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AMERICAN INSTITUTE OF ACCOUNTANTS

ACCOUNTS
OF
GOVERNMENTAL BODIES

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135 Cedar Street, New York

"A fair conclusion is that to secure the best city government three elements are indispensable: (1) an effective form or structure; (2) a competent personnel; and (3) an alert, intelligent citizenry, insistent on the public welfare; in other words, good structure, skilled administration and public spirit. The absence of any one of these hampers the others. Together they can assure for city dwellers a local government agency that will be at once democratic and effective."—WALTER J. MILLARD (in *Public Management*, April, 1935).

Introduction

Although the business of government covers a wider scope and a greater variety of activities than any other business, the facts concerning it are all too little known to its owners, the citizens. As owners, however, they are entitled to a continuous and complete accounting for the activities of government and should be able to interpret such information and to act upon it intelligently.

A special committee on governmental accounting is set up in the American Institute of Accountants for the purpose of bringing about needed improvement in the accounts and reports of public bodies and for informing citizens, civic organizations and other groups as to the principles and practice of governmental financial procedure. The bulletin here presented has been prepared for the purposes of providing concise information as to matters which are essential for proper accounting of governmental bodies and of enlisting their intelligent interest and activity in its application.

It is my conviction that the suggestions, herein contained, will result in improved conditions which will be beneficial in every agency and community where they are followed.

GEORGE ARMISTEAD, *President*

Houston, Texas

October 15, 1935

Accounts of Governmental Bodies

PREPARED BY THE

Special Committee on Governmental Accounting

OF THE

American Institute of Accountants

GOVERNMENT HAS WIDE SCOPE

The term "government" as used here includes every public body which is engaged in the exercise of an essential governmental function through which it has authority over persons subject to its jurisdiction. It includes the federal government, the state government and all forms of local governments. The various divisions of local government include counties, townships or towns, cities and villages, schools and other miscellaneous groups, among which may be mentioned park districts, sanitary districts and road districts. According to a recent survey, the number of local governmental units in the United States exceeds 175,000. In other words, this number of separate agencies is engaged in carrying on the business of government in the United States.

CITIZENS ARE ITS "STOCKHOLDERS"

Every citizen in the United States is a "stockholder" in one or more of these units of public business. No person, however small his property or income, escapes a share of the expense of maintaining these various branches of government. For that reason, the efficient and economical management of government is of direct concern and importance to every person. As an owner, he must have reasonable knowledge of the financial facts and problems of that business. Such knowledge can be obtained only through proper systems of financial records and reports.

PUBLIC BUSINESS DIFFERS FROM PRIVATE

The operations of government differ materially from those of privately owned business. In the latter the fundamental consideration is toward the creation of a profit and the avoidance of a loss. In government the end is that of service which can not be measured in terms of profit or loss.

Government is not an income-producing enterprise. It is an agency for expending moneys made available to it by its owners for whom it acts as an agent in carrying on certain coöperative services. Some of its activities are and should be comparable with privately conducted enterprises of a similar character, while others, in fact the majority, can have no such standard.

In a private business the physical property and other assets of the concern form the basis for its borrowing power. In a government the principal asset is the power to tax; but property owned by the government is not available to meet its obligations. Possession of such property does not affect the financial policy.

Borrowing by a private concern can be carried on to any extent that its credit and resources justify, whereas, in a government, various legal restrictions are placed on borrowing power.

A government is not only responsible for receiving and expending money, but often it must administer permanent funds as well, and these funds must be kept inviolate, the income only to be expended. Much of the income of a government is ear-marked in advance for specific purposes. Expenditures are limited and controlled by constitution, statute and regulation.

A government is a complex financial structure. It is an owner, operator and trustee, all in one.

Whenever a special tax levy, bond issue or other specific source of revenue or income is authorized a separate fund is created. Some funds may be expended, while others must be left permanently intact. Each fund is a distinct financial entity and all money and other assets belonging to it must be segregated and applied only to authorized purposes. A fund differs from an appropriation: a fund consists of money or other resources set aside for carrying on certain activities or attaining certain objects; an appropriation is the authorization to expend a part or all of a given fund for specified purposes.

Because the owners of the government include all its citizens, the utmost publicity concerning its operations is essential.

The proposals made here have to do with principles of procedure. It is recognized that in many instances existing laws and regulations make requirements which are not in harmony with these proposals. Obviously, where this is the case, the laws and regulations must be followed until they can be modified to make possible the application of correct principles.

ACCOUNTS SHOULD BE CENTRALIZED

The first essential of a governmental accounting system is that the accounts be centralized under the direction of one officer who will be responsible for keeping or supervising the keeping of all financial records. This does not necessarily mean that all accounts must be kept in one office or at one place. It does mean that all accounts necessary for the governmental unit should be coordinated and unified, which can only be accomplished when the entire accounting system is under the supervision of one responsible officer.

To make this requirement fully effective, the general system should be of a double-entry character, with a general ledger in which all accounts are contained or controlled. The operation of a general ledger in which all assets, liabilities and equities appear and in which all transactions finally rest, either individually or in total, gives the best assurance that the accounting system is comprehensive, complete and represents a full control over all financial transactions.

ACCOUNTING OFFICERS SHOULD BE PROPERLY QUALIFIED

Keeping and supervising the accounts of a municipal or other government and assisting the administrative officers through the medium of timely and proper information requires at least as high a degree of ability and experience as does such a position with a mercantile concern handling a similar volume of business. In addition to preparing budgets, keeping the various funds properly accounted for and preparing statements for administrative guidance, public finance officers must know the numerous legal requirements affecting municipal affairs. Voters should insist that persons seeking such offices have appropriate training for the post which is sought. Taxpayers should not be influenced by political considerations alone or by sympathy for someone who is out of a job or has failed in trying to carry on his own business. It is not reasonable to expect that a person can look after public business satisfactorily when he has failed miserably in conducting his own business of a much smaller size.

CAREFUL SELECTION IS NECESSARY

If competent service in public financial positions is to be secured there are certain fundamental principles which must be followed:

(1) Persons who seek election or appointment to such positions should be required to possess minimum training and experience

for the post which they seek, depending on the nature of its responsibilities.

(2) Officers keeping accounts or responsible for financial management and the keeping of accounts should be selected on a merit basis.

(3) There must be adequate salaries paid in order to attract well qualified candidates or applicants.

(4) The tenure of office for such positions should be of a more permanent character so that the benefit of experience and efficiency may be retained.

GOOD ACCOUNTING IS NECESSARY

To say that a good system of accounting and financial reporting is essential for every business enterprise is to state an accepted fact. Yet, in public business, the importance of these tools of administration is even greater than in private affairs. Here the uses for the accounting system go beyond that of the mere recording of financial facts. The accounts must be depended upon to prove the integrity of officers and the efficiency of their services. They provide essential information for the guidance of executive and administrative officers, for the aid of the legislative body and for the information of the public in the exercise of its control over governmental bodies and officers. "A government can not rise above the level of its bookkeeping."

The accounts should be kept in accordance with the principles and classifications recommended by the National Committee on Municipal Accounting.*

BUDGET CONTROL IS NECESSARY

The budget is the heart of the financial system of any governmental body and should constitute its fiscal program as well as its constant guide in financial operation. To this end the accounts of revenues and expenditures should be maintained in such a way as to provide continuous check against the approved budget and should make it possible readily to compare estimates

* NOTE.—The National Committee on Municipal Accounting is a joint committee of representatives of national associations of public officers and municipal bodies and of public accountants, including the American Institute of Accountants. Its program includes the formulation of principles and terminology for municipal accounts, reports and audits. Its headquarters are at 850 East Fifty-eighth Street, Chicago.

with achievements. This requires attention to the following points: (1) whether or not the expected revenue is being realized; (2) whether or not the expenditures, both paid and incurred, are within the authorizations; (3) that, whenever it becomes evident that actual revenues will not equal the estimates, steps shall immediately be taken to curtail expenditures and to avoid incurring liabilities in excess of the income available to meet them.

If the budget is to operate effectively it must be reflected in and controlled by the accounting system. A budget that is operated independently of the accounting system or in loose relation thereto can not be carried out with a full degree of security. The presence of budgetary accounts in the general accounting system is a positive necessity for showing the current fiscal condition of the funds and of the municipality.

Budget control includes control from the time when obligations are incurred. Consequently, it is necessary to account for encumbrances such as orders or contracts which will eventually become expenditures. Such items must be entered as a charge against budget authorizations at the time they are incurred. The budget accounts should also provide constant information as to the extent to which estimated revenues are being realized.

CERTAIN FINANCIAL REPORTS ARE ESSENTIAL

No business enterprise can be successfully carried on without frequent information concerning its financial operation and condition. Its owners are entitled to such information regularly. Government is not an exception to this rule. In fact, its public nature makes the principle all the more significant in its case. First of all, there should be a balance-sheet or statement of assets and liabilities. No enterprise should be without this essential statement. No set of accounts is complete unless it produces the information necessary for such a statement. This balance-sheet should be drawn in such a way that the condition of each fund will be clearly shown. There should be statements of revenue and expenditures, showing how both compare with the budget, and showing clearly whether or not the revenues of the year have exceeded the expense, both paid and incurred, and the net result. There should be an explicit statement of bond and other liabilities. There should be operating statements for utilities and other similar services, prepared on a profit-and-loss basis. Financial

statements should be prepared, not only annually, but monthly, or as often as necessary to supply proper information.

INDEPENDENT AUDITS ARE ALSO NECESSARY

The record of any financial operation is incomplete without suitable provision for audit. The organization of every governmental agency, large or small, should be such that reasonable provision is made for continuous internal check. The nature of that check depends upon the size of the unit and the scope of its operations. In a small division, a separate personnel for such a check is not practicable and greater dependence must be placed on the periodical audit by public accountants. In a large municipality, for example, provision for a continuous internal audit of financial transactions, independent of both operating departments and the central accounting department, is essential.

The internal check should be supplemented by a periodical audit by public accountants. Such an audit should be looked upon as essential for every public body. It is needed for the protection of officers responsible for financial transactions, for the protection and information of the legislative or governing body and for the protection of the public. To be adequate, it must serve all these ends. It must also cover all officers and departments responsible for the receipt and disbursement of money. The more frequent or continuous this audit is, the better for all concerned.

Engagement of auditors should be carried out in accordance with suggestions in the American Institute bulletin, *Audits of Governmental Bodies*. Care should be taken to select auditors who are qualified by preparation and experience to carry out an audit of a public agency in a satisfactory manner. The scope of the audit and the form and contents of the audit report should follow the recommendations of the National Committee on Municipal Accounting. Regardless of who makes the independent audit, these provisions should apply.

UTILITY ACCOUNTS SHOULD REVEAL TRUE RESULTS

In accounting and reporting of municipal utilities the general principles followed should be those applying to a similar enterprise under private ownership. All costs and expenses should be allocated to the enterprise. The true income, expense and profit or loss should be determined.

The important thing is to apply proper principles of cost accounting to publicly owned enterprises as they are applied to privately owned enterprises of a similar type and not to show profits in one fund at the expense of some other fund.

LOCAL GOVERNMENTAL UNITS SHOULD BE COÖRDINATED

The problem of the taxpayer is not solved by considering only the taxes levied and collected by one local government. Many governments and governmental units, including state, city, county, township, park district, sanitary district, school system and others, levy taxes paid by the residents of a given community.

In most communities no means of coördination of the activities of these different tax-levying bodies exists. Each body proceeds independent of all the others, the only limitation set upon it that imposed by the state legislature. The budgets of all these bodies should be brought before a central agency or a representative group of citizens for review. Suitable means should exist for public participation in this proceeding. Only through such a procedure can an adequate review of the taxpayer's interests and of the financial problems of the various governmental units concerned be carried out.

EACH CITIZEN CAN HELP

The improvement of public business rests on the individual citizen. There are specific things which he can do toward this end:

1. Take an active and continuous interest in the affairs of government.
2. Demand proof of competence on the part of those seeking public office and work for legislation which will set minimum requirements for positions requiring technical ability.
3. Insist on adequate publicity of the financial programs and operations of every government.
4. Insist on adequate independent review of the finances of every governmental unit by competent auditors.
5. Work for revision of obsolete and imperfect laws and regulations which hinder the carrying out of sound principles of financial procedure.
6. Work for coöperative effort of all citizens and civic bodies to bring about a unified program of public finance embracing all taxing bodies in each community.

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