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DISCUSSION MEMORANDUM

FEDERAL
FINANCIAL
MANAGEMENT
ISSUES & SOLUTIONS

Prepared by the Task Force on
Improving Federal Financial Management

American Institute of Certified Public Accountants
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Preface

Sound fiscal policy and accountability consists of: a balanced budget, an effective and informative budget process and format, and good financial management. How to balance the federal budget and the reordering of national priorities to control and even reduce the unprecedented deficits that have plagued America throughout the 1980s, and how to restructure the budget and streamline the budget process are not addressed in this Discussion Memorandum. The AICPA believes that those are issues that can only be resolved by the President in cooperation with Congress.

However, the AICPA does believe that the President and Congress do need timely and reliable accounting data and accurate reporting and financial statements that can be used in the decision-making process. No less a source than the U.S. Constitution proclaims that citizens are entitled to such an accounting of the federal stewardship, particularly with respect to the overview of information about the government — the budget, deficits, revenues, and expenditure accounting.

Unfortunately, the federal government has never fully adopted and used generally accepted accounting and reporting standards. Meaningful annual department and governmentwide financial statements are not issued, and no independent audits of information published by departments or used by the President and Congress have ever been required. Further, there is no federal executive — a chief financial officer — who is responsible for changing and improving this unacceptable and high-risk condition of financial management that has persisted in the federal government for decades.

The AICPA established the Task Force on Improving Federal Financial Management to assist the federal government in identifying ways to improve how it provides information and data to its citizens about its financial conditions and the results of operations in a complete, consistent, reliable, useful, and timely manner. The following are the task force’s recommendations:

- Establish a single, independent chief financial officer of the United States, and charge that person with the responsibility for executing the constitutional mandate for reporting annually the fiscal and financial management of the government. Hire com-
petent controllers for each department and agency and charge them with responsibility for the financial management of their respective organizations.

- Establish a uniform system of financial accounting and reporting practices and procedures that will be used consistently throughout the federal government.

- Issue annual financial statements at the departmental level and governmentwide in a complete, consistent, reliable, and timely manner.

- Establish a requirement for annual independent audits of the financial statements governmentwide and for each department and agency.

Implementation of all of these recommendations is essential to achieving the needed improvements in federal financial management. The AICPA recommends legislative and administrative changes that will provide complete, consistent, reliable, useful, and timely financial information that clearly reflects the unique operations of the federal government and its financial condition on a regular basis. Reliable financial data will assist Congress and the President in their efforts to reduce the annual budget deficit and the national debt. The American taxpayer deserves no less.

The four issues and solutions presented in this document were developed by the Task Force on Improving Federal Financial Management and will be discussed at a colloquium sponsored by the AICPA to be held at the National Press Club in Washington, D.C. on December 11, 1989. Participation at the colloquium will be by invitation only and will include representatives of Congress, the Administration, the news media, and other interested parties. Comments on the issues and solutions presented in this discussion memorandum are welcome and should be addressed to Stuart L. Graff, Technical Manager, Federal Government Relations Division, American Institute of Certified Public Accountants, 1455 Pennsylvania Avenue, NW, Suite 400, Washington, D.C. 20004-1007 by November 30, 1989.
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The task force wishes to acknowledge with appreciation the contributions of Robert C. Hacking in the preparation of this discussion memorandum. The task force also thanks the many other individuals too numerous to identify who contributed to its work and helped develop the recommendations presented herein.
CHAPTER I

A System in Need of Reform

No money shall be drawn from the Treasury, but in consequence of appropriations made by law; and a regular statement and account of all public money shall be published from time to time.

The United States Constitution
Article 1, Section 9, Clause 7.

An Historical Perspective of Federal Financial Management

Our founding fathers' intention in the clause cited from the U.S. Constitution could not have been clearer: citizens are entitled to a comprehensive accounting of how the government spends their monies. Presumed in this Constitutional directive is that financial statements prepared and published should be timely, meaningful, and on the same basis of accounting as those of prior years.

For more than two hundred years, Congress has passed laws concerning how federal finances are to be managed and has periodically assessed and defined what it considers to be appropriate accounting and reporting practices and procedures. The most significant results of these deliberations generally is believed to be the Budget and Accounting Act of 1921, amended and extended by the Budget and Accounting Procedures Act of 1950. Although these and other laws have established important parameters, they have failed to assign to one body responsibility for accounting, financial systems, and implementation of sound fiscal and management controls, choosing instead to spread the responsibility among several central agencies and leave the implementation tasks to the discretion of the numerous federal departments and agencies.
Little wonder that for the past fifty years myriad congressional committees, independent commissions, Comptrollers General, and, more recently, Inspectors General have described a litany of deficiencies in the government's financial management practices. Numerous reports painstakingly document the inefficient and antiquated accounting and management information systems and the scarcity of reliable financial information about major weapons systems and significant assets, inadequate disclosures of costs and liabilities, and inability to consider the relative benefits of capital investments.

Throughout the 1980s, some measures were taken to address these deficiencies. Congress provided legislation to address weak internal accounting, administrative, and systems controls. Efforts of the Comptroller General, the Office of Management and Budget (OMB), and the U.S. Treasury Department (the "Treasury") produced changes and improvements in financial management practices and in the way the federal government conducts its business. However, most of these changes are dependent upon the priority the government officials give them — an inconsistent proposition at best.

1987 — The Financial Credibility Crisis Unfolds

Plagued by one financial adversity after another, 1987 brought the need for improved federal financial management to a head. The year opened with citizens trying to decide how to reorganize their business and personal lives to comply with the new tax legislation and ended in stock market uncertainty. Throughout the year, Congress and the executive branch were at odds over how to contain an increasing budget deficit.

Hoping to avert further erosion, efforts were made in both houses of Congress to correct the inadequacies of the present financial management structure. Senators John Glenn, William V. Roth, Jr., Lawton Chiles, Daniel Evans, and William Proxmire determined that the financial management systems of the federal government were obsolete and inefficient and provided incomplete, inconsistent, unreliable, and untimely information. Their recommendations for change were included in S. 1529, The Federal Financial Management Reform Act, introduced in July 1987. At the same time, fifty-six
members of the U.S. House of Representatives sponsored an even more ambitious bill, H.R. 3142. H.R. 3142 called for a chief financial officer of the United States, with a ten-year term; required an annual report on the government's consolidated financial position; and mandated that the federal government use the accrual method of accounting.

At fiscal year-end, the federal government published a budget deficit of $148 billion — a number immediately challenged by various groups as being too low by billions. Some maintained that the current policy of using the surpluses of the Social Security and other trust funds to reduce the budget deficit hides the growing problem and the true size of the deficit. To account for the higher estimates, the challengers also cited "cooperative accounting," a practice which counts certain cash receipts as federal revenues and delays, or rolls over, federal expenditures from one fiscal year to the next. Two examples of this questionable accounting and reporting detailed by the media, as well as by the General Accounting Office (GAO), included the treatment of cash withheld from federal employees' paychecks as federal receipts and the delaying and rolling over of 1987 federal expenditures into fiscal year 1988. The adoption of convenient accounting and reporting practices for federal receipts and expenditures has continued into fiscal years 1988 and 1989 and appears to be a basis for the 1990 reporting as well.

The AICPA Responds to the Crisis

In November 1987, the AICPA's board of directors concluded that continued use of the current federal financial management practices would further undermine the government's ability to provide credible and reliable financial data. The Task Force on Improving Federal Financial Management was established to identify causes and cures for the financial management crisis. In a letter to the President, members of Congress, the heads of departments and agencies, and presidential candidates, the AICPA leadership urged that a joint effort be made to reform financial management in the federal government.

The AICPA believes that the federal government's existing financial management practices must be improved. Their continuation will further undermine the credibility of governmental data used to discuss and define the true magnitude of the federal government's
financial problems. The time has come for Congress to pass the legislation that meets both the letter and intent of the Constitution with respect to accounting for and reporting of federal government activities.

**AICPA Recommendations**

The work of the AICPA Task Force on Improving Federal Financial Management led to the conclusion that the fiscal financial credibility crisis is, in part, related to four major financial management inadequacies. Consequently, Congress, the President, and the American people would know the true financial condition of the federal government and have a better basis for future social and economic policy decisions if the following inadequacies were corrected.

1. There is no single chief financial officer (CFO) charged with and held responsible for the fiscal and financial affairs of the country. The government needs a full-time CFO for the entire government and controller in each department and agency to organize and execute financial management responsibilities.

2. The current accounting and reporting practices and procedures may not be appropriate to the unique circumstances of the federal government and are not being applied consistently governmentwide or within individual departments and agencies. The government needs to adhere to consistent accounting and reporting criteria across its many departments and agencies.

3. The financial statements are not comparable governmentwide, or within individual departments and agencies. The government needs to annually prepare and publish complete, consistent, and reliable financial statements of its financial position and results of operations.

4. The federal government does not require annual independent audits of its financial statements, although it has legislatively imposed this requirement on many state and local governments, publicly owned companies, and others. The federal government’s financial statements need to be independently audited annually.

4 • FEDERAL FINANCIAL MANAGEMENT—ISSUES AND SOLUTIONS
The following recommendations will go a long way towards reme-
dying the financial management inadequacies in our present system,
which is in need of reform. Each recommendation will also be pre-
sented in greater depth in a subsequent chapter of this publication.

In making its strong reform appeal, the AICPA supports the efforts
of those in the federal government who are working for improved
financial practices, acknowledging that they cannot accomplish what
needs to be done singlehandedly. Additional legislation, commit-
ment, and adequate funding is needed to restructure current financial
practices and procedures so that the federal government can be run
like the trillion-dollar-a-year business that it is.

A Chief Financial Officer

The AICPA believes that legislation is required to make a single
office or person responsible for the federal government’s accounting
and financial reporting.

Surprising as it may seem, no one individual has the overall
responsibility for recording, monitoring, and reporting the financial
operations of the federal government. The absence of such an official
with governmentwide responsibility is a primary reason why the
federal government has never implemented consistent accounting
standards, uniform reporting, and adequate financial systems and
controls.

Since 1983, a concerted movement has taken place — within and
outside of government — to call for the establishment of a CFO and
to position that office in the executive branch. Hearing the plea, the
OMB responded. In July 1987, the position of CFO for the federal
government was established administratively by the Director of the
OMB. The title and responsibilities of CFO were added to those
already assigned to the OMB’s associate director for management.
The OMB expected its CFO to provide the needed central direction
and guidance for establishing an improved governmentwide financial
management organization and in carrying out the improvement
program.

Chapter II discusses the need for building upon this financial man-
agement initiative, by describing the contributions a CFO could
make to significantly enhance federal financial management and the
need to establish legislatively a governmentwide CFO and department controllers. It also presents the essential characteristics of the office.

An Improved Set of Accounting Standards

The AICPA believes that an improved accounting standard-setting and reporting process is urgently required.

In 1921, the Budget and Accounting Act created the Comptroller General’s office and delegated to it the responsibility for prescribing accounting standards for executive departments. The Budget and Accounting Procedures Act of 1950 expanded these responsibilities to include all executive departments and agencies.

The 1950 Act created a climate for confusion and noncompliance by giving the executive departments the responsibility for establishing and maintaining systems of accounts that conform to GAO standards and integrating those systems with the OMB’s budgetary accounting requirements and the Treasury’s reporting requirements. Although the GAO, headed by the Comptroller General, has prescribed accounting principles and standards, the Treasury, the OMB, and individual departments and agencies have disagreed with the GAO over the need for or applicability of a number of the GAO’s accounting principles and standards. Inadequate due process and irrelevance of some standards are also cited as reasons for noncompliance. The parties affected by the standards felt that the process by which standards were established did not provide for the free and open debate that was necessary for consensus. Some of the prescribed standards are perceived to be irrelevant to the unique objectives and environment nature of the federal government. Noncompliance has resulted. Further, because independent financial statement audits are not required for the federal government, failure to adhere to established standards is not routinely reported by independent auditors. Such reporting would provide the added incentive for management to follow the established standards in the preparation of financial statements.

Chapter III sets forth the criteria for standard setting and the recommendation that a commission be established to recommend how accounting standards should be set in the federal government.
Consistent and Reliable Financial Statements

The AICPA believes that all citizens are entitled to a comprehensive, understandable, and consistent reporting of the federal government’s financial position and operations.

When prepared pursuant to uniform and consistently applied principles and standards, financial statements — a balance sheet, statement of operations and of cash flows — disclose such things as what the government’s liabilities are, what assets are available to it, and its revenues, expenditures, and the source and uses of cash. Further, preparation of such financial statements requires the underlying systems to be functioning as designed. Without such financial statements, questionable financial management practices flourish, reporting inconsistencies abound, and instances of unreliable financial data proliferate. The federal government expects entities with which it does business to prepare financial statements on a regular basis — an integral and important element of sound financial management.

Likewise, for many years, the GAO has recommended, quite appropriately, the preparation of financial statements by federal departments and agencies. Unfortunately, these recommendations have not been implemented. In many departments, the financial systems necessary to produce such statements have not been developed. For varying reasons, and on more than one occasion, the Treasury and the OMB have opposed the GAO in implementing this requirement. Rather than seek the solutions required to create the desired financial statements, congressional hearings have tended to dwell on problems and impediments preventing compliance. Although it has been about thirteen years since the Treasury initially began publishing comprehensive financial statements for the federal government, it still labels those statements as a “prototype” and annually highlights basically the same litany of accounting and reporting problems — many of which have not been resolved by either Congress or the executive branch.

The task is not impossible. In 1987 and 1988, some departments prepared and published comprehensive financial statements covering their total operations. These initiatives are a tribute to both the persuasive ability of the Comptroller General and the personal and professional interest some government officials have in the value of
publishing better financial data. Unfortunately, some federal agencies still do not see the need for comprehensive departmental financial statements.

Yet the need continues. Current financial reports focus on congressional appropriations, budget results, cash receipts, and cash disbursements. The basis of accounting in the federal government is inadequate and does not fully disclose the financial position or operating results of individual departments and agencies or of the federal government as a whole. Mandatory, across-the-board, annual disclosures of financial and operating data must occur. These requirements must be legislated and implemented through executive orders, OMB policy statements, Treasury Department pronouncements, and Comptroller General issuances.

Chapter IV details these serious voids and presents some of the benefits of annual financial reporting. Public accountability is the responsibility of all government officials.

**Independent Audits**

The AICPA believes a program of annual independent financial audits is a critical link to improving financial management in the federal government.

To increase the reliability and credibility of its financial reporting, the federal government must impose upon itself a requirement for an annual independent audit of its financial statements. The results of these audits must be made known to Congress, the President, the government's CFO, department and agency heads, and the public.

Until there is an annual financial audit, questions will continue to arise concerning the credibility of financial reports to the public. Audits will provide reasonable assurance to the recipients of federal financial statements that —

1. Transactions and accounts that should have been recorded are reflected in the financial statements.
2. Receivables and other assets of the government are appropriately valued and reported at the balance sheet date.
3. Liabilities and expenditures of the government are reported in the appropriate period.
4. Contingent liabilities and other relevant information are appropriately classified, described, and disclosed.

5. The required accounting and reporting principles and standards have been consistently applied.

Further, users of the audited financial statements will be informed of any material changes in accounting practices and procedures. At present, federal budget accounting and reporting practices often appear to change to meet specific OMB or congressional fiscal or financial circumstances. The reader often is unaware of the nature of the changes that were made.

Just as Congress frequently requires financial statements from the entities with which the federal government does business, it also imposes an annual independent financial audit requirement on many states, counties, cities, towns, special authorities, corporations, financial institutions, and not-for-profit organizations. The time has certainly come for the federal government to impose this annual independent financial audit requirement upon itself.

Chapter V describes the benefits that will accrue from a program of independent financial audits and why this activity should commence as soon as possible.

Implementation Plan

The most meritorious recommendations will accomplish nothing if not implemented. It is clear that to move forward in a meaningful way all of the elements of a federal financial management improvement plan must be mandated by legislation. Such a mandate would have many benefits. Most important of these is that the legislators are provided an opportunity to put their own thoughts into the provisions that become law. Other benefits include providing the CFO and all federal controllers with a written blueprint of their authority.

Chapter VI sets forth a plan for implementing the four recommendations, namely —

- Establishing a CFO for the federal government and a controller in each department and agency.
- Establishing a Presidential Commission to recommend how accounting standards should be set in the federal government.
• Issuing annual financial statements at the departmental level and governmentwide in a complete, consistent, reliable, and timely manner.

• Establishing a requirement for annual independent audits of the financial statements governmentwide and for each department and agency.
CHAPTER II

A Chief Financial Officer of the United States and Controllers for Each Department and Agency

*The important next step is to develop legislation that will define and provide statutory underpinning for a permanent Chief Financial Officer structure throughout Government.*

— Office of Management and Budget
President's Fiscal Year 1989
Management Report (p. 34)

*Consensus is growing that congressional action to legislate a CFO for the government would ensure continuity in and progress toward improving the government's financial management.*

— General Accounting Office
Financial Management, Progress of OMB’s Chief Financial Officer
(GAO/AFMD — 88-52, p. 3)

The statements introducing this chapter appeared over the last few years as suggestions for improving the federal government’s financial management. The need for such improvement was defined by the two organizations in the same reports.

*Once a leader in the early days of automation, the government’s financial systems and operations have eroded to the point that they do not meet generally accepted standards.*

— Office of Management and Budget
Management of the United States Government — Fiscal Year 1989 (p. 33)
Financial management systems, concepts, and practices by the federal government are weak, outdated, and inefficient.

— General Accounting Office
Financial Management — Progress of OMB’s Chief
Financial Officer (GAO/AFMD—88-52, p. 4)

From these statements and others by such organizations as the Association of Government Accountants; the National Association of State Auditors, Comptrollers, and Treasurers; and the Financial Executives Institute; it is clear that there is wide concern about the condition of federal financial management.

The Growing Concern Over Federal Financial Management

At present, there is a fragmentation of federal financial management roles among the various federal departments and agencies. Assistant secretaries have some responsibility for the financial planning and administration of their individual entities, but almost none perform a full range of financial management functions. Further, the average tenure of today's presidential appointees is less than two years. This high turnover not only undermines the stability necessary to build confidence in the reliability or credibility of financial data, it complicates installation of new accounting systems, which takes many years to complete. For that reason, most of these appointees never complete what they start.

Clearly, officials charged with federal financial management must have longer tenure in office. And the people in positions of responsibility should be held accountable for implementing sound accounting practices, uniform financial reporting, and for informing Congress, the White House, and the public when problems exist. A trillion-dollar-a-year business cannot afford to operate without competent, responsible, and accountable financial managers whose tenure is of sufficient length to ensure they can accomplish their tasks.

The concern for the quality of the government’s financial management operations is gaining momentum. The Joint Financial Management Improvement Program (JFMIP) has published a document describing the generic core requirements for agency financial sys-
tems, a uniform general ledger has been designed, and increased emphasis has been given to financial controls. Organizationally, there has been activity in three broad areas: a governmentwide CFO has been named; agency controllers have been designated; and bills regarding the organization of federal financial management have been introduced in Congress.

Establishing a Governmentwide CFO

Much is being written and said about the need for a chief financial officer at the federal level. Although improvements are being made, the AICPA suggests a series of recommended major changes — among them, a legislatively established CFO of the United States, augmented by controllers in all departments and agencies.

The OMB's creation of a CFO for the federal government in July 1987 was a milestone event. That this important responsibility was added to duties of the associate director for management is unfortunate. Both positions require full-time dedication. This is not to say that the person so designated has not done a good job. In June 1988, reporting on the progress of the OMB's CFO, the GAO stated that the process of establishing a central office and position dedicated to planning, implementing, and monitoring financial management reform efforts had begun. Although the GAO had not expected the CFO to resolve all of the government's serious financial management problems in the short time frame since his appointment, it believes that the position has enhanced the stature of these efforts and the likelihood of progress.

Although a commendable beginning, this OMB initiative is not a sufficient response to the deteriorated condition of financial management throughout the federal government. As an administratively established position, the CFO lacks formal congressional support. Because of other responsibilities, the appointed official could give only part-time attention to this critical task. Neither the OMB nor Congress provided additional staffing or significant additional financial resources to support this role. Even more unfortunate, with the new administration, the first appointed CFO has left government. His replacement has been named, but he too has other responsibilities. This administratively appointed CFO still lacks the necessary status
as an agency head to meet, deal, negotiate, and enforce needed changes with cabinet-level executives.

Fortunately, concurrence exists among some members of Congress, the GAO, the OMB, and others regarding the need for a chief financial officer. So, rather than focusing on the need, discussions now center around (1) where the office should be located and (2) the responsibilities of that office.

**Locating the CFO Organizationally**

A typical private-sector organization chart places the CFO directly under the chief executive officer or chief operating officer. This direct reporting relationship underscores the high priority financial matters are given organizationally.

By contrast, in the federal government, there does not appear to be a similar recognition of the CFO's significant management role. The federal government needs a single official position of CFO, charged with and held responsible for its overall fiscal and financial affairs.

There is consensus that the CFO must be located in the executive branch rather than in the legislative branch. Although potential organizational settings for the CFO of the United States include the Treasury and the OMB, we believe that a separate CFO office in the executive branch appears to be the most effective approach. It would send the appropriate message to the rest of the government and underscore the significance of the office. Actions of a separate office would be more likely to be viewed as having greater independence than those emanating from the Treasury or the OMB and, therefore, more acceptable to other agencies. Organizationally, an independent office would place the CFO on an equal level with the heads of these organizations and others in government and, therefore, give it the clout to get the job done.

**Controllers in Each Federal Department and Agency**

Individual federal departments and agencies are not small businesses; many are multibillion-dollar organizations whose accounting, reporting, controls, and financial management practices should
reflect a level of financial sophistication appropriate to their stewardship responsibilities. Just as there is a need for a CFO of the United States charged with and held responsible for the fiscal and financial affairs of the government, controllers are needed in the federal departments and agencies.

Accounting and financial management functions for department and agency controllers would include —

- Reporting to the CFO of the United States and department heads on the financial condition of the entity and other financial matters.
- Performing actual accounting functions, including evaluating compliance with externally imposed reporting requirements.
- Developing organizationwide and individual program accounting and expenditure information systems (including policies, practices, procedures, standards, systems design, and implementation); reporting systems (requiring adherence to reporting frequencies and creation of report formats of maximum benefit to operating managers); and systems of internal controls (defining policies, practices, procedures, standards, systems design, and implementation).
- Monitoring and evaluating the effectiveness and responsiveness of accounting, information, and reporting systems.
- Preparing and disseminating timely performance reports to operating managers.
- Participating in the appointment, professional development, and periodic evaluation of financial managers.

Departmental and agency controllers must be responsible for budget tracking, financial reporting, accounting, fiscal reviews, systems development and implementation, financial analysis, internal control reporting, and some degree of internal review in their respective departments, agencies, or offices.

**Current Efforts**

By December 1987, each major agency had appointed a CFO — another "good news/bad news" scenario. Many of these department
and agency CFOs were "name only" appointments, assigned to the person who had been serving as the lead financial person for the agency, regardless of organizational placement or to the chief management/administrative person (typically an assistant secretary or equivalent level), even if the appointee is only involved in financial matters on a part-time basis. Obviously not all of the designees were qualified by education or experience to perform the tasks needed to significantly improve the quality of the financial management practices.

Legislation

Recent congressional bills — ranging from specific focus on a governmentwide CFO to broad financial management changes — seem to support the need for a CFO. There is less consensus on the specific placement within the executive branch (for example, the OMB, Treasury, or Executive Office of the President).

Committees of both the House of Representatives and the Senate have held hearings or solicited comments in 1987 and 1988 concerning the desirability of governmentwide CFO and departmental controllers. In 1988 the House Committee on Governmental Operations solicited views from many, in and out of government, on several federal financial matters, including the need for and organizational placement of the CFO and department controllers. These initiatives did not result in legislating any change in 1988.

AICPA Recommendations

The AICPA believes that legislation is required to make a single office or person responsible for the accounting and financial reporting on the government's financial conditions and the results of operations for the government as a whole and for each department and agency.

A governmentwide CFO and department controllers are essential for improvement of federal financial systems and strengthening of management controls. Yet, formal designations are not the sole answer. As one of several actions required to strengthen the government's capability to improve financial management operations, the
positions must be legislatively established and filled by individuals with the proper management skills, training, and experience to lead and carry out the job.

Following are the AICPA’s recommendations relative to CFOs.

Financial Management Responsibility and Authority Must Be Centralized

A primary reason for designating a CFO for the United States and departmental controllers is to centralize financial management activities governmentwide and within departments and agencies. Properly implemented, a CFO and departmental controllers can bring together responsibilities and authorities that have been scattered by various laws and two centuries of practice.

Even without statutory authority, the OMB initiative has been positive, and several aspects of financial management have improved. In recent years, the Treasury has assisted agencies in developing better reporting systems. The GAO has played a significant and important role in developing the core requirements for uniform federal systems. Similarly, departments and agencies are increasingly focusing on financial management responsibility and authority. Previously independent bureau and subordinate systems are starting to be consolidated at departmental levels. This momentum is welcomed, needed, and must continue.

But, there is a need to focus these initiatives. One organization and group of officials — the CFO — and controllers must be made responsible, by law, for the systematic and continuing enhancement of federal financial management. Appropriate legislation will help to ensure that the necessary priority is given to requests for resources, both human and financial, to make certain that improvements take place.

In conceiving a centralized organization, the AICPA envisions the nucleus of the CFO’s office to come from the few hundred positions currently dispersed in the Treasury, the OMB, the GAO, the General Services Administration (GSA), and the Office of Personnel Management (OPM). New positions would be required to augment existing positions.

Departmental and agency controllers should be statutorily established. They should be selected by their agency head in consultation
with the CFO of the United States and serve at the assistant secretary or equivalent level. All attempts should be made to keep turnover to a minimum: those appointed will develop the desired commitment if serving for a reasonable interval.

The agency controller should be qualified to lead the organization’s financial management activities (with the exception of budget development activities), including designing and implementing financial systems and financial reporting. Similarly, the financial managers of decentralized subordinate agencies (bureaus) should report to their bureau heads, but should be appointed with the advice of the agency controller.

**Term of Office Must Be Fixed and Long**

To be effective, the CFO should serve a time period that is sufficient to allow for accomplishments — considerably longer than the time assistant secretaries for administration or management are now serving. Ideally, the CFO should be appointed by the President for a fixed term, much like the fixed term of the Comptroller General. Such a tenure would give greater clout to the office and its apolitical reporting responsibility.

**CFO Responsibility Must Be Broad and Direct**

The CFO of the United States must have governmentwide responsibility for prescribing and implementing a full range of financial management policies, procedures, and practices. The office’s effectiveness will be in direct relation to the breadth and substance of the responsibilities and authorities vested in this official. A clear responsibility of the CFO must be direct involvement with departments and agencies in requesting, obtaining, and expending resources to achieve both governmentwide and individual agency financial goals.

**CFO Responsibilities**

The AICPA recommends that the CFO of the United States be legislatively established within the Executive Office of the President, with
the following responsibilities:¹

- Report to Congress and the President on the government’s financial position, results of operations, and status of financial management.

- Promulgate policies, practices, and procedures governing accounting and reporting for all financial activities of the federal government.

- Participate in the selection of individual department and agency controllers to ensure that their backgrounds, experience, and capabilities satisfy job requirements.

- Conduct independent reviews and evaluations of controllership activities governmentwide and within departments, agencies, and offices.

- Develop and implement long-range federal financial management planning.

- Recommend to Congress and the President the financial resources needed to correct deficiencies and improve federal accounting and financial systems.

- Conduct professional development and training programs implemented to maintain the quality of federal financial management.

Under existing laws, these federal policy-setting responsibilities are currently dispersed among the GAO, the Treasury, the OMB, and the GSA. Responsibilities for implementing these policies are further spread among the heads of the many individual departments, agencies, offices, and commissions. To be effective, the CFO of the United States must be the focal point for all of these essential tasks.

CFO Position Must Require Excellence

Because the position of CFO of the United States is a position at the highest level of government, it is essential that the appointee be an outstanding individual, a respected professional, and a proven doer. Candidates can be expected from government (federal, state, and local), academia, and industry. Ideally, candidates should have spent some time in government service at relatively high levels. The best candidates for the CFO of the United States should possess most of the following qualifications:

- An understanding of, and appreciation for, the utility of sound financial management, solid integrated systems, and objective accounting and reporting.

- A solid combination of proven technical skills in systems; finance, accounting, and reporting; internal controls and administrative procedures; and information resources management.

- An understanding of, and interest in, the need for all federal managers to receive and use accurate and timely financial data.

- A sincere interest in government service.

- A commitment to the position for a term long enough to get things done, recognizing that the job is enormous and will require a great deal of time.

- Proven managerial skills, including ability to achieve in an environment of conflicting viewpoints.

- Outstanding communication skills, including the ability to be persuasive in describing goals, objectives, approaches, and the rationale for each.

- Ability to attract and inspire good people.

- The willingness, patience, and ability to create and the security to feel comfortable breaking new ground.

At the departmental and agency levels, the thrust should be to get the best people for the controller positions, regardless of political affiliation. Such attributes as past or current governmental experi-
ence, knowledge of the federal budget, CPA certification, and MBA degree are pluses but are not as critical as those requirements previously enumerated. The retention of senior-level finance managers, as a vital part of the government's management team, will be an incentive for good managers to stay in government or, perhaps, return to government — a situation which, unfortunately, does not currently exist.
CHAPTER III

Accounting and Reporting Practices for the Federal Government

I think it an object of great importance...to simplify our system of finance, and to bring it within the comprehension of every member of Congress...the whole system [has been] involved in an impenetrable fog. [T]here is a point...on which I should wish to keep my eye...a simplification of the form of accounts...so as to bring everything to a single center[;] we might hope to see the finances of the Union as clear and intelligible as a merchant’s books, so that every member of Congress, and every man of any mind in the Union, should be able to comprehend them to investigate abuses, and consequently to control them.

— Thomas Jefferson in a letter to Secretary of the Treasury, Albert Gallatin (April 1802)

Thomas Jefferson would never believe that his plea “to simplify our system of finance” has yet to be heeded. He would be even more astonished to discover that many individuals, both in and out of government, continue to call for proposals very similar to those he proposed.

Sound practices and procedures consistently applied by all departments and agencies are essential to permit the federal government to properly report government assets, fully disclose liabilities, and appropriately recognize revenues and costs. The question, obviously, is not if but how to effectively establish and implement such standards. Proposals on the subject include recommendations to —

• Adopt private sector accounting standards.
• Require adherence to accounting and reporting standards used by state and local governments.
• Establish a set of accounting and reporting standards specific to the federal government.

Although accounting and reporting standards used by the private sector, and state and local governments contain many essential and sound concepts, it is possible that neither is the best answer for the federal government. Accordingly, the suggestion to adopt uniform guidance tailored to the federal government is, most likely, the appropriate solution.

An Historical Perspective of Federal Accounting and Reporting Standards

Financial accounting and reporting standards are currently promulgated for the federal government by the Comptroller General, under authority granted by the Budget and Accounting Procedures Act of 1950. To appreciate the significance of that legislation, a brief historical perspective of accounting and reporting standards in the federal government is useful.

The General Accounting Office, headed by the Comptroller General, came into being as a result of the Budget and Accounting Act of 1921. That legislation transferred to the GAO — a part of the legislature — the responsibility for expenditure audit (that is, expenditure certification or approval), which had been conducted previously by the Treasury. In making the transfer, Congress expected to exercise greater control over the spending habits of the federal government. Accordingly, throughout the 1920s, 1930s, and 1940s, the GAO maintained financial records of expenditures and developed standards for systems and procedures that agencies were required to main-

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1For purposes of discussion, the term financial reporting refers to financial statements prepared in conformity with accounting principles intended to portray a governmental entity's financial position and results of operations. The term budgetary reporting refers to financial statements prepared in accordance with practices applied in the reporting on the government's annual budgets.
tain for the administration of an appropriate fund-accounting process.

As the federal government's activities grew, so did the volume of its expenditures and the need for their examination and approval. As a consequence, the GAO also grew in size and stature. The futility of expecting one agency to approve the expenditures and maintain the records on behalf of the entire federal government became evident during World War II, when the volume of expenditures grew beyond all expectation and the ability of the GAO to cope with its responsibilities.

In an effort to address the paperwork crisis and improve government efficiency, in the late 1940s, President Truman established the first Hoover Commission to study and make recommendations on how the government's business operations might be improved. It recommended the establishment of a separate office of an Accountant General, to whom would be transferred the responsibility the GAO had assumed for federal accounting system development and the GAO's role in accounting and system standard setting for the federal government.

The Budget and Accounting Act of 1950 evolved from the Hoover Commission recommendations. Under the act, federal government agency heads, rather than the GAO, were charged with the responsibility for initial expenditure audit and the maintenance of their respective accounting systems. The GAO retained the responsibility to set accounting standards and was granted the additional responsibility to "approve" agency-developed accounting systems.

The 1950 Act also transferred the budget preparation responsibility from the Treasury to a newly created Bureau of the Budget — thereby creating the budget process, which exists today. Since then, budgetary accounting has received substantially increased attention throughout the government; financial accounting, on the other hand, has languished.

The Differing Objectives of Budgetary and Financial Reporting

Since the 1950 Act's passage, both the executive and legislative branches have placed significant emphasis on an annually approved
budget as the principal means of controlling federal expenditures. It was not unexpected, therefore, that budgetary accounting and reporting practices and procedures evolved before federal officials developed concerns about financial accounting and reporting.

A cash basis of accounting is the primary method used in budgetary reporting. For budgetary purposes, commitments are reflected on the books when contracts are executed. However, receivables, and certain significant government liabilities are generally recognized only when cash is received or paid — not when revenues and costs are earned or incurred. These practices contrast sharply with the matching of revenues and expenditures concepts generally used in financial reporting.

But, moreover, the differing objectives of budgetary and financial reporting are important. Budgeters and legislators often argue for preservation of the budgetary basis of accounting and insist that no other accounting principles or basis of accounting is needed. The exclusiveness of this position is unfortunate because such opposition has retarded the issuance of meaningful annual financial statements for the federal government.

The truth is that the two bases are not mutually exclusive and that both reporting methods must be understood and used by public officials charged with fiscal responsibilities. Budgeting includes defining what resources are needed and how they will be spent. Financial accounting and reporting reflects how the budget was executed and other financial information. In fact, history has shown that neither public companies nor private citizens can, for long, manage their finances by relying exclusively on the cash basis of accounting.

An Assessment of the Standard Setting Process

Since 1950, the GAO has issued a series of accounting and reporting procedures, known as Title 2 Accounting Principles, in its Administrative Procedures Manual. Yet, years after the passage of the 1950 Act, the federal government still does not use a generally accepted set of financial accounting and reporting standards. The primary reason for this is that the federal government still does not provide an environment that insists on compliance with those standards.
Many have suggested that noncompliance results from —

- Insufficient representation by users and preparers of the financial statements in the development of new standards.
- Inadequate "due process," in which input and discussion by users and preparers is received during the development and adoption of standards.
- Insufficient personnel resources, both in terms of quantity and experience, devoted to the standard-setting process.
- A perception that the GAO (the federal government's auditor and representative of Congress) may not be sufficiently independent of the process.
- Lack of support by the executive branch (OMB and Treasury) and the legislative branch (Congress) for the process.
- Lack of independent audits of the financial statements to disclose failure to adhere to prescribed standards.

The following are examples of how remedies implemented to correct those weaknesses will improve financial management and benefit the federal government:

- Improved integration and coordination between accounting and reporting standards and budgetary standard-setting activities, where appropriate, will result in a more efficient use of government resources.
- Integrated and coordinated financial accounting and reporting and budgetary standards will result in a better understanding of the relationship between budgetary and financial reporting.
- Elimination of "innovative" financial reporting will increase acceptance by those who use the statements.

Each of these is by no means an inconsequential benefit. Collectively, they incorporate the goals of every prudent financial manager — sound controls, reduced costs, and increased credibility attributed to financial statements issued.
The Absence of a Mandate for Change

At present there is no mandate for governmentwide financial reporting for the federal government other than on a budgetary basis. Not surprisingly, if reporting is not mandated on other than a budgetary basis, there is obviously little urgency, need, or concern demonstrated for the development of better financial accounting and reporting practices and procedures. Similarly, there is also little concern for the environment or organizational structure in which such standards are established, all of which create a climate that places minimal value on accounting and reporting on a basis that is uniform throughout the federal government and that is consistent from one year to the next.

Since passage of the 1950 Act, efforts to set financial accounting and financial practices have been somewhat sporadic. This has occurred, in part, because of the lack of —

- Demand by Congress and the public for better financial reporting on the part of the federal government.
- Clear identification of the accounting and financial reporting issues required to be addressed — the absence of a reasonably complete inventory of the federal government’s unique accounting and reporting needs.
- An established methodology or structure within which to consider accounting and reporting issues.

There have been other deterrents. The central tripartite organizational structure responsible for the development and implementation of financial and budgetary accounting and reporting standards, all too often, has not been in agreement. The provisions of the 1950 Act, which allocated selected segments of the standard-setting process — among the participants — accounting and reporting standards to the GAO, budgetary standards to the OMB, and annual reporting to the Treasury — have created serious impediments.

Criteria for Standard Setting

Five criteria are generally cited as essential to any acceptable standard-setting process: independence, adequate procedures, compe-
tency of the standard setters, adequacy of the resources, and effective compliance. These are an appropriate benchmark for evaluating the quality and effectiveness of the current federal accounting and financial reporting standard-setting structure and are, therefore, worthy of further discussion.

**Independence**

The standard-setting body must be free of undue influence by any particular segment of its constituency.

It is of utmost importance that the constituency of the standard-setting organization perceive it to be independent.

The GAO could restructure its current efforts to be perceived as being more independent. In May 1989, the GAO did propose to change its current process to include greater participation and acceptance. The GAO suggested the establishment of the Federal Government Accounting Standards Advisory Board to prescribe and establish, under the oversight of the GAO, accounting principles and standards. The fact remains that a legislative agency may continue to encounter resistance in setting this type of guidance for the executive branch.

**Appropriate Procedures**

The standard-setting body must seek a broad range of views and thoroughly study the merits and consequences of the various alternatives before adopting standards.

No authoritative study of the federal financial structure and its needs has ever been made to identify procedures, practices, and principles that address the uniqueness of the federal government or how that guidance should be developed and implemented.

In the past, direct involvement and input into the standard-setting process by users and preparers of federal financial statements has been limited to the occasional convening of informal *advisory panels*, whose deliberations have usually not been published and, therefore, have not acted as a catalyst for consensus. Despite the many and varied attempts by the GAO to encourage participation, comments on exposure drafts of proposed standards have been limited. Further,
there has been no effective forum for public debate of the issues involved in the proposed standards.

Formally documented and consistently applied procedures must be established by the federal government to assure the sufficiency of research and study conducted on proposed accounting standards.

Undoubtedly, the most frequent criticism of current procedures is the perceived lack of due process, or appropriate constituency representation in the standard-setting process. This is probably attributed to the failure to consistently apply a proven and accepted standard-setting methodology. Accordingly, generally practiced and administratively recognized due-process procedures must be followed.

**Competent Staff and Adequate Resources**

Two principal elements are necessary to establish acceptable standards — qualified people and sufficient funding. Neither by itself can assure the desired result.

The standard setters must be highly knowledgeable in all areas of accounting and financial reporting, with particular expertise in the government area, and must be supported by a technically competent staff. Among other areas of knowledge and experience, the staff utilized in the standard-setting process must be knowledgeable in all aspects of federal accounting, financial reporting, and financial management controls. Generally, staff with such qualifications have not been involved with past standard-setting attempts.

Identifying qualified, competent candidates to fill standard-setting positions is essential to the success of the process. There is no question that “highly knowledgeable” individuals, expert in the standard-setting process, do not abound in the federal government. Therefore, assistance may be needed from other sources, such as members of Congress; the AICPA; the Association of Government Accountants; National Association of State Auditors, Comptrollers and Treasurers; the Government Finance Officers Association; and corporate America. In addition, members of the securities industry, academia, and users of financial statements may be willing to assist.

The standard-setting body must also have sufficient funds to support its work. Because no separate standard-setting budget appears to have been established by the GAO, the OMB, the Treasury, or others,
such resources have been provided on an as-needed basis, rather than at a level needed to support continuing research and development.

It is doubtful that any private-sector funds can be counted on for what is widely perceived as a federal government problem. Most likely, it will be suggested that the federal government should fund this effort as it has in the past, and as it has funded the legislatively established Cost Accounting Standards Board and the Railroad Accounting Principles Board. Accordingly, the federal government is the most likely funding source.

**Authority and Compliance**

The capability to set federal accounting and reporting procedures and practices must be recognized. In addition, the failure to comply with these pronouncements must be generally considered unacceptable.

Some will contend that legislation may not be required to implement any agreed-upon standard-setting process. There is little question that a solution cannot be achieved without the appropriate level of compliance and without the wholehearted endorsement of both the executive and legislative branches.

**AICPA Recommendations**

In May 1989, the GAO issued an exposure draft, *Proposed Framework for Establishing Federal Government Accounting Standards (Exposure draft)*, which describes the proposed framework under which the Comptroller General would prescribe the accounting principles, standards, and requirements that federal executive agencies are required to use. That framework is intended to provide an opportunity for interested and affected parties to participate in a consistent and uniform process for setting accounting standards for the federal sector. The Task Force on Improving Federal Financial Management has reviewed the exposure draft and commends the GAO for its efforts. However, because the GAO must operate within the limits of the existing laws, the AICPA does not believe that the proposed framework will meet all of the five criteria for standard setting previously described. Accordingly, it believes that additional steps must be taken to enhance the accounting and reporting process for the federal government.
The issues involved in arriving at an appropriate solution to the standard-setting dilemma are many and complex. As a result, the identification of an appropriate and effective future course of action is not expected to be easy. The concerns expressed frequently by members of Congress that financial accounting and reporting must be sensitive to the unique "business" of the federal government are certainly real and must therefore be dealt with in a realistic fashion. The solution must also serve to bring together the views of the GAO, the OMB, the Treasury, and the numerous other federal agencies on the need for a more responsive basis of reporting to the public at large. The role of the federal government, its past and present fiscal position, and its influence on financial markets of the nation and the world has certainly raised the interest of the financial community in the federal government's financial affairs. Also, not to be denied, is the interest of the taxpaying public and the accounting profession.

It is perfectly understandable therefore that the nature and purpose of any change in financial reporting be debated in a forum that includes representation from those organizations that are inexorably linked to the process. Unless the solution has the support of the parties at interest, it is unlikely to be lasting, and, most important, effective. In recognition of the need for widespread support, the AICPA recommends that a Presidential Commission be established and charged with the responsibility of recommending an appropriate mechanism by which accounting and reporting practices and procedures are established in the future. To assure a timely response to the situation, the commission should be asked to submit its report no later than January 1, 1991.

The AICPA also proposes that this Commission include representatives of the following:

- Congress — from the Senate and the House
- Comptroller General of the United States.
- Secretary of the Treasury
- Director, Office of Management and Budget
- Senior-level federal financial executives
- Private sector, senior-level executives
Such membership would assure a broader base for considering federal financial principles and standards and address the real and perceived independence impediments.
CHAPTER IV

Financial Reporting by the Federal Government

Financial reporting plays a major role in achieving public accountability in a democratic society. Public accountability is based on the belief that the taxpayer has the right to know, a right to receive openly declared facts that may lead to public debate by the citizens and by their elected representatives.

— Governmental Accounting Standards Board, in its published objectives

Inherent in a citizen's right to know is the assumption that data published by the government is complete, accurate, uniformly collected, and consistently compiled and presented from year to year. This principle is equally appropriate for all levels of government, including the federal government.

Presently, the total assets, liabilities, revenues, and expenditures of individual departments and agencies and the entire federal government are not classified and summarized in a uniform financial reporting format. Essentially, accountability of federal officials and agencies is on an appropriation-by-appropriation basis, as are the budgeting and fiscal reports to the OMB, the Treasury, and Congress. Financial statements on an entity basis should also be prepared.

Regular and periodic preparation of financial statements is needed to assist in identifying and controlling the federal government's assets and liabilities. A requirement to prepare and issue financial statements will also result in identifying internal control weaknesses throughout the federal government. Good internal controls are neces-
sary in a financial system that produces reliable financial statements. Properly prepared financial statements will provide better data to Congress, the administration, and the public.

The Case for Financial Statements

External financial reporting on an organization’s operating results and financial position is a routine part of management stewardship.

State and local governments, businesses, not-for-profit organizations, and an increasing number of federal government departments and agencies have issued external financial reports. They are prepared regularly in a uniform format that is helpful for comparison between fiscal periods and organizational entities.

It is essential that Congress and the administration reach agreement on a consistent set of financial reporting requirements. Proposals on this subject range from imposing corporate reporting standards on the federal government to requiring adherence to those used by state and local governments to establishing a set of reporting rules unique to the federal government. Although corporate and state and local government accounting and reporting systems contain many essential and sound concepts, neither may be the best answer for the federal government.

To achieve uniformity, Congress and the administration should—

1. Establish a reporting system that allows Congress, the administration, and the public to see where monies originate, how monies are spent, and the amount of surpluses and deficits.

2. Agree on the nature, content, and frequency of financial statements and management reports governmentwide and within departments and agencies.

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1In this discussion memorandum, *external financial reporting* refers to the preparation and issuance by the government and its individual departments and agencies of financial statements and related notes that present the financial position and results of operations in accordance with a defined and prescribed set of accounting principles and standards uniquely defined for the objectives and environment of the federal government.
3. Develop a standard format for financial statements and operating reports to be used by federal financial managers in presenting data to those within and outside the government.

Financial statements, prepared by departments and agencies and governmentwide on a recognized and accepted basis of accounting, are essential to the perceived integrity and acceptance of the federal financial management process. Timely, meaningful, and reliable financial statements are a key element to informing American taxpayers on how their money is spent. Financial statements can also provide the President and Congress with information that is useful in determining the financial implications of fiscal policy decisions.

Financial statements are a scorecard by which those external to federal departments and agencies can assess the stewardship and financing needs of those agencies. Budget reports and funds-control reports are still needed, although external financial statements can supplement this reporting requirement. External financial statements can help the public and executive and legislative policymakers to better assess the cumulative effect of actions and decisions.

The Need for a Unified Approach

The issue of external financial reporting for the federal government is not new. It has been documented repeatedly and called for in numerous public and private studies and reports, articles, projects, and public testimony. Initiatives have included the following:

- The GAO’s revision of accounting standards.
- The OMB’s issuing of a standard general ledger to improve the accumulation and classification of agency financial data.
- The Treasury’s reissuing of its financial reporting requirements for federal agencies.

Individually and collectively, these actions clearly demonstrate a recognition that changes are possible and that improvements can be made. Each addresses an essential piece of the financial management process. This piec-by-piece approach is far from ideal. Instead, a concerted, unified movement toward the issuing of regular financial statements is absolutely essential.
As mentioned in chapter I, at the close of fiscal 1987, the federal government reported a budget deficit that was immediately challenged as being too low by several billions of dollars. The Congress, the White House, the Treasury, and the OMB were all accused of modifying or "playing games" with the reporting of the federal government's revenues and expenditures. At the same time, the General Accounting Office reported that nongovernmental funds withheld from federal employees' paychecks had been treated as if they were federal receipts. Fiscal year 1987 federal expenditures were delayed and rolled over into fiscal year 1988. All of these factors contributed to a lack of confidence in the deficit figure.

Meeting Conflicting Information Needs

Managing the financial activities of the federal government is unquestionably a formidable and complex task. There are competing and conflicting financial management information needs in Congress, in the administration, and in the departments and agencies and at a variety of levels. Having reliable, consistent information is critical for well-informed management decisions and resource allocation. Having the capability to provide this information in different ways and on different bases can be beneficial and may result in different actions or choices.

What is needed today is a focus for direction and leadership, as well as a legislative mandate for change. Answers are needed to some or all of the following questions:

- What are government revenues?
- What are government expenditures?
- Which expenditures are related to capital investments? Which to operating costs?
- What current federal government liabilities for current services will require a payment sometime in the future?
- Which is the most credible basis for reporting budget authority, incurred obligations, expenditures, checks issued? Under what circumstances?
• How large is the federal deficit?

• What acceptance is there for the data and bases used to estimate the fiscal year budgets and are the bases used the same from year to year?

• What taxes or other sources of revenue are needed to meet both long- and short-term total federal government debts?

• What is the value and cost of the federal government’s assets?

Unfortunately, preparation and issuance of external financial statements by departments and agencies or governmentwide is not deemed necessary by many in the federal government, and has not been for far too long. Those making the case for no financial statements plead an absence of credible and reliable data; the lack of integrated accounting systems; a greater need for day-to-day operational reports than for broad, comprehensive externally oriented financial statements; and a greater need for internal budget reporting and funds control. These are clearly important requirements and should be recognized in the long term.

External financial statements will give focus and instill discipline in the design, development, implementation, and management of financial systems and processes that can benefit users of both detailed and more aggregated financial information. Financial statements provide tangible output on the application of the desired accounting standards.

Potential Benefits of Preparing and Issuing Financial Statements

Financial statements are only a part of a continuum. They also serve as a focus for other key financial management reform initiatives including organizations, standards, systems, and audits. Yet, their preparation and issuance can result in three broad benefits: better systems definition, improved accountability, and as a catalyst for change.

Better Systems Definition

Frequent criticisms heard regarding federal financial management systems center on their lack of integration, fragmentation, and
incompatibility. External financial reporting can help, by requiring standard financial reporting based on consistently and uniformly defined and applied accounting and reporting terminology and classification structures. It can also become the keystone for an added degree of discipline in the financial management and financial systems processes.

In order to meet the defined reporting needs, financial systems would have a common foundation of baseline or core data elements as part of their financial structure. These would go beyond cash accounting and obligation accounting, particularly in recording assets (such as inventory, capital assets, or receivables) and liabilities (such as pensions, lease obligations, or long-term contracts). This foundation could also help to standardize the need for financial systems and, perhaps, limit or reduce the accounting system fragmentation that exists today. Additionally, it could considerably mitigate the enormous cash investments previously made by many agencies for customized financial systems.

**Improved Accountability**

Regular, periodic reporting requires greater fiscal and management discipline, which, in return, helps to address the criticism of lack of timeliness, especially when considered with improved systems definition. Unquestionably, external financial statements present a more comprehensive and timely financial picture, based on an established set of common rules. Tangible operating benefits can also result from the improved ability to manage assets (such as receivables due, loan portfolios, capital assets, debt collection, and inventories). As assets are identified, quantified, recorded, and reported, management accountability can be expected to increase and executive performance improve. Demands on current and future resources and, as a result, determination of the adequacy of available resources can be quantified when liabilities are recorded for such major items as pensions, long-term contracts, and Social Security. Taken together, asset and liability management can serve as input to credit and cash management programs. In fact, effective executive management of resources should have as much visibility and accountability as revenue collections, funds control, and prompt payment programs. For
example, if liabilities are recorded properly and in a timely fashion as part of the routine financial management process, improvements should be expected in early and late payments on liabilities with concurrent savings in borrowing or interest penalty costs.

If standardized systems and procedures and uniform and consistent classifications and terminology become an integral part of the financial management process, it is possible for administrators and Congress to evaluate and measure similar activities among and within agencies. Accordingly, standardization can help determine improvement needs, evaluate performance against defined objectives, and assess alternative service delivery choices all done with attention focused on how to make an improvement, avoid a cost, or achieve a saving without having questions on the reliability of the numbers.

**Catalyst for Change**

Good financial statements can focus beneficial attention by simply defining and enforcing the result, output, or target. Properly defined, financial statements force an assessment of the systems, controls, and procedures that are necessary and appropriate and working. They provide a framework within which to initiate needed corrective actions agencywide or governmentwide.

**AICPA Recommendations**

The AICPA believes that all taxpayers are entitled to a comprehensive, understandable, and comparable reporting of the federal government's financial position and operations. To achieve this, a requirement for providing reliable financial information must be implemented governmentwide and within all departments and agencies.

Achieving improvements and initiating programs for external financial reporting require strong, committed leadership in all levels of the federal government: Congress, the administration, and the departments and agencies. State and local governments have demonstrated that it can be done. Certain federal departments and agencies have also experienced considerable success. This strong precedent should be the foundation for Congress and the administration to capi-
talize on the momentum and legislate external financial statement reporting requirements. The task is formidable, but not impossible.

Granted, dispersed federal financial management responsibility, less than uniform accounting standards, data deficiencies, incompatible systems, and the lack of independent audits remain open issues. While in need of ultimate resolution, they should not become barriers to progress. All issues and open items need not be addressed to improve, to change, and to move forward. What is essential is to begin.
The accuracy of financial information about the federal government is uncertain because most of the information is unaudited.

— Charles A. Bowsher, Comptroller General of the United States, before the Committee on Governmental Affairs, United States Senate, May 13, 1986

The federal government is the last major institution in America for which independent financial statement audits are not required. Historically, the task has been perceived as too large. Nevertheless, the AICPA believes an independent annual financial audit is the final and most critical link in a program to improve the federal government’s financial management. Audits of departments and agencies, and of the government as a whole, would provide Congress, the President, and citizens with an independent opinion of whether the financial statements present fairly, in all material respects, the financial position of the federal government and the results of its operations in conformity with established accounting principles. It will also report identified material weaknesses in internal control and material non-compliance with applicable laws and regulations identified during the audit.

What Is an Audit?

An independent financial audit is a periodic examination of an organization’s financial statements and the auditor’s opinion of whether the financial statements present fairly in all material respects the financial position and results of operations in conformity with estab-
lished accounting principles. The performance of an audit typically includes the following orderly set of events:

1. The independent auditor obtains an understanding of the internal controls relevant to the audit.

2. The independent auditor examines, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assesses the accounting principles used; and evaluates the overall financial statement presentation.

3. The independent auditor issues a report on the financial statements that contains an opinion of whether the financial statements are presented fairly in all material respects in accordance with prescribed standards.

4. *Government Auditing Standards*¹ require that the independent auditor provide a report on internal controls identifying, among other things, material weaknesses identified as a result of his or her audit work. In addition, material instances of noncompliance with applicable laws and regulations identified during the audit are required to be reported.

**Audit Benefits**

The discipline required to prepare financial statements for audit will move federal officials to remember and pay heed to their responsibilities to Congress, the President, and the public for the financial resources entrusted to their care. Management officials will be moti-

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¹In practice, *Government Auditing Standards*, issued by the Comptroller General of the United States, are sometimes referred to as generally accepted governmental auditing standards (GAGAS) or the "Yellow Book." *Government Auditing Standards* include standards for financial audits, as well as standards for performance audits. Among the matters that *Government Auditing Standards* addresses are quality control, continuing education, working papers, and audit follow-up. The references to *Government Auditing Standards* in this discussion memorandum encompass only the standards for financial audits and not the performance audit standards.
vated by the audit process to ensure the agency's systems are adequate for correctly recording transactions, safeguarding resources, and communicating and disclosing financial information in conformity with required accounting principles to improve understanding of the agency's activities.

Independent audits provide a basis for persons removed from the government's operations to interpret and assess the reliability and credibility of information released by the federal government. Beyond the benefits already listed, there are others. In preparing for annual audits, government officials must—

- Confirm and reconcile cash accounts. Unidentified and uncontrolled imprest funds are an invitation to unauthorized uses.
- Do a better job of managing and tracking receivables. The comprehensive receivables information prepared for an audit enables an agency to more effectively bill and dun, thereby converting receivables to cash more quickly.
- Provide a tighter control over inventories of supplies and materials. Periodic physical checks rapidly reveal the accumulation of excessive quantities, the deterioration or obsolescence of materials and, therefore, the difficulty of future use and unexpected shortages that are indicative of illegal or improper acts.
- Identify and track liabilities so that they can be liquidated without generating additional costs or, of greater concern today, that the accounts properly reflect liabilities and the resultant demands for current or future funds.
- Improve the timeliness of financial reporting. Financial audits impose a deadline that financial managers know they have to meet — and do meet. Cutoffs are required for transactions, accounts are closed, reconciliations must be completed. A periodic report card is a desirable feature in any enterprise.
- Improve the skills and understanding of the agency's financial managers. Regular preparation of comprehensive and reliable financial statements that can withstand the scrutiny of independent audit experts is an excellent way to enhance the expertise of departmental financial management. The process builds an ongo-
ing understanding and appreciation of how an organization’s financial data flows from the basic transactions to the overall financial statements.

More than theory, example after example, as follows, underscores these audit benefits.

- An agency was thoroughly confident in its bill-paying system. In its first financial audit, the typical audit step of reconciling the agency’s disbursement accounts with the Treasury’s cash accounts revealed substantial differences. The agency did not have the available funds it believed it had.

- An agency believed it was operating an aggressive debt-collection program. The independent auditor routinely mailed requests for confirmations of the loans to several debtors and discovered that the agency did not have the loan balances it believed it had.

- The financial statement audit of one agency disclosed a long-standing, unresolved dispute between two agencies over an asset. Both federal agencies were simultaneously showing the same $300,000,000 of buildings on their respective financial statements.

- One agency’s enabling legislation specified that it should lend money “at the agency’s cost of money rate.” A financial audit revealed a substantial accumulated surplus. Further analysis indicated that the operations for each of the last seven years had been extremely successful, which indicated that money was probably lent at more than the cost of money rate and that adjustments had not been made in the subsequent years to offset the effect of the prior years’ surpluses. The agency’s constituents were paying more for the government services than Congress had intended or authorized.

Why Hasn’t Congress Mandated Annual Audits?

Financial audits are currently performed on the financial statements of most government corporations. Congress recognizes the impor-
tance of audits (conducted by the GAO or an independent public accountant) for government corporations, but has failed to apply this same wisdom governmentwide and to individual departments and agencies.

Several federal agencies are recognizing the value of financial audits. In recent years, agencies such as the General Services Administration, Veterans Administration, Social Security Administration, Department of Labor, General Accounting Office, and major parts of the Department of Agriculture (such as the Commodity Credit Corporation, Farmers Home Administration, and Federal Crop Insurance Corporation) have had their financial statements audited by the GAO, offices of inspector general, or an independent public accountant. Financial audit efforts are also underway in the Environmental Protection Agency, the Department of the Air Force, and the remainder of the Department of Agriculture.

Although a step in the right direction, it must be recognized that these are "voluntary" audits and are a reflection of the persuasiveness of the Comptroller General and some inspectors general rather than a government requirement. These audits have been a valuable addition to these agencies' controls and represent an external assessment of existing financial management practices, but there is no assurance that they will occur more than as a one-time experiment.

Why hasn't Congress mandated financial audits throughout the federal government if they—

- Increase discipline into the design and development of new accounting systems?
- Help to ensure that managers operate the systems as intended?
- Highlight departures from congressional intent?
- Provide credibility for the financial amounts reported by and to the agencies, the President, and Congress?

Many agency managers, many members of Congress, and even many past senior managers of the OMB have not been convinced that they can derive benefits from financial statements, much less audited statements. They have not seen the value of an independent audit of the information contained in their financial reports; they view an
audit as merely an attestation of the statements’ numbers, failing to recognize that an additional benefit is the fostering of management and internal control improvements; and they are fearful that audited information might drive the political process, thereby imposing a fiscal constraint on management.

Although the AICPA understands why some may question the value of audits, it does not agree with these positions. For example, financial statements do not drive the political process at other levels of government for which they have been prepared. To the contrary, financial statements provide policymakers with the information necessary for enlightened decision making. Audited financial statements provide information about assets, liabilities, costs, and the like.

There appear to be other concerns. One is that financial data is not available or reliable at the agency level, particularly for such accounts as receivables, fixed assets, governmental guarantees, and actuarially determined liabilities.

Because a primary focus in today’s federal government centers on the unspent balances of individual appropriations, financial statements are not generally prepared for agencies or other organizational units. Appropriations financial statements (TF220s) are often prepared from estimates of results, rather than integrated flows of financial data from subsidiary systems. The journal vouchers that establish or adjust the amounts in the TF220s are frequently not supported. It is inaccurate to equate an appropriation with an agency: the two are not the same. At times, a single appropriation equates to a single agency. At other times, a single agency is responsible for several appropriations. Moreover, there are other instances where agencies have no direct appropriations but support their operations from allocations of other agencies’ appropriations.

Of no small concern is that agency financial personnel, and most of the government’s auditors, have little or no experience preparing agencywide financial statements and obtaining or performing audits of these statements. An impediment in itself, this deficiency is greatly amplified due to the complexity of the agency’s financial activities and the financial statements that would result, as well as the magnitude of the audit scope. The lack of available and reliable data and the lack of people able to prepare comprehensive financial statements are precisely the shortcomings that must be eliminated. These
shortcomings are preventing the government from getting the best use of its limited resources.

A Suggested Audit Approach

At any time, the audit of the entire federal government would be an enormous undertaking. For the initial audit, the issues and problems would be even more overwhelming. Obviously, considerable thought must be given to how to approach an audit of the federal government and its agencies.

Toward this end, there are the following two basic approaches:

1. Performing one audit of the comprehensive financial statements of the federal government, recognizing that the effort would have to be divided into manageable pieces or segments.

2. Performing audits of individual departments, agencies, and other organizations, rolling them up into what, eventually, would be an audited financial statement for the entire federal government.

Of these two, the individual-to-the-total approach is more feasible, provides more benefits, and can be started immediately. The audits of individual government corporations and several agencies that have already been performed have given the financial management personnel and auditors sufficient experience that could be carried over to audits of the financial statements of other federal agencies. These financial statements could reflect roll-ups of the appropriations for which each agency is responsible, and for which there are already the TF220s. Moreover, the expansion would be in accordance with a schedule of defined criteria. The financial statements of all agencies could be regularly audited; the CFO for the federal government could combine or consolidate these agency financial statements into one financial statement for the entire federal government; and an audit could then be performed of the federal government.

Mechanically, audits can be performed by a combination of three already recognized resources: the Comptroller General, inspectors general, and independent public accounting firms that already per-
form financial audits of governments at the federal agency, state and local level and for other large, multilocation, complex organizations.

The Comptroller General has the independence and legislative authority to perform audits. Certainly, the Comptroller General has the background to coordinate the process, which would entail such things as the following:

- Identifying and maintaining a record of the ongoing and completed audits
- Stimulating and assisting with the initiation of audits where they have yet to be performed
- Defining, developing, and promulgating standardized approaches and techniques that would reduce audit costs while increasing audit consistency and results
- Organizing forums for the exchange of information and experiences
- Conducting some audits, particularly to obtain and maintain experience in the program
- Contracting for and overseeing audits performed by others, to gain experience in relying on the work of other auditors.

From a cost standpoint, it must be recognized that quality financial audits, conducted by persons with knowledge and experience to identify systems' weaknesses and opportunities for improvement, require funding. The only acceptable way to limit costs may be to initially obtain the audits every other year. It is likely, however, that this approach will not last. State and local governments that started with biennial audits soon recognized the value of financial audits and switched to annual audits.

**AICPA Recommendations**

The AICPA believes a program of annual independent financial statement audits is a critical link to improving financial management in the federal government.

The federal government has taken steps during the last several
years to improve its financial management. As a result of these efforts, some agencies are operating better financial systems, some have fewer control deficiencies, and, in some instances, financial information is more reliable.

Now is the time to complete the financial management linkage by requiring independent audits to provide an independent assessment of management's representations, to assure that improvements in financial management continue in the 1990s and beyond, and to restore credibility at home and around the globe to the financial information published by the U.S. government.
It is the policy of the Congress in enacting this part that—

(a) The accounting of the Government provide for full disclosure of the results of operations, adequate financial information needed in the management of operations and the formulation and execution of the budget, and effective control over income, expenditures, funds, property, and other assets.

— Section III, Budget and Accounting Procedures Act of 1950

The preceding five chapters described the problems of ineffective financial management in the federal government and detailed the four recommendations of the AICPA for implementing improvements. In this sixth and final chapter, the four recommendations are summarized and a plan is presented for incorporating them into the management structure and laws governing the conduct of the business of running the federal government.

Summary of Recommendations

The four recommendations presented by the AICPA are intended to provide an integrated approach to improving the financial management of the federal government. Each of the four AICPA recommendations has been refined and tested over time in private enterprise and state and local governments. The critical elements of the recommendations are presented as an exhibit at the end of this chapter.

The idea is to apply proven principles of financial management to the unique environment of the federal government. Any entity can be
expected to exhibit financial responsibility and make sound economic decisions if it is headed by a qualified and knowledgeable CFO with the authority to act, if uniform agreed-upon standards for financial accounting and reporting are in place and complied with, if annual financial statements are prepared under the direction of the CFO and in compliance with the agreed-upon standards, and if annual independent audits confirm that its financial statements are compiled and presented according to the agreed-upon standards.

Implementation Plan

The most meritorious recommendations will accomplish nothing if not implemented. The plan for implementing the four recommendations of the AICPA must consider the current status of each of its four elements and the complexity of the political and administrative processes that need to be followed. It is also necessary to acknowledge that two hundred years of financial administrative history cannot be rewritten with a single stroke.

All federal government controllers must comply with the legislative requirements that we are proposing for congressional action. These would include assuming full-time responsibility for financial management, being charged with adhering to the agreed-upon federal accounting and reporting standards and preparing annual financial statements in accordance with those standards, obtaining adequate human and financial resources to carry out the mandated objectives of the office, and demonstrating possession of the personal and professional qualifications required of a federal CFO to be enunciated in the CFO provisions of the proposed law.

The recommended Presidential Commission to examine the existing process for prescribing accounting and reporting standards will need to be appointed. The first orders of business for the commission will be to define due-process procedures and set priorities.

The most important element in the implementation of uniform federal financial statements is a legislative mandate that such financial statements are not only desirable, but required. Such legislation should encompass financial systems requirements, a prescribed general ledger of federal accounts, an accepted standard-drafting mecha-
nism, and the requirement that annual financial statements be independently audited annually to ensure compliance with all requirements. As of this time, only a few federal agencies prepare annual financial statements.

The proposed legislation should acknowledge the complexity of implementing departmental and agency financial statements by providing for a multi-year phase-in period, which would assign to each entity one of five specified fiscal years as its first year to publish financial statements according to prescribed standards. The federal government, as an overall entity, should be given an additional year beyond the latest year assigned to any of its component departments and agencies. This would allow time for planning the initial compilation effort.

It is generally recognized that audits enhance compliance with financial accounting and reporting standards. Many laws thus contain audit requirements. The requirement that the financial statements prepared for all federal agencies and the federal government as a whole be independently audited is a natural extension of many other laws and regulations requiring virtually all other types of entities issuing financial statements to be audited. Without such legislation in place, it has often been difficult for agency heads and inspectors general to justify the cost of conducting such audits along with audits of the many programs for which audits are now a statutory requirement. In recognition of the effort necessary to coordinate all of the component audits, the implementation and transition provisions of the audit requirement should follow a similar phase-in schedule to that applied to the prescribed financial statements.

Call to Action

There is little doubt that improvements in the financial management of the federal government are needed. We are all aware of deficit positions with regard to the federal budget, international trade, and international credit. We are also aware that there is much room for improvement in how loans, taxes receivable, and other assets are managed. We have also heard numerous discussions on the need to know objectively and with confidence what is the actual financial position of the country, including the extent of the deficit.
There are many who support the nature and substance of the recommendations contained in this document. As this report was being bound into its final form, forty-eight of the fifty-one state CPA societies had endorsed these recommendations and more are in the process of doing so. In addition to the AICPA, other professional organizations including the Association of Government Accountants, the Government Finance Officers Association, and the National Association of State Auditors, Comptrollers and Treasurers have taken similar positions on some of these recommendations. In addition, the OMB has administratively appointed its second CFO who leads an active council of agency controllers, and the GAO is preparing the necessary administrative and professional support to put a federal accounting and reporting standard-setting board in place.

The AICPA has provided four recommendations for improving federal financial management and stands willing to assist in the effort to effect their implementation. There is also a great deal of support from many in government and out for following through with the implementation of these recommendations. The need has been identified, the plan has been presented, the time to act is now.

Initiating the Legislation

It is clear that to move forward in a meaningful way all of the elements of a federal financial management improvement plan must be mandated by legislation. Such a mandate would have many benefits. Most important of these is that the legislators are provided an opportunity to put their own thoughts into the actual provisions that become law. Other benefits include providing all federal controllers with a written blueprint of their responsibilities to follow and their authorization to act, according to an agreed-upon timetable for implementation.

This paper provides the substance of the proposed legislation in accordance with the views of the AICPA, the professional association of over 285,000 CPAs. Representatives of the AICPA are willing to meet and work with whichever congressional committee or subcommittee takes the lead in drafting the bill covering improving federal financial management. In the meantime, all legislators who read this document are invited to sponsor the legislation that we believe is needed to ensure that improvements actually occur.
EXHIBIT

Essential Elements of Federal Financial Management
Essential Elements of Federal Financial Management

A Chief Financial Officer of the United States

- Heads an independent agency in the executive branch
- Same executive level as Budget Director, Treasury Secretary, and Comptroller General
- Appointed by the President with advice and consent of Congress
- Fixed term of office
- Qualified through background, experience, skills, and education to serve as the chief financial officer of the United States
- Responsible for uniform accounting, reporting, and measuring performance against the federal budget
- Reports to Congress and the President on the federal government financial position, results of operations, and status of financial management
- Recommends to Congress and the President financial resources needed to correct deficiencies and improve federal accounting and financial information systems
- Participates in selection of individual department and agency controllers

Uniform Federal Accounting and Reporting Standards

- An enhanced accounting and reporting process for the federal government is urgently needed.
- Uniform accounting and financial reporting standards must be adhered to by the federal government and all its departments and agencies.
• A Presidential Commission should be established and charged with the responsibility to recommend to Congress an appropriate mechanism by which accounting and reporting principles and standards are established in the future.

**Federal Government Financial Statements**

• The federal government and all its departments and agencies are to issue annual statements of financial position and results of operations.

• The federal financial statements will be prepared in conformity with federal accounting and reporting principles.

• The federal financial statements will be timely issued subject to transition provisions.

• The federal financial statements will be made available for public inspection within thirty days after presentation to Congress and the President.

**Independent Audits of the Financial Statements**

• The financial statements of the federal government and all of its departments and agencies are to be audited in accordance with Government Auditing Standards issued by the Comptroller General.

• The auditors are to be independent in fact and appearance and professionally qualified in federal government accounting and auditing.