect of governmental accounting."
- Instead of repairing the practices, the profession responded by lowering the standards. This occurred in 1974, when the AICPA published its industry audit guide, Audits of State and Local Governmental Units. Noting that the primary purpose for recording fixed assets is that of stewardship and that infrastructure fixed assets normally "are innovation able and of value only to the governmental unit," the audit guide declared the recording of the infrastructure assets to be "optional." The NCGA followed suit when it published NCGA Statement 1 in 1979.
Concern with fixed assets wasn't always at such a low level. In 1914 the Metz Fund Handbook had urged that "an annual charge to expenses should be made for depreciation, and provision for this charge should be included in the budget of expenses," so that there would be "a fund sufficient to replace the property at cost." And Francis Oakey, whose 1921 text Principles of Government Accounting and Reporting had a major influence on the development of the standards, was basically opposed to the recording of fixed assets, but he understood the real issue. He claimed that the valuation of fixed assets whether it be at cost or replacement value, "has little significance as a measure of the city's resources in the form of property, since it indicates nothing as to the value of the property to the community, namely, capacity for service." Oakey would have preferred "an estimate of the financial burden to be assumed in order to supply the needed capacity."

Furthermore, even though fixed asset accounting was confined to memorandum records, early writers like Morey embraced infrastructure assets within the scheme of record-keeping. Infrastructure assets are far more significant than the other fixed assets like buildings and vehicles. They are often the things that you don't notice and that, as citizens, you take for granted unless something goes wrong: the roads, the bridges, the water mains, the sewer pipes, the street lighting systems. They tend to be immovable (although certain water mains in New York City and bridges in Connecticut have a bad habit of moving when they are not supposed to) and of value only to the general citizenry.

And so here we are in 1985 with a nationwide infrastructure crisis so serious that the U.S. Congress passed Public Law 98-501 in 1984 "to establish a National Council on Public Works Improvement to prepare three annual reports on the state of the Nation's infrastructure." And yet we have an accounting standard for state and local government that has no requirement for the recording of infrastructure assets and no concern for its deterioration. It is particularly fascinating to ponder the influence of the lack of infrastructure reporting on public finance policy: Would more effective fixed asset reporting influence the tax policies of state government? Would a report on the state of the Nation's infrastructure influence the Federal government's attitude toward the recently reported state government "surpluses?" We might also ponder the impact of knowledge concerning deferred maintenance on the audit opinion: Would information concerning a large accumulation of deferred maintenance cause a "going-concern" qualification?

The GASB has established a project on fixed asset/infrastructure reporting. I do not believe that we will accomplish very much if we try to resolve the issues by falling back on traditional commercial accounting thinking. The solution, it seems to me, lies in taking a broad financial management and engineering approach; to add to our traditional concerns for stewardship and accountability, a concern for capital planning, capital maintenance, and, as Oakey put it, capacity for service. As a former preparer of governmental financial statements, I must confess that I had little concern for fixed asset reporting until I realized how improved fixed asset reporting could influence capital planning.

Prof. Robert Mautz provided an interesting perspective in a recent article when he suggested that governmental fixed assets are more like liabilities than assets. They don't facilitate the production of goods leading to the generation of revenue; but they do need to be maintained, often at very great cost. A road has utility only so long as the potholes are repaired; a subway system has utility only so long as the doors on the trains and the signal system on the way are working. Governmental fixed assets, I believe, can be conceived of as embodiments of service capacity, having utility over a period of time in relation to their life cycle cost, including the cost of repair and replacement necessary to keep the asset functional.

I visualize the development of new standards for fixed asset accounting and financial reporting within the following framework:

- A requirement for the reporting of all fixed assets, including infrastructure assets.
- Clear reporting of all fixed asset expenditures, either by requiring all such expenditures to flow through the capital projects fund or by appropriate reporting categorization.
Tie-in of the records maintained by the fiscal officer with the records maintained by departmental planning and maintenance managers

- Reporting of fixed assets at both historical cost and replacement cost.
- Development of means for estimating and reporting deferred maintenance and service capacity needs.
- Development of means for reporting planned expenditures against deferred maintenance and planned expenditures to meet unfilled service capacity.
- Development of means for comparing actual capital expenditures in a particular year with asset deterioration in a year, based upon current cost.

I believe this will be an extremely difficult undertaking but if it can be accomplished, it will provide useful data for measuring fixed asset deterioration and needs.

**Financial Reporting**

There has been some progress in financial reporting standards for state and local government since I took Accounting 245 at Baruch more than 35 years ago. And yet, I think it is fair to say that today's governmental financial reports remain a puzzlement to all but the most sophisticated financial analysts. Taken as a whole, the comprehensive annual financial reports issued by state and local governments provide a wealth of information for the knowledgeable user, but they are not readily understood by the uninitiated. How can one cope with a set of financial statements where the balance sheet has eleven columns, where there are three sets of operating statements, and where the label "memorandum only" precedes the total columns?

I would summarize the major financial reporting issues with the following questions:

- What are the objectives of governmental financial reports? To whom and how should they be oriented?
- How and to what extent should the data contained in the financial reports be aggregated?
- What is the most appropriate means for presenting the financial condition and results of operations of the governmental entity as a whole including the separately operated activities?
- In the absence of the "net profit" figure, should the financial report provide surrogate types of data to measure efficiency and effectiveness?

Since the first set of standards was promulgated more than 50 years ago, governmental financial reports have been presented primarily from the perspective of internal government users, the very people who have access to whatever information they need. With the emphasis on funds and fund types, governmental statements have a stewardship, legal compliance orientation. The Chatters and Morey texts speak vaguely of preparing financial reports for the "public," but very little has been done to identify the financial reporting implications of meeting the "public" needs.

Two "user needs" studies are now under way. One is a joint study by the U.S. Comptroller General and the Canadian Auditor General with regard to federal government reporting; the other is being made by the Governmental Accounting Standards Board concerning state and local government financial reporting. The GASB study identifies three major user groups: investors/creditors (including bond rating agencies and insurers), citizen groups/taxpayers (including public finance researchers and media), and governmental oversight bodies. Tentative hypotheses have been established on the basis of face-to-face interviews with representatives of each group and a questionnaire has been sent to a large number of persons and organizations within each group. The GASB anticipates that this research will result in the preparation of a set of financial reporting objectives for state and local governments. I expect that the research will also influence the standards adopted by the GASB.

Before the GASB can come to grips with the other financial reporting issues, I believe it must first resolve the entity issue. The entity issue stems from the compartmentalization aspect of the
governmental environment that I mentioned earlier: that is, in addition to general-purpose governmental units such as states and cities, there are numerous special-purpose governmental units such as universities, hospitals, toll roads, transit systems, and park districts. There are two elements to the entity issue, the definitional aspects and the display aspects. Before it went out of business, the NCGA took a major leap forward by defining the reporting entity. The entity was defined primarily within the context of oversight; that is, a special-purpose governmental unit is a component of a general-purpose governmental entity if the general-purpose entity exercises oversight as manifested by such factors as financial interdependence, budgetary approval, and appointment of management. Some problems still exist with regard to the definition, but I believe it is basically sound.

The real problem lies in financial statement display. The NCGA concluded that: all components falling within the entity definition had to be displayed in the financial statements; component unit financial data had to be aggregated or "blended" by fund type with the financial data of the oversight entity; and discrete presentation of component unit financial data in the financial statements of the oversight entity had to be kept to a minimum. Unfortunately, the NCGA reached this conclusion without first setting forth the objectives to be achieved by this type of aggregation.

Not all special-purpose governmental units are alike. Some are highly dependent upon the oversight entity for financial assistance; others are completely independent, with the ability to levy user charges in amounts sufficient to cover their operating needs. The net revenues of some components are passed on to the oversight entity; in other instances, the oversight entity has no access whatsoever to the net revenues of the component. Debt relationships between the oversight entity and the components run the gamut from guaranty to moral obligation to no obligation. The legal and administrative relationships between the components and the oversight entities can be extremely complex, as anyone who has studied the New York City Transit Authority, the Port Authority of New York and New Jersey, and the Municipal Assistance Corporation knows.

In order to "present fairly" the financial position and results of operations of the oversight entity, I believe that emphasis must be placed not on the administrative relationships between the oversight entity and its components, but rather on the financial relationships. I believe that close analysis on the financial relationships (with emphasis on substance rather than form) will lead to a conclusion that the financial data of some components should be incorporated directly into the data of the oversight entity; some should be aggregated with the oversight entity but by means of an additional column so as to clearly distinguish the financial data of the oversight entity from that of its components; and others should be disclosed only in the notes.

Completion of the user needs study and resolution of the entity issue will, I believe, help in resolving the broader issues of aggregation and display. To what extent should the financial data of the various fund types be combined or consolidated? How can display be improved? I suggest the following set of broad principles:

- In the governmental environment, where there are legal restrictions on the use of funds, there is value in both aggregated and dis-aggregated data; both sets of data belong in the basic financial statements.
- The governmental funds that account for the results of the day-to-day operations of government should be presented on a consolidated basis, with activities financed by taxes and other general revenues segregated from those that are financed by user charges; this financial statement should be followed immediately by data presented on a disaggregated basis.
- A supplementary operating statement should be prepared in matrix form, showing expenditures by function and sources of revenues (e.g., federal grants, state grants, taxes, and user charges) for each category of expenditure.
- Balance sheets and operating statements should not be cluttered with columns containing fiduciary and other funds that have no bearing on the financial position and operations of the government itself; thus, the net pension liability should be reported, but not the pension trust
fund, whose assets are inaccessible to the government.

I am a strong believer in the need for disclosing data that will help taxpayers, researchers, and governmental officials evaluate the relative efficiency and effectiveness of governments. Absent the "net profit" line, we need to develop surrogate means of reporting on efficiency and effectiveness. I have in mind such data as cost per ton of garbage collected, number of employees per 10,000 of population for various functions of government, ratios of administrative personnel to teaching personnel in elementary and secondary schools, etc. It will be extremely difficult to develop objective measures of efficiency and uniform reporting among governments. But I believe the data is vital both to public administration and to public accountability.

When I went to Baruch College it was known as the School of Business and Civic Administration. I have spend the great bulk of my working life as an accountant and as a civic administrator. Therefore, when I think about government accounting, I tend to think not only as an accountant, but also as a civic administrator. I believe that there is much to be done in the field of governmental accounting. But it cannot be accomplished solely by applying traditional commercial accounting theories, because the governmental environment differs from the commercial environment.

I spoke earlier of the need for demonstrating compliance with finance related legal requirements. But I believe the need for demonstrating public accountability goes beyond that; and there is less room for debating disclosures by government than there is by private enterprise. If Accounting 245 is to be updated, it must be done by applying the best of our accounting discipline within the context of modern Civic Administration.

REFERENCES


