ACCOUNTING AND FINANCIAL MANAGEMENT REFORM IN THE UNITED STATES GOVERNMENT: AN APPLICATION OF PROFESSOR LÜDER'S CONTINGENCY MODEL

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ABSTRACT

This paper uses Lüder's contingency model to explain two recent significant events in accounting and financial management reform in the United States Government. These events are the passage of the Chief Finance Officers (CFOs) Act and the formation of the Federal Accounting Standards Advisory Council (FASAB) in 1990. These events are accounted for mostly by factors associated with "stimuli" and "producers of information." These factors include: (1) management and financial scandals, (2) increased importance of management in periods of rising budgetary deficits, (3) lobbying by professional interests, and (4) competition between legislative and executive agencies. The Congress, as a user, required the preparation of agency-wide consolidated financial statements on an experimental basis. Other users were hardly visible. The paper further identifies the barriers that hamper rapid introduction of the accrual accounting and consolidated financial statements. The objectives of federal financial reporting - the cornerstone of a conceptual framework - and current activities of the Federal Accounting Standards Advisory Board are discussed in the concluding section.

1. INTRODUCTION

During the past five years, comparative international governmental accounting research has progressed from a series of loosely coordinated country studies (Chan and Jones, 1988) to country studies with an explicit comparative purpose (Lüder, *et al.* 1989). CIGAR has also moved from almost purely descriptive studies to an explicit analytical framework, as in Professor Lüder's (1992) model of governmental accounting innovations. The model, using contingency theory and informed by empirical observations in a dozen countries in Europe and North America, is expected to influence future directions of theoretical and empirical research in comparative governmental accounting. With appropriate modifications to incorporate micro-level variables (Chan, 1992), it could also serve as a guide for actions to introduce innovations.

The contingency approach is particularly appropriate for CIGAR because of its open-mindedness. To the question "Why do nations differ in their governmental accounting systems?" it answers: "It depends on ..." This motivates scholars to search, with minimal value judgment, for the reasons underlying the differences - and similarities - among nations. The model as proposed by Professor Lüder highlights the influence environment has, in terms of the characteristics of the political and administrative system on governmental accounting.[1] As shown in Figure 1, the model seeks to explain what and how environmental factors influence the introduction of more informative public sector accounting systems.

The formulation of the contingency model was itself influenced by a series of field studies over several years in almost a dozen jurisdictions beginning in the mid-1980s and still continuing. The United States was one of the countries studied in depth. Both the national (or federal) government, and selected state and local governments were included in Professor Lüder's field investigations. The detailed results are reported in Lüder (1989).

The Governmental Accounting Standards Board (GASB) was created almost ten years ago to set standards for state and local governments in the United States (Chan, 1985). GASB has received more publicity and recognition than its Federal counterpart, Federal Accounting Standards Advisory Board (FASAB). GASB standards and state and local practices are sometimes regarded as representative of American governmental accounting. That, however, is not necessarily the case. The Federal Government in the United States, by virtue of its uniqueness as the national government and its sheer size and complexity, has many conceptual and practical accounting problems. These problems, while extensively discussed in Congressional hearings and among the responsible officials and agencies, have not received adequate attention outside of the Federal Government until recently, and much less internationally.[2] This paper is intended to redress this imbalance of academic attention paid to the two levels of American government, in the hope there will emerge a more coherent American government accounting model appropriate for international comparisons.

Based on his field studies in the late 1980s, Professor Lüder's judgment was that all levels of American government shared favorable stimuli, social structures and political-administrative structures. Implementation barriers were favorable for state governments; however, they were unfavorable for the Federal Government (Figure 2 [see Lüder Fig. 2, in this publication]). This paper, by focusing on the U.S. Federal Government, extends Professor Lüder's field study report. It details the extensive activities that took place after Professor Lüder concluded his American field work. These activities eventually culminated in two significant events - the passage of the CFO Act in late 1990, and the almost simultaneous creation of the FASAB. The Act, besides creating CFO positions for the entire Federal Government and for most federal agencies, mandates performance measurement and audited agency financial reports. FASAB, jointly sponsored by legislative and executive branch agencies, was charged with recommending accounting standards for preparing such reports. These events together represent a milestone in improving financial reporting and management in American government.

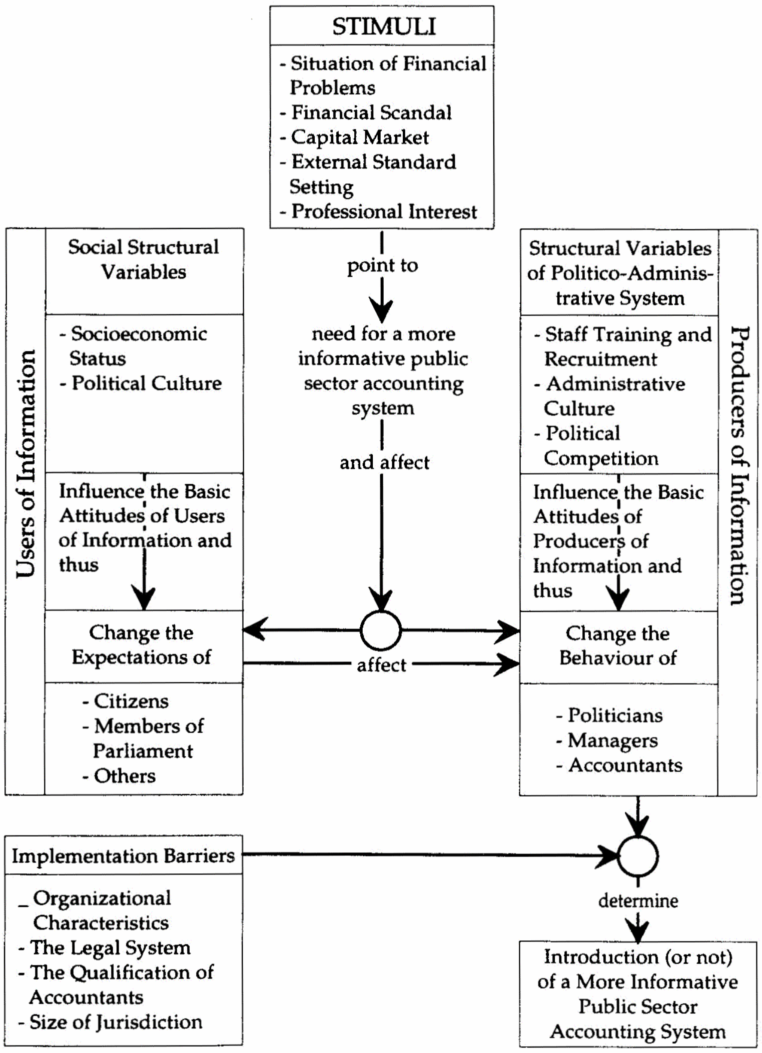
Professor Lüder's 1992 paper reported the signs (+ or -) of the contributing factors, but the weights were only implicit. In any event, the weights could very well change over time. Thus this paper also hopes to build on the current contingency model by trying to differentiate the weights of the factors that contribute to accounting innovations.[3] In particular, I will try to discern the relative importance of stimuli, users and producers. To serve as a basis of this discussion, the Lüder contingency model is briefly summarized in the next section.

2. THE LÜDER CONTINGENCY MODEL (1992)

As outlined in Figure 1, the basic purpose of Lüder's model is to explain why governmental accounting innovations took place in some countries and not in others.

The countries providing observational data that laid the foundation for Lüder's conceptual model are: Canada (federal and provincial governments), Germany (the

Federal Republic), Denmark, Economic Community, France, Sweden, United Kingdom and the United States (federal and state governments). Field studies were undertaken in the late 1980s, and continue to the present time. Continuing field studies, especially in other cultural environments, such as Japan, may lead to the modification of the original model. This paper is based on the English version of the model published in *Research in Governmental and Nonprofit Accounting* (RIGNA) in 1992.



Source: Lüder (1992)

Figure 1: The Contingency Model

The "dependent variable" was whether there had been a successful outcome in introducing a "more informative public sector accounting system." The 1992 RIGNA paper was not explicit about what constitutes a more informative system. It may, however, be inferred that such a system would call for full disclosure of a government's financial condition and performance, measured under the accrual basis of accounting.

The “independent variables” are organized in several clusters:

- Stimuli
- Characteristics of the social and politico-administrative system
- Implementation barriers.

The logic of the model runs as follows:

1. Accounting system changes involve both the users and producers of government financial information
2. The external environment provides stimuli that might potentially jolt the system in action
3. The users’ change of expectations is a necessary, but insufficient, condition for innovations. Producers must also change their behavior and make a policy decision to change
4. For these efforts to succeed in overcoming the implementation barriers, they have to be sufficiently intense and sustained.

More specifically, governmental accounting innovations have a greater probability of occurring under the following “favorable” conditions:

- Existence of at least one stimulus
- Strong political competition, presence of high socioeconomic status users, or open political culture
- Influence of private sector accounting on staff training
- Open administrative culture and high political competition
- Absence of implementation barriers.

These conditions existed in varying degrees and various combinations in the countries being compared. Professor Lüder’s overall conclusions are: (1) favorable conditions existed in Canada, Denmark, Sweden, and the United States (both at the federal and state levels); (2) conditions were not conducive for reforms in Germany and France; and (2) conditions were not conducive for reforms in Germany and France; and (3) conditions in the European Community and U.K. were indecisive.

The remainder of this paper follows the spirit of Professor Lüder’s contingency model to explain the legislative process and the content of the Chief Financial Officers Act.

3. THE CHIEF FINANCIAL OFFICERS ACT OF 1990

3.1. Reforming Federal Financial Management: A Brief History

The Constitution of the United States requires the Congress to pass appropriations before money could be drawn from the Treasury. It also requires the Secretary of the Treasury to produce periodic financial reports.

The 1789 Treasury Act established an auditor and comptroller in the Treasury Department, and required the Treasury to submit an annual report to the Congress. One hundred years later, in 1894, the Dockery Act required the Treasury Department to submit to Congress annual combined statements of receipts and expenditures.

The 1921 Budget and Accounting Act created (1) the Bureau of the Budget (BOB) and (2) the General Accounting Office (GAO), which is headed by the Comptroller General and acts as the investigative arm of Congress. BOB was subsequently transferred to the Executive Office of the President in 1939, and was renamed the Office of Management and Budget (OMB) by President Nixon in 1970. Despite the doctrine of separation of powers, the necessity for cooperation in budgeting and financial management led to the creation of the Joint Financial Management Improvement Program (JFMIP) in 1948. Current JFMIP participants are GAO and the key central management and finance agencies, namely OMB, Treasury, and Office of Personnel Management (OPM) [Trask, 1991].

The Federal Government's expenditures grew tremendously during World War II and required a corresponding expansion - and reexamination - of financial management functions, including accounting. In 1949 the first Hoover Commission recommended the creation of an "Accountant General" in the Treasury to prescribe financial and administrative control. It also recommended the use of accrual accounting. These recommendations, however, were not implemented. The second Hoover Commission in 1956 again recommended accrual accounting. This led to the passage of a law (P.L. 84-863) requiring government agencies to install accrual accounting "as soon as practical". This escape clause permitted delays lasting several decades. At the present time, accrual accounting is still not fully implemented.

A major milestone in improving Federal accounting and reporting was the 1950 Budget and Accounting Procedures Act. The act mandated accounting systems for individual agencies and gave GAO the authority to (1) prescribe accounting principles and standards, and (2) approve agency accounting standards. GAO therefore proceeded in the 1950s to prescribe accrual accounting principles to supplement the obligation basis of accounting. During the 1960s and 1970s, GAO's attention increasingly turned to program evaluation. However, in performing its traditional role of system approval, GAO routinely found non-compliance of agency standards and systems. In 1984, through its policy and procedure guidance for Federal agencies, GAO began requiring agency-wide (consolidated) financial reporting on the accrual basis. For the U.S. Government as a whole, the Treasury Department began producing a prototype of consolidated financial statements in the 1970s. These ideas continued to meet with reservations and implementation was slow.

Since President Franklin Roosevelt's Administration in the 1930s, the executive branch has continued to object to GAO's role, as a legislative agency, in accounting and financial management matters, on the basis of constitutional separation of powers. In 1989, GAO intended to formalize the consultative role of OMB and Treasury in setting accounting standards by including them in a federal accounting standards advisory board. The purpose of the new board would be to recommend accounting standards to the Comptroller General. After negotiation, this proposal evolved into a body with the same name, FASAB, but as a collaborative effort between the principals of the JFMIP (except OPM). Under the arrangement, no one was required to concede any existing authority.

On the budget side, problems with the fragmented budgeting system led the President's Commission on Budget Concepts to recommend a unified budget in 1967. The commission also advocated that the accrued-expenditure basis be used in preparing the annual unified budget. Later, President Johnson ordered federal agencies to practice PPBS (planning programming budgeting systems). This was followed by two decades of congressional activism in budgeting. The 1974 Congressional Budget and Impoundment Act created the Congressional Budget Office (CBO) as the legislative counterpart of OMB. In the face of rising deficits during the first term of the Reagan presidency, Congress passed the Balanced Budget and Emergency Deficit Control Act in 1985, popularly known as Gramm-Rudman-Hollings Act. This Act established deficit reduction goals and the sequestration (i.e. cancellation or withdrawal of budget resources) procedure aimed at balancing the budget by 1991. Subsequently the time period was extended and fixed targets were abandoned in favor of adjustable targets. The 1990 Budget Enforcement Act further set discretionary spending limits and stipulated that spending outside of the annual appropriation process and revenue legislation could not increase the deficit. By the end of 1992, overall annual deficit had reached $300 billion, and Bill Clinton was elected President. His economic plan unveiled on January 18,1993 called for a reduction of the deficit by $500 billion in four years through a combination of increased taxes and spending cuts.

Another legacy of the Reagan presidency is a series of visible moves to ferret out real and perceived waste, fraud and abuse in government. The President appointed a Private Sector Survey on Cost Control headed by a businessman to wage a “war on waste”. In addition to the Inspector General Act, passed in 1976 to strengthen internal audit function, Congress enacted the 1982 Federal Managers’ Financial Integrity Act to require agency internal control systems and reporting in accordance with GAO standards. The Single Audit Act of 1984 streamlined audits of federal assistance programs for state and local governments. Furthermore, “Reform 88” was launched to improve internal financial management functions of the Federal government. OMB began issuing a series of circulars to provide central direction and guidance in financial management matters, such as internal control, prompt payment, financial management system. In response to external pressure, a relatively low level position of Chief Financial Officer was administratively created in 1987. Efforts were made to improve system consistency and compatibility through a standard general ledger, core requirements, single primary accounting system and systems integration.

3.2. History of the 1990 CFOs Act

As can be seen from the previous section, financial management reform was gathering momentum within the Federal Government throughout the 1980s.

In the early 1980s, the Federal Government was called upon to do what many corporations do - appoint a chief financial officer. The calls came from the accounting profession (Haller, 1983), from state officials (Burris, 1985), from federal government accountants (Task Force on a Chief Financial Officer for the Government, 1983, referred to in Kusserow, 1991), and from public administrators (National Academy of Public Administration, 1984). They all tried to find ways to solve the management problems, especially financial management ones, in the Federal Government (e.g. Roth, 1983; President’s Private Sector Survey on Cost Control, 1984).

Having begun initially as a Federal controllership, as in Senator John Glenn’s “Federal Financial Management Reform Act of 1987,” the idea quickly expanded into a chief financial officer (CFO) position for the Federal Government as a whole, and eventually into a network of agency CFOs led by a government-wide CFO. The U.S. General Accounting Office was a moving force behind the CFO legislation. In 1987, GAO drafted a comprehensive piece of legislation to reform the financial management of the Federal Government. GAO's proposal became the subject of a hearing on "Improving Federal Financial Management" (September 22, 1988) before the Legislation and National Security Subcommittee of the Committee on Government Operations in the House of Representatives- during the second session of the 100th Congress. During that hearing, GAO's proposal was thoroughly examined and divergent views were expressed on both the institutional aspects (e.g. where to locate the CFO position) and technical questions (e.g. should the Federal Government have a capital budget? Should it also practice accrual accounting and produce consolidated financial statements?).

These diverse positions were reflected in bills subsequently introduced in the Congress. During the first session of the 101st Congress, Rep. Craig introduced H.R. 54 "Truth in Government Efficiency Reform Act of 1989" on January 3, 1989 and reintroduced it as H.R. 3064 later on August 1, 1989. During the second session, Sen. Glenn introduced S. 2840 "Federal Financial Management Improvement Act of 1990" on July 11, 1990. On August 3, 1990, Rep. Horton introduced H.R. 5492 "Federal Management Reform Act of 1990".

A hearing was held on September 17 and 18, 1990 before Chairman Brooks' Committee on Government Operations in the House. Afterwards, Rep. Conyers on September 21, 1990 introduced H.R. 5687 "Chief Financial Officer Act of 1990". This bill was eventually passed, with amendments, by the House and Senate in October, 1990 and was signed into law by President Bush in November.[4]

3.3. Requirements of the CFOs Act of 1990

Regarded by GAO (1992) as "the most comprehensive and far-reaching financial management improvement legislation since the Budget and Accounting Procedures Act of 1950", the 1990 CFOs Act lays four cornerstones for Federal financial management reform:

1. Strong leadership structure
2. Long-range planning
3. Strengthened accountability reporting
4. Audited agency-wide financial statements.

These are briefly described below.

1. CFO Leadership Structure

After comparing the merits of locating the CFO position in the Treasury Department and the Office of Management and Budget (OMB), Congress opted for OMB as a way to strengthen the "M" side of OMB and to leverage on OMB's formidable policy leadership in the Executive Branch.

A two-tier structure was created. The Act established the position of OMB Deputy

Director for Management, at par with the Deputy Director for Budget (who was previously the only Deputy Director). The incumbent of this position, serving as government-wide CFO, has overall leadership responsibility for policy setting, implementation and operations in all management functions of the U.S. Government, including financial management.[5] As chairman of a CFO Council consisting of agency CFOs, he will establish CFO qualification standards and advise on CFO selection. He will also assess agencies' financial management capabilities, oversee their activities and determine their resource needs.

To support and substantiate the high visibility of the CFO, the 1990 Act set up an Office of Federal Financial Management within OMB. Headed by a Controller and having its own line item budget, this office is charged with carrying out OMB's financial management functions.

These senior OMB officials will lead a network of 23 agency CFOs and Deputy CFOs, who report to agency heads and together form a CFO Council. These CFOs are responsible for directing a full range of financial management functions. In particular, they are charged with

- Developing and maintaining integrated accounting and financial management systems used in monitoring budget execution
- Producing financial reports and cost information
- Conducting systematic performance.

Furthermore, the Act specifies that the enhanced systems should comply with applicable accounting principles, standards and requirements, internal control standards, and requirements of OMB, Treasury and others.

2. Long-range Financial Management Plans and Annual Update

To keep a tight rein on implementation of the Act, Congress required OMB to develop a five-year financial improvement plan by February 1992 and update it annually. The plan should include an integration strategy, systems projects, resource requirements, and milestones for achieving various tasks. Agency CFOs are required to make annual management reports with 60 days after the audit report to agency head and OMB, which transmits them to Congress. OMB itself has to make an annual management report, in conjunction with the five-year plan, no later than January 31st of each year .

3. Accountability-Based Financial Information

The 1990 Act requires the production of cost information and systematic performance measurement. By clearly linking accounting information with budgeting, the Act seeks to strengthen management control and planning. It also substantially expanded the scope of annual reporting through the inclusion of performance data.

4. Audited Agency-wide Financial Statements

As mentioned earlier, since 1984 GAO has required the preparation of agency-wide consolidated financial statements on the accrual basis. These accounting policies - consolidation and accrual - had not been widely accepted, and were debated extensively in the hearings leading to the passage of the 1990 CFOs Act (House Committee on Government Operations, Hearings on September 22,1988). The 1990 Act took a gradual approach in this regard as follows:

1) Based on the belief that there are accounting standards readily applicable to the commercial functions of the Federal Government, the Act required that audited financial statements be prepared for trust and revolving fund operations and for agencies' substantially commercial functions beginning with Fiscal Year (FY) 1991.
2) It authorized an experiment - a pilot project - in which an increasing number of agencies were required to prepare agency-wide financial statements for specific years.[6] The financial statements are due no later than six months after the close of the fiscal year, and the audit report no later than nine months after year end. OMB is required to report to Congress on the benefits, costs and difficulties of this effort by June 30, 1993.

The "go slow" approach in mandating audited financial management resulted, in part at least, from the perception or conclusion that existing Federal accounting standards did not adequately reflect the unique nature of the Federal Government. The Act made reference to "applicable" accounting principles, thus sidestepping the question of whose standards should be followed. It also recognized the cooperative efforts undertaken by GAO, OMB and Treasury in creating the Federal Accounting Standards Advisory Board (FASAB) in the same month.[7]

The Act nevertheless gave OMB the authority to specify the "form and content" of financial statements. This sowed the seed for a contention by the OMB representative at FASAB, for a period of time, that FASAB should restrict its purview to "accounting" matters only. Congress was, however, reluctant to completely delegate accounting-standard setting authority. Reflecting concern over the idea behind a capital budget and the scope of "capital",[8] the 1990 CFOs Act specifically required that:

No capital accounting standard or principle, including any human capital standard or principle, shall be adopted for use in an executive department or agency until such standard has been reported to Congress and a period of 45 days of continuous session of the Congress has expired.

In short, Congress reserved the option to intervene if and when it saw fit.

4. EXPLAINING THE CFOs ACT OF 1990

The 1990 CFOs Act is a milestone toward the introduction of a more informative public sector accounting system in the U.S. Government. In terms of the basic building blocks of the contingency model, the Act declared managers and Congress as the primary users of financial information, and empowered a cadre of fiscal officers to supply such information.[9] The purpose of this section is to explain how the favorable "stimuli" were able to overcome unfavorable "barriers" to produce this piece of legislation.

4.1. Stimuli

4.1.1. Financial Problems

During the decade of the 1980s, the annual budget deficit - on the cash basis - of the Federal Government in the United States tripled from $74 billion in 1980 to $221 billion in 1990 (Table 1). By the end of the Bush presidency, the "on-budget" annual deficit reached $340 billion in FY 1992. Running largely on a campaign to reduce the deficit and solve the country's economic problems, Bill Clinton won the presidential election in November 1992. Barring drastic intervention, which has been proposed by the newly elected Clinton Administration, the annual deficit is projected to reach $400 billion by the year 2000.

U.S. Dollars in Billions		(A)	(B)	(C)
FY	President	Annual Deficit	Cumulative Deficit	Year-end Debt
1980		$ 74	$ 74	$ 709
1981	Reagan	79	153	785
1982		128	281	919
1983		208	489	1,131
1984		185	674	1,300
1985	Reagan	212	886	1,499
1986		221	1,107	1,736
1987		150	1,257	1,888
1988		155	1,412	2,050
1989	Bush	206	1,618	2,189
1990		221	1,839	2,410
1991		269	2,108	2,688
1992		290	2,398	2,999
1993	Clinton	310	2,708	
1994		291	2,999	
1995		284	3,283	
1996		287	3,570	
1997	?	319	3,889	
1998		357	4,246	
1999		350	4,596	
2000		400	4,996	
2001	?	454	5,540	
2002		514	5,864	

Explanation and Sources:
Column A: Actual budget deficit for years up to FY 1991; estimated deficit for FY 1992. FY 1993 to 1998 projections contained in CBO's January 1993 report. Remaining years are reported by The New York Times (January 3,1993) based on CBO projections with no date.
Column B: Author's computation.
Column C: Debt held by the public at year end.

Table 1: Federal Deficit and Debt

Table 1 details the trend and shows the cumulative deficit, beginning with 1980, the outset of the Reagan Presidency. It should be noted that the annual deficit is the result of offsetting the larger "on-budget" deficit with social security trust fund surplus in recent years. For example, the FY 1992 on-budget deficit, $340 billion, was reduced by $51 billion social security surplus, resulting in the unified budget deficit of $290 billion.

Considerable efforts were mounted in the 1980s to reduce the budget deficits. A detailed study of these efforts is beyond the scope of the paper, suffice it to note that attention has been focused on the annual budget deficit - computed on the cash basis - and the amount of "public debt" (actually the debt of the Federal Government). Less attention is paid to the approximately $1.25 trillion in pension liabilities, or the almost $200 billion in insurance liabilities associated with the over $6 trillion exposure due to Federal credit and insurance outstanding.[10] Nevertheless, there is a general sense that the fiscal house of the Federal Government is not in order. This provided a context, if not impetus, for financial management reform.

4.1.2. Management and Financial Scandals

Financial *management* reforms serve as the umbrella under which accounting and financial reporting changes take place. These reforms have been periodically launched to fight real or perceived fraud, waste and abuse in government.[11] In the early 1980s, President Reagan appointed a Commission on Private Sector Survey of Cost Control, commonly called the Grace Commission, which issued a report entitled *War on Waste* (1984). Throughout the late 1980s, taxpayers were repeatedly asked to bail out insolvent savings and loan associations, with some estimates reaching $500 billion. Then there were some glaring management deficiencies that became scandals, such as the one in the U.S. Department of Housing and Urban Development. It is these scandals that energized the legislative process and moved politicians.

For example, rising in support of H.R. 5687, Congressman Lantos described the "HUD scandal" in these terms:

> ... During the past decade, many Federal agencies, ... [including HUD] ... lost control of their financial management systems, resulting in losses in the billion of dollars. ... Ms. Harrell [a HUD official] explained that she was able to siphon off millions of dollars from the sale of HUD properties simply by not submitting the proceeds to HUD.... no one at HUD asked her where the money was. HUD's failure ... has cost taxpayers more than $50 million.
>
> ... Millions of dollars [were] lost under the coinsurance program. Under this program, a few private financial organizations were handed Uncle Sam's checkbook and wrote millions of dollars of Government-insured mortgages.
>
> ... Had a chief financial officer with an obligation to report to OMB been in place at HUD, I believe these abuses might have been detected sooner, and the hemorrhage of dollars away from the Treasury stopped. [Congressional Record - House, October

15,1990, p. H 9604]

This and other testimonies on “high risk” areas led to the general finding that:

> Billions of dollars are lost each year through fraud, waste, abuse, and management among the hundreds of programs in the Federal Government ... These losses could be significantly decreased by improved management, including improved central coordination of internal controls and financial accounting. [CFO Act, Sec. 102. Findings and Purposes, (3) and (4).]

4.1.3. Capital Market

The capital market has played no perceptible role in stimulating financial management and reporting reform in the Federal Government - the default risk of U.S. Government obligations is virtually zero. This contrasts sharply with the state and local government sector. There, bond-rating agencies played an almost instrumental role in improving financial reporting by linking the quality of reporting with bond ratings.

4.1.4. External Standard Setting

In a general sense, the move to appoint CFOs in the Federal Government emulated the practice of many American corporations over the past several decades in enlarging the functions and responsibilities of the corporate controller. In the 1950s, Herbert Simon coined the trilogy of the accounting functions: score-keeping, attention direction and problem solving. These functions fit well with the roles envisioned by the Congress for the CFOs in the Federal Government.

Being a sovereign government, the U.S. Government is not subject to a higher authority, but its accounting and reporting might still be influenced by *ideas* in the private sector and in the state and local government sector. External accounting and financial reporting standard setting exerted minimal impact on the reporting requirements of the CFO legislation. By inaction, the Act left standing the requirements that government corporations should follow business accounting standards, and increased the frequency of audit from once every three years to once a year. Congress also readily brought the commercial activities of the government under commercial accounting standards - and reported in audited financial statements prepared under the accrual basis.

However, it was a completely different matter as far as the governmental activities were concerned. The preparation of agency-wide (consolidated) financial statements using the accrual basis of accounting became a requirement in the 1984 revision of Title 2 of GAO *Policy and Procedure Manual for Guidance of Federal Agencies.* At the urging of the Comptroller General, the Treasury Department also has been preparing prototype consolidated financial statements for the entire U.S. Government. This report is inspired, in part, by the experimental report prepared by Arthur Andersen & Co. in 1975 for the Treasury Department. The Treasury Secretary at that time was sufficiently interested as to appoint an advisory committee to develop a guide. These financial statements have been published and refined ever since. Arthur Andersen (1986) has labeled them as GAAP-based financial statements, a label unfortunately taken by many to mean corporate type reporting. GAO subsequently conducted a joint study with the Office of the Auditor General of Canada (1989) that further refined the accrual and consolidated principles. In its draft legislative proposal in 1987, GAO included these requirements and was accused by some of attempting to inject business accounting - uncritically - into the Federal Government. This met considerable resistance from various quarters.

The objection to the GAO proposal was expressed in a statement of Congressman Brooks at the conclusion of the 1988 hearing of the House Committee on Government Operations:

> ... I continue to have very serious doubts about the feasibility, accuracy, usefulness, and cost of preparing and auditing corporate-type financial statements for every Federal agency, and for the Government as a whole.
>
> ... The Federal Government is unique, and requires unique accounting treatment in some respects. We should focus our attention on designing accounting standards that produce accurate, complete, honest information upon which to base decisions in both the executive and legislative branches.
>
> ... So I therefore urge the Comptroller General to remove from GAO's accounting standards the requirement for annual agency and consolidated financial statements until such time as it can be clearly demonstrated that, one, we have the capability to develop accounting standards which adequately reflect the unique nature of the Federal Government; two, that such statements actually will provide useful necessary information; and three, that the preparation and auditing of such statement is an efficient, cost-effective means of improving financial management. [Hearings, September 22,1988, p. 279]

Congressman Brooks' - and others' - skepticism and hesitancy was subsequently reflected in the experimental approach adopted in the 1990 CFOs Act, with respect to audited agency financial statements.

The Comptroller General made a key point that the accrual basis of accounting was not intended to replace the obligational basis, or even the cash budget. In a complete system, one could have all three. By accruing liabilities, the Congress is provided an early warning system. This observation, however, was obscured by opposition to the accrual basis of accounting. In addition, there were so many legitimate unresolved conceptual issues that an earlier version of the CFOs Act required GAO to conduct a two-year study on accounting issues. This requirement, however, was dropped from the bill that was passed.

4.1.5. Professional Interests

The CFOs Act would increase the demand for financial management professionals - including accountants, auditors, financial managers - whose expertise would be needed in the implementation stage. It is not surprising that professional groups, such as the Association of Governmental Accountants, the National Association of State Auditors, Comptrollers and Treasurers, the Government Financial Officers Association, and the

Financial Executive Institute (representing corporate CFOs) - all lined up in support of the legislation. A telling example is a notice in the newsletter of the Financial Executive Institute, alerting its members of the pending vacancies in CFO positions resulting from the 1992 presidential election.

The Act would also elevate the financial managers in the organizational hierarchy of the Federal agencies, and especially at OMB. Even after President Nixon added M - for management - to the name of the agency, the M side has not received as much attention - and resources - as the B or budget side. Successive OMB directors also have held rather different attitudes toward accounting matters. OMB's first director, Roy Ash, called accrual accounting a "bottomless pit". David Stockman, OMB director under President Reagan, ridiculed corporate type of accounting for the Federal government as "Alice in Wonderland nonsense, not remotely possible or useful".[12] Richard Darman, OMB Director under President Bush, seemed to have a greater appreciation for what accounting had to offer. Under his direction, the Budget for FY 1992 documented "hidden liabilities" and President Bush's last budget document even contained a balance sheet presentation (OMB, January 1993). The economists and budgeters provided considerable support to the financial management office in deliberations on accounting objectives and standards. At last, the complementary relationship between budgeting and accounting has begun to be cemented.

The statutory creation of a Deputy Director for Management as a government-wide CFO and a Controller for a separately budgeted Office of Federal Financial Management enhanced the visibility of and resources for the financial management function.[13] However, a consequence of elevating these positions to Presidential appointments is that their incumbents are affected by the change of Administration, in addition to the historically high turnover rate of OMB's deputy directors.

The "clout" of financial managers may also be expressed in budgetary terms. A total of $2.2 billion in budgetary authority was requested by the President's FY 1993 Budget for financial management improvement activities, including: $101 million for financial reporting, $659 million for financial systems, and $1,444 million for asset management. In total, $7.6 billion in budget authority was requested for FY 1993 for improving management in general, an increase of $770 million over FY 1992 [OMB, FY 1993 Budget, Table 15-1; OMB, Federal Financial Management Status Report and 5-Year Plan, April 1992, p. 66]. These budgetary resources would allow for the recruitment and retention of personnel and purchase and maintenance of systems. Since agency inspectors generally are allowed to contract out financial audits to CPA firms, the latter would clearly benefit from increased audit requirements.

In anticipation of these tangible and intangible benefits, it was hardly surprising that public sector finance professionals almost universally supported the 1990 CFOs Act.

4.2. Users and Producers of Information

The CFOs Act declared Congress and executive branch managers to be users of financial information. Their needs were later addressed in the objectives of financial reporting proposed by FASAB. Other users were, however, conspicuous by their absence in the deliberations of the CFOs Act. This is hardly surprising. As Jones (1992) has pointed out, users and user need serve to legitimize accounting in general, and accounting conceptual framework in particular. Indeed, the label "GAAP" (generally accepted accounting principles) has become a symbol of legitimacy [Carpenter and Feroz, 1992].

As a user, the Congress, through the CFOs Act, was instructing the "producers" - the CFOs - to experiment with agency-wide financial statements. It then entrusted the setting of accounting and financial reporting standards to the central finance agencies. The hint of potential congressional intervention was given by the reference to standards on capital.

4.3. Barriers

After a considerable period of fermentation, the concept of CFOs gained acceptance. Indeed, a government-wide CFO position was created administratively and was filled in 1987. The Reagan Administration also appointed a number of agency CFOs. There was recognition of a "pressing need to make central policy *permanent* for a government-wide financial management program", stated OMB Deputy Director Joseph R. Wright, Jr. at the 1988 hearing of the House Committee on Government Operations. He went on to say:

> We cannot - and should not - rely solely upon the priority that future Administrations might give to this area. A legislation base is necessary to assure that these [financial management improvement] undertakings are sustained. Consequently, I support the need for legislation creating a permanent CFO structure for the Government. I am not alone in this view. I believe the Committee requested comments on the Comptroller General's proposed legislation from several Assistant Secretaries and Inspectors General and their predominant response was in support of a permanent government-wide CFO structure, and a CFO in each Department and major Federal agency [Hearings of the House Committee on Government Operations, September 18,1988, p. 156.].

The only major disagreement was on where to locate the CFO position. GAO favored the Treasury Department primarily for reasons of continuity; many others favored OMB because of its government-wide leadership role and perceived clout by virtue of being a part of the Executive Office of the President. The second view prevailed.

The preparation and auditing of agency-wide consolidated financial statements on an annual basis turned out to be the major issue, for the following reasons:

1. Consolidated financial statements on the accrual basis were labeled by their detractors as "corporate-type" accounting inappropriate for unique governmental entity such as the United States Government.
2. There was little, or little persuasive, evidence that such statements would provide useful and necessary information.
3. Concerns were expressed by several inspectors general about the personnel resource demands made by annual audits of agencies' financial statements.
4. Finally, the lack of clarity of existing accounting definitions and standards -for example, concerning capital - gave rise to serious concerns about the potential and uncertain impact on the budget and the budgetary process.

For these and perhaps other reasons the 1990 CFOs Act adopted an experimental approach - authorizing only a small number of pilot projects on the annual preparation and audit of agency-wide financial statements. Congress wanted to know, by July 1993, the results of these experiments, including the ability of the central finance agencies to come up with accounting standards that take into account the uniqueness of the Federal Government.

5. CONCLUSION

At present, the major challenge in accounting reform in the U.S. Government is of an intellectual nature. The institutional structural issues were resolved by the CFO Act in creating the CFO leadership structure and by the Memorandum of Agreement between the three central finance agencies - GAO, OMB and Treasury - to form the Federal Accounting Standards Advisory Board (FASAB).

The intellectual challenge is to come up with a conceptual framework that will reflect the uniqueness of the U.S. Government and have credibility with the major constituencies - Congress and executive branch managers, among other groups. Unlike the GASB, FASAB and its sponsors do not have the luxury of saying their principles take precedence over legal provisions on accounting and financial reporting. The principles, after adoption, *are* legal provisions. They are, however, ultimately subject to Congressional approval.

FASAB has initially chosen not to tackle directly the conceptual issues that figured prominently in the deliberations leading to the passage of the CFOs Act. It seems to be following a strategy of induction - deriving principles by considering specific cases. Thus it has considered selected assets and liabilities, inventories and related tangible assets, loans and loan guarantees, and liabilities and claims, and other topics.[14]

While few general accounting principles have emerged or enunciated to date, FASAB has exposed a series of objectives for Federal financial reporting. These objectives are:

Budgetary Integrity

Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the government's legally adopted budget and related laws and regulations. Federal financial reporting should enable the reader to determine:

- How budgetary resources have been obtained and used and whether the acquisition and use were in accordance with the enacted budget
- The status of budget resources
- How budgetary reporting relates to other information on the costs of program operations and whether information on the status of budgetary resources is integrated and consistent with other accounting information on assets and liabilities.

Operating Performance

Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity, the manner in which these efforts and accomplishments have been financed, and the management of the entity's assets and liabilities. Federal financial reporting should enable the reader to determine:

- The costs of providing specific programs and activities and the composition of, and changes in, these costs
- The efforts and accomplishments associated with federal programs and the change over time and in relation to costs
- The efficiency and effectiveness of the government's management of its assets and liabilities.

Stewardship

Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.

Federal financial reporting should enable the reader to determine:

- Whether the government's financial position improved or deteriorated over the period
- Whether future budgetary resources will likely be sufficient to sustain public service and to meet obligations as they come due
- Whether government operations have contributed to the nation's current and future well-being.

Deterring Fraud, Waste, and Abuse

Federal financial reporting should assist report users in understanding whether adequate financial management systems and internal controls are in place.

These objectives are a promising beginning for creating a sound accounting system for the U. S. government - the largest, and perhaps the most complex organization in the world.

[1] For the purposes of this paper, accounting is a generic term that refers to the measurement and recording system, and financial reporting. Budgeting is also involved at least in the minimal sense that budgetary comparisons are made governmental financial statements. To encompass budgeting per se in the boundary of accounting may smack of disciplinary imperialism.

[2] Academic recognition of the importance of Federal accounting issues is evidenced by recent appointment of a Federal Government Financial Reporting Committee of the Government and Nonprofit Section in the American Accounting Association. The author has the privilege of chairing this committee. Volume 9 of *Research in Government and Nonprofit Accounting* is also planned to be devoted to a discussion of Federal Government financial management and reporting issues.

[3] The paper has benefited from my experience as a participant observer of the CFOs Act implementation and FASAB process over the last two years. During most of the period from summer of 1991 to the spring of 1992, I was an Academic Fellow in the Accounting and Financial Management Division of the U.S. General Accounting Office (GAO). My primary role was to advise and assist Mr. Donald H. Chapin, the Assistant General Comptroller who represents GAO on FASAB. The views expressed in this paper are my own; they do not necessarily reflect Mr. Chapin's or GAO's official positions.

[4] The legislative history of H.R. 5687 introduced the following events:
September 21,1990: Introduced by Rep. Conyers in the House.
October 15,1990: Considered and passed House, amended.
October 26,1990: Amendment No. 3196 submitted by Sen. Glenn and Roth.
October 26,1990: Considered and passed Senate, with amendments.
October 27,1990: House concurred in Senate amendments.
November 15, 1990: The Chief Financial Officers Act of 1990 (P.L. 101-576) was signed into law by President Bush.

[5] These general management duties include: systems, procurement and information policy, grant, property and human resource management and regulatory affairs.

[6] The FY 1990 list includes: Agriculture, Labor, Veteran Affairs, General Services Administration, Social Security Administration. Most of these had experimented with agency-wide financial statements up to that time. The FY 1991 list includes the above and adds Housing and Urban Development. The FY 1992 list includes the FT 1991 list plus Air Force, Internal Revenue Service and Customs Service. Furthermore, the Act requires government corporations to prepare annual management reports, which contain audited annual financial statements.

[7] The CFOs Act left unspecified the working relationship between the executive branch (as represented by OMB) and the legislative branch (as represented by GAO). The report of the Committee on Government Operations did take note of the agreement between OMB, Treasury and GAO to form a Federal Accounting Standards Advisory Committee (FASAB), as follows:

The Committee [on Government Operations] has strong reservations about this revised process [i.e. FASAB] for establishing accounting principles and standards given the statutory authority granted to the Comptroller General to set accounting standards, notwithstanding the belief by some parties that this power was called into question by the Supreme Court separation of powers decision in *Bowsher v. Synar* (1986) 100 S. Ct. 1031. The Committee expects that Congress will be regularly consulted during the standard setting process. [Report of the House Committee on Government Operations to accompany H.R. 5687, p. 29]

[8] The House Committee on Government Operations report accompanying the House bill reported:

... Specific concerns were expressed about the potential for Federal accounting to bias budgetary decisions in favor of capital investment programs, which construct or acquire a physical asset in detriment to specific program, which do not result in a physical asset whose costs might be depreciated over a number of years. Other witnesses express concern about accounting for unique government assets. For example, the Inspector General of the Department of Interior questioned how monuments such as the Jefferson Memorial and national treasures such as the Grand Canyon would be valued ... [Committee Report, p. 28]

[9] Sec. 102 (b) (3) states that the purpose of the Act is to "Provide for the production of complete, reliable, timely and consistent financial information for use by the executive branch of Government and the Congress in the financing, management, and evaluation of Federal programs".

[10] Budget of the United States Government - FY 1993, Table E-l "Government Assets and Liabilities"; FY 1992, Tables A-l "Federal Credit and Insurance Outstanding" and A-2 "Potential Federal Costs".

[11] For a long history of financial management reforms in the Federal Government, refer to the two-volume study prepared for the Senate Committee on Government Operations (1971).

[12] Ash was quoted by Congressman Brooks and Stockman by John Lordan in the September 22, 1988 hearing, p. 226.

[13] For a review of OMB's role in financial management, see McMurtry (1986).

[14] Periodic progress reports in the form of a monthly newsletter and various exposure drafts of recommended standards are available upon request from the Federal Accounting Standards Advisory Board. The address of the Board is: 750 First Street NE, Room 1001, Washington, D.C. 2002, U.S.A. Telephone: (202) 512-7350; Fax: (202) 512-7366.

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